2020 HOME LOAN GUIDE

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What type of buyer are you?

Understanding the type of buyer you are will help you navigate the complexities of the home loan market, to find the best loan for your needs.

Are you an investor or an owner occupier?

Do you want to buy a property as an investment or as a place to live in?

This fundamental question is crucial in selecting both a property and a loan to suit your needs.

Investors: If you're looking to invest, you might seek an in-demand apartment in a high-growth property area, rather than a home in a specific area with features that match your lifestyle.

Owner Occupiers: If you intend to live in your property as an 'owner-occupier' you are seen as a more stable customer to lenders. As you have a vested interest in keeping the roof over your head, lenders may offer lower interest rates.

Are you a refinancer?

A refinancer is someone who 'refinances' their home loan, by switching from one home loan to another. This can either be with the same lender, or with a different one.

Why refinance?

- Change from fixed to a variable rate
- Borrowing money (e.g. for renovations)
- Switch to a more competitive rate

Keep an eye on your rate

Refinancing can potentially save you $1000s, so it's worth checking your rate throughout the year and reassessing your loan every few years.

Home loans might be long-term financial products but the market is continually evolving and improving. There's every chance there are new features available that don't exist in your loan, if it's been a while since the ink dried on your mortgage.

Insider Tip: Refinancing

Try to avoid extending the length of your loan term. This can increase the amount you pay in total interest on your loan and could negate any savings you might make from a lower rate.

Are you a First Home Owner?

A first home owner is someone who is buying a property for the first time, whether as an investment or to live in.

If you are going to live in the property, you may be eligible for the first home owners' grant or a stamp duty tax exemption, to help you get a leg up into the property market. This is provided you meet a range of criteria.

Are you eligible for a First Home Owner Grant (FHOG)?

First home owner grants began in 2000 but are increasingly hard to come by due the continued tightening of eligibility criteria.

Eligibility Criteria

- You must be over the age of 18 and an Australian citizen or a permanent resident.
- Grants are only for newly-built, substantially renovated properties, or properties that have never been occupied before.
- You can't have owned a property prior to 2000.
- You can't have applied for a first home owners grant previously.
- You need to live in the property you buy with your grant for a minimum of six months, within the first 12 months of owning it.

How much can you get in your state?

NSW:	Up to $10,000
VIC:	Up to $10,000 ($20k in regional Vic)
QLD:	Up to $15,000
ACT:	Up to $7,000
WA:	Up to $10,000
SA:	Up to $15,000
TAS:	Up to $20,000 (until 30 June 2020)
NT:	Up to $26,000

First Home Buyer Concessions:

In the ACT, the FHOG is no longer valid, unless you entered into the transaction on or before 30 June 2019. From 1 July 2019, ACT first home owners can claim an exemption from stamp duty via the Home Buyer Concession Scheme. This scheme applies to vacant residential land and both new and established homes, anywhere in the ACT, at any price.

Concessions on stamp duty are available for first home buyers - up to $23,928.60 – but you can only claim either the FHOG or the concession. Non-first home buyers purchasing or building a new home can claim up to $7000, and seniors, pensioners and carers can claim up to $10,000.

Concessions are not available to first home buyers in South Australia, they can only apply for the First Home Owners Grant. The previously available concession allowing home owners to claim a concession for off-the-plan apartments endedon 30th June 2018.

For first home buyers in Victoria, a concession may apply to the purchase of a new home or a block of vacant residential land. The concession is based on a sliding scale, according to property value, provided buyers meet the eligibility criteria.

First home buyers in NSW can apply for both the First Home Owner Grant and the First Home Buyer Assistance Scheme (FHBAS). The FHBAS applies to new homes, existing homes and vacant land on which you intend to build a home – and can provide a concessional rate or an exemption on your transfer (previously known as stamp duty).

The QLD government provides a range of transfer duty concessions for people buying either their first home, their principal place of residence or a vacant block on which they intend to build. The first home concession only applies to a home valued under $550,000 and can save you up to $15,925. If you do not meet the first home concession eligibility criteria, you may still be entitled to a concession, via the home concession which could save you up to $7,175.

