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Revolving Lines of Credit

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People who wish to start out investing in property may need to finance their purchase by way of a loan. With the number of loan products and the numerous features pertaining to them, some investors may perceive the process of choosing the right investment loan to be quite daunting. Along with Variable and Fixed amortising products there are a large number of Revolving Line of Credit (RLOC) facilities available to potential investors. Using the extensive amount of information on the CANNEX database, this article aims to provide readers with a clearer picture of common investment product features, and in particular, RLOC products currently available on the market.

The benefits and disadvantages of the various types of investment mortgages available can vary depending on the specific needs and circumstances of the borrower. However, outlined below are some general points on each type of product.

Amortising Products

Fixed period investment mortgages can provide the borrower the ability to accurately budget repayment costs over the fixed term of the loan because the repayment amount does not vary during the fixed period. Also, a fixed loan can protect the borrower from the threat of rising interest rates. Alternatively, if interest rates fall, there is no benefit gained from the reduction. Paying a fixed loan off before the fixed portion of the term is complete, can incur breakcosts. Breakcosts are also known as economic costs. They are charged by an institution to recoup interest lost through a borrower refinancing with another institution or paying their loan out early. Breakcosts are normally only charged on fixed rate loans where the amount of interest the institution would receive can easily be calculated. If establishment fees were not paid up-front, you may be required, in addition to any break costs, to pay any deferred establishment fees.

Variable facilities allow the investor to take a risk on the direction of interest rates. Benefits can be gained through reductions in interest rates due to subsequent lower minimum repayments. Higher minimum repayments can also result from any increases in interest rates. Most variable loans will allow the borrower to pay the loan off at any time, however, a deferred establishment fee may be charged if the loan is paid off within a pre-specified time period.

Both fixed and variable amortising loans can have a redraw feature attached to the loan. Redraw provides the ability to withdraw any money paid into the loan over and above the required repayments. Money can only be withdrawn up to the balance of the mortgage would have been at that date, if only standard monthly repayments had been paid. As an example, if a customer was required to pay \$1000 per month but paid \$1100 instead, after six months they would only be allowed to redraw the extra \$600. A flexible loan can allow a customer to automatically deposit their salary into the loan and redraw money as necessary. If used properly, a redraw facility can save on interest charges while allowing easy access to the

extra money a customer has paid in. Some issues which potential borrowers may need to consider are minimum redraw amounts (which can be up to \$5000) and redraw costs (up to \$50). If redraw is not offered by the institution initially chosen, it may have another feature that effectively achieves the same thing – a mortgage offset account.

Revolving Lines of Credit

Revolving Line of Credit facilities work differently from both the variable and fixed loans. A RLOC allows a customer to access equity that they have in their home (or other property) for various uses, one of these being property investment. In a way, it is a method of gaining access to funds that normally would have been inaccessible to a borrower with an amortising loan. The customer can (but does not have to) draw up to a pre-determined limit, paying interest charges only on the money drawn from the account. This is similar to a carry-balance credit card (only with a significantly lower interest rate and higher limit). This type of account can be very handy as it allows a customer immediate access to funds without having to always seek prior approval from their lender.

The main drawback of these products is their flexibility and ready access to available funds. As will be outlined below, issues such as access to funds, security, portability and cost, can all play a part in product flexibility.

Access to funds within the facility is an important issue as limited access may restrict or complicate any transactions which may need to be made. Table 1 below outlines the percentage of Banks and Non Banks (ie Building Societies, Credit Unions and Mortgage Originators) that allow access to funds through certain channels. The difference between the two groups is quite significant, especially in the areas of Internet access, Branch access, Visa and Direct Debit Access. Ultimately, a facility should offer as many access channels as possible to allow for maximum flexibility. However if this is not the case, then knowing which access channels will be used most before taking out a RLOC can help in choosing the right facility. Most RLOC facilities offer either a number of free transactions or unlimited free transactions when accessing funds from the facility. When choosing a product with limited free transactions, it is important to understand any associated costs relating to exceeding the allowed number of free transactions.

Table 1: Methods of access to RLOC funds

Accessibility	Banks	Non-Banks
Cheque access	96%	75%
ATM access	96%	73%
EFTPOS access	96%	71%
Internet access	67%	33%
Telephone access	82%	74%
Branch access	96%	65%
Visa debit access	24%	41%
Direct debit access	76%	49%

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As mentioned earlier, a RLOC facility uses equity from a home or other property as security for the loan. Table 2 below outlines the types of security that Banks and Non-banks (ie Building Societies, Credit Unions, Mortgage Originators etc.) accept as security for their RLOC facilities. As is demonstrated, unless a borrower wants to use Commercially Zoned Property or Company Title as security for their facility, they should not encounter many problems. This is especially true for more “conventional” types of security such as houses, flats and townhouses.

