AUSTRALIAN MORTGAGE PRODUCT REPORT NOV 2004 - BORROWER'S GUIDE

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INTRODUCTION

Huge variations between lenders on interest rates, together with wildly different approaches to fee charging, means Australian home loan borrowers can literally save thousands of dollars a year with the right choice of home loan, an in-depth study of the home loan market by Infochoice shows.

"Borrowers who don't do their loan homework, or don't make sure their broker is doing it for them properly, stand to lose a fortune over the life of their loan," said Denis Orrock, general manager of Infochoice.

The Australian Mortgage Product Report for 2004 analyses more than 550 home loans offered by 90 lenders around the country on the basis of:

Interest Rates
Fees & Charges
Product Features

In particular, we look at different groups of lenders in the market:

Big Banks
Tier-2 Banks
Large Non-Banks
Other Non-Banks
Credit Unions and Building Societies

There are big rate and fee discrepancies across all lenders, but borrowers should take note of particular issues with each type of loan:

Standard Variable Rate
Basic Variable Rate
6-Month Introductory Rate
12-Month Introductory Rate
Fixed Rate

Interest Rates

Standard Variable Rates

Borrowers looking for a standard variable rate should compare not just a range of lenders, but a range of lender types.

The two specialist mortgage groups have the lowest average interest rates with Large Non-Banks at 6.76 per cent and Other Non-Banks at 6.74 per cent. This compares with the predominant rate of the Big Banks (7.07 per cent). Credit Unions & Building Societies average 6.88 per cent and Tier-2 Banks 6.97 per cent.

There is a 33 basis-points (0.31%) difference in interest rate on average between Other Non-Banks and Big Banks which amounts to $660 dollars a year in interest on the average $200,000 loan.

Borrowers should not be satisfied, however, with a non-bank lender comparing its products only with those of the Big Banks. Good value can also be found among the other banks and the credit unions.

The value of professional or relationship rate discounts offered by the Big Banks and some credit unions should also be considered. But the value of any discounts should be weighed up against the overall product offering on rates, fees and features.

Basic "No Frills" Rates

Basic no frills loans with low interest rates can turn out more expensive than standard loans.

The cheapest home loan is not always the one with the lowest rate, it's the one that can be paid off the soonest. There are still 7 per cent of basic loans that don't allow do not allow extra repayments to be made during the course of the loan. Of the 93 per cent that do, often the extent of extra repayments is restricted.

A Basic Variable Rate loan for $200,000 at 6.5% over 25 years that does not allow extra repayments will attract $205,100 interest over that time. A standard variable rate loan at 7 per cent where the borrower repays an extra $23 a week or $100 a month above the minimum monthly repayment sees a borrower pay just $193,000 interest all up and cut almost four years off the loan.

Borrowers should understand that some lenders heavily promote a basic low-rate "no frills" loan with little intention of supplying it. Such loans are used to get prospective borrowers through the door for the purposes of up-selling them to higher rate loans with more flexibility and features. Most borrowers would find the flexible loan more suitable anyway but to ensure they are truly getting the best deal it should be compared with similar loans on offer from other lenders.

Introductory "Honeymoon" Rates

The lower the honeymoon rate, the more expensive the loan in the long run.

The analysis shows that often the lower the headline interest rate is on a honeymoon rate loan, the higher the long term cost after the loan has reverted to a higher rate at the end of the honeymoon period.

Likewise, the best value honeymoon rate loans are often those with the highest honeymoon rate.
Illustration: Home Building Society has one of the highest headline intro rates at 6.10 per cent yet the lowest effective rate over time at 6.61 per cent. For some lenders the opposite is true – low intro rate, high effective rate.

This underlines that of all products in the market, it is introductory honeymoon rate loans that borrowers must be especially wary of. By all means take advantage of them but only after assessing and comparing their real costs over time.

Comparison Rates are especially effective in ensuring transparency and the true cost of introductory rate loans. Borrowers should demand lenders or brokers to provide the relevant comparison rate for their loan amount and loan term and a comparison across the market.

Fixed Rates

The banks still lead overall on fixed rates but there are few non-bank lenders competing hard and undercutting them.

Given the wide variation of fixed rates on offer for any given term, looking for the best rate can mean the difference between locking in below the average standard variable rate or substantially above it.

In the three-year example based on rates offered on 1/9/04, you could lock in as low as 6.79 per cent, 0.05 percentage points below the average SVR or as high as 7.55 per cent which 0.71 percentage points above the average standard variable rate. On an average $200,000 loan this means a difference of $2000 in interest payments every year.

The old advice to shop around applies in spades to fixed rate loans. Borrowers should not assume that because they found a competitive variable rate with one lender that the lender's fixed rates are also going to be competitive.

Offset Accounts

Check closely the offset interest rate on a mortgage offset account.

