Types of home loans

The range of home loans on the market appears vast but there really aren't as many as you think. The lenders use flash brand names for their loans to try and appear different but at the end of the day, they can be broken down to 10 different sorts of loan styles. They may vary slightly from lender to lender but they are essentially the same.

In this PDF we're going to have a little look at the types of loans around, what makes them tick and in which circumstances they would be most suitable. There is some finance jargon in this paper which I hope I have explained at the time of use but you may wish to have the "technical terms" web page open while you read this to clarify things.

Standard variable: This is the default loan type which is available just about everywhere. Being variable the interest rate will fluctuate with the market rise and falls. The standard variable usually has all options available in it from extra re-payments, re-draw, loan splits (more than one account), portability (move loan to another property), construction and various payment and access features.

It is never the cheapest loan in the market and is rarely used when a loan is initially set up (unless it has a discount package on it – more about that in Professional packs). Its primary use from a lenders perspective is when you automatically change from a "Honeymoon" or "Fixed" interest rate product at the end of the fixed term, you end up on the Standard Variable until you specify some other form of loan.

Generally, if you're on a standard variable, you could probably change products and save yourself some money. (Doesn't apply to specialist lending where the only rate is standard variable. Specialist lending is covered in its own section below)

Basic variable: A real favorite of mine, the basic variable is the "no frills" version of the Standard Variable. The interest rate is still variable but is generally half a percent lower than the standard variable. Traditionally the basic variable has had limited features to justify the lower rate but in these days of electronic banking, a number of lenders are throwing in the internet features for free (such as re-draw, Bpay, pay anyone etc)

The reduced rate is for the life of the loan (subject to market fluctuations) and the entry fees are usually lower as well which makes it a brilliant general purpose product. Not all lenders offer the internet bonuses so you should speak to a mortgage broker on 1300 139 883 to find the right one for your needs.

Discount, Introductory or Honeymoon rate: A loan with a significantly discounted interest rate for the first year or eighteen months, switching to the Standard Variable rate at the end of the discount period. These loans can be Fixed or Variable depending on the lender or product.

They seem like a great idea but when you have a look at them closely, after the initial discount term, you end up on the Standard Variable rate which is a higher rate than you probably need to be on. We used to be able to get around that by switching to a Basic rate at the end of the Discount term but a number of lenders have twigged to that one and now won't let you switch from the Standard Variable for 5 years so in the long run you end up paying more.

Fixed rates: these are loans where the interest rate is "locked in" for a specified period of time (usually 1 to 5 years but can be as long as 15 years). Good for people who are concerned about interest rate rises and want to lock in a set monthly repayment.

There are a couple of disadvantages – They can be expensive to get out of if you "break" the Fixed term (don't take a 5 year fixed rate if you intend to sell the property after 2 years for example). They have very little flexibility (minimal extra re-payment options and most don't have re-draw). The interest rates usually start above the standard variable (unless interest rates are likely to come down in the short term) so you pay more for them anyway and interest rates would need to go up for you to come out ahead in the long term.

Banks generally don't like to lose money so they price their fixed term rates accordingly. They are rarely wrong and pay financial economists a lot of money to get it right. By the time you think rates will be going up, they have already factored that into their Fixed rates.

Professional Packs: These are interest rate reductions off the Standard variable for loans over a certain size. They give you all the benefits of the Standard variable but at a rate more like the Basic variable.

These loans were originally brought out for Professionals (hence the name) but have changed theses days to focus just on the loan amount. They can be fixed or variable and sometimes available for Line of credit and Lo-Doc loans as well.

The interest rate discount is partially offset by monthly or annual fees but when set up correctly Professional packs are often the cheapest interest rates going around. The discounts vary from lender to lender buy usually kick in with a .5% discount at $250,000 and up to .7% discount over $500,000 borrowings. Some lenders also require you to take a bundle of products to qualify (such as a credit card, savings account or insurance product)

All in one / Line of credit (LOC): These are brilliant loan ***in the right hands!*** And, if used correctly can reduce your home loan very quickly. They generally have an interest rate around the standard variable or in some cases higher but are worth it because you have the ability to reduce your loan quickly and save much more interest that the higher rate would cost.

