

Navigating the mortgage market during 2023

WHAT YOU MUST KNOW
BEFORE YOU REFINANCE



ProSolution
PRIVATE CLIENTS

Level 8, 31 Queen street, Melbourne, VIC
(03) 8624 4600
www.prosolution.com.au
advice@prosolution.com.au

Table of Contents

Executive summary	2
Loan structure fundamentals	3
Always borrow the maximum and use an offset account	3
Interest only or principal and interest repayments?	3
Fixed or variable interest rate?	4
Maintain minimum LVR at 70%	5
Avoid cross-securitisation	5
Never mix business with pleasure (for self-employed persons)	6
Step-by-step example of how to structure an investment property portfolio	7
Loan structure considerations	8
Determining your borrowing capacity	9
How banks assess your borrowing capacity	9
Further reading	9
How to get the best deal	10
Examples of recent discounts and incentives that our clients have enjoyed	10
Would you like our help?	12

Executive summary

Many Australian borrowers need to navigate significant changes to their mortgages throughout 2023 including fixed interest rate expiries. The banks understand borrowers are likely to be more active this year and are well-prepared to offer discounts and cash incentives to retain customers.

This eBook aims to help borrowers make informed decisions.

It is important to adopt a strategic approach when making any changes to your mortgages to ensure you (1) achieve your financial goals at (2) the lowest overall cost. This involves two steps. Firstly, you must determine your most optimal loan structure and borrowing requirements that maximises the chance of achieving your financial goals. Secondly, once that is determined, you must identify the lender that can provide you the necessary structure at the lowest overall cost.

The reality is that for most people the top 5 lowest cost lenders are likely to all be similar in terms of interest rates and fee. It is the non-cost related considerations such as borrowing capacity and product features that are likely to determine the best lender for you. For example, it's a false economy to choose a lender that offers a 0.01% p.a. lower interest rate but has a lower borrowing capacity and as such won't allow you to make another planned property investment. Not being able to invest is likely to cost you a lot more than 0.01% p.a.

If you do not already work with an experienced and professional mortgage broker, I would encourage you to start doing so. The information in this eBook will help you assess whether your existing mortgage broker or banker has been doing a good job. Whilst knowledge is important, experience is critical, which is why having a good mortgage broker on your team will help you tremendously.

We update this report regularly. Please visit [this page](#) to ensure you have the most recent version.

Of course, if you need any help, you are most welcome to reach out to [our team here](#).

Would you like more information or our assistance?

If you would like to discuss engaging our mortgage broking services (or any other services) we invite you [contact us here](#).

If you have found this eBook useful, we invite you to follow us:

Blog

- Every Wednesday at 10:30am Stuart publishes a blog which you can subscribe to [here](#).

Podcasts

- *Investopoly*: Stuart records his weekly blog topic as a podcast which you can follow [here](#).
- *The Holistic Accountant*: Stuart and Mena record a short (usually 5 minute) podcast on tax and financial planning topics aimed at helping business owners which you can follow [here](#).

Books

Stuart has written two books which might interest you; [Rules of the Lending Game](#) and [Investopoly](#).

Loan structure fundamentals

This section sets out the typical rules that we follow when structuring mortgage portfolios.

Always borrow the maximum and use an offset account

The first thing to be very mindful of is that you typically only have one opportunity to set the maximum tax deductible loan in respect to a property and that is when you initially purchase it. You cannot contribute cash and borrow a lower amount when you initially purchase a property and then subsequently increase the loan at a later stage (as the purpose/use of the additional funds will determine whether the loans are tax deductible or not).

The second thing to keep in mind is that time and time again it is proven to me (through dealing with hundreds of clients) that there is one thing that doesn't change in life and that is change itself. Therefore, you will do yourself a great service to structure your finances to give you as much flexibility as possible.

Borrow maximum: case study

Dr Smith purchases an investment property for \$500,000. He has repaid his home loan and has no other debt. Dr Smith has \$190,000 of cash savings to contribute to the investment. He has two options; ignoring costs (stamp duty) to keep this example simple, he can borrow what he needs being \$310,000 (\$500k less \$190k cash) or he can borrow \$500,000 and deposit \$190,000 in a linked offset account. The latter option won't cost him any more as the bank will only charge interest on the net balance of \$310,000.

Dr Smith can still access the \$190,000 cash savings at any time. For example, if a few years after purchasing the property Dr Smith decides to undertake some renovations to his home costing approximately \$100,000, he can withdraw this amount from the offset. Of course, because the balance in the offset has reduced, his interest bill will increase but all the interest will be tax deductible. If he had not have structured his loan with an offset, he would have had to borrow the \$100,000 for the renovations and the interest on that loan would have not been tax deductible.

