HOME LOAN JARGON UNPACKED:

A NO-NONSENSE HANDBOOK FOR ALL HOME BUYERS

BROUGHT TO YOU BY yourmoney& your life WLTH

INTRODUCTION

HOW DO YOU CALCULATE AN LVR? SHOULD YOU GO WITH P&L OR INTEREST ONLY? ARE YOU BETTER OFF ON A FIXED OR VARIABLE RATE? DO YOU NEED AN OFFSET ACCOUNT, AND WHAT DOES IT OFFSET?

Buying a home is one of the biggest investments you'll make, but let's be honest, the home loan lingo can sound like gibberish at times. It's a minefield of acronyms and industry-specific terms that can leave you bewildered rather than excited and empowered.

"I had a very bad experience when I bought my first home," says Claire Mullen, Mortgage Lending Specialist at WLTH.

"I was made to feel dumb. People used words I didn't understand, and they spoke numbers at me, and I just felt foolish."

Whether you've taken out a home loan before or are making your first leap onto the property market, you deserve to feel confident about such a big decision. That's why Your Money & Your Life, Australia's online destination for personal finance news and tips, has teamed up with leading impact lender WLTH for this eBook.

We want to help you cut through the mortgage muddle and arm you with the smarts in plain, easy-to-understand language. We'll cover the key terms to know about:

1. Applying for pre-approval
2. Securing your property
3. Settlement and beyond

Are you ready? Let's go.

THE PRE-APPROVAL PROCESS

So you've got a pool of savings, you're scoping out open homes, and you're itching to buy soon.

To afford that property of your dreams, you'll likely need a home loan. Research and compare lenders while you're on the hunt. Remember that you'll need to repay that loan with interest over a long period (typically 30 years).

To be ready to make an offer when you find 'The One', get your ducks in a row and work out how much you can borrow and what you can buy. This process is called applying for pre-approval or **conditional pre-approval**.

CONDITIONAL PRE-APPROVAL

Borrowers can either go through a mortgage broker or speak to a lender directly to seek pre-approval. Pre-approval involves gathering several documents that best reflect your financial position and determine your borrowing capacity (more on that soon). Pre-approvals can vary, but they are often valid for 90 days.

When you speak to a lending specialist about conditional pre-approval, you'll need to clarify:

Is my property owner occupied or an investment property? Owner occupied means buying a home you'll live in, while an investment property is one you intend to rent out to generate income. This is an important distinction as it will decide the kinds of loans available to you.

Am I eligible for the First Home Owner Grant (FHOG)? The Australian government's FHOG scheme gives first-time homeowners a one-off grant if they meet specific criteria. For example, in NSW, the grant covers $10,000 when you buy or build your first home valued at under $600,000. Visit firsthome.gov.au to see what's available in your state.

LENDER TIP

If someone doesn't have the deposit and government costs for the purchase price that they're interested in, then I'd tell them you need to work on it, and when you have, come back. Let's play around with servicing calculators to see what can work for you.

CLAIRE MULLEN, MORTGAGE LENDING SPECIALIST, WLTH

UNDERSTANDING YOUR BORROWING POWER

SO, WHAT IS YOUR BORROWING POWER, AND HOW DOES IT IMPACT YOUR ABILITY TO SECURE A LOAN?

In the pre-approval process, you'll be asked by a lender to paint an accurate picture of your financial situation. This will involve gathering documents, including proof of identity, income statements, assets like savings, super and shares, liabilities or debts, and living expenses.

Note that every application for pre-approval is recorded in your credit history, so you'll want to be 100% sure you're ready to buy so your credit score is not impacted.

Also, don't forget how much you can borrow doesn't include the funds you need to complete your purchase, such as the stamp duty, valuation fees, solicitor fees, and any lender fees (like discharge fees on a loan if you are refinancing). **Stamp duty**, which is also known as transfer duty, is a tax that state and territory governments charge on property purchases.

LENDER TIP

Customers are quite often under the assumption that as long as they don't have a default, collection, judgment or discharge, they're fine. But they don't know that your credit score drops every time you make an inquiry, regardless of whether you go ahead or not. And just like when we are on a driver's licence, you lose points on your credit score.

CLAIRE MULLEN, MORTGAGE LENDING SPECIALIST, WLTH

SO, HOW DOES YOUR LENDER COME UP WITH THE MAGIC FIGURE YOU CAN BORROW? THIS DEPENDS ON A FEW THINGS, LIKE YOUR CREDIT SCORE, THE LOAN-TO-VALUE RATIO (LVR) AND YOUR LOAN SERVICEABILITY.

