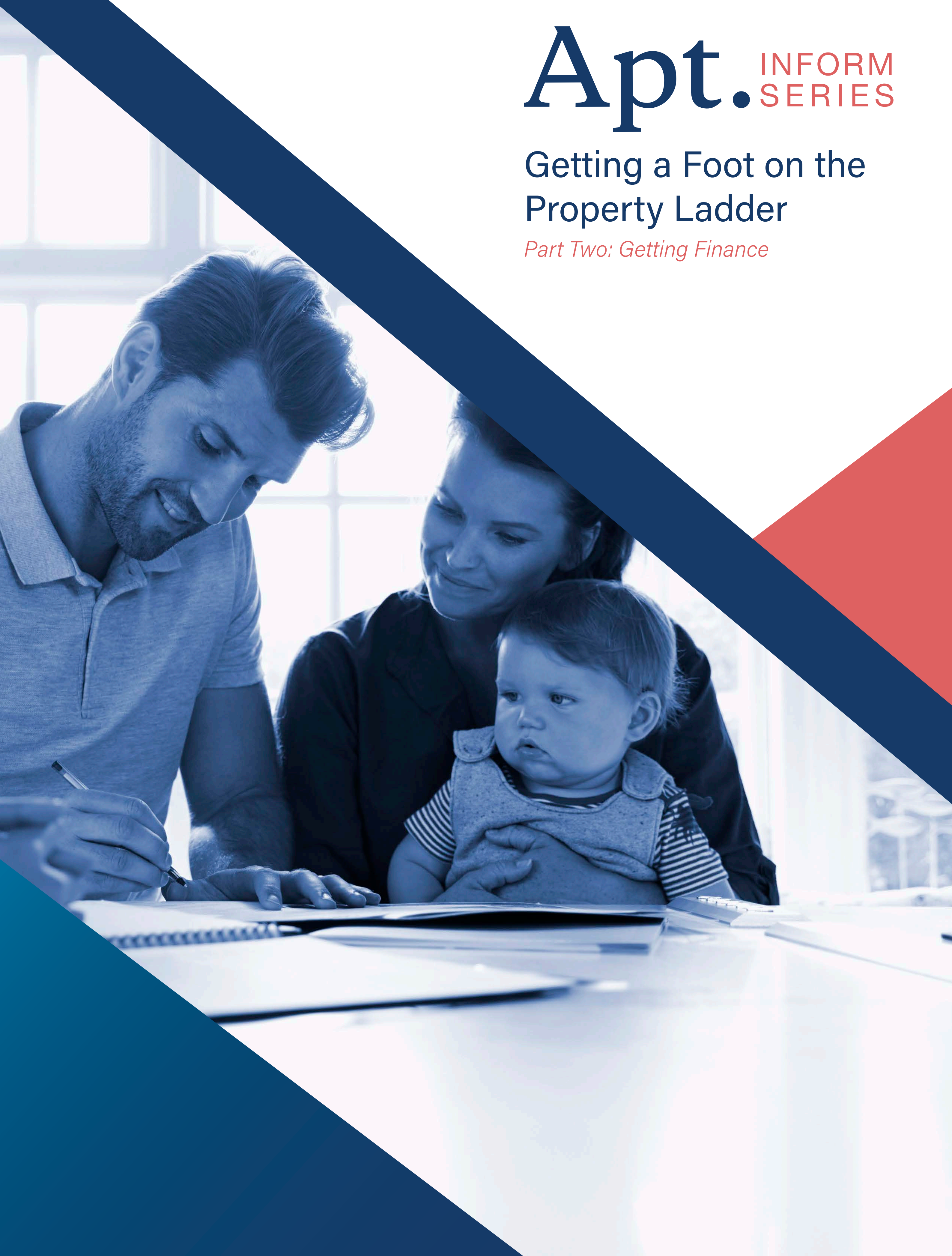
Apt. INFORM SERIES

Getting a Foot on the Property Ladder

Part Two: Getting Finance



Getting Finance

Welcome

Welcome to part two in the Apt Inform Series: Getting a Foot on the Property Ladder whitepaper, which is all about securing finance. If you haven't read part one, which is about your home loan deposit, should start there. If you haven't received a copy, you can request yours by emailing info@aptwealth.com.au. Preparing and applying for a home loan can be a stressful time, particularly if this is your first property purchase.

Knowing what to do before you apply to make yourself an attractive loan candidate is important, and a mortgage broker can really help you navigate the system.

