



EXPLAINER:

Interest Only Loans



BORROWING TO BUY A PROPERTY AND REPAYING ONLY THE INTEREST FOR A SET PERIOD CAN BE A GREAT CHOICE FOR SOME, BECAUSE INTEREST-ONLY LOANS CAN OFFER THE RIGHT CANDIDATE FINANCIAL FLEXIBILITY WHILE THEY INVEST. THERE ARE, HOWEVER, SOME VERY IMPORTANT RISKS TO TAKE INTO CONSIDERATION.

With interest rates at historical lows, interest-only loans may sound more appealing than ever because they offer the opportunity to enter the property market with lower repayments. In saying that, care must be taken, because interest-only loan repayments do not pay down the actual purchase price of the property or reflect a realistic repayment on a standard mortgage.

Firstly, the principal amount borrowed will not reduce unless the consumer chooses to make extra repayments, if that is allowed under the loan terms.

As a result of that, the interest-only loan may cost the consumer more over the full term of the loan.

If you're only repaying the interest on a loan, you're not building up the equity on your home during that period.

For an interest-only loan to be part of an effective property investment plan, borrowers must be comfortable that a property's value will increase substantially. If the value doesn't increase by more than the interest paid, they may end up losing out on the equity front.

Eventually, interest rates will rise again as the market ebbs and flows and, once a loan reverts to principal-and-interest repayments, borrowers who are unprepared may find themselves in a financial struggle.

It's important that consumers have a clear plan for what they are going to do when the interest-only period ends and how they are going to meet those additional repayments.

It would be important for somebody considering this type of loan to make sure they understand the issues involved. Consumers need to have a

very clear plan for what will happen when the interest-only period expires.

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