Financing Your Home Purchase

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- **The A-Z of Home Purchase**
- **A Guide to the Costs of Home Purchase**
- **Debt Consolidation, how does it work?**
- **Mortgage Assistance Scheme**
- **How to choose a Mortgage Broker**
- **Home Buyer's Checklist**
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Before you start looking for a new home

Most people need to borrow money to buy or build a home. Therefore it is a good idea to spend time getting to know the various sources and types of housing finance. Start enquiring about a loan well in advance. Establish with your Mortgage Broker:

- How to become eligible for a loan
- How much deposit you need
- Which lenders would come to the party
- How much you can borrow

How much you can borrow will normally depend on:

- Your income
- The size of your family, number of dependants
- The Term of the loan and Interest Rate charged
- Your other commitments such as credit cards and personal loans (these will reduce the amount you can borrow)
- How much deposit you can contribute towards the purchase

You will be eligible for a loan if

- You have enough to pay a deposit on a property and have sufficient funds for additional costs; and
- You are in regular employment and receiving sufficient income to service the loan required; and
- You have a clear credit register or high enough credit score to qualify;
- and
- You meet the requirements of the lender.

Other loan commitments

A housing loan is a long-term commitment and the home it provides will be important to your health and well being. Don't jeopardize this by over committing yourself with other liabilities. Other liabilities reduce the amount you can borrow and your capacity to make your home loan repayments. This is especially important when you first move into your home and there is a great temptation to purchase new furnishings, a large flat screen TV, new fridge etc. The most common reason home owners get into difficulties when repaying their mortgage is over-commitment to other liabilities.

The deposit

The larger your deposit, the easier it will be to buy a home. You won't need to borrow as much and will be more attractive to a lender. Generally, you will need 5% to 20% of the property's purchase price as a deposit plus the associated cost such as legal fees and stamp duty.

If you already own a property or a relative is prepared to go guarantor, you will be able to borrow 100% of the purchase price plus any cost associated with the purchase.

Please refer to our ebook "A Guide to the Costs of Home Purchase" for further information on home purchase costs.

The National Consumer Credit Protection Act

The National Consumer Credit Protection Act is a set of rules for lenders, mortgage brokers and borrowers about their obligations in undertaking credit transactions. Under the Act, institutions providing home loans are required to truthfully divulge all relevant information about the loan in a written contract.

The contract must include information on interest rates, credit fees and charges, commissions etc. A broker or lender also has to make an assessment as to the suitability of a proposed credit arrangement for the specific borrower. Make sure you have your Mortgage Broker or solicitor explain these to you.

The Mortgage

The mortgage is the legal document which expresses the terms and conditions of a loan where property is being used as security for repayment. Generally, if repayments are not maintained or the borrower otherwise breaches the mortgage conditions, then the lender has the right to sell the property to recover outstanding debt. The property is used as security (also called "collateral") to ensure repayment. If a property is sold to repay the debt, the lenders are often prepared to let the property go for what is owing on it with little regard for the borrower.

Interest Charges

Interest is charged to the borrower for the use of the lender's money.

The interest rate is the annual percentage of a loan amount that is charged as interest. The interest rate will fluctuate with changes in economic conditions. Rates of interest may be fixed or capped (the can go down but cannot go above a predetermined level) for a period of time, or alternatively, may vary during the term of the loan in line with general interest rates. When interest rates rise or fall, your repayments may vary or the lender may offer to extend the loan term and leave your repayments the same. But remember, the longer you take to pay off your loan, the more interest you will pay.

Mortgage Insurance

This type of insurance is required when the purchaser is borrowing more than a set proportion of the valuation, as specified by the lender. This is usually 80% with a couple of lenders prepared to go to 85% in some circumstances.

The mortgage insurance premium is a once only payment. Mortgage insurance protects the lender, **not the borrower.** If the borrower defaults on repayments and the property is sold for less than the outstanding loan amount, the insurer will pay the monies owed to the lender. The borrower will then be liable to repay those monies to the mortgage insurer. Most lenders require Lenders Mortgage Insurance if you wish to borrow more than 80%. Some lenders will claim that they don't charge lender's mortgage insurance for borrowings of more than 80%. Beware! They will have the charge in another form, they may call it loan extension fee, risk fee or any other name they choose.