If you are ready to get professional advice from a financial planner, mortgage broker, property expert or insurance specialist, Apt Wealth Partners can help.

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What should you do before applying for finance?

In the wake of various inquiries into the banking industry, many lenders have significantly tightened lending criteria. To give yourself the best chance of securing the right loan for you, there are some things you can do to make yourself a more attractive candidate.

Before you apply:

Have an honest discussion with your partner

If you are buying with someone else, whether a partner, friend, or family member, it is important to have an open and honest discussion about your financial position and history. The last thing you want is to find out that your partner has a credit default when your application is rejected. Knowing about these upfront is critical. If you or your partner do have defaults on file, it doesn't have to be the end of the line. A mortgage broker can help you determine which lenders will be more likely to lend to you with your specific history. Most lenders will look at your whole story and, if the default is an outlier, securing finance is still a possibility.

> *If your credit history isn't perfect, your property dreams don't have to be over - you might just need some expert advice.*

Review your credit rating

Your credit rating is basically a number that tells potential lenders how likely you are to repay your loan on time based on your history. It looks at how many accounts or credit facilities you have available to you and whether or not you are repaying them on time, as well as the number of facilities you have applied for.

There are a number of providers, such as Equifax, who will let you pull your own credit report for free. You'll receive a score between 0 – 1200, with a higher score being better. The resulting number will play a big part in determining how much, or even if, a lender is willing to lend to you.

What does your credit rating mean?

- 833+ = Excellent
- 726 – 832 = Very Good
- 622 – 725 = Good
- 510 – 621 = Average
- 0 – 509 = Below Average

What to do if you have a bad credit rating

If your credit rating is not great, it's not all over, but you may need to put the brakes on your property plans in the short-term and dedicate yourself to paying off any existing debt and paying all bills on time before you can apply. If you are in this situation, it's best to get financial advice that can help you put a plan in place to improve your credit rating and set you on a pathway to your property goals.

Reduce or cancel existing credit cards and loans

Even if you do not have any debt on your credit card, lenders will treat it as though you have used all your available credit when considering your ability to repay your loan. This is because it is a line of credit open to you, so there is nothing stopping you maxing it out at any time during the life of your loan and potentially getting into financial difficulty.

If you have credit cards, focus on paying them off before applying for a loan, and if they are already paid off, consider whether you are in a position to reduce the amount of credit or even cancel them all together.

Put post-pay in your past

Post-payment services, like AfterPay and Zip, are essentially small loans and these companies typically reserve the right to pull your credit file and report negative behaviours, such as failure to pay on time. Some providers do check your credit and others don't as, at the time of printing, they are not legally bound to do so. However, a good rule of thumb, generally, is to avoid buying things you don't need unless you can afford to pay upfront, and this is even more important when you are considering a home loan. Lenders will look at your spending habits and how many credit facilities you have applied for, and using post-payment services could well be a red flag.

Determining how much you should borrow

While the bank will determine how much to lend you, they have their own formula for affordability which is about protecting their investment, not your lifestyle. There are numerous calculators out there, but you really need to consider the type of lifestyle you want to lead after your property purchase, and this is going to be different for everyone.

You are taking on significant debt, and as such, you should expect your lifestyle to change, but it's also important that you are not sacrificing everything you love. If buying with a partner, this is also a good chance to discuss your lifestyle expectations after buying a home, and make sure you are both on the same page.

This is where a financial planner can really help, and professional advice should pay for itself in the long-term. A trusted adviser can act as your money coach, taking into account everything you want to achieve today and tomorrow, so the decisions you make now are the right ones.

Understanding home loan features

Your loan should be competitive in terms of rates and fees, but it should also suit your needs now, and into the future.

Some of the core features of home loans are discussed below, but when deciding on the right option for you, it is a good idea to engage a mortgage broker. A broker will be able to compare offers and options between lenders, as well as guide you through the features and benefits to help you get the most out of your loan. There are also a handful of lenders that offer discounted fees and/or rates to first home buyers, and your broker can help you investigate and evaluate these offers.

Maintaining an ongoing relationship with your broker is also a good idea, as they can periodically review your loan to ensure it remains competitive and in line with your needs as your lifestyle changes.

Packaged loan vs. Basic loans

A packaged loan is one that allows you to bundle other banking products with your loan to access various features, such as splitting your loan into part fixed/part variable, credit card facilities and linked offset accounts. These loans tend to incur an annual fee for packaging but do include package interest rate discounts and account fee waivers. The fee varies from lender to lender, usually around $350 - $400.

