



Debt Recycling: Turning Your Home Loan into a Long-Term Wealth Strategy

For many Australians, the home loan is their largest financial commitment. The traditional strategy is simple: pay the mortgage down as quickly as possible, become debt free and then start investing.

But for some homeowners, particularly those with strong incomes, substantial equity and a long investment timeframe, there may be another strategy worth discussing with their financial planner and mortgage broker.

Debt recycling is a strategy designed to progressively replace non-deductible home loan debt with debt used for investment purposes, while simultaneously building an investment portfolio.

Done well, it can potentially accelerate long-term wealth creation without necessarily increasing your overall level of debt.





What is Debt Recycling?

Imagine you have a \$600,000 home loan.

Over time, you use your surplus income to reduce that mortgage. Rather than simply leaving the debt permanently reduced, a debt recycling strategy may involve establishing a separate investment loan split and borrowing an equivalent amount for investment.

For example:

Step 1: Pay \$50,000 of surplus cash into the home loan.

Step 2: Establish or increase a separate investment loan by \$50,000.

Step 3: Invest the borrowed \$50,000 into an appropriately diversified investment portfolio.

Your overall debt may initially remain broadly similar, but its composition has changed.

You have reduced \$50,000 of private home debt and replaced it with \$50,000 of debt used to acquire investments.

In Australia, the purpose for which borrowed money is used is important when determining whether interest may be deductible. This is one of the reasons the loan structure and movement of funds need to be carefully managed.



Why can debt recycling be powerful?

The strategy can potentially achieve three objectives at the same time:

- reduce non-deductible home loan debt;
- progressively build an investment portfolio; and
- convert part of your debt into investment debt where interest may potentially be tax deductible.

The objective isn't simply to "borrow more", it is to **make existing debt work more efficiently** while building assets outside the family home.

Consider Greg and Jackie, both in their mid-40s. They have built a strong financial position but still have a significant mortgage.

These figures are illustrative only and actual investment returns, interest rates, taxation outcomes and cash flow will vary.

Greg and Jackie want to have their home effectively debt free well before retirement, but they don't want to wait another decade before beginning to build investments outside their home and superannuation.

Their financial planner and mortgage broker therefore explore whether debt recycling could form part of their broader wealth strategy.

Home value	\$1,500,000
Existing home loan	\$600,000
Combined gross income	\$250,000 p.a.
Available annual surplus for debt	\$60,000
Initial investment portfolio	Nil
Investment timeframe	20 years
Illustrative long-term investment return	7% p.a.
Illustrative lending rate	approx. 6.5% p.a.



Strategy One: Pay off the mortgage first

The conventional approach is for Greg and Jackie to direct their available surplus towards their home loan.

Once the mortgage has been repaid, the cash flow previously being directed towards the mortgage can then be invested.

This strategy has some significant advantages.

It is relatively simple, progressively reduces financial risk and provides the emotional security of becoming debt free.

The disadvantage is **time**.

If Greg and Jackie spend the next decade concentrating primarily on eliminating their mortgage, they potentially lose ten valuable years of investment compounding.



Strategy Two: Progressively recycle the debt

Under a debt recycling strategy, Greg and Jackie continue directing surplus cash towards reducing their home loan.

However, instead of waiting until the mortgage has been completely repaid before investing, they progressively establish separate investment loan splits.

For example, if they reduce their home loan by \$60,000 during a year, they could potentially borrow \$60,000 through a clearly separated investment loan and invest those funds.

Their balance sheet begins to change. Initially:

Home loan: \$600,000

Investment debt: \$0

After progressively recycling \$300,000:

Home loan: \$300,000

Investment debt: \$300,000

Eventually, they could reach:

Home loan: \$0

Investment debt: \$600,000

Their total debt hasn't necessarily increased as a direct result of the recycling process.

What has changed is **the purpose and composition of the debt** — and at the same time they have been building an investment portfolio.



The power of starting earlier

This is where the strategy becomes interesting.

Assume, purely for illustration, that Greg and Jackie ultimately direct an average of \$60,000 each year towards building investments and those investments achieve an average return of 7% per annum over the long term.

Starting that investment process earlier gives the first contributions significantly more time to compound.

Over a 20-year period, \$60,000 invested annually at an assumed 7% return could grow to approximately **\$2.46 million** before allowing for tax, investment costs and outstanding investment debt.

