UNDERSTANDING YOUR LOANS FACT SHEET

Obtaining a mortgage for either investment or owner occupied purposes can be a complex and confusing process. This step by step guide will help you understand what each type of loan means and the pro's and con's of each.

Standard Variable Loans

Australia's most popular type of home loan. The interest rate can vary throughout the term of the loan – both up and down based upon economic factors. The term is usually 20 to 25 years.

Advantages:

- If interest rates fall, your repayments will come down.
- You have the option to fix or split your loan; can make additional repayments without incurring a penalty and then have the option to redraw the additional funds.
- More flexibility than other types of loans.

Disadvantages:

If interest rates rise you will have to make higher repayments.

Basic Variable Loans

Many lenders now offer basic variable loans with lower interest rates than standard variable loans but with fewer features. Like all variable loans, the interest rate and your repayments can vary over the term of the loan.

Advantages:

- The biggest advantage is price. Basic variable loans have a relatively low interest rate.
- Repayments are usually lower than standard variable loans.

Disadvantages:

- Most of these loans do not offer the same range of features or flexibility as other variable interest rate loans. For example, many basic variable loans cannot be used in combination with other loans and are not portable.

However borrowers can opt to pay for additional flexibility and features.

Fixed Loans

The interest rate is fixed for the term of the loan – usually between 1 and 10 years. This means that the monthly repayments will remain the same for the duration of the fixed period.

Advantages:

- The security of knowing that your repayments will not increase for the fixed period.

Disadvantages:

- If interest rates fall during the fixed period you will be paying a higher rate by comparison.
- Fixed loans often lack the flexibility of making extra repayments that shorten the duration of your loan.

Line of Credit

A line of credit is an interest only variable rate loan secured against a residential property allowing access to funds whenever you need them. They have the added flexibility of a transaction account built into the home loan. Line of credit products provide flexible ways to raise funds for investment purposes by providing cash at call up to the prearranged credit limit.

Advantages:

- You can use the money as you need it and pay it back when you can.
- Interest rates tend to be lower than for credit cards or personal loans.
- Credit limits are usually higher than for credit cards or personal loans.

Disadvantages:

- Unless you are careful, there is the potential you may inadvertently reduce the equity you have built up in your home.

Interest rates are generally higher than standard variable loans.

Home Equity Loans

Allow borrowers to use the equity in their existing property for other purposes such as renovations, investing in shares or managed funds, or financing an additional property.

Advantages:

- Interest on home equity loans are tax deductible provided the funds are utilised for investment purposes.
- Usually at a lower interest rate than other home loan products.

Disadvantages:

- As with a line of credit, there is potential to reduce the equity you have built up in your home.

100% Offset and All-in-one Loans

100 per cent offset accounts are a separate savings account attached to your home loan. The interest rate on the offset account is the same as on the loan. Any money you put in the offset account is deducted from your loan balance before interest is calculated.

Advantages:

- It operates like a transaction account and typically has a cheque facility and a cash card.
- The interest savings on 100 per cent offset accounts/All-in-one loans are higher than what you would get on other savings and transaction accounts.
- Any extra money in your transaction account saves you interest on your loan, thus shortening the term of your loan.

Disadvantages:

- You may have to pay a slightly higher interest rate or monthly fee to have a 100 per cent offset account.
- You may have to have a minimum balance, such as $2,000 in the offset account for the offset effect to be calculated.