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Finance - Interest Only Option

Some Banks of late have voiced concerns regarding approving finance with interest only components on either or both the business and residential loan. With the Government and the RBA attempting to slow down the economy we will see a slow down in property price growth which will have an adverse effect on the value of the Mangers Unit. Interest only sees your loan balance remain constant until Principal and Interest repayments are instigated. Should you intend only a short stay in your business (say three to five years) then you will be relying on capital growth in both the unit and the business while on Interest Only. The unit growth will come from general increase in the property market and the business from your efforts to improve the business. Should you intend a longer stay then the above growth conditions will apply together with debt reduction from either bulk repayments and or Principal & Interest repayments.

Interest Only is generally granted when the Terms of Agreements are long enough that a strain is not placed on income when the loans are reverted back to P & I and the loan needs to be paid off over the remaining term. Interest Only is beneficial to those that do not intend to stay in the business for any length of time. History shows that those in Holiday complexes tend to stay between three and five years. Principal & Interest repayments will not show any significant reduction in principal for up to five years.

Principal and Interest repayments are generally required initially when Standard Module Agreements are in place and at best the terms of agreements are ten years. (Even then we can generally get at least one year interest only). Principal & Interest repayments could also apply when you intend to stay in the business for an extended term. It may be prudent to take advantage of the full term of the agreements from the outset. It may also be that a portion of your residential loan is not tax deductible and there would be no point in delaying reduction.

In the past twelve months we have been able to secure for most our clients up to five years interest only on both the residential and business loans. This would be subject to variables such as, loan to value ratio and length of terms on agreements etc. Most loan structures these days allow for bulk reductions and redraws on both interest only and principal and interest loans (as long as they are not fixed rate facilities).

Banks will as a part of their approval process assess your repayment capacity on a Principal and Interest basis with an increased “Qualifying” Rate. Different Bank policies will also dictate whether Interest Only is available at any given time. The

Bank Managers that we deal with, will, on occasions advise that due to current policy Interest Only is not available and we will not waste your, their or our time by pursuing the matter. We will either move on or accept the umpire's decision and take principal and interest as offered. It may be that in twelve months time you apply to the Bank to convert to Interest Only and the request may be granted given the current economic climate or the fact that you now have a history with the Bank.

Interest Only is an option and still has its place in finance for Management Rights.

Mark Harvey
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