The Australian Finance Podcast Episode Transcript

Episode: Mortgage Broking 101 with Chris Bates
Release Date: 21/06/2021
Speakers: Owen Raszkiewicz, Kate Campbell & Chris Bates
Duration: 39:31

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Episode transcript:

Owen:
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Owen:
Kate, welcome back to this episode of, The Australian Finance Podcast.

Kate:
It's great to be back, Owen.

Owen:
Today, we are doing a user or listener-inspired episode with, I guess, the best, mortgage broker we know, we were chatting with him off-air, Chris Bates from Wealthful, based out of Sydney. He's a mortgage broker, his firm just ranked ninth out of 16,000. Is that right, Chris?

Chris:
Yeah. I'm not sure exactly how many brokers are out there, whether it's 16 or 17 or something, but there's a lot of brokers, and our firm did do very well last year and grew a lot. So I'm super happy, mainly because that means the amount of impact we're making in their lives are changing by helping them make great property decisions, ultimately, not just get a home loan, but the property they buy, how did that fit into their longer term plan and client outcomes is always our focus and what gives us real meaning.

Owen:
Yeah, I know we have so many questions that have come through from Facebook for you, people wanting to know everything from the basics, right through to things like debt optimization, things that I didn't really know that much about. Kate. Why don't you fire off with maybe the first question?

Kate:
Yes. So we haven't talked about property that much. We've been trying to talk about a little bit more recently because of Owen's property journey last, but I'd love if you could cover off some mortgage broking 101s, what does a mortgage broker do? When do you need them? What do they cost? And some of the key questions to ask.

Chris:
Yeah. So if we just focus on what a mortgage broker is, it's a simple concept really, most people should be able to understand it. You can go directly to a bank branch, or you could go to an online lender, and try to figure out who's the best bank for you. Or you could go to, say, someone who does that all day, every day, and has done that for many years and can guide you through picking the best mortgage, really. The good thing about mortgage broking is that it is funded by the banks, basically. And so it's not consumer funded. You don't go and pay a mortgage broker a fee, some brokers will charge you a fee, but the vast majority don't. And they basically are paid pretty much exactly the same, every lender, so there's no real conflict of interest there for them to support one bank over another.

Chris:
And what they'll do is, most people think is about getting the best rate, but what we find is, every client's got a different personal situation really. Someone might be casual, or contracting, or maternity leave, or the type of property they're wanting to buy versus how much deposit they've gotten, that will then basically be, we're watching Australian Open Tennis at the moment. They're playing that game where they knock down certain personalities, it's a little bit like that with a bank. We've got 30 banks on our list and we start knocking them down and saying, "Well, really there's two banks that are probably the best suit for you, and then which of those two banks is going to give you the best rates?"

Chris:

So really, policy's the driver a lot of the time, but the big thing that also determines the bank you use is turnaround times. How long is that bank going to take to get to your file, to then go through all the, there's usually a tennis match as well, where the credit assessor asks us for more details and you have to send it. The process, sometimes speed's really important, especially when people are trying to buy their first home, getting a pre-approval and taking two months. So, turnaround time is another big thing we choose in banks.

Chris:
The good thing is, mortgage brokers is not a new job. So consumers have spoken with their feet, really, and over 60% of loans go through mortgage brokers now, and in the banks, mainly the way they get new customers is from mortgage brokers, because you don't go and open up a new bank account at a new bank. So, that gives you a bit of background on how the mortgage broking industry is growing every year. That used to be 20%. Now it's 60%.

Owen:
And why do you think that is, Chris? Is that just because it's quite complicated to get a loan, if you're not very financially literate?

Chris:
I think a lot of it is the way that the remuneration is. So hence why, in the Royal Commission, one of the big yellow banks tried to kill mortgage brokers by suggesting consumers should pay for it. And because consumers don't have to pay for it and they get all this great advice, guidance, structuring, comparing the whole market, why wouldn't you use a broker than going direct to a bank?

Chris:
And also when you present your case to the bank, guiding you through the documents or things you need to fix up, it's also a long-term relationship. If you go to a bank branch, I worked in the banks for three years at the start of my career, and if you're any good in a bank, you get moved around pretty fast, because you get a little cross, maybe a tick, and you get moved to another branch where you kept moved up. So it's hard to get great staff in the bank that you can have a long-term relationship with. Which, with a broker, you could go back to and say, "I need to get money for renovation," or etc. So I think it's the long-term relationship's another key point.

Owen:
How much does the broker make, and how are you guys funded, effectively?

