What Every INVESTOR Needs To Know About Finding A FANTASTIC FINANCE DEAL

But Didn't Know Or Was Afraid To Ask

By Steve McKnight & Chris Berry

Revealed! What Every Investor Needs To Know About Finding A Fantastic Finance Deal... But Didn't Know Or Was Afraid To Ask

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Why Knowledge Saves

Having invested for nearly twenty years, purchased hundreds of properties, and written hundreds of loans, here's a statement we've come to know is true: if you want to be successful at something you'll need these two things:

1. Knowledge of what you're doing
2. An understanding of the rules of the 'game' you're playing.

Take playing sport for example and basketball in particular. The tactics of offense (i.e. shooting goals) and defense (i.e. defending your goal) are important, but so too are the rules that govern how the game is played. For instance, you might be a great goal-shooter, but if you don't know you can't run with the ball without bouncing it then you have precious few opportunities to excel.

A common mistake made is to focus on *what* to buy, at the expense of fully understanding *why* and *how* to buy.

Investing is the same. Investors need to know how to make money (offense) and how to avoid buying a dud (defense). They also need to know the rules of how to facilitate the overall transaction. This includes knowing how to sensibly finance an acquisition to avoid paying unnecessary interest or being saddled with a loan that fails to deliver the flexibility and features they desire.

For instance, most investors interested in acquiring real estate will usually have an area in mind they'd like to target. They have some idea of what type of property they'd prefer – such as a home, apartment, townhouse, etc. – and hopefully some concept of both the profit they desire and how it will be made. Yet, an area of knowledge that even some relatively successful property investors pay little or no attention to, but which can significantly impact your investment's performance, is a moderate understanding of how the financial system works.

If you lack this knowledge, then you are in dangerous territory because you'll have to rely on the accuracy of what lenders tell you. Sadly, what some lenders say can benefit their bottom line rather than be what's in the client's best interest. For example, the Commonwealth Bank has been taken to task because of the second-class financial advice some of its staff provided to customers.

The cost of ignorance adds up to much more than paying thousands of dollars in unnecessary interest. Investors can forego opportunities because they're unable to finance purchases that could be extremely lucrative.

The aim of this booklet is not to make you a finance expert as such, but rather to provide you with enough knowledge so you know who best to speak to, and what sort of questions to ask. It will allow you to find the right loan, at the right price and with the right conditions to facilitate your planned property acquisition.

The right loan will allow you to buy the right property, at the right price, over and over again.

So grab a coffee and let's start at the beginning – with an explanation of the unique yet complicated beast that is the Australian finance industry.

An Industry Insider's Introduction to the Finance Market

The money market is not an open free-for-all. It is very heavily regulated with specific laws and regulations existing to protect consumers from dodgy lenders – and themselves – insofar as that is possible.

It's not a perfect system. You don't have to search far to find a story of an unfortunate soul who's been taken for a ride. In fact, the industry has its own 'cop on the beat' in the form of a Financial Ombudsman (**www.fos.org.au**).

It seems a consumer cop is very much needed! Did you know that on average there are more than 90 complaints lodged with the Financial Ombudsman each and every day? Hopefully, you'll never need to lodge a complaint, but rather than leaving things to chance, gaining protection starts with knowing who and what you are dealing with. Here goes…

Meet the Players

The Australian financial system has three parts:

1. The *payment system*, which provides bank notes and coins so that goods and services can be acquired without requiring you to exchange what you've produced for what you consume.
2. The *financing system*, which enables you to use credit or obtain a loan and obtain foreign currencies.
3. The financial market *risk management* system, which involves the use of other types of markets and derivatives.

The more you know, the more tools you'll have at your disposal to find the best finance solution, with regard to both price (interest rate) and terms (conditions).

Most of the time you will only ever need to know about #1 (using cash) and #2 (deposits and loans). You can leave #3 to those with finance degrees who stare at computer screens for 15 or more hours of the day.

Specifically, if you're hoping to borrow money, you'll be most interested in those who service the financing system. They are called financial services providers. They are entities involved in the transfer of funds between borrowers and savers.

The major players in the financial services industry are:

- banks
- non-bank financial institutions such as credit unions, building societies, money market corporations and finance companies; and
- insurance companies.

Not all of these players will be relevant to you, but it's a good idea to know who's involved in the game, as it will assist you in understanding where lenders source their money, who your best lender may be and the risks for all parties.

Banks

Banks have traditionally been the dominant institutions in the financial sector, and many consumers think of them with 'confident scepticism', (i.e. they have *confidence* in the belief they will keep our savings safe and *scepticism* because they have a track record of serving themselves first and foremost). It seems a long, long, time ago when a bank manager was seen as a highly trusted career appointment (that said, a bank officer with more than five years' continuous service can still witness a statutory declaration).

Banking is a pretty simple game to understand. Banks *borrow* money by accepting deposits (in cheque and savings accounts, term deposits) and by issuing debt securities such as banknotes and bonds. They then *lend* money to customers via various means (e.g. personal loans, home loans, business overdrafts, etc.), and by investing in marketable debt securities and other forms of money.

The net margin of the bank's interest received over their interest paid is their main bread and butter. The jam on top are the fees they charge for the services they provide.

Most banks provide the following services:

- *Retail banking* – dealing directly with individuals and small businesses
- *Business banking* – providing services to mid-sized businesses
- *Corporate banking* – directed at large business entities
- *Private banking* – providing wealth management services to high net worth individuals and families
- *Investment banking* – relating to activities on the financial markets.

