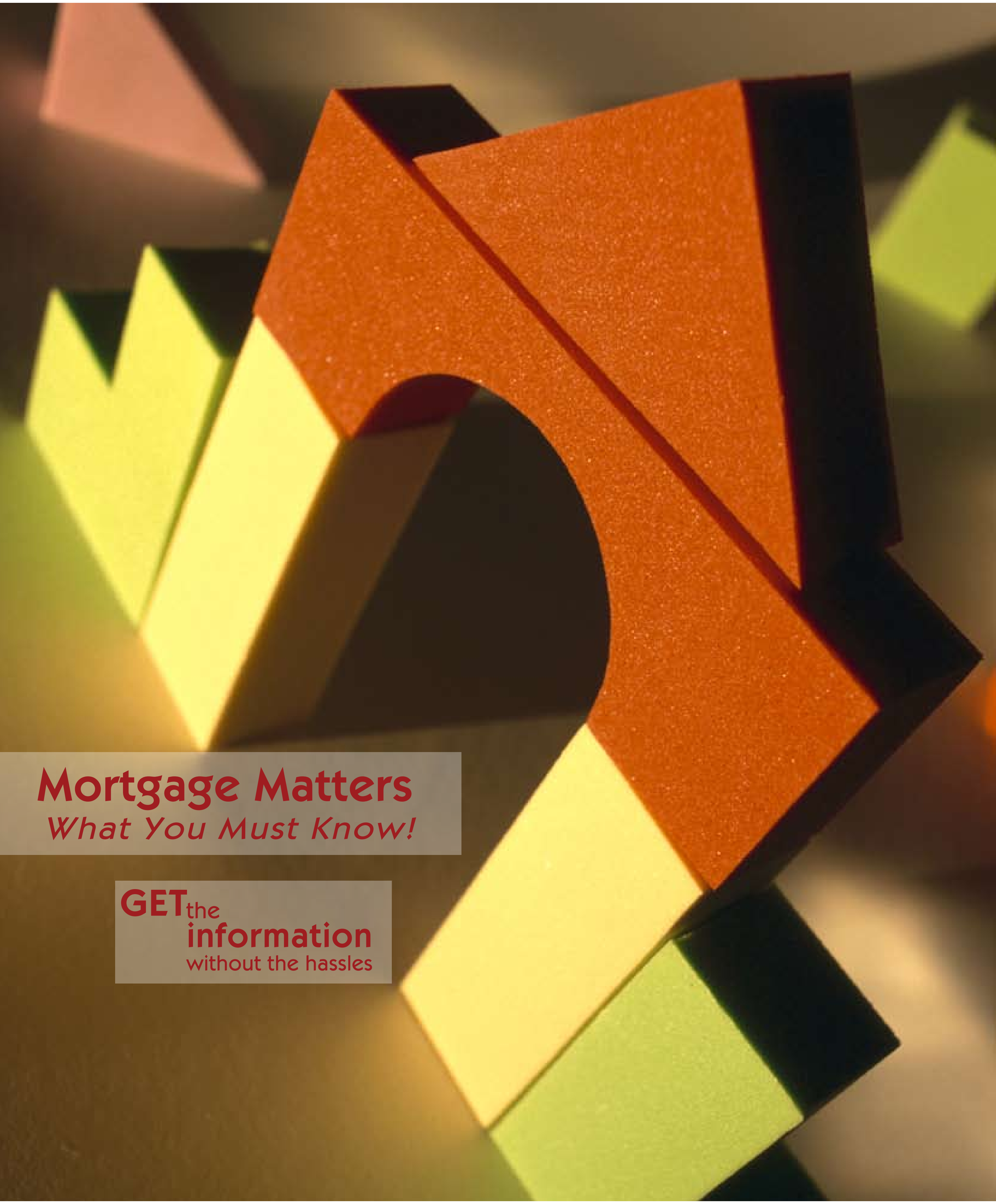
MyHouseValue.com.au



Mortgage Matters

What You Must Know!

GET the **information** without the hassles

Introduction

A home is likely to be the biggest purchase in anyone's lifetime, and a home loan the biggest financial commitment. Choosing the right loan plays an integral part in the cost of that commitment, in terms of both money and peace of mind. The purpose of this book is to help you make the right choice by outlining and explaining your options, as well as offering some handy checklists and tools.

You'll probably look at many places before finding the home you want to buy. It's a good idea to be just as careful when choosing a mortgage, since the repayments over time (interest and principal) could add up to considerably more than the original cost of the home.

Mortgage regulations have changed significantly over the last few years, making the range of options wider than ever. There are now hundreds of loans to choose from, each with its own interest rate, fees and degree of flexibility. These features all have an impact on the cost of the loan and the length of time to pay it out.