Chris:
So if you think of, a bank wants to sell you a $500,000 mortgage, right. They make roughly, let's say, 2% on that mortgage is their margin, over the next 30 years. They lend it to you with, say, crazy rates now, let's say 3%, but their cost of getting that money is maybe 1%. So they make a lot of money off you as a customer if you've got a mortgage for them in that 30 years. They know that they're not going to keep you for 30 years, every three or four years, a lot of people refinance. So there's a cost of acquisition for that customer, for that bank. And that's what they

pay mortgage brokers for, really. But we also packaged that customer up on a plate for them. We get all their documents, we make sure it hits policy. And we say, "Here you go. Here's a great customer that you can lend to."

Chris:
So that's why they pay mortgage brokers. So how much money do they make, generally speaking, they make 0.65% times the loan amount. So a $500,000 mortgage would be about $3,200, that's how much the broker would make upfront. If you leave that bank, though, let's say you go to a broker and a year later, you want to refinance. If it's under 12 months, the broker has to give all that money back to the bank, there's a hundred percent claw back. If it's in two years, they usually have to give 50% of that money back to the bank, because the bank's not making any money, really. Then ongoing going the bank gives a broker 0.15% times the loan amount. So every $500,000, the broker makes $750 every year for servicing, and to be there, really, for that port of call. If someone wants to change their loan to fixed versus variable, which we're going to talk about, or extend interest only, or consider a renovation, that's where a broker can add a lot of value and talk a client through, and that's what that's really paying for.

Kate:
Wow. I didn't realise you'd have to give the money back if they left early.

Chris:
It's a cost for them, really. If you come and you leave, that's a cost for them to set up. And I think it's right. We very rarely, we've had very limited claw back issues in seven years the business is almost running, now. The reason is, if a client does get a better deal with something else, we just go to a different bank, and maybe we have claw back, and go to another bank. It's unlikely you're going to want to swap banks in 12 months anyway. So some brokers, who potentially haven't got the best experience, the client really wants to get out of that broker anyway, and will realise it's not the right lender. That's where brokers like that do get claw back back issues.

Kate:
So I guess it incentivizes you to find the best fit for the customer at the beginning.

Chris:
Clients are so savvy nowadays. And so you should be, right. Google is your friend. Type in, "Best rate," there's so much media out there around rates, RBA reports on it, ABS, so people can figure out what's a good rate pretty quickly. And so if a broker is not offering you a close to best in market product, or justify to you why you had to use that bank over another bank, consumers switch on pretty good. So the lazy brokers out there that are just working with the bank they're comfortable with, consumers will figure that out pretty quick. So you've got to be good to be a good broker long-term.

Owen:
One of the questions, Chris, that everyone asks is, what's the difference between the comparison rate or the interest rate, air quotes. So we hear a lot of talk about comparison rates.

I saw it on my loan documents, which was, "Term rate," the first time I heard that, but comparison rate, why is that important, or why is it not important?

Chris:
Comparison rate's a little bit like stamp duty. It hasn't really changed for a long, long time, and comparison is biassed on $150,000 loan. Now I'd love to think most properties were 150 or $200,000, but good luck finding that. There's some big property spruikers out there that like to buy properties like that. So that's what it's based on, is $150,000 loan. So what it does, the interest rate is, say, 3%, but because of $400 in annual fees, which a lot of the quality property mortgages are around $300 to $400 a year for the good packages, because of those fees, that makes a big difference to your overall cost of that mortgage. So you have to pay the interest, plus those fees. So the comparison rate isn't really a fair rate if you're borrowing more than $150,000, because it should drop.

Chris:
So if you're borrowing 500 or a million dollars, what really matters is your interest rate, because what most people would do would be, get a similar type of loan, which we'll probably talk about, which is package loans, and every bank charges, probably $200 to $400 for a package loan. So it's not the fee that matters. It's really your interest rate.

Owen:
And that's because the value is so much more than $150,000. So it's the interest that is slugging you, not that $400 in fees a year.

Chris:
Yeah, exactly right. So, 3% on a million dollar mortgage is $30,000 a year. $30,000 plus $400 isn't a big deal, right? But if you had a $150,000 mortgage, the numbers are a lot less then, so that $400 really increases your overall cost.

Kate:
Are you able to talk a little bit about loan structures? One of the questions we had come up in our Facebook group was, what's the difference between a fixed and variable loan? And, splitting loans versus single loans.

