# Home loans

Buying your own home may be one of the biggest financial decisions you'll ever make. While a few fortunate people may already have enough money to buy a home outright, most will find themselves taking out a sizeable **home loan** (or **mortgage**) and making repayments for many years to come. So it's worth taking the time to consider your options and find the right deal.

## How do home loans work?

There are many different types of home loans on the market, but they all have a few features in common:

- There is an **application process**, where you need to show the credit provider that you're a suitable borrower and can afford the loan repayments.
- Your loan is **secured** by your home. That usually means you pay a lower interest rate than for other kinds of lending – but it also means that, if you fall seriously behind on your repayments, your credit provider has the right to sell your home to get their money back.
- You usually have to start with a **deposit**, although some credit providers now offer no or low-deposit loans. However, you should treat these with caution; if you're forced to sell, you might find yourself still owing money on your loan, even after your house has been sold.

## TIP Work out how much you can afford to borrow

Before you take out a home loan, make sure you can afford *all* the costs – including **up-front costs** like stamp duty and legal fees, and **ongoing costs** like loan repayments, rates and insurance.

Be realistic about what you can afford to borrow. Paying the extra expenses involved in taking out a loan will mean you have less money for other things. The clearer you are about the real state of your finances, the better prepared you'll be to ride out any future changes in circumstance. So consider these questions before you apply for a loan:

- **How much do you need for a deposit?** The more you can save for a deposit, the less you will have to borrow and the more you will save on interest payments. Read our online money-saving tips at **www.fido.gov.au/money** or download our free booklet *Your money*. You can also call ASIC's Infoline on 1300 300 630 and we'll send you a copy.
- **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 **www.firsthome.gov.au**) or a First Home Saver Account to help you save for your first home through a combination of government contributions and low taxes (see **www.homesaver.treasury.gov.au**).
- **How much can you afford in repayments?** Use our budget planner at **www.fido.gov.au/credit** to get a realistic picture of where your money goes now. Use our loan calculator to work out what you can afford in repayments. Remember to add in all the extra costs like stamp duty, legal fees, land and water rates, house and contents insurance, and repairs.

## Tony and Alex saved $53,000 on their home loan

Tony and Alex saved up a deposit of around $100,000 to buy a two-bedroom apartment. They used a home loan repayment calculator to work out what they could repay on the loan each month. They decided they could afford to borrow $200,000 with a term of 25 years.

They first considered a loan with an interest rate of 6.5% but, after comparing loans online, they chose a loan offering a lower interest rate of 6.0%. They also realised that, by making repayments fortnightly instead of monthly, they could pay their loan off faster and save on interest.

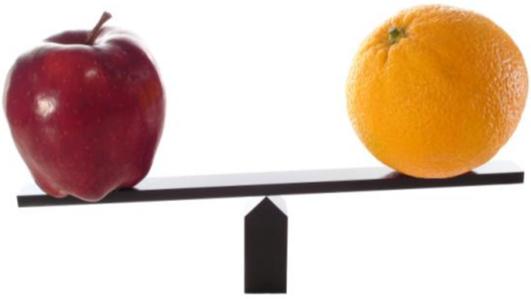
By paying 6.0% rather than 6.5%, they will save $18,000 in interest over the term of the loan (assuming the interest savings remain the same over 25 years). By making fortnightly payments, they will pay the loan off four years earlier than if they make monthly payments, saving a further $35,000 in interest.

**That's a total saving of $53,000.**

# What type of home loan is right for you?

Check out different lending options to find the one best suited to your needs and circumstances. Most credit providers will approve a loan **in principle**, allowing you to look for a house within a specific budget range.

The interest rate is by far the biggest single factor in determining what your home loan costs you and what you have to pay back each month. Even a small difference in the interest rate can make a big difference to what you have to repay over the long term. You can generally choose between **variable**, **fixed** and **introductory interest rates**. **Partially-fixed rates** are also available.



## Using a comparison rate

Because it is difficult to compare home loans with different interest rates and fees, credit providers must state a **comparison rate** on advertised home loans where they also state an interest rate or weekly repayment amount. This is calculated by adding the interest rate to the main fees and charges on the loan. When using a comparison rate, make sure the loans being compared are for the same amount and term.

| Loan option | Interest rate | Fees and charges | Comparison rate |
|---|---|---|---|
| **Home loan A** | 8.00% | 0.5% | 8.50% |
| **Home loan B** | 8.25% | 0.1% | 8.35% |

In this example, home loan A has a lower interest rate than home loan B, but a higher comparison rate, because of its higher level of fees and charges.