The amount of research you do when shopping for your mortgage and even small differences in the way the loan is structured can cost or save literally thousands of dollars and years of expense.

It is also important not to be distracted by giveaways, competitions or gimmicks that don't provide any benefit on the loan itself.

Whether you are about to buy your first home, or are planning to make a move to your next home, it is critical to be informed about the factors involved.

In this book, you will find the following information:

- What you need to do to borrow money for your house
- Who will lend you the money?
- How much you can borrow?
- Different types of mortgages
- Fees and interest rates
- Managing your mortgage
- Tools - checklists and a glossary of terms

Disclaimer: This document is for information purposes only, and should not be relied upon as a substitute for professional services or legal advice.

First steps

Before talking to a broker or lender about borrowing money to buy your new house, there are some preliminary steps to take which will save a lot of time.

Have the deposit ready

Whether shopping for a first home loan or looking to change an existing loan, the first step is working out how much money you have for the deposit.

Most people who buy property will need to obtain a loan from a bank, financial institution, non bank lender or mortgage broker. Generally speaking, these lenders won't lend you 100 per cent of the property value, and therefore require a cash deposit towards the purchase of the property. This deposit is usually around 10 or 20 per cent of the value of the property.

If you already own property in which you have built up equity, then part of that equity could be used to fund the deposit required to purchase another property.

Know what you can afford

As a general guide, monthly mortgage repayments should be less than or equal to around 25 to 30 per cent of your gross monthly income. When it comes to borrowing money to buy property, your current levels of debt, credit card bills, car payments and living expenses all play a role. In an ideal world, these should also be less than or equal to around 30 per cent of your gross income.

There are many "online" calculators which can give you an idea of what a lender may lend you to buy a property. But remember, these calculators should be used as a guide only. You will still need to make a formal application in order for your home loan to be approved.

Make sure your finances are in shape

When you apply for a home loan, the mortgage provider will look at your credit history to determine your eligibility or any risks associated with lending you money. Your credit history will show any previous loans you have applied for, whether you've paid out these loans, your current amount of debt, the number of bank accounts you operate, etc. If you are thinking about buying, it's a good idea to check your own credit history before applying for a loan. This will give you time to check the accuracy of the report and advise of any errors your record may contain.

Work out what sort of loan you need

Do you get bonuses at work? Find a loan that allows lump sum repayments at no penalty. Will you need cash to renovate the kitchen or bathroom in a few years? Make sure the loan lets you re-draw money for home improvements.

Since mortgages are usually very big loans, they are paid off over long periods of time, usually around 15 to 30 years. They also represent a hefty investment, so be diligent in your research and selection of a loan that is well suited to your particular situation.

Understand the commitment

Buying a property means ongoing commitment and expenses. Before committing, make sure you understand the ongoing expenses. These may include homeowner or landlord's insurance, council rates, water rates, body corporate levies and general repairs, replacements and maintenance costs.

In addition, there will be additional costs associated with buying a property. These can include mortgage insurance, solicitor's fees, loan establishment fees, stamp duty (on loan and conveyance) and settlement costs. In rough terms, additional expenses range somewhere between two and seven per cent of the value of the property.

Your lender should always give an estimate of additional expenses as part of your loan documentation, while your solicitor can advise on the amount of stamp duty payable and their costs and disbursements related to the conveyance.

Can you afford to buy a home?

The first thing any prospective homebuyer needs to do is determine whether they can afford to buy the home they want. A deposit of around 10 to 20 per cent or more of the value of the property will qualify you for a conventional loan provided you have the income to service the loan for the balance of the purchase price.

Once you have determined how much you can put toward a down payment, it's time to approach a lending institution (bank, mortgage broker, building society etc) for a mortgage.

Most mortgage lenders look at five factors when determining whether you qualify for a home loan: your income, debts, employment and credit history and the value of the property you want to buy.

One of the first things a lender will consider is how much of your total income you'll be spending on housing. This helps the lender decide whether you can comfortably afford to buy a home.

The lender will then look at your debts, which generally include house payments as well as other monthly payments on loans, charge cards, child support etc.

This is what is called your “debt-to-income” ratio, or the percentage of gross monthly income (before taxes) that you spend on debt. This is why, if you are thinking about buying property, it is very important not to spend money on items which will increase your debt-to-income ratio. For example, if you earn $5,000 a month and you have a car payment of $400, the amount you can borrow on a 30 year loan would be reduced by approximately $55,000 (using an interest rate of 8 per cent).

Even if you feel you can easily afford the car payment, lenders will approve the mortgage based on their guidelines, not yours. So, if the idea of buying a car comes up, think ahead to the impact it may have on a home loan later.