Chris:
Generally speaking, you should be in a variable camp. That should be your go-to. You shouldn't be consciously thinking, "I want to go fixed rate, I want to go fixed rate." Because if you look at all the stats, long-term, generally you'll win on variable over fixed rate, but at some points in your personal situation, a rising rate may be really confronting, it might push you. You might not have enough buffer, or you might be going to one income with a family. And so you might be like, "I want certainty on my mortgage." And so going for a fixed rate might just give you that sleep at night factor, which the RBA does not, with the interest rates, you don't have to worry about.

Chris:

The thing with variable versus fixed, it's not one or the other. Generally, it should always be both. And I get frustrated sometimes when I get clients come to me and they say, "I went to a broker, or I went to a bank, and I fixed a hundred percent of my loan," because with fixed loans besides one bank, you can do it with, for one year, you can't have offset accounts with them. The big problem is, when you go all fixed, if you get extra money through a bonus or financial windfall or an inheritance, or you save a lot more than you're expecting, then you can't offset fixed rate mortgages. You can only offset variable rate mortgages. So generally with clients we are potentially only fixing maybe 50 or 60% of their loan, and keeping 40 or 50% variable.

Chris:
With fixed rates, in Australia, you can't get 30-year fixed rates. So in the US you can, and they're pretty cheap when you look at them, and a lot of other countries you can as well, but really you can't really get more than five years in Australia, at a competitive rate. So, when you're having a 30-year mortgage, all you're committing to is, "For five years, I'm going to guarantee this rate." The big thing with fixed rates, which I don't want to ramble on, it's just, you've got to be always careful that if you lock in a rate, and you decide to leave or cancel, sell that property, you might have to close that fixed rate down, and there may be a break cost, which can be a lot of money, especially right now, because rates have fallen a lot, and a lot of people are on big fixed rates with big break fees.

Owen:
So what would be an example of a break fee? I have no idea, when you say big fee, it could be thousand dollars, $10,000. Like what is the-

Chris:
$30,000, $40,000?

Owen:
Whoa. $30,000 or $40,000?

Chris:
Yeah, we've got one at the moment, a client at Suncorp paid $600,000 at 3.99, which was actually not a bad rate, this was 2018, I think it was, or 2017, I think it was. And the rate spiked when Trump got in, and then they dropped right back down to under 4%. No-one expected what was going to happen. Anyway, that break fee was $35,000, because rates have fallen so much. It's unlikely to get those sort of break fees now because rates are already so low, but you can get huge break fees, especially if the fixed term's a long term, like five years, then your break fee compounds.

Owen:
Wow. That's scary. You mentioned the offset accounts. Can you explain what an offset account is and why you are, or are not, a fan of them?

Chris:

I've been a financial advisor for 13 years, we don't do that in house anymore, but offset accounts at one of the most powerful tools that you can have access to, because what they do is they link it to your home loan. So let's say your home loan's, they're big numbers, but let's just say, easy, a million dollars, and you've got a hundred thousand dollars' spare cash, you can put that into an offset account, offsetting your mortgage. And so you're only paying interest on the difference, which is, say, $900,000. So you're not paying any interest on that hundred thousand, because it's in an offset account, but if you decide tomorrow, "Look, I want to do a renovation. It's going to cost $50,000," then you can just take it out of your offset.

Chris:
The other reason why I'm a big fan of offset accounts is really with tax. It's really important to understand, your tax deductible limit is what you can claim when you do your interest in your tax return. So you've got to be very careful paying down property loans just by paying them down, because what you're actually potentially doing is reducing your future tax-deductible debt. And so a lot of people don't realise that.

Chris:
Say it's a first-time buyer, they buy an apartment, and it's $500,000, and they get a loan of $400,000. Common sense drilled into you, "Debt is bad, pay off debt." Well, that person with that apartment might smash their $400,000 down to $300,000, to $200,000, because they bought within their means and they saved really hard, but when they decide to upgrade and buy a house, because they've paid off that property, they've paid off their tax deductible debt. And then, if they want to buy a house, they've got to borrow a lot of money for their new house, which is non-deductible.

Chris:
So that's another big reason why offset accounts are really good. They're really amazing strategy tools. You keep a lot of money in liquidity, and you also offset your mortgage.

Owen:
Just so I have that right, because that the tax deduction element of it got me a bit lost there, Chris, but you're saying that-

Chris:
Yeah. So that's how, in that scenario there, the client had a $400,000 loan. Instead of paying down that loan, actually paying the loan down, $398,000, $395,000, $380,000, they just had an offset account, and that offset account went from $5,000 to $20,000 to $50,000, a hundred thousand, and they didn't really pay down that loan directly. When they decided to upgrade, they could just take the money from the offset account to use for the deposit on the new place, and keep the tax deductible debt on the investment property, much higher, rather than paying it off. It's a really common mistake for first-time buyers, and first-time investors, because they get to us a few years down the line, and say, "We want to upgrade. We want to keep it. It's a great property," but because they've paid off the loan, it means they're going to have a huge non-deductible debt rather than keeping quite a bit in investment debt.

