Capital
Wealth Managers

The Ultimate Guide for Mortgage Reduction

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INTRODUCTION

A mortgage is very likely the biggest financial commitment you will ever make. How many times have you heard someone say, 'We don't actually own our home – the bank does!'

If you're one of those people, you've probably thought about how incredible it would be not have to say that any more. To own your home outright is a dream and a goal many of us have. Yet how many of us truly believe it's something that will likely happen in the not-too-distant future?

We're here to tell you that it is possible – and that you can start working toward this goal from today. There are some major success factors which contribute to owning your own home sooner, and what could be better? Eliminating bad debt (that which isn't providing any income or tax benefits) feels good – just ask anyone who's finished paying off a blown-out post-trip credit card bill or car loan.

To anyone paying a mortgage, the idea that you can own your own home is very enticing. It's a huge psychological boost, providing security and freeing up money so you can do other things.

So how can you really pay off your mortgage faster? Should you re-finance? Will extra features, such as a redraw facility, mortgage offset account or a line of credit help you? Or, should you go for a basic 'no frills' loan instead, and make additional payments whenever you can?

While certainly times have changed and people are more prepared to use debt to improve their financial situation, it is still a dream for many Australians to be able to one day own their own home outright. Unfortunately the trend seems to be going the opposite way, as today's home loan is not the same home loan as generations past.

Firstly, property values have gone up in proportion to wages, so affordability has decreased. Home loans are therefore, as a whole, larger than they've ever been, out of sheer necessity. In some areas of Sydney a home loan upwards of $800,000 is normal.

Secondly, a home loan is not just a home loan any more. In reality, it is the sum of what will be borrowed on the house.

Your house needs a new bathroom in a few years' time. Where will you get the funds? If you're like most people, you don't have an extra $40,000 stashed away ready for the next renovation, so you'll likely draw it out of the house using your line of credit. How about a second storey? Again, you won't necessarily have access to the funds at the time you require them, so you'll tack the bill onto the home loan.

There's no doubt about it, the home loan is changing, thanks to a number of factors such as our increasing appetite for material goods and the low affordability of housing today.

With this in mind, it is more important than ever that individuals put effort and time into ensuring they are doing what they can to reduce their non-income producing debt. Avoiding a situation where home loans are extended (potentially until retirement) should be made a priority.

The Three Kinds of Debt

Understanding the different types of debt can help you see why it pays to reduce your mortgage.

Bad debt is borrowing simply to spend, either on day-to-day things like clothes, or on things that lose value from the day you buy them, like cars and washing machines. This is the typical credit card or car or home appliance finance debt, and it is the worst kind of borrowing.

Good debt that can actually fuel personal wealth creation is when you borrow to buy an appreciating asset such as real estate or shares. Not only is the asset you buy likely to increase in value over time, but the interest you pay on the loan is tax deductible. So depending on your income and your tax bracket, you could end up borrowing for investment virtually tax-free.

Own Home debt is when you borrow money to buy an appreciating asset, but are legally unable to claim any tax rebate on the interest you pay. Home mortgages fall into this category because home mortgage interest is not tax deductible. This is a great pity, because over the lifetime of the mortgage, you will probably pay more than twice the value of the original loan in interest. That is why you should pay your mortgage off as soon as possible to reduce the total interest bill.

BACKYARD TREASURES

In the popular fable, The Alchemist by Paul Coelho, Santiago the Andalusian shepherd boy follows his dream and sets off on a journey. In search of a hidden treasure, he wanders off to faraway places, into the desert. After years and years of endless searching far and beyond, scouring foreign lands, living with Bedouins and Arabians, Santiago finally returns home only to find the elusive treasure is actually in his own backyard.

So what on earth does this have to do with mortgage reduction, you're thinking? Just as Santiago was looking in faraway places for the answer, you too may be looking outside of yourself for the hidden treasure. You've got the dream home, and maybe even an investment property, and you're now hoping for the magic pill that's going to miraculously wipe out your mortgage overnight.

