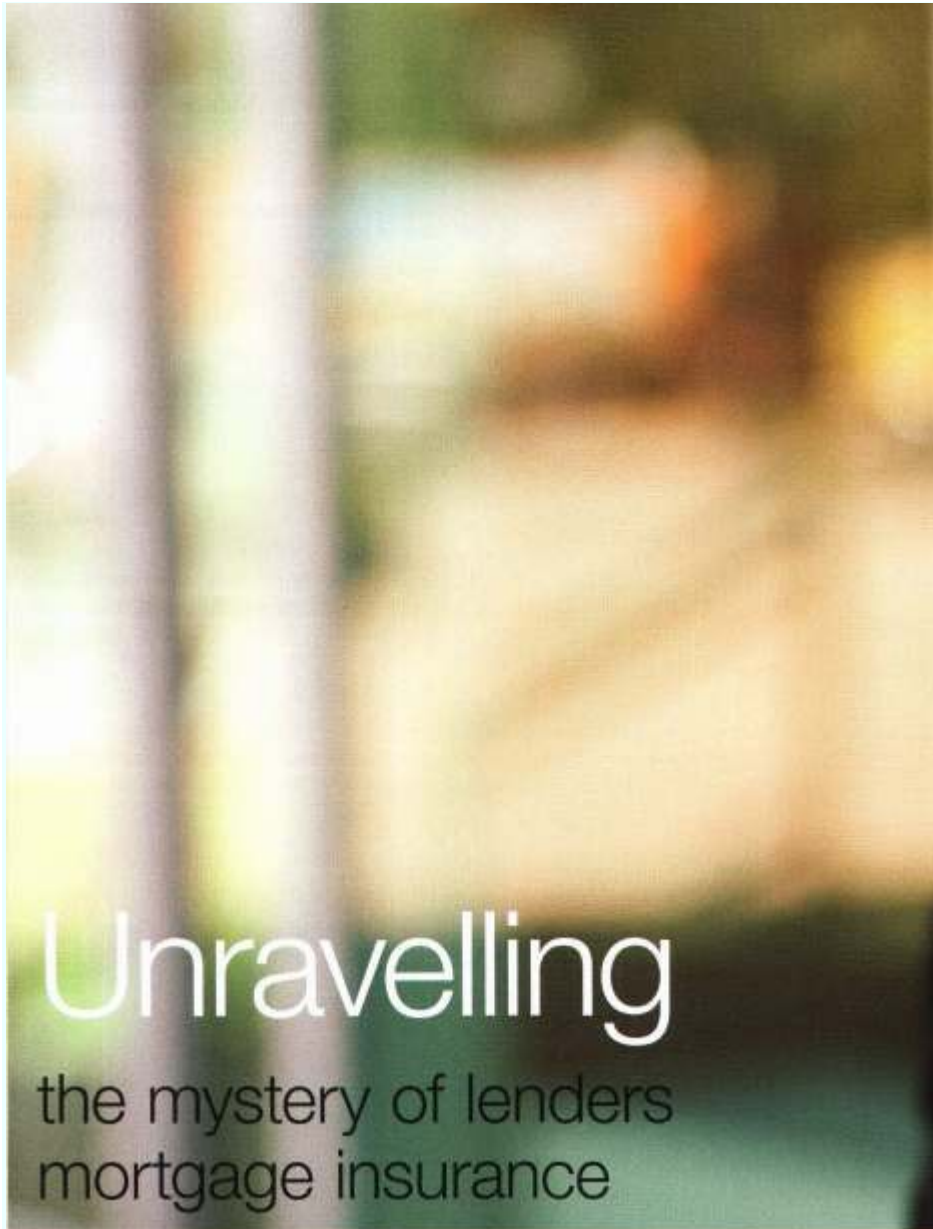




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Lenders mortgage insurance is an unwelcome extra cost when you're trying to get the money together to buy a house. **Nick Yates** demystifies the concept and shows you how to avoid the cost

Lenders mortgage insurance (LMI) remains a mystery to many borrowers who think it covers them if they can't pay their mortgage. However, the truth is, an LMI premium is paid by the borrower but protects only the lender if the borrower defaults on a mortgage.

The premium can either be paid upfront as a lump sum when you take out the loan or it can be capitalised into

the loan, meaning it is broken up and added to your monthly payments.

