

## 10 Tips for a Happier Home Loan

# The Wealth Focus Home Loan Guide



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### Introduction

Australia is often referred to as 'a nation of homeowners'.

That's hardly surprising, given that over 70% of Australians own their own home, which is a far higher proportion than many other countries in the world.

Of course, the money to buy our home has to come from somewhere, which is why at the start of 2007, Australian's had borrowed over \$20.2 billion towards home loans.

Most of us take out a 25 year mortgage, which we repay by way of three hundred monthly repayments.

If you're going to make the most of your mortgage, you need to minimise the amount of interest that you pay (and the same goes for other mortgage-related expenses, too).

*This guide shows you how to do just that - and points out a few pitfalls to watch out for.*

## 10 Tips for a Happier Home Loan

### Contents

<b>No.1</b>	Don't over-stretch yourself	4
<b>No.2</b>	Loyalty costs you plenty	6
<b>No.3</b>	Get the best mortgage	7
<b>No.4</b>	Over-paying your mortgage	9
<b>No.5</b>	Watch out for overpriced insurance	11
<b>No.6</b>	Beware of ultra-low rates	13
<b>No.7</b>	Sleep easy with a fixed or capped rate	14
<b>No.8</b>	The horror of hidden fees	15
<b>No.9</b>	The benefits of a flexible mortgage	17
<b>No.10</b>	Watch out for smoke & mirrors	18

## 10 Tips for a Happier Home Loan

No.

1

### Don't over-stretch yourself

When you're arranging a mortgage, you need to be sure that you can keep up your repayments. If arrears begin to pile up, you could end up losing your home. You may have seen this warning on literature from mortgage lenders, "Your home is at risk if you do not keep up repayments on a mortgage or other loan secured on it."

Of course, the cost of your home doesn't stop at its price. There are other upfront costs to consider, including stamp duty (roughly an extra 2% to 5.5% of your purchase price), survey and legal fees (around \$1,500 or more). Also, your mortgage repayment is just one of a host of monthly

expenses, including insurance policies (life, sickness, buildings and contents, etc.), council rates, maintenance costs, utility bills and so on.

#### Here are three ways to reassure yourself that you're not going to be over-stretched:

1. Put down a large deposit. If you have a 20% deposit, you're less likely to fall into negative equity (where your home is worth less than your loan) than someone who has a 100% home loan.

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## 10 Tips for a Happier Home Loan

No.

1

### Don't over-stretch yourself

**2.** Limit yourself to borrowing a repayment figure of 30% of your disposable income. People borrowing large proportions of their disposable income (say, 50% of net income) have fallen foul in the past.

**3.** Most home loan repayments go up and down when interest rates change. Budget for a 2% increase in rates, that way, you won't suffer a 'payment shock' when interest rates start to climb.

Remember a 2% rise in interest rates is an almost 25% increase in repayments on an 8% mortgage rate (interest only)

You should also double-check your figures by listing all your income and outgoings so that you know how much income you have spare to meet your mortgage repayments.

One rule of thumb is not to spend more than a third of your disposable income on your mortgage. If your mortgage is costing you more than half of your spare income, you don't have much room for manoeuvre if things take a turn for the worse!

*Continued....*

## 10 Tips for a Happier Home Loan

No.

2

### Loyalty costs you!

Although being faithful is to be prized in other relationships, it's harmful when it comes to your mortgage. Why limit yourself to dealing with a single mortgage lender, when there are over 50 lenders eager to do business with you?

Being loyal can cost you a fortune. If you don't have a special-rate deal with your lender, you're likely to be paying its standard variable rate (SVR). Generally, big lenders charge an SVR around 1.2% above the Reserve Bank's base rate. However, the lowest rate variable-rate loans come in below the base rate, which means a saving in excess of 1.2%pa

a year. On a \$300,000 interest-only loan, this means an extra \$6,000 a year in your pocket.

One great strategy is to become a 'rate tart', finding a better deal whenever you can do so without penalty. This approach should save you tens of thousands of dollars over the life of your home loan.



## 10 Tips for a Happier Home Loan

No.

3

### Get the best mortgage

As Australia's hyperactive housing market slows down, lenders are falling over themselves to tempt homeowners away from the competition. Re-mortgaging is big business and accounts for a large proportion of total lending.

Nevertheless, before going elsewhere, talk to your current mortgage lender. All the major Aussie lenders have a 'turnaround' team, whose job it is to hang on to your custom. If you have a good payment history, you should be able to squeeze a much better deal from your lender by threatening to take your business elsewhere.

Ask for a settlement figure or redemption statement - that'll grab their attention!

When looking at switching lenders, find out what incentives are on offer. Many lenders provide assisted switching deals by paying/contributing towards your valuation and legal fees.

