


# Refinancing can be worth it for the right reasons

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Refinancing is all the rage. There are more people resetting their home loans than actually getting new loans. Unfortunately, many of them are doing the whole exercise the wrong way.

Typically, the main attraction to refinance is to switch to a lender that offers you a lower interest rate.

However, this is rarely necessary.

In my personal and professional experience, borrowers should contemplate a refinance mainly for two reasons: to restructure a loan, or to maximise the “borrowable equity”.

Your loan structure can have a big impact on your cashflow, risk, taxation liabilities, flexibility and ability to add to your investment portfolio.

Probably the most common loan restructure involves resetting an interest-only period. Often, investors will set up loan repayments as interest only, so they can direct cashflow towards other endeavours such as the repayment of their home loan.

However, interest-only terms only run for five years. Therefore, at the end of the term you must apply to the bank to roll over on to another term. If you have already made one such application in the past, most banks will not approve a third interest-only term. As such, it appears the only solution is to refinance to a new lender.

There are other important loan restructures that borrowers and their advisers often contemplate, including the reset of a loan’s term back to 30 years, which is particularly advantageous if a loan is switching from interest only to principal-and-interest repayments.

Applying to the bank to release superfluous security (property) is also a wise thing to do, especially if you are planning to sell an asset. This will give you full control over the sale funds, rather than the bank being in control. This is important — the bank may not suggest it — the move is up to you.

Finally, other loan restructure goals include unwinding cross-securitisation, consolidating loan accounts, splitting accounts, consolidating unsecured debts and so on.

Now to the issue of borrowable equity. This term refers to the amount you can borrow given your current income and assets.

A big factor is the lender's assessment of the value of your existing properties. A lender will engage the services of an external valuer to independently ascertain these valuations. However, due to the subjectivity with valuations, it is not uncommon for valuations to vary considerably.

For example, I recall two bank valuations varying by \$300,000 for one of my properties (one came in at \$1.2m and the other \$1.5m). Consequently, sometimes a refinance will result in a much higher level of borrowable equity.

What's more, lender credit policies — and related borrowing capacities — can vary significantly. These policies also change regularly. The lender that offers you the highest borrowing capacity today, could have a below-average borrowing capacity only a few years later. In reality, sometimes it's necessary to switch lenders to safely maximise your borrowing capacity.

Put simply, refinancing to a new lender is often necessary to restructure your loans or extend your borrowing capacity.

However, if the goal of refinancing is to obtain a lower interest rate, you should speak to your existing lender first. Often, but not always, your lender will offer you a lower interest rate to retain your business.

A refinance is not a costless exercise. Lenders will charge discharge and settlement fees. Government fees also apply. The total cost typically amounts to about \$750 per loan. Many lenders offer cash incentives to new customers of between \$2000 and \$4000 which more than cover any costs.

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