First home buyers of established homes and pensioners downsizing to new homes may be eligible for concessions, depending on their settlement dates and other factors. The Tasmanian government has a handy tool online called PropertyBuyer, where you can check your eligibility for any concession or grant that may apply to your intended purchase of property.

When a home buyer is eligible for the First Home Owner Grant, a concessional rate of transfer duty will apply if the value of the dutiable property is below certain thresholds.

Are you a Renovator or Builder?

Planning to buy a vacant lot and build your dream home? Or perhaps you are in the market for a renovator's dream?

Either way, if you intend to carry out major building work before you move into your home, then a construction home loan could be a good option.

Construction Loans

A construction loan is purpose-built to cover the expenses you incur as you build your home. It is structured to release money in stages, when certain milestones in the building process are reached.

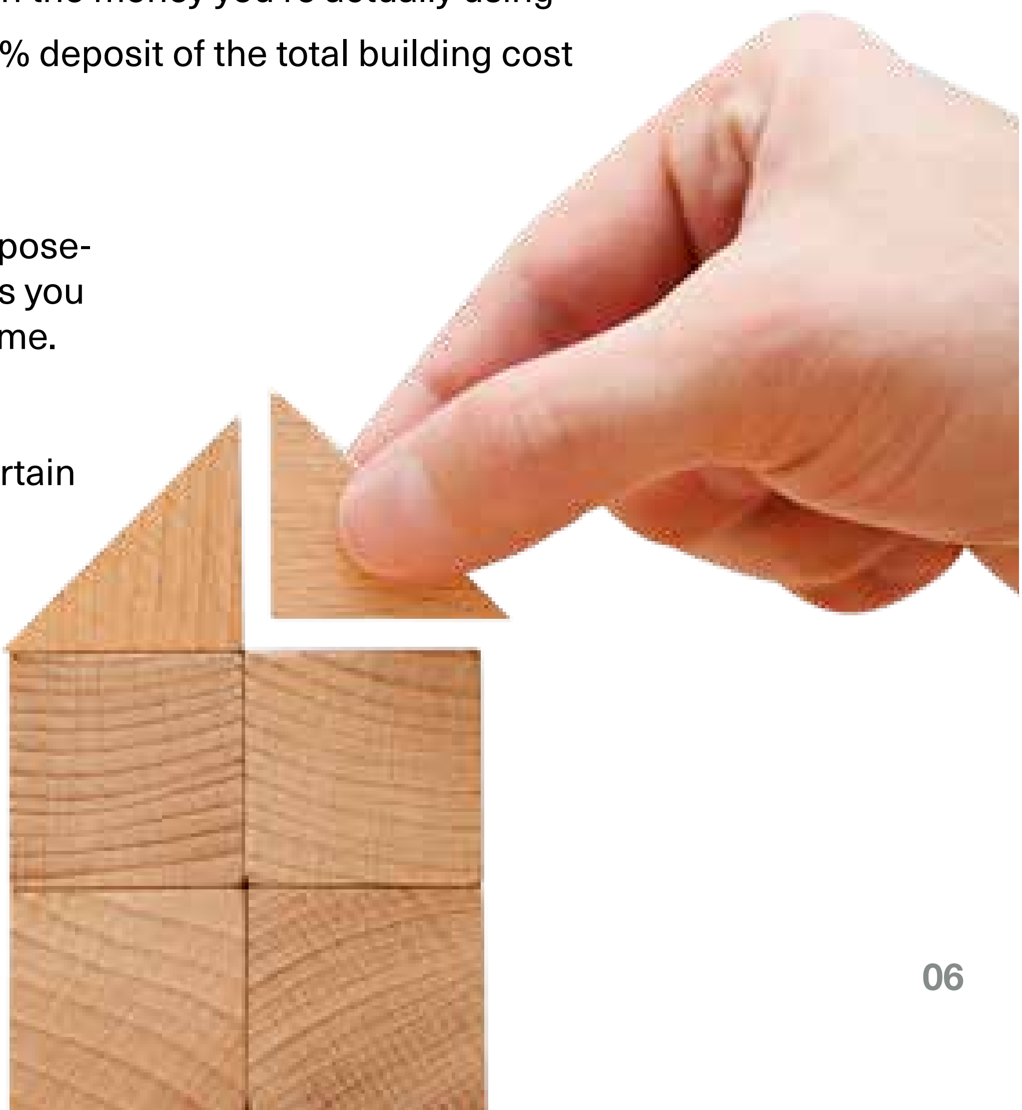
Benefits

- You only pay interest on the money you're actually using
- You may only need a 5% deposit of the total building cost

Interest-Only

A construction loan is purpose-built to cover the expenses you incur as you build your home.

It is structured to release money in stages, when certain milestones in the building process are reached.



Payment Stages in a Construction Loan

Slab:

This amount is for building the foundationof your home, including the base, plumbing and waterproofing. This can be around 10% of the total amount.

Frame:

This phase is where your builder will focus on constructing the 'frame' of your home including the windows, roofing and some brickwork. This can be around 15% of the total amount.

Lock up:

This is usually around 35% of the loan, and covers the elements that are needed to "lock up" your home. This can include external walls, doors and insulation.

Fixing:

Shelving, kitchen, bathroom cabinets, tiles, cladding and all other internal fixtures and fixings are included in this stage, and can make up around 20% of the contract.

Completion:

As the name suggests, this payment stages covers the completion of the building contract. Around 15% of your loan will cover this, and includes all final installation pieces, including building property fences, cleaning, painting etc.

What type of rate do you want?

The amount you repay on your home loan can depend on a range of factors, including the interest rate charged, your repayment frequency and whether you have an 'interest-only' loan.

Interest Rates Explained