A history of steady employment helps qualify for a mortgage. A recent switch to a new job shouldn’t be a hindrance in obtaining a loan, as long as there have been no gaps in income over the last two years.

Good credit is very important in qualifying for a loan. Make sure you have maintained all payments and limit the number of credit cards you have. The lender will also want to know the price you plan to pay for the property you wish to buy and will arrange for a valuer to independently assess the value of the property.

The size of the deposit affects the amount of your monthly mortgage payments. A smaller down payment will mean a larger loan sum and therefore higher repayments, but it may allow you to buy sooner rather than later.

Mortgage payments for principal and interest generally should not exceed 30 per cent of your gross monthly income. Simply multiply your gross monthly income by 0.30 to determine your maximum monthly payments. If your gross monthly income is $4,000, the most you can afford is $4,000 x 0.30 = $1,200.00 a month to cover mortgage payments.

Remember that there will be other expenses over and above your mortgage payments. There are many online mortgage calculators which can help you determine what a bank will lend for a home or investment property purchase, so check them out.

Budgeting

Budgeting helps keep track of your spending. It allows you to put aside money for a deposit to cover the many costs of owning and maintaining a home, such as mortgage payments, property taxes, utilities, insurance and maintenance. Whether you are considering buying a home for the first time or are already a home owner, having a budget is essential.

Sticking to a budget may actually improve your chances of getting a mortgage. By establishing a regular savings pattern you make your loan application stronger and increase the chances of having it approved by the lender.

New homeowners have many new types of bills they probably didn't have when they were renting. They may be paying utilities such as water, rates and electricity and then be faced with unexpected bills to repair a roof, hot water heater, stove or other maintenance costs.

Budgeting can help you avoid the temptation of making major purchases on a credit card. By knowing exactly how much you have to spend each month, you'll be less likely to build up debt payments.

Here are a few tips for putting together a monthly budget:

- For one month, write down all daily expenses, no matter how small. Carry a small note pad and write everything down.
- Identify all large, regular monthly expenses such as rent, car loan, utilities, phone, insurance and calculate how much you have to set aside to pay them when they're due.
- Calculate your monthly, after-tax income. Include everything - take home wages, tips, bonuses, any investment income, even child support.
- Compare expenses and savings with your net income. Look for areas where you can cut expenses and increase your savings. Many people find they can cut down on entertainment, clothing, and dining out. Reducing the number of credit cards you have and consolidating the payments is a good financial management measure.

Once you've created a budget and found ways to increase your savings, it becomes easier to plan ahead to afford to live comfortably in your own home. The more you can save each month, the faster you can build the funds needed to buy, maintain or improve your home.

Continuing to save each month as an emergency fund over and above your monthly living expenses can provide extra peace of mind.

Which lender?

Once you have determined how much to put down as a deposit on your new home, and the amount you can afford to pay each month, it is time to decide where to go to borrow the money.

The choice will depend on various factors, the most likely being how much time you have to shop around and compare the best loan type and interest rate to suit your needs.

According to recent research, banks remain the prime choice for a home loan, but recently brokers have leap-frogged credit unions into second place as the next most likely source of a loan.

Banks, building societies and credit unions are the more popular of the lending institutions, as they offer a wide variety of packages and rates. Customers often tend to choose them because of their good reputation, or they have a history of successfully dealing with them in the past while some offer consistently competitive rates and lower fees.

On the other hand, mortgage brokers and non-bank lenders specialise in doing everything, making things easier for the customer – they have access to multiple lending institutions and therefore have a wide range of loans available to them; so they will shop around on behalf of the customer to help get the best deal. Mortgage brokers in Australia are estimated to have accounted for a third of all home loans or about $A200 billion worth of loans in 2003/04.

Depending on the broker's panel of lenders, consumers can achieve access to various loan products without having to "do the legwork" themselves. The broker works closely with the client to prepare the documents for the lender, submits the application and answers any questions through the approval stage of the loan while liaising with both parties throughout the process.

However, the Mortgage Industry Association of Australia (MIAA) recommends consumers take one small precaution: do not become complacent when making a choice and make sure you are working with a qualified professional.

There are over 7,800 mortgage brokers currently approved and accredited by the MIAA (AMCs) as having had at least two years' industry experience (or completed education courses and testing) as well as minimum levels of Personal Indemnity Insurance. AMCs are required to be members of a recognised independent dispute resolution scheme and most importantly, are subject to an industry Code of Practice requiring professionalism, ethical behaviour, and transparency.

To find an Accredited Mortgage Consultant in your area, visit www.miaa.com.au.

Which loan is for you?

Banks, mortgage managers, brokers, building societies and credit unions all offer a seemingly endless choice of loan options – introductory rates, standard variable rates, fixed rates, redraw facilities, lines of credit loans, interest only loans; the list goes on.

