Need an interest only loan?

Yes, interest only home loans end up more expensive in the long term. But for savvy investors and borrowers who just need a brief respite from full repayments they can be a good choice.

Richard Whitten Updated Dec 18, 2020. **What changed?** **Fact checked** Share

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This article was fact-checked and reviewed by Paul Wilson, an Accredited Property Investment Adviser and Australian Financial Services Representative with over 25 years' industry experience. Content has been updated for 2020.

Interest only home loans start with very cheap repayments. But you're not actually paying off the loan and your repayments will er up higher later on, costing you more in the end. But that doesn't mean interest only loans are a bad idea. They're a popular option investors trying to minimise their loan repayments while maximising their tax-deductible expenses (more on that later).

Even home owners find these loans useful if they need to reduce their repayments for a short time. You just need to make sure the suits your goals and prepare for the higher repayments later.

Leave Feedback

What's in this guide?

Interest only home loan rates

Home Loans | Speak to a Mortgage Broker

Data indicated here is updated regularly

Borrowing amount $ 150000 | Period years 30 | Calculate

Name	Interest Rate (p.a.)	Comp. Rate^	Application Fee	Ongoing Fees	Max LVR	Monthly Payment
UBank UHomeLoan Variable Rate - The Real Reward Offer Owner Occupier Interest Only						

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Bluestone
Commonwealth Bank
Community First
CUA
Easy Street
Endeavour Mutual Bank
Freedom Lend
Greater Bank
G&C Mutual Bank
Heartland Seniors Finance
Heritage Bank
Homestar
HSBC

U BANK	2.88%	2.55%	$0	$0 p.a.	80%	$623.83	Go to site More Info

Compare

This is a competitive interest-only rate product that's also low in fees.

ANZ Breakfree Package Home Loan - 1 Year Fixed (Investor, IO)

ANZ	2.79%	4.72%	$0	$395 p.a.	80%	$616.64	Enquire now

Compare

UBank UHomeLoan - 3 Year Fixed Rate (Investor, IO)

U BANK	2.44%	2.69%	$395	$0 p.a.	80%	$589.12	Go to site More Info

Compare

Pay no ongoing fees on this investment loan fixed for 3 years.

ANZ Breakfree Package Home Loan - 3 Year Fixed (Investor, IO)

ANZ	2.69%	4.4%	$0	$395 p.a.	80%	$608.71	Enquire now

Compare

Fix your rate and make interest only payments for 3 years with this investment loan.

Athena Variable Home Loan - Owner Occupier, IO

ATHENA	2.84%	2.46%	$0	$0 p.a.	80%	$620.63	Go to site More Info

Compare

Owner occupiers can refinance to one of the most competitive interest-only rates in the market. No application fee and no ongoing fees.

UBank UHomeLoan - 1 Year Fixed Rate (Owner Occupier, IO)

U BANK	2.29%	2.36%	$395	$0 p.a.	80%	$577.55	Go to site More Info

Compare

A one year fixed rate offer with no ongoing bank fees.

Aussie Select Basic Fixed Rate Home Loan - 2 Year Fixed Rate (Investor, IO)

Aussie	2.84%	3.68%	$0	$0 p.a.	90%	$620.63	Enquire now

Compare

UBank UHomeLoan - 1 Year Fixed Rate (Investor, IO)

U BANK	2.44%	2.74%	$395	$0 p.a.	80%	$589.12	Go to site

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homeloans.com.au
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ING
loans.com.au
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ME
Mortgage House
NAB
Newcastle Permanent
P&N Bank
Pepper Money
RACQ Bank
RAMS
Reduce Home Loans
Sydney Mutual Bank
St.George
State Custodians
Suncorp
Tic:Toc
UBank
Virgin Money
Well Home Loans
Westpac
Yard
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Aussie
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Mortgage Choice
Yellow Brick Road

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Investors can enjoy flexible repayments and an easy application process with this pioneering online lender.

ING Mortgage Simplifier Home Loan - $1M+ (LVR ≤ 80% Owner Occupier, IO)

ING	3.5%	3.52%	$0	$0 p.a.	80%	$674.63	Enquire now
Compare							

This basic loan offers a discount for borrowing more than $1 million

UBank UHomeLoan - 3 Year Fixed Rate (Owner Occupier, IO)

U BANK	2.29%	2.35%	$395	$0 p.a.	80%	$577.55	Go to site More Info
Compare							

A competitive 3 year fixed rate with no ongoing bank fees.

ING Orange Advantage Loan - $150k to $500k (LVR ≤ 80% Owner Occupier, IO)

ING	3.59%	3.91%	$0	$299 p.a.	80%	$682.18	Enquire now
Compare							

Get a 100% offset account, access to a redraw facility and a competitive rate tied to your LVR.