They are not for everyone and to be managed effectively you need to be a conservative spender and have a good control of you budget.

They work on the theory that your home loan becomes an alternative to you savings account (in truth, a well run LOC removes the need to have a separate savings account). Your entire income goes directly into your home loan while you live off an attached credit card. The credit card gets paid in full by the home loan on the due date and any surplus income remains on your home loan helping to reduce the balance.

There are a number of traps though, they are hard to keep track of and can easily get out of control. Set up is critical to the success of a LOC and you should know how to work it inside and out before attempting it. Banks don’t particularly like them very much and often set them up with flaws in them or simply don’t tell you how to use them properly. If you would like to know more, call 1300 139 883 for more information.

Offset loans: Similar to a Line of Credit in theory, they operate in basically the same way except that instead of running everything through the home loan; you run everything through a savings account, the balance of which is offset against the balance of the home loan debt. E.g. if your home loan was $100,000 and you had $10,000 in your Offset account, you would only pay interest on $90,000.

I prefer a line of credit myself but some people like Offset accounts because they are easier to track. An Offset should be run as a LOC but doesn’t have to be and as with the LOC, there are a number of traps so call 1300 139 883 for more information.

No Deposit loans: Contrary to popular belief, these loans are very hard to get. Very few lenders do them and those that do like people to be in stable jobs, have good credit and be buying a normal property in a city or large regional center. The interest rate is usually higher (due to the risk of lending the entire amount of the property) and the entry fees can be quite nasty as well.

There are a number of different requirements which can change depending on the lender, all of which are too numerous to mention here, if you want a 100% loan, you will need to be squeaky clean and ready to jump through a few extra hoops to get one.

There are also a few options available where an existing family member has equity in some property and allows you to use their property as security for the loan which can do the same sort of thing. These loans have really replaced the old fashioned Guarantors to assist in getting loans; Guarantors other than this form have effectively disappeared from mainstream lending.

Low-Documentation loans / Lo Doc (self employed): A growing area in the market over the last few years which seems set to continue. Unless under extra-ordinary circumstances, these loans are for borrowers where at least one is self employed (generally for at least 2 years with a registered ABN).

There are some exceptions to these rules but they will usually come under specialist lending so I won't go into detail here.

Lo Docs allow self employed people to buy or refinance properties without the need for complicated financials or tax returns. You simply make a signed declaration about how much you earn and the lender takes your word for it. They are suitable for anyone who has an ABN including sub-contractors and can save a great deal of hassle. Most lenders will allow various different loan types with a Lo Doc including Professional packs, Fixed rates, Offsets, LOC's, construction loans etc.

The downside: Interest rates and fees can be a little bit higher and the ratios the lenders use are usually lower as well (most lenders will only go to a maximum 80% against the value of the property for Lo-Doc's instead of 95% for a normal loan). But aside for a bigger deposit, they do fill a need that has revolutionized lending to self employed people. Higher ratios than 80% are possible but can become complicated, for more information call 1300 139 883

Non-conforming or Specialist loans (including bad credit): Anything that isn't covered by the rest of the loan varieties is usually found in the realm of the Specialist lenders. These lenders use a risk-to-rate grading to price these loans so the interest rates can be higher than mainstream lenders, but they will do many loans that the banks won't do (risk to rate lending means that the more complicated or riskier the loan the higher the interest rate).

These include bad credit history, unusual property types, unusual employment types, Lo Doc loans above 80%, asset loans, home loans to ex bankrupts and many, many more. The range is so vast and each scenario so different that each loan has to be handled on its own merit and any other general information is almost impossible. I can tell you however that in the current climate Specialist lending won't go higher than 90% of the value of the property and that ratio gets lower the more difficult the situation is. If you have bad credit or an unusual situation, call 1300 139 883 to find out what your options are.

As you can see, each loan has its good points and bad and each has its unique place in the market to cater for most situations. The challenge in life is working out which loan out of the thousands out there is suitable for your specific needs. While banks want you to think they are all looking out for your best interests, they have a duty to their shareholders and will try to sell you the closest thing they have rather than sending you to a more suitable lender. Get unbiased advice - talk to a broker with a wide range of lenders on 1300 139 883.