Non-Banking Financial Institutions

The Australian financial system includes a range of non-bank financial institutions (NBFIs), including: building societies, credit unions, finance companies, fund managers, securitisers and mortgage managers.

Building societies and credit unions are the most common NBFIs you'll see advertised in the mainstream media. Whereas a bank is operated for the benefit of its shareholders, a building society or credit union is usually a non-profit business operated for the benefit of its members. Therefore, to be a borrower you must also be a member.

These NBFIs are not usually open to the general public. To join you must share a common bond. For example, they may be open to people working in the same industry – like police, nurses, etc. That said, with amalgamations between different credit unions these bonds are less prevalent and most people would now qualify to join a credit union.

Finance companies provide various types of loans, including credit for retail sales, personal loans, finance for housing, wholesale financing, lease financing and other commercial loans. Most loans to consumers from finance companies are for the purchase of consumer durables over relatively short terms.

Fund managers pool the investment funds of individual investors and invest them on their behalf. The main forms of managed funds are:

- Superannuation funds, which are long-term savings arrangements to provide retirement income
- Insurance offices, which generate funds available due to the time difference between receiving premiums and making payments
- Public unit trusts, which are collective investment schemes.

Other forms of managed funds include:

- Cash management trusts
- Common funds
- Friendly societies.

Securitisers play a very important role in residential lending. Aussie Home Loans was the first non-bank lender to seriously challenge the banks in the residential mortgage market during the 1990s, when it became a pioneer of the securitisation market.

Securitisation involves the conversion of nonliquid assets with predictable cash flows into marketable securities. Say what? Well, a $200,000 mortgage lasting 20 years is not a very liquid asset. It is also not easy to onsell as it is a small fish – a krill – when you consider its size in the overall lending market (the world's oceans). Securitisation means packaging up a whole lot of smaller loans into a bigger loan pool, and then selling that loan pool on to an institutional investor (a whale) who wants the security of mortgage-backed assets. Once sold, the seller has more funds to relend.

Many non-bank residential lenders don't have their own funds. Instead they operate as **Mortgage Managers**. These businesses generally obtain funds through wholesalers who raise money through the securitisation markets mentioned above. Aussie Home Loans (through its own branded loans) and Home Loans Ltd are perhaps the most recognisable high-profile examples of Mortgage Managers.

How Safe is it to Borrow?

Given the finance industry is so heavily regulated, it is quite safe to borrow money in Australia. However, there are risks to be managed.

Loans Being Called in

Most loan documents include a clause that allows the lender to 'call in' the loan after a notice period. Having a loan called in is rare, but it does happen. For instance, during the Global Financial Crisis (GFC), when the loans of some troubled lenders were acquired by other lenders, some delinquent or deficient loans were called in. The best protection against this happening is to keep your loan in good standing (i.e. don't let it get in arrears).

Margin Calls

Alternatively, instead of having the whole loan called in, sometimes there might be a margin call to keep the loan within the agreed parameters. For instance, say you borrow $400,000, being 80% of a property valued at $500,000. Prices immediately fall and the assessed value of the property drops to $400,000. Now the maximum loan should be $320,000 (i.e. 80% of $400,000). The lender might ask the borrower to repay $80,000 to keep the loan within the agreed 80% threshold.

If this sounds unusual, it isn't. Many property developers and commercial real estate investors have had to meet margin calls that repriced their loans to match new bank lending practices. If they can't make the call, the property has to be sold, and if the market is slow there can be horrendous financial consequences.

Break Costs

At the time of the GFC, many residential lenders included significant break costs in their loan contracts. This meant that once you had signed the loan documents they had you on the hook since you had to pay a fee to refinance elsewhere.

With the market captured, some unscrupulous lenders would then increase their rates on existing loans in the knowledge they'd either receive an increased interest return if the customer remained with them, or extra fee income if the loan were refinanced.

Break costs on variable loans have been banned since 2011.

Over-Servicing

It may not be in your best interests to borrow as much as a financier is willing to lend you.

Just because you can, doesn't mean you should.

Remember that a lender makes money on what you borrow. There is no point paying interest on money you won't use, or being over-serviced to buy a bigger or better home or investment property than you might otherwise have bought if you had borrowed less.

The same can be said for being 'sold' bells and whistles on your loan that you pay for but don't use. These include things like redraw facilities, lines of credit, automatic insurance, etc.

Don't let the finance tail wag the investing dog.

An Unintended Unfair Playing Field

Capitalism can't be left unchecked, lest there be booms followed by severe busts. It has been a long time since there was a run on an Australian bank, and confidence in the financial system – in deposit-taking institutions – is extremely important to an efficient economy.

Ensuring the financial system has integrity requires government intervention. One way this is done is by the Federal Government offering a limited guarantee of deposits in approved accounts. Unfortunately, while well-intentioned, this creates an unfair playing field as depositors prefer bank accounts that qualify for this guarantee over other options. When this was introduced in the wake of the GFC, it gave such deposit-offering institutions a big capital boost. Economies of scale meant they could then reduce their interest rates.

Who's Best to Borrow From?

There's no doubt that banks are subject to tighter controls than other lenders. The Federal Government has consistently shown its willingness to assist banks in times of difficulty and to shield them from potentially unpleasant scrutiny. Similar assistance has not been extended to other lenders. However, non-bank lenders are subject to various regulations too, and the risks of a lender becoming insolvent having a major impact on its borrowers do not seem to be particularly high, at least at the time of writing.

From a stability perspective, a larger bank is inherently safer. Yet larger banks are also quite bureaucratic (perhaps a better word is bulldozing?) in their approach. They can be quite unfriendly despite their slogans about caring. If you have a standard loan application and want an off-the-shelf type of loan, then you'll be a customer they want to hear from.