LMI varies depending on the size of the loan and the amount borrowed compared to the value of the property – something referred to as loan to value ratio (LVR). (See box for examples.)

Typically, you're obliged to take LMI when your deposit is lower than 20% of the value of the property. LMI is required because the risk of default is perceived



Neither PMI nor Genworth will insure credit-impaired loans because the risk of default is too great. This is why you pay higher interest rates, as the lender, or the lender's investor, is taking on the risk themselves.

Some bigger lenders or banks provide their own LMI through something called a captive insurance company. This is an insurance fund created by that firm to fund losses incurred during lending.

Some lenders will not charge LMI to certain borrowers but will instead charge their own fee in return for accepting the risk themselves.

When do you pay LMI?

After the borrower's initial loan application, lenders consider whether the borrower needs to pay LMI. If the lender is happy with the application, it is 'conditionally approved'.

The major condition is whether the lender can insure the loan against the possibility that the borrower defaults on the loan.

In order to establish this, the LMI company reviews the loan application and determines whether or not it represents an acceptable level of risk. If the mortgage insurer is prepared to accept the risk and insure the loan, then your application is likely to be accepted.

Lenders may seek to charge borrowers LMI on low-doc loans to protect their interests. Low-doc loans are being increasingly marketed by banks for self-employed people or contractors who sometimes find it hard to provide accurate predictions of their income.

In some cases, mortgage insurers may refuse to insure a loan, in which case a borrower's loan application will be rejected. Common reasons for which mortgage insurers will refuse to insure a loan include:

- The type and location of the property, eg the property is less than 50m²
- A high LVR
- Unusual employment records
- Poor credit history

Refunds and negotiations

Most companies only provide refunds for the first two years of the LMI premium. Genworth will refund the premiums if the policy is cancelled within two years of inception and if the borrower hasn't defaulted on the home loan repayments.

to be higher and the loss to the lender is greater on mortgages with low deposits.

Benefits of LMI

While LMI is primarily a safety net for the lender, it's also beneficial to the borrower. "Saving a large enough deposit remains the biggest hurdle for many first homebuyers," says Peter Hall, country executive and director, Genworth Financial.

"LMI enables borrowers to achieve home ownership and increased equity sooner without a large deposit or in some cases no deposit at all.

"But there still seems to be many potential borrowers who are unaware of the LMI option."

Hall adds that without LMI lending is restricted to 80% of the value of the home, which means the buyer has to come up with a 20% deposit: "In 2006, the average loan for a first homebuyer was approximately \$228,600, meaning a 20% deposit would be \$45,720. For many young couples, that could take years to save," he says.

Who provides LMI?

The major providers of LMI in Australia are Genworth Financial, PMI Mortgage Insurance and MGIC. These three companies deal with the majority of lenders in the country and guarantee them against losses in return for the LMI premium that you pay.



What is cash-flow cover?

Cash-flow cover is a premium sometimes paid by borrowers using non-bank lenders. The non-bank lender has raised the money used for the loans from investors. Those investors expect a monthly dividend, which is paid using the mortgage repayments from borrowers.

In the event of a significant number of these loans going into arrears, the dividends can't all be paid on time (there is a cash-flow crisis). The cash-flow cover means that the mortgage insurer will cover the dividend payments to investors until the arrears can be collected.

Refunds aren't typically paid to borrowers after two years of taking the loan. If you're thinking of refinancing, you must check with the mortgage insurer about refund policies.

If you refinance to a different lender, then you may need to take out another insurance policy. The premium of the new insurance will be assessed on your revised circumstances, depending on LVR and loan size.

Negotiating a price on LMI is difficult because you never deal directly with the insurer.

It's up to the lender to try and drive down the cost of LMI by securing discounts from the insurers and passing that on to the borrower.

Peter James, CEO, Mortgage Ezy, says his company regularly gets discounts on

LMI premiums by getting quotes from all the companies operating in the Australian market – Genworth, PMI and MGIC.

"We get the LMI providers to compete for our business. We can save 20–30% when there's that competition happening. It shows that there's more to saving money on a loan than just interest rates."

Avoiding LMI

Most lenders charge LMI when you borrow more than 80% of the value of the property you intend to purchase. Therefore, the best way to avoid paying for LMI is to save for a bigger deposit than the 20% of a proposed property purchase.