Others offer cashback when you draw down your loan. Typically, these perks can be worth \$500 to \$1,000, which you should factor into your calculations.

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## 10 Tips for a Happier Home Loan

No.

3

### Get the best mortgage

If your existing lender won't come up with a winning deal, it's time to try the opposition.

Our Mortgage Section is a good place to start, as are the Best Buy tables in the weekend papers.

Also, for truly independent advice, contact a reputable no-fee mortgage broker. These companies will find the deal that's right for you by searching through hundreds of home loans.

Beware of tied agents or brokers using a panel of lenders, they are less likely to get you the best rate for your circumstances than a broker using the whole market.

*You would always look to get several quotes from tradesman before choosing one, so do the same with your home loan!*



## 10 Tips for a Happier Home Loan

No.

4

### Over-paying your mortgage

Taxpayers who save money in savings accounts have to pay tax on their interest: most are paying almost a third (30%) and some pay as high as 46.5%, almost half of the interest they have earned. So, a gross (pre-tax) rate of 5%, would fall to 3.5% or 2.33% after tax is deducted.

On the other hand, if you overpay your mortgage, you effectively 'earn' tax-free interest at your mortgage rate. So, if your mortgage rate is, say, 7.75%, your tax-free return is also 7.75%.

To earn 7.75% in a taxed savings account, as a 30% taxpayer you'd need to earn 11.07% before tax (14.49% if you're a top level taxpayer). Since no safe investment offers this kind of return, 'saving' into your mortgage can be a good idea.

Investment guru Warren Buffett has remarked that, for most people, overpaying their mortgage is the best financial move they can make.

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## 10 Tips for a Happier Home Loan

# No. 4

### Over-paying your mortgage

Overpaying your mortgage can also reduce the term of your mortgage. A borrower with a \$300,000 principal & interest home loan, paying a discounted rate of 6.75%, could reduce their interest bill by \$63,500 by overpaying \$100 a month.

Even better, this overpayment means that the mortgage term falls from 30 years to 26 years, which means 4 years more fun and in later life!

Before setting up a standing order or dropping a lump sum into your mortgage, check with your lender to make sure that you won't be punished for doing so.

If you will be penalised, put the money into a savings account and throw it into your mortgage when you're free to do so without penalty.



## 10 Tips for a Happier Home Loan

No.

5

### Watch out for overpriced insurance

Australian banks make billions of dollars a year from mortgage borrowers, thanks to the vast amount of home loans. However, they also make enormous sums from selling high-priced protection to their borrowers.

Mortgage lenders make it 'easy and convenient' for you to buy their own cover, often cross selling you products at the same time as selling you your mortgage on the basis of a discount for having your mortgage with them or that it's all under one roof. This is simply a sales angle to make you forget that you're over-paying for this protection!

For example, your mortgage lender may have 'encouraged'

you to buy one or more of these policies:

#### Life insurance

If you bought this from your mortgage lender, your premiums could be as much as three times higher than elsewhere in the market. Getting cheaper cover will save you thousands over the life of your mortgage. Although essential if you have a partner and/or dependent children, if you're young, free and single you're unlikely to have a need for this cover, you're much better off using these payments toward trauma insurance and income protection.

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## 10 Tips for a Happier Home Loan

No.

5

### Watch out for overpriced insurance

#### Income protection

Long-term sickness cover which covers you for long term illness and trauma (critical illness) insurance which provides protection against cancer, heart attack, stroke and other serious conditions is also typically overpriced, shop around and you may be pleasantly surprised to find the 'discounts' you were given for keeping all your loans and insurance under one roof are substantially beaten elsewhere.

#### Home & contents insurance

Buildings insurance is another earner for mortgage lenders cross selling products. Ignore any sales patter, such as

"our tailor made products make it easier to claim". Instead, switch and save with an insurance product suitable to your needs and your pocket.

#### Mortgage payment protection insurance

Sickness, accident and unemployment cover should not be confused with income protection policies, these plans can be relatively expensive. Shop around and call a reputable insurance broker. You could dramatically reduce your monthly premiums/dramatically increase your benefits.

## 10 Tips for a Happier Home Loan

No.

6

### Beware of ultra-low rates

If something sounds too good to be true, it usually is.

Be suspicious of financial offers that look too good to be true. It's likely that a lender is looking for their pound of flesh once your out of the honeymoon/fixed rate period. For example, whilst it is good practice to entice your business with a reduced (honeymoon) rate, the only way a lender is going to offer you an *ultra low* honeymoon rate is when they know that they'll make it back somehow.

For example, if you take out a mortgage with an *ultra low* honeymoon rate, say 6.5% for two years, you can bet that you'll be

locked in at a high Standard Variable Rate for a long time after your honeymoon period ends. Your repayments rocket and, if you want your freedom back, you'll have to buy your way out with a 'Early Repayment Fee'.

