How to trim your mortgage by $700 a month

Big savings for borrowers who meet higher lending criteria. **Bill Frymire**

by **Duncan Hughes**

A borrower could slice about $740 off monthly repayments of a 30-year $1 million mortgage by switching from the current average variable rate of 4.77 per cent to new low rates of 3.5 per cent.

Lenders competing for market share are offering nearly 100 home loans of less than 4 per cent. The best is 127 basis points lower than the average variable rate, according to financial product comparison site Canstar.

But as rates go down, the serviceability criteria for owner-occupiers and investors involving income, other loans, household outgoings and disposable cash at the end of each month continue to rise.

Teachers Mutual Bank, with more than $5 billion in assets and 170,000 members, is weeding out "unsuitable" property investors by warning borrowers they need minimum monthly surplus income of $1000 (after taxes, costs and expenses) to qualify for a loan.

The $1000 buffer above "assessment repayment ability", which is the traditional benchmark for a borrowers' capacity to repay, applies to all investment loans despite loan-to-value ratios of more than 80 per cent.

The bank blames it on policies of the Australian Prudential Regulation Authority

(APRA) to prevent property market overheating by imposing an industry-wide requirement that limits annual investment lending growth to 10 per cent.

PAY OFF LOANS FASTER

Moving to a cheaper loan offers an opportunity for savvy property buyers to pay off their loans faster by maintaining repayments at the higher rate.

"Borrowers who switch to a lower rate but pay more to reduce debt could save themselves tens of thousands of dollars in fees and charges over the life of a loan," says Christopher Foster Ramsay, managing director of mortgage broker Capital Home Loans.

"Less debt creates greater flexibility and more options for other saving and investment."

But looking for a better loan means keeping abreast of tougher surplus income requirements among lenders.

For example, National Australia Bank's Advantedge home loan product has in recent months been gradually ratcheting up the monthly surplus income needed to service a loan to 30 per cent of borrowers' total monthly outgoings.

P&N Bank, one of the nation's largest mutual lenders, is telling brokers that "certain income types" will have the annual total of overtime, allowances and commissions "shaded" – or reduced – by 20 per cent when assessing eligibility.

OFF-THE-PLAN SQUEEZE

Police, nurses, teachers, fire fighters and prison officials are considered "dependable" and will not have the value of overtime payments automatically reduced.

All other occupations where total income is supplemented by irregular income, which could range from auctioneers to taxi drivers, will be reviewed.

The squeeze is also being applied to buyers of off-the-plan properties, which have been particularly popular with first-time buyers and self-managed superannuation fund investors.

ANZ warns it will only accept property valuations up to three months old.

Off-the-plan buyers apply for loan approval when applying to buy the property and have the property revalued and the loan reassessed in the lead up to completion, which can be years later.

Fears that apartment values in oversupplied postcodes, such as the central business districts of Melbourne and Sydney, could be less than the original purchase price is behind the tightening.

BIG COMMISSIONS

That has not stopped property spruikers from offering generous commissions to financial advisers who recommend properties by repeating their claims about rental vacancies, potential yields and growth prospects.

Properties are being offered in Brisbane for a 10 per cent deposit with the promise of

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an annual yield of 5.5 per cent, which might be attractive to retirees attempting to generate income from much lower single-digit fixed term deposits.

But investors need to look beyond the headline figure at borrowing and maintenance costs, the likelihood of finding tenants and prospects for capital growth in postcodes where prices are under pressure thanks to over-supply.

House yields in Brisbane have fallen by about 0.5 per cent and apartments are up 1.5 per cent compared to this time last year, reports SQM Research, which monitors income and capital growth from apartments and houses,

Andrew Peters, managing director of Semaphore Private, a certified financial planner, whose clients include residents in Melbourne's leafy inner-suburbs, says longer-term investors are often sitting on big capital gains but struggling to generate income.

DRAIN ON CASH FLOW

An example based on a real-life investment involves a $1.2 million second property and debt of $1.03 million, $23,000 annual rent and $55,000 annual interest and expenses.

Gross return is 1.9 per cent and net 1.4 per cent. It is a drain on the owner's cash flow after tax and expenses.

Overseas buyers, particularly those wanting to use foreign income, are facing increasingly tough terms and conditions because of fears about money laundering and fraudulent applications.

Some major Australian banks, including Westpac and ANZ, are reviewing foreign loan applications amid concerns of systemic fraud.ANZ has discovered loan applications with incomplete or missing documentation, such as pages removed from passports and documents supporting overseas employment income from companies that could not be traced.

Bendigo and Adelaide Bank, Australia's fifth largest, has told more than 30 mortgage managers and thousands of brokers to immediately stop lending to foreign borrowers and exclude foreign-sourced income from local real estate deals.

Its move also follows a surge in applications in response to a tightening of lending terms and conditions by competitors.

CRACKDOWN ON CURRENCIES

Citigroup accounts for less than 1 per cent of the total Australian property market but has a high profile in Asia, where it targets rich Asian, or foreign-based, investors seeking to diversify asset allocation. The only foreign currencies it will accept from overseas borrowers are the Canadian dollar, Danish kroner, euro, Hong Kong dollar, Japanese yen, New Zealand dollar, Swedish kroner, Singaporean dollar, South Korean won, Swiss franc, UK pound sterling and US dollar.

Martin North, principal of Digital Finance Analytics, which provides saving and spending research to financial institutions, says mortgage refinancing is the new battleground for lenders.

A dilemma for house buyers is whether to lock into recently reduced two-year fixed rates or hold out in expectation of additional cuts.

"Borrowers comfortable with the flexibility of a standard variable rate might just as well stay put and see what the future brings," says Jessica Darnbrough, spokeswoman for Mortgage Choice.

ANZ recently slashed 44 basis points off its two-year fixed-rate mortgages to 3.9 per cent.

Within days, NAB responded by dropped its two-year fixed rate by 30 basis points to 3.99 per cent. It undercut ANZ by reducing its exclusive rate for mortgage brokers to 3.89 per cent.

Some smaller lenders, including Illawarra Credit Union, Newcastle Permanent and BankVic, are offering cheaper two-year fixed rates.

Canstar reports about 100 home loans with advertised rates of between 3.5 per cent and 4 per cent.

"I think we are seeing the start of a two-year fixed-rate war," says Canstar's Justine Davies. "When two major banks move like this, we are probably at the start of something."

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