Owen:
So, can I give another example, then. My partner and I bought this house, as you know, last year, we're currently fixing it up. Let's say in three years, we're like, "We like the sound of moving to the beach, but we want to keep this house as well. We want to rent this house out." You're saying the interest that we're paying on this bigger loan, just purely from a tax deduction perspective, it may be a better case that we have the interest to pay on this loan, and we have a bigger loan when we move out, and this becomes our investment property.

Chris:
Yeah, exactly. So what we want to do with you, Owen, is keep that debt as high as possible. And if you're going to get excess cash, just keep putting it in your offset account. Because when you move out of it one day, you're keeping that debt as high as possible, from a tax deduction point of view, because your next property will be a home, which is non-deductible debt. And so you don't want to have this low debt on your place, and then paying a lot of money and a lot of debt on this beach house, which is a home. Now, when interest rates are really low, at two or 3%, it's not that big of a cost, but it's only three or four years ago, we're talking fours, fives, sixes. And that's when that investment debt versus home debt, it's really much better to have a lot less home debt versus investment debt.

Kate:
So if you had a $400,000 loan, and you had $400,000 in your offset, you would be paying nothing to the bank?

Chris:
That's a dream situation to be in. If you could, that'd be great, because you would have full flexibility. If you wanted to, tomorrow, I don't know something bad happened with your health, and you need $150,000, let's say, then you've got it there. You haven't paid off the property. You haven't got to go back to the bank and say, "Can I borrow $150,000?" It's a big thing when people lose their job. They pay off a property, because I think that's the right thing, and then they lose their job and they go, "Actually I want to get some money back, because I need a buffer." Then the bank says, "You haven't got a job. I can't lend to you." And so that's another reason why your offset's good, because it just is building buffers in life, and personal situation or in business, buffers is what gets you through the bad times.

Kate:
Yeah. Okay. That's interesting. And one of the other questions we had was, what are some strategies to reduce your mortgage payments and own your own home in less than the typical 30 years?

Chris:
This is a good question because it's, "I'm trying to take ownership of my mortgage," and this is what you're doing. This is how you do it, really. The reality is, the bank says, "We'll lend you this money for 30 years," and 99% of loans are set up on 30 years. A bank doesn't get away with

giving you a 40-year loan terms. If you're in your fifties and sixties, maybe they'll shorten your loan terms, so maybe you'll pay 10 or 20-year loans, but most people are getting 30-year loans. And so a bank saying to you, "Don't worry about paying it off fast, just pay it off slowly over 30 years," because they make more money through interest. And that's the reality. So when interest rates fall, your monthly repayment falls, but really that's the time to take an opportunity to say, "Well, yeah, my repayment's fallen from $3000 a month to $2,500 dollars a month." At that point in time, don't reduce how much you're paying off your mortgage. Keep paying $3,000 a month.

Chris:
And the reality is, what I try to say to clients is, do your own budget, figure out what you can afford per month, ideally the more, the better, and put that amount into your offset account for that year. Have a focus of 12 months, "I'm going to do $6,000 a month every month. If my mortgage repayment's $3,000, that's fine. I'm going to be saving $3,000 a month in my offset account." Now, if you get a pay rise, I think that's always a good moment to stop the treadmill of, "Earn more, spend more." And that's the point where you say, "You know what? We're living a good life. I don't really need to change my lifestyle. Why don't we just pay that off the mortgage?"

Chris:
So for me, they're the two things. It's really about you taking ownership, you figuring out what you can afford, and then trying to, low interest rates is a great opportunity to actually pay off your mortgage faster, because if rates do rise in the future, you're going to have a much smaller loan, much smaller interest. There's a really big snowballing effect as well, just like superannuation in reverse. A lot of people look at it and go, "I've got nothing in it, it's pointless. I don't even need to look at it." It's tough in those first, twenties, thirties, even up to your forties, it doesn't look like you've got much in super, but when you get to your forties and your fifties, you go, "Wow, that's a lot of money. I should take care of it." That mentality needs to be in your twenties, when you're still building your super up. It's the same with a mortgage. It doesn't feel like you're reducing it fast, but you are, you just creating this snowballing effect. And so the earlier you can get on top of it, the better.

