Your Mortgage Your Options

A home owners guide to refinancing a home loan

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Introduction

There's no question the current mortgage environment is one of the most competitive in our nation's history.

Refinancing provides Australians with a platform to get a better deal on their current mortgage, many of which may have been locked in some years ago at interest rates well above what's on offer in today's competitive market. That's potentially thousands of extra dollars in a borrower's pocket.

Yet refinancing isn't solely about finding the cheapest interest rate. With a plethora of new mortgage products and features now available, borrowers can be better off in a variety of ways through the flexibility these offer.

Revisiting your mortgage can also be the precursor to freeing up capital to purchase another property - perhaps the first step into the potentially lucrative field of property investment.

Whatever your situation, a simple visit to your lender or mortgage broker to reexamine your mortgage could put you years closer to achieving your financial goals and dreams.

I hope you enjoy your home owners guide to refinancing a home loan and use it to make smarter financing decisions.

Sincerely,

Phillip Tarrant

Editor

Making the most of your mortgage

As you move through the various stages of life, your priorities and goals will change. The same applies to your financial plan and mortgage options.

Change is a part of life. So it should come as no surprise that if over the years your personal circumstances change, over time so too will your financial needs.

As a result, the mortgage you have now may no longer be the best option for you. So, is it time to take a look at refinancing?

Refinancing is the process of changing from one home loan to another. It is often a fast and flexible strategy to ensure your loan fits your financial plan and goals as effectively as possible.

It is a good idea to check with your existing lender before deciding to refinance, as there may be significant break costs depending on the type of loan you have with the lender.

Gone are the days of mortgages being viewed as a kind of shackle. On the contrary, your home loan is a powerful tool which can be used to your advantage to improve your financial future dramatically, as well as your lifestyle.

Here are several ways that refinancing can help you improve your financial position:

- **Making more of what you already have** – Maybe you'd like to purchase an investment property but don't want to spend years saving for the required deposit. Refinancing can help you unlock the equity in your home, giving you the funds to act now. You can also refinance to unlock equity to renovate and add value to your home – a new kitchen, garage or the addition of new storey, for example.
- **A better fit** – There is a range of product features and options which can make your home loan work better for your individual circumstances. Refinancing can often result in improved flexibility and superior home loan arrangements.
- **Interest rates matter** – There are now many opportunities for those looking to secure a better interest rate, and refinancing your mortgage may prove to be a very effective cost-saving strategy. You could save thousands of dollars' worth of interest.
- **Managing your debt effectively** – If you have several sources of debt mounting up – such as store and credit cards – refinancing them into your mortgage can make managing your debt easier as well as potentially save you thousands in interest repayments.

Establishing which home loan is suitable for you can be quick and relatively stress free. Once you've determined your financial goals, we can work with you to identify the most appropriate product to meet your needs as well as help you through the application process.

Should you consider refinancing?

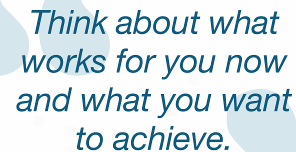
Ask yourself the following questions:

- [ ] **Am I happy with my current interest rate?**
Refinancing allows you to reassess your current mortgage and find out whether there is a product better suited to your needs.

- [ ] **Do I want to purchase an investment property or upgrade an existing one?**
Refinancing can help you unlock the equity in your home, giving you the funds to act now.

- [ ] **Am I struggling with mounting debt?**
Refinancing all your debt and placing it under your mortgage is a fantastic way to centralise your financial outgoings. It could save you thousands.

- [ ] **Do I want a better lifestyle?**
Refinancing doesn't just have to relate to property. You may be able to unlock equity to fund school fees, an overseas holiday, renovations and more.



Refinancing to invest

Some reshuffling of your home loan arrangements may help you realise your property investment dreams.

If the great Australian dream is to own your own home then perhaps the second greatest Australian dream is to invest in property.

Real estate is without a doubt an Australian passion – and rightly so. Over the years, bricks and mortar has proven to be one of the most solid investments you can make. While stocks and shares can waver with the local and global economies, the Australian housing market has largely endured even the most tumultuous economic periods.

