ZENITH FINANCE

8 Strategies to Reduce Mortgage Costs

Strategy 1: Get a Better Rate

“Make sure you get a discount.”

Don’t fall into the trap – as 1 in 10 borrowers does – of paying the advertised or headline mortgage rate.

Banks give customers a discount of up to 0.7 percentage points, usually as part of a “professional” package, so make sure you get it, too.

If your bank refuses, remortgage with an institution that has a better rate. Despite the credit crisis, lenders are still interested in new borrowers who have loan-to-value ratio of 70 to 80 per cent (that is, equity of 20 to 30 per cent), or better.

While the standard variable rate is now about 9 per cent, there are still deals to be had below 9 per cent.

Of course, if you get a better rate but keep your repayments at the same amount you were paying before, you’ll save even more money and dramatically reduce the life of your loan.

Strategy 2: Don’t Rush to Fix

“Fixed-rate mortgages typically charge break fees if you make early repayments.”

The Joneses decided to fix their mortgage rate at the November 2007 level, but fixed-rate mortgages might not be so attractive at today’s level.

The rising cost of borrowing across the world means Australian banks are passing on increased costs to customers. Analysts estimate banks’ costs have risen about 1 per cent, and that about 30 or 40 basis points of this has been transferred to customers in the form of higher mortgage rates, both fixed and variable.

A leading data provider says fixed and variable rates are now pretty similar. Remember, hardly anyone actually pays the quoted variable rate – most receive a discount of between 0.5 and 0.7 percentage points. And fixed-rate mortgages typically charge break fees if you make early repayments.

One experienced business manager says “The question of whether or not to fix rates in the current interest rate environment depends on which camp you fall into – those who believe interest rates still have further upside potential, or those who think we will start heading down again soon.”

“Also of importance is your own individual financial situation. If you’re currently struggling to make your repayments, the extra security you might be able to receive from fixing now might be worth the risk that you’re fixing at a premium.”

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Strategy 3: Offset Your Savings

Another type of mortgage you might want to consider is one that comes with an offset account. This allows you to reduce the balance of your loan while still having access to the funds for a rainy day.

Deposit your money in a savings account and you might get 4 per cent interest. But put it into an offset account instead and you'll reduce the interest payable on a mortgage possibly costing you 9 per cent interest.

In other words, putting your money into your loan earns you twice as much as in a savings account.

You could go one step further and have your salary paid into your offset account, using your credit card for expenses and paying it off monthly.

Here's an example of how it works: John owns an investment property worth $500,000 and has a mortgage of $400,000 on an interest-only basis at 9 per cent a year. By putting $2,000 a month away in his offset account he pays interest on his $400,000 mortgage loan less the $24,000 he has in his offset account at the end of the year.

Dollar Saving: John would save $1,265 in the first year of his loan.

"Putting your money into your loan earns you twice as much."

Strategy 4: Go Interest-Only

Opting for an interest-only loan instead of a capital-repayments loan can reduce your outgoings significantly. And if you combine an offset account with your interest-only loan, you'll actually be paying off principal by putting money into that account.

Paying off some of your home loan with a lump sum can also have a huge impact. If you've got spare cash, it could serve you better by reducing your mortgage rather than it sitting in a savings account. After all, every dollar you pay off the principal is a dollar you're not paying 9 per cent mortgage interest on each year.

Redraw facilities available on most standard variable loans allow you to take back extra payments if and when you need them.

But remember that with an interest-only loan you're not paying off the principal and you'll need to do this at some stage, or repay your loan by selling the property.

Dollar Saving: Paying interest only would reduce monthly payments by $2,622 a year.

"Redraw facilities on most standard variable loans will allow you to take back extra payments."

"You'll be ahead by a full fortnight at the end of the year."

"Typically, the lower the introductory rate the more costly the loan."

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Strategy 5: Pay Fortnightly

If you thought there was no difference between paying your mortgage monthly and fortnightly, think again.

This simple change can really help you get ahead in your mortgage payments.