Whilst it's standard practice to want to tie you in for 2/3 years after your honeymoon rate ends, some Early Repayment Charges can end up costing you an arm and a leg.

A short term bargain can end up as long term misery, so look for hidden horrors in the small print!

## 10 Tips for a Happier Home Loan

No.

7

### Sleep easy with a fixed or capped rate

Although interest rates are relatively low at the moment, if they increase this can cause difficulties in repayment. For example, in 2006, the typical Standard Variable Rate (SVR) rose from 7.30% to 8.05% effectively increasing the cost of a \$300,000 interest-only mortgage by \$187.50 a month.

If you don't fancy the rise and fall of the interest-rate roller coaster, consider an affordable fixed or capped rate over, two to five years. Note that a fixed rate is guaranteed not to change over a set period. However, a capped rate means that your rate is variable, but will not rise above a

the pre-set ceiling (the 'cap') for the agreed capped rate period. At least with a fixed or capped rate you have the security of knowing that you can afford to meet your repayments for the foreseeable future - and you don't have to worry about interest-rate rises for some time.

Many first-time buyers choose fixed or capped rates to guarantee their payments in the early years, whilst they are adjusting to life as homeowners.

## 10 Tips for a Happier Home Loan

No.

8

### The horror of hidden fees

Purchasing a property opens you up to a whole raft of bills and costs in addition to just your monthly mortgage repayments. For example, there are upfront and exit costs including:

#### Solicitors/Conveyancing fees

This is for the legal work to complete your home loan. Historically, solicitors were used for the conveyancing work in completing home loans. However, licensed conveyancers are able to complete your legal work at a fraction of the cost.

#### Application fees

Also known as a booking fee, can \$500 or more.

#### Completion fees

(paid when you draw down your home loan).

#### Valuation or survey fees

Paid to the surveyor who values and inspects your home.

#### Sealing & deeds release/Discharge fees

Payable when you up when you pay off your home loan or switch to another lender, typically \$200-\$300.

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## 10 Tips for a Happier Home Loan

No.

8

## The horror of hidden fees

### Early Repayment Fees

When transferring or paying off your mortgage during the honeymoon or early redemption period an Early Repayment Fee may become payable.

### Lender's Mortgage Insurance

If you want to borrow more than 80% of the value of your home, lenders will charge you a Lender's Mortgage Insurance (LMI). This is a lump sum insurance premium that protects your lender if they have to repossess your property and has no financial value to you. You pay the premium, but the policy protects the lender!

Since lenders may be using a

different LMI provider, you may find the premium charged to you is cheaper with one mortgage lender over another.

If you have a 20% deposit, own at least a fifth of your current home or can raise the deposit using other properties you own, you should be able to avoid paying the LMI.

Considering these can be thousands of dollars, they are worth avoiding.

Lenders advertise headline rates prominently, while tucking away any chunky charges in the small print. Make sure you look beyond the advertised rate to find those additional fees!

## 10 Tips for a Happier Home Loan

No.

9

### The benefits of a flexible mortgage

Modern 'flexible' mortgages allow you to overpay, underpay, take repayment holidays, skip repayments, and withdraw or deposit lump sums. As highlighted earlier, making regular overpayments and/or dropping in the occasional lump sum can seriously reduce your interest bill and shorten the life of your mortgage.

Offset mortgages combine your mortgage, current and savings accounts under one roof.

By offsetting the credit balances in your current and savings accounts against your mortgage, your debt is reduced and you pay less interest. Offset Current

Account Mortgages are the pinnacle of mortgage evolution, but they aren't suitable for everyone.

This is because their rates are typically higher than the best of breed variable, fixed or capped rates. However, if you're financially disciplined and have substantial savings, they can be a great way to bring forward your mortgage-free date.

## 10 Tips for a Happier Home Loan

No.

# 10

## Watch out for smoke & mirrors

Whilst modern home loans allow you to have an offset facility for your savings, flexible lines of credit and some even have debit cards allowing you to draw down on your loan at any time. Unless you have substantial savings in your offset account, choosing a home loan on the basis of these benefits alone can be at a substantial cost to you.

Beware of lender's "slight of hand" focusing on their *extra* benefits. You may find, alternative products without the bells and whistles offer much lower rates.

For example, a \$200,000 home loan with direct salary crediting a \$5,000 pm into an offset mortgage current account with a 7.5% interest rate will save you approximately \$200 pa, yet you may be paying an extra 0.5%-1% pa (\$1000-\$2000) for the additional *benefit* of direct salary crediting.

**Putting it another way, why pay \$2 to save \$1?**

We're proud to offer an independent broker affiliation:

- Comprehensive advice
- Easy to use service
- Independently owned, open panel brokers

## The Wealth Focus Mortgage Service

*We hope this guide helps you to a happier home loan*