Smaller financiers tend to be more nimble and more willing to work through 'out of the box' issues.

The best answer is that you should find a lender who:

- is willing to lend to you
- on terms that are affordable
- with conditions you can work with; and
- offers access and service standards appropriate to your circumstances.

The Role of Government

As mentioned earlier, if lenders were left to their own devices there would be more severe extremes in the boom and bust economic cycles. Self-interest erodes prudent lending standards, and so the government needs to step in to protect consumers from lenders and lenders from themselves.

One way the government intervenes is by establishing regulatory bodies to oversee and manage government policy in the financial system. Allow me to introduce three statutory bodies:

1. Australian Prudential Regulation Authority (APRA)
2. Australian Securities and Investments Commission (ASIC)
3. Reserve Bank of Australia (RBA).

APRA

The main focus of APRA is to oversee the ability of financial institutions to honour their commitments as and when they fall due. APRA's duties often overlap with other regulatory bodies, in particular ASIC. Both APRA and ASIC acknowledge the close links that exist between the agencies.

APRA administers the prudential components of the following pieces of legislation:

- *Superannuation Industry (Supervision) Act 1993* (the *'SIS' Act*)
- *Retirement Savings Accounts Act 1997*
- *Life Insurance Act 1995*
- *Insurance Act 1973.*

These Acts give APRA responsibility for the prudential regulation of superannuation funds, banks, credit unions, building societies, friendly societies and insurance companies. APRA can intervene when it believes that a financial entity either has, or is likely to, become unable to meet its obligations as and when they fall due. This intervention may even allow

APRA to assume effective control of 'at risk' entities. APRA also takes responsibility for the authorisation of Authorised Deposit Taking Institutions (ADIs), a list of which is published on the APRA website (**www.apra.gov.au)**.

ASIC

ASIC is the main regulator of financial product advisers and financial institutions that participate in the Australian financial system. ASIC describes its purpose as follows:

> *We regulate Australian companies, financial markets, financial services organisations and professionals who deal and advise in investments, superannuation, insurance, deposit taking and credit.*

RBA

The RBA is Australia's central bank. It is responsible for the implementation of monetary policy and the maintenance of financial stability in the Australian economy. The major tool of monetary policy is interest rates, which are heavily influenced by RBA policy. In addition, the RBA provides some banking and registry functions to various government entities.

The Reserve Bank has a role both in mitigating the risk of financial disturbances that may have systemic consequences and in responding to a financial system disturbance should it occur. The RBA works on these matters with other relevant agencies, mainly through the Council of Financial Regulators (CFR).

The CFR, chaired by the Reserve Bank Governor, brings together the RBA, APRA, the Treasury and ASIC, with a mandate to contribute to the efficiency and effectiveness of regulation and the stability of the financial system.

How do these Bodies Affect Lenders?

Banks are highly leveraged, in that the money they lend is largely derived from loans they themselves receive from depositors or other institutions. The RBA influences the cost of the funds utilised by banks by setting a target for the cash rate. The cash rate is the rate at which banks borrow from and lend to each other on an overnight, unsecured basis. This directly influences the costs incurred by banks and also influences the cost and availability of money elsewhere by altering supply and demand within the wider market for money.

APRA is able to have a direct influence on the operations of licensed banks, through their control over factors such as capital management. Put simply, banks are required to set aside an amount of money in a reserve against every dollar that is lent out. This ensures that the banks remain solvent should borrowers default on loans. The higher the percentage the banks are forced to set aside, the lower their profitability unless they respond by charging higher interest rates.

What is the Point of Knowing all this?

When you sign a loan contract you commit to a long-term relationship with that particular lender. Your best chance in making a good decision when choosing a lender lies in having some knowledge about them and how they operate, particularly given the potential for uncertain financial times.

Borrowers are often nervous when considering smaller lenders, seeing them as inherently less stable. While this may be accurate in some circumstances, you now have a detailed picture of the various ways in which lenders are regulated to prevent widespread insolvencies and consequences similar to those experienced in many countries post the 2007-08 Global Financial Crisis (GFC).

Why all the Red Tape?

There are certain obligations that all lenders and brokers must meet in servicing your needs. It is helpful for you to have some knowledge about these requirements as they have a significant effect on the way services are delivered to you, the requirements that are imposed on you during the loan application process, and ultimately, your ability to borrow.

The Australian Government imposes a national consumer credit regulation framework for responsible lending conduct. This framework applies to those who lend or lease and to people who provide credit assistance in relation to loans. These obligations are aimed at better informing borrowers and preventing them from entering, extending or remaining in unsuitable finance products.

The National Credit Code (NCCP)

Not long ago, each State in Australia had its own consumer credit code. This was quite cumbersome and inefficient. In 2008, the Council of Australian Governments (COAG) agreed to the Commonwealth Government taking over responsibility for the regulation of consumer credit, with ASIC becoming the national regulator for consumer credit and finance broking.

ASIC recognised credit as a product on 1 July 2010. It now administers the *National Consumer Credit Protection (NCCP) Act 2009* that regulates the following areas:

- Home loans, personal loans, credit cards, consumer leases, overdrafts and line of credit accounts, among other products and services
- Contractual and pre-contractual forms and disclosure requirements, restrictions on interest, fees and charges
- Changes to contracts both by agreement or resulting from hardship or unconscionable conduct by the lender
- Provision of account statements with specified information
- The termination of credit contracts
- Provisions regarding security types and guarantees
- The definition of breaches and subsequent remedies
- Credit-related insurance, including restrictions on financing insurance premiums, limits on commissions paid by an insurer and provisions automatically terminating an insurance contract where a loan is terminated
- Changes to interest rate and comparison rate disclosure requirements as well as restrictions on false or misleading representations, harassment and credit hawking
- The requirement for all persons who engage in credit activities to have an Australian credit licence or be a representative of a credit licensee.

