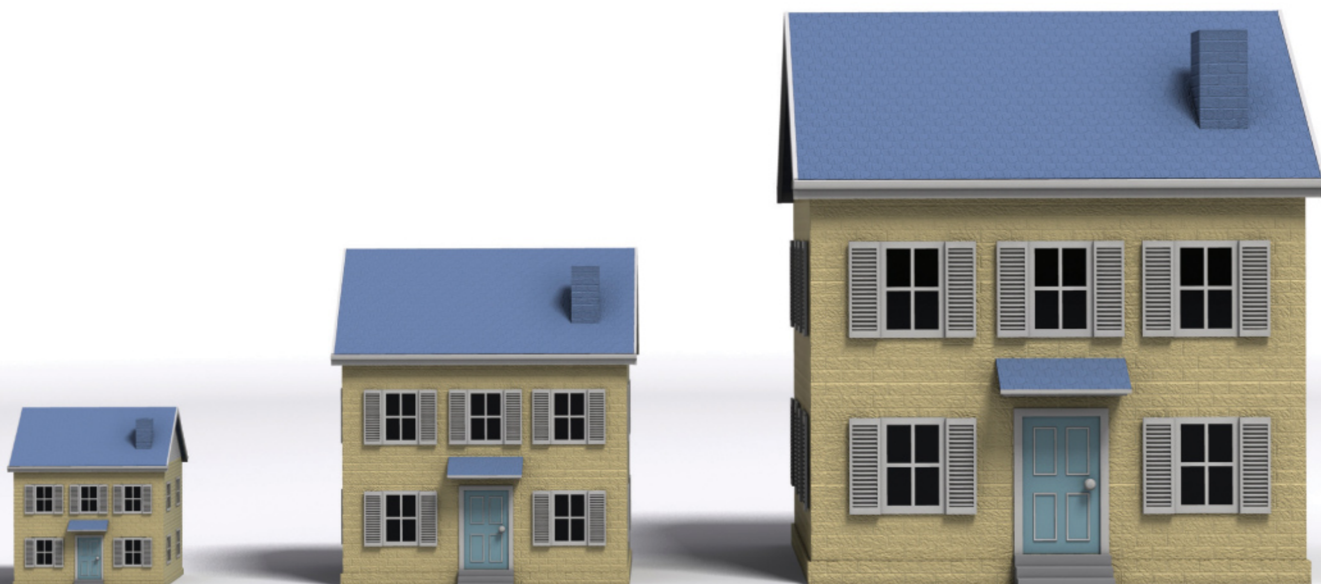
Mortgage News

Your guide to mortgages, finance and property

Winter 2008



Start small; think big

Your *first* home doesn't necessarily have to be your *dream* home

Rising interest rates combined with climbing property prices present a daunting prospect for many first time buyers. But backed by a solid plan, a little flexibility and a long-term approach, your home ownership dreams may quickly become a reality.

The trick to beating the affordability trap is to start small and to keep your eye on the final prize. Even a modest property investment can be a stepping stone to bigger and better things through allowing you to get the most out of the equity you build in your property with each and every mortgage repayment.

Equity is simply the difference between a property's value and what you still owe on your mortgage. Through starting with a more humble first home purchase not only will you build equity more quickly, your initial deposit amount will also be smaller – which means you won't need to spend as much time or money renting before you make your first purchase!

When deciding on how much you can afford to spend on your first home you will need to take a close look at what you can realistically manage in mortgage repayments. Your budget should be your guide – so set yourself a price limit, arrange a mortgage pre-approval through your broker and start searching for properties that match.

It is important to look for suburbs where values are still growing so you can achieve the maximum return on your investment (i.e. grow your equity). This may mean moving to an area that is not initially ideal; just remember that you're looking to get your foot in the door and you won't have to live there forever!