In summary, it is nearly always the best approach to borrow the full cost of a property and deposit cash in the offset as it increases your financial buffers which is important considering property is relatively illiquid.

Interest only or principal and interest repayments?

When deciding whether to structure your mortgage repayments as interest-only or principal-and-interest, there are typically two important matters you should consider being (1) cash flow and (2) interest rates.

Consideration 1: Cash flow

The advantage of opting for interest only repayments is that you minimise your monthly commitment. You might want to do that either because you want to divert cash flow elsewhere such as repaying your (non-tax-deductible) home loan or make other investments. Or maybe you want to minimise your loan repayment commitments simply to minimise your risk. In addition, structuring your repayments as interest only allows you to preserve the original tax-deductible loan amount and accumulate any cash savings in a linked offset to minimise your interest expense, as explained in the above case study.

Consideration 2: Higher interest rate

The downside to interest only loans is that they attract higher interest rates. In 2017, the banks began charging higher interest rates for interest only loans to dissuade borrowers from requesting them (at the time the banking regulator was concerned that 40% of new loans were interest only and it wanted to reduce it).

Interest-only investment loans attract a higher interest rate of 0.26% p.a. (on average) compared to principal and interest investment loans (or a 0.55% p.a. for interest only home loans) – that is the premium you pay during the interest only loan term. Remember, if you are borrowing for investment purposes, you are entitled to a tax deduction for the interest, so the after-tax cost of the interest premiums is just less than 0.14% p.a. (if you earn over \$180k p.a.) which is probably not a big premium to pay for the additional flexibility.

Fixed or variable interest rate?

When it comes to fixed rates, there are two common considerations.

Firstly, do you want to have certainty over your cash flow commitments? For example, if cash flow is tight, you might not be willing to take the risk that variable interest rates might rise and cause you financial stress. In this case, you can protect yourself by fixing your interest rate.

The second consideration is what is likely to be cheaper i.e., fixed or variable. Fixed interest rate terms range from between 1 and 5 years (although ANZ does offer fixed terms for up to 10 years). Ultimately, you must form your own view about whether current fixed rates represent value i.e., whether you are likely to pay the same or less interest over the fixed rate term compared to the variable rate.

To do this you can consider what the money market is pricing in regarding future cash rate movements, economic forecasts (I have found Bill Evans, the chief economist at Westpac to be the most reliable forecaster) and compare the current variable rates to the fixed rates that are on offer. This data is summarised below.

Current RBA cash rate	4.10%	
Cash rate futures in Nov 2024	4.21%	Implying a 0.11% rise in interest rates over the next 18 months
3-year government bond rate	3.94%	Implying a 0.16% reduction in the cash rate over the next 3 years
5-year government bond rate	3.87%	Implying a 0.23% reduction in the cash rate over the next 5 years
Westpac forecast cash rate	3.85%	By December 2024 implying 0.25% of rate cuts over the next 18 months.
Current 3 year fixed	Starting from 5.79% for home loan and 6.09% for investment	
Current 5 year fixed	Starting from 5.89% for home loan and 6.29% for investment	
Current variable rate*	Starting from 5.60% for home loan and 6.45% for investment	

* See page 10 below for more information about current interest rates.

Make sure you visit [this page](#) to ensure you have the most recent report, as we update these interest rates regularly.

Fixed rates have risen materially over the past 4 to 6 weeks (to 17 July 2023) because there's a lot of uncertainty about whether the RBA needs to hike interest rates further, and how long it needs to hold rates at elevated levels for to curtail inflation. If subsequent data suggests that inflation is under control, like it has in the US recently, it is possible that forward bond yields fall, and fixed rates become more attractive. Until that happens, we do not think fixed rates are attractive and therefore recommend borrowers remain on variable interest rates for now.

Maintain minimum LVR at 70%

Most banks will lend up to 80% of a property's value without charging Lenders Mortgage Insurance. Many banks offer additional interest rate discounts if your loan-to-value (LVR) ratio is below 70%.

I always advise clients to maintain their LVRs at 70% (possibly 80%) to ensure they maximise their available borrowing capacity. For example, if your investment property is worth \$1 million and your investment loan is only \$550k, I would typically recommend establishing a second loan secured by that property for \$150k (being 70% of \$1m less existing loan of \$550k). The new loan funds can be deposited into an offset account, so you don't pay any interest, but are available if needed in the future.

Personally, I maintain my LVR at 70-80% even if I have no planned purposes for the funds. The way I see it is that increasing my access to funds (borrowings) reduces my risk as it prepares me for a rainy day.