When it comes to investing in residential property, what tends to separate those Australians who invest from those who don't is usually quite simple – knowledge and attitude. In other words, understanding how to invest and becoming confident enough to do so are usually the only things that prevent many Australians from becoming investors.

What many home owners simply fail to realise is that they do not need to pay their house off before they purchase an investment property. Moreover, they may not need to save up a deposit for a subsequent property purchase.

If you're an existing home owner – even one with an existing mortgage – you may be able to give your buying power a boost simply through refinancing.

The process of refinancing to invest is simply tapping into equity you have built up in your home to finance another purchase. In other words, you may be able to access some of the value accumulated in your home to purchase another. That accumulated value could be used as a deposit with an additional investment loan used to secure the remainder of the purchase.

For example, if your home is currently worth $400,000 and you have $150,000 owing on your home loan, your accumulated equity may be up to $250,000. It is this equity that you may be able to tap into to finance your next purchase.

It is worth noting that future rental returns from an investment property are often included when a lender is considering your eligibility for and ability to service a new loan, affecting how much you might be able to borrow. As long as you can meet any shortfall between your rental income and loan obligations you'll be in a strong position to secure financing for an investment purchase.

The advantages of refinancing to invest are clear. First of all, you can purchase another property much sooner than if you were to wait for your first property to be paid off.

Second, investing via refinancing enables you to leverage off your existing asset to purchase another asset of far greater value than you could simply by saving your dollars.

REFINANCE

Refinancing to invest: A case study

Sally and John purchased their first home together in 2003 for $360,000. It is now worth up to $500,000, with an outstanding mortgage balance of just $120,000.

The equity they have accumulated in the property may amount to $380,000.

Sally and John decide they would like to purchase an investment property. They speak to their lender who tells them that they can refinance their home loan, using a portion of that $380,000 as a deposit for a second purchase.

The couple find a one bedroom unit they believe offers a good investment return. With a price tag of just $320,000, they are also comfortable that the purchase won't be too large a financial obligation.

With their lender offering loans of up to 80 per cent LVR, Sally and John need a deposit of $64,000 which they can easily access from their available equity.

With the purchase of their investment property Sally and John now have one new home loan, at a total of $184,000 (the original $120,000 mortgage plus the $64,000 they borrowed against it).

This case study is an example only, so you should consider your own circumstances to see if refinancing for investment would suit your situation.

Creating a better finance structure

Refinancing to achieve a more efficiently structured loan can pave the way to a better financial position, both for now and in the future.

Whether you're in search of a better interest rate, looking to save money or struggling under the weight of mounting debt, refinancing can be a very powerful strategy.

The good news is there are now more borrowing options than before to improve your financial arrangements. Switching from one mortgage product to another is now easier than ever – and certainly involves a lot less stress.

So how can refinancing boost your financial position?

Secure a better deal

If you think you might not be getting the most competitive interest rate or perhaps you feel you're missing out on valuable home loan features and options, refinancing can be a great move.

Over the years, many aspects of your life will change and some will impact your financial situation.

As a consequence, the mortgage you signed up to at the beginning of your financial journey may no longer be the most suitable product for you.

If you have had the same mortgage for several years now, chances are your home loan arrangements are no longer the best arrangements for your specific needs.

Tying up loose ends

That old mantra, 'put it on credit', has become almost second nature for many Australians. And while there is definitely an array of benefits associated with credit cards, there are many downsides, mainly that most of us tend to spend first and think later.

As a result, an increasing number of borrowers are turning to their mortgage to help get their debt under control.

Refinancing your accumulated debt into one central location, such as your home loan, can be an effective strategy to help you gain greater control of your finances and get your debt repayment back on track.

'Debt consolidation', as it is called, is a process whereby all outstanding credit card payments, store credit and personal loans are rolled into your mortgage. This means you only have to manage one loan, rather than a plethora of bills, creating a simpler and more effective debt management system.

Moreover, this strategy can also save you considerable amounts of money as a mortgage traditionally has had a much lower interest rate than the rate tied to a credit card.