The interest rate on your mortgage is the rate at which the bank will charge you interest on the amount you have borrowed.

The rate is expressed as an annual percentage, but lenders calculate interest on a daily basis so that the interest compounds over time.

A range of factors can affect the amount you repay your bank, including:

- Fixed vs variable rates
- Principal and interest repayments
- Advertised rate vs. comparison rate
- Frequency of repayments

Fixed vs Variable Rate Loans

Before you decide on a home loan, it's a good idea to decide what type of interest rate you want to pay. In the Australian mortgage market, there are three main options:

- Fixed rate loan
- Variable rate loan
- Split loan

Which loan should I take out: fixed or variable?

Refinancing can potentially save you $1000s, so it's worth checking your rate throughout the year and reassessing your loan every few years.

Home loans might be long-term financial products but the market is continually evolving and improving. There's every chance there are new features available that don't exist in your loan, if it's been a while since the ink dried on your mortgage.

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Home Loan Types Explained

Fixed Rate Home Loan

A fixed home loan is a loan where the interest rate is set for a certain amount of time, usually between one and 15 years.

The advantage of a fixed rate is that you know exactly how much your repayments will be for the duration of the fixed term. There are some disadvantages to these types of loans including a limit or fee for extra repayments, and some charge a significant break fee if you decide to terminate the loan before the fixed period finishes.

Pros:

- Pre-set repayments: Provide simplicity and stability
- Avoid rate increases: Potentially saves you money if the variable rate increases during the fixed term
- Easy budgeting: Beneficial to frivolous spenders, as your set monthly repayments provide a level of assurance

Cons:

- Fees & Charges: Potentially costs you money if the variable rate falls, and fees may include break fee, legal fee and settlement fee
- Less flexibility: Some loans don't allow additional repayments or offer tools such as an offset account to help you reduce your interest
- No Rate Cuts: Fixed rate loans do not change based on changes in rates, so if your lender cuts your rates, they will not pass these on

Variable Rate Home Loan

A variable home loan has an interest rate that can change over the courseof your loan, based on your lender's rates. The variable rate is determinedby the lender, not the Reserve Bank of Australia (RBA), so while thenational cash rate might go down, your bank may decide not to follow suit.