How interest only loans work

There are two components to a home loan repayment, the principal and the interest:

> **The loan principal.** This is the money you borrow from the lender. It's also called the loan amount. Eventually you have to repay the loan principal.
>
> **The interest.** Your lender charges interest on the money you've borrowed (the principal). This is how your lender makes a profit. The amount of interest charged depends on the loan's interest rate.

With those two concepts explained we can now talk about the two home loan repayment types, principal and interest home loans and interest only home loans.

Principal and interest repayments

Most home loans have principal and interest repayments. With these loans you repay the loan principal and some interest at the same time. The lender calculates these repayments in such a way that you pay more interest at the start and over time the amount of principal you repay increases until the debt is repaid. This is called an amortisation schedule.

Interest only repayments

With an interest only loan you just repay the interest on top, not the money you've borrowed. At first. When the loan reverts to principal and interest repayments, you have to repay both the principal and the interest together.

This means interest only loans start with much lower repayments. But over time they cost you more because you have to pay more interest to make up for the lower repayments at the start.

They can be risky because the principal is the main part of the loan. If you're not repaying the principal, you're not really owning more of your home and building home equity. You're essentially borrowing money without actually paying it back (until you start paying off the principal).

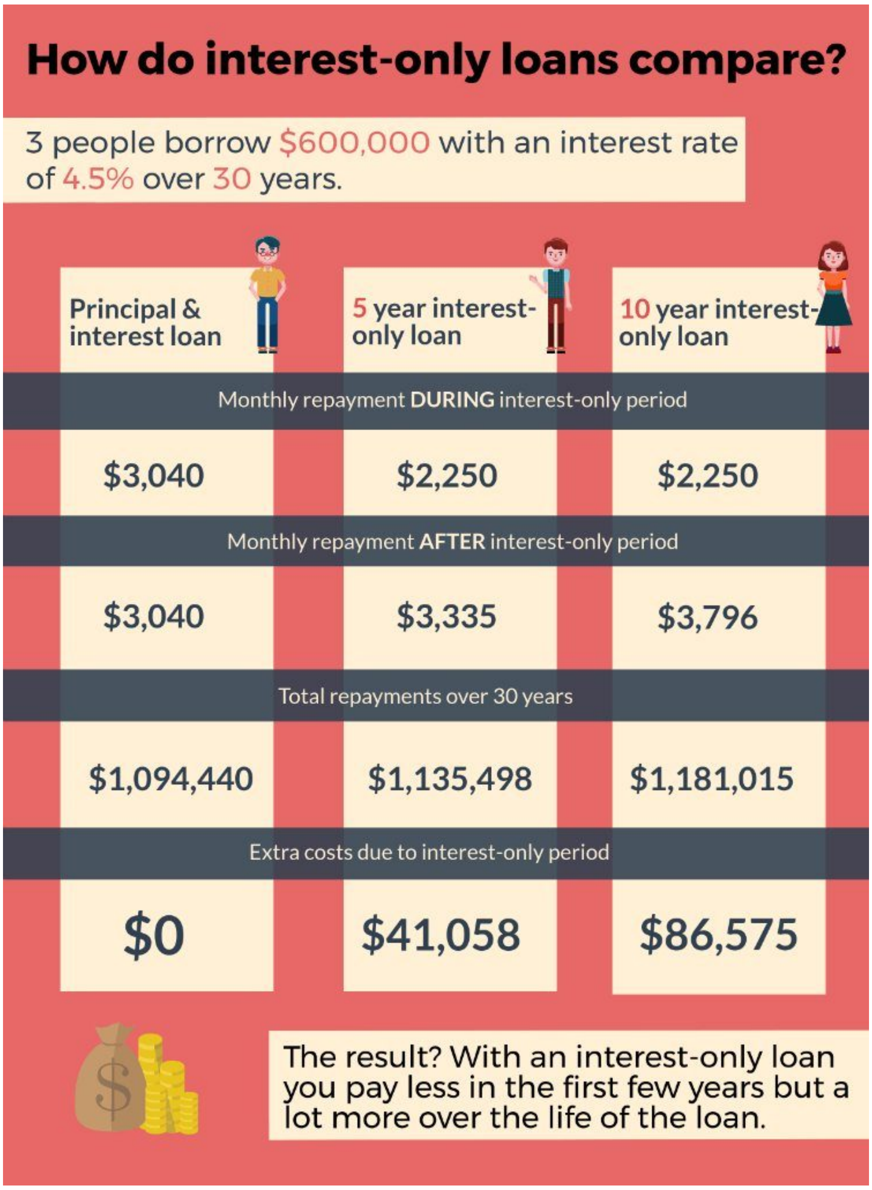
Let's compare two otherwise identical loans, one with principal and interest payments, the other with interest only repayments for the first two years.