Is it time to review your mortgage?

Have you recently changed jobs? Have your income levels changed? Has your relationship status stayed the same or has your family grown? Has it been a few years since you've reviewed your home loan?

If you have answered yes to any of these questions, chances are it is time to review your mortgage.

When your circumstances change, or the market changes, it is certainly time to take a closer look at your home loan.

Whether you find a cheaper interest rate, secure a special offer or adjust your mortgage to suit new investment plans, having a mortgage health check regularly is a sure fire way to keep more money in your back pocket – and achieve your ultimate financial goals.

Goal setting and key considerations

You would plan for a wedding or a holiday, and it makes just as much sense to plan your home loan commitments.

When it comes to making changes to your home loan arrangements it pays to think about the bigger picture.

The better prepared you are, both for the short and the longer term, the better placed you will be to select the most suitable home loan.

Before you refinance, be sure to take the time to consider your options and what you want to achieve with the loan.

What are your life goals?

Before you get down to the financial nitty gritty, you've got to think about your long-term personal goals. The steps you take now will likely affect how quickly and easily you realise those goals, so it pays to do a bit of forward thinking.

If you can see children on the horizon, or perhaps retirement – at 45, with $10 million worth of property? – or you have other major goals and aspirations, these all need to be considered when refinancing your mortgage.

What are your financial goals?

Once you've thought about the bigger picture, ask yourself how refinancing your mortgage will help you achieve your slightly more immediate financial goals.

Are you looking to purchase an investment property or renovate your existing home? Are you seeking cash flow or capital growth? Or are you simply looking to make ends meet and better manage your mounting debt?

Each situation could require a different type of loan and different features, so you need to do your research to ensure you end up with the right one.

If you are looking to grow a portfolio or renovate your existing property, tapping into the equity built up in your current home could give you the necessary deposit.

If you are feeling the pressures of mounting debt, then refinancing may be your best option.

Consolidating debt and placing it under one mortgage product is a tested and effective strategy that has already helped many Australians better manage their finances.

Remember, your personal circumstances will change many times during the life of your home loan. Financial freedom begins with planning, so avoid the headache and take some time to consider your future before making decisions.

How much more can you afford to borrow?

Before refinancing, you should ask yourself how much additional debt you can – or *should* – take on.

Refinance needn't be a hassle, so long as you are aware of some basic lender assessment protocols, similar to when you initially purchased your home with your current lender. Also it's important to consider any applicable break costs with your current lender, if you decide to exit from your current home loan.

When refinancing, a lender will need to re-assess your capacity to service the loan. This means determining whether you have a safe and secure income stream that will be adequate for the mortgage repayments. The lenders requirements for refinancing are similar to when you initially purchased your property. Amongst other things, you will still need to ensure you have stable employment.

Any assets you already own, such as property, will be taken into consideration and assessed by the lender when you refinance your loan. If you are planning on borrowing more than your existing loan amount. The type, value and location of any properties you own will also be considered. For example, it may be harder to secure additional finance using the equity you have in a tiny studio apartment than if you own a four bedroom home in a blue chip location.

Your credit history will also play a major role in determining the amount the new lender will allow you to borrow. Any missed bill payments or mounting debt will certainly work against you, so be sure to keep up to date with all credit card, phone bill or other loan repayments.

How much should I borrow?

You need to consider your proposed home loan amount very carefully.

Keeping in mind changes to your lifestyle and your income compared to your financial expenditure and any future financial commitments that you may be considering.

The lender will re-assess your expenditure when considering refinancing your current loan amount and any additional funds you may wish to borrow. This includes taking into consideration any financial commitments you already have, such as car loans, credit card debt or personal loans, as well as day to day living expenses.

Don't forget to include all regular costs such as school fees, club memberships – and your monthly discretionary spending. Ask yourself: 'How much can I afford to borrow?'

While you may be living comfortably now, expect the unexpected and factor in any future events or mishaps that could occur.

Also remember to imagine your lifestyle with any new commitments in mind to ensure you'll be comfortable meeting your new loan requirements.

