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How to find the best property refinancing deal

More borrowers are refinancing their home loans to fund lifestyle.

by **Duncan Hughes**

Refinancing a home or investment property could mean a lot of work for little financial gain, analysis of lending rates and switching fees reveals.

But that is not stopping more than one in three property owners from considering a change – a three-fold increase in just over one year, says investment bank JP Morgan.

For top-end owners with loads of equity in their properties, it could be a sassy strategy – potentially saving thousands of dollars in repayments a year.

Buyers with little equity locked into a fixed rate and struggling to make ends meet might be better off sticking with their existing deals.

Rates and fees on variable and fixed home loans.

"Cheapest is not always best," says Christopher Foster-Ramsay, managing director of Capital Home Loans, a mortgage broker.

"Borrowers come to me and say they have seen a new cheap rate and want to switch quickly because they need the money for, say, renovations," Foster-Ramsay says.

BEWARE DELAYS

"But a lot of these special rates are lenders attempting to grab market share. In some cases the lender cannot handle the increased volume and there are delays in processing and lower service standards."

In other cases, lower rates mean sacrificing useful services such as offset accounts, which can be linked to a home or investment account. The credit balance of the transaction account is offset daily against the outstanding loan balance, reducing the interest payable against the loan.

"There's not a big difference between fixed-rate mortgages regardless of the owner's equity in the property," says Justine Davies, editor-in-chief of research house Canstar, which compiles and compares rates.

But owners with an 80 per cent loan-to-value ratio (the proportion of the loan against the value of the property) who use a standard variable loan could slice more than 40 basis points off their repayments.

Refinancing is about negotiating better terms on a mortgage from either the existing or a new lender, or releasing equity for other investments as house prices rise.

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SEEKING EQUITY RELEASE

A home borrower with a $250,000 to $300,000 mortgage is typically refinancing to reduce payments, extend terms or get additional benefits, according to analysis by JP Morgan.

Those with loans greater than $750,000 want to release equity for other investments, its research reveals.

Investors are driven by concerns ranging from needing rental income to service to fear of higher interest rates and potential changes to negative gearing.

In recent years refinancing has largely been by financially literate, active investors with higher incomes, loan balances, property values, bigger discounts on their borrowings and higher net yields.

These wealthy seniors, young affluent and exclusive professionals were looking to fund alternative investments, such as investment properties, with their extra cash.

CALL OUT FROM CASH-STRAPPED HOUSEHOLDS

But in recent months there has been a sharp increase in stressed seniors, young growing families and urban battlers who need additional cash to fund their lifestyles.

Research has found many buyers will be financially distressed if interest rates rise to 6 per cent, 150 basis points lower than the stress-test rate used by lenders when approving a loan.

"Rather than make repayments on a personal loan or credit card, some people are consolidating debt into their home loan to reduce overall loan repayments," says Mario Borg, principal of Mario Borg Strategic Finance.

"Unsecured debt is much more expensive and comes with a very high interest rate, plus the repayments are usually high as the loan term is usually much shorter."

OPPORTUNITY TO SELL MORE PRODUCTS

Banks are keen for profitable long-term owner-occupier loans on low-risk assets, particularly since regulators cracked down on their lending to property investors by raising loan-to-value and other repayment criteria.

They also see opportunities for spin-off financial products such as mortgage, household and contents insurance, credit cards and investment products ranging from superannuation to fixed term deposits.

"Banks are in business to lend money and 'winning' new customers is their number one priority," adds Borg.

"There will always be 'special offers' to attract new home loan customers. But I am yet to meet anyone who has received a phone call from their bank to be told that their home loan rate is being reduced for no apparent reason."

Jessica Darnbrough, a spokesman for mortgage broker Mortgage Choice, reminds borrowers that refinancing is "not free" and urges close scrutiny of any small print.

"Significant fees and charges mean it is important to weigh up costs against benefits before making the leap," Darnbrough says.

BE AWARE OF FEES

Costs can include application fees, lenders' mortgage insurance, break costs, mortgage registration fees, legal work and time and effort involved in shopping around for alternative offerings.

Differences in fees and charges between lenders might provide ideas for negotiating better deal for someone considering a switch.

Only one in 10 of several hundred lenders monitored by finder.com, which compares rates for financial products, have application fees. Those that do have the fees charge between $300 and $1500.

Most have upfront fees of about $700, which covers services such as legal costs, valuation, settlement and administration.

Switching from a variable loan before the term ends is likely to incur an administration fee of about $320.

CONSIDER LEAVING COSTS

Mortgage exit fees were abolished for new loans in 2011 but might still apply for older loans.

"Refinancing can shave dollars off current home loan repayments. But a borrower 10 years into their loan who refinances into another 30-year mortgage might pay more over the extended loan," Darnbrough says.

Analysis of rates also shows marginal benefits for investors on fixed rates, which can cost thousands of dollars to switch from.

Fixed rate investors are usually better off waiting until the loan reverts at the end of the term.

"Many clients do not understand how much it is going to cost to exit a fixed rate," says Foster-Ramsay.

HIGHER RATES FOR INVESTORS

It currently costs about $2000 but five years ago, when rates were higher, it was between $15,000 and $17,000.

It's worth finding out more about fee scenarios across owner-occupier and investor loans.

For example, a property owner with a $500,000 loan and 5 per cent deposit could expect to negotiate 4.88 per cent for an owner-occupier deal and 5.03 per cent for an investor deal.

An owner with 20 per cent deposit could expect to pay an average of 4.42 per cent for an owner-occupied property and 4.74 per cent for an investor property.

That means a saving of 46 basis points for owner occupiers and 29 basis points for investors.