If your LVR is very low (say 20%) and you own two or more properties, then perhaps you can ask the bank to discharge the mortgage on one property and give you the title back. There's no point giving the bank more security than they need. The title is safer in your hands (without any encumbrances).

Avoid cross-securitisation

Cross-securitisation is where any one loan uses more than one property as security. A simple example of cross-securitisation is where you have an investment loan secured by two properties; your home and the investment property. There are 3 predominant reasons why we avoid cross-securitisation wherever possible:

(1) May not allow you to maximise borrowable equity (i.e. lack of control over valuations)

It is not by chance that this is my first point as maximising your [borrowable equity](#) is critically important as the sooner you invest, the more money you make over time (because of compounding capital growth). If you avoid cross-securitisation you can determine which properties to revalue and when.

It is likely that it won't make sense to revalue all your properties at the same time (as the amount and quality of recent sales of comparable properties often determines if it's advantageous to revalue a property or not. If there are not many comparable sales, try and defer any bank valuations). If your loans are cross-securitised, the bank must revalue all the properties that secure your mortgage/s – not just the ones you want to revalue. Consequently, you might get a mixture of higher and lower valuations which may negatively impact on your overall borrowable equity (as the lower valuations might more than offset the value of the higher valuations).

(2) Tying you to a particular lender which reduces your flexibility

If all your mortgages are cross-secured your banking can become very entangled and it may prevent you (or make it very costly/difficult) to take one property away from your existing bank to get a better deal. You may want to use a new lender because, for example, it's offering a special (fixed) rate or perhaps it has a higher borrowing capacity and you have fully utilised your existing banks borrowing capacity. However, you may not want to refinance your whole portfolio. Having all your properties separately secured gives you more flexibility as you might be able to refinance one property to the new lender. This will probably help you maximise your borrowing capacity too (borrowable equity).

(3) Less control over sales proceeds

If your mortgages are cross secured, the bank can control all sales funds (if you sell a property) and force you to repay other debts, which you may not want to do. However, if there is no cross-securitisation, the bank can only demand repayment of the mortgages secured by that property only. It is then up to you what you do with the balance.

This is important as you might be selling property to realise cash reserves and allowing the bank full control over your money negates the benefit of selling in the first place. This is an important risk management point as many investors rely on the assumption that if things go pear-shaped, they can sell and walk away with cash. This might not be possible if you are cross-securitised.

Never mix business with pleasure (for self-employed persons)

Sometimes having your business (for self-employed clients) and private banking with the one bank might seem convenient. It could very well turn out to be very convenient and you may not run into any trouble. However, I have seen plenty of situations where this hasn't worked out well for clients. The problem with this is that the bank has too much control and they know too much.

For example, if you have a dip in revenue for a few months and then apply for a personal investment loan, they might start asking questions. Instead, if you separate your business banking from your personal banking, you control the amount of information each side has. This might be less important when things are going well but becomes a lot more important if your financial situation becomes a little more complex or changes. In hindsight, it's rarely worthwhile to use the same bank for business and personal banking.

Step-by-step example of how to structure an investment property portfolio

The [video](#) below explains how we structure an investment property portfolio.



Loan structure considerations

We suggest reviewing your whole mortgage portfolio at one time instead of reviewing loans individually. Doing so ensures that you achieve the best overall outcomes.

When reviewing your loan portfolio, it is wise to consider a few matters such as:

- Will your borrowing capacity change in the future? A change in employment, income or financial situation could either improve or impair your borrowing capacity. These changes might dictate when you make any changes to your loans.
- Do you expect to sell or buy property in the future? If you plan to buy, you need to ensure you have access to equity to fund a deposit and that your lender offers a sufficient borrowing capacity. If you plan to sell, make sure your loan/s are not cross securitised.
- Do you have adequate buffers in place? It's always good to have loan buffers in case of unexpected changes or unforeseen expenses (e.g., property repairs).
- Does the bank need all properties as security? It's wise to keep your loan to value ratios under 70% to obtain the highest interest rate discounts. But there's no point giving the bank anymore security than it needs.
- Would you like to access equity? Some investors like to have access to as much equity in property, even if they have no plans on using the funds. I'm one of those investors. You never know when a good investment opportunity might arise – it doesn't cost anything to have access.
- Can you consolidate loan accounts and/or clean up your structure? If you have multiple loans that relate to the one property or investment, you should consider consolidating them (if it doesn't require cross securing your loans). Also, it's cleaner to have your loans secured by the property they relate to (if equity allows). These options are typically available to investors that have held their properties for a while.
- Is your current lender under-valuing your property? Different lenders will use different valuers, and valuations can vary significantly. So, if you are short on equity, consider getting another valuation.
- Do your lender/s policies still suit your circumstances? If your situation has changed a lot since you began using your existing lender/s, it is possible that their credit policies and products don't suit you anymore. Dealing with the wrong lender is frustrating – it's akin to trying to put a square peg in a round hole.
- Would you like to help your children in the future? If you would like to offer your kids a [family guarantee](#) (which is usually the best way of helping children), then it's important that you use a lender that not only provides these but is easy to deal with in this regard.