A basic loan is the no-frills option and may have cheaper rates and fees because the lender is not offering you a range of features. The loan that is right for you will really depend on your goals and needs, and a mortgage broker can help you determine the appropriate options for you.

Principal and interest vs. Interest-only repayments

In almost all cases, principal and interest repayments are best, because you are building equity in your home from the outset, reducing your loan limit and minimising interest over the life of the loan.

There are, however, occasions when an interest-only repayment term may make sense, particularly if you have a temporary period of increased outgoings or decreased income. For example, when you are building or renovating your home and paying rent during the build or taking parental leave, you may need more cash available to cover living expenses.

It’s important to remember that while you are paying interest-only, you are not paying down the principal of the loan and may need to make higher repayments later to recover from it. Going interest-only for even a short period of time is a complex financial decision, and it’s best to seek expert financial advice before going down this path.

Variable vs. Fixed rate loans

It is not possible to accurately predict what will happen to interest rates but fixing part or all of your loan for a period of up to five years can help protect you against rate rises and also may assist in budgeting, as you will know how much your regular repayments will be. With fixed rate loans, however, you typically can’t make extra repayments and may incur break costs if you discharge your loan during this period.

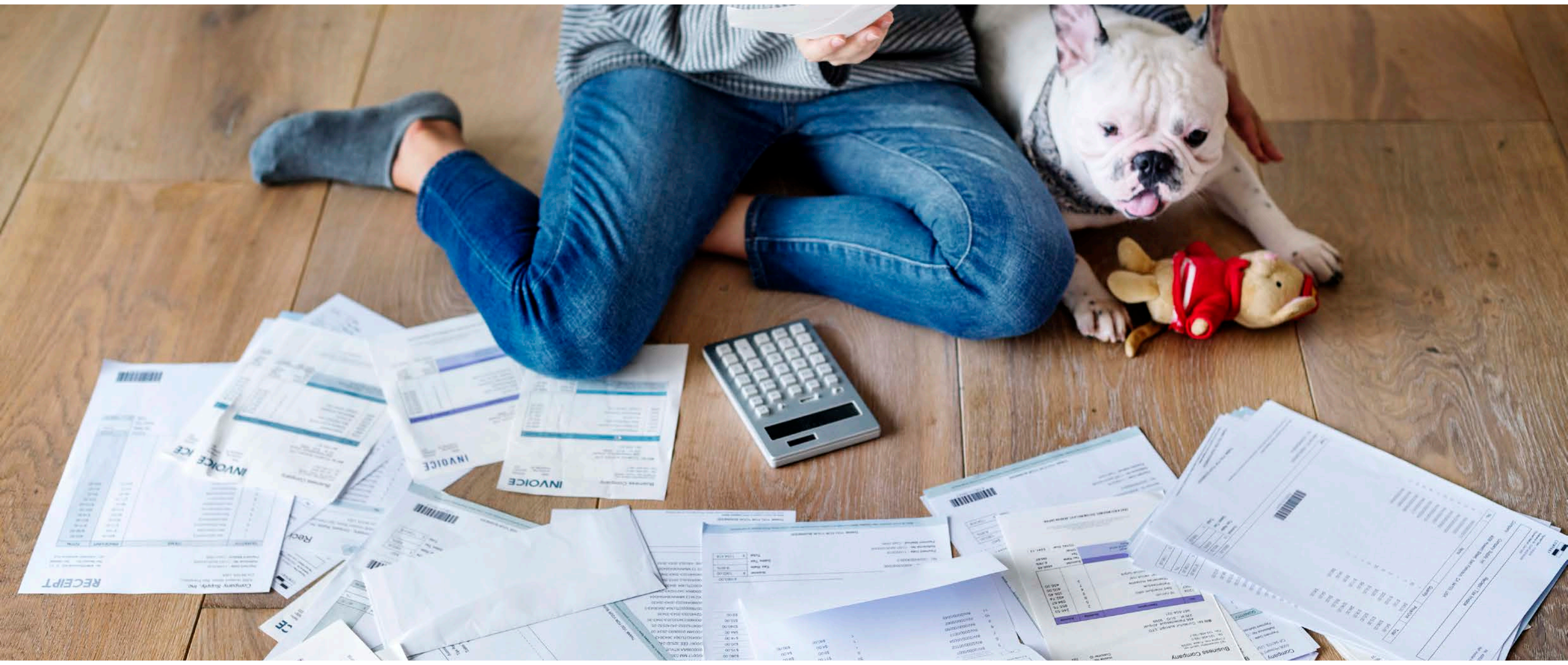
A variable loan is largely about having the flexibility to make extra repayments and reduce the principal quicker. Variable rates tend to be lower than fixed rates, but you are vulnerable to interest rate rises. With a variable loan, you can also use redraw and offset account facilities.