Pros:

- Rate Cuts: If your lender cuts their rates, the interest rate on your loan will drop and you may end up saving money
- Flexibility: With variable rate loans, you can often switch lenders at any time with minimal cost
- Extra Features: Variable rate loans will often let you make extra repayments and provide features such as redraw facilities and offset accounts, which can help reduce your interest overall

Cons:

- Repayment Uncertainty: If your lender increases their rates, your repayments will increase, or if they reduce their rates, your repayments will decrease – so you can never plan for the same repayment every month
- Mortgage Stress: If your repayments increase due to an interest rate hike, you could struggle to meet repayment deadlines, and may go into mortgage stress
- Difficult to Budget: As the loans may change in value, you cannot budget for your repayments – which can be worrisome if you're an undisciplined spender

Split Rate Home Loan

A split loan can be a good option for someone who wants the peace of mind that regular repayments can provide, but still wants to retain some of the additional features variable loans typically provide, such as an offset account.

Of course, as with most things in life, split loans are still a trade-off. If the variable rate goes down, for example, the lower interest rates will only apply to the percentage of your loan that you didn't fix.

‘Interest-Only’ vs ‘Principal and Interest’ Repayments

Most loans require borrowers to pay both the amount owed, and the interest charged – known as ‘principal and interest’ repayments.

However, some lenders will give you the option of making ‘interest-only’ payments for a limited amount of time. While interest-only payments are lower on a monthly basis, ultimately, they cost significantly more in the long run because you aren’t reducing the principal amount you owe the bank.

Conversely, by paying down the principal on your loan, your monthly repayments might start higher, but they will reduce over time to a point where you’ll become mortgage-free one day and own your home outright.

Why go interest-only?

Interest-only repayments are popular with investors who want to minimise the amount of equity tied up in a property. This frees their money up so they can invest it elsewhere while still benefiting from any capital gains the property might have.

Negative Gearing

Negative Gearing is a form of financial leverage, where an investor borrows money to acquire an income-producing investment, like a rental property, and the gross income generated by the investment is less than the cost of owning and managing the investment.

Negative gearing rules in Australia mean that some investors can write off the interest paid on their investment, if their investment is running at an overall loss. However, anyone considering investing in the property market should do their research thoroughly and talk to a financial expert before committing.

Example

Jackie and James decide to move onto interest-only repayments for the first five years of their $500,000 mortgage while they take time out to travel overseas. Because they have an interest rate of 5%, doing so reduces their monthly repayments from $2,684.11 to $2,083.33 – a ‘saving’ of $600.78.

After five years however, their monthly repayments will increase to $2,922.95 for the remainder of their 30 year loan, which is $238.84 more than what they would have paid each month if they had kept paying principal and interest.

As a result of the interest-only period, Jackie and James will also pay their bank an extra $35,605.2 in interest.

Advertised Rate vs Comparison Rate

Ever wondered why banks display two different interest rates when advertising a home loan?

Advertised Rate

The first rate is typically the bank's 'advertised rate' which is the percentage of interest they will charge you on your loan.

This is often found in plain sight on the lender's website, as it is the lowest rate and therefore most attractive to the buyer.

VS

Comparison Rate

The second rate, known as the 'comparison rate', factors in most of a loan's fees and charges to help Australians understand its overall cost, and make a more balanced comparison of home loan products.

Comparison rates are calculated using an industry-wide formula, based on a $150,000 loan over a 25-year period, which all lenders are legally required to display alongside their advertised interest rate.

Repayment Frequency

A lot of mortgage holders don't realise that the frequency of your mortgage repayments can make a noticeable impact on how much you'll pay your bank in interest over the life of your loan.

Benefits of paying fortnightly

Banks calculate your interest on a daily basis, so if you opt to pay fortnightly instead of monthly, that means for two weeks of each month you'll be charged slightly less interest because you've already paid off part of your monthly repayment. It will only amount to a few cents at a time, but add it up over 360 months in a 30 year loan and it starts to turn into dollars. There is, however, another much bigger trick to paying fortnightly.

Let's say you have a $500,000 home loan with a 6% fixed interest rate, and a loan term of 30 years. If you pay fortnightly, you will save $124,060 in interest over the length of the loan.