There are also a few lenders out there who don't always charge LMI, but it often depends on the type of borrower.

"LMI enables borrowers to achieve home ownership and increased equity sooner without a large deposit or in some cases no deposit at all"

Peter Hall, country executive and director, Genworth Financial



Examples of LMI cost

Loan amount	No cash-flow cover			Cash-flow cover		
	85% LVR	90% LVR	95% LVR	85% LVR	90% LVR	95% LVR
\$300,000	\$2,430	\$4,240	\$5,300	\$2,790	\$4,880	\$6,100
\$400,000	\$3,390	\$5,920	\$7,400	\$3,900	\$6,800	\$8,500
\$500,000	\$4,860	\$8,440	\$10,550	\$5,580	\$9,720	\$12,150

Above premiums include GST
Above premiums do not include state-based stamp duty
Single premium for the term of the loan
All of the above premiums may be capitalised

Source: PMI



ING DIRECT is an example of a bank that will take on the risk of default itself for certain clients and charge them a reduced equity fee rather than make them take out LMI. The result of this is that they pay less for mortgages over 80% LVR.

Brett Morgan, executive director of retail mortgages, ING DIRECT, says this is only available to borrowers with a good credit history.

"This product is for people with a clear credit history, who have been with their employer or self-employed for two years and who are purchasing, rather than refinancing," says Morgan.

The product is not available for low-doc loans, but can be taken out by first-time buyers. Morgan says that the product is designed to repay the better borrower,

who shouldn't have to pay the same insurance premiums as everyone else.

In the non-bank sector there are also lenders who will allow you to avoid paying LMI. Mortgage Ezy is a firm that believes it's able to assess its own credit risk and has persuaded its investors to trust that judgment.

James says the company will provide certain borrowers with loans completely free of LMI or risk fees, up to 85% LVR. Above that, they will charge a risk fee for residential loans, but it's usually around half the cost of LMI.

"We go to 85% without any LMI or risk fee whatsoever, so they only have to raise a 15% deposit rather than 20%. We'll do this for customers who would qualify for a loan from a bank, not sub-prime borrowers," adds James. 🏠



Know your LMI options and save thousands



Derek Porsche and his partner Leticia bought a house in Southport on Queensland's Gold Coast in May this year.

They decided on a four-bedroom property at \$460,000. They wanted to put as much money towards the property as possible and were unhappy to hear that they would be hit for more than \$4,000 in lenders mortgage insurance (LMI).

They were introduced to lender Mortgage Ezy and were told they could avoid paying LMI if they were able to raise a 15% deposit, rather than the usual 20%. The 85% LVR loan would normally have attracted an LMI charge of \$4,144.60, but they were able to get the loan for a risk fee of \$399. In addition, Mortgage Ezy offered to waive the risk fee because they were approved applicants with a stable income.

"They said that because we're both government employees [a teacher and a Centrelink official] they'd waive the LMI cost as long as we could raise a 15% deposit. What we saved on the premium, we put into the loan," says Derek.

Derek and Leticia's home loan choice

Lender: Mortgage Ezy – Ezy Standard Variable No LMI
Property price: \$460,000
Loan size: \$391,000
Deposit: \$69,000 (15%)
Risk fee: \$399 (waived)
LMI saving: \$4,144.60 (excluding stamp duty)



Cost of ING DIRECT reduced equity fee

Loan amount	LVR	Reduced equity fee**	Equivalent LMI cost	Saving
\$500,000 P&I*	90%	\$5,700	\$7,466	\$1,766
\$300,000 P&I	90%	\$2,640	\$3,443	\$803

*Principal and interest; **Only available to certain borrowers (see article)

Source: ING DIRECT

Cost of Mortgage Ezy risk fee

Loan amount \$500,000	Risk fee	Mortgage insurance	Indicative saving	Saving
85% regulated*	NIL	\$8,600.00	\$8,600.00	100%
90% unregulated**	\$7,700	\$17,038.75	\$9,338.75	55%
100% regulated	\$13,145	\$25,423.75	\$12,279.00	48%

*Regulated: Owner-occupied, residential properties; **Unregulated: Commercial, investment properties

Source: Mortgage Ezy