Table 2: Accepted Securities – Revolving Line of Credit facilities

Security	Banks	Non-Banks
House	100%	100%
Semi-Detached	100%	96%
Duplexes	100%	99%
Strata Titled Units	100%	96%
Flats and Apartments	100%	95%
Town Houses	100%	99%
Commercially zoned property	16%	32%
Vacant Land	74%	75%
Bedsitter Home Units	67%	44%
Acreage/Rural	58%	58%
Company Title	65%	15%
Dual Occupancy	91%	57%
Community Title	60%	30%
Inner City apartments	95%	77%

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Another issue which may be important to investors is whether a RLOC facility is portable. Portability allows a borrower to change the security of their loan, which is especially useful to those selling a property and wishing to purchase another. This feature can save borrowers considerable a amount of money and effort. Generally, if a product is not portable then the borrower must close their existing account, apply for a new loan (secured against the new property) and pay any associated fees and charges. Of the RLOC products currently available, 72% allow portability at an average cost of \$281.12. This cost is relatively inexpensive compared to the upfront fees of the 5 star products (Table 4 below).

Some issues which may need to be considered when wanting to change the security on a loan are the value of the properties and any associated costs. The value of the properties being exchanged as security can have a bearing on a number of factors, including cost. If the value of the property which is being used as security is higher than the value of the property which is being substituted, this may present an issue in that most lenders require a borrower to take out mortgage insurance if the Loan to Value Ratio of the loan exceeds a certain percentage. Mortgage insurance can increase the cost of exchanging security significantly. In fact, if the LVR is too high then the exchange may not be possible without reducing the loan amount.

Interest rates offered on RLOC facilities are slightly higher than a variable amortising loan for both Banks and Non Banks. Basically, it is up to the individual to decide how they intend to use the facility and whether a readily accessible supply of funds is worth the small premium. Being a variable loan, RLOC's are affected by movements in the official cash rate, however, some institutions may allow the ability to "Split" their RLOC with a fixed loan in order to hedge against possible increases in interest rates.

Table 3: Interest Rate Comparison

	Revolving Line of Credit	3 Year Fixed Rate	5 Year Fixed Rate	Premium Variable Rate
Banks	6.96%	6.87%	7.19%	6.79%
Non-Banks	7.07%	6.97%	7.29%	6.68%

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CANNEX mortgage star ratings – RLOC Products.

Our last article (API Magazine April/May 2001) featured an explanation on "What makes a 5 star Mortgage". In the months since this article was published, an adjustment was made to the distribution of the weightings to RLOC products. After consultation with industry representatives, the weighting for the Revolving Line of Credit category in the **CANNEX mortgage star ratings** (Table 4) was adjusted from 85% Costs, 15% Features to 70% Costs, 30% Features. The major reason behind this is that the available features (and therefore

flexibility) of a RLOC facility are paramount. Of course, while features are important, price still plays a major role.

While it is important for an investor to decide exactly which features are most useful to them in the immediate term, a RLOC should also offer enough features that will give the product some longevity (such as portability), which will allow the borrower to use the facility for many years to come. While Table 4 only outlines the 5 star products, it is important to note that prospective borrowers should also consider the 1 to 4 star products as they have all achieved strong results in the star ratings process to obtain a rating.

Table 4: **CANNEX mortgage star ratings: 5 Star Revolving Line of Credit Products (June 2001)**

Institution	Product	star rating	Rate	AAPR*	Total upfront fees**	Ongoing fees
ANZ Bank	Equity Manager	★★★★★	6.90%	7.00%	600	150/a
BankWest	Gold Equity Line	★★★★★	6.76%	6.88%	600	8/m 100/a
Colonial	Line of Credit Quarterly	★★★★★	6.60%	6.66%	Nil	12/m
Commonwealth Bank	Viridian LOC Variable	★★★★★	6.97%	7.03%	Nil	12/m
HSBC	Home Equity Loan	★★★★★	6.90%	6.95%	755	Nil
Mortgage House of Aust	Equity Gold CL Loan	★★★★★	6.70%	6.74%	600	Nil
National Australia Bank	National Flexi Plus	★★★★★	6.96%	7.10%	600	250/a
Savings & Loans CU (SA)	Latitude Line of Credit	★★★★★	6.96%	7.00%	570	Nil
St George Bank	Portfolio Loan	★★★★★	6.92%	7.02%	754	10/m

* AAPR is calculated on \$250,000 loan amount, 75% LVR, 7 Years, Interest Only.

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** Total upfront fees calculated on \$250,000 loan amount, 75% LVR.