

DESTROY YOUR DEBT

It's a bit like being attacked once a month by a school of piranhas. You start off with a nice, healthy-looking pay cheque. Then the bank takes a nibble, the credit card providers take a bite, those greedy store cards devour a huge chunk and, before you know it, most of your hard-earned salary has been gobbled up by your debt repayments.

You're making these payments left, right and centre, but by the time the piranhas have had their fill, you're barely even managing to stay afloat – never mind swim away unscathed.

The answer, some would say, would be to refinance and consolidate your debts. This is a bit like taking all those heavy shopping bags you've been carrying, throwing away all the excess carrier bags and uniting everything into a huge, single backpack – a mortgage – which you can carry on your back more easily.

The only problem is you're carrying your most valuable financial possession in that backpack: your home. Not a big deal? Think again. If you consolidate all those debts into your mortgage and then find you can't manage the monthly repayments, you could be much worse off. Why? Because, unlike most personal loans and credit card debts, mortgages are secured loans – debts 'secured' against your property. That means your home could be repossessed if you fail to keep up the payments – a serious matter indeed.

If you take unsecured debts and consolidate them into your mortgage repayments, you should pay a lower interest rate on your debt and your immediate outgoings are likely to be reduced – but you could be exchanging a short-term headache for a long-term migraine.

You could lose your job or your relationship with your partner could break down. By refinancing for a larger amount of debt, you're leaving yourself very little slack to cope with problems like these, and you're putting your property at risk.

Lower Rates

Get advice on debt management plans from a reliable mortgage broker. In some circumstances, refinancing to consolidate debt is a good idea. After all, when the bank is biting, you have to provide those pounds of flesh somehow – and mortgage interest rates are usually lower than the interest rate on other types of debt.

Right now, mortgage lenders charge less than ten per cent interest on most deals. Compare this to most credit card providers, who charge about 20 per cent, and some store cards, which charge up to 35 per cent, and it is easy to see that consolidating your debt into your mortgage can cut down the amount of money you owe considerably.

For example, for every one per cent of interest saved per \$10,000 of debt, you will save \$100 a year. There's nothing wrong with consolidation as long as you can afford to make your mortgage repayments.

And there it is, the crucial question you must ask yourself before the piranhas sink their teeth in and painfully answer it for you: can you really afford to refinance?

Mortgages and personal loans

Jane Smith has \$20,000 worth of debts and a mortgage of \$100,000. Would she be better off consolidating her debt by refinancing or taking out a personal loan?

Say she takes out a \$120,000 mortgage on a fixed rate which is 9.1% over 25 years. It will cost Sue \$1,007.62 per month to pay for the whole mortgage.

Of that \$1,607.22, \$162.94 per month would go towards paying off the additional \$20,000 of debt. Unfortunately, because she takes 25 years to pay it off, the extra \$20,000 of debt would end up costing Jane \$50,382. However, the monthly payments of \$169.94 are affordable.

It would cost \$413.00 per month at 9.1% in total; Jane would pay \$24,780.39 for the \$20,000 of debt.

The repayments on the 5 year loan are more than twice as high as the repayments on the mortgage, but the debt is cleared quicker, saving \$25,601 if the \$20,000 portion was paid off over say 5 years.

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Do the maths

Luckily, it’s not all that difficult to figure out whether or not you can afford to refinance. All you need to know is what your disposable income is, which is simply the money you have left each month

after paying your current mortgage, rates, household bills, travel costs and other essential expenses.

If you weren’t in debt, you could save this money or spend it on a holiday. But if you have debt, that’s the total amount of money you can afford to use to repay your debts every month.

Makes sense so far? Good, because this is the important bit: If your disposable income is smaller than the minimum monthly payments you’d be expected to make on your new mortgage, you cannot afford to refinance because you cannot afford the repayments.

Don’t assume that refinancing will be a good idea simply because the minimum payments are lower than those on your unsecured loans or credit cards.

You might still find yourself unable to make those minimum payments. And if the debt you ran up on your credit card is now part of your mortgage, it could ultimately cost you – and your family – your home.

Even if you can afford the minimum repayments, remember that mortgage payments are usually spread over a longer period of time than personal loans. The debt could end up costing thousands more as part of a mortgage because you have to pay interest on it for longer.

Added benefits

There are other benefits of refinancing. Why not take a good long look at your current mortgage and work out whether you would want to switch to another product anyway, even if you didn’t have to consolidate your debts?

It could even be the case that, if a borrower can refinance to a much better rate than the one they are currently paying, they can consolidate their debt and still reduce their monthly mortgage repayments.

THINGS TO DO

- **Work out** your disposable income
- **Make sure** you've got money put aside for a financial emergency before you put your home at risk.
- **Figure out** whether your current mortgage deal is competitive and weigh up the costs of switching.
- **Talk to** a registered NZ Mortgage Brokers Assn broker (we are) about your best options. They will be able to give you figures showing your savings.

In this situation, consolidating your debt by refinancing is the financial equivalent of having your cake and eating it. It's a decision that needs to be considered carefully but, with the right attitude and the right payment plan in place, refinancing could well be the start of a new, worry-free, wealthier existence. It's time to say goodbye to your debt – and swim off into the sunset.