So how do you determine whether a home loan is suitable for you?

The main challenge is to look beyond interest rates to the features that a home loan offers. Often there is a trade off between interest rate and flexibility. Make sure the loan suits your circumstances and the way you want to pay it off:

- Will you want to make extra repayments?
- Do you want to have redraw access to any extra payments made?
- Will you need to move within five years?
- Can you benefit from having your salary directly credited to your loan account?
- Is it better to just look for the lowest rate?
- Should you avoid a home loan with ongoing fees?
- Are you eligible for a First Home Owner Grant?

The mortgage provider will assess your personal circumstances, then recommend and explain loan types to suit.

Comparison rates were introduced in Australia in July 2003 to help home buyers weigh up the true costs of a loan. For instance, honeymoon loan rates may seem like a great idea but when compared to other loans on the market, could actually work out over the long term to be considerably more expensive than a low-priced basic or standard variable loan without the initial discount.

All lenders must disclose a benchmark comparison rate for all their loans to show the total annual cost of each loan, so make sure you ask to see it before making a choice.

Some home loan options are:

Basic home loan

A basic home loan account, as it sounds, offers borrowers a low interest rate home loan with few or no regular fees - a "no-frills" loan, which usually carries no additional features. Be aware it also usually doesn't have any flexibility in paying extra off the loan or varying repayments.

This loan is ideal for people who don't foresee a dramatic change in their personal circumstances and therefore don't need to have flexibility with their home loan, or who may not have the means to repay any more than the minimum home loan repayment.

Fixed rate loan

This type of loan has a fixed interest rate for a certain period of time, most often between 2 and 5 years. Once the fixed rate period ends, customers may be offered another fixed rate period or the rate will convert to a variable interest rate, which can rise and fall.

Basic & Standard Variable Home Loans

If a loan has a variable interest rate, that means its rate will fluctuate during the loan term. When the Reserve Bank of Australia lowers or raises the official cash rate, the interest rate on a variable home loan will change accordingly. Standard variable home loans usually offer more features than the basic variable home loan, such as being able to make extra payments or being able to redraw the money deposited.

Fully flexible home loans

This loan works in a similar way to a basic home loan but, depending on the loan products, will allow the borrower to make additional repayments whenever possible, pay their salary directly into their loan account or discharge the home loan at any time without penalty.

Introductory or 'Honeymoon' rate loans

Virtually every bank in the marketplace now offers borrowers a loan with an introductory or "special honeymoon" rate. The introductory rate is usually a lower interest rate than the standard variable home loans and runs for a specific period of time, say six months or one year. Once the honeymoon is over, the interest rate on the loan will revert to either the standard variable home loan interest rate or sometimes even a higher interest rate.

These loans may be appropriate for people who want to minimise their initial repayments (whilst perhaps doing renovations) or to those who wish to make a large dent in their loan through extra repayments while benefiting from the lower rate of interest.

Be careful when choosing this loan that you can afford repayments at the higher post-honeymoon interest rate level. You need to weigh up how competitive a loan will be over its expected life. It doesn't matter how low a lender's interest rate is for the first 6-12 months if you then end up paying far more than necessary for the next 29 years!

Tip: If you start paying off this loan at the post-honeymoon rate, you will effectively be paying off extra and will not have to make a lifestyle change when the introductory offer has finished.

Interest only loan

This type of home loan allows borrowers to make payments in the form of interest only – that is, no payment is put toward the principal balance of the loan.

Interest only loans are offered by all major lenders and can generally be fixed for periods of one, three or five years. At the end of the term the principal is either refinanced for a further fixed term, reverts to a principal and interest basis, or is repaid. A part repayment with the balance refinanced is another option.

This loan may be a good choice for people who want to avoid any cash flow stress that a sharp rise in interest rates may cause. It is also a viable option for property investors, as only the interest on a loan is tax deductible, therefore if you have an interest-only loan, your repayment each month is tax deductible.

A redraw home loan

Again, this is similar to an all in one home loan and a 100% off-set account, but the redraw loan is an account that allows you to put additional funds, such as salary or other savings, into the loan in order to bring down the principal amount and reduce interest charges. As the name suggests, you can redraw the extra money deposited at any time in the future as needed.

Simply put, rather than earning (taxable) interest from your savings, putting them into the loan saves money on interest charges and helps pay off the loan faster. However, you are still saving for the future.

The benefit of this type of loan is the interest charged is normally cheaper than the standard variable rate and it doesn't incur regular fees. Be aware there may be an activation fee to obtain a redraw facility, there may be a fee for each time you redraw, and it may have a minimum redraw amount.

These loans are suited to low to medium income earners who can put away that little extra each month.

