

Interest/Ijarah only Loans & Repayment Types

Understanding Interest/Ijarah Only (IO) Home Loans:

- An IO loan mandates only the Ijarah/interest payment on the borrowed amount, leaving the principal amount unchanged.
- Typically, IO loans are available for a limited duration, often up to five years. Post this period, the loan usually converts to a Principal & Ijarah/Interest (P&I) loan unless an extension is sought.

Is an Interest Only Loan Right for You?

- **Not for Everyone:** IO loans aren't generally recommended for standard homeowners. The longer the principal remains unpaid, the more interest/Ijarah accumulates over the loan's lifespan.
- **Ideal for Investors:** Property investors might find IO loans beneficial due to the tax deductibility of Ijarah/interest on investment properties. It can aid in optimising investment strategies, tax benefits, and cash flow.

Distinguishing IO Repayments:

1. **Initial Lower Repayments:** IO loans typically have lower repayments at the start but might come with a slightly higher Ijarah/interest rate than P&I loans.
2. **Post-IO Period:** Once the IO term concludes, repayments rise to cover both principal and interest, leading to a substantial increase, especially given the shortened time frame to repay the principal.

Benefits of IO Loans:

1. **Reduced Initial Repayments:** IO loans offer smaller monthly repayments during the IO term compared to P&I loans.
2. **Enhanced Cash Flow:** The saved money can be redirected to other financial endeavours like debt clearance, other investments, or further education.
3. **Tax Advantages for Investors:** Ijarah/Interest on investment property loans is often tax-deductible, following ATO guidelines. However, this doesn't apply to owner-occupiers.
4. **Flexible IO Terms:** Options often range from one to ten years, aiding in tax minimisation and financial planning.

Key Considerations:

1. **Equity Building:** IO loans don't contribute to building equity. Without property value appreciation during the IO term, financial growth remains stagnant.
2. **Transition to P&I:** Post the IO term, loans typically revert to P&I. It's crucial to prepare for this transition, whether it's through renegotiation, refinancing, or property sale.
3. **Restrictions:** Some lenders might not permit extra repayments during the IO term, and features like offset accounts might vary.
4. **Long-Term Ijarah/Interest Costs:** IO loans can accrue significantly more Ijarah/interest over their lifespan compared to P&I loans from the start.
5. **Missed Opportunities:** By not reducing the principal during low-interest or low-Ijarah periods, you might face higher repayments when rates rise.

Final Thoughts: Interest-only loans offer unique advantages, especially for property investors. However, they come with their set of challenges. It's essential to weigh the pros and cons, considering personal financial goals and market conditions, before opting for an IO loan.

Disclaimer: This fact sheet offers general information and isn't tailored to specific legal, tax, or financial planning situations. It doesn't account for individual needs, goals, or financial circumstances. Before acting on this data, evaluate its relevance to your situation. All loan offerings depend on lender approval and come with terms, conditions, and potential fees.