The key facet of the obligations required of lenders under NCCP is that they:

- reasonably inquire and verify your financial circumstances to assess whether the proposed loan will meet your requirements; and
- that you have the capacity to repay the loan contract.

Discharging this responsibility demands increased identification, income and expense verification to be required by lenders for all loans, and it explains why it is harder for certain types of people to borrow. It is definitely true that loan applications have become very invasive in respect to the information you're required to provide. It is unlikely things will ever revert to the easier way they once were, particularly as having more information allows lenders to cross-sell other products to you.

Here are some of the questions or considerations a lender has to contemplate when you make a loan application:

- Your current amount and source of income or benefits (this would include the nature of your employment, e.g. full-time, part-time or casual)
- The extent of your fixed expenses (such as rent, repayment of existing debts, child support and recurring expenses such as insurance)
- Your variable expenses (and drivers of variable expenses such as dependants and any particular or unusual circumstances)
- The extent to which any existing loans are to be repaid from the credit advanced
- Your credit history, including any existing or previous defaults by you in making payments under a loan
- Your existing credit arrangements when considering whether to offer credit as part of a refinancing transaction
- The maximum amount to be repaid under the loan (including fees)
- Your personal circumstances, including age and number of dependants
- Your assets (including nature and value)
- Geographical factors connected to where you live, such as remoteness, which may require consideration of specific issues (such as potentially higher living costs compared to urban areas
- Your future prospects, including any significant change in your financial circumstances that may be reasonably foreseeable (such as a change in the amount you may have to pay under the loan or under any other loan to which you are party).

The significance of these inquiries will be dependent on the circumstances. For example, expenses such as a monthly mobile phone bill may be a proportionately significant expense for a low income earner, therefore reasonable inquiries would seek to ensure that such matters have been included in the borrower's expenses. In contrast, the mobile phone expense may not be significant to a high net worth individual and may require little further inquiry.

It is easy to become frustrated with the amount of information you are required to provide when applying for a loan, but you need to remember that brokers and lenders have no choice but to operate within the credit policies of their employer, and the robust legislative requirements enforced by ASIC and other government departments.

Help your lender help you!

The people trying to assist you are unlikely to ask questions or require particular information for any reason other than to make your application more likely to succeed and to meet their own legal obligations.

Building a Winning Relationship with your Lender

Relationships in the finance industry are very important, as they are in all areas of life. Yet many people forget this when dealing with money. They also may not fully appreciate that relationships are between people; institutions have no feelings.

Buildings don't have feelings. People do.

As an investor, you're likely to (at some stage) want to push the envelope in terms of leverage, pricing, servicing or some other facet of lending. In the current environment where lending rules are very rigid and decision-makers are loath to move outside of their stated policies, a strong track record and either an ally inside the lending institution of your choice, or assistance from someone with such a relationship, are critical to achieve your objective.

This doesn't mean that you must be monogamous with a particular lender or broker, but it's necessary to have empathy with the position of the person you're dealing with. The incomes of loan officers and brokers are tied to the business they do with you and other customers. Often there are financial repercussions for them if loan applications are declined or discharged early. If you do not disclose all relevant information about your current position and future plans you make yourself significantly less valuable to them. You can expect this to be exhibited in the way that they deal with you in future. This is human nature.

The issue of commission claw-backs comes up frequently and often causes friction between property investors and brokers. Most lenders reclaim commissions on loans that are discharged within two years of being first drawn. There are some brokers that require customers to sign contracts obliging them to reimburse this amount. We (along with most other brokers) do not do this. We see such expenses as a cost of doing business, but it is important that you recognise that the person you are dealing with is likely to be working for free if they arrange a loan for you that you intend to discharge within two years. It is important to your future relationship with them that you are open and honest about your intentions if you wish to develop a strong working relationship.

The Role of Mortgage Brokers

Mortgage broking rose from the ashes of large-scale bank redundancies. Some bright spark decided that, instead of having salaried employees, banks could reduce their overhead by laying off loan staff and then re-engaging them as consultants paid on commission. That way they could reduce overheads and increase their sales force at the same time.

A good broker won't cost you a cent. They will be paid by the lender, and only if the deal is done.

Since that time, the mortgage broking industry has evolved into something useful, albeit sales-focused. Unless the broker is 'fee for service' and charges an agreed rate, they will only get paid if a loan is successfully written. They will be paid by the lender rather than the borrower.

A smart mortgage broker is a powerful ally because they will know how to best match your deal with a lender that is interested in your business. This can save time and stress, as, instead of trying to build your own network, you can rely on theirs.

Some mortgage brokers are still affiliated with a particular lender, for example they may be an ANZ mobile lender. These are normally franchises sold by the bank based on regions. In this case, the broker is still tied to ANZ lending policy and so the choice of options they can offer you may be limited. That said, the broker will have an intimate understanding of what can be done and how to work the process to the best benefit of all parties.

Broker or Banker?

If you have an existing relationship, you'll probably get the best deal by choosing to stay with the banker or broker you know and who has a track record of good performance. Having said that though, it's wise to shop around from time to time, or to get a second opinion, to ensure the terms you are being offered really are the best available.

It would be remiss of us not to mention that Chris Berry and his expert team can help you find a lender and a loan that meets your finance needs – at no cost to you. See the special offer at the end of this report for more information about how to take advantage of this.