It helps to remember that although there are 12 months in the year, each month differs in length. While we think of a month being four weeks long, there are actually 52 weeks in year rather than 48, and 26 fortnights in a year rather than 24.

What difference does this make to your mortgage? Well, if you make half your required monthly mortgage repayments fortnightly, you'll be ahead by a full fortnight at the end of the year; if you pay a quarter of your monthly mortgage repayments weekly, you'll come out ahead a full month.

Be warned, though: this works only if it's something you do off your own bat. If you go to your lender and ask to pay fortnightly, in all likelihood they'll recalculate the loan so that it still takes 25 to 30 years to pay off.

On a $400,000 loan at 9 per cent interest, paying half your monthly payment fortnightly is equivalent to prepaying $128 a fortnight.

Dollar Saving: First-year savings of $157 understate the advantage of this strategy. Over 30 years, you would save a whopping $80,016 in interest.

Strategy 6: Watch the Fees

When choosing a mortgage product or remortgaging, be aware of fees and how any "honeymoon" deals work.

Be wary of interest rate offers that last just six months to a year before automatically reverting to the standard or headline rate offered by that lender. Typically, the lower the introductory rate the more costly the loan will turn out to be over time.

You should also think about the type of lender you use. For example, major banks with large pools of retail deposits are more likely to be able to withstand financial market turmoil without having to increase rates, whereas non-bank lenders will have less flexibility.

Then there are monthly account fees, transaction costs, exit costs and mortgage insurance costs.

For a start, try not to borrow more than 80 per cent of the value of your property. That way you avoid paying lenders' mortgage insurance.

You can evaluate how much you're paying in the way of fees by multiplying the monthly fees by 12 and dividing the answer by your mortgage loan balance. This gives you a percentage rate that is effectively the additional percentage on your mortgage loan rate.

Dollar Saving: A $10 a month fee is equivalent to an extra 0.03 per cent interest rate on a $400,000 loan. So you'll pay an extra $120 a year.

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Strategy 7: Consolidate Your Debts

If you're struggling with paying the interest on a number of loans – perhaps a car loan, credit card and home loan – you might want to consider consolidating all your debts into a home loan.

But remember that although this will reduce your regular interest payments, it could increase the total interest you pay.

This is because while your debts will be rolled into a loan at a lower interest rate, some of the debt will now be spread over a longer period.

But here's a way you could make it work for you. Let's say Jane has a credit card balance of $5,000 and car loan of $5,000, on which she's paying 12 per cent interest a year over a five-year term.

If she consolidates her loans by refinancing her existing home loan so it's now $410,000 at 9 per cent interest, she'll save money as long as she doesn't extend the life of the home loan.

Before consolidation, Jane would be paying $38,622 annually on her $400,000 home loan, plus $2,774 in principal and interest on her other debts.

Dollar Saving: If Jane consolidates her $10,000 debts into her home loan, she'll save $1,809 a year.

"Consider consolidating all your debts into a home loan."

Strategy 8: Troubleshooting

If you're struggling to meet your monthly repayments on your existing mortgage, finding a better deal elsewhere would certainly help. But you could also ask your existing lender to "reamortise" your loan – in effect, asking the lender to start the clock ticking again.

Put simply, this means spreading your outstanding loan balance over a fresh 25 (or even better still 30) years, with the result of lower minimum monthly repayments.

If you're five years into a 30-year loan where you borrowed $400,000, you'll be refinancing a balance of $383,521 over a period of 30 years. This can help immensely when you're feeling the pinch. But be aware it will increase your total interest bill.

You could also consider renting out your house or flat. While the rent might not meet the mortgage in full, it could go a long way towards helping you make the repayments while you rent somewhere cheaper until you get back on your feet. At the end of the day, if you get into trouble contact your bank early to protect your credit rating.

Dollar Saving: If you refinance the balance of $383,521 in our example, the reduction in payments over the first year will be $1,591.

"Ask your lender to start the clock ticking again"