THE COST OF OPPORTUNITY

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Lenders mortgage insurance is a misunderstood but often essential tool to help first time buyers enter the property market. *The Adviser* examines how veteran brokers address the topic with clients, and turn what is sometimes perceived as a negative into a positive

SHARP PRICE growth in most property markets over the last 18 months combined with increasing interest rates has left a growing number of Australians well short of the traditional 20 per cent deposit needed to purchase a home.

As the market gets harder to crack, brokers can now expect one in four borrowers to require lender's mortgage insurance (LMI) if they are to enter the market.

So with LMI now playing an increasingly significant role in enabling borrowers to achieve home ownership, what are the attitudes, observations and experiences of leading brokers in addressing LMI with their clients?

In August *The Adviser* and Genworth Financial brought together a group of leading brokers and industry practitioners to discuss the practical approach they take in addressing LMI with their clients, and how a perceived negative can be turned into a positive.

LMI MISUNDERSTANDINGS

- Borrowers often don't know what LMI is or who it covers
- Borrowers aren't sure how LMI is paid for, with some thinking it is an annual fee
- Borrowers don't know that in most cases they can add the cost of LMI to their loan repayments

Q1 AFFORDABILITY IS AN INCREASING CONCERN FOR MANY BUYERS – HOW HAS THIS IMPACTED THE TYPICAL LOAN TO VALUE RATIOS (LVR) YOUR CLIENTS ARE LOOKING FOR?

JANE

We've actually seen an increase in enquiries from first time buyers who want a 100 per cent loan plus cash to renovate. I get a feeling a lot of people got scared by shares during the financial crisis and now feel that property is the way to go. But there is a misunderstanding that you don't need to put in any equity.

JOEL

You also tend to find that there are enquiries from existing clients who already have property portfolios where they've built up equity and they have reasonable capacity to service another loan.

PAUL

What I try and do with all of my clients, if it's going to be tight and they're going to be pushed, I always suggest they take a step back. I don't do 16 hour days to see any of my clients fall over. I'm looking to achieve the best possible returns for them and my goal is to find them positively geared property.

I'm always looking for the biggest start possible for them and in many instances that may mean taking out a higher LVR loan.

Q2 WHAT KIND OF CLIENTS DO YOU GENERALLY FIND NEED A HIGHER LVR PRODUCT? WHY?

CHRIS

The singles are struggling, but so are the over 35s. The over 35s are struggling to get into a house. Units are ok, but houses are where they can bring up a couple of children: they're struggling with this. People think if you finish university and work for 10-15 years you'll be able to afford to buy a home but they are realising, in the Sydney market specifically, it's not that simple.

Q3 WHEN DEALING WITH BORROWERS WHO ARE LOOKING FOR A HIGHER LVR LOAN, HOW IS LMI BROUGHT UP? AT WHAT STAGE IS IT MENTIONED?

GERARD

You usually know before you've even met the client if they're going to need LMI – you know from the first phone call. It's something I like to address from the outset – that helps ensure that it doesn't become an obstacle down the track.

JANE

I ask them how much do you want to contribute? If it's less than 20 per cent, I ask them if they understand that LMI will be involved? You then explain how LMI is calculated, you explain the bands, and how LMI differs.

I actually include a written explanation on LMI before we talk about it. I talk about the opportunity cost. It makes the discussion easier. I position it like 'by the way, there's only one fee, but the bank will let you put it into the cost of the loan', then they're happy and relieved.

THE ROLE OF LMI

- Tougher affordability has made higher LVRs more predominant, therefore the role of LMI has become more important
- It's not just young singles who are having difficulty entering the property market but even middle aged couples and families

Q4 HOW MANY BORROWERS LOOKING FOR A HIGH LVR LOAN DO YOU FIND HAVE SOME UNDERSTANDING OF LMI?

PAUL
Usually first time buyers have spoken to friends or family or a bank and have been told it's something they shouldn't do, or only in the worst case scenario.

GERARD
I've also found that there's sometimes confusion as to the real costs involved – I've had clients who have thought that LMI was charged annually.
I tell them the only way to avoid LMI is if mum and dad go guarantor. I make it their choice. I put it on them, so it's their call, not mine.

ROSS
There is also a lot of confusion about who LMI actually covers. A lot of borrowers think it covers them.

JOEL
There are a lot of clients who want 95 per cent loans but it's really tough to get these through.

BRIDGET
We are finding that awareness of high LVR loans, in the current market, is growing among borrowers. What we find when we speak to brokers is that most first time buyers typically have $20,000 in genuine savings. With LMI they can look to purchase a property of $400,000. If you take LMI out of the equation, borrowers with a $20,000 deposit would only be able to purchase a property with a value of $100,000. This makes it very difficult for borrowers to achieve the dream of homeownership in Australia today.

Q5 HOW OFTEN DO YOU COME ACROSS CLIENT OBJECTIONS TO TAKING OUT LMI, AND WHAT ARE SOME OF THE COMMON CONCERNS? WHAT HAVE YOU FOUND TO BE THE MOST EFFECTIVE METHOD OF ADDRESSING CLIENT OBJECTIONS AROUND LMI?

CAMERON
It's often perceived as a necessary evil, a fee – and that's a problem. The result is that it is then seen as a cost, not an opportunity, and that can put the borrower in the wrong mindset.

JANE
We have had some people coming in using first home buyers grants (FHOG) over the past year or so; they've come into the market looking for an investment property but have gone back to these traditional mum and dad strategies of paying it all off, having a 20 per cent deposit. We have to show them it's an opportunity cost and demonstrate examples.

ROSS
I put it back to the client. Would you invest in me? I'm going to buy a $300,000 property with $285,000 of your money. The banks are investing in that client and the client is taking all the benefit in the capital gain and so for that they need to pay a small fee. They can understand that.

PAUL
I give them a choice – I say we can do a 95 per cent loan with LMI – it's going to cost them around $35,000, including your FHOG – or a 20 per cent deposit upfront in which case it's going to cost you say $75,000. I then show them the stats.

I am telling them to take it. It's the cost of business. It's six of one, half a dozen of the other. You're in the market and off you go. You'd rather be in the market now than waiting two years until you have your 20 per cent deposit and prices have gone up $50,000.

BRIDGET
We find that we need to educate borrowers on an ongoing basis about the differences between other types of insurance and LMI. What most don't realise is that LMI is a one-off payment, not an annual premium. What they also don't know is that in most cases the payment can be added to their mortgage repayments, so they don't have to pay it upfront. ■