We've got news for you: the answer is inside of you. There are some fundamental tools you can use to help you on your journey, which we will reveal later, but ultimately it's your resolve which is the determinant of your success. Paying off a mortgage requires sacrifice and the discipline, and both of these elements must come from within.

'Tricks' of the trade, such as re-paying a loan fortnightly rather than monthly, will help you slash years off a mortgage (we'll explain how this works later on), but in and of themselves they are not enough. Mortgage reduction is like many things in life: you must be prepared to make the sacrifices required for success.

Many of us don't know the true meaning of sacrifice because our lives have been so plentiful we've grown accustomed to getting whatever we want, whenever we want it. These more affluent times are a huge contrast to 50 years ago when a generation of Australians lived through times where basic needs were not something to be taken for granted.

Our standard of living has improved and creature comforts have become more accessible. At the same time, so has easy access to an endless number of consumer goods, and the credit needed to purchase them today, whether we have the money or not.

Having grown up with many luxuries readily available, we've changed our whole perspective of 'want' and 'need'. Many kids growing up today will struggle to imagine Foxtel being anything but a bare necessity, whereas 40 years ago just having a television was a luxury. In many respects, luxury has become the norm. The latest mobile phone, a new iPod, a new car – many of us spend our time accumulating all of these things on a regular basis; and we've gotten used to outsourcing many domestic duties such as cleaning and ironing.

So what's wrong with all of this? Nothing, if you can afford it. But let's face it, if you were debt-free, had money invested for your future security, with spare cash to spend on the latest model BMW 3 series, then you probably wouldn't be reading this book. Which means it's time you faced the fact that reducing your mortgage is a pretty large feat which will probably require you to change your ways on some level in order to succeed.

Making larger or more regular repayments on your loan is one of the best ways to reduce your mortgage, simple but true. Those spare funds will come from money that would otherwise go towards non-essentials. Quantifying what those repayments can mean long term will give you the incentive to move forward, so we're going to show you how mere pocket change can transform into thousands of dollars in savings.

TURNING LOOSE CHANGE INTO THOUSANDS

Becoming more aware of your ability and desire to make the necessary sacrifices becomes easier when you can quantify just what you are going to get in return for deferring consumption. When it comes to reducing a mortgage, a bit of self-reflection can go a long way. Just how much do you 'need' that daily cup of coffee? Or that nightly dose of Foxtel? Or that fancy dinner out each week?

Think of the cup of coffee you have each day on your way to work. You can consume it right away, get a great buzz, and it's gone in a couple of hours. Now, think about that coffee and what it's worth to you.

That daily coffee works out to $15 per week, or $65 per month. If you were to put that amount into a $500,000 mortgage on top of your regular payments each month, you'd save $38,397 and take 1.6 years off your loan. That is equivalent to earning $62,945 before tax (assuming a tax rate of 39%). **Over $60,000 earned for simply putting aside a small amount each week.** [1]

Effects of Extra Payment of $65 per Month on a Home Loan[2]

No Extra Payment		Extra Payment Of $65 per month	
Loan amount	**$500,000**	**Loan amount**	**$500,000**
Monthly repayment	**$2,997**	**Monthly repayment**	**$3,062**
Total interest paid	**$579.192**	**Total interest paid**	**$540,795**
		Total interest saved	**$38,397**
		Time saved	**1 year, 6 months**

You may not decide to kick your coffee habit, but at the very least, this exercise might help you savour that daily cup of coffee one bit more!

The real value of this exercise is that it shows what seemingly small amounts of excess money can do when they are fed into your mortgage on a regular basis. It's the power of compounding in action, so the sooner you begin to channel any additional funds in the mortgage, the larger the rewards.

Paying off a mortgage is at least a 20-year journey in most cases (although it doesn't have to be), so depriving yourself of things which you cherish is not the answer. Understand though that small sacrifices can be powerful over the long term, and with that in mind, dig deep inside and think about what sort of lasting changes you think you can make.

[1] $15 per week multiplied by 52 weeks divided by 12 months = $65 per month.