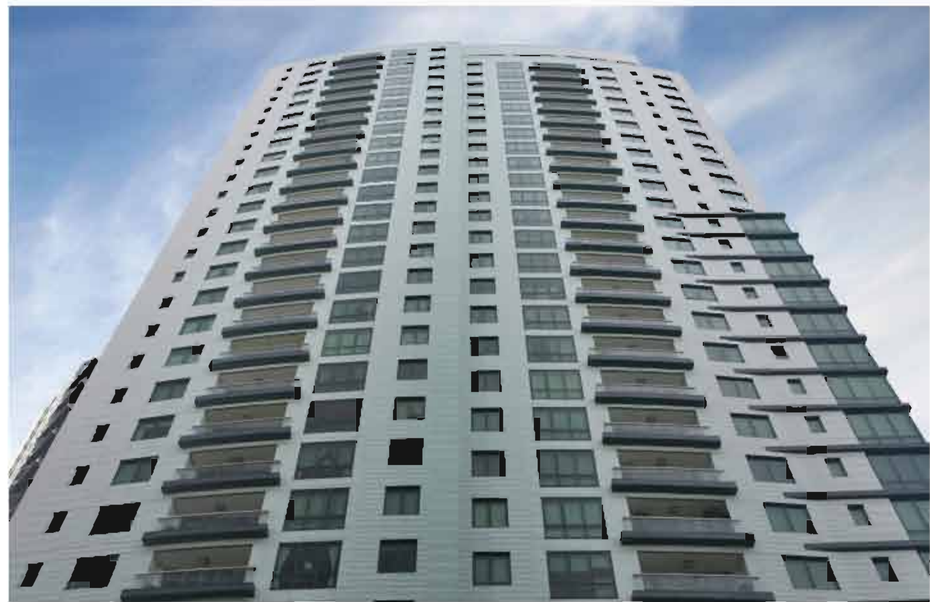
Properties in need of a little TLC or a few minor improvements are also a great way to jump into homeownership without breaking the bank.

Once you have pinpointed the right property, immediately start working at building your equity. A tight control on your household budget and other debt will let you chip away at your repayments. With capital growth as your goal, you may soon be on the move and ready for that next buy.

Becoming a landlord

With demand for rental properties at an all-time high, there may never be a more opportune time to purchase an investment property. Nevertheless, while the potential for strong rental returns have rarely looked better, meeting repayments in a high interest rate environment can be a challenge for investors. Here are a number of important issues to keep in mind if you are considering purchasing an investment property:

- Make sure you can cover the shortfall between rental income and mortgage repayments. Remember, rental income is likely to fluctuate from month to month as repairs and other expenses are deducted. Moreover, increases to interest rates may add to your mortgage repayments. Try and have a buffer of several thousand dollars in your current account to cover the months where rental income falls short.
- If you don't have the time or experience to manage your property it might be a good idea to use an agency. On the upside they'll find and manage tenants as well as look after the collection of rent. However their services come at a cost – usually between five and ten per cent of the rent.
- Property can decline quickly if repairs aren't carried out on a regular basis; you will also lose good tenants if maintenance isn't kept up to scratch. Make sure you have a slush fund available to tackle problems as they happen, and ensure you can afford to keep your property in good shape.
- Understand tax advantages associated with property investment and how to capitalise on them. In this case it is best to discuss these issues with your accountant. If you don't yet have an accountant speak to your broker as they will be able to offer a referral.



Tax breaks

One of the main benefits of an investment property is potential tax savings. While the following list is far from exhaustive, here are a number of costs you may be able to claim against your investment. Make sure you speak with your accountant when factoring any of these costs into your yearly tax return:

• Interest on mortgage repayments	• Land tax
• Advertising for tenants	• Pest control
• Bank charges	• Property agent fees or commissions
• Body corporate fees	• Repairs and maintenance
• Borrowing expenses	• Stationery
• Council rates	• Telephone
• Decline in value of depreciating assets	• Water charges
• Gardening and lawn mowing	• Insurance
• Travel undertaken to inspect the property or to collect the rent	

Cosy doesn't necessarily have to mean costly

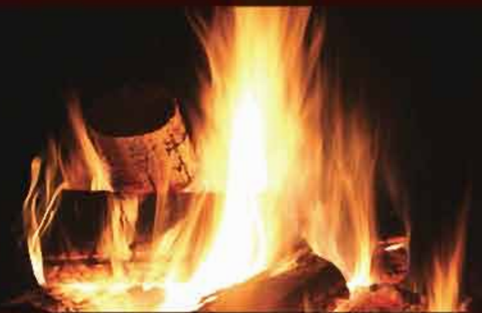
With the winter months upon us, preparing for those cooler nights often means a steeper electricity bill will soon be on its way. The good news is that there are plenty of ways you can reduce your power bill this winter and help the environment to boot.

Use what you've got: To start with, look at all the ways you can keep your house warm without turning on the heater. Keeping blinds and curtains closed and doors sealed when it gets dark should help retain heat. You can also put rugs down on hardwood floors and keep unoccupied rooms shut to retain heat in the main areas of the house.

Invest in a long-term solution: Insulating your home is an easy way to cut your ongoing heating costs – it will also help keep your home cool in the summer. Insulating bats or fibre in the roof will save considerable heat loss; insulating loose fitting windows and doors can also make a big difference.

