April 2005 Newsletter

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How Much Deposit/Equity Do I Need?

Whether you are buying your first home, upgrading your existing property or buying an investment property, the first question many people have is how much deposit or equity do they need. With the average house price increasing dramatically in the major capital cities in recent years, it's becoming more costly to buy a decent sized property in a good location. Lenders have reacted to this, albeit slowly.

There are three major categories of products available to borrowers (classified in terms of deposit requirements) which are:

- Standard loans;
- 100% loans; and
- 105% loans.

I will discuss each category in turn.

Standard Loans

All lenders in Australia will charge Lenders Mortgage Insurance (herein referred to as mortgage insurance) if you borrow over 80% of a property's value. Mortgage insurance is a one off charge that can be added to the loan. The cost is calculated as a percentage of the loan amount. This percentage rate is influenced by the loan amount and the percentage of the property's value you are borrowing. Generally, mortgage insurance costs in the range of 0.5% to 2.5% of the loan amount. Mortgage insurance covers the lenders risk, not the borrowers.

Mortgage insurers may require borrowers to prove that they have been able to save a deposit (often referred to as genuine savings). Genuine savings are defined as money held or accumulated in a bank account for a period of 6 months (also includes shares and other investments). Genuine savings proves to the lender that potential borrowers have surplus income to put towards loan repayments. For example, if your proposed loan repayments are $2,000 per month and you can prove that you have saved $2,000 per month (over 6 months) then the lender will be comfortable that you can afford the new loan. Most lenders will require borrowers have 5% of the property's purchase price in genuine savings.

The minimum deposit that property purchasers need is 5% of the property's price plus costs. Costs include stamp duties, loan application fees, solicitor's fees, etc. As a 'rule of thumb' costs normally equate to 5% of the property's purchase price (unless you qualify for first home stamp duty concessions). Therefore, borrowers need to contribute a total deposit of at least 10%. This is only available for loan amounts up to $500,000.

If you borrow over $500,000 but less than $750,000 then you will need a total deposit of 15% (i.e. 10% deposit plus costs). If you borrow between $750,000 and $1 million then you will need a total deposit of 20% (i.e. 15% plus costs). Mortgage insurance is generally not available for loans over $1 million (therefore you need 20% plus costs if you borrow over this amount).

Purchase price	Loan amount	Deposit	Costs	Total deposit required
Up to $525,000	Up to $500,000	5%	5%	10% ($55,000)
Up to $830,000	Up to $750,000	10%	5%	15% ($130,000)
Up to $1,175,000	Up to $999,999	15%	5%	20% ($245,000)

100% Loans

There are many banks and mortgage managers that will now lend up to 100% of a property's value. The maximum loan amounts for these products range from $500,000 to $700,000.

Mortgage insurance is payable on 100% loans and normally costs in the range of 2.0% to 2.5% of the loan amount. Borrowers can include this in the loan (and effectively borrow 98% plus 2% for mortgage insurance) or they can pay for it from their own funds. Interest rates for 100% loans range from 7.09% to 8.32%.

Most 100% loans cost more than standard loans. These extra costs might come as higher interest rates or higher fees (sometimes included are high early repayment fees). Some borrowers view 100% loans as short term debt and once their loan complied with standard policies (i.e. loan to value ratio is 95% or less) they will then switch to a standard loan.

Many of these 100% loans will require the applicant to have 5% of genuine savings (to pay for costs). However, there are a small amount of lenders (e.g. St George) that will not require any genuine savings. Therefore, purchasers that receive gifts from their family can still use these products.

105% Loans

I am aware of only one lender (Establishment Loan) that will lend 105% of a property's value. Therefore, they will lend enough funds to pay for 100% of the purchase price plus stamp duties and legal costs. The maximum loan amount is $750,000 (but depends on location). The interest rate for this loan is 8.55% (which is 1.23% above the banks standard variable rate). Up front fees are also higher. These loans are available for home or investment purchases.

Price of money...

As you can see it doesn't matter really matter how much deposit you have, there is generally a loan solution for you. The only question is how much the loan will cost. Therefore, if you have no or little deposit you can probably still purchase a property – it will just cost you more. However, if you have the ability to hold off and save a 10% deposit then you may end up saving yourself a lot of money.

There is a growing need for lenders to increase the proportion of the property's value that they will lend. There are a lot of high income earning professionals out there that have been living a great life and essentially spending everything they earn (on holidays, toys, etc.). Just because they haven't been able to save a significant deposit does not make them a higher risk for the banks. They have just been at a different stage of life. As lenders start to appreciate this I am sure they will develop new products.

Any questions about this article? Email us.

HSBC Rewards Customers For Their Loyalty

HSBC has introduced a new product called Home Rewards. This is aimed at the professional package market. Customers will receive an increasing interest rate discount the longer the loan remains with HSBC. The interest rate for the first year will be the standard variable rate (currently 7.24%). The clients will receive a 0.25% discount in the second year. In the third and subsequent years the interest rate discount will increase to 0.75%. The application fee is $500, settlement fee of $150, valuation fee is $185 and there are no ongoing fees. The product has a deferred establishment fee of $1,000 if the loan is repaid or refinanced within 4 years.

This is quite a good product if you are borrowing less than $500,000 (there are better deals for over $500,000) providing you definitely plan to hold the property for longer than 5 years. One major downside is that the product doesn't offer an offset account. Offset accounts can save borrowers up to 5% to 7% in interest costs (depending on the borrowers' income).

BankWest Reduces Rates & Fees!

BankWest has announced that it has reduced the interest rate on its Lite Home/Investment Loan product from 6.70% to 6.65%. It has also reduced the application fee from $700 to $500. Furthermore, the application fee is refunded in full to customers on the third anniversary of the loan. There are no ongoing fees and no early repayment fees. The product offers interest only repayments and has a redraw facility.

This product is very attractive for investors (where they only need an interest only basic variable loan). It is also good for home owners that are borrowing less than $250,000.

Westpac Leaps Into The 1990's

Approximately 10 to 15 years ago lenders used to charge higher interest rates for investment property loan compared to home loans. For some reason Westpac has continued this tradition long after all other lenders equalised home and investment interest rates. However, since 21 March 2005 Westpac reduced its investment rates by 0.10% so that its home and investment rates are the same. These new rates do not apply to existing clients (but I think they would give them to you if you rang them up and complained).

Westpac is also waiving application fees for investment property loans for a limited time.

Westpac has increased its annual package fee on its Premier Advantage package from $300 to $395 from 1 April 2005. This is now the second most expensive annual professional package fee (second to CBA's Wealth Plus package which includes a Platinum credit card).

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