	Fortnightly	Monthly
Repayment Amount	$1,499	$2,998
Total interest paid over 30 years	$455,131	$579,191

Many lenders calculate fortnightly payments as half of your monthly repayments, but because there are more than four weeks in most months, over the course of the year you'll effectively end up making one extra monthly repayment (fun fact – in a 52-week year, there are 12 months, but 26 fortnights).

Ultimately this means you're tricking yourself into making higher repayments. It could be a trick worth playing, because it could save you thousands.

Loan fees & hidden costs

Fees are much like taxes – they're pretty much unavoidable and home loans are notorious for them. The good news, however, is that there are lenders in the market who have minimal or no fees – it's just a matter of knowing what to look for.

Upfront fees

An 'upfront' or 'application' fee is a one-off expense your bank may charge when you take out a loan. The average start-up fee is over $570, however there are many loans on the market with none at all. All lenders are different, so make sure you check the PDS or speak to your broker before you sign anything.

TIP: If the loan you want does include an application fee, you can try and negotiate with the lender to have it waived.

Ongoing fees

Ongoing fees are any regular payments charged by your lender in addition to interest, including annual fees, monthly account-keeping fees and offset fees.

The average annual fee is close to $250, however there are many home loan products that don't charge an annual fee at all. There are plenty of extra costs involved when you're buying a home, such as conveyancing, stamp duty, and moving costs, so often the more fees you can avoid on your home loan, the better.

While $200 per year might not seem like much in the grand scheme of things, it adds up to $6000 over the life of a 30 year loan – money which may be much better off either reinvested into your home loan or in your back pocket for the next rainy day.

Example

Anna is tossing up between two different mortgage products for a loan of $350,000. Both have the same variable interest rate of 4.00%, but one has a monthly account-keeping fee of $20. With this loan, she'll pay $1690.95 per month for 30 years, and repay $608,743.26 in total.

By picking the loan with no fees, and investing an extra $20 a month into her loan, Anna will still pay $1690.95 per month, but end up shaving 8 months off her 30 year loan, and pay a total of $595,026.11 – a saving of $13,717.15!

Break fees

Break fees are charged when a customer terminates a fixed-rate mortgage. The amount you are charged is determined at the time you decide to break the loan and is typically based on how much your bank stands to lose by you breaking the contract.

Discharge Administration fees

The Federal Government banned exit fees in 2011, removing one of the biggest barriers to switching home loan providers. Lenders can still legally charge a discharge fee, which is payable when you come to the end of your home loan, however these fees are relatively small, averaging at around $300, while many products don't have them at all.

Redraw fees

Redraw fees may be charged by your lender when you want to take money you have already paid onto your mortgage back out. Typically, banks will only allow you to take money out of your loan if you have a redraw facility attached to your loan, and only the money from any additional repayments you've made. The average redraw fee is around $19, however there are plenty of lenders who include a number of fee-free redraws a year.

TIP: Negative-gearers beware – any money re-drawn is often treated as new borrowing for tax purposes, so there may be limits on how you can use it if you want to maximise your tax deduction. Contact a tax accountant for more information.

Flexibility: comparing home loan features

When looking for the right mortgage, a loan's features can sometimes be just as important as the interest rate, especially if you are planning to put extra money towards your mortgage at some point over the life of the loan.

Additional repayments

Additional repayments are payments you proactively make onto your home loan in addition to your set monthly or fortnightly payments. This extra money goes towards reducing the amount you borrowed (the principal) and as a result, can significantly reduce the amount of interest you pay.

While additional repayments don't have to be regular, they can be a good way of chipping away at your debt, potentially saving you thousands of dollars and stripping years off your loan term. Before you sign up to a mortgage, check whether it allows you to make extra repayments – this can often make or break someone's decision to take out a particular loan.

Example

Alex has a $500,000 home loan with a 30-year term. Paid monthly at 4% interest, this mortgage will cost Alex $2387.08 per month, or $859,347.43 in total.