Owen:
Chris, then, an interesting question we always get asked is, "Instead of paying on the mortgage, why don't we just invest? Because interest rates are so low?" But you could invest that money in a diversified portfolio and you get dividends. And we know that over the very long time, the stock market tends to go up, etc., etc. How do you answer that question? Save more or invest more?

Chris:
So the first thing is you're already in a good place, right? You're saving, right? And so, as long as you're building up money in your buffers, and you've got some money in your offset account as that buffer, and you're on top of your mortgage repayment, then yeah, potentially now's a

good time to consider what your options are. Do I keep just putting money into my offset account, or should I look to get a better return on that and invest that money?

Chris:
The thing that I think sometimes, even financial planners, astounds me sometimes, don't get this, because they don't understand finance. What you really want to be doing, is you can negative gear shares just exactly the same as you can negatively gear a property. You can borrow to buy shares through equity in your property. And so, let's say you want to save $50,000 over the year. Instead of just putting $50,000 out of your offset account to buy some shares, like a diversified portfolio that you spoke about there, Owen, what you're probably better off doing is paying off your house $50,000, and then refinancing and releasing $50,000 of equity as an investment loan, and then investing that money into your shares. Because what you're doing is you're creating a tax-deductible debt against those shares, and you're lowering your non-deductible debt, which is your home. Which is that debt recycling strategy that sometimes people talk about. What you do is you pay off your home loan, that increases your equity in that property. You withdraw that equity, and then you use that to buy assets like shares, and you have a tax deduction interest off it.

Owen:
Because one of the things there, Chris, is that a lot of people talk about margin loans, which are scary things, in my opinion, very scary, but I've also heard of some investors, and this is probably more of an intermediate to advanced discussion, but is this like using your house as credit, and you get like a separate loan. So it's not your mortgage, it's like a separate loan against the house. Is that what it is?

Chris:
Yeah. And so you've got to be really careful, because if you are investing money, right? So this is, disclaimer, you need to know what you're doing when you're investing your money, but let's say you know your long-term fundamentals, etc., etc., which we won't go to. But assuming that knowledge, from a finance point of view and a tax point of view, if you had a property worth $500,000, and your home loan was, say, $300,000, you can release equity up to 80% on the value of that property. So, $400,000. And so, in that situation, you could get an investment loan of a hundred thousand dollars against your home, and that's the money you would use to go and buy your shares. And if you had a hundred thousand dollars, you'd just pay off your mortgage, from $300,000 down to $200,000 if you wanted to, or you'd use an offset account, really.

Chris:
So that's really what you're doing, is using equity in your home, or an investment property, and using that to buy shares. Now there's no margin call on this, because that's what's, and it's usually a much lower rate. It's at 3%, versus a marginal loan might be at five or six. And so if that cost of capital is cheaper, then the return has to be cheaper, lower, to make a profit. So if you've got equity in your house, you shouldn't really be doing margin loans, in reality. And if you've got equity in your house and you've still got a mortgage, you shouldn't really be buying

shares with cash. You should be paying off your mortgage and redrawing, and buying it with debt, just a better tax strategy.

Owen:
That's an interesting thing, Kate, we haven't spoken about in the show before, which is a margin call. Just for those who don't know what we're talking about, sometimes you can get offered loans from brokerage accounts, banks, etc., and you can use that money to invest in shares. It almost always is a bad idea, because the interest rate is so high, but because shares can go up and down quite a bit, you can have a margin call, which is where the bank says to you, "Listen, the value of the investment's gone down. We need you to stump up some cash, or we're going to have to sell some of these shares from underneath you." And as we know, we've talked about this before, in long-term investing, the stock market falls ever so often, and oftentimes that is the worst time to get out. But these margin calls can trigger a decision that's outside of your control, so that's a bad idea.

Owen:
And by the way, I should just add, The Elephant in the Room Podcast, is a podcast that Chris co-hosts. So you can learn about all these strategies, and different property market musings, and all that sort of thing on there. We'll put links in the show notes.

Owen:
Kate, you've got a really interesting question for Chris.

Kate:
Yeah. So off the back of the mortgage first, excess cash for shares discussion, one about listeners was wondering if the answer would be different, if the property was a rented investment property and the interest was tax deductible?

Chris:
Yeah. I wouldn't still be, if it's an investment property and you're paying it off, to me, that's a bit of a red flag, really, because you should be using an offset account. You really don't want to be paying off your investment properties through paying it off. Now I know that sounds crazy, it's the mortgage broker telling me not to pay off debt? No, a hundred percent, we want you to pay off, build, save, and build money in offset accounts. It's just, there's no financial advantage in putting the money in an offset account versus paying off the mortgage.