Line of Credit

Line of Credit home loans allow you to borrow a pre-approved amount of money against the equity in your home, at an interest-only variable rate, either in its entirety or in bits at a time. This loan is popular because of its flexibility and ability to reduce mortgages quickly. However, the borrower usually has to offer the property as security for the loan. A line of credit can be set to a negotiated time (normally 1-5 years) or be classed as revolving (longer terms), and you only have to pay interest on the money used (or 'drawn down').

Most of these loans have a monthly, half yearly or annual fee attached. Interest rates are variable and, due to the level of flexibility, are often higher than the standard variable rate.

These loans are suited to people who are financially responsible and already have property and wish to use their property or equity in their property for renovations, investments or personal use.

All in one home loans

This type of home loan allows you to combine your savings account, cheque account and home loan account in to one. This means all your income is deposited directly into the loan account and because interest on the loan account is charged daily (but billed monthly), the effect is that the amount on which interest is calculated is reduced. If you need money, simply withdraw it from the home loan account as you would a normal savings account.

Normally these loans will be at the standard variable rate or slightly higher and may incur monthly fees. Be aware that if the account is split into the loan account, with credit, cheque and ATM facilities placed into satellite accounts, you will need to check access to funds, how many free transactions are available and what associated fees the loan may have.

These loans are suited to medium to high income earners.

100% offset loan

The offset loan works in a similar way to an all in one loan in that it allows you to place all earnings and savings in one account. This effectively reduces the balance of interest payable on the home loan, although the offset account is actually a separate account linked to the home loan.

Whatever is in the Offset Account then comes directly off the loan, or 'offsets' the loan amount for interest. So you are not earning interest on your savings, but are benefiting in that what would otherwise be interest on savings is calculated as a reduction on your loan. The advantages are similar to the All-In-One Account. These loans normally have a higher interest rate and higher fees due to their flexibility.

These loans are directed at medium-to-high income earners, and to disciplined spenders, as the more money kept in the offset account the faster you pay off your loan.

Partial offset account and an interest offset account are also available.

Split loan

The Split Loan combines different loan types into one home loan, where the amount borrowed is split into different segments, with each part having a different loan structure i.e. part fixed, part varied and part line of credit. These loans are directed at people who seek to minimise risk and hedge their bets against interest rate changes while maintaining flexibility; however, the way the splits are structured may give rise to taxation issues in some circumstances.

“Low Doc” loans

“Low-doc” or low documentation loans are structured for the self-employed who have income and assets but don’t have the documentation (financial statements, tax returns etc) required to obtain traditional home loans. The interest rate is often higher than the standard variable rate although the gap is narrowing. These loans generally carry a requirement for mortgage insurance, adding to their cost.

These are just some of the home loan products now available. Before deciding which one is right for you, make sure you think carefully about your employment situation now and what it’s likely to be in the future, as well as any special features that could be included in the loan. Once that is sorted, talk to a mortgage broker or shop around until you find the best deal. Good luck!

Your credit rating

Your credit rating plays an essential role in the approval of a loan. It determines the type of loan for which you potentially qualify, so the higher the credit rating, the better position you will be in to negotiate the loan and save thousands of dollars on the mortgage.

There are a few steps to take right now, to ensure all the available information is accurate and up-to-date, so there are no unwanted surprises when you apply for a home loan.

Firstly, find out what is on your file. This information is available from www.mycreditfile.com.au. If there are incorrect details such as the listing of an overdue account which has actually been paid but not updated on the file, you can have it corrected before applying for a loan.

Avoid extending the limit on a credit card or buying a new car in the months before house hunting, as one of the factors used to calculate the credit score is the number of times potential creditors request your report. Too many of these inquiries may lower your credit score.

Besides, major expenses or financial commitments (like car repayments) can affect how much a bank or mortgage provider will lend you to buy a property. Loans are approved largely on the percentage of your income used to pay off debt and other financial liabilities. Approval is more likely for a larger mortgage and therefore a more expensive home if you have lower payments on credit card, student loan, hire purchase or other debt.

Low doc loans

Life has changed a great deal over the past few decades and more and more people now fall outside the traditional home borrower's mould of a steady employment history, good income and clear credit record. This may be due to circumstances such as financial commitments as a result of a divorce, being self-employed, but whatever the specifics, lenders have recognised that it is important that individual situations be weighed up on a case by case basis and realistic assessments made about people's ability to repay a home loan.

"Low doc" loans apply to people who have been self employed for a period of two or more years but who may experience uneven cash flow, are unable to verify full income, or have personal and business expenses combined.

The borrower is usually required to sign a declaration of annual income instead of providing evidence of income on a tax return, hence the name, low documentation (or "low doc") loan.