It may be worth considering splitting your loan into part fixed/part variable. A mortgage broker can provide you with more guidance on the right option for you.

Offset account and redraw facilities

An offset account effectively reduces the balance on your loan for daily interest calculation purposes. If you have, for example, $20,000 in your offset account and your loan is $600,000, interest will be calculated on the effective balance of $580,000. However, you still have full access to the funds to use for any transactions you would like. As you withdraw or deposit funds, the balance amount fluctuates for interest calculation purposes.

With a redraw facility, this same $20,000 sits in the loan itself and has the equivalent impact on interest calculations, but you need to fully withdraw the funds from the loan account before you can use them for transactions. Redraw facilities often have more restrictions on access to your funds.



The lending process

The lending process works in two phases; initially you will apply for pre-approval, also known as an approval in principle, which lets a vendor know that you are in a position to buy and can make an offer.

Once you have made a successful offer, the lender will review your contract of sale and make sure the value of the property and your offer are aligned before agreeing to the loan. This second phase is usually a very quick process and often more a formalisation than any further review.

While it is unlikely, there are a few things to consider when making an offer to ensure you can protect yourself as much as possible in the event that you don't receive final approval, which will be covered off in part three of this guide.

Repaying your loan

The life of a home loan can be up to thirty years. It can be very difficult to imagine what you will be doing that far into the future, and it can be scary to think you'll still be paying your mortgage. The bank will usually give you a very long time to pay simply because long loan life = more interest.

While it's not possible to pay off your loan immediately (or you wouldn't need a loan!) there are some strategies you can employ to pay it off faster:

- Increasing your regular payments to an amount that is more than the minimum will have an effect. Even a small increase is noticeable over time.
- Paying more frequently (e.g. weekly instead of monthly) can shave off some of the total interest charged over the month.
- Consider using offset or redraw facilities that allow you to reduce your interest while still having access to your funds.
- Work with a financial planner to develop the best strategies to repay your loan sooner.

Protecting your biggest asset

When it comes to the insurances you'll need as a homeowner, most of us think of the obvious: Home buildings insurance, and while this is certainly a must-have, there are other insurances that are critical too.

You are taking on significant debt when you take on a home loan and for most of us this will be the biggest debt we will ever find ourselves in. It's important to think about your future and consider what might happen if you or your partner were unable to work due to accident or illness.

Although it's unpleasant to think about, when you are taking on debt of this magnitude, you also need to consider what would happen if you were to pass away. Who would be left paying your mortgage? Would your partner need to sell the property, potentially moving away from family and friends during a difficult time?

Most Australians are drastically underinsured when it comes to income protection and life insurance, with many of us relying on premiums in our superannuation, which are often fairly basic and, in many cases, wouldn't cover living expenses, let alone mortgage repayments.

When asked what their biggest financial asset is, you'll often hear people say their house, but for most of us, the real answer is our future income. Based on a 45-year working career at just the average annual income of $82,436, that's a cool $3,709,620.

How much cover do I need?

A good rule of thumb when it comes to income protection is to ensure you have enough cover to pay out 75% of your current income until you are aged sixty-five.

With life insurance, there are a few factors at play. If you are the main income earner in your family, you'll need to ensure the amount covers your loved ones to pay off the mortgage, as well as any other large expenses you are anticipating, such as the costs of raising children to age 18.

It can be worthwhile to get professional advice that takes into account your situation and goals. In many cases, Apt Wealth Partners' clients are able to secure the cover they need without it costing more than they are currently paying for the basic cover included in their superannuation.

Working with a mortgage broker

In a world where so much information is at our fingertips, it can seem easy to research and organise everything yourself, and this may be true in some cases, such as holidays, where often the best deals can be found online. But a home loan isn't two weeks in Asia; it could be the next thirty years of your life, and expert advice is critical to get the best deal now and in the longer term.

A good mortgage broker will work hard to find you the best loan and guide you through the application process. This may be the first time you have applied for a home loan, but an experienced mortgage broker has been through this process countless times, supporting buyers with a broad range of situations, credit histories, and goals.

