LOOK BEYOND THE COST

As well as the interest rate and fees, the features of your mortgage are important considerations

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Getting the right loan to fund your investment property is almost as important as choosing the right location and property. Get it wrong and it could cost you thousands over the life of the loan. And APRA's crackdown on investment lending has made it more important than ever to shop around for the right loan. Not only is it harder for property investors to secure a loan but they are now paying a higher rate to borrow the money. (See "Credit climate cools".)

That probably brings us to the most important factor when comparing loans – the interest rate. Sure, the interest you pay on an investment loan might be tax deductible but you still shouldn't pay any more than is absolutely necessary. "While almost 60% of the market has lifted their investor rates, a decent range of lenders are still offering competitive deals – it's just a matter of finding them," says Sally Tindall, money editor at RateCity.com.au. "RateCity data shows that rates for investors are on average 4.92% but they can go as low as 3.99% for those with a big deposit of 20% or more."

The interest rate isn't the only cost associated with a loan – you also need to look at what fees the lender is charging. These can include application and establishment fees and annual or monthly fees. They, too, can add to the total cost of the loan. High fees can make a low-rate loan more expensive than a higher-rate loan with no or few fees. This is where the "comparison rate" or AAPR comes in handy, as it takes into account the rate and fees. Most lenders publish these on their websites or in home loan fact sheets. Contact the lender if you're not able to find this information easily.

Costs should not be your only consideration – the cheapest loan won't necessarily be the best one. You also need to take into account the features you want in your loan. For example, you may want the option to be able to make interest-only repayments. Anouska Linz, online sales manager at State Custodians, says most lenders

"More than ever investors need to get in early to get finance approved"

CREDIT CLIMATE COOLS

In December 2014 the Australian Prudential Regulation Authority (APRA) announced it was taking further steps to "reinforce sound residential mortgage lending practices". At the time APRA flagged three key areas of concern for particular attention:

- Higher risk mortgage lending – for example, high loan-to-income loans, high loan-to-valuation (LVR) loans, interest-only loans to owner-occupiers, and loans with very long terms.
- Strong growth in lending to property investors.
- Loan affordability tests for new borrowers.

To combat strong growth in lending to property investors, APRA asked banks to limit growth in investment lending to under 10% and it appears to be working. RateCity's Sally Tindall says this led to the biggest drop in investor lending the market has seen in years, with a decrease of almost $2.4 billion since June 2015.

The APRA crackdown has also resulted in increased interest rates. Although this has been across the board, both for owner-occupied and investment loans, it has been investment loans that have felt the brunt of this, says Anouska Linz from State Custodians.

"The eagerness with which banks and smaller lenders have hiked rates for investors has been widespread, with almost 60% of all lenders opting to apply higher interest rates to these loans," says Tindall. "Of these, the average difference between investor and owner-occupier rates is 0.34 percentage points; however, the gap can be as wide as 1.44 percentage points, with some lenders aggressively targeting new owner-occupiers while providing little incentive for new investor business."

Linz explains that the increases have been applied differently by different lenders. "Some have applied a loading to interest-only loans, some on investment purposes and some to loans secured by an investment property, so it pays to shop around," she says.

The APRA crackdown has definitely resulted in greater scrutiny and tightening of credit policy by lenders, says Linz. "For responsible lending this may be a good thing but borrowers more than ever need to get in early and get pre-approved when they are looking to purchase so that they understand how these changes have impacted them," she says. "When refinancing we have had borrowers who are really surprised that they are unable to refinance an existing loan that they were previously approved for some years ago due to changes in lending policy."

limit the number of years a loan can be interest-only and this can vary, so if you want an interest-only loan it is a good idea to shop around and compare. "If you get to the end of the interest-only term and you want to extend it, you usually have to renegotiate with your current lender or refinance," says Linz.

The other thing to check is whether you'll pay more for the privilege. "We're even seeing some lenders charge an extra 0.10 or 0.20 percentage points for interest-only repayments, a return of a trend that was around a decade ago," says Tindall.

Another feature that might be appealing to investors is the option of a fixed rate. "Some property investors like the repayment predictability of a fixed-rate loan and are not as concerned about the restrictions that come with it," says Linz. These restrictions can include a limit on additional repayments or not allowing redraw. "With an investment property, investors are not worried about being able to pay extra or redraw, or the possibility of needing to upgrade or sell, thereby needing to break the fixed term," she says.

With interest rates so low and stable, borrowers are favouring a variable-rate loan for their investment properties, which gives them the flexibility and features they want, says Linz, who doesn't expect this to change until interest rates rise. "Fixed-rate loans can make sense for some investors, though. They know how much rent they are receiving, so from a cash flow perspective if the repayment amount is fixed it helps," she adds.

You might also want to be able to choose the timing and frequency of your repayments. "Similar to repayments on your own home, if the repayments can be timed to occur just after you are paid the rent by the property manager, it may help with juggling cash flow on your investment property," says Linz.

