

June 2006 Newsletter

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The 3 minute mortgage health check...

Many lenders are competing on interest rates, fees and credit policy to win new business. An uncompetitive mortgage could be costing you thousands. However, many people rarely check the competitiveness of their mortgage product on a regular basis (should be done annually). Why not invest 3 minutes of your time by answering 6 questions about your mortgage product?

1. What rate are you paying? It's surprising how many people don't know what interest rate they are paying on their mortgage. It's probably the single largest expense you have, so it's certainly worthwhile knowing what rate you are being charged. Maybe you are paying too much, or the lender could be charging you the wrong rate – it pays to check. The maximum variable rate you should be paying is 6.87%, being a 0.70% discount off the standard variable rate of 7.57% (if your loan amount is over \$250k). If your loan amount is under \$250,000, then there are plenty of basic variable products with variable rates of 6.90%.

If you have a fixed rate, then there's generally no point in comparing it to the market. The reason for this is that fixed rate break fees may apply if you refinance the loan. These fees generally don't make it worthwhile refinancing. You should check with your lender to determine if these fees may apply to your loan before comparing your rate to the market.

2. Monthly fees? The amount of monthly fees you pay depends on your product type. If you don't have an offset account (refer point 3 below), then you shouldn't be paying any monthly fees. If you have an offset account attached to your loan, then monthly fees range from \$5 to \$12.

Many lenders offer professional packages that

bundle a number of products together for one annual fee. These products will generally include a home loan, gold credit card and a transaction account (with unlimited transactions, excluding other bank ATM fees of course!). Annual fees generally range from \$300 to \$500, although most fees should be less than \$400. The value in these packages isn't really with the transaction account and credit card. The main benefit is with the interest rate discounts that they apply. Therefore, we can't really get carried away with the satellite benefits.

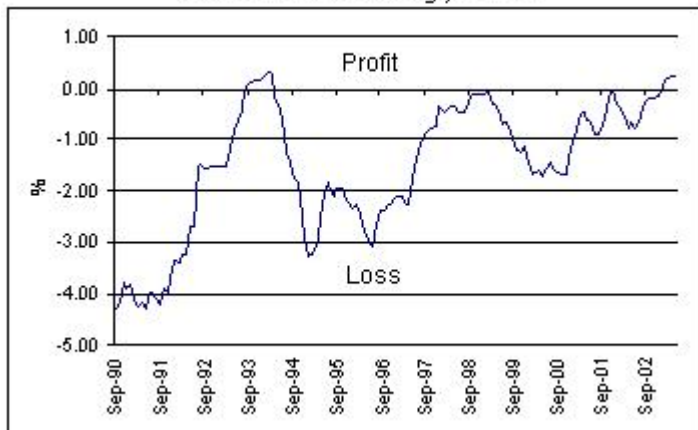
3. Make sure you have the right product. Having the wrong product could be just as costly as choosing the wrong lender. There are two major issues to look out for here. If your loan amount is more than \$250,000 and you earn more than \$60,000 per year, then you probably should have an offset account. Offset accounts save you money because any money deposited in your transaction account offsets the loan. The more you earn, the more money is in your transaction account and the more you save.

Lines of credit are not good products for some people. The reason for that is your income and your loan are combined into one account. Therefore, it's too easy to spend all your cash (and even draw on debt) without realising it. However, if you have a standard loan (or even better, an offset), you can clearly identify your loan balance and your transactional account balance. Therefore, you can see if you have spent this month's salary or not. Many borrowers that have lines of credit repay their loans slower than standard loans. Be honest with yourself. If you have a line of credit and your balance hasn't reduced much, then switch products.

4. Consider fixing your rate. Using the data collected by the Reserve Bank of Australia that dates back to September 1990, I have compared the average 3 year fixed rate to the average standard variable rate discounted by 0.70% (because that's the most common discount). The graph shows an interesting trend. Except for a few months in 1993 and 1994, most fixed rate borrowers have been worse off up until recently. In the last 4

months of the data, fixed rate borrowers have been better off (of course I can't calculate the profit or loss after May 2003 because the 3 year term hasn't completed yet). In my opinion, it's not meaningful to look at the data before 2000, because the mortgage market is a lot more competitive now. The loss from entering into a fixed rate has been decreasing since 2000. In fact, borrowers that fixed their rate during February 2003 to May 2003 have been better off (on average). There is anecdotal evidence to suggest that the competitiveness of fixed rate mortgages has increased more than variable rates over the past few years. Discussions with lenders suggest that profit margins on fixed rate mortgages are less than variable. This stands to reason, as there is more certainty for lenders as to the cost of funds over the fixed period, so they can price the loan more aggressively. However, it is difficult to tell if the recent trend (of fixed rates being financially better than variable) will continue.

Profit or loss from fixing your rate



The best 3 year fixed rate we have negotiated in the past week is 6.84%. The best 5 year rate is 6.99% (or 6.94% in some cases). These rates compare favourably with the standard variable rate of 7.57% and the professional package variable rate of 6.87% (i.e. 0.70% interest rate discount).

- Has bad service cost you time? Time is becoming the new commodity. People are working longer hours, so personal time is becoming more precious. How much is your time worth to you? You certainly don't want to spend your spare time in bank queues, or listening to hold music on the phone to a call centre! Consider the service that your bank has provided you. Maybe you are with a smaller lender that doesn't have a branch

network, so you are forced to use busy agencies with long queues like Aussie Post. If your lender has cost you time, then it might be time to switch (there are lenders that offer personal bankers so you don't have to go to branches or deal with call centres).

- Will your product/lender accommodate you in the future? Maybe a change in personal circumstances might require a more flexible mortgage. For example, some mortgage products offer 'parental leave', which means you can halve your repayments for 6 months when you have a child (as cash flow might be tight around that time). Perhaps you would like ready access to funds, just in case an investment opportunity arises. There are many situations where a mortgage needs to adapt to changes in your life. Therefore, consider the potential changes that you might be facing in the future and if your mortgage product offers the flexibility required.

How does your product rate against these questions? Is there any room for improvement? Remember, your mortgage is your biggest expense. You work hard for your money, so you owe it to yourself to make sure you are getting the best deal!

If you think your mortgage product isn't the best for you anymore, then feel free to contact us and we will be happy to provide a free assessment.

Reduction in tax rates and negative gearing

The federal government will be reducing marginal tax rates from 1 July 2006. Of course, this is good news for taxpayers. However, the reduction in marginal tax rates will reduce the tax benefits derived from negative gearing.

MLC has calculated the reduction in negative gearing benefits based on owning a \$500,000 investment property. An investor that earns \$80k p.a. will save \$486 less in tax. Investors earning \$120k p.a. will be worse off by \$1,701 and if they earn \$200k p.a., the investor will down by \$486. However, it's not all bad. The tax savings from the reduction in marginal rates will more than offset the reduction in gearing benefits.

It's a good opportunity to stress that tax benefits should not drive your investment strategy because the tax system can change, but investment fundamentals do not. The dominant goal of investing is to increase wealth, not save tax. If an investment provides some tax benefits, then that is an added benefit.