Be energy smart: Try putting heaters on a time switch to minimise wastage – the same goes for hot water. And if you have central heating, knocking down the thermostat temperature by a few degrees could help save dollars when it comes to paying the bills.

Winter proofing your home



- Keep blinds and curtains closed
- Shut doors to keep heat in main rooms
- Use rugs on hardwood floors
- Turn heating thermostat down
- Install energy efficient appliances

Home loan extras

Drive your mortgage down quicker with a mortgage offset or redraw facility

You might not be aware that a number of handy features are now available with your home loan to help you manage it more effectively – the most common being mortgage offset accounts and redraw facilities.

Both features can make a significant impact as part of a mortgage reduction strategy, taking years off your mortgage and helping to save in interest repayments.

The basis for each technique is simple: by making extra repayments to your principal loan amount you will reduce the interest you are charged – thereby reducing the life of your loan.

While both offset accounts and redraw facilities can be an effective mortgage reduction tool for many borrowers, you may find that you are paying a higher rate on your loan for bells and whistles you don't really need. When discussing these options with your broker, here are some important points you'll need to consider:

- **Redraw facility:** Lets you make extra repayments directly into your loan, helping to drive the principal down faster. This reduces the interest you're charged each month, allowing you to channel more money into cutting the principal loan amount further. Unlike a basic home loan, you can redraw additional repayments if required – to cover school fees for example – without having to refinance your loan. While this offers a degree of flexibility, a redraw is ultimately more expensive: you can often incur fees for each withdrawal and may find that the amount or frequency for withdrawals has a cap. Additionally, you will need to exercise restraint from redrawing amounts too frequently as you may actually extend the life of your loan.
- **Mortgage offset:** This feature effectively allows you to save on the interest you are charged on your mortgage through offsetting its balance against your savings. For example, rather than earning a few per cent interest in a traditional savings account, through placing your savings into your mortgage offset you could save between nine and ten percent interest – the average standard variable interest rate charged on a home loan. You can also direct your salary into the account while servicing your bills and other debts as required. Mortgages that have an offset account attached to it usually charge a higher rate of interest, and often require a substantial amount of cash to remain untouched in the account to reap maximum benefits.

There are obviously pros and cons with both options; make sure you talk through your objectives with your broker before making a decision on adding a redraw or offset facility to your mortgage.

Loan extras at a glance

Feature	Pros	Cons
Redraw facility	Gives you the flexibility to add or withdraw repayments at any time.	A higher rate of interest and additional fees can add up.
Mortgage offset	Allows your working capital to shrink the interest charged on your loan.	Borrowers may need to keep a substantial amount of cash in the offset account in order to be rewarded.

Economic Round-up

A wave of relief washed over homeowners on the third of June as the Reserve Bank of Australia (RBA) spared borrowers from a further rise in interest rates.

Increases in the cash rate in both February and March, on top of independent rate hikes from lenders, have been a heavy cross to bear for most Australian families over recent months. But rates have held steady for three months now and most households have adjusted to their new mortgage repayment costs.

While there is no immediate sign that inflationary pressures will subside, economists have tipped it will peak towards the end of the year. In line with this, the RBA has indicated that a further rate rise could be expected later this year, but some commentators suggest that there is a possibility that rates may even fall as early as next year.

Considering current market conditions it is little wonder that buying and selling activity has indeed slowed significantly and the median Australian property price has all but stalled.

Despite this slowdown, house values are holding up quite well in some states, and with supply constraints expected to remain tight for the foreseeable future, house values are expected to hold steady.

The only capital city market of real concern is Perth where values have declined by 1.3 per cent in the year to April, according to RP Data. Adelaide and Brisbane however continue to offer the strongest levels of yearly growth of 21 and 16.4 per cent respectively.

For those households less highly geared or free from any considerable mortgage burden, it may be a good time to think about an investment purchase. With more and more properties coming on to the market, and less buyers in the position to purchase, bargains are simply waiting to be found.

But for households under pressure and feeling the strain of rising interest rates, they should brace for another rise. While there is no guarantee rates will climb further, it is always prudent to prepare for further belt tightening.

Take the time and effort to get on top of your household finances now and you will be well positioned to keep on top of any additional rate hike. It's always important to build a cash buffer ready to absorb the impact of any increase in mortgage or loan repayments. It is also a good idea to check that your loan is still the best in the market for your needs and to ensure that you take advantage of all of its features.

Whether you are ready to enter the market, or need some advice on managing your mortgage repayments, be sure to visit your mortgage broker for sound, professional advice.

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