| Type of interest rate | What it means | Advantages | Disadvantages |
|---|---|---|---|
| **Variable rate** | The rate you're charged goes up and down in response to changes in the **cash rate** (set by the Reserve Bank of Australia and reviewed every month) and other changes made by your credit provider. | Variable rates usually decrease if the underlying cash rate decreases.<br>There are usually no restrictions on making additional repayments. | Variable rates usually increase if the underlying cash rate is increased.<br>May also increase independently of the cash rate. |
| **Fixed rate** | This allows you to lock in an interest rate, typically for 1–5 years. | Safeguards you against future interest rate rises.<br>Helps you plan your finances because you know exactly how much you will be repaying. | You won't benefit from falling interest rates while your rate is fixed.<br>There may be restrictions on making additional repayments.<br>On a fixed rate mortgage, there may be significant fees for terminating the fixed rate period early, particularly if interest rates have fallen since you fixed your rate. |
| **Introductory rate** | Some credit providers offer low interest rates for an introductory period. Also called **honeymoon rates**. | Low interest rate for 1–2 years. | These rates usually come with other restrictions. In particular, there may be high **early termination fees**. You may be effectively locked in to the loan even though there may be better deals available elsewhere.<br>The interest rate when the introductory period ends may give you nasty surprise – find out what it will be before taking up this option. |
| **Partially-fixed rate** | A partially-fixed rate loan (also known as a **split loan**) enables you to pay fixed interest for an agreed portion of your loan and a variable rate of interest on the remaining balance. | This is a good option if you want the assurance of a fixed rate on part of your loan but also want to take advantage of interest rate drops on the other part of your loan.<br>There are usually no restrictions on making additional repayments on the variable rate portion of your loan. | The fixed rate portion of a loan provides you with certainty about your future repayments during the fixed rate period, but provides less flexibility than a fully variable rate loan.<br>If interest rates fall, you will only get the benefit of lower interest on the variable portion of your loan.<br>You may also have to pay a significant **break fee** if you want to pay out or refinance the fixed rate portion of your loan. |

| Type of loan | How it works | What to watch out for |
|---|---|---|
| **Standard loan (principal and interest)** | Most people take out a **standard home loan**, where you make regular payments to cover the **interest** on the loan as well as the **principal** amount borrowed. This usually takes place over an agreed time, such as 25 years.<br><br>The interest rate on a standard home loan will often be cheaper than a more sophisticated loan that offers additional features.<br><br>Fixed, variable and partially-fixed rate loans are all variations on standard principal and interest loans.<br><br>There will always be penalties for paying out the fixed rate portion of a loan early.<br><br>A **redraw facility** is often available for no extra cost. This allows you to pay in extra that you may redraw later, getting the benefit of reduced interest in the meantime.<br><br>This can make similar savings as a **line of credit** (see page 5) or **offset account** without the higher interest rate or the risk that the loan balance won't reduce.<br><br>With an offset account, your savings are offset against your home loan to reduce the interest you pay. | You can generally repay a standard loan in full at any time, but you may be charged a fee.<br><br>A standard principal and interest loan is the surest way of paying your home loan off because regular repayments mean your loan balance always goes down.<br><br>If you get a redraw facility, be aware that in some cases, a credit provider can change its mind about releasing the redraw funds. Ask what conditions apply to your loan before you select this option.<br><br> |
| **Interest-only option on a standard loan** | With an **interest-only loan**, you only pay off the interest on the loan for a fixed period of time.<br><br>Interest-only loans are an option if you can't initially make higher repayments. | It will take you longer to pay off the loan, because you will still have to pay off the principal after the interest-only stage.<br><br>You will pay more interest overall.<br><br>In a falling house price market, you will face a greater risk that you will end up owing more than your house is worth. The faster you pay down your loan, the more likely it is that you will owe less than your house is worth (this is called having **equity**).<br><br>With an interest-only loan, the balance does not decrease over time until the interest-only period expires and you start paying off the principal as well as interest. |
| **Low-doc loan** | With a **low-doc** (low-documentation) **loan**, you won't need to give your credit provider or mortgage broker as many documents to prove your income, assets and liabilities.<br><br>But there are usually some strings attached, so make sure you know what you're getting into. | Interest rates are usually higher and there may be higher or extra fees.<br><br>These loans are intended for borrowers who cannot provide regular pay slips, such as small business owners. You should not be using a low-doc loan if you are on a regular wage or salary.<br><br>Always check that the credit provider or broker is registered or licensed with ASIC (see step 3 on page 7).<br><br>Make sure you understand the **terms and conditions** of the loan before you sign anything.<br><br>**Never sign blank forms** or leave details for the credit provider or broker to fill in later. |