Types of Lenders

There are many different types of home lenders, each with different interest rates, terms, conditions and lending criteria. The most common types of lenders are:

Banks

Banks are the biggest lenders in Australia's owner-occupied home loan market. Banks can provide integrated banking packages eg. lending products, financial services, transaction and savings accounts. Banks lend funds with up to 30 year terms. The minimum deposit required can vary from 0% to 20%.

Building Societies / Credit Unions

Building societies are co-operative organizations whose members are shareholders. Building societies are also known as mutual societies. Building societies operate in much the same manner as banks in that members enjoy integrated financial services eg. home loans, savings accounts, cheque accounts, credit card access and financial planning and investment services.

Mortgage Managers

Mortgage managers organize funding for homebuyers from a variety of sources. The owner of the mortgage is not the mortgage manager but the provider of the funds, who operates through a trustee. They are an important element in the market to have some genuine competition for the banks and often offer cheaper rates and lower fees than the banks.

Mortgage Brokers

Mortgage brokers act as agents between borrowers and prospective lenders. The task of the mortgage broker is to find and arrange the most suitable loan for the borrower. They do not lend money or manage loans. Because they can arrange a loan for you from a large range of lenders, they are a great source of information and provide much more choice than any of the individual lenders. Please refer to our ebook "How to choose a Mortgage Broker" for more information.

Types of Loans

Standard variable interest rate loan

This is the usual loan offered by lenders and therefore the most popular type of home loan. The interest rate can vary up or down throughout the term of the loan. Repayments, made weekly, fortnightly or monthly, are the same throughout the term of the loan, changing only with the rise and fall of interest rates. In the early years of the loan, the bulk of each repayment is directed towards interest charges and less towards reducing the loan principal (the amount borrowed). In later years the opposite applies. Features such as added flexibility in making repayments and a redraw facility are often included in this type of loan.

Basic variable interest rate loan

This type of loan offers a lower interest rate and repayment than a standard variable interest rate loan but has fewer or none of the features of those loans. In reality, they resemble standard variable loans more and more, at a cheaper rate though. Ask your Mortgage Broker to explain the difference and to provide you with the right advice as to which loan to choose.

Fixed interest rate loan

This type of loan offers a fixed interest rate for a specific period, eg. six months to ten years. At the end of the fixed rate period the loan is renegotiated for a further fixed term or reverts to the variable interest rate current at that time. With most lenders, but not all, you may only make limited amounts of additional repayments without incurring a monetary penalty. A monetary penalty usually applies if the borrower wishes to pay out the loan during the fixed interest rate period, especially if interest rates have dropped. Those penalties can be very hefty if the loan is fixed for a lengthy period.

Part-variable/part-fixed interest rate loan

Often referred to as split or combination loans, this loan enables the borrower to pay a fixed interest rate on a portion of the loan while paying interest on the remaining portion at the standard variable rate. Combination loans allow the borrower to limit increased repayments during periods of rising interest rates and provide a blend of repayment flexibility and certainty.

Capped or introductory interest rate loan

Under this type of loan, the interest rate is capped for a predetermined period, which is usually 6 –12 months. During this period, the interest rate cannot go higher but may go lower if the lender's standard variable interest rate falls below the capped rate. These loans are commonly referred to as honeymoon rate loans. Often these loans offer the lowest interest rates available and this can assist a new borrower to adjust to mortgage repayments. However, the borrower needs to be aware that lenders will recoup the cost of the discounted rate later, either in higher rates for the remaining period of the loan or in changeover fees.

All-in-one loan

An all-in-one loan is usually a variable interest rate loan, which permits the borrower to place all their income into the one account, consequently reducing the loan balance and the interest paid. This type of loan operates like a transaction account and allows the borrower to access the account to meet day-to-day expenses. Additional payments are permitted without attracting penalties. The perceived added flexibility however comes at a higher cost, either through a higher interest rate or higher fees or both. Seek advice from your Mortgage Broker to find out if this is the right product for you.

Home equity loan

A home equity loan allows a borrower to utilise their equity (the portion of the property the borrower owns) in the home to gain access to an immediate source of funds. There are two types of home equity loans.

Under the first type of home equity loan a borrower may borrow an additional lump sum secured by the borrower's equity in the home; the borrower is required to make regular monthly repayments at a variable or fixed interest rate, based on an 'interest only' or 'principal and interest' repayment arrangement. Borrowers often use such loans for a specific purpose, eg. the purchase of an investment property.

