INVESTOR SERIES

TOP TEN TIPS

Debt Elimination Strategies

Dymphna Boholt

1. The 'Debt Avalanche' Technique

When starting to pay off debt, you will need to determine which debt to pay off first. The debt you select to pay off first will be the debt you target for rapid pay off, your 'debt avalanche'. Should any extra money come your way by either windfall or additional earned income, or by careful budgeting and reducing your expenditure, this money should all be applied against this debt. I find that 6 simple steps works best when using the 'debt avalanche'.

1. **Simply list out to whom you owe and what the debt was for**
2. **List the amount or balance owed**
3. **List the minimum monthly payments for each debt**
4. **Divide the amount owed by the minimum monthly payment.**
   The higher this number, the less immediate impact it is having on your cash flow. Conversely, the lower the number the greater its effect on your cash flow. Consequently, the debt with the lowest number is the debt you should target first for your avalanche repayment strategy.
5. **List the interest rate for each debt.**
6. **Determine which debt you will pay off first.** In most cases you will want to pay off the highest interest rate debt first, but not always.

2. Debt consolidation technique

Debt consolidation is the process of increasing one loan, usually the home loan which has a much lower interest rate, to pay out other smaller debts that have a higher interest rate and higher monthly repayment requirements. These higher monthly repayments mean your cash flow can be severely stretched.

The big trick, then, is to keep those debts paid off and not let them creep up again. I like to discuss this strategy with my friendly loan broker. It is important that you find a good loan broker.

Refinancing your mortgage with your current lender or an alternative lender, could also reduce your payments in the interim while you eliminate other higher interest debts. Exploring this option may be helpful, although you should be sure that the benefits outweigh the cost of refinancing as there may be penalties and fees for such a process.

It is also advantageous to arrange to pay your mortgage every fortnight or even weekly instead of monthly. You will save a significant amount of interest doing this as you are reducing your mortgage every week or two weeks. As a word of caution, when using this strategy, ensure the bank or financial institution calculates your repayments on a daily basis and not monthly, as this one difference in the mathematics of your loan, could save you thousands.

3. Mortgage Repayment Accelerator – Using 'Lines-Of-Credit'

One of the more aggressive approaches to your debt elimination could be to use a form of debt called a line of credit. Imagine your house being used as a security for one big credit card. The interest rate you would pay on that credit card would obviously be lower than other credit cards as the bank has your home as security. Essentially, the interest rate is similar to that of any other housing loan.

This loan is called a 'line of credit' facility or 'revolving line of credit'.

With this type of loan, the bank will normally lend you up to 80% of the value of your property and interest is calculated on a daily balance from the amount outstanding. Mortgage insurance may be required for a higher percentage. As interest is calculated daily on the balance of the loan, the balance is best kept as low as possible by keeping money in the account longer. With money in the account longer, there is less interest to pay and more money goes towards paying off the loan amount. This in turn means you have less interest to pay and so on.

But remember, it can be a dangerous tool if you do not control it!

4. Use Equity To Produce Passive Income

Extensions to this basic philosophy of using interest free credit arrangements to maximise your personal mortgage reduction, include using the unused equity in your home to buy assets that have a positive cash flow over and above the cost of borrowing the money. By buying higher income yielding assets than the cost of the borrowed funds, you are able to apply the extra income to reduce your mortgage even further.

It doesn't matter what type of investment you choose – what is important is that you do your due diligence and make sure whatever it is you are buying does actually put back more money than it is costing you.

Make sure that the amount of passive income that the investment is paying you every year also is sufficient to warrant the time and effort you spend earning that extra cash flow.

5. The Last Resort

Up until now, we have covered processes for reducing your debt. Unfortunately, some of you may have gone too far into debt and may not see that there is any way out.

When things seem out of hand, there are several arrangements that can be entered into with your creditors to work through for the best result for all concerned. The next few tips are arrangements that are to be considered the very last resort when all other avenues have been unsuccessfully attempted.

6. Informal Arrangement

This is an agreement made with your creditors to give you more time before legal action is taken. Once creditors are contacted and realise your financial hardship is genuine, they may assist you by giving more time to pay before taking the matter any further. This arrangement is not binding and all creditors must agree. If one creditor rejects the offer, this may impact on the entire informal arrangement.

7. Debt Agreement

A debt agreement is a simple way to enter into a binding agreement with your creditors. A proposal such as this could be periodic payments out of your income to the creditor or a transfer of property from you if repayments are not met. There are certain criteria that must be met to be eligible for a debt agreement, and these would need to be investigated in full. Under this agreement all provable unsecured debts are frozen. Not all creditors have to agree, and it can even be decided by a vote from creditors whether to agree to the proposal or not.

This agreement can still result in a record on your credit reference file for 5 years and it will also be recorded on the public insolvency record. You cannot set up a debt agreement if you have been bankrupt, or have had a previous debt agreement or Part X arrangement in the last 10 years. If you set up an agreement and fail to make the repayments, it is considered an 'act of bankruptcy' and your creditors can make you bankrupt.

8. Part IX And X Arrangements

These arrangements can be an alternative to bankruptcy providing your creditors accept this proposal. The main difference is that this arrangement may still allow you to retain some assets and/or continue to operate your business.

Once the proposal is drawn up, a meeting of creditors is called to vote, so long as the majority agree, and 75% of the dollar value of creditors vote, the proposal will then be set in place.

The difference between the two arrangements is basically that a Part IX has a limit on your assets or debts and a friend is able to act as an administrator. Part X has no income, asset or debt limits and can only be done by a registered trustee, which makes this a more expensive option.

9. Bankruptcy

Bankruptcy should be considered as a last resort, as it has serious consequences, and there can be many alternatives, which should be thoroughly investigated. When you are being increasingly pressured by creditors, bankruptcy could seem like an easy option. You can become bankrupt voluntarily or through a creditors action. A period of bankruptcy is usually 3 years, however this may be extended to 5 or 8 years if terms of agreement are not met for example.

Unsecured creditors are unable to take any further action against you to obtain any money owed. Creditors may lodge claims in the bankruptcy. Bankruptcy does not protect you from ongoing utilities payments, breaches of law fines, or Department of Social Security debts or any form of maintenance payments. You are also limited in what you can own and your credit rating is badly damaged for 7 years. Furthermore, your name will be added to a Government database for life.

It is not something that should be entered into lightly. However, if there is absolutely no other way then make sure you realise the impact it will have on you and your credit rating in the future.

10. Preventative measures

You can be guided through debt management, debt elimination, debt negotiation and debt agreements with an experienced financial counsellor. This may be a viable option before embarking on any of the above strategies or agreements. Learning to manage your money and how to take financial responsibility will help prevent you from ending up in the same situation again.

Do not put your head in the sand when debt seems to be looming over you. Ensure that you take the right preventative or strategic options so that you are able to succeed financially in the future.

To find out more **call (03) 9490 8888** now or go to **www.iloverealestate.tv** to register for our next **FREE Webcast** where you'll discover the strategies, techniques, structures and support you need to successfully invest and prosper from Australian real estate.

Yours in success,

Dymphna.

Dymphna Boholt

I LOVE
REAL ESTATE