Home loans

Factsheet October 2014

Buying your own home is one of the biggest financial decisions you'll ever make.

So take the time to consider your options, shop around for the best deal and find the right loan for your needs and circumstances.

How do home loans work?

This is how a typical home loan (or mortgage) works:

- **Save a deposit:** The more you save, the lower the amount you need to borrow and the less you will pay in interest over the life of the loan.
- **Apply for a loan and get it approved:** The lender approves the loan in principle, enabling you to look for a property within a set budget.

  Once you've decided on the loan amount, you'll need to finalise the loan documents with your lender.
- **Offer the property as security:** This means you pay a lower interest rate than for other loans. But, if you fall seriously behind on your repayments, the lender has the right to sell your home to get its money back.

Case study: Jie and Ming save $100,000 on their home loan

Jie and Ming saved up a deposit of around $70,000 to buy a two-bedroom apartment. They used a mortgage calculator to work out what the monthly repayments would be. They decided they could afford to borrow $380,000 over 25 years.

They first considered a loan with a variable interest rate of 6.5% but, after comparing online, they found a loan with the features they wanted at a rate of 6%. This could save them around $35,000 over the life of the loan.

Jie and Ming also realised that, by making slightly higher repayments fortnightly (calculated by dividing the monthly payment by 2), they would end up making an extra monthly payment each year. This means they could pay off the loan 4 years early and save about $65,000 in interest.

These two simple steps could save them up to $100,000 over the life of the loan.

Home loan checklist

- ☐ **Do a budget:** Use MoneySmart's **budget planner** or download our free booklet **Managing your money**. You can also call ASIC's Infoline on 1300 300 630 to order a free copy.
- ☐ **Work out what you can afford:** Only borrow what you actually need and can afford. Use our **mortgage calculator** to work out your repayments.
- ☐ **Get a key facts sheet:** Ask the lender for a **key facts sheet** for each loan you are considering, and compare interest rates and fees.
- ☐ **Choose your features:** Typically, the interest rate on a 'no-frills' loan will be lower than on one that offers more features. So make sure you're not paying extra for things you don't need.
- ☐ **Know who you're dealing with:** Lenders and brokers must be licensed with ASIC (or be an authorised representative of someone licensed). To check this, search ASIC Connect's **Professional Registers** or call ASIC's Infoline on 1300 300 630.
- ☐ **Read before you sign:** Read the terms and conditions in the **loan contract** before you sign anything. Ask questions if there's something you're not sure about. Never sign blank forms or leave details for the lender or broker to fill in.

Work out how much you can afford to borrow

- **How much do you need for a deposit?**
  As a rough guide, aim to save 20% of the purchase price, plus enough to cover costs. If you borrow more than 80% of the purchase price, you may have to pay lenders' mortgage insurance (LMI). This is an insurance that protects the credit provider from the borrower(s) not being able to repay the loan.
- **How much can you afford to repay?**
  Taking out a loan will mean you have less money for other things. Use MoneySmart's **budget planner** to understand where your money goes. And use our **mortgage calculator** to work out how much you can afford in repayments.
- **Can you afford all the costs?**
  Include up-front costs like stamp duty and legal fees; and ongoing costs like loan repayments, land and water rates, house and contents insurance, and repairs.
- **Are you a first-time home buyer?**
  You may be eligible for a one-off payment through the Australian Government's First Home Owner Grant scheme (see **firsthome.gov.au**).

Ask your lender for a key facts sheet

From 1 January 2012, all lenders offering standard home loans must give you a key facts sheet when you ask them. So make sure you get one for each home loan you are considering.

Key facts sheets use a set format so you can compare loans and understand what they will cost in fees and interest.

Look for important information such as:

- Loan amount and term (make these the same on each, for easy comparison)
- Type of interest rate
- Personalised comparison rate (interest rate with fees included)
- Repayment method and frequency
- Establishment fees (if any) and ongoing fees
- Total amount to be paid back (loan amount plus fees)
- What happens if interest rates increase?
- How can I repay my home loan faster?

How do interest rates work?

Type	How it works	Advantages	Disadvantages
Variable rate	▶ The rate you're charged goes up and down	▶ Usually able to make extra repayments	▶ Your lender may put the rate up at any time
Fixed rate	▶ Allows you to lock in an interest rate, typically for a period of 1–5 years ▶ May be offered for an introductory or honeymoon period ▶ Reverts to a variable rate at the end of the period	▶ Your interest rate will not go up during the fixed rate period ▶ Know how much your repayments will be during this period	▶ Won't benefit from falling interest rates ▶ May not be able to make extra repayments ▶ May be charged a break fee for terminating the fixed rate period early

What type of home loan is right for you?

Type	How it works	Advantages	Disadvantages
Standard loan (principal and interest)	▶ Make regular payments to cover the **principal** amount borrowed and the **interest** charged ▶ As you pay down your loan, you build up **equity** (the value of your property, less what you owe) ▶ Fixed, variable and partially-fixed rate loans (see below) are all variations on a standard loan	▶ As you pay off the principal, the balance goes down ▶ Can usually repay loan in full at any time ▶ A **redraw** facility may be available at no extra cost, enabling you to pay in more when you can (to reduce your interest) that you may redraw later ▶ May have option of an **offset** account, where the amount in your savings account is offset against your loan balance to reduce interest payable	▶ May be charged a break fee for early pay out or refinancing of a fixed or partially-fixed rate loan ▶ In some cases, a lender may not release your redraw funds when you want them (so check loan conditions)
Split loan (or partially-fixed)	▶ You pay fixed interest for an agreed portion of your loan and a variable rate on the rest	▶ Know what repayments will be on fixed rate portion ▶ Usually able to make extra repayments on variable rate portion ▶ May benefit if rate goes down on variable rate portion	▶ Less flexibility than a fully variable rate loan ▶ May be charged a break fee to pay out or refinance the fixed rate portion

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ASIC Infoline: **1300 300 630**

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