| Type of loan | How it works | What to watch out for |
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| | | Never give false information as there are criminal penalties for fraud and it is not in your interest to have a loan you cannot afford to repay.<br>New **responsible-lending obligations** apply to low-doc loans, as well as other forms of consumer credit. |
| **Line of credit** | With a **line of credit loan**, you use a single account for your home loan and your everyday spending.<br>The limit on the line of credit loan is fixed and does not reduce as you repay the loan. This means you can always draw up to this limit.<br>You can make everyday purchases directly from the loan. You may also use a credit card with an **interest-free period** that is automatically paid by the line of credit loan.<br>Your wage and other money stay in the loan account and your credit card is paid off each month from this. The money in your account reduces how much you owe on the loan for part of the month and therefore the interest you'll pay. | Unless you are a careful budgeter, you could end up spending more each month than you pay off on your loan and never reduce the loan balance. So instead of saving money, it will cost you more.<br>Be aware that, if you take out this type of loan with someone else, either person can take out money on the loan (up to the credit limit) without the consent of the other person, unless you specify when you set up the account that both signatures are required for withdrawals.<br>In a falling house price market, you face a greater risk that you will end up owing more than your house is worth. The faster you pay off your loan, the more likely it is that you will owe less than your house is worth (this is called having **equity**).<br>With a line of credit loan, you need to be disciplined about reducing your loan balance, because repayments that reduce the balance are usually not required. |
| **Equity release products (such as reverse mortgages)** | If you already own your home, an **equity release product** such as a **reverse mortgage** allows you to borrow cash against the value of your home (subject to eligibility criteria).<br>You (or your estate) usually don't have to repay the loan until you leave and move into care, sell your home or die. This payment is usually made from the proceeds of selling your home.<br>Because you usually do not make any repayments with an equity release product, your debt compounds with time.<br>In addition to lending you the initial loan amount, your credit provider is also lending you the interest you owe. They then charge you further interest on this interest, so your loan balance can grow very quickly.<br>The higher the loan balance, the less **equity** there is left for you in your home to draw on if you need it.<br>For example, if you borrow $50,000 through a reverse mortgage at 7.5% interest per year, in ten years you will owe your credit provider close to $100,000 because of the interest compounding each year. | Make sure you think about how much money you will need to live on, including costs like aged care accommodation and health care. Factor in these costs when you're weighing up how much you can afford to borrow.<br>Don't get talked into borrowing more than you actually need.<br>Look for a product with a **no negative equity guarantee** (NNEG). This means that the loan can never be more than the value of your home, an important protection for you.<br>Get good independent legal and financial advice before you sign anything.<br>Use the reverse mortgage calculator and checklist at **www.fido.gov.au/calculators** to work out how much interest you might end up paying over the life of the loan.<br>If you're thinking about one of these loans, read our free booklet, *Thinking of using the equity in your home?* It's available at **www.fido.gov.au/publications** or call ASIC's Infoline on 1300 300 630 and we'll send you a copy.<br>You can also call the Equity Release/ Reverse Mortgage Information Service on 1800 615 676 for assistance with understanding equity release products. |

## TIP How to save money on your mortgage

- Shop around for the best possible interest rate. It's the underlying rate that counts, not the honeymoon rate. If you're thinking of refinancing, make sure you'll be better off first. Don't get **churned** – that is, don't get talked into changing to another loan that may benefit your broker in terms of fees and/or commission, but may not be a better deal for you. When you are working out if you will be better off with a new loan, remember to take into account the costs of **switching** (see below).
- If you want additional features, look for a **low interest rate loan** that has them. Paying an extra 0.5% interest for a loan with money-saving features will probably end up costing you more than you'll save.
- Make **extra loan payments** whenever you can (subject to your loan's terms and conditions). They'll make the most difference in the first few years of the loan, but can be a good idea at any time.

# Switching home loans

If you already have a home loan, you could save yourself thousands of dollars in interest or take advantage of features offered by another credit provider. But before you decide to leave your current loan, work out how much it will **cost you** to switch. Your current credit provider might charge you fees to exit your current loan, and a new provider might charge you fees to start a loan.

Work out whether reducing your interest rate with a new loan outweighs the costs of switching from your existing one. The lower the **exit** and **start-up fees**, the more you stand to gain by switching. If the fees are high it may not be worth switching or may be better to wait and switch later.

Read more about switching home loans at **www.fido.gov.au/switching**.