Not over committing yourself makes for a more comfortable and stress-free mortgage.

> *Consider what future lifestyle or financial changes could impact on your ability to meet repayments.*

The right finance for you

When it comes to refinancing, it's important you select your new home loan carefully.

Whatever your reasons for refinancing, it's a significant step to take and it's important to weigh up your options carefully. It is also a good idea to check with your current lender if there are any significant break costs that apply if you decide to refinance. Only by doing this will you ensure the result is an arrangement that fits your financial circumstances and commitments, as well as supporting your longer term goals.

Home loans have evolved dramatically over the past couple of decades and there a myriad of features and options available, all worth due consideration. A little time spent contemplating exactly what you need from your home loan – as well as what you don't – will be time spent wisely.

Just which loan types and features are right for you will depend on your individual goals and needs.

Some of the key options and features you'll need to consider include:

The interest rate

The interest rate for your home loan will have the most far-reaching impact on your pocket so it's important to seek out a competitive deal. However, you should always keep in mind that the interest rate is only a part of the picture. You'll need to balance a loan product's interest rate against the overall product offering.

Interest only versus principal and interest repayment options – An interest only loan is a popular option among investors for a range of reasons – with the most obvious being lower repayments. Lower repayments, generally means more cash flow for other projects and commitments, or simply less of a burden in terms of investment obligations. However making principal and interest repayment will ensure you're actually paying down the amount of your home loan. But both options have their own merits and your choice will depend on your purchasing and overall financial strategy.

Fixed versus variable interest rates – Whether to select a fixed or a variable interest rate loan is a major decision for any home buyer or investor. With choosing a fixed interest rate for a term of your loan, you'll need to be mindful of any significant break costs that may apply, should you wish to make changes to your loan within the fixed rate term.

Historically, data shows that Australian home buyers have typically preferred to chance their luck with a variable rate, although a fixed rate is a popular choice for investors who need certainty with their outgoings, or home buyers who prefer security of a fixed rate over the unknown fluctuations that come with a variable rate option.

There is also the option of a combo loan, in which you can choose to have a portion of the loan amount on a fixed rate and the other portion on a variable rate.

You will need to make a personal decision about which one you feel is most suitable for you, but remember if you do opt for a fixed rate you will have to stick with it, even if rates fall. Conversely, if you go for a variable rate and rates increase, you'll have to stump up larger repayments.

Payment flexibility

Being able to make extra repayments towards your mortgage can really help to drive the balance of your mortgage down even quicker, especially early on. Bear in mind that not all home loans will allow 'ad hoc' payments, particularly fixed interest loans, so it is a feature worth asking about. Fixed rate loans may also have a limit on any additional repayments you may wish to make during the fixed rate term.

Offset accounts and lines of credit – These can be a great feature for investors looking to fund further investments or renovations. A line of credit is a variable rate loan facility secured by your mortgage with a credit limit usually much higher than that of a credit card and a much lower interest rate. Similarly, an offset account is a standalone transaction account linked to your home loan. It can be very effective in reducing loan interest and keeping funds separate for tax purposes. The savings balance is deducted from the loan balance so you only pay interest on the amount of the remainder.

Counting the cost of refinancing

While frequently the main goal of refinancing is to save you money, it could actually end up costing you money if you don't do your homework first.

On 1 July 2011 the government banned exit fees for new homes loans. This gave Australian investors the freedom to move from one mortgage product to another, possibly to secure a better interest rate. It certainly sounds appealing.

However, it's important to remember that switching home loans is not guaranteed to come entirely cost-free. If you are on a fixed rate loan and decide to exit your loan before the expiry of the fixed rate term, you may be liable for break costs.

The cost of an early exit

In theory, the removal of exit fees should make it easier to refinance with a new lender but it's important to remember the ban on exit fees only applies to loans taken out after 1 July 2011. It also doesn't apply to break costs that a lender is entitled to charge borrowers should they break a fixed rate term on their loan.

Nonetheless, many lenders are offering incentives for borrowers to switch and these include offering to cover some or all of the costs of changing home loan provider.

