

# Focus On Smart Debt

How getting rid of 'bad' debt and getting into 'smart' debt can help you achieve financial freedom!



According to statistics, Australia's total household debt now stands at \$897 billion. And we owe approximately \$36 billion on credit cards alone.

**T**hen there are the billions we owe on the finance we use to buy things like cars, boats, furniture, surround sound systems and big screen TVs.

However, while these are worrying figures for some, being in debt is not always a bad thing.

Debt allows us to buy things that we would otherwise not be able to own and enjoy, like the family home. What's more, using debt the right way can be a great way to create wealth and reduce tax along the way.

The trick is to make sure you've got the right type of debt. Let's start by putting the different types of debt into categories - 'bad' debt, 'good' debt and 'smart' debt.

### 'Bad' debt is bad news

'Bad' debt is borrowing money, typically at a high interest rate, to buy something destined to go down in value. Usually the loan provides no tax advantages.

Using 'easy finance' or a credit card to buy a wide screen TV is an example of 'bad' debt. Paying well over 10% interest on a personal loan from the bank to buy a second hand car is another example of bad debt.

In both of these cases, you're not really buying an asset as both the TV and the car will be worth considerably less than they initially cost long before the loan is paid out.

The characteristics of 'bad' debt are high interest, no tax advantages and the purchase of something set to go down in value over time. Borrowing money to pay for a holiday is arguably even worse than bad debt as you're left with nothing except a few happy snaps to show for it!

### 'Good' debt is good news

For most of us, 'good' debt is the unpaid mortgage on the property we live in.

Whilst the interest repayments are not tax deductible, your home at least has the potential to grow in value in the long term. And, you get somewhere to live without paying rent.

The characteristics of 'good' debt are a low interest rate and the potential for the asset to grow in value.

### 'Smart' debt is even smarter

So, if the upside of 'bad' debt is 'good' debt, what is the upside to 'good' debt? It's called 'smart' debt and is defined as debt:

- That has a low interest rate
- Is used to purchase an asset that grows in value
- That purchases an income producing asset, hence the interest costs maybe tax deductible.

#### Example:

You use the equity in your home to buy a rental property, managed funds or share portfolio.

The magic of this type of loan is threefold:

1. It allows you to purchase more assets than you would otherwise be able to own - assets that have the potential to grow in value over time.
2. The investment produces income to help you meet your loan commitments.
3. Any shortfall between the income from the investment and the cost of the money borrowed to own it is tax deductible.

In a nutshell, without raising too much of a sweat, 'smart' debt can lead to quite marvellous capital gains.

But a word of caution. This type of loan also carries the risk of losses should there be a stagnation or decline in the value of the asset you borrowed money to buy.

If 'smart' debt appeals to you, contact your Infocus adviser for an obligation free consultation.

### 'Bad' debt, 'Good' debt, 'Smart' debt.

	'Bad' debt (Credit Cards)	'Good' Debt (Home Loan)	'Smart' Debt (Investment Loan)
Low interest rate	✗	✓	✓
Growth asset	✗	✓	✓
Interest tax deductible	✗	✗	✓

**If you would like to learn more about how you can benefit from the use of smart debt, contact your Infocus Financial Adviser.**

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