Chris:
Now, a big disclaimer, if you've got sticky fingers, impulsive purchases, and you like to spend money and you need that commitment with paying off the mortgage, and you can't leave the money in the offset account, I think you still can come up strategies to make that hard for yourself. You can get rid of your internet banking. Just because you've got a mortgage with someone doesn't mean you need to do all your day-to-day banking with them. In fact, I don't, I do NAB and my mortgage is with St. George, for example. I don't even look at my St George loan, because I'll just transfer it to that every month, and I do my day-to-day spending

elsewhere. And so, when you've got a mortgage, etc., you don't really want to be looking at your offset account. Don't do your day-to-day spending out of that account, and don't have a debit card for it. So if you haven't got internet banking, you haven't got a debit card, it's getting a bit tough to get access to that money.

Chris:
So there are strategies you can do to stop yourself spending that money. But if that's still a problem, then maybe you just pay your mortgages off, and that's an option, but really try to use offset accounts if you can, especially on investment debt.

Owen:
Because this is one thing that we often talk about on the show, Chris, we talk about having that, you said a buffer, we call it this emergency fund. It's the same thing. It's just about having a set amount of money for those rainy days, but it's pretty much useless if you just dip into it. "It's an emergency holiday to Queensland," that's not what we're talking about. This is money that's strategically placed in an area. So if you are the type of person that likes to be impulsive, maybe just put a barrier in front of you, no matter how small it might be. Chris, there's one... Oh, sorry-

Chris:
Get rid of your Amazon account, which you do. Oh, that would be a big win for you, I think.

Kate:
That's his favourite account.

Chris:
Yeah.

Owen:
One-click purchases.

Chris:
Yeah, exactly. I think that, if you're coming from a financial planning, I think it's not what you earn. A lot of people get excited with, and this is society creating a perpetual money problem, right? It's short-term credit. Even getting paid on a monthly basis, with people who've got, it's not judgemental at all, with potential lower financial literacy on how to manage money, all the marketing in the world, you get paid this lump sum and then there's all these costs, etc. And so it's not what you get paid, if you get say $10,000 a month for you as a couple. It's, once you minus off all your living costs the fixed expenses, the things you really want to do to have a life, that $10,000 reduces dramatically. And that's what you need to spend based on, it's what you've actually got left over after all those essentials, and people realise they're earning a lot less than they think they are because they're not minusing off all their fixed costs.

Owen:

You touched on this earlier on, but one of the questions that came through Facebook was just an explainer of, what is debt recycling or debt optimization? I know that's a broad thing, but maybe if you can just explain that in the simplest way possible.

Chris:
Financial planners love this strategy. There's only so many strategies, financial planners have in their toolkit, right? And this is one that they will use. I do have a bit of a worry with this strategy, so I do caution people looking at debt recycling. The idea behind debt recycling is, you borrow using equity in your home loan, which is kind of what we spoke about. You buy assets, and as those assets go up, you sell those, so you buy, let's say you do a hundred thousand dollars of equity, you buy some shares. As those shares go to $150,000, you sell those shares, pay off your home loan, $150,000. And now it's $50,000 less, and then you re-borrow and buy more shares. And so this is what the recycling is. You buy some assets, they grow, you sell them, you pay off your home loan, you re-borrow, you buy shares.

Chris:
I just don't think that sort of mindset works with share investing. It's very short term, and then you have to pay capital gains tax. So I don't really like debt recycling as a strategy. I think if you're going to pay your mortgage off, the main way to do that is what we spoke about, is paying a lot more than the monthly repayment, and making sure you're getting the sharpest rate you can, because they're the two controllables. And using an offset account, discipline, setting, as you get pay rises, keep improving your amount.

Chris:
If you want to do other investing, that's a different conversation. You pull equity out, and you invest long-term, and you invest longer than 10 years, ideally 15, 20 years, the longer, the better. And you use that equity for that reason, not to pay your mortgage off faster. Use equity to buy investments for your longer-term future, don't use it to pay off your mortgage. I just don't think it's a great strategy. Financial planners listening will be like, "Argh," but the reality is, that's the truth, because you're paying capital gains tax and timing markets, etc. I'm a massive believer in dollar cost averaging, which I'm sure you've covered on your show multiple times.

Owen:
Yeah. Yeah, we are indeed.

Kate:
Absolutely. I'm going to put you on the spot with this question, Chris, but do you think the banks, in what you've seen have been looking negatively on people with, "Buy now, pay later," histories or current debts, when they apply for their mortgages?

