



Why Paying Off Your Credit Card is Not Enough?

Applying for a loan? Don't just pay off the credit cards

It seems like a no brainer, right? You are buying a home, so you'll pay off your credit cards to reduce your debt, but keep them active so you can buy some furniture or deal with emergencies even when you have a mortgage to pay. Wrong.

It's obvious that a lender will consider your credit card debts and the monthly repayments on those when you apply for a mortgage. But what many people do not realise is that credit cards that don't have any balance owing can also impact a lender's assessment of what you can afford to borrow.

If you have a high credit limit, you also have a high debt risk in the eyes of your lender. As the logic goes, there is nothing stopping you from racking up debt on your credit card the day after your loan is approved. Say, on lovely furniture to fill that new house.

"We have to take account of 3.8% of the total credit card limit, regardless of what the applicant owes," says Tony Imbruglia from My Mortgage Professionals.

"If they had a \$10,000 limit but they only owe \$1000, we still have to assess \$380 a month and that comes directly out of their liability. It does make quite a difference", says Tony.

From this, it can be surmised that if you haven't put a cent on your credit card for the past five years, a high credit limit will negatively affect your serviceability; \$380 per month off a mortgage

repayment means quite a bit over the life of a loan. In fact, being able to repay an extra \$380 each month on a 30-year \$500,000 loan at 5.5 per cent interest will mean paying it off 5 years faster, and saving approximately \$100,000 on the total cost of the loan. Alternatively, it may mean that you are able to borrow an extra \$50,000.

The best thing you can do is lower your credit limit or close your credit account.

“You need to pay out your credit cards and avoid having any other debt,” says Tony. “You need to be able to use your full amount of income.”

For those who have to pay off their credit account before dreaming of cancelling their liability, it is, of course, imperative to make those payments on time to avoid negatively impacting your credit history.



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