# Six steps to smarter borrowing

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| **Step 1.** | Work out if you can afford to borrow | ■ Before you take out a home loan, use FIDO's **budget planner** at **www.fido.gov.au/credit** to see exactly where you spend your money and how much you can afford in repayments.<br>■ Allow for interest rate rises and anything that might affect your future income (such as changing jobs). |
| **Step 2.** | Shop around for the best deal | ■ Take the time to compare interest rates, product features, and fees and charges. Even a small difference in the interest rate can make a big difference to your payments over time.<br>■ **Compare products** using our multi-loan calculator at **www.fido.gov.au/calculators** or by using online comparison services, such as:<br>• **www.canstar.com.au** • **www.mozo.com.au**<br>• **www.infochoice.com.au** • **www.ratecity.com.au**<br>■ Research published by the independent consumer group CHOICE can also help you find the right product for your particular needs and budget – see **www.choice.com.au**.<br>■ Check for **hidden charges** like deferred-establishment fees or early-exit fees that may make the loan more expensive than it seems. Exit fees aren't factored into comparison rates and can be very high – especially in the early years of a fixed rate loan. |

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| | ■ Make sure you understand the circumstances in which such fees will be applied. Remember, your circumstances may change for reasons beyond your control and you may need to refinance or sell your house in the first few years of the loan. |
| **Step 3.** Know who and what you're dealing with | ■ From 1 July 2010 anyone who wants to engage in credit activities (including brokers) must be **registered or licensed** with ASIC or be a representative of someone who is registered or licensed (that is, they must either have their own licence or come under the umbrella of another licensee as an authorised credit representative or employee). It they aren't they are operating illegally, so make sure you only deal with someone who is registered or licensed.<br>■ There is currently an exemption from registration and licensing for credit assistance provided through some businesses (for example, retail stores and car yards). While the store may be exempt, the actual credit provider must still be licensed or registered. If you are unsure who the credit provider is, ask the salesperson or broker to point out the name in your credit contract.<br>■ To find out if a credit provider or broker is registered or licensed, visit **www.fido.gov.au/credit** or call ASIC's Infoline on 1300 300 630.<br>■ From 1 January 2011 anyone engaging in credit activities must give you a **credit guide** (with information including their licence number, fees and details of your right to complain) before they provide you with any credit assistance.<br>■ Don't let a pushy salesperson pressure you into making a quick decision.<br>■ If you use a **broker**, do your homework beforehand. Ask them exactly what loans they offer and make sure you're comfortable with any fee or commission to be paid. For tips on what questions to ask, see our factsheet *Using a broker* at **www.fido.gov.au/credit** or call ASIC's Infoline on 1300 300 630 and we'll send you a copy.<br>■ Always check the **terms and conditions** of any loan contract before you go ahead. Ask the credit provider for clarification if there's anything you're not sure about. Consider getting independent legal or financial advice before signing. See our tips for understanding credit contracts at **www.fido.gov.au/credit**. |
| **Step 4.** Keep up with your repayments | ■ Make sure you keep your repayments up-to-date to avoid incurring **penalty fees**.<br>■ If your circumstances change, and you find that your current loan is not meeting your needs, go to **www.fido.gov.au/switching** to work out whether you may be better off changing to another loan. |
| **Step 5.** Get help if you can't pay your debts | ■ **Act quickly** if you're having trouble making repayments. Even though it may be difficult to face the problem, ignoring it will only make things worse.<br>■ If you can't make the full repayment, pay what you can. Contact your loan provider without delay.<br>■ If you are experiencing financial difficulties, you have the right to apply to the credit provider for a **hardship variation**. If the credit provider refuses a variation, you may apply to its independent dispute resolution scheme for a variation on the grounds of hardship (see contact details for the Financial Ombudsman Service and the Credit Ombudsman Service Ltd below).<br>■ There are places you can go for help – visit **www.fido.gov.au/credit** for sample letters and information about support services such as financial counselling and legal assistance, or call ASIC's Infoline on 1300 300 630.<br>■ See our factsheet *Can't pay your debts?* at **www.fido.gov.au/credit**. |
| **Step 6.** Complain if things go wrong | ■ Try to resolve your problem with your credit provider first.<br>■ If you aren't satisfied, take your complaint to your provider's **independent dispute resolution scheme**. This will be either the Financial Ombudsman Service (FOS) at **www.fos.org.au** or the Credit Ombudsman Service Ltd (COSL) at **www.creditombudsman.com.au**. Both schemes can be reached by calling 1300 780 808. |

- If you think that a credit provider has acted unlawfully or in a misleading way, you can complain to ASIC online at **www.asic.gov.au/complain** or call ASIC's Infoline on 1300 300 630.

## Find out more at **www.fido.gov.au/credit**

Find out more about credit, debt and borrowing at FIDO, ASIC's website for consumers and investors. Download our free booklet, *Credit, loans and debt: Stay out of trouble when you borrow money.*

Other factsheets and booklets can also be downloaded from **www.fido.gov.au/publications**.

Or call ASIC's Infoline on **1300 300 630** and we'll send you a copy.