Chris:
So, if it was Klarna, and you were getting a mortgage through CBA, they'd be like, "Yay." But if it's Afterpay, or zipMoney, probably not. And we have had clients that have got, it's a close decision for credit, right? Maybe that's very tight on servicing, which means they generally would

do the loan. You don't need to have a lot of, be borrowing well within your limit. Banks have a calculator for a reason. But they may have just poor credit behaviour, taking out lots of short term credit, credit card recycling to get free travel points that you can't use, all those sorts of things. If you've been that sort of person, the bank know that, the credit report reports that. And then if got Afterpay and zipMoney, then it can be a decision where credit may say, "You know what? We just don't like you as a customer. You're a bit of a player, I guess, of the banks," and that's where we have had clients declined in that situation.

Chris:
I'm not a fan of those products anyway. I just don't think, they're just buying into consumerism, and short-term credit and the benefits are very minimal at best. And so I think it, I'm just not a fan.

Owen:
Yeah, because that's the question that we had emailed through to us. It was more so along the lines of, "Should I get a debt, even if it's just a small one, so that I have some sort of better credit score?"

Chris:
No, the banks will probably want you to believe that, and they're probably doing marketing out there to tell you that you need that credit card to get the mortgage, but I don't think you do. The other thing I want to be careful here is that, a debt of a thousand dollars with zipMoney, or Afterpay, if you don't declare that on your bank application, it becomes an undisclosed debt, and that's a big tick in why the bank would decline your loan. Undisclosed debts means that you're not telling the bank the truth, and is one of the easiest things for the bank to check on what you've got out there. Those do pop up on credit files, and so if you don't disclose that account, you're basically shooting yourself with the mortgage application. Hence, why we do a credit check on our clients before we launch any application, because we'd never want an undisclosed debt declining an application.

Chris:
I don't think you need to take out credit cards, or car leases or anything to get good credit history. It's not an American point-scoring system, Australians aren't as advanced, which is probably a good thing. So yeah, you don't need it. As long as you haven't got any bad credit, you pay your Optus bill on time, you pay back your JB Hi-Fi sofa, etc. So don't do any silly credit mistakes, and you'll be fine to get a home loan.

Kate:
And I think if you spend a bit too much time listening to American financial YouTube, and podcasts, you get the idea that a credit score is really essential and that you should get a credit card. So I think it's really good to hear it from an Australian perspective, because we don't put as much weight on that over here.

Chris:

It is concerning that we may be going in this direction, and maybe preferential rates for people who borrow, and it's going to get this real margin where sometimes, when things get more competition and more complex, then people start to get marginalised. And so I do worry that we are going to go into that direction, where people who have potentially had bad credit mistakes, people always make mistakes, that's why the banks are a bit smarter than, sometimes, consumers, and then they're going to have to pay higher rates for a long-term, and get really, for something that was just a short-term mistake.

Kate:
Wasn't there some positive credit reporting introduced a year or two ago, where if you pay off something well, that has to get reported?

Chris:
So there's this sort of open banking, competency of credit reporting, which she's talking about. That's really exciting, because what it really means is that banks will be able to ask less information and share that data across the banks. But it is actually, this is what I was saying, maybe going this direction, it is allowing the banks to say, "I know more about you. Now I can start to charge you different rates. And if I know you're a great customer, I could give you a better rate. I know that you're pretty poor, I'm going to charge you a higher rate." And so then you start getting this marginalisation. Those things are happening, and it potentially could get much better products and create competition. That's what we're hoping, because banks can assess your applications easier, because they know more about you, which means that the turnaround times will be faster, etc. So there's lots of positive things, I think, out of open banking, but that's my worry.

Owen:
We see a lot of these Neobanks appearing and these really trendy agile banks, like we've had, Up Money, on the show before, and we've talked about a few others. This open banking effectively looks to me like it can create some serious automation in the ability for a bank to assess you before you even requested credit. I feel like, for some people, that getting a loan, that it just lays it all out and it's just, it's bad. The bank will know who you are before you even got to them. Is that where you see it going?

Chris:
I hope so, just because I think that the banks' process at the moment is definitely stuck a long time ago, and that's on purpose. The reality is, technology is out there. The bank could be creating a much smoother process, but the big banks, in particular, who own the markets, 80% of loans are through one of them, or their different banks that they own. They don't really want people switching banks, and all the big four banks are extremely worried that they're going to lose their market share. So what they try to do is make it difficult for people to swap banks, hence why they weren't a fan of open banking. This is being quite frank.