As long as the lender can be satisfied that the applicant can repay the loan, mortgage providers can lend as high as 90 per cent of the value of the property under a low doc loan, although mortgage insurance may be required.

In response to an increase in demand, most major lenders now offer low doc loans to their customers.

Be aware, however, that non-conforming loans can be very expensive in the long term, so it is best to use as an interim measure only, until your circumstances improve. Sign up, establish a good repayment record, and then move as quickly as possible on to a conforming loan with a lower interest rate.

Fixed rate or variable?

When considering a home loan, you will need to understand how interest rates are applied to mortgages, so that you can assess how an increase or decrease in interest rates will affect your repayments.

The Reserve Bank of Australia (RBA) sets the official cash rate according to the state of the economy. Once a month, the RBA examines indicators such as the rate of inflation, unemployment figures, consumer price index (CPI) and uses the cash rate as a tool to control the way the economy is going. That is, the RBA may decide to slow it down by raising the official cash rate (OCR), thereby effectively stopping you from spending money by increasing your loan repayments.

There are two types of interest rates that apply to home loans - fixed and variable. You choose whether you prefer one or the other or a combination of both, depending on the type of loan product you decide on.

The majority of home loans in Australia have been taken at a variable interest rate. As the name implies, variable loan rates will fluctuate with the market and the official cash rate. Therefore if the official cash rate rises, your loan interest rate rises and so do the repayments. On the other hand, when the OCR goes down, your repayment amount reduces – leaving you either with more cash in your pocket or the opportunity to continue paying at the higher rate, thereby reducing your loan considerably.

Loans with variable interest rates tend to offer more flexibility in payment options. Most lenders will also allow you to move from a variable to a fixed rate, though there may be fees applied.

The most important question to ask yourself when considering a variable rate loan is whether you can easily manage the loan repayments if rates increase.

Fixed rates offer a high level of stability and security with a fixed monthly payment over the life of the loan, regardless of fluctuations in the marketplace. Lenders typically offer terms of 25-30 years for repayment. These mortgages are ideal for people on fixed or limited incomes and for people who want a consistent payment during the life of their loans.

The fixed interest rate also reduces any cash flow stress that a sharp rise in interest rates may cause.

Fixing might sound like a good idea, but most fixed rate products restrict you from making extra repayments during the fixed period. On the other hand, if you lock in your interest rate for a set amount of years, at least you will be assured that your payments will remain steady during that time.

It is a matter of investigating products that are right for you.

Insuring your loan

Having a home loan approved to buy a house is an exciting event - but it's also a serious commitment. What if something happens to you that may affect your ability to pay off your home loan? For instance, if you have an accident, worker's compensation or sickness benefits may mean that you have to live for a while on a lower income.

There is no single insurance product to protect your home if you don't make your mortgage repayments, but many lenders will offer loan protection packages.   These may include:

- Life insurance, designed to pay off your home loan if you die.
- Disability cover, to pay your loan repayments if you can't work due to injury or sickness, either permanent or temporary as defined in the policy.
- Involuntary unemployment / income protection insurance, which will cover your loan repayments for a nominated period of time if you are involuntarily unemployed

Disclaimer: Prospective borrowers should consider their personal circumstances and seek specific advice from qualified financial professionals or insurance brokers in respect to insurance products.

Lenders mortgage insurance (LMI)

Lenders' Mortgage Insurance (LMI) enables many people, especially first home buyers, to enter the market with a smaller deposit. LMI is insurance that protects the lenders, because their risk is higher by lending you a higher percentage of the value of the property.

When a person borrows more than 80 per cent of a property's value, LMI insures the lender against risk if the borrower defaults on the mortgage and the lender takes possession of the property and sells it. The insurance covers the potential shortfall between the loan amount and the net proceeds from selling the property.

The LMI insurance contract is arranged by the lender. Lenders typically pass this cost onto the borrower to either be paid as a one-off fee, or added to the loan amount (often referred to as 'capitalising LMI').

What does it cost?

The cost of LMI is calculated based on a percentage of the loan amount. The greater the proportion of the property's value that you borrow, and the higher the loan amount, the higher the percentage cost of mortgage insurance. Generally, the cost of LMI can range from 1 per cent to 2.5 per cent of the loan amount.

Is it tax deductible for investors?

The cost of LMI is classified as a borrowing cost. As the cost of LMI is always over $100, property investors are entitled to claim the cost of LMI equally over five years (or over the loan term where the term is less than five years) as a cost of investment. As always, you will need to obtain independent taxation advice to ensure the deductibility of LMI applies to your situation.

Note: if you refinance your loan within one or two years of taking it out, you may be entitled to reimbursement of part of your initial LMI payment. This is dependant on the mortgage insurers' policy and is subject to other variables. If the policy provider offers a rebate, the refund will be a percentage of the amount paid.