By contrast, delaying investing for ten years while concentrating on the home loan means those early contributions never receive the benefit of the first decade of compounding.

This isn't a forecast or guarantee. Investment markets don't produce a consistent 7% return every year, lending rates change and the tax position of each investor is different.

It does, however, demonstrate one of the central ideas behind debt recycling: **Time invested can be just as important as the amount invested.**



Why the loan structure matters

Debt recycling is not simply a matter of withdrawing money from your home loan and buying investments.

The structure of the lending is critical.

Ideally, private home debt and investment debt should be clearly separated into different loan accounts or splits.

Mixing private and investment expenditure within the same loan can make record keeping and determining deductible interest considerably more complicated.

This is an area where collaboration between the client's **financial planner, mortgage broker and accountant** becomes particularly important.

The financial planner can determine whether gearing and investment are appropriate within the client's overall financial strategy.

The mortgage broker can help structure the lending appropriately and identify suitable loan facilities.

The accountant or tax adviser can advise on the client's taxation position and deductibility of interest.



Debt recycling isn't about maximising debt

This is an important distinction.

A good debt recycling strategy should not automatically mean taking on increasingly large amounts of leverage.

For many clients, the objective is to keep overall debt within an agreed risk limit while progressively changing its composition.

As wealth grows, clients may eventually choose to reduce investment debt as well.

The strategy can therefore move through three stages:

Build equity → recycle debt → build investments → ultimately reduce debt.

For clients approaching retirement, the final stage can be particularly important.

The objective should be to arrive at retirement with a balance sheet that provides flexibility rather than unnecessary financial pressure.



What are the risks?

Debt recycling involves borrowing to invest, so it is not suitable for everyone.

Investment values can fall. Interest rates can rise. Income circumstances can change. Tax legislation can change.

An investor also needs sufficient cash reserves to avoid being forced to sell investments during a market downturn.

Before implementing a strategy, consideration should therefore be given to:

- employment and income security;
- emergency cash reserves;
- loan-to-value ratio;
- investment timeframe;
- tolerance for investment volatility;
- insurance protection;
- diversification;
- interest-rate sensitivity;
- retirement timeframe; and
- the client's capacity to maintain the strategy during a significant market downturn.

A strategy that looks attractive in a spreadsheet can become uncomfortable when markets fall 20% and the mortgage still needs to be paid.

That is why debt recycling should form part of a broader financial plan rather than being treated simply as a lending technique.



The financial planner and mortgage broker working together

Debt recycling is a good example of where financial planning and lending advice intersect.

The financial planner might identify that a client has strong surplus cash flow, substantial home equity and a 15- or 20-year investment horizon.

The mortgage broker can then examine whether the client's existing lending structure supports the strategy.

That may involve reviewing:

Loan structure: are private and investment borrowings properly separated?

Interest rates: is the client paying a competitive rate?

Loan flexibility: does the facility provide the splits, offsets and repayment flexibility required?

Borrowing capacity: can the client comfortably support the proposed structure?

Future strategy: will the lending structure still work if the client changes home, refinances, reduces working hours or approaches retirement?

The result is a lending structure designed around the client's financial strategy — rather than the financial strategy being constrained by an incorrectly structured loan.



The Lydian approach

At **Lydian**, we believe debt should be considered as part of a client's overall wealth strategy.

For the right client, debt recycling can potentially transform the family mortgage from simply being a liability that needs to be eliminated into part of a disciplined long-term wealth-building strategy.

But it requires careful planning.

The investment strategy, lending structure, taxation consequences, cash-flow requirements and risk management strategy all need to work together.

If you have clients with **strong incomes, significant home equity and a long-term investment horizon**, it may be worth reviewing whether their current debt structure is working as efficiently as it could.

Speak with your Lydian lending specialist about undertaking a debt strategy review alongside the client's financial plan.

Important information: This article contains general information only and does not take into account any person's objectives, financial situation or needs. Debt recycling involves borrowing to invest and can increase financial risk. Investment returns are not guaranteed. Tax outcomes depend on individual circumstances and tax laws. Clients should obtain appropriate financial, credit and taxation advice before implementing a debt recycling strategy.

Important: This article is general information only and does not constitute financial, tax or credit advice.

BRCO Pty Ltd (ABN 61 204 224 600) and Jacob Reus are Credit Representatives of Lydian Financial Services Pty Ltd (Authorised Representative No. 525 778). Australian Credit Licence No. 387025 held by Specialist Financial Group.