Types of Home Loans

Better choices for a better life

When considering a home loan, there are three main loan types to choose from: variable interest rate loan (standard and basic), fixed interest rate loan, Line of Credit loan (equity loan) and split loan which are described in detail below.

Variable rate loan

The variable rate loan is the most popular type of loan in Australia. The interest rate charged on a variable rate loan moves up or down with movements of the official cash rate set by the Reserve Bank of Australia (RBA). Each lender will determine the percentage of the official rate change that is passed on to borrowers depending on how their institution is affected by global money market forces. As a result, the borrower's loan repayments will increase or decrease throughout the life of the loan. e.g. if the RBA decides to move rates by half a percent, then the interest rate on a standard variable loan may increase or decrease by a corresponding rate. Generally there are two types of variable rate loans: standard and basic.

Standard variable rate loan

Interest rates charged on standard variable loans are generally higher than those charged on basic variable loans because they usually offer more features, making the loan more flexible. Different lenders may include different features with their standard variable product, so it is important to look at each loan product carefully in light of the borrower's specific needs.

Basic variable rate loan

A basic variable loan either does not have the additional features of the standard variable loan or those features may be more restrictive or have higher fees attached. Because of this, the interest rate charged is usually lower, but the loan may not be as flexible.

Fixed rate loan

A fixed interest rate loan is set at a specific interest rate for a defined period, e.g. 5.7% p.a. for three years. The borrower is able to "lock in" their repayments for the fixed rate period. Common periods for fixing interest rates are 1 year to 5 years, although some lenders do offer longer periods.

At the end of the fixed rate period the borrower is usually given a choice of converting the loan to a variable interest rate for the remaining term of the loan (this will generally happen automatically if the borrower does nothing) or fixing the interest rate again for a further period at the current market rates.

Line of Credit loan

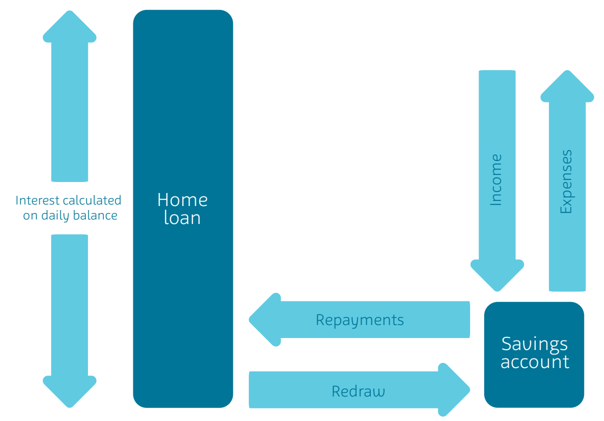
A Line of Credit loan combines the borrower's home loan from which the borrower can draw cash up to a pre-approved limit with an everyday transaction account. A Line of Credit loan requires an interest only repayment as a minimum each month if the credit limit has been reached. The reduction of the loan balance is entirely up to the borrower, as there are generally no set repayments. Each month the loan amount balance is reduced by the amount of cash coming in and increased by the amount paid of any drawings, direct debits or cash withdrawals. As long as there is consistently more cash coming in than going out, these accounts can work well.

The benefits of a Line of Credit can be maximised by combining the loan with an interest-free credit card. By using this credit card for living expenses during the month, the borrower will not be drawing on the loan. Instead, the loan balance is only increased once a month when the credit card balance is paid. Most lenders will have the ability to set this up to happen automatically and this type of arrangement can result in significant interest savings.

Split loan

A split loan allows the borrower to have part of their loan amount fixed and part of it variable. This allows them to take advantage of the flexibility of a variable rate, whilst at the same time, fixing a portion of the loan to give more certainty to repayment amounts. The borrower can select how much to allocate to each.

Typical variable loan



Line of Credit loan