Some of the critical roles your mortgage broker should play include:

- Increasing your chances of success: A broker can give you personalised advice on increasing your attractiveness as a loan candidate, to give you a better chance of securing the right loan for you.
- Finding a loan that meets your needs: Understanding your long and short-term goals to ensure you apply for a loan with the right facilities.
- Checking with lenders first: Running your scenario by their contact at a specific lender to get a better understanding of whether you will be approved before you go through the application process.
- Helping you prepare the application: Supporting you through the process, ensuring you have the right documentation and are ready to go when it's time to make an offer.
- Coordinating the process: The broker can carry through the loan process, acting as a liaison between you and the lender, and even your conveyancer or solicitor.
- Saving you money: By considering your lifestyle and goals and applying their extensive knowledge, a mortgage broker should save you money.
- Getting you the best deal in the future: By maintaining a relationship with your broker after you have purchased the property, they'll let you know when you may be able to get a better deal in the future, and can also help you work out your options during life events, such as parental leave, renovating, or upsizing.

Mortgage broking FAQs

How much does a broker cost?

Brokers typically work on a commission basis, meaning you don't pay anything for access to their experience and expertise. If you successfully secure a loan through the broker, they will usually receive a commission from your chosen lender. Because most lenders offer the same or very similar commissions and a broker's business is only as good as their reputation, it isn't in their interests to push you towards a product that doesn't suit you.

How do you choose the right broker?

Ask trusted people for advice – ask family and friends who they used and if they were happy. The key here is 'trusted' people. People often ask this question on social media groups or online forums, but you can't be sure the advice you are receiving is genuine.

Meet with the broker – Rapport is key to a good relationship with your broker, and this can be easily determined at first meeting. You don't need to be friends with them, but you do have to trust them and have confidence that they will work in your best interests. Prepare lots of questions before you meet; make sure they can answer them and that they ask a lot about you in return.

Follow up with the broker - ask additional questions following the meeting. Making sure they are responsive and will give you the time you need before you engage them can help you to make the right decision.

Home loan FAQS

When should I apply for a loan?

It is critical that you apply for a loan prior to the property search so that you can secure approval in principle, also known as pre-approval. While it is not a 100% guarantee that the bank will lend you the money you need (they'll also consider the value of the property against the amount you want to borrow), it is a good indicator that you can buy and it puts you in a position to make an offer. You should allow at least 2-3 weeks for this process, as it can take time to get the documents together and the lender may come back to you with questions.

What documents will I need?

As with any banking product, you'll need 100 points of ID, as well as:

Proof of income: Typically a month of pay slips, your PAYG summary and at least one previous tax return. If you are or have been doing casual or temp work in your recent past, they may ask for up to two years of documentation. For self-employed applicants, they'll want to look at a minimum of two years' income, personal and business tax returns. Additionally, if you have investments that make income, such as dividends, they'll want to see these statements too.

Proof of expenses: Generally 3-6 months of bank statements, as well as up to 6 months of statements for any credit cards or loans you have.

Additional information: When reviewing your application, a lender may have additional questions and may ask you for documentation to support your responses. It can be worthwhile getting together any documentation that may support your financial position during the application process so you are ready to respond.

How many different loans should I apply for?

Just one. Never apply for multiple loans simultaneously. It will have a negative impact on your credit rating, and it may be a red flag for some lenders, meaning you could miss out on the best deal for you, potentially costing you thousands in the long-term.

Do's and don'ts of getting finance

- Do be realistic when thinking about how much you can afford.
- Do budget based on paying off your loan as soon as possible.
- Do get pre-approval before you begin your search.
- Do give yourself ample time to prepare, it takes longer than you think to get all the documents together.
- Do consider working with a broker to get the best loan for you.
- Do give the broker and/or lender an accurate indication of your financial position.
- Don't omit anything, be thorough. It will just come out later, and omissions, even if they are unintentional, can be a red flag for a lender, particularly if they have other concerns.
- Don't apply for multiple loans.
- Don't assume you are guaranteed to get a loan – there are many things a lender looks at and no one is a shoe-in.

For more information, please read the remaining two parts in our Apt Getting a Foot on the Property Ladder whitepaper series. If you downloaded this guide, these will be sent to you over the coming days. If you received this via another channel, you can request copies of the remaining parts by emailing us at info@aptwealth.com.au

Part 1: **Your Home Loan Deposit**
Part 3: **Finding and Buying Your Property**

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