Interest only loan repayments end up more expensive over time

Details	Principal and interest	Interest only
Loan amount	$500,000	$500,000
Loan term	30 years	30 years
Interest rate	2.70%	2.70%
Interest only period	N/A	2 years
Monthly repayments	$2,027	$1,125 (during interest only period) $2,122 (after interest only period)
Total loan cost over 30 years	$730,075	$740,126
Difference in cost	$10,051 cheaper	$10,051 more expensive

In the scenarios above opting for interest only repayments for two years will cost you $10,051 extra in interest.

If you prefer to understand tricky financial concepts visually, here's an infographic breaking down two borrowers with different interest only loans and one borrower with a principal and interest loan. As you can see, the longer your interest only period is the more interest you pay in the end.



What are the risks and benefits of interest only home loans?

Lower repayments. Interest only loans are cheaper at first. If you're struggling to make repayments this loan type can help, for a while.

Enter the market sooner. An interest only loan makes your borrowing costs cheaper. For some borrowers, this makes an interest only loan an affordable way to enter the market. A principal and interest loan might make your repayments too expensive. This is a risky option because you are relying on your income rising in the future so you can meet the higher repayment costs later. It's probably a safer option if you have stable employment and a strong likelihood of a higher salary in future (or you may be a single income family with kids and you're expecting to go back to two incomes soon as the kids get older).

Tax savings. If you're an investor, your interest costs are tax-deductible. This makes interest only loans popular with investors, who can get rental income and watch their property (hopefully) grow in value while their loan costs can minimise their yearly tax bill.

But the risks of interest only loans can't be ignored:

No equity. If your property doesn't grow in value, you won't build any equity if you're not repaying any of the principal. You could end up in negative equity.

Revert. Repayments will jump up when the loan reverts to principal and interest. If you get caught by surprise this could be a painful adjustment.

Higher interest rates. Interest only mortgages usually come with higher interest rates than principal and interest loans. Of course, the repayments are still lower because you're not paying back the loan amount yet.

For the well-informed, well-organised borrower an interest only loan can work well. But if you don't know what you're doing it can get messy.

Learn more about the pros and cons of interest only loans

What kind of borrowers choose interest only loans?

Every individual borrower has their own reasons for choosing a certain type of loan. But there are certain types of borrower who have the most to benefit from interest only repayments.

Investors who want to minimise their tax bill. Property investors in Australia can deduct their investment loan interest costs from their tax. If you are just paying interest on a loan then the entire borrowing cost for your investment is tax-deductible. This can be a real benefit for an investor who is receiving rent and paying less tax. They may choose to focus on repaying the loan on their family home (which has no tax benefits) and repay the investment loan principal later.

Property flippers. Some investors think they can sell a property at a profit after just a few years. They decide to use an interest only loan and then sell the property quickly. They minimise their costs and never repay the loan, but by selling at a profit they can come out ahead. This can work in a booming market, but it can be a bit of a gamble.

Read more about how investors can make use of interest only mortgages.

Borrowers who need a break. Sometimes things don't go as planned. People get sick, people lose jobs. Unexpected expenses come out of nowhere. If you are struggling to make repayments, your lender may let you switch to interest only repayments until you get back on your feet. This can cost you more in the long run, but if it keeps you making your repayments to the lender it can be worth it.

The interest only trap

Imagine you bought an investment property in 2016. For three years you made interest only repayments. You had trouble renting it out, but you were waiting for the property to grow in value.

But the market slowed and your property lost value. Then your loan reverted to principal and interest.

Now your repayments are much higher and your property is worth less. You haven't paid off any of your loan and if you sell you'll still be in debt.

This is the worst outcome of having an interest only loan. Most borrowers won't find themselves in this situation, but it's important to understand the possible risks.

How to compare interest only loans to find the best one for you

Every borrower wants the best home loan. And it's a complex question. You can read our full best home loans guide if you want some tips for getting the best deal possible.

And it's important to remember that the best loan looks different for every borrower. It depends on your financial situation, your goals, your spending habits and your appetite for risk (or desire for certainty). There are also more factors such as the interest rate (the lower the better) and fees (the fewer and lower the better).