[2] Interest rate of 6% with a term of 30 years

PRICE VERSUS COST

A helpful tool for helping us curb unnecessary spending and reconsider our habits is looking at the real cost of goods and services. The price of a burger might be $7 but you actually need to earn $13.20 (assuming a 47% tax rate) to pay for it. Viewing consumables from this perspective can help you consider what they are really worth to you, and how much you really want them.

Sacrifice is the act of giving up something valued for the sake of something else more important or worthy. Essentially, it is a deferral of consumption; not spending now, spending later.

You've identified what you want: to pay off your mortgage in the shortest time possible. The first step you need to take is to accept the idea of sacrifice. Only once you've overcome this psychological hurdle will you be able to succeed in reducing your debt.

There's nothing magic about the 'magic pill' we are about to prescribe. It involves making the sacrifices today for better prosperity tomorrow. When combined with having a structure in place to maximise the features available in today's lending products, you'll be on the right track.

What do you really need in life? Examine what's important to you. What can you live without?

If your passion in life is your prized wine collection, doing away with your wine club membership is going to leave you feeling deprived? But if it's just another thing that you have 'because everybody else does it,' or because you're too lazy to change your ways, think again.

If you're fairly content with your house, but are constantly pouring money into it because that's what the neighbours are doing, for example, then maybe it's time to re-visit what's important to you. Or if you're always on the go, eating three meals a day on the run, then again, maybe a bit of forward planning could make a dent in your expenditure.

No one aspires to be a pedantic number cruncher who whips out the calculator at dinners out with friends, but finding out the cause of 'leaky wallet syndrome' is a necessary evil if you want to get serious about mortgage reduction.

A word about budgeting: it is so simple and basic but often overlooked. It's also a bit like a trip to the dentist in that no one would choose to do it for fun, yet if it's something you do regularly you can prevent a lot of future pain. If you haven't sat down to figure out where your funds are going, you're missing a huge opportunity to stop those leaks before they get out of control and prevent you from moving ahead.

There are many budgeting tools available online which are fast and easy-to-use. If you are planning on seeing a financial adviser, they will also help you with budgeting.

The first step on your journey toward reducing your mortgage is to ask yourself: what are you willing to sacrifice in order to achieve freedom from debt? Can you differentiate between what you need and what you want? If that line has become increasingly blurred you may have to do some soul searching in order to determine whether some lifestyle changes are in order.

My Needs Versus Wants Inventory

THE RIGHT STUFF

If you have decided that you are willing to make sacrifices towards your goal of reducing your mortgage, you are one step closer to reaching your objective. But the whether this materialises into something that makes a difference comes down to discipline. Discipline is about action, or inaction (which is an act itself). All of our actions form habits, which lead to consequences, which we may or may not like. There are bad habits, and there are good habits which serve the outcome we are striving for.

Some of us are better at discipline than others, just as some of us are more prudent consumers than others and are more aware of how we can be swayed by external factors. There's no doubt though that it's not easy to be disciplined with the amount of advertising we are exposed to, and it would be naive to assume that advertising has no effect. Today's marketers are doing their job well. They've had decades of practice and it is effective. This means your vision needs to be strong and clear, because if you don't have a clear vision, and the resolve which stems from it, you are at the mercy of the barrage of products available.

Are your habits helping you create the vision you are after? Remember, whether you like it or not, your actions are going to specify an outcome, so make sure it's the one you intended. We may be only human, but we do have free will, and the ability to change our behaviour.

Popular personal development blogger Steve Pavlina has a 30-day challenge he uses to change habits he doesn't find helpful. Here are the questions he uses:

- What new habit(s) can I commit to maintaining for the next 30 days?
- What will this do for me if I succeed?
- When will I begin this 30-day challenge?
- How will I reward myself after 30 days of success?

It can be much too hard to rely on our discipline skills on a day-to-day basis if we don't have the right structures in place. Today's consumer-centric world relies on our inability to be disciplined, so we need to make a concerted effort to follow the right path towards our goals.

