NSW DEPARTMENT OF HOUSING

Financing your Home Purchase

Other publications available from the
Home Purchase Advisory Service:

- A-Z of Home Purchase
- Buying Land and Building a Home
- A Guide to the Costs of Home Purchase
- Mortgage Assistance Scheme
- Home Buyer's Checklist
- Home Buyer's Budget Planner

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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 the various lending bodies:

- How to become eligible for a loan
- How much you need for a deposit
- If funds are always available
- How much you can borrow

How much you can borrow will normally depend on:

- Your income
- The interest rate charged
- The term of the loan
- Your other commitments such as credit cards and personal loans (these may reduce the amount you can borrow)

You may 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 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 jeopardise this by overcommitting yourself with other credit. Other credit reduces 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.

The most common reason home owners get into difficulties when repaying their mortgage is overcommitment to other credit.

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. However some lenders will lend 100% of the value of the property, provided the borrower meets certain strict conditions. You will also need to budget for costs associated with buying a home, such as:

- Legal expenses
- Lender's fees
- Government charges
- Inspection costs

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

The Consumer Credit Code

The Consumer Credit Code is a set of rules for borrowers about their obligations in undertaking credit transactions. Under the Code, institutions providing home loans are required to truthfully divulge all relevant information about the loan in a written contract. The contract should include information on interest rates, credit fees and charges, commissions etc.

For further information on the Consumer Credit Code, contact your nearest Office of Fair Trading Centre.

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.

Second mortgages may be obtained for a range of reasons including when additional funds are needed to complete the purchase of a home. Again, the property is used as security (also called "collateral") to ensure repayment. Second mortgages are usually taken over a shorter term than a first mortgage and the interest rate tends to be higher as the lender is taking a greater risk. If a property is sold to repay the debt, the lenders are paid in order of their mortgage. The first mortgage is paid first, and so on.

The first lender has to agree to the borrowing of additional money. Generally, lenders prefer to lend all of the money and hold first and second mortgages.

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 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. 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.

Additional insurance such as Income Protection Insurance covers the borrower's mortgage repayment in the event of illness, accident, unemployment or death.

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 deposit required can vary from 5% to 25%.

Building societies

Building societies are co-operative organisations 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, saving accounts, cheque accounts, credit card access and financial planning and investment services.

Credit unions

Most credit unions lend housing funds to members. Credit unions can be a good source of finance when additional funds are required.

Mortgage managers

Mortgage managers organise 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.

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.

Co-operative housing societies

Co-operative housing societies provide housing loans predominantly to low and moderate income earners. Customers of co-operative housing societies achieve membership of the society by purchasing a share at nominal value.

Superannuation funds

Housing loans are sometimes available to people who contribute to certain superannuation schemes. Borrowers usually must meet membership and/or qualifying criteria.

Solicitors

Some solicitors have clients' funds available for housing loans. Usually, these loans are available for two or three years only and at the end of this time finance has to be obtained from another source. However these loans can often be "rolled over" to give the borrower another set period of time before the loan has to be repaid. These are interest-only loans and therefore there is no reduction in the amount borrowed.

Finance companies

Finance companies generally have loans available but usually these are not suited to first mortgage housing loans because interest rates can be higher than other sources.

Vendor finance

Sometimes the vendor (the seller) is prepared to lend part of the purchase funds to the buyer, usually over a two or three year term. Interest only is paid and therefore there is no reduction in the amount borrowed. At the end of the term, finance has to be obtained from another source.

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, usually monthly, are the same throughout the term of the loan, changing only with the rise and fall of official interest rates. In the early years of the loan, the bulk of each repayment is usually 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.

Fixed interest rate loan

This type of loan offers a fixed interest rate for a specific period, eg six months to five 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. It may not be possible to pay extra amounts off the principal without incurring a monetary penalty. A monetary penalty usually applies if the borrower wishes to refinance the loan during the fixed interest rate 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 fixed for the capped 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 prepared for an increase in loan repayments once the capped period ends.

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. Due to the flexibility of these loans, the borrower may incur greater costs, eg a higher interest rate and/or higher monthly fees.

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 amount which acts like a second mortgage. Here the loan is 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 over time, 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 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 less than the interest rate on a personal loan or credit card.

Consolidated loan

A consolidated 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.

Interest-only loan

An interest-only loan requires the interest to be paid during the loan term, with the principal becoming due at the end. These are usually short-term loans, of one to five years, and are often utilised for investment property purchases.

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 short-term housing loan where repayments meet the interest only. The principal becomes due at the end of the loan term. As higher interest rates are usually charged for bridging finance, it is best to keep the term as short as possible.

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 repayment a year because there are 26 fortnights (or 13 sets of four weeks) in a year, and only 12 months. Making repayments fortnightly can reduce the term of your loan and save you 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 savings account conducted in combination with, but separate to, a home loan.

Any interest earned on the savings account is applied to reduce the interest payable on the home loan.

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

It is recommended that you make appointments at various lending bodies to speak to a loans officer about a potential home loan. Take information to help them assess how much they will lend you, for example current bank statements, payslips 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.

At this stage, because you are not making a formal application for a loan, there will be no charge. This preliminary interview gives you a good idea of how much you can expect to borrow and when it might be available.

Shop around and compare the interest rates and loan conditions offered by the various lenders. If you are a first homebuyer, ask about any special concessions that may be available.

After comparing various lenders, you will have to decide which one suits you best. 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.

Once you have selected a property to buy, make a formal application to your chosen lender. You will be required to complete an application form and provide details of the property.

Questions to ask lenders

When seeking information from lenders or attending a loan interview, it may be helpful to ask the loans officer the following questions:

Question	Answer
What fees apply to the loan application?	
Should the loan not proceed, will any of the application fees be refunded?	
Do these fees apply to this application only or can they apply partly to a subsequent loan application?	
How much can I borrow?	
What percentage of my income will be committed to loan repayments?	
How much deposit will I need? (including approximate associated costs)	

Question	Answer
What conditions apply to fixed rate, capped and introductory loans?	
Is the interest daily or monthly reducible?	
In the event of an increase in the interest rate, will the term be lengthened or will I have to meet the increased repayments?	
Are there any further charges from the lending body if the loan proceeds and any ongoing charges/monthly fees?	
What arrangements does the lender have for making repayments? Is there a repayment book? Can repayments be taken directly from my salary or bank account?	
How long will it take to receive formal loan approval?	
What legal fees will be charged by the lender for the preparation of documents, such as mortgages?	
Are there any penalties for repaying the whole loan before the full term or for making extra payments?	
Does the lender offer a mortgage offset facility?	
Does the lender offer a redraw facility?	

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