

Why is the lowest rate not always the best deal?

When it comes to searching for a low rate, many people forget to consider the total out of pocket cost involved. Although having a competitive rate can be a great saving, it shouldn't be the only factor that drives your decision. Each lender offers different products and inside each product there are different features you can opt for. For example, let's just say you have a lender offering 3.99% per annum, you think "great that's the lowest rate I have seen!" However, from someone who works in the industry I would be inclined to think, what's the catch? Where else are they making up the difference? Could it be in ongoing fees and charges? Could it mean the features of the loan are somewhat reduced? If it's a fixed rate could there be a costly break fee clause making it much harder to modify the loan in the future?

It's also worth mentioning here for those who are not aware, that there are different ways a rate can be calculated. The first way is known as the 'True' rate and the other is called the 'Comparison rate'.

Here is the difference:

- True Rate - this is calculated by using the actual loan amount, for example:

Net Rate: 3.99%

Actual Loan amount = \$400,000

Loan fees over a 30year term is \$450 per year x 30 years = \$13,500

Principal and Interest over 30 years = \$686,650

Less the principal as this is not a cost: (\$686,650 – \$400,000) = \$286,650

Interest plus loan fees to calculate overall cost: (\$286,650 + \$13,500) = \$300,150

We then calculate the cost of fees as a percentage of the overall cost (annually)

$(13,150 / 300,150) / 30 \text{ years} \times 100 = 0.14\%$

Add this percentage to the net rate to give you a true yearly rate: $(3.99 + 0.14) = 4.14\%$

- **4.14% is the True rate using this calculation**

- Comparison Rate – this is the same calculation but instead of using the actual loan amount, a loan amount of \$150,000 is used over a 25year term.

Net Rate: 3.99%

Loan amount used by all lending institutions: \$150,000

Loan fees over a 25year term is \$450 per year x 25years = \$11,250

Principal and Interest over 25years = \$237,279

Less the principal as this is not a cost: (\$237,279 – \$150,000) = \$87,279

Interest plus loan fees to calculate overall cost: (\$87,279 + \$11,250) = \$98,529

We then calculate the cost of fees as a percentage of the overall cost (annually)

$(11,250 / 98,529) / 25\text{years} \times 100 = 0.45\%$

Add this percentage to the net rate to give a comparison yearly rate: $(3.99 + 0.45) = 4.44\%$

- **4.44% is the Comparison rate using this method**

As you can see the True rate is a more accurate calculation, but all lenders must display the Comparison rate by law.

Another thing to consider is, what does having the lowest interest rate actually mean to you? Does it mean more than getting the highest loan amount? Does it mean more than a fast turnaround time, that ultimately gets you the property you want as its going to Auction this weekend!? Does it mean more than getting the features you want that actually allow you to reduce the interest you pay over time, sometimes to a greater value than if you had gone with the initial low rate offer? These are the questions you should be asking yourself.

To recap here is a checklist of important variables and features to consider when selecting a lender/product:

- The True Rate
- The maximum loan to value ratio
- The maximum loan amount
- The features of the loan i.e. Does it have an Offset account or a Redraw Facility?
- The lenders turnaround times
- Whether you are paying interest only or principal repayments
- Whether the rate is fixed or variable

- Whether it is only an introduction rate and what the rate will revert back to after the intro period lapses

To summarise, it's important to take in to account all the variables, and not just the one that is being marketed to you. This will give you a more accurate picture of what is available and help you make an informed decision that will benefit you the most.

Check our blog for more information and videos: www.peasy.com.au