A tip to remember if you are shopping around is to get indicative pricing without approving credit checks. Otherwise you will have multiple enquiries on your credit record and this can be a red flag to some lenders.

The Three Essential Loan Variables

The three most important pieces of information regarding a potential loan are:

1. The type of loan that best matches your assessed situation – full doc, no doc, non-conforming, etc.
2. The structure of how the loan will be repaid – principal and interest (P&I), interest only (IO), redraw, etc.
3. How the interest on the loan is levied.

1. Assessment

Understanding how a lender will assess your application is important because there's no point applying to a financier if you aren't a customer they desire or commonly lend to.

If you take away all the reasons why a lender may say no, they'll have to say yes and your loan will be approved!

Here are some of the more important variables a lender will consider when evaluating your finance application.

Borrowing limits

This is sometimes referred to as the maximum loan-to-valuation ratio (LVR) a lender will accept. For instance, a loan of $800,000 against a property valued at $1m would result in an LVR of 80%.

Different lenders are willing to lend differing percentages of a property's value. For instance, Lender 1 may lend you up to 80% of the purchase price, whereas Lender 2 may lend you up to 90%. This could be the case with the same property, same application. It just means that to one financier you and the property may be a more appealing risk proposition, and so they'll be willing to lend more.

Factors such as the property's location, the type of property to be financed, the financial status and history of the applicant, and whether the application is to fund a purchase or a refinance, are all variables that will affect the final LVR that you are offered.

Does your proposed lender offer a loan with a sufficient LVR to meet your borrowing needs? If not, find a different lender, or find a way to increase your deposit.

The willingness of a lender to provide the level of funding you seek should be the primary factor in your choice of lender!

Documentation

The amount of documentation you can provide to support your finance application will mean your loan is assessed as either full doc, low doc or non-conforming.

Full Doc Loans

Full documentation loans, known in the industry as 'full doc' loans, are the highest quality, and therefore the most sought after form of substantiation.

To qualify for a full doc loan, you'll need to verify your income and assets through the provision of financial and other related documents (see below). Providing these documents will help prove your ability to repay the loan, and therefore support your creditworthiness.

- At least the past two years of income tax returns
- Pay slips confirming your gross salary and any deductions
- Bank statements
- If you are a business or self-employed, financial statements including a profit and loss and balance sheet. If these cannot be provided, then a letter from your accountant supporting management accounts/budgets
- Loan statements and details of debt obligations, including amounts, interest rates, minimum repayments, etc.

Most of the documents listed above should be easily accessible, especially with some assistance from your accountant.

Potentially, LVRs of up to, and even exceeding, 95% are possible to obtain, provided you qualify as a full doc loan applicant.

This next revelation is very, very important. When taking out a loan of up to an 80% LVR for a full doc loan, borrowers are generally not required to pay for Lenders Mortgage Insurance (LMI).

The better your documentation, the more you'll be able to borrow.

LMI is insurance that the lender can claim against to be paid in the event you default on the loan. It is not for the benefit of the borrower, just the lender.

Interestingly, almost every non-bank loan written will be insured with LMI. However, the cost is absorbed rather than passed on if the loan is full doc and has an LVR of 80% or less.

The cost of the LMI premium is determined according to the dollar amount and LVR of the loan. The higher the loan and/or the higher the LVR, the higher the cost of insurance. Not having to pay LMI can save you hundreds, maybe thousands of dollars. Furthermore, sometimes a mortgage insurer will impose even tighter restrictions than the lender on factors such as loan size.

Are you self-employed? If so then it may be harder for you than a salary- or wage-earner to borrow money. That said, most self-employed or small business borrowers are able to demonstrate their income by providing financial statements and tax returns prepared by their accountant. However, there are many cases when you don't have regular income streams or when you may not be in a position to provide current financial information as required by lenders. All is not lost, as you may still be able to qualify for a 'low doc' loan.

Low Doc Loans

As implied by the name, a low doc loan requires less documentation on the upside, but there are some nasties as described below. Documentation required for low doc loans varies from lender to lender, but typically includes:

- A self-declaration of your income
- An accountant's letter to verify your personal/business solvency and trade position
- 12 months of Business Activity Statements
- 3 months of business account statements.

If you're self-employed then you'll also need a current Australian Business Number (ABN) and to be registered for the Goods and Services Tax (GST). The ABN must also have been registered for at least a period of between six months and two years depending on the lender.

Low doc loans generally attract higher interest rates and have lower LVR thresholds. They typically have a maximum LVR of 80%, with LMI payable by the borrower on loans that exceed a 60% LVR.

Non-Conforming Loans

If you don't meet the requirements of a full doc or low doc loan, you may still qualify for finance in the form of a 'non-conforming loan'. These home loans tend to be provided by specialist lenders who target borrowers who do not meet the lender's strict credit criteria for mainstream lending. These borrowers include those with a bad credit history, loan defaults, new migrants with no credit history, seasonal or casual workers, etc. Non-conforming loans are generally more expensive than other products as lenders price in higher risk in the form of premium application fees and inflated interest rates.

2. Structure

Once upon a time, mortgages were provided by brand name banks. They were principal and interest (P&I) loans and went for 25 years. Period.

Nowadays, there is a lot more flexibility, a lot more choice and many more lenders. Here are some of the common key terms when it comes to describing the way your loan may be structured (i.e. set up).

Term Loans

The most common type of loan is a simple term loan. This is a facility set up to be fully paid off over a defined period, generally 25 to 30 years. Term loans may have the option of an interest-only (IO) period before reverting to P&I payments.