CREATING THE STRUCTURE FOR SUCCESS

If you've ever visited amazon.com, the giant online bookseller, and noticed their 'one-click' shopping feature, you will have seen how easy it's become to spend money. Anytime and anywhere, we have the ability to purchase goods and services. If you're looking to cut expenditure, the marketers are doing what they can to make it as difficult for us as possible, but ultimately it's our responsibility to be disciplined.

The structure which you surround yourself with – meaning the structure in which your money flows and with which you give yourself access to your money – is a make or break element in the mortgage reduction game.

If you already know that you struggle with discipline, the best thing you can do is acknowledge this. One powerful statement someone can make is: 'I'm undisciplined, I can't sacrifice.' We can get around these issues by creating the right structures which can be used to force behaviour on us.

Putting your finances on autopilot is one part of the equation, but on a more strategic level, you must structure your finances properly in the first place in order to make sure they are optimised for helping you succeed in reaching your mortgage reduction goals.

The story of one mighty dollar

Let's say you earn $5,000 a month, and each month you spend $4,999, so the crumb that's left behind is one dollar. What happens with that stray dollar? If you're like most people, you'll spend it.

You wouldn't write a check for one dollar to pay off your mortgage. In other words, the easiest thing to do is to either spend the money or leave it in your account. The easiest path is not to pull out your check book, write a check for a dollar and walk off to the bank and deposit it into your mortgage. This system then is obviously not going to be the most conducive to putting excess cash into your mortgage.

If you can figure out how to structure a system which most effectively captures the extra dollars then a lot of other things will take care of themselves.

Imagine the same scenario – a $5,000 salary with one dollar left at the end of the month. Instead of putting it into your bank account it goes straight into your mortgage. You spend your $4,999, and the spare dollar is now automatically in your house. It automatically goes into your mortgage because the structure lent itself to that.

Having the right structure in place can mean the difference between success and failure. **The most effective way to reduce your mortgage is to make extra repayments, more frequently**, so a structure which lends itself to doing this most effectively is going to help you succeed.

SET-UPS FOR MORTGAGE REDUCTION SUCCESS

Line of credit

There's a number of ways of setting this structure up. On a $500,000 loan you would have a $50,000 line of credit, with a $450,000 principle and interest loan at the lowest rate possible, and a credit card. These three pieces would form the jigsaw puzzle. Your salary goes directly into the loan each month, and the crumbs remaining after each month's expenditure (on the line of credit) would be captured into the loan. This reduces the loan amount and the interest you are paying. The line of credit would start at $50,000 and go down, and one or two years later you write a check (redrawn from the line of credit) and make a lump sum reduction of your home loan and you then continue to wash your income through the line of credit again.

This structure can work wonders and has the potential to wipe off a mortgage. In some cases it can turn a 25-year mortgage into eight or nine years, because the 'crumb' isn't a dollar. In many households, after the essentials are paid for, it's two or three thousand dollars a month and the impact is profound.

Buyers beware though! This debt-based structure requires divine diligence and **therefore only works for a small number of people**. A knowledgeable, responsible financial adviser would only recommend it with a lot of care. Even so, it is only a structure which should be implemented on a trial basis, and then continued if it is proven to be suitable.

It's a fact of life that it's simply too hard for most people to resist finally renovating the bathroom or buying a ski boat, or going on a fabulous holiday when there is extra money on the line of credit available to them for spending.

There also needs to be a substantial difference between what you earn and what you spend, and if you have a job where you're not around to spend it – such as a pilot – then even better.

If you happened to be one of those rare animals that has a huge gap between what you earn and what you spend and can contain your expenditure for just what you need while having access to all this credit around you, then we commend you. The reality is that most people are not in this situation, and the line of credit system is therefore only fantastic in theory.

It's also worth mentioning that lines of credit can also allow you to take advantage of your reduced mortgage and have your funds available for other purposes such as investment. It provides a lot of planning power, so it can be used effectively in the right situation.

Cash-based system

While the line of credit is intellectually great, very few people can make it work. A cash-based system works best for most people because it provides near-instant feedback when they overspend.

