Home loans for beginners

In the beginning, Banks created credit… But they wouldn't lend to anybody, they would only lend to people in stable employment and with a good credit history. Then the government kicked in with some legislation called the Uniform Consumer Credit Code (UCCC) to ensure the banks lent money fairly and that people who borrowed weren't charged excessive fees, unfair interest rates and could afford the repayments without financial hardship.

And so formed the framework for the rules of lending. It's a combination of trust, character, capacity, security and legislation which every lender interpret in their own way. Some are more generous than others in different areas but the theory is all the same.

Let's break them down in their individual sections so that we can study them separately. At the end of the day, you need to remember that the lenders don't know you from Adam & firstly need to determine whether you are going to make the repayments on time and, if you don't and they have to foreclose, whether they can sell the property easily and not lose any money.

Trust – JP Morgan, one of the most influential men in the US banking world said to a congressional committee hearing in 1912, when asked which is most important, money or character

"(Character is) before money or property or anything else. Money cannot buy it" and then "Because a man I do not trust could not get money from me for all the bonds in Christendom."

Sums it up really, if a loan assessor doesn't trust the information provided or thinks you're hiding something, they are more likely to look for an excuse to decline the loan. In the world of lending, it's usually a better policy to tell all and give a good excuse because chances are, they will smell a rat and find it anyway if you withhold information (you can really sense it when there's something not right). The true test of trust is to have a good look in the mirror and ask yourself based on the facts, would you lend yourself money?

Character – Character and trust go hand in hand. Trust makes up part of your character but lenders tend to define character as stability. Keep in mind they don't know you personally; they are going off the written facts. Stability is how long you have been in your job, how long you have lived in one place, whether your job is full time or casual, whether you have a history of saving money for a rainy day and whether you have paid all you bills on time.

The easy way to get a loan is to have a stable full time job, good credit history, excellent history for paying rent (or mortgage if refinancing), credit cards within limits at all times and paid on time, personal loans paid on time, 5% of the purchase priced in savings show over 6 months in a bank account, working for the same employer and living in the same house for over a year… that shouldn't be too hard should it…?

Capacity – Can you afford the loan repayments? You might think you can, but the lender doesn't know how you live and anyway, the government has this UCCC thing which says the lenders have to show a mathematical equation which proves you can afford it.

This is serious stuff. Most people think that a home loan repayment will be about the same as rent. But it is usually more. Also you will need extra money for Rates; which you didn't have to pay before, general maintenance to the property (which the landlord used to do) and for those in units or townhouses, body corporate as well.

So they have a formula which takes your income, deducts the tax and Medicare fees, deducts the poverty index (or thereabouts) for general living expenses for you and your dependants and spits out a figure which is you surplus income. It's this figure that will determine the maximum monthly repayment you can handle.

But wait, there's more. Out of the surplus income has to come your existing debts. If you have a $10,000 credit card limit, the calculator will set aside $300 per month to cover that payment; even if you owe nothing on the credit card. The lender has to assume that you have used the card to the limit because you could at any time. A car loan of $450 per month? That comes out too. It's not hard to see how consumer debt reduces your lending capacity. To give you a practical idea, consider the following three hypothetical scenarios:

Scenario 1	**Scenario 2**	**Scenario 3**
Monthly surplus $2,000	Monthly surplus $2,000	Monthly surplus $2,000
	Credit card limit $10,000	Credit Card limit $10,000
		Car loan $450 per month
Max loan $226,000	**Max loan $192,000**	**Max loan $141,000**

It all has some practical use, I once had a person who earned $30,000 per year want to buy a $400,000 property, the repayment of which would have been about $36,000 per year… how are you going to buy food?

Security – This is the critical one from a lender's perspective. If the loan fails and they have to sell the property out from under you, can they sell it quickly and without loss. This is the reason 100% loans are very hard to get, this is the reason they don't like lending in small towns, this is the reason they won't lend on dilapidated properties or on houses in flood plains.

I've seen lenders discount a valuation because there were several car bodies on the property – the valuation was discounted by the estimated cost of removing them. In another case, they would only accept the value of the vacant land because the house was riddled with white ants and the lender thought it was in danger of falling over.

The lesson in this one, the more unique the property, the less a lender will like it. The harder it is to sell, the less they like it. They haven't seen or fallen in love with the property; to them its individuality is its downfall.

As a rule the maximum loan for a standard residential property is about 95% of the valuation or purchase price (whichever is lower) the smaller the town or unique the property the lower that ratio gets to the point where you mat only be able to get an 80% loan or even only 60%. Not all property is the same and never assume the lender will love it too.

Legislation – We've pretty much covered most of the important legislation throughout this paper; most of it is covered in the UCCC which you can easily download from the internet if you want to put yourself to sleep by reading it. It is an important document although very few people know it's protecting them. The lenders take it very seriously because they get into a lot of trouble if they make a mistake. Entire loans have been "set aside" (the borrower gets to keep the house without having to pay back the home loan). Lenders have lost a lot of money and been fined (You don't hear about this sort of stuff because it's the banks suffering not the individual and the various current affair programs don't see that as a problem).

The wrap up: If you don't fit into all the boxes don't panic, most people don't. The more you have in your favour the easier it gets and with most of these issues, 6 or 12 months of good hard commitment will do you the world of good before you go for a home loan.

For those who definitely fall outside the square, there are still options. Some lenders will lend a little less or charge a slightly higher interest rate and might still give you a go. The smartest thing you can do is ask an expert on 1300 139 883 to see what you can do to make yourself attractive to a lender.