Redraw, which is a popular feature on owner-occupied loans, probably should be avoided on investment loans. An offset account will probably be a better option. "It is useful to park your savings in if you don't have owner-occupied or personal debt, often referred to as non-tax-deductible debt," says Linz. "For tax reasons it is best not to have funds flowing in and out of the investment property loan unless it is related to the property. An offset account allows you to save on interest on your investment loan without the funds being paid into the loan itself."

Something else you may need to consider is how much deposit you will need because requirements vary between lenders. "For an owner-occupied loan, you can borrow as high as 95% of the value of the property with a large number of lenders, so the deposit required is 5%. For an investment property, your contribution is going to be double this at around 10% as there are very few lenders that will lend above 90% for investment properties," says Linz. In fact, some lenders have reduced how much they will provide to 80% or even,70% of the value of the property. "This is where you need to shop around and ask the question early as to what your contribution will need to be for a particular loan."

If your first property is an investment, you may need to show evidence that 10% of the purchase price has been saved (genuine savings). If you have received a gift and not saved this money yourself, the amount you borrow may be restricted even further, says Linz.

Before you buckle down and do your research, it's worth taking a moment to clarify what type of investor you are, says RateCity's Tindall. Are you investing in a quick buy-and-sell renovation job or are you committing to a long-term retirement strategy? These factors will all play a role in selecting the right home loan for your investment needs, she says.

"Negatively geared investors can save money on their loan by opting for a no-frills loan that doesn't include an offset account or redraw facility. These features typically attract higher interest rates and sometimes fees, so if you're not going to use them don't bother paying for them," says Tindall. "But for those investors who are positively geared, or who want to use the property as a source of income in the longer term, an offset account can definitely come in handy.

"Quick-fix entrepreneurs looking for a renovator's dream will want to steer clear of fixed terms that lock them in for a set number of years. However, they might want to consider a construction loan if they are considering major renovations. Here funds are released in stages by the lender so you only pay interest on the money you are actually using."

You should also think about whether you will be using the equity you build in that property to fund future purchases. If the answer is yes, there are extra issues to consider. "Some investors like to periodically get a new valuation done on the property and increase the loan to access the equity that has built up to fund the purchase of another property," says Linz. "Some loans and lenders don't allow this so it is definitely worth asking the question if this is something you would be looking to do."

If you are thinking of using the equity in your home for investing or paying the deposit on an investment property, you could consider having a line of credit. "You will only pay interest on what is drawn down and once approved the funds can just sit there until they are needed," says Linz. "This could also help you avoid cross-collateralising your properties and you can be free to choose to have different loans with different lenders."

When it comes down to narrowing down your choices, the internet is a great place to start. "To get the best deals on offer, it is getting more and more important to roll up your sleeves and do some of the research yourself. Most of the research can be done online, so it can all be done from the comfort of your own home," says Linz. Use comparison sites such as Canstar, RateCity and Finder to find out what's available.

"If you have two loans that are very similar, it may be useful to check up on the lenders' track record by looking at reviews online. These can be useful in understanding what type of service you can expect and what type of issues you may encounter along the way and help you choose between two similar offers," says Linz.

She also recommends putting lenders to the test by calling them. "Are your calls returned? Do you have to wait hours or days for responses to your questions? Do they sound like they know what they are talking about and do you feel confident that they are providing you with the correct information? Are they friendly and approachable or formal and stuffy?" she says.

If it all seems overwhelming, think about consulting a mortgage broker. They can help you identify how much you can borrow, the types of features you might find useful, some of the loans that would suit your needs – and they'll take care of all the paperwork.

They generally won't charge you anything but they will be paid a commission by the lender if you take out a loan. Make sure you find out how many lenders they have on their books, how they are paid, how they'll identify the best loan for you and whether they are a member of the Mortgage and Finance Association of Australia. (See page 56 for more tips on choosing a mortgage broker.) It's always a good idea to back up a broker's recommendation with your own research. **M**

> *"To get the best deals, roll up your sleeves and do some research"*

JUGGLING TWO MORTGAGES

If you're a home owner paying off a mortgage, taking on an investment loan can involve tackling two mortgages. Staying on top of it all calls for a planned approach. It will mean facing two sets of expenses, and this is an area where landlords can be caught short.

It's a good idea to draw up a budget to see how well you will manage two sets of expenses. When crunching the numbers, think about how well you could handle the costs of owning an investment property if the place is vacant or major repairs are needed. You should also factor in potential rate rises.

It's also vital to keep the two loans separate so you don't confuse investment property expenses and non-tax-deductible personal spending. It will make tax reporting simpler. Also make sure you don't dip into the investment loan to fund personal costs.

If you have spare cash, put it into your home loan and not your investment loan, because interest on your home loan can't be claimed on tax.