Borrowers use home equity as billion-dollar piggy bank

Duncan Hughes *Reporter*

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Home-owners are using rising property values and increased equity to top up their mortgages, by nearly $93 billion in the last year, spending up on renovations, cars, and real-estate investments, or to prop up struggling small businesses.

During June, mortgage top-ups soared to about $10 billion, or about 17 per cent, compared to the same month last year, with loans by owner-occupiers rising nearly 30 per cent, according to government statistics.

Mortgage brokers say top-ups have been booming as the nation's major property markets posted double-digit percentage growth, interest rates are at record lows, and exuberant investors bid up prices.

Mortgage top-up loans can be much cheaper than personal loans or credit cards. **iStock**

Most lenders have replaced traditional products, such as lines of credit, with top-up loans, or supplementary loans, using property equity as security. Lines of credit came under fire because of the risk that borrowers redrew repayments, rather than paying down the loan over time.

"It got out of hand for many borrowers because they would only pay down the interest and not the principal," says Anita Marshall, managing director of Advanced Finance Solutions, a mortgage broker.

Most lenders have replaced them with top-up mortgages, typically a new loan based on how much equity is available in the property and the borrowers' capacity to repay.

But they are not available for all home loans. For example, Commonwealth Bank of Australia, the nation's largest lender, will not allow top-ups for fixed or guaranteed interest home loans without breaking the original contract.

This will result in a costly "early adjustment repayment", or break fees, plus administrative fees to break the fixed rate. In addition, there is an establishment fee for the new loan, typically about $300 plus monthly loan service fees.

Shop around

Rates for the loans also vary, so it pays to shop around for the best deal. Sally Tindall, research director of RateCity, says the average interest rate on a top-up loan is around 2.6 per cent, compared to about 5.8 per cent on a personal loan and more than 17 per cent for credit cards.

But those increasing a loan for a holiday, or new car, should try to pay it back as quickly as possible to avoid additional costs. "If you pay the money back over a long period of time, then you could end up paying more. The final cost of a loan is heavily influenced by the loan term," Tindall says.

For example, the total interest paid for borrowing to buy a $50,000 car over a five-year term will range from around $7762 for a 5.8 per cent unsecured loan to about $3400 on a 2.65 per cent top-up. But extend the term on a top-up to 15 years and the total interest paid jumps to more than $10,600.

The lending boom is based on soaring property prices that, during the past two years, have boosted owner equity, sliced loan-to-value ratios and increased their eligibility for even more debt.

On average across the country, an owner-occupier who bought a median-priced house in July 2019 with a 20 per cent deposit, paying principal and interest on a 30-year loan term, has experienced a 170 per cent increase in equity, or more than

$180,000. The analysis is based on CoreLogic's national median house prices. The loan to value ratio has fallen from 80 per cent to 59 per cent.

In Sydney, the median property value over the same period has jumped from $865,000 to $1.25 million, a rise of about $393,000. The equity is up by about 242 per cent, or $418,000. The loan to value ratio (LVR) is down from 80 per cent to 53 per cent.

Melbourne's median property value is up from about $710,000 to $946,000, a rise of around $236,000. Equity has risen around 180 per cent and LVR is down from 80 per cent to 58 per cent.

Equity key

In addition to topping up existing loans, borrowers can also use lower LVRs to shop around for a new lender offering better terms and conditions.

The lowest variable rates on offer, such as Reduce Home Loans headline rate of 1.77 per cent, or Homestar Finance's 1.79 per cent, require a deposit of at least 40 per cent. Other major lenders, including Westpac, St George, Macquarie and Bank of Queensland, are offering discounts for deposits of between 30 per cent to 40 per cent.

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"The more equity you have, the greater the chance of negotiating a better rate with your existing lender," says Christopher Foster-Ramsay, principal of Foster Ramsay Finance. "Lenders are keen to keep their good customers," he says. "Each application is different, but a borrower with a good repayment record and evidence that it can be maintained might be able to knock 20 or 30 basis points off their rate."

Some lenders, such as Athena Home Loans, automatically reduce the rate as the loan is repaid. Alternatively, borrowers who bought with a small deposit and used a guarantor – a person who provides additional security – could remove them from the loan as LVR falls below 80 per cent.

The ongoing uncertainty surrounding lockdowns means that many lenders are tightening lending terms and conditions. For example, ASX-listed non-bank lender Resimac is targeting Victorian and NSW borrowers with mandatory questions about how the pandemic is affecting their income, or explaining why it is not.

Other lenders, such as Suncorp, have been increasing the comparison rate – or the real cost of borrowing including fees and charges – on variable and fixed rates by up to 20 basis points.

Duncan Hughes is a Walkley award-winning personal finance reporter, based in our Melbourne newsroom. *Connect with Duncan on Twitter. Email Duncan at duhughes@afr.com.au*

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