Mortgage insurance can be complicated so if you need to pay mortgage insurance make sure you speak to your lender and fully understand your rights and obligations as well as those of your bank and the mortgage insurer.

As always, don't sign any document unless you understand it and if you don't understand - ask.

Paying off your loan

The most effective way to pay off your home loan faster is to make extra mortgage repayments. In the first five to seven years of a loan, most of the mortgage payments you make go towards paying off the interest on your loan. This is why extra payments during the first few years can reduce the amount of interest you owe and thereby cut years off your home loan.

Here are some quick steps to making an impact:

Make fortnightly instead of monthly repayments, thereby making an extra payment per year

Pretend to be on a fixed rate and make higher repayments

Increase your repayments by as little as $10 per week (or three cups of coffee)

Choose not to "take home" any tax cuts in your salary. If you could live on your pay last week, the extra can go directly into your mortgage account without being missed.

Apply the occasional windfall - a bonus in your pay, that small inheritance from your aunt's second cousin, the proceeds from selling the couch you always hated - straight into your mortgage account.

Be aware however, of any charges that may be incurred for lump sum and early repayments. This applies particularly to fixed interest loans. The money may need to be saved in a separate bank account until you can transfer the sum to your mortgage without penalty.

In conclusion

These days home loans can offer a wide variety of additional features and benefits including honeymoon periods, redraw facilities and credit card options. If you want additional features with your home loan, look carefully at the costs associated with these features then determine whether you need the additional feature and whether or not you can afford to pay for it.

Glossary

In this section we attempt to clarify some words and expressions that you may come across when researching and talking to people about home loans.

"Debt-to-income" ratio

A debt-to-income ratio is the percentage of your gross monthly income (before taxes) that you spend on debt. This will include interest payment, principal payments, taxes, insurance, credit card debts, student loans and car payments, etc

Credit file

Credit files are kept for people who have been credit-active during the past seven years. They hold information such as when credit was applied for, how much and from whom as well as overdue accounts, bankruptcy details, etc. Banks, retailers and credit providers use the data, along with the information you provide to them, to determine whether to lend you money or not.

Redraw Facility

Loans with redraw facilities allow you to put additional funds such as salary or other savings into the account, thus reducing both the principal amount and interest charges) then redraw the deposited money as needed.

Line of credit loan

Line of Credit home loans allow you to borrow a pre-approved amount of money against the equity in your home, at an interest-only variable rate, either in its entirety or in bits at a time.

Interest only loan

This type of home loan allows customers to make payments in the form of interest only – that is, no payment is put toward the principal balance of the loan. At the end of the term the principal is usually either repaid, refinanced for a further fixed term, or reverts to a principal and interest basis.

Non-conforming mortgages

Non-conforming mortgages are home loans which cater for people who may fall outside the traditional lending criteria, possibly because of previous loan defaults, low or part-time income, or because they would like to borrow a large amount. Generally speaking, non-conforming home loans incur higher up-front fees and higher interest rates.

Equity

"Equity", in real estate terms, can be defined as the dollar amount of a property that is actually owned. For example, if you own a house worth $250,000, but you have a mortgage of $100,000, then the amount of "equity" in the property is $150,000. As your mortgage decreases and the property value increases, the amount of equity rises.

Low doc loans

"Low-doc" or low documentation loans are structured for the self-employed who have income and assets but don't have the documentation (financial statements, tax returns etc) required to obtain traditional home loans. The interest rate is often higher than the standard variable rate, although the gap is narrowing. These loans generally carry a requirement for mortgage insurance, adding to their cost.

Non-conforming loans

Non-conforming loans (like low-doc loans) are designed to cater for people who can't meet the standard income and asset verification requirements – such as those who are self-employed, have a poor credit record or who have recently arrived in Australia. They consequently carry a higher interest rate and often a requirement for mortgage insurance, adding to their cost.

LVR

"Loan to Value Ratio" refers to the maximum amount lenders will approve against the value of any property taken as security for your home loan. For example, if you wish to purchase a property worth $100,000, the lender may approve a loan for 80 per cent of the property value. It will then be up to you to provide the remaining 20 per cent plus costs (mortgage registration and stamp duty etc).

Portable Loans/Portability

A portable loan allows you to sell your house and move to a new one without having to refinance. This saves on application and legal fees. Most lenders however insist that the loan amount is the same or less.

Basic or 'no frills' loans

Many lenders offer a basic home loan that has a lower variable interest rate than their standard variable rate loan. The trade-off is that these discounted loans generally have less flexibility and fewer features, e.g. no extra repayments can be made, the repayment level cannot be varied or no redraw is available.

