

How interest free loans work

Interest free loans can work in a number of different ways:

- Pay by instalments - regular payments are required each month.
- Buy now, pay later - you are not required to make any minimum repayment.

What you need to know

Minimum payments - In most instances the minimum repayment will not be sufficient to repay the loan during the interest free period. If you wish to repay the loan within the interest free period you will need to make additional payments each month. In some instances you will need to make arrangements with the financier to make these additional payments otherwise the additional amount may be held in credit against future minimum repayments.

Interest rates - Interest will start to be charged at the end of the interest free term, usually at a very high rate. It is not uncommon for these interest rates to be in the high 20%'s or even higher. Worst still is that penalty interest may be charged for not paying the balance off within the interest free period.

Payment default - If you default on the loan (eg miss a repayment during the interest free period) it is not uncommon for the loan to cease being interest free with commercial rates of interest being charged moving forward. It is best to set up regular direct debits from your bank account to ensure that all payments are made on time.

No discount - Ever notice that when you buy an item with an interest free loan that the retail attendant will never discount the purchase price? This is because the retailer is not generally the financier and there is a third party. The retail store will normally share a percentage of the sale price with the financier to ensure that the financier receives some payment in the event that you repay the loan within the interest free period.

High fees - Even though there may be no deposit and interest, most loans do charge application and monthly fees. It is not uncommon for these monthly fees to be \$4.95 per month, being nearly \$60 per year.

Comes with a credit card - Some financiers offer a credit card with the loan to tempt you to spend more. Be warned as most of these credit cards have interest rates significantly above other credit cards available in the market.

How to take advantage of interest free loans

Work out the numbers - Ask the retail assistant what discount would be available for a cash sale then determine the monthly charges to calculate how much the interest free loan will actually be costing you. Consider if utilising your home loan redraw facility to purchase the item at the discounted price will be cheaper. In many instances if the item is less than \$1,000 it very well could be.

Repay during the interest free period - Make sure you repay the loan within the interest free period to avoid default interest or extremely high rates of interest. If it is unlikely that you will be able to repay the loan then:

- consider using a redraw facility on your home loan to repay the loan as it will be at a much lower interest rate, or
- re-finance your home loan to consolidate the interest free loan into your home loan.

Be aware, unless you pay additional monthly payments and have the goal to pay this portion off as soon as possible, then you may actually be adding this debt to your 20 year home loan.

It is always wise to call our office, even for the smallest consideration of new debt. We will let you know about all the hidden and long term costs of interest free loans, making sure you understand the consequences of your decisions.

If you are looking to utilise your re-draw facility or re-finance to pay off your interest free loan, then contact the office today or ask for our fact sheet on 'debt consolidation'.

