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Mortgage redraw vs. an offset account

At Blue Key Finance we often get asked the question on whether it's best to apply for a variable loan with a redraw facility versus applying instead for a variable loan with an offset account. We now examine when either one is better in different circumstances.

A redraw facility lets you take money out of your mortgage if you've put in extra. Whereas, an offset loan involves a savings account that's linked to your mortgage. Rather than being paid separate interest on your savings which is fully taxable, the balance of the offset savings account is taken off the balance of your loan when loan interest is calculated.

Generally, loans offering a redraw facility tend to be slightly cheaper than offset loans in its interest rate and total fees.

As you can see from the illustration below, we make a comparison on those who have a mortgage with redraw and those who have a mortgage with an offset account. In both cases, the home loan is for \$250,000 at 5.5%, you pay an extra \$400 into the loan each month, only use the redraw facility or offset account twice a year for a \$1,000 each time.

In the first 5 years of having a mortgage, the offset style mortgage is the winner but only if you hold an average monthly balance of \$5,000 continuously over that period. It actually comes out \$1,339 cheaper, and that's \$1,339 better off in your pocket than the Bank's.

As a rule of thumb, an offset works best if you have significant savings and a large mortgage.

Redraw Versus Offset Account				
\$250,000 mortgage, 25 years	Redraw	Offset Account		
Interest Rate	5.5%	5.6%		
Monthly repayment	\$1,535	\$1,550		
Extra monthly repayment	\$400	\$400		
Withdrawal, twice per year	\$1,000	\$1,000		
Withdrawal fee	\$5 per withdrawal	\$0		
Balance in offset account	-	\$0	\$2,000	\$5,000
Total interest, first 5 years of mortgage	\$63,138	\$64,279	\$63,635	\$62,668
Mortgage balance after 5 years	\$206,976	\$207,268	\$206,624	\$205,657

Source: Canstar Cannex, February 2009



Enjoy a coffee while taking in the following facts ...

“Reassess your budget. Visit our website and download our comprehensive budget planner”.

Ways to make extra cash

There's no doubt there will be hard times ahead for all of us, even for the next two to three years.

This is why we felt it was important to list a few ideas in this newsletter that may inspire you to find ways to make extra cash.

Please consider the following:

- If you have a spare room, consider renting it out. Don't forget that you will need to declare this income for tax purposes.
- Get a second, weekend or night job. Again, there are tax implications so make sure it is worthwhile.
- Sell unwanted items. You may have over a \$1,000 worth of unwanted clothes. Consider selling on eBay or have a garage sale.
- Reassess your budget. Visit our website under 'Calculators' then 'financial tools' and complete our comprehensive budget planner.
- Do you still have the right home loan? Ask us for a free 'home loan health check'
- Know when to fix as timing is everything. Lenders often factor in potential future rate rises when setting their fixed rates. Chances are when variable rates go up, fixed rates rose a few months earlier as lenders anticipated the increase.
- If your credit card is not in control consider the offers that come in the mail to transfer on a 0% introductory offer and take advantage of this interest free period
- Get the max for your savings. Look into online savings accounts. Be wary of special promotional rates as the end rate may be non competitive and incur hefty exit fees which would erode any early savings benefit.
- Take care of your superannuation. Track down any lost super by visiting www.unclaimedsuper.com.au. Secondly know where your super money is being invested. Choose either the fund and/or investment options. Seek the advice of a financial planner to determine what you need to invest now in order to derive a retirement income that you desire.
- Do you have enough insurance? Seek a discount at all times. Pay the annual amount is usually cheaper than monthly instalments. Increasing your excess can reduce the premium. Consider a longer waiting period for your income protection insurance. Purchase insurance online may instill a discount. Don't pay for extras you don't need.

Do you have enough insurance?

Now, more than ever is a time to delve into your current insurance policies and even look into taking out other types of insurance policies. Below, we examine the six most common types of insurance and what in particular to look at with each of them.

1. Income protection

If you're sick or in an accident, an income protection policy will pay you 75% of your income until you're back on your feet. The premiums are tax deductible. Keep in mind, it only covers you for illness or accident and not if you lose your job.

2. Life insurance

This will make sure your family or estate is looked after if you die. You should have enough to clear all your debts and then think about all your other expenses. A common suggestion is ten times your annual income.

3. Building insurance

Look for insurers with a "total replacement policy", meaning they'll cover you to rebuild your house.

4. Contents insurance

This is vital. If most of your valuables were gone, could you afford to replace them? Consider absolutely everything you own when deciding on an amount.

5. Car insurance

An important safeguard if you have a car loan. If your car is old even look at getting a third party property damage policy. So, if you smash into a Ferrari you won't have to worry about how you'll pay for the repairs!

6. Private health insurance

It may be expensive, but depending on how much and your tax situation, you may be better off.

"A quick visit to www.iselect.com.au for a quote told me that to insure a home for \$450,000 and contents for \$70,000 would cost me \$803, with a \$300 excess. By upping the excess to \$750 I would save \$137..."

FAQ

Q) What are some ways to reduce a mortgage quicker than 30 years?

A popular question for borrowers

- Pay more frequently—with fortnightly repayments you will be actually making one additional repayment a year. However, for this to be effective it is important that you ask your lender to halve your monthly repayments rather than recalculating them.
- Make extra repayments above the minimum—even \$80 a month on a \$300,000 home loan at 5.10% will save you 3 years and 1 month off your standard 30 year loan term.
- Extra money like inheritance, a good tax return, a bonus from work should be credited into your home loan. If you have a redraw facility you still have access to this extra repayment when needed.
- Make your first repayment at settlement.
- Consider a 100% offset account.
- Salary crediting: you can use a credit card with a good interest free period to pay for your regular living expenses and at the end of the month have the card 'swiped' (or paid off) against the home loan.
- If interest rates keep falling ask your lender to leave your repayments as is.
- Do a regular stock take on your home loan. A loan may start off as good but have its competitiveness eroded by increased fees or rates, or by the introduction of better priced products on the market.
- Interest repayments on an owner occupied home loan are non tax-deductible, which means it makes good sense to give priority to paying off your home loan quickly instead of directing funds towards paying off investment loans or having them sit in low interest-bearing deposit accounts (where any interest received will also be taxed)



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We are a full member of the Mortgage & Finance Association of Australia (MFAA). We liaise with our panel of 25 residential lenders and 15 commercial lenders offering over 400 home loan products to find you the best finance structure and product to suit your specific needs. We specialise in housing loans, commercial finance, personal loans, lease finance, deposit bonds, general insurance and mortgage protection insurance. We organise immediate preapprovals, unconditional approvals, refinancing and answer any enquiries you may have. You deal with one professional from interview to settlement and beyond.