Five years into his home loan, Alex gets a pay rise and decides to use some of the extra cash to help pay off his mortgage faster. By committing to paying an extra $200 a month onto his loan for the remaining 25 year term, he works out he will pay $36,721.70 less and slash 3 years off his loan.

Lump sum repayments

Lump sum payments are similar to additional repayments, although typically they are larger sums of money, deposited onto your home loan as a one-off. Like additional repayments, the lump sum goes towards the principal owing on your loan and works towards lowering your overall interest costs and loan term.

People will decide to make lump sum payments for all different reasons – you may have received an inheritance from a long-lost aunt, or collected a surprise tax return that year.

The earlier you make the payment, the greater the potential benefits – the bank will start charging you less interest as soon as you make the deposit, which will have a significant compounding effect.

Example

Instead of making additional repayments, Alex decides to make a one-off lump sum contribution onto his home loan of $60,000, but he's undecided about when to do it.

He decides to work out what the difference will be and is shocked by the results: putting the $60K in at 5 years will see him save $86,958.93 in interest repayments over the life of his loan, while putting the $60K in at 15 years will save him just $41,818.31 – a difference of over $45,000.

Offset Accounts & Redraw Facilities

Offset accounts and redraw facilities are tools you can use to put extra money onto your home loan to reduce the amount of interest you're charged.

Offset Accounts

An offset account is a transaction account attached to your mortgage. Money in your offset account is counted when calculating your interest charges.

For instance, if you have a $300,000 loan and have $10,000 in your offset account, you'll be charged interest as if you only owed $290,000. Some banks will only allow you to partially offset your mortgage, so ideally look for one that enables you to offset 100% of the interest, rather than just a portion, which can significantly limit your savings.

PROS	
Convenience:	Instant, unlimited deposits and withdrawals, can include ATM access
Save money:	Money reduces the amount of interest you are charged
Build valuable equity:	You will not pay tax on the interest you earn, unlike with a savings account, so this can be more beneficial than a savings account

CONS	
Difficult for spenders:	This type of account requires diligence to refrain from 'dipping in' to the account – not recommended for undisciplined savers
Fees:	This type of account can incur an offset account fee
High rates:	Loans with offset accounts can often attract higher interest rates

Redraw Facilities

Redraw facilities allow customers to take money out of their mortgage that they have already deposited as additional repayments. The extra money is kept in the loan, rather than a separate account, and there are often limits on how many redraws you can make, or fees attached to making a redraw.

PROS	
Emergency funds:	Redraw facilities can provide a contingency for future debts
Tax advantages:	Any interest that you save on your home loan by holding money in a redraw facility will not be subject to tax
Reduce interest:	Maintaining an available redraw balance can help reduce interest on your home loan

CONS	
Limited frequency:	Lenders can limit the amount and or frequency of withdrawals
Fees:	Redraw transactions often have fees and charges attached to them
Waiting times:	Withdrawals are usually not instant, unlike offset accounts

How much should you borrow?

Taking the time to understand your ideal deposit size, additional mortgage costs, property value and your ability to repay can help clarify the application process and enable you to properly allocate any additional expenses involved.

Deposit size

Determining how much you need to borrow is often not as straight-forward as you might think. After you've worked out where you want to buy, you'll need to work out how much you can put forward as a deposit, how much you can afford to make in monthly repayments, and how much you need to borrow overall.

Working these out is a bit like a chicken and egg scenario – it can be hard to determine which one comes first. Your loan size will affect how big your deposit needs to be, while your ability to meet regular repayments will affect your loan size.

Loan to Value Ratio

The Loan to Value Ratio (LVR) shows the value of your home loan as a percentage of the property's value. It is calculated by dividing the loan by the property's value. Many lenders will offer 80-90% LVR, however you may be able to get 100% or sometimes 110% if the lender is offering a promotional deal.

When buying a property, your lender will ask for a cash deposit as security on the loan. The bigger the deposit, the happier they'll generally be, as it provides them with more collateral should the deal turn sour. It also helps prove to them that you are financially secure enough to have saved up this amount of money.