Depending on the lenders involved, exit fees may or may not be a cost you'll need to consider.

It all adds up

In addition to any exit fees, if you decide to change home loan providers you will also need to consider the costs that come with setting up a new home loan. That means any administrative charges, such as a home loan establishment fee, break costs, as well as any legal costs.

If you are refinancing your mortgage with a new lender for a loan amount that is more than 80 per cent of the value of your property, you will generally also be required to pay lenders' mortgage insurance (LMI) – even if you already paid it with your original lender.

LMI is not transferable so this can be a considerable cost to bear.

Different lenders have different policies regarding how much they are willing to lend before you need to pay LMI so you will need to check this carefully.

If you are refinancing with a view to purchasing an investment property using some of the equity built up in your current home, you'll need to revalue your property to determine just how much equity you can access. A valuation can cost up to $500.

Certainly, refinancing for a better home loan could save you a significant amount, but you'll need to carefully weigh up the costs and benefits before switching your current home loan to another loan product or another lender.

> *"Costs such as exit fees, insurance or a property valuation may be applicable depending on your circumstances."*

An alternative to the banks

Mortgage managers are an increasingly popular provider of home loans for both home buyers and investors.

If your local branch of a big bank was once pretty much the only place to go for a home loan, that is certainly no longer the case.

There is a wide variety of institutions that offer borrowing options to Australians, from credit unions and building societies to 'non-bank' lenders, such as mortgage managers.

Mortgage managers have become a key source of financing for Australian investors and other borrowers.

A form of non-bank lender, mortgage managers provide a similar service in that they offer home buyers and investors access to finance to fund their property purchases.

The difference is that rather than sourcing their funds from customers' deposits – mortgage managers do not take deposits – they source funding from a range of other places, predominately from local and international capital markets, as well as the banks themselves.

Originally, non-bank lenders sought to compete with the major banks on price, offering Australian borrowers significantly cheaper options than the big four. But they have also been a big driver of innovation, pushing out products that have enabled borrowers to borrow more or have greater flexibility.

No longer is a mortgage always viewed as a shackle; rather, it can be a powerful financial tool and mortgage managers are the ones that have helped to drive this evolution within the lending industry.

Traditionally, mortgage managers have also catered to those who have often been shunned by the major banks, such as the self-employed and credit impaired. They also continue to cater to less mainstream borrowers, with many innovative products designed for first home buyers as well.

Why choose a mortgage manager?

If you're looking to refinance your home loan, a mortgage manager is well worth considering alongside the banks.

Aside from their innovative product offerings, mortgage managers are especially known for their customer service.

Because they are typically much smaller than banks, they tend to be able to offer a more personalised service. Approval turnaround times can be much quicker than those of the banks, and you can often speak to the loan processing team with ease – rather than having to plough your way through a succession of customer service reps.

Of course, as with any financial decision you need to make, you should ensure you choose a mortgage manager carefully as some are better than others.

Do your homework, ask as many questions as you want to and go with your gut instinct. Your home loan is a major financial commitment and you want to deal with someone you feel comfortable with.

Why it can pay to stay

Changing your home loan arrangements needn't necessarily mean changing your lender – if you talk to them first.

Switching lenders can be a costly exercise and, unfortunately, you do not always end up making the savings you hoped you would.

When you consider the cost of having your property valued, and perhaps of taking out new lender's mortgage insurance, it can pay to stay put.

A borrower may find they may not even need to switch lenders or loans if they simply speak with their current provider first.

There are literally hundreds of loan products now available to Australian borrowers, and chances are the loan you originally signed up for is no longer the one best suited to you.

However, your current lender may also have a range of products, features and prices they can offer you, rather than lose you to another lender, which may well meet your needs.

If you have been with your lender for several years, it's highly likely that you have become a valuable customer and one they would prefer to keep. This may translate into bargaining power which you can use to achieve a discount or other concession.

You may not necessarily be able to obtain a lower interest rate without refinancing, but your mortgage broker can assist you by reviewing your current loan and perhaps organising a more suitable payment plan.

