New loan shares the burden
Sunday Herald Sun
1 April 2007

A NNIE Percy wants to buy an apartment in Melbourne without compromising her lifestyle or selling her Adelaide home.

She looked at drawing on the equity she has in her first property, but has opted to take a shared equity mortgage which involves the borrower sharing a stake in the property.

With the new loan product, Ms Percy's lender will provide an interest-free loan for up to 20 per cent of the property's value.

In return, Ms Percy agrees to give the lender up to 40 per cent of the property's growth in value when she sells or refinances into another loan.

For Ms Percy, 34, the loan means she can buy a property of a better quality and higher price than she would otherwise have been able to afford.

For many others, the loan means they can buy a property sooner with a smaller deposit.

The loan, also known as an equity finance mortgage, allows borrowers to reduce their up-front costs and repayments by up to 20 per cent.

So someone who would traditionally take a $380,000 loan to buy a $400,000 property can now have a normal $300,000 loan and an $80,000 interest-free equity finance mortgage.

The catch is that if the value of the property rises significantly, the borrower agrees to give up to 40 per cent of the capital growth to the lender.

On the flip side, the borrower is protected if the property declines in value because the lender agrees to cover up to 20 per cent of the fall in value.

A big bonus for the borrower is that they make repayments only on the normal bank loan, which can reduce repayments on a $400,000 property by about $600 a month.

Ms Percy, a physiotherapist, said by having a smaller interest-bearing loan, she would be able to pay more off it. And the interest-free component of her loan would bolster her borrowing power to help her buy the property she wants.

"I will be able to buy an apartment that is bigger, or with better renovations or in a nicer group than I would be able to get otherwise," she said.

What does she think of having to give some of her capital gain to her lender?

"It was not my money in the first place," she said. "And it means I will be making more on this property because it will be of a better value than one that cost less."

The loan has been launched by PMI Mortgage Insurance and global real estate funds manager Rismark International in a deal with Adelaide Bank.

Rismark executive Christopher Joye said the product helped first home and low-income buyers enter the market.

Continued next page

From previous page

Mr Joye, who led Prime Minister John Howard's Home Ownership Taskforce in 2003, said there was expected to be significant demand for the product once it became widely known.

The equity finance mortgage is open to owner-occupiers in most metropolitan areas who have at least a 5 per cent deposit.

The chief executive of the Mortgage Industry Association of Australia, Phil Naylor, said other lenders were looking to introduce similar products as rising interest rates and property prices worsened housing affordability.

Equity finance mortgages were helpful in bridging the gap for people who did not have a full 10 per cent deposit, he said.

A similar scheme has been launched by the British Government under a $2.5 billion home ownership scheme and the federal Opposition is believed to be studying the concept.

A shared equity loan offered by Aussie Equity provides 100 per cent finance to cover the purchase price of the property and fees such as stamp duty.

Borrowers need only a $3500 deposit which can be drawn from first home buyers' grants.

Interest on the loan is charged at market rates. After five years the borrower pays an amount equal to 1.5 per cent of the purchase price a year, up to a maximum of $25,000, to the lender.

Aussie Equity national co-ordinator Peter Jones said borrowers could buy a house even if they had no money, provided they could service its debt.

Aussie Equity also offered to negotiate the property purchase, he said.

Shared equity mortgages are the latest loan product to hit the market aimed at giving borrowers more options and greater flexibility.

They follow the growth of reverse mortgages, which are becoming increasingly popular with asset-rich but cash-poor retirees.

Reverse mortgages involve borrowers being paid an amount out of the equity in their home without having to make repayments. Interest is repaid when the borrower sells or dies.

Financial adviser Kevin Bailey said shared equity mortgages were attractive to the "have it now" generation.

Borrowers would do better to tighten their belts for a few years to save more and avoid needing an interest-free loan that demanded a repayment linked to property price growth, he said.

"They would do better to buy into a smaller house and not have to give up anything of its future value," said Mr Bailey, of The Money Managers.

Financial analyst Harry Senlitonga, of independent financial services research company Cannex, said the loans could force up house prices if they became widely used and encouraged people to spend more than they otherwise would.

Cannex analysis found that in Melbourne over the past four years, a borrower would have been financially advantaged with a 75 per cent traditional loan and a 20 per cent shared equity loan compared with a traditional loan of 95 per cent of the purchase price.

In cities of higher growth, such as Perth, borrowers would have gained greater advantage with a traditional loan, which did not require sharing the capital growth with the lender.