Determining your borrowing capacity

If you are considering whether to refinance to a new lender to get a better deal, it is important to ensure that you meet their credit criteria i.e., that they will approve your loan. You must ensure that you have sufficient borrowing capacity. Borrowing capacity has fallen by 30%+ over the past year due to the RBA's aggressive interest rate hikes.

How banks assess your borrowing capacity

The banks will make several adjustments to your projected cash flow to calculate your borrowing capacity. Whilst all lenders have different rules, the below table summarises the typical approach.

Item	Description	Example
Employment income	The bank will verify your income using the YTD income on your payslip. They won't always include 100% of bonuses, commission or any 'at risk' income.	Rick and Karen are both employed. Rick's salary is \$270k and Karen works part-time earning \$100k. Their monthly after-tax income is \$20,306 .
+ Rental income	Most lenders will include 80-90% of gross rental income to allow for expenses.	Rick owns an investment property, and the tenant pays \$550 per week. The lender includes \$1,907 of monthly income.
- Living expenses	You will be asked to itemise your living expenses in the mortgage application form. Banks will use benchmarks to ensure what you have stated is reasonable.	Rick and Karen have stated that they spend \$8,000 per month.
- Credit cards	Most banks will multiply your credit card limits by 3.8% to work out the minimum repayment if your card was fully drawn.	Rick and Karen have \$15,000 of credit card limits so a monthly expense of \$570 is added.
- Mortgages	Repayments are worked out using an interest rate 3% higher than your actual rate on a P&I basis.	Rick and Karen have two loans. A home loan for \$850k on 5.30% and an investment loan for \$750k on 5.90%. Monthly repayments over 25 years at the benchmark rate are \$12,973 .
= Result	Total income must be greater than total expenses.	Total income is \$22,213. Total expenses are \$21,543. Monthly surplus is \$670 .

Conclusion: It is very likely that Rick and Karen would be able to refinance their loan to a new lender.

Further reading

Here are some links to recent blogs that I have written about how to maximise your borrowing capacity:

- [Important changes to your borrowing capacity \(Oct 2022\)](#)
- [To what extent does rental yield affect your borrowing capacity? \(Oct 2022\)](#)
- [Video: 5 steps to \(safely\) maximise your borrowing power \(Aug 2020\)](#)

How to get the best deal

Different client circumstances and lenders may dictate different approaches but typically we follow these steps:

1. **Research your options.** If your fixed rate is expiring or you just want to ensure your variable rate is competitive, you must research your options. It is important to ensure you are comparing apples with apples. Factors to consider include:
 - Your LVR (lower LVRs attract higher discounts);
 - Whether your product is a home loan or investment loan;
 - The number of loan accounts (typically, the greater the number of individual accounts you have the lower the discounts);
 - The amount you have in offset accounts; and
 - Whether your repayments are structured as interest-only or principal-and-interest.

The fastest way to ascertain the highest discounts on offer is to speak to a good mortgage broker. They will be able to quickly tell you what to ask for.

2. **Speak to your lender.** Once you or your broker has researched competitor offers, you should speak to your existing lender and request that they match the highest discount. Most banks allow brokers to apply for higher discounts via online platforms, so it is usually a quick process, although it might take a day or so for the lender to respond.

If your lender refuses to play ball and match a better offer, you may need to refinance (assuming the saving is material of course). **However, before you do that, we recommend sending your existing lender a Discharge Authority. A Discharge Authority is a form used to request a refinance. Sometimes banks won't offer a better deal until they receive a Discharge Authority, as they know you're serious about refinancing. Often you can find the Discharge Authority online (e.g., [here's a Google search for CBA](#)). Otherwise you will have to call the bank to request it. Tell them that you have decided to refinance.**

3. **Begin the refinance.** If you don't receive a better offer within 2 to 3 weeks from submitting the Discharge Authority, it confirms that you will need to refinance. Whilst it can be a bit of a "process", in the scheme of things it is likely that you will be well rewarded for the effort.