Chris:

Am I a fan of Neobanks? Absolutely. Is there going to be, really, they're just different colours. They open up accounts fast. That's the key differentiator. And hence why a lot of them are failing, the Xinjas of the world, and that there's been multiple, even 86 400, which was probably the best innovative bank for mortgages. They had this product where you didn't have to require payslips. You didn't have to require these things, because they could get it off your bank account. They've just sold out to one of the big four. And so, even if these digital banks do successful, ultimately, I think, the big four will buy them.

Owen:
Last year, when I approached you, I called you up on a Friday night and said, "Hey, mate, bought a house, need a loan, settles in about a week." And you were like, "Hold on a second. I'll just go inside." And we had a conversation, fortunately, we got over the line. You said at the start of the show that sometimes you need to just be prepared, it takes a while. So if someone is listening to this, and I imagine probably thousands are preparing to buy a house, how long, reasonably, and when should they get in contact with a mortgage broker like yourself? How long should they be talking to you before they actually lodge the application?

Chris:
I would personally, just start a conversation, if you think about, or you're planning to. I actually really like that chat. "I know I'm not ready to buy today, but I'm a great long-term customer, and I want to work with you, because you've been referred to me by my friend," or whatever it is, right. Just start that conversation with a broker, a good broker is in business long-term, will invest in you because they know that you're a great future customer, right? And so, have a conversation with them. And a good broker will explain to you what you need to do to get prepared for when you do want to borrow in a year's time, and give you some really good tips on how much deposit you need. Maybe you've got to change things with your income or your work, etc. So I don't think there's any, maybe if you're you're 20 and you've got $2,000 in the bank, maybe it's a little bit early, but as you're getting a bit closer to starting to save, and take it more serious, than definitely open up a conversation.

Chris:
If you're thinking about buying something, though, in a hot market, and I never like to be the guy that talks up the property market because it's just too obvious you'd think that a broker does that, but what interest rates do is one of the biggest drivers of the prices of property, because it's the cost of capital determines client behaviour, consumer behaviour. So when the market's hot, you need speed. You need to be pre-approved, you need to be ready to go. And so if you are thinking about buying, don't go to a broker, like you, Owen, after you've purchased. Get ahead of the train. Turn-around times could be two to four weeks. That's just being frank, a broker may say, "I turn it around in a week," but some banks may do that. Macquarie might be able to do it in a week, if you need speed, but generally allow two to four weeks, especially if you have something that might not be vanilla, and to be honest, everyone's not vanilla, and you might need to use a bank that's maybe a bit slower.

Chris:

So give yourself a bit of lead time, but once you're pre-approved, you've done. You're ready to go. And then when you finally find a property, which could take many months, and that's actually a good thing, it means that you're being selective. When you do purchase a property, then you've usually got six weeks or 60 days, and then you'd go back to the market, and then it's much easier and much quicker to get a formal approval, because the bank knows you're a customer ready to go. The pre-approval, most of them don't go ahead. Most people who get their pre-approved with a bank, they don't buy it, or they go and use a different bank. And so it's always a lot slower to get pre-approved than if you've just purchased something, like you, Owen.

Owen:
There you go, Kate, there's some advice. Plan ahead.

Kate:
That was a nail-biting week for you, Owen. You were definitely sweating there.

Owen:
Chris Bates from Wealthful, you've got the website, wealthful.com.au. You have, The Elephant in the Room Podcast, which you co-host, just fantastic. So people can find out more about you there. Can they get in contact with you on the Wealthful website?

Chris:
Yeah, absolutely. Like I said, we just really want to help people make great property decisions. We don't want to, and this is what our property mission, I guess, you've got to be careful with these sort of big things, but ultimately we want to make sure, not only do people just borrow the money and get a property. We're more informed. We've been doing this for a while, we've seen thousands of people over 13 years being an advisor. We know what works, what doesn't move. What we want to do is help people make good property decisions. And a lot of the time it's maybe just save more, get a better property, or don't buy that off the plan, and get something like a future home. And there's all these sort of strategies, and that's what we want to add the value in, and then ultimately people get a great decision then. So yeah, really, anyone who wants to have a chat, please reach out.

Owen:
Kate, as always, thanks for joining me for this episode of, The Australian Finance Podcast.

Kate:
Awesome. Thanks so much, Chris.

Chris:
Thank you, Kate. Cheers. Thanks, Owen.

Kate:

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Owen:
You can also join our online community by following the link in the description. If you enjoyed the show, what we'd love is for you to leave us a snappy review on iTunes, and you can follow us on Twitter and Instagram, @RASKAustralia. Kate and I also own both of those channels. Finally, if you have any feedback, suggestions for episodes, or guests to come on the show, or you just have a question for us, shoot us an email at podcast@RASK.com.au.