Term loans may have fixed or floating (i.e. variable) interest rates. Variable interest rates can go up and down depending on movements in the Reserve Bank cash rate and bank policy.

As a side note, in the US, variable loans are called adjustable-rate mortgages or ARMs. If you are a student of history, then you may be interested to know that ARMs were credited for having a substantial part to play in causing the global financial crisis. In the US, lenders provided heavily discounted fixed-rate loans in the form of upfront cheap finance. But once the cheaper fixed period wore off, a higher variable rate took over. The fix against paying a higher rate was to refinance to another low-interest fixed loan before the initial low-interest period ended. However, as credit became tighter, refinance became more difficult and so borrowers who were stuck with the higher variable interest rate were faced with dramatically higher loan repayments. As job lay-offs hit and unemployment increased, house prices fell and a large percentage of those ARMs (which were syndicated and sold around the world as AAA debt) went into delinquency.

Offset Accounts

An offset account is a deposit account that is connected to your loan. When calculating the interest due, the balance in the deposit account is deducted from (i.e. offset against) the amount you owe on your loan. For example, if you have a $300,000 home loan and you have $10,000 in your offset account, interest is calculated on the balance of $290,000. Most loans have interest calculated daily, so the daily balance of both accounts at the specified time is used. Funds in your deposit/offset account are usually accessible at call and without any fees.

Be sure that your loan is a 100% mortgage offset rather than an interest offset. Rather than offsetting the account balances, an interest offset deducts the interest on the deposit account from the interest on the loan account. However, typically the interest on the offset deposit account is a lot lower than the interest on the debt, and the interest earned is subject to taxation, whereas interest saved (by using a 100% mortgage offset) is not taxable.

Be sure to know what sort of offset account you're getting.

Mortgage offset accounts can be very effective if used correctly, but bear in mind that some lenders charge additional monthly fees for the privilege of having this feature. It's important to do your sums to weigh up the cost versus benefit of an offset facility. If you have little savings to put in the offset account then you might be paying for something that isn't overly useful to you.

Redraw Facility

If you decide to make extra payments on your mortgage and would like to then access the surplus you have repaid, or else you would like to take back some of the principal you've repaid, you may be able to make a 'redraw' request.

Whereas an offset facility entails a separate deposit account, which then offsets the loan, a redraw is a payment off the actual loan account.

Assuming you can redraw, some lenders have minimum amounts you can redraw, and there may be a fee to access the money.

Line of Credit (aka Equity Loans)

Line of credit (LOC) or equity loans are loans that provide you with a specific credit limit that is secured against a registered mortgage over a residential property.

Borrowers use these loans for a number of reasons including for renovations, investments or to purchase other properties. The alternative is to use savings, which might be unattractive because of the opportunity cost, or other loan products (such as credit cards or personal loans), which might be unattractive because of the higher borrowing costs.

Usually, you are required to pay minimum interest repayments on your line of credit each month, with the principal repayments not usually required. Interest is only charged on the portion of credit that is used.

Building and Construction Loans

If you're building a new home, developing a property or planning major renovations to your existing home, a construction loan is generally the most appropriate funding option. The major difference between a construction loan and a standard home loan is that in the case of a construction loan, the loan is usually drawn down in stages. Progress payments, or drawdowns, coincide with the initial purchase of the land followed by a number of key construction stages. This type of loan is ideal for building or developing as you only pay interest on the amounts you have drawn down.

One of the negatives of a building and construction loan is that the lender won't lend a percentage of every dollar needed, but rather 100% of the last portion of the loan. For instance, if you had a construction loan that was for 80% of a $500,000 house you were building, you would need to put in the first $100,000 and then the bank would fund the remaining $400,000, as opposed to providing 80 cents in every dollar. In other words, you need to fund the initial 20% spend upfront.

Portable Loan

A portable loan allows you to transfer an existing loan to another property without refinancing. This saves you time and money on application and legal fees. While you can substitute properties with a portable loan, you won't be allowed to change lenders.

Some Expert Tips on Loan Structuring

Smart loan structuring requires that your banking is efficient, interest costs are minimised and allowable tax deductions are maximised.

Interest rate is important, but it is not the be-all and end-all of the loan.

When comparing loans, most borrowers look at the interest rate first, second and third! Yes, the interest rate *is* important, but it is only one factor that influences the end cost of a loan. All the features mentioned above have great value in certain circumstances and should be considered on merit.

Issues relating to the tax deductibility of interest are often complex and should be considered on an as-needs basis with your accountant. That said, here are some guiding principles:

- The tax deductibility of loan interest depends on the purpose for which the funds were drawn, not the security for the loan. For instance, the interest on a $10,000 redraw using a loan secured against your investment property to pay for a family holiday to Croatia won't be deductible (as the purpose was to pay for a holiday, not to earn assessable income).
- The purpose of the initial drawing of funds from a loan is obviously important, but so too are the purposes for any funds accessed through redrawing from a term loan or a LOC.
- The movement of funds in and out of an offset account has the same impact on interest costs as paying down and redrawing from a loan, but it does not alter the loan balance and so there is no change in the purpose of the funds drawn. Be sure to consider HOW to take offset account funds out if you want to use them to purchase a further investment. You wouldn't want to 'mix' your personal drawings with investment drawings. Speak to your adviser about this scenario.
- There is little or no cost involved in splitting a loan into two or more accounts if there is more than one purpose for the funds. Having these split accounts can make keeping track of deductible and non deductible interest a lot easier!

Please note again that while this information is important to know, it is general in nature and cannot replace appropriate advice from your accountant.