Examples of recent discounts and incentives that our clients have enjoyed

- Client has over \$5 million in lending (with a lot in offset). To retain business, CBA increased his interest rate discount from 2.35% to 2.97% **saving the client over \$20,000 in interest p.a.**
- Client is purchasing an investment property and will borrow 85% of \$2 million without mortgage insurance. We achieved a 3.00% interest rate discount for this client from his existing lender.
- Refinance one loan for a client from ANZ to Westpac to increase discount from 2.29% to 2.85% and obtain \$4,000 cash incentive. We also manually repriced existing loans at ANZ post refinance and increased discount from 2.29% to 2.95%. **This will save the client almost \$7,000 in interest p.a.**
- Client's loans were with Westpac on a discount of between 2.40% and 2.50%. We approached Westpac to increase the interest rate discount and it refused. We then obtained an offer in writing from CBA which confirmed it would offer higher discounts and Westpac agreed to match

these. The client's discounts now range from 2.70% and 3.08%. **This will save the client over \$11,000 in interest p.a.**

- Client was going to refinance from CBA to ANZ because interest rate discount of 1.57% (investment, interest-only) was uncompetitive. Prior to refinance going through, CBA matched ANZ with a discount of 2.55% and paid them a cash incentive of \$4,000 to stay. This is why we recommend submitting a Discharge Authority prior to beginning the refinance to extract the banks best and final offer.
- Client's interest-only term was expiring, and CBA refused to offer a new interest only term, so we began a refinance to ANZ. At the last minute, CBA offered a new interest-only term and increased the interest rate discount from 2.81% to 3.14%.

Important changes the week beginning 8 May 2023

Both CBA and NAB announced that they will cease offering cash back offers (monetary incentive to refinance) in May/June 2023. We expect that other lenders will follow and that interest rate discounts are also likely to reduce over the course of 2023, as discussed at the 5-minute mark in [this presentation](#) recently.

Update on 15 June 2023

Cash back offers have now been removed from the market – few to no lenders offer these incentive anymore.

Interest rate discounts have also reduced somewhat. We think discounts are still very attractive and expect a further decline in the future.

Would you like our help?

ProSolution Private Clients is a holistic financial services firm that seeks to establish long term relationships with clients so that we can work closely to achieve their financial and lifestyle goals. We can provide clients with several services including tax and business advice, financial advice (including super, shares, property and so on), insurance advice and mortgage broking services.

We understand the importance that borrowing capacity and loan structuring play in allowing you to implement your financial plan. Our holistic approach ensures these matters are optimised.

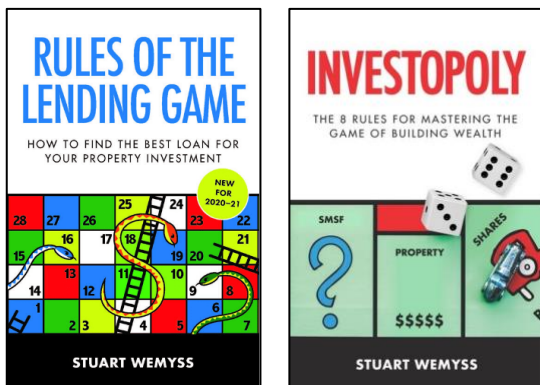
To learn more about these services and our fantastic team, visit our [website](#) or contact us.

Contact us

Office: +61 (0)3 8624 4600

Email: advice@prosolution.com.au

More information



Licences and Authorities: Stuart Wemyss, Jodi McKeown are Credit Representatives of ProSolution Group Pty Ltd's Australian Credit Licence (238449). Stuart Wemyss, Cecilia Christodoulou and ProSolution Wealth Advisory Pty Ltd are all Authorised Representatives of ProSolution Group Pty Ltd's Australian Financial Services Licence (AFSL No. 238 449). Stuart Wemyss and Mena Abraham are authorised to provide tax advice pursuant to ProSolution Tax Advisory Pty Ltd's tax agency registration.

Disclaimer

This report is published solely for informational purposes. This report has been prepared without taking account of the objectives, financial situation or needs of any specific person who may receive this report. Any such person should, before acting on the information in this report, consider the appropriateness of the information, having regard to the specific person's objectives, financial situation and needs and, if necessary, seek appropriate professional or financial advice. We believe that the information in this report is correct at the time of writing and any opinions, conclusions or recommendations are reasonably held or made, based on the information available at the time of its compilation, but no representation or warranty, either expressed or implied, is made or provided as to accuracy, reliability or completeness of any statement made in this report. Any opinions, conclusions or recommendations set forth in this research report are subject to change without notice. We do not accept any liability for any loss or damage arising out of the use of all or any part of this report. Past performance is not a reliable indicator of future performance.