Let's say you have dinner at a restaurant, and the bill comes to $201. Your limit is $12,000. Have you gone over budget? This is a trick question. The answer is 'how can you know?', because there is no budget.

Again, you go to a restaurant, and the bill comes to $201. There is $200 in your bank account. You go to use a check or a debit card. Have you gone over budget? Of course! So firstly, you're going to be more aware of what's actually available to you, and secondly, there is instant and immediate feedback that you've gone over budget.

In the first scenario, you have no way of knowing whether you've cut into your budget. The only way you'll know is 12 months later, when there have been a thousand transactions, and they're all done essentially blindfolded.

In the cash-based system, it's instant. You start off the month with $5,000 and if you spend $5,001 you instantly know about it.

Our financial advisers use a cash hub where all income enters, which acts as a mechanism to put a gap between you and your money. This provides you with one central operation account for all your cash flows and with this you can decide how much to set aside for day-to-day expenses, how much for less frequent, larger expenses and how much for investments – all with instant feedback.

In this operating account, if there's any excess, it can go back into your mortgage. There's instant feedback because at the end of the month if you run out of money, it requires adjusting.

Whether you use this type of system or not, it's important to realise that the way you structure your finances can impact the amount and speed with which you pay down your mortgage. Having feedback mechanisms in place allows you to take control of your spending and finances and allows you to see what is actually happening, and make the changes required if need be.

We've shown you how important it is to have the right structure in place in order to help you reach your financial goals. You may want to consider the benefits of enlisting a financial adviser to help you set up the right structure properly from day one.

TRICKS OF THE TRADE

We've talked about the major strategic concepts of mortgage reduction. In this section we will talk about more tactical ideas for reducing your mortgage.

Set it up right

Option 1

A structure where your salary goes straight into your mortgage account. This reduces the overall interest you pay on your mortgage debt. General expenses are then paid using credit cards – taking advantage of a 55-day interest free period.

Option 2

A structure where your mortgage, savings and current accounts are in separate pots. Your savings are used to reduce - or 'offset' - your mortgage. In many cases it is worthwhile getting advice because in many cases a mortgage is not just a mortgage. The way your debt is structured can affect your entire financial picture. Some mortgage brokers will be able to provide strategic advice for debt management. Otherwise, find a financial adviser who can help you with your overall planning and cash flow management.

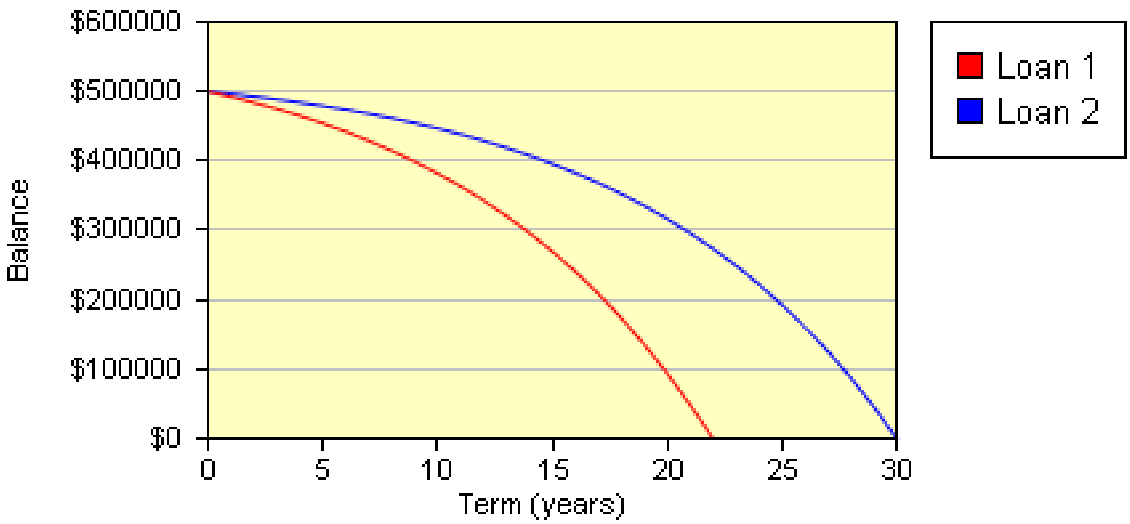
Fortnightly versus monthly repayments

It may seem like magic but this 'trick' made famous by 1980s money guru Noel Whittaker is simply a way of making an extra payment per year, without feeling the pain.