3. Interest

The cost of finance is calculated based on a formula with the following variables:

1. The interest rate
2. The time period
3. The principal loan sum outstanding.

Most loans have interest calculated daily, so the interest rate applicable on that day is applied to the loan amount outstanding, multiplied by one three-hundred-and-sixtieth (i.e. one day based on a 360-day year, which is a standard used in the lending industry).

Some common terms used to classify loans based on how interest is determined are looked at below.

Variable Interest Rate Loans

We outlined these loans a little earlier when we noted that they're called ARMs in the US, and they were partly responsible for the global financial crisis.

To recap, a variable interest rate loan means the interest rate (remember – that's the price you pay for borrowing someone else's money) your lender charges will vary throughout the life of your loan, according to market conditions and bank policy.

Once upon a time, interest rates moved quite predictably with movements in the Reserve Bank of Australia's (RBA) cash rate. Not so any more. To protect their profits, lenders will sometimes cut rates by less than the decrease in the RBA's cash rate, and sometimes they will increase over and above the RBA cash rate increase (or even increase without an RBA increase).

In other words, a variable interest rate loan means your loan repayments can increase or decrease at any time. No one is too concerned about a rate decrease, but a rate increase can be a real headache if it makes your loan less affordable.

Interest rates can't stay at historic lows forever!

In more modern times, interest rates have been at historic lows. This is the complete opposite to the early 1990s when interest rates on home loans hit 18% per annum, and on business overdrafts the rate was in the low 20% range! Ouch!

Interest rates can't stay at historic lows forever. Sooner or later they will rise, and as an investor you need to have a plan for what you'll do when that happens.

Many variable loans now offer a plethora of features such as an offset account or the ability to make extra repayments and redraw funds. Some institutions also offer basic or 'no-frills' variable loans with a lower interest rate but fewer features.

Your interest rate is usually negotiable. Go on – ask for a discount and see what happens!

Benchmark Home Loan Interest Rate

The standard variable home loan interest rate is called the 'benchmark rate'. It is the headline rate quoted by banks and other lenders. Somewhat oddly, these rates are not what customers usually pay. Instead, they are the starting rate and further discounts are usually applied depending on what a borrower may qualify for. For instance, if you are borrowing more than $500,000, and you are part of some professional or union body, you will generally qualify for an interest rate discount of between 0.10% and 0.70% per annum.

That said, the advertised interest rate tends to be no-frills, so if you want something creative then that will be the lender's opportunity to add more margin by increasing the interest rate.

A smart money tip, when interest rates are falling, is to keep your loan repayment amount the same (rather than reducing it), and to apply the extra money towards repaying the principal loan sum. This will help you repay the loan sooner and can save you thousands of dollars of interest over the term of the loan.

Fixed interest rates deliver repayment certainty, but it comes at a price.

Fixed Rate Loans

Unlike variable loans, fixed rate loans allow you to fix your interest rates, and therefore your repayments, for an agreed period of time. In the US, you can fix your loan for 25 years! This is not the case in Australia where the term of a fixed rate loan is shorter: usually one to five years. At the end of the fixed rate period the loan will typically revert to a variable loan, or you may choose to roll over for another fixed term at the interest rate applicable at that time.

There are widely varying opinions on the efficacy of fixing rates.

Arguments for fixing your interest rate	Arguments against fixing your interest rate
• Provides protection against the extra cost of higher interest rates • Allows you to budget with greater confidence • Gives you peace of mind	• The fixed interest rate is sometimes higher than the variable interest rate • There is probably going to be a break cost if you want to repay the loan early • Offers less flexibility for creative options

Most finance professionals hold the belief that fixing your interest rate has merit when you plan to hold the asset for the long-term and either cannot afford higher rates, or where you wish to lock in a particular level of cash flow return. Fixing or not fixing purely because you hold a view on where rates are likely to head is very much like speculating or gambling.

Here's a good tip – if you are planning to fix your interest rate, make sure you match your fixed-rate period to the minimum time you plan to keep a property. For example, do not take a fixed rate for ten years if you may sell the property in three years. Why? Because there can be significant costs involved in breaking a fixed rate loan contract.

Split Loans

A split loan is one where a portion of the principal attracts a fixed interest rate, and a portion attracts a variable interest rate.

Honeymoon and Introductory Loans

These loans have short-term appealing features, such as a low headline interest rate, but when the term is over, they revert to reality, which is usually a standard variable rate. The honeymoon or introductory period is usually one year, although it can be shorter (say six months) or longer (as much as three years). Sometimes these special rates may be fixed or capped for the initial period but, make no mistake, once the grace period is over, your cost of finance will increase, so be sure to make the most of your honeymoon interest rate.

Limited Guarantor Loans

If your credit is unproven or blighted, you can still qualify for credit if your loan performance is underwritten by another person or party who is creditworthy. This arrangement is called a *guarantee*, and the person who provides it is known as the *guarantor*.

Where possible, try to avoid guarantees.

As the name suggests, a limited guarantor loan or an equity guarantee loan is a loan that allows family members to assist you with your loan, by guaranteeing a part of your loan. Family members 'pledge' to aid the borrower and will act as the guarantor by providing extra security and/or by assisting with repayments.

Lenders like guarantees. While it reduces their risk, they rarely if ever reduce their rate. A good rule to apply is to avoid offering up something that you are not being compensated for.

Comparison Rate

You won't be surprised to learn that a common advertising trick a while back was to offer a very low headline interest rate, but to then load it up with fees, so that the actual effective rate after fees was substantially higher than the advertised rate. In an effort to add transparency, laws were introduced so that lenders had to advertise a comparison rate – one that included all interest and fees – alongside the headline rate.