All of this is especially true for interest only loans, which are more complicated and potentially riskier than principal and interest loans. Here's what you need to do to find the best interest only home loan for you:

- **Compare and get a low rate loan.** Every borrower benefits from a more competitive interest rate because it makes your repayments lower. It's not the only factor you need to focus on, but the best interest only loan for you will have a rate that's lower than most.
- **Find a loan with the right features.** What features you need in an interest only loan depend on your goals and strategy. If you have extra cash lying around (or just some savings) you can use a 100% offset account to save on interest charges. But if you're an investor and you have an owner-occupier loan as well, you may want to save your money there instead (because interest on investment loans is tax-deductible). Some borrowers benefit from extra repayments, allowing them to repay their loan faster.
- **Add up the fees.** Some loans slug you with monthly fees, which can add up to a few hundred dollars a year. Others come with a hefty one-off application fee while others have no fees at all. If you can avoid fees, why not avoid them? But if there's a better loan for you with a $200 fee attached it could still be a better deal than a worse loan with no fee. Compare the entire loan not just the fees.
- **Choose your lender carefully.** The best interest only home loan depends partly on the lender. Different lenders have different ways of evaluating your loan application and different risk appetites. One lender will give you a significantly larger loan amount than another. When it comes to managing your loan once you've got it, a lender with a great online banking system or a handy smartphone app will make life much easier. Research lenders as much as you can before applying.

Tips for managing an interest only home loan

Borrowers with interest only loans need to pay careful attention to their home loan. To help you stay on top of your mortgage, here are some tips.

Understand when the interest only period ends

No interest only loan remains an interest only loan forever. It eventually must revert to a principal and interest loan. Otherwise you'd never repay it.

You need to understand how long your interest only period lasts for. It could be two years or it could be four. If you don't know or can't remember, check with your lender.

You can prepare for the end of the interest only period by using a loan repayment calculator and checking how much your repayments will increase with principal and interest repayments.

Note that your interest rate will change when the interest only period ends. Fortunately, it should go down because principal and interest loans have lower rates in almost all cases.

Check your new rate anyway when the time comes. If it's not competitive you should consider refinancing to a better deal if you can.

Repay more than the monthly minimum before you have to

One way to get ahead on your interest only home loan is to make extra repayments on top of the monthly minimum your lender charges you. Now, you can only do this if your loan allows for extra repayments (if you have a fixed rate loan you might not be able to).

You could try slowly repaying more than the minimum amount each month and slowly build up to the full amount you'll be paying once you switch to principal and interest repayments. This will take away the sudden shock of having your repayments increase massively.

If you're a property investor trying to minimise your non-tax-deductible costs then making extra repayments probably isn't the best use of your money. You might be better off repaying your owner-occupier home loan if you have one or putting the money in an offset account

Talk to a mortgage broker

A mortgage broker can answer tricky loan questions and help you structure your interest only loan in the way that works best for you.

They can offer you some tips for staying on top of your interest only loan too.

Is it harder to get an interest only home loan now?

APRA's limits on interest only lending have been lifted, but lenders are still careful when assessing interest only borrowers.

Maximise the chances of getting your application approved by:

- **Saving a bigger deposit.** Many banks are more willing to consider an interest only home loan if you have a lower loan to value ratio (LVR). A bigger deposit, usually at least 20%, will make you a more attractive borrower. Check out our detailed guide to saving a home loan deposit.
- **Making a plan.** Lenders will want to know why you want an interest only home loan instead of a principal and interest loan. If you can explain your justification for the loan and demonstrate your investment plans, you'll be in a much better position.
- **Talk to a mortgage broker.** A broker's job is to help you find a loan that suits your needs and financial situation. The broker vets your application before the lender does, maximising your chances of approval.

Detailed guide to home loan applications and paperwork

Was this content helpful to you? Yes No

Richard Whitten

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Richard Whitten is a senior writer at Finder covering home loans and property. He helps everyone understand the ins and outs of mortgages so they can make smarter property decisions. He has written for Yahoo Finance, Money Magazine, Homely, and for multiple banks and lenders. Richard trained as a high school teacher but found it easier to manage personal finances than a classroom full of kids. Before joining Finder, he edited textbooks and taught English in South Korea. Richard has a Bachelor of Education, a Graduate Certificate in Communication and is currently studying a Certificate IV in Finance and Mortgage Broking.

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Paul Wilson is the founder of the Income2Wealth Group, a national company that provides a diverse range of investment pathways for investors. As an Accredited RG 146 and Property Investment Adviser, he has shared his vast knowledge in investing as a guest speaker at investment expos, business conferences and in media articles and podcasts. Paul is also a property investor, buyer's agent and advisor with 25+ years experience, and is an Australian Financial Services Representative and Licensed Real Estate Agent.