By paying fortnightly or weekly rather than monthly, you can save thousands of dollars in interest costs. If you pay monthly you make 12 payments per year, whereas if you pay fortnightly you make 13 monthly repayments because there are 26 fortnights in a year. This 'extra' and more frequent payment system results in huge savings.

Effects of Fortnightly Repayments versus Monthly Repayments on a $500,000 Loan

	Loan 1	Loan 2
Repayment frequency	Monthly	Fortnightly
Repayment amount	$2,997	$1,498
Total interest charged	$579,192	$456,990
	Total interest saved	$122,202
	Time saved	5.4 years



Re-financing

Shop around for the best possible interest rate, and remember that it's the underlying rate that counts, after fees are accounted for, sometimes known as the comparison rate.

If you want additional features, look for a low interest rate loan that has them. Paying an extra 0.5 per cent interest for a loan with features that may save you money, but the higher rate may end up costing you more than you'll save.

It all depends on your overall financial situation because sometimes the extra features are necessary to achieve your tax and investment objectives, so these are issues which should be considered as well. Speaking to a financial adviser can help clarify what type of financing would benefit you most.

You may incur termination fees for exiting your current loan early, and for fixed rate loans, in particular, these fees can be high. You will also have to pay the lender's legal fees for discharging the mortgage over your property, fees and costs associated with the new loan (application fees, stamp duty on your new mortgage, valuation and legal fees).

If you're thinking of refinancing, you must do a full check of all costs and fees to make sure you would not be better off staying with your existing loan. Speaking to a mortgage broker can help you understand this process, and will be able to help you find out whether or not you are better off refinancing or staying with your current lender.

Whether your choose to refinance or stay with your existing lender – or even renegotiate with them to find a better deal, the same principles still apply. Sacrifice, early on preferably, pays huge dividends. Only a few spare dollars can help you make huge inroads, if you are willing to form the right habits. If you are not willing to make the sacrifices necessary, then no amount of tricks and tips are going to help you.

CONCLUSION

Paying off a mortgage is not a two-month exercise; it's a 25-year journey that you are trying to shorten. You can motivate yourself to do something new for a month or two but if it doesn't stick for the next 20 years because you don't have the discipline to do it – then you probably aren't going to make a huge impact. If you want to pay off your mortgage you have to embark on a voyage that will involve some self-reflection, and an understanding of the role sacrifice and discipline play in your success.

Knowledge is power, so assess your situation, and consider enlisting a financial adviser to help you with your planning. Most importantly, remember that having a clear vision for the future is the first step towards creating the habits that will help you achieve your goals.

Please take the opportunity to book a meeting with us to discuss your financing needs. Introductory meetings carry no obligation and are free of charge.

CAPITAL WEALTH MANAGERS - FINANCIAL EDUCATION

Financial Independence is a point in life when you are no longer dependent on work, government or family for your income. It is a point where you are generally debt free and have sufficient investments and income to look after you.

A Financial Adviser is a professional who brings together a wide array of skills, experience and disciplines to develop and execute a financial strategy to help clients achieve their goals and objectives on their journey towards financial independence.

A Financial Plan is a written document that outlines a steady path towards your financial independence.

A survey was carried out on Harvard MBA students. The question they were asked was:

"Have you set clear, written goals for your future and made plans to accomplish them?"

- 3% had goals and they were written down
- 13% had goals but they were NOT written down
- 84% had no specific goals

10 years later those same students were followed up. The 3% who had goals written down were earning 10 times as much as the other 97% combined.

Our observation from this is that written goals keep you focused and give you purpose.