The problem with a comparison rate is that while it is helpful, assumptions need to be made to calculate the percentage and these assumptions (such as loan amount, term, repayment frequency, fees and charges, etc.), and these variables, are before negotiation and may not apply to your circumstances.

Choosing a Loan and a Lender that's Right for you

Money is homogeneous (meaning it's the same no matter where it comes from), which is why lenders have to add various bells and whistles to carve out a market niche and market position. Some seek out certain types of borrowers based on their career, others prefer to lend to businesses rather than consumers, some target higher risk borrowers, others target housing product.

The debt market is wide and it is deep. Provided you qualify, there will be a loan for you.

It's useful to remember that in order to make a profit, a lender has to lend at a margin above their cost of funds. We'd be surprised if Chris and his expert team couldn't find a lender for you irrespective of your credit history and loan needs.

That said, you don't just want to accept money from anyone. The best loan for you is one that matches your time (loan term or duration), money (sum you want to borrow), affordability (what you can afford to repay – both in respect to interest and principal), and convenience needs (bells and whistles such as offset, redraw, etc.).

The cheapest loan may not be the best loan!

This is a very, very important point…

A cheap loan is nice, but if it doesn't meet your time, affordability or convenience needs then steer clear.

Let me say this again. For the most part, you should choose a loan product that best suits your time, money, affordability and convenience needs. Where the money comes from is largely irrelevant.

Ten Summary Points

If you've been diligent and managed to read this entire special report, then well done! You are now armed with knowledge that can help you make smarter financial decisions.

To conclude, we'd like to leave you with these ten points:

1. Lenders need you as much as you need them. Without borrowers they don't have profits, and without profits they don't have a business.

2. Not every lender will want you as a client. That's okay, there are a lot of lenders and there is sure to be at least one that will lend to you – at a price.

3. The best loan for you is one where the loan's time, money, affordability and convenience match your investment needs.

4. Money supply (meaning being able to source a loan), is more important than the cost of money.

5. If the difference between saying yes and no to a potential acquisition is squabbling about a few percentage points on the loan, then it's unlikely to be a good deal in the first place.

6. There isn't much loyalty in lending. If you can refinance to get a better deal, then a dollar saved is an extra dollar earned. Just make sure the savings match the hassle of swapping lenders.

7. Just because you can borrow more, doesn't mean you should. Avoid being over-serviced by only paying for the loan features you will think you'll need and use.

8. If you have an existing relationship, keep it strong. Paradoxically, it is easier to source finance when you don't need it whereas the more desperate you are, the harder it will be.

9. If you have a plan for getting into debt, also have a plan for getting out of debt, eventually.

10. It only makes sense to borrow when you can get a return on investment sufficiently higher than the cost of debt to cover overheads and your desired profit.

How To Get Me And My Expert Team Working For You For **Free**... And If We Can't Find You A Better Finance Deal **I'll Give You $100!**

From Mr Chris Berry – PropertyInvesting.com's In House Finance Expert

Dear Friend,

If you're in the market for a great finance deal and would like to have me and my expert team source and secure a fantastic loan for you, then read and act on this incredible offer now!

My name is Chris Berry and I'm the guy in charge here at PropertyInvestingFinance.com.

I own and operate a boutique mortgage broking service that has a special niche – helping property investors just like you source and secure finance that works.

I'm a property owner too, and I know just how frustrating it is dealing with boring bankers and bothersome brokers – folks who make you feel like they're doing you a favour by returning your call or email… if they even do that!

You see, we pride ourselves on finding smart financial solutions and have special expertise in working with property investors, such as Christopher Henry.

> *"I met Chris at Steve McKnight's Millionaire Mega Conference held in June 2018 after previously contacting him via email. From reading Chris' articles on propertyinvesting.com I was initially drawn to his insightful, in depth and up to date financial knowledge.*
>
> *From the outset Chris was extremely helpful with my initial enquiries, providing me with a no-nonsense clear approach to my financial situation and goals. He provided unbiased advice which has increased both my knowledge and confidence by immeasurable amounts.*
>
> *Chris has been nothing short of amazing to deal with in terms of customer service, attention to detail and prompt assistance. He has been instrumental in assisting me to reach a financial position whereby I can now invest in my chosen strategy, which before I met Chris I estimated to be over 18 months away.*
>
> *Not only has Chris assisted me to release much needed equity in my own home. He has restructed my mortgage to achieve an interest rate decrease of over 40 basis points and been pivotal in securing investment finance at a time when lending is at its toughest.*

I have been able to contact Chris at any time of day including weekends for valued and prompt assistance.

I could not be more satisfied and could not recommend Chris highly enough to anyone seeking finance or lending advice.

I look forward to continuing to work with Chris as part of my team in reaching my financial goals.

—Christopher Henry

And now my team and I would like to help you too, and best of all, it won't cost you a cent. How can this be? Well, we will get paid by the lender, but only if the loan meets all your needs, and theirs. But here's a guarantee we can only afford to give because we're so good at what we do… if we can't find you a better deal than what you've currently got or been offered, then we'll give you $100 cash just for trying us out.

You have nothing to lose, other than the chance of having me and my team find you a fantastic finance deal. So come on, let's get the process going. Simply register your details at **www.PropertyInvestingFinance.com** and me or one of my expert team will be back in touch with you as soon as possible.

Sincerely,

Christopher Berry

Chris Berry

P.S. Remember, this is no-obligation and won't cost you a single cent! Just be quick because the sooner you register, the sooner we'll get to work to find you the fantastic finance you deserve!