Conversation Guide
General Mortgage Loan Considerations

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About this Guide

Taking out a mortgage is both an exciting and serious financial commitment. There are a number of factors which you should consider before deciding to apply for a mortgage loan. This Guide highlights some of those factors.

Some Mortgage Related Factors

Some of these factors may apply to your mortgage loan.

Interest Only

- During an interest only period, your monthly repayments equal the interest charged that month. The principal amount of the loan will not decrease.
- At the end of an Interest Only period, most Interest Only loans revert to Principal and Interest (P&I) repayments, to ensure the loan is repaid in full over the remaining loan term.
- You should consider whether the higher P&I repayments, at the end of the Interest Only period, will have an impact on your ability to repay the loan or to maintain your current lifestyle.
- Also, P&I repayments after an Interest Only period will be higher than the P&I repayments you would have paid if you had made P&I repayments over the full loan term.

Refinancing and extending your initial loan term

- You may wish to refinance your existing loan with a loan that has a longer term than the remaining term of your existing loan.
- Each time you refinance your mortgage and extend the term of the loan longer than the original loan term, you may end up paying more interest over the life of the loan. To reduce the interest you pay, when you refinance a loan you may seek to arrange for the new loan term to end no later than the original term of your loan.

Offset Accounts

- You may decide to take out a loan to which you can link an offset account. For most offset accounts, the lenders will calculate interest on the loan account for a day after deducting the balance of the offset account from the loan balance that day. That way, you can reduce the loan interest you pay.
- You can use funds in your offset account any time. Each time you use those funds, you reduce the balance of your offset account and reduce the interest you save on your linked loan account.

- Sometimes, offset accounts are offered only with variable rate home loans that have a higher interest rate or with loans that have multiple features.
  - This may mean you have to pay extra in banking fees and charges for the loan, which can reduce the savings you make using an offset facility.
  - If you cannot retain a reasonable amount of cash in your offset account, the interest you save with an offset account could be less than the benefit of taking out a loan without an offset account, but with a lower interest rate.

Fixed rate terms

- Fixed rate loans give you the benefit of knowing what your loan repayments will be for the whole fixed rate term. For variable rate loans, the loan repayments could change with changes to the interest rate.

- By choosing a fixed rate term, you may lock in an interest rate that is higher than the then current variable rate available on the loan. Or, if variable rates fall below the fixed rate on your loan during the fixed rate term, you may miss out on the benefit you had initially with a lower fixed rate. On the other hand, you may be better off if variable rates rise above the fixed rate on your loan during the fixed rate term.

- For a lot of fixed rate loans, you may not be able to make extra payments or may be restricted by the total amount of extra repayments you can make on your loan or make use of an offset account during the fixed rate term.

- If you repay the loan before the end of the fixed rate period, you may be liable for break costs. The cost or loss usually arises because of changes in money market rates of interest between the start of the fixed rate term when a break event occurs. Fixed rate break costs can be high and will increase the amount you owe the lender.

- Before fixing all or part of your loan, consider whether you intend to sell your property; make extra principal repayments; or change your lender during the fixed rate term.

Variable rate loans

- Variable rate loans are subject to market conditions and lender decisions that may differ from Reserve Bank of Australia decisions about cash rates.

Property values

- A loan secured by a mortgage over residential property can be impacted by reductions in property values. Your mortgaged property may reduce in value so much that you owe more than what the property is worth. This is known as “negative equity”. You will still need to repay the loan in full.

Lenders Mortgage Insurance

- This insurance protects the lender in the event of you are unable to meet the repayments of the mortgage. It is commonly required when you borrow more than 80% of the value of the property being offered as security for the loan. If property values decline, the security may not be enough to cover the outstanding loan when the lender comes to sell it. LMI is a one-off insurance payment incurred at the time the loan settles, and usually the lender will pass on the cost of the LMI premium to you, the borrower, as a fee.

- Lenders' mortgage insurance should not be confused with mortgage protection insurance, which covers borrowers for the payment of their mortgage instalments in the event of unforeseen circumstances including unemployment, illness or death.

Hardship

- You still need to repay your loan even if your personal circumstances change. For example if you experience a change in your job or income levels, unemployment, illness, change in expenditure patterns or expenditure commitments, birth of children, divorce or death of a family member. If your circumstances change, you can make a hardship application to your lender to give you relief whilst you work through those circumstances.

Insurances

- You should consider, or seek advice regarding, insurances that may be appropriate to protect your property and your financial circumstances.

Other information

Please talk to your mortgage broker or your lender if you have any questions about your loan.

References

www.moneysmart.gov.au