For example, moving from monthly to fortnightly repayments could save you thousands over the long term.

By identifying your concerns and goals, there's a good chance you can work with your existing lender to find the outcome that is right for you.

Refinancing - what to expect

Whatever your reasons for refinancing, remaining on top of the loan application process is the best way to ensure a successful outcome.

Whether you're looking to secure a more affordable mortgage, rein in mounting debt or boost your property portfolio, refinancing can help.

But you'll also find that being aware of what the loan application process involves and what you need to do to prepare for it will pay off.

Keeping check

Before seeking out a lender, it is wise to assess your financial situation and outline your goals and reasons for refinancing.

A lender will need to determine whether you have a safe and secure income stream, to ensure you can service the loan.

Be sure to check your credit history as any missed bill payments or mounting debt will be noted and could result in your application being declined.

Valuing your assets, including property and cars, is a smart move as the more collateral you can put in front of your lender the more influence you can have over the amount you will be eligible to borrow.

Applying for a loan

When you apply for your loan, the lender will require, amongst other documents, proof of income and identification, often supplied in the form of a recent pay slip and a driver's licence.

Your income level will largely determine your ability to repay a loan and therefore how much you are eligible to borrow.

If you are refinancing to purchase an investment property, you will need to provide evidence of a rental income.

Consider the amount you are looking to borrow and the value of the property you are looking to purchase, as this will determine whether or not you will need to pay for lenders' mortgage insurance (LMI).

Generally, the lender will require you to pay LMI if you're applying for an amount above 80 per cent of the value of the property.

After you submit all your requested documents, they will be checked, verified and accepted by the lender (based on their credit criteria). Once your loan is approved, the loan contract should be ready to sign.

Approval and settlement

There is very little you can do during the actual process of approval; however, with settlement quickly approaching now is not the time to sit on your hands.

Seek out a trusted legal representative to help you read through all loan documents and explain the detail to you, prior to signing any paperwork.

Whether you use a solicitor is up to you, but it is important to have some form of legal representation and to take legal advice before you sign any financial documents. After all, for most people, a mortgage will be the largest loan they take out during their lifetime.

You've given it some thought, so is it now time your home loan had an update?

Throughout this guide we have outlined the many reasons for revisiting your mortgage arrangements, features and rates.

Keeping regular tabs on a home loan is essential because life does not stay the same and so you need to ensure you reassess your arrangements regularly. That means every two to three years.

If that means you're due for a mortgage 'health check', be sure to examine your personal and financial circumstances carefully before making any significant changes.

Being certain of your financial objectives will put you in the best position to choose the right home loan and get you towards your ultimate goal sooner rather than later.

So why refinance? Let's recap:

- **To secure a better interest rate:** Mortgage rates shift constantly and lenders are always looking to outdo each other by offering discounted products to secure your business. If it has been a while since you reviewed your current interest rate or your lifestyle has changed, chances are there is a mortgage product better suited to your current financial needs than the one you currently have.
- **To build wealth:** Since you first purchased your property, it is highly likely that the value will have increased. This will allow you to unlock the equity or added value in your home and use this additional cash to boost your property portfolio or renovate your existing property sooner.
- **To get on top of debt:** If you are feeling the burden of mounting debt and want to gain greater control of your finances, then refinancing can be an effective strategy. By placing all accumulated debt in one location – your mortgage – you will be in a position to pay down the principal more effectively.

Swapping ships

Borrowers may view refinancing as a wealth generating strategy, however there are some associated costs with switching from one lender to another, which you need to be aware of.

Certainly, you'll need to consider the loan package overall. And even if exit fees for new packages no longer exist, a major consideration is if there any break costs associated with your existing loan. Break costs can be substantial and you should check with your lender if they apply to your loan. In addition, any establishment fees and other front-end fees will also need to be accounted for.

Examples of other costs often overlooked that can still be considerable include: a new property valuation, stamp duty and potentially lender's mortgage insurance.

Weighing up these costs is vital to establishing whether or not changing lenders is right for you and right for your wealth creation strategy.

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