What's this LVR thing? Loan to Value Ratio - Put simply, it's the amount of money you borrow (the loan) as a percentage of the cost of the property (the value).To work it out, divide your loan (minus any deposit) by the property's value, and voila! You have the LVR. The lower your LVR, the lower the risk to your lender.

Loan serviceability: Once your lender knows the LVR, they will also consider your serviceability. Imagine you've decided to get fit and are signing up with a new trainer. Before you begin, the trainer will put you through a series of stress tests to check your fitness level. Your lender will do something similar. They will look at your income (after tax) and expenses to see how much you can comfortably afford to pay. This will give them your debt service ratio (DSR).

Your DSR explained: In layperson's terms, your DSR is a monthly calculation of how much of your income goes towards paying off (servicing) debt. When calculating this figure, there is usually not much wriggle room, as lenders are under strict guidelines from the Australian Prudential Regulation Authority (APRA) to ensure they don't issue loans to people who can't afford to pay them off.

To figure out your DSR, your lender will also add a buffer to your loan interest rate (anywhere between 3-7%) to account for rate rises over the life of the loan. If you sign up for a loan of $1,000,000 at 5% interest, your lender may assess you on an interest rate of 8% to ensure you can endure future rate hikes (there's that stress test, again).

THE WAYS TO PAY

Hoorah! You've found your dream property, and the amount you can borrow has been decided - but now, how will you pay off your loan? Your lender will have flexible options - anything from variable to fixed rate to interest-only. So which one is right for you?

INTEREST-ONLY

An interest-only loan is just as it sounds. When you opt for interest-only payments, you only pay the monthly interest on the amount borrowed (the loan principal). Interest-only can be helpful to property investors who intend to flip and want to maximise their cash flow and deductions. Or they can also come in handy during life moments when your income might be reduced. However, interest-only loans can usually only be set for 1-5 years, after which they will revert to principal and interest.

PRINCIPAL AND INTEREST

Most loans in Australia are principal and interest. With these loans, every monthly payment pays off a portion of the loan principal (the amount you borrowed) plus the interest owed. At the end of the loan term, you will own your property free and clear. These loan types come with various interest rate options, which have pros and cons.

FIXED-RATE

A fixed-rate home loan locks in the loan's interest rate for some time. The benefit is you will know what your loan repayments will be and won't be subject to rate fluctuations (you can typically fix your rate for three years). The downside is, that as the term of your fixed-rate period expires, you could roll onto much higher rates or potentially miss out on interest rate drops.

VARIABLE INTEREST RATE

With a variable-rate loan, your interest rate can change throughout the loan period. This can be a rollercoaster ride: Interest rates may rise and fall depending on several factors, including the cash rate set by the Reserve Bank of Australia (RBA) and any funding costs that may impact your lender. You could benefit from low-interest rates or be hit with high ones, depending on the rate cycle.

Both fixed and variable appeal to you? Well, good news! You can split your loan so that a portion of the loan is paid off at a fixed rate, and the remainder is variable.

COMPARISON RATE

It's also important to understand your comparison rate. Your interest rate is how much interest you will be charged. Your comparison rate includes the fees and charges that come with a loan and will give you a more accurate picture if you want to compare loan products.

LENDER TIP

When you hear someone ask, what is your comparison rate? You know that they know a little bit about something. So if you're on a 7% interest rate and the comparison rate is 7.85%, your true rate is 7.85%. That may include fees like your annual application fee, your app fee and your discharge fee.

CLAIRE MULLEN, MORTGAGE LENDING SPECIALIST, WLTH

READING THE FINE PRINT

Now we've got a basic understanding of the approval process and mortgage types and rates, some nitty-gritty still needs to be unpacked. Let's begin!

Offset or redraw? Most variable home loans offer redraw or offset accounts as part of the loan. Both have benefits. An **offset account** is an everyday transaction account that sits beside your home loan. The benefit is any money in an offset account will offset the interest that is paid on your loan.

A **redraw facility** allows you to make extra payments on your loan, which you can take back out (redraw) should you need to. A redraw facility can be better than a credit card or personal loan, as the interest on a home loan is usually at a more competitive rate.

Some lenders may charge you extra to have an offset or redraw account, while other lenders have these features built into the loan. Be sure to double check what you are paying for.