Offset accounts surveyed are split into those offering a full offset (ie. paying interest on savings at the same rate as that charged on the loan) and those offering a partial offset (a lower rate than the loan rate).

Partial offsets usually only offer a fraction of the interest rate charged on the home loan creating a very small offset benefit (1 or 2 per cent versus 6 or 7 per cent). Some lenders now offer the choice of full or partial offset account. So why would you choose a partial offset over a full offset? The lender will charge a fee on the full offset and no fee on the partial offset. But it will often turn out better to wear the fee and get the higher rate.

Comparison Rates

Demand your loan provider supply comparison rates across a number of loans – relevant to your desired loan amount and term.

The legislation requiring compulsory disclosure of comparison rates as a measure of the true cost of loans over time in interest and fees has not worked as well as credit authorities would have liked, despite the ability for such information to increase transparency of loan products in the market.

The unwieldy documentation of comparison rate schedules has been a turn off for many borrowers. But the problems of practicality appear to have been exacerbated by some brokers and lenders who are exaggerating the documentation overload.

While a full set of comparison rate schedules for a suite of loan products can run to scores of pages, borrowers should ask loan providers to supply only those comparison rates relevant to their circumstances, ie. across a range of similar products but only for their specific loan amount, term and fees.

Broker or lender?

Also beware of mortgage brokers acting as lenders, initially offering their own products with the intention of pushing customers onto other lenders' products which offer lucrative commissions.

FEES AND CHARGES

Fees Overall

In broad terms, the Big Banks are the most consistent fee chargers. In just about every fee category, they charged a fee and each of the five charged a very similar level of fees.

Institutions in the other four groups were less likely to charge across all fee types but when they did the fee levels were wide ranging.

Comparison Rates and Loan Fees

Exit fees are payable only if and when early termination occurs and therefore have the added advantage of avoiding inclusion in comparison rate calculations. In practice this means more emphasis on fees that apply on exiting a loan or charges that occur during the term of the loan that cannot be quantified at the beginning of the loan period.

Exit fees are discussed in detail below.

Upfront/Establishment Fees

Borrowers should ask to be shown a full, all-up figure for the total in upfront fees that will be charged for taking out a loan.

In noting the different approaches to upfront fees, borrowers should not get too preoccupied with comparing the size and type of the different fees, establishment, application, legal and valuation fees. There is a clear trade-off between application fees, valuation fees and legal fees such that a low or no application fee is often matched with higher valuation or legal fees.

Ultimately, what's important to the borrower is knowing the total of all charges payable at the beginning of the loan regardless of how they're broken down.

This is especially important when dealing with smaller lenders which may outsource legal and valuation tasks and not include these costs in their own fee schedules.

Exit/Early Payout Fees

Ask about exit fees and consider how long they're likely to stick with a loan.

Watch out particularly for the big sting from deferred establishment fees which come into play if you leave the loan early, typically within the first 3-5 years of a loan.

The massive increase in loan churning and the resulting fall in the average life of a mortgage has seen new emphasis placed by lenders on fees for leaving a loan after the first few years.

While most don't expect to change their loan in the first few years, the fact is that the average life of a home loan is now very short – as low as 20 months according to latest industry analysis – before refinancing, moving house, or payout result in a borrower terminating a loan arrangement.

Exit fees could be a flat fee of $700 to $2000 or a percentage fee of 1-1.25 per cent of the amount outstanding at the time. On an outstanding loan of $200,000 this could be as high as $2500. These fees are not incorporated in lenders' comparison calculations, one of the reasons there is an increasing incidence of these charges.

Redraw Fees

If you value redraw facilities, watch the fees. They vary widely.

Redraw has become a standard feature on home loans but the fees applying to each redraw transaction vary enormously.

Roughly half the home loans where redraw is available have no fee at all. Where fees are charged, there is very wide range from $5 to $55.

The Non-Banks were the stand-out groups of lender on redraw, with very few instances of redraw charges among Major Non-Banks and few among Other Non-Banks.

Late Payment/Dishonour Fees

If you miss a repayment or find you won't have enough in the deposit account from which a repayment is direct debited, contact your bank as soon as possible to avoid penalty fees.

The number of home loans on which penalty fees are charged for not paying the regular repayment on time or having a payment dishonoured for insufficient funds in the debited account is increasing.

These are a relatively new class of fee on the scene and one with which there is a certain amount of discretion employed in charging it, ie, borrowers who contact the bank and explain the circumstances can often avoid being slugged. Specified arrears periods before a fee or penalty are typically a week, a fortnight or a month.

Conclusion

The Australian Mortgage Report for consumers represents Infochoice's latest analysis of the home loan market.

It should be read along with our comprehensive and timeless Guide Articles and Tips & Tricks in the search for a home loan. Go to:

http://www.infochoice.com.au/banking/learn/

To compare home loans offers currently on the market, go to:

http://www.infochoice.com.au/banking/homeloans/default.asp