INTEREST RATES SERIES PART 2:

WHAT DETERMINES A SUCCESSFUL HOME LOAN APPLICATION?

The next part of our Interest Rates Series focuses on the banks' criteria for lending and how by understanding what determining factors are involved, consumers can be better prepared for the outcome when hoping for a successful loan application.

While each bank has their own lending criteria, they all typically follow the same guidelines and will focus on two main areas: Loan to Value Ratio (LVR) and Serviceability, which is how much you can borrow. So what do these terms mean – and how do they affect your loan application?

Loan to Value Ratio (LVR)

The LVR is the loan you're wanting to borrow compared to the value of the property in question. For example, if the property you wanted to purchase was valued at $800,000 and you wanted to borrow $400,000, the LVR would be 50% - a ratio considered low risk by the banks, as the buyer's equity in the property would be much greater than 20%, so there is no need for Lenders Mortgage Insurance (LMI).

But by comparison, if a consumer wanted to borrow $425,000 for a property valued at $500,000, the LVR would be 85% - which means there is less equity in the home, and a higher potential risk for default on the loan. The banks however cover themselves for higher risk loans, with an LVR over 80% generally requiring LMI. But be aware, this protects the lender - not the consumer – and can cost a lot of money.

For consumers wanting to buy a new property or their first home, the LVR may not be an issue in their minds – unless they want to avoid paying LMI, as in that case they would want to save a bigger deposit. But for homebuyers wanting to purchase a property using existing equity, they may face significant hurdles – particularly if the value of their property isn't as high as they think it should be, and in the current market is considerably less than what they paid say, four or five years ago.

This doesn't mean panicking and selling up. Valuers have been advised by banks to make sure that the valuation they do is for a sale within a short time. The fact is that most people selling at the moment are in one of two classes of people. They either have to sell, or they are wanting to sell their existing property and upgrade.

Serviceability

When determining how much an applicant can borrow, AAG will undertake a review of their borrowing ability – or Serviceability.

This essentially looks at how much income you have versus your expenses, and there are a few considerations to be aware of when we review the amount that can be borrowed:

Assessment Rate

This is the rate the bank puts as an interest rate on your lending. A buffer is also added to allow for any future increase in interest rates. The regulator for the banks, APRA, recently dropped the Assessment Rate from 7% to 2% above your actual rate, which means if an applicant's actual interest rate is 3.50%, the bank will now see if they can afford the loan at a rate of 5.50%. Previously this would have been 10.50%.

This APRA change will make a significant difference for homebuyers because if an individual wanted to borrow $500,000 as an example, the decreased Assessment Rate will mean they should be able to afford an extra $10,000 a year of interest payments.

Living Expenses

This is the most significant change that has occurred. Banks now want evidence of spending and will review an applicant's last three or even six months' worth of bank and credit card statements to check expenses. For example, they will consider grocery shopping, if you are going to hotels or restaurants, car loans, Foxtel, Netflix, Stan or other entertainment.

This means that as part of our process, AAG will need to conduct a review of our clients' spending activity and if required will raise any areas of concern around spending habits in order to be as prepared as possible for the bank.

Note that we do not pass judgement on our clients' positions – instead, we simply want to make sure that once a loan application has been submitted to a bank, we have the explanations for the expenses and where your money has been allocated, in case the bank asks us.

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Principal & Interest, or Interest Only

The banks have been advised by the regulator, APRA, that interest-only mortgages are no longer in favour. This has meant that some banks will not allow for an interest-only period to be extended once the current period expires, creating issues for clients as they may not be able to afford the higher principal & interest repayments. They may also be unable to refinance to another bank due to the potentially lower valuation of their property, or the new lending rules that are applied.

Banks are also wanting loans to be repaid within a 25-year term rather than the usual a 30-year term. Therefore there is less time to pay off your loan, combined with an increase in monthly loan repayments – which is likely to cause a financial headache for many.

Other Liabilities

Banks are now looking closely at other liabilities that clients hold, including credit cards and investment property loans. When undertaking their loan application reviews, some banks use their own internal loan interest rates to assess serviceability while others will allow for the actual interest rate or repayment to be used.

With plenty of recent media attention around interest rates and recent hype suggesting they may continue to fall, it's easy for consumers to believe that this translates to easier lending. However, as we've outlined above, this isn't often the case with new lending rules affecting more than 50% of home applications.

But this doesn't mean you should give up! In fact, AAG has many stories where we have successfully worked with clients to better their financial position – helping them to obtain loan application approvals and better interest rates for the long term.

If you have any questions or need more information about how we can help you, please call our Client Services team on (08) 9227 6300 or email clientservices@austasiagroup.com.

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AustAsia Group
Business, Finance & Taxation Solutions

AustAsia House, 412 Newcastle Street, West Perth WA 6005

PO Box 332, Leederville WA 6903

T: (08) 9227 6300 **F:** (08) 9227 6400 **E:** clientservices@austasiagroup.com

www.austasiagroup.com