Additional mortgage costs

Taking out a mortgage has its own list of additional fees and charges, from organising building inspection reports to legal fees.

Two of the biggest expenses are ones home buyers often forget to factor in: Lenders Mortgage Insurance and Transfer Duty (previously called Stamp Duty).

TIP: You can use RateCity's stamp duty calculator and mortgage repayments calculator to help assess all the costs related to your loan, including LMI and stamp duty.

RateCity

Transfer Duty (Stamp Duty)

Stamp duty is a tax that Australia's state and territory governments apply when a property is purchased. The tax is paid by the buyer in addition to a mortgage registration fee and a transfer fee.

It's fair to say stamp duty is probably not one of people's favourite taxes, especially as it can be over 4% of the property price and comes at a time when most people are stretching the budget anyway.

In addition to stamp duty, most state and territory governments will also charge for the transfer of the title and the registration of the mortgage, however these are typically much smaller fees.

Based on the RateCity Stamp/Transfer Duty Calculator, Queensland is the cheapest place for stamp duty (excluding transfer fees), although it's probably not wise to pick your future home based solely on these unavoidable taxes!

State	Stamp Duty	Registration Fee	Transfer Fee	Total Amount
ACT	$14,600	$135	$262	$14,997
NSW	$17,900	$110	$219	$18,311
NT	$23,929	$142	$142	$24,213
QLD	$8,750	$169	Fees applicable	$8,919+
SA	$21,330	$157	Fees applicable	$21,487+
TAS	$18,248	$129	$198	$18,575
VIC	$21,970	$114	Fees applicable	$22,084+
WA	$17,765	$164	Fees applicable	$17,929+

Lender's Mortgage Insurance (LMI)

Lenders mortgage insurance or 'LMI', is a type of insurance required by your bank if you have a deposit of 20% of the property value or less (an LVR of 80% or higher).

This insurance covers your lender, not you, in the event you're unable to pay your loan back. Most banks pass the cost of LMI on to the borrower.

The cost of LMI depends on the size of your loan compared to your deposit and the value of the property and can climb as high as $10,000 or more if you're stretching the budget to buy your home.

Associated Fees & Costs

In addition to LMI and stamp duty, there's a range of smaller costs that could add to your bottom line when buying a house. While some won't be applicable to your circumstances, it's worth checking off each one.

Conveyancing/legal fees: While there are some DIY conveyancing kits on the market, it's often a good idea to consider engaging a professional when it comes to managing legal documents. There are two types of professionals you can engage: a conveyancer or a solicitor. A conveyancer is likely to be cheaper, however they are more restricted in the advice they can give you.

Mortgage fees: There are a variety of upfront fees your lender might charge at the start of your loan, including application fees, documentation preparation fees and bank valuation fees. Check with your lender before you lock yourself in, and find out what you'll pay in total for your upfront fees.

Inspections: There are a range of inspections you will want to consider before buying a property, including a building inspection, a pest inspection and a strata report, if you are buying an apartment. These reports will help you determine whether there are any current or previous issues with the place you want to buy – information you'll want to know before you secure the keys to your new home, rather than after.

Council, water and strata rates: If the previous owner paid for these services a year in advance, you'll be asked to refund them for the remainder of the year.

Home Insurance: Insurance is vital if you want to protect your new purchase. If you are moving into the place, home and contents insurance could be worthwhile, while investors who are renting the property will probably want to opt for landlord insurance.

Moving costs: If you're planning on moving into your new home, you might need a removalist. Professional removalists can be expensive, particularly if you have a large house or you are moving interstate. If you want a low-cost alternative, online service forums can help you nab a competitive deal.

Telecommunications: The relocation of phone lines, internet and any Pay TV services can add up, so make sure you factor in a few hundred dollars for this. These companies can also be booked for months in advance so it's often a good idea to call them early.

Rental costs: If you're an investor you won't be looking for a removalist, but you might need a real estate agent to find tenants and manage the property, if there aren't already tenants in the place. It takes time to find the right tenant, so you may not start receiving rental income straight away, and even then, a percentage of this income may be eaten up by agent fees.