LENDERS' MORTGAGE INSURANCE

Contrary to popular belief, Lenders' Mortgage Insurance (LMI) does not benefit you, the buyer, but rather the bank. If your home deposit is less than 20%, your lender will insist you take out LMI to protect them if you cannot repay your mortgage. It's often confused with mortgage protection insurance, which insures a borrower against unforeseen circumstances like illness, injury or death.

Guarantor: Sometimes, a lender might need additional security before approving a loan, in which case they will ask for a guarantor. This is usually a family member or friend who guarantees to repay the loan if you can't. They may have to put up an asset - such as the family home - to secure the loan and will be responsible for the debt should you default.

Suppose you're buying property through a self-managed super fund. In that case, the guarantor will usually be the director of the trustee of the fund. And remember, a word of warning: if you go guarantor on a loan, the total debt will apply to your serviceability and could impact your ability to refinance or secure future loans.

Cooling off period: The cooling off period is a short amount of time in which a buyer can back out of a sale. The time varies from state to state (for example, in NSW, it is five days). Once the cooling-off period ends, you can no longer back out of a contract for sale without attracting significant financial penalties. Cooling off does not apply to auctions. So bid carefully!

LENDER TIP

Every dollar you put in your offset account will offset the mortgage. Suppose you've got a mortgage of $400,000, and you have $50,000 in that separate offset account. In that case, you're only going to be calculating interest on $350,000 rather than $400,000. However, you will still have the ability to use those funds whenever you want. It can reduce your loan term significantly

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SETTLEMENT AND REFINANCING

YOUR OFFER'S BEEN ACCEPTED, OR YOU HAD THE WINNING BID AT AUCTION… NOW WHAT?

First, you will agree on the **settlement period** for your purchase. This is set out as part of your sales contract. In Australia, settlement periods can range from 30-90 days, and you can specify a fast settlement date as a condition of purchase should you desire.

With the settlement date in place, you will need to **engage a solicitor or conveyancer** to act on your behalf during the process. They will check that any existing mortgage or title on the property by the vendor (seller) is removed, that any clauses conditional to the sale are fulfilled and that the new land title and mortgage transfer are registered with the title office.

Meanwhile your lender will **register the mortgage** against the title of your property and provide you with the purchase funds into your loan account. While all this is happening, you need to ensure you have all your completion funds in order (remember that pesky stamp duty, LMI and any other valuation or inspection fees).

Then, it's time to do a **final inspection** of your new property (usually on the day of settlement). This is to check that everything is in the same condition as when you purchased it - such as appliances, locks, and keys in working order and that all fittings and fixtures are in place.

If everything looks hunky dory, then it's time to pay your land and stamp duty. Then, your lender will **draw down on your loan** - meaning they will take the amount they paid at settlement from your loan account, completing the purchase.

Now, all that's left to do is collect your keys from the agent and take possession of the property!

WHEN DOES REFINANCING MAKE SENSE?

Your fixed rate loan is about to expire or you've seen another lender with a better deal? Both are valid reasons to consider refinancing. Here's when and why you should refinance.

Loan terms and interest rates are constantly changing, so it makes sense that you would think about refinancing at some point during your loan life. Alongside market changes, your financial situation could also change, too, prompting you to shop for a new loan. As a rule of thumb, consider refinancing every few years.

A few reasons to refinance include:

- To secure a lower interest rate,
- To consolidate your debt
- To get equity out of your home

Before you refinance, get educated. Heard of loyalty tax? It's when a loyal customer pays a higher rate than a new one, and it's widespread in the finance, telco, and energy sectors. So do yourself a favour, check out the rate your lender offers new home loan applicants, and use the info to your advantage.

LENDER TIP

Before moving to another financial institution, I would always encourage a customer to request a rate review. Because it's going to cost you approximately $1500 to move when you include the fees. Or about $2500-$3000 on an SMSF. So why not contact your current institution and ask for a rate review. See what they can do to hopefully retain you.

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WANT TO FIND OUT MORE?

For the latest news and resources to help you manage your money better, head to the Your Money & Your Life website: ymyl.com.au.

For weekly money, life, and business updates from Your Money & Your Life's David Koch, subscribe to the My Money Digest newsletter.

Keen to speak to a lender about the right home loan for your circumstances? Visit wlth.com or give their specialists a call on 13 WLTH. WLTH offers flexible lending options with lower rates, highly competitive loans and fast approvals.

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