Loaded revolver

Be careful you don't shoot yourself in the foot when opting for a revolving credit home loan, says Finance Editor Susanna Stuart

THE TYPE OF MORTGAGE you choose is crucial. Most Kiwis opt for a table mortgage where you pay back a mix of principal and interest, usually over 25 years. The advantage of a table mortgage is that it lets you pay a set amount each month or fortnight. You can also see your loan balance reducing over time.

A second type is a flat or interest-only mortgage, where the borrower expects to pay off the principal as a lump sum, but at a later date. These are popular during optimistic times, for example when you buy a property and expect to 'flick it' at a profit perhaps a year later.

But thanks to soaring house values, a third mortgage type has gained in popularity – the revolving credit facility. It's not unlike having a huge overdraft; the bank lends you a predetermined sum which you can draw down at any time. This type of loan often works in tandem with your cheque account so any surplus cash helps reduce the balance of the outstanding amount. The ability to borrow at any time is handy if you have a short-term cashflow crunch that you know will be dealt with in the near future – home renovations, say, where a revolving credit facility lets you draw cash as you need it.

Revolving credit also helps smooth things for those of us with irregular income or lumpy cashflow. By having a standing arrangement with the bank, you apply only once and then draw cash as you need it. It's generally cheaper to borrow this way than to use other avenues like credit cards. However, the interest rate payable is typically 0.25% a year more than a table mortgage rate.

Revolving credit doesn't suit everyone. I've met people who have arranged the facility for a specific project, then started borrowing for holidays and cars. If you don't watch it, your mortgage may be going backwards. There's a cost to the line of credit facility plus revolving credit attracts a floating rate, usually more costly than a fixed-term rate when interest rates are rising.

In short, revolving credit will work for you if you earn far more than you spend or can stick to a budget. If not, reconsider. The mortgage burden can get a lot worse if you keep borrowing extra! N

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