The other home equity loan is an equity overdraft or line of credit. A line of credit is comparable to an overdraft, secured by the equity in the borrower's home. This permits the borrower to access their equity when necessary. Maximum credit limits may decrease overtime, while some loans allow the credit limit to be adjusted on the basis of changes in the borrower's income and/or the property value. Borrowers using a line of credit often have to make regular minimum repayments, which can be principal and interest or interest-only. The interest rate on a line of credit is usually higher than for other home loans, but much less than the interest rate on a personal loan or credit card.

Consolidation loan

A consolidation loan permits the borrower to combine several loans such as a home loan, credit card debt and personal loan into a single variable or fixed-rate loan. This can result in a lower overall repayment and interest rate. Please see our ebook "How to save money with a debt consolidation loan"

Interest-only loan

An interest-only loan requires only the interest to be paid during the interest only period. You are not making any reductions in the amount owing during the interest only period. After the interest only period, they revert to principal & interest for the remainder of the loan term. They are often utilized for investment property purchases. Lenders currently charge a higher interest rate on interest only loans. Make sure it is worth your while opting for an interest only loan. Your mortgage broker is happy to give you the right advice.

Bridging loan

A bridging loan is often used for the purchase of a new property while awaiting the sale of an existing property. A bridging loan is a loan for a period of 6 to 12 months. Some lenders will require payment of the interest whilst the loan is outstanding, others will capitalize the interest and charge it when the old property is sold. In our experience, this is the most dangerous of all home loans as borrowers can get into real problems if the old home doesn't sell in time. Ask us to do the sums with you before you commit to a purchase without having sold your old home.

Additional Loan Features

Fortnightly repayments

You can save money by making fortnightly rather than monthly repayments.

Simply divide your monthly repayments in half and make these once a fortnight. This means you will effectively make one extra monthly repayment a year because there are 26 fortnights (or 13 sets of four weeks) in a year, and only 12 months. Because you are making higher repayments, you will reduce the term of your loan and save a lot of money on interest repayments.

Extra repayments

Most variable and some fixed rate loans allow the borrower to make additional or lump sum repayments without penalty. If you can afford it, regularly adding a little extra to your repayments can significantly reduce the amount you pay over the term of the loan. If you can make a lump sum payment into your home loan account, this will also reduce the term and the total amount you repay. If you opt to make additional or lump sum repayments, you are not committed to paying the same amount each time, as long as you cover your minimum required repayment.

Mortgage offset account

A mortgage offset account is a transaction account linked to a home loan. Any interest earned on the transaction account (calculated at the rate you are paying on the home loan) is applied to reduce the interest payable on the home loan. Because you are still making the same repayment on the home loan, you will pay it of faster as less of the repayment is eaten up in interest and can therefore come off the money owing. Offset accounts are a great feature that can save you thousands, as long as you are not charged a much higher interest rate.

Redraw facility

A redraw facility permits the borrower to withdraw additional repayments, which have previously been made, subject to terms and conditions, which vary significantly between lenders. When comparing redraw facilities, you should ascertain:

- The minimum redraw amount
- The maximum redraw amount
- The fee per redraw
- The allowable number of redraws each year

To have a redraw facility on your home loan is important because it allows you to make additional repayments in the knowledge that you can get those funds back in an emergency.

The Home Loan Interview

Be well prepared for the home loan interview. We always provide you with a list of documents required well before we meet. Provide us with all the information we ask for so that we can assess how much the various lenders will lend you, for example current bank statements, pay slips or other proof of income and documents showing ownership of any property.

Be prepared to furnish details of any financial commitments you have, eg. personal loans, credit cards.

If you are a first home buyer, ask about any special concessions that may be available. We will then provide you with a range of lenders that could suit you. We will also make a recommendation, based on our experience with the various lenders and purely financial parameters.

It is then time to apply for a loan. Most lenders will provide written preliminary approval (usually valid for three months) giving you confidence to look for a property within a certain price range.

If you have a pre-approval in place, the process of converting this is usually fast and easy once you have selected a property to buy.

At The Homeloan Guru, we will evaluate your situation and prepare three options for you to chose from with all the fees and charges as well as interest rates taken into account. This is the surest way to make an informed decision and giving you peace of mind that you are not paying too much on your mortgage. And we will have the answers for all the questions, with an explanation where required, ready for you.

Just give us a ring on 02 4322 3588 or drop us an email at info@homeloanguru.com.au.