Comparison rate

Since July 2003, all lenders must disclose a benchmark comparison rate in their advertising of home loans and personal loans. Designed to reflect the total annual borrowing cost, it wraps up all the interest payments and fees, showing them in one rate.

Establishment Fee

Also called an Application Fee, this covers the basic costs in setting up a loan from the initial interview to the loan drawdown. Some lenders choose to absorb this fee.

Exit Fee

This fee is imposed by some lenders in the case where you seek to refinance with another lender within the first few years of the loan.

Honeymoon Rates

"Honeymoon" or introductory rates are offered to entice borrowers with a low advertised rate that may be up to 2 percentage points below the standard home loan rate and therefore look very attractive. The rate can be fixed, capped or variable for the first six to 12 months of the loan. They then automatically revert to the standard rate offered by that lender, so some caution is recommended.

Service Fee

Usually a monthly fee levied to cover the cost of administering & maintaining the loan account i.e. fixed and variable costs such as staff, IT software / hardware

Standard Variable Rate

This is the rate which lenders apply to their 'premium' home loan product. It offers features such as a redraw facility, portability, salary account and mortgage offset.

Mortgage Insurance (MGI)

Some lenders offer to provide up to 95 per cent of the funds for a loan if you agree to take out mortgage insurance (MGI). This figure is a once-off payment usually made at the time of settlement. It allows the lender to recoup the unpaid principal in the event of default and the borrower's debt is transferred to the Mortgage Insurer.

Appendix 1

Twelve questions to ask when applying for a loan

A home loan is a long-term financial commitment, so it is important that you know just what you can and can't do with it, and what the costs are, before you sign up. Take this checklist with you and make sure you are satisfied with the answers.

1. What is the interest rate on this mortgage?

It's important you understand exactly what you'll be paying in interest over the life of the loan. Even if you have a `honeymoon' interest rate for the first year of the loan, be clear about what the interest rate will revert to after the honeymoon is over, and make sure the monthly repayments on this higher amount will not be a burden.

2. What fees do you charge?

For all loans, ask about application fees and any other charges. For fixed interest loans, ask what fees apply if you want to lift the repayments, make lump sum repayments, or repay the whole loan early.

3. What will be the total cost of this loan, including fees and interest, for the sum I am borrowing and the term I have chosen?

The lender will have to make an assumption about interest rates to do this calculation. But it will show you how much you'll pay back in total. Ask for the fees to be shown separately from the interest. Also, ask for the total regular payment in a year if the interest rate were to be 1 per cent higher than now. That will give you some idea of the risk to your budget if rates rise.

4. Can I lock in an interest rate if I need to and what will it cost me to do so?

The interest rate of the mortgage you're applying for may go up or down between the time you apply and the time you close, so you might decide to lock in the rate for a specified period. Be sure to ask the lender if there is any fee for locking in the rate.

5. What are the bank guidelines for approving the loan?

The bank's guidelines might relate to your income, employment, assets, liabilities and credit history, so be clear about what you'll be asked and ensure you have the documents to support your application.

5. What documents do I have to provide?

Speaking of documents, you will probably need to provide proof of income and details of your assets and liabilities to get a loan. Find out what documents will be required in your particular situation by asking your lender and make copies of those documents for your lender.

7. How long will it take to process my application?

The approval process for your loan will vary from lender to lender. It often depends on how much business your particular lender is doing and how much business the market is seeing as a whole. When borrowers are knocking down doors all over town, loan approval will probably take longer. Just make sure you get a realistic estimate on how long your approval will take and use that estimate to determine when you should start house hunting.

8. Is there a minimum deposit required for this loan?

Depending on the amount of your deposit and the percentage it represents of the price of the home being bought, you might be charged different interest rates or quoted different loan terms. Loans at high loan-to-value ratios can cost more than loans with larger down payments. Still, customers with good credit or those who are willing to pay mortgage insurance may be able to borrow more than 80 per cent of the value of the property.

9. What other costs will be charged on this loan?

Every mortgage comes with fees and charges for various services that lenders and other parties involved in the transaction provide. These may include application fees, valuation fees, bank solicitor's fees and stamp duty on the mortgage documents. You need to find out what you'll be charged and whether these costs can be rolled into the loan or need to be covered separately.

10. Can I make additional repayments on the loan?

Some mortgages only allow you to make the minimum monthly repayment, while others will let you make additional payments. If you can make additional repayments you should find out whether these payments will be credited towards the loan interest or the principal amount.

11. Is there an early repayment penalty on this loan?

The early repayment question is most important for loan shoppers. Generally speaking, a home loan is not tax deductible and should be paid off as quickly as possible. Therefore, if you do come across extra money which allows you to pay off your loan early, it's important to ensure you won't be penalised for early repayment of the loan.