EXPATLAND MORTGAGES

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When you move to Expatland, your Australian mortgage goes with you.

Whether you are transferring from, returning to Australia or about to embark on the next stage of your Expatland adventure you will need to consider your mortgage finance options and the tax implications of such a decision.

Some of the things that either new expatriates need to do when they come to Australia are;

1. Purchase a new family home or
2. Purchase a new investment property

Returning Australian residents often have to consider:

1. Refinancing an existing family or investment residence; or
2. Upgrading their home to something larger.

There are many issues to think about for a new expatriate or a returning Australian resident.

When looking to borrow the profile of the borrowers may be:

1. An Individual;
2. A company or trustee of a trust; or
3. The Trustee of a self managed superannuation fund (more this below)

As with any structure there are benefits, risks and features which vary from country to country, state to state and city to city.
We always recommend that you seek tax and structuring advise from one of our tax specialists in our Expatland E Teams prior to committing to any new purchase.

If time is short and you have to make a quick purchase, then consider signing any contract along the lines of - signed on behalf of "..... and/ or nominee" and always make any purchase "subject to finance" in order to manage structuring risks and/ or buyer's remorse.

Mortgage Products:

These typically are available to individuals, joint borrowers and personal investment vehicles (family companies & trusts). Mortgage products include:

1. Owner Occupied Home Loans. These loans are for Australian residential properties which are intended to be for your family residence.
2. Residential/ Commercial Investment Loans. These are for Australian properties held for investment purposes and those which generate rental income.
3. A line of Credit which is generally a finance facility with a limit that allows the loan to be drawn for a number of purposes
4. Specifically, earmarked self-managed superannuation fund (SMSF) investment loans. These types of loans can be somewhat complex, but they can suit a certain type of investor. Generally, these loans are limited recourse loans against the security financed under a "bare" trust structure.

Loan terms are up to 30 years in duration for residential property & 15 years for commercial property. Interest only terms may be available for periods up to 5 years.

Most expatriate borrowers generally have had some past experience when applying for residential loans.

SMSF loan facilities on the other hand warrant further discussion and we draw your attention to:

- Loan Structure. A bare trust structure is required which can be expensive & will require ongoing costs to maintain;
- Loan terms. Generally tightened to reflect the nature of loan facilities. Typically loan to value ratio's ('LVR's) are reduced and the loans are required to be fully amortised over a reduced loan term of say 25 years for residential security.
- Other loan/ regulatory requirements. Some of the regulatory requirements would include a prohibition to re-borrow or increase a loan or seek to access future equity by way of debt on the property. Lenders also look at certain minimum superannuation fund sizes and there are different types of liquidity tests a superannuation fund is required to have.

We recommend interested parties seek independent financial and legal advice from our E Team members prior to committing to lending under SMSF structures.

Interest Rates / Repayments:

Repayments to mortgage loan arrangements have been heavily weighted towards interest only repayments in the past. This is commonly due to tax planning considerations where a property is used to generate income.

More recently however many lenders are offering preferred interest rate structures for owner occupied & investment loans with principal & interest repayments.

Typical loan repayments can be structured between:

- Variable Rate. Where the interest rate paid over the life of the loan (usually 30 years) is a function of Official Cash Rates as determined by the Reserve Bank of Australia. Any change in the Official Cash Rate will usually see a similar change in your variable loan interest rate.
- Fixed Rate. The interest is fixed for a predetermined period of up to 5 years.
- Hybrid. A mix of both fixed & variable rate optioned facilities.

With loan terms up to 30 years repayments are usually monthly and can be structured:

- Principal & interest at loan inception for terms up to 30 years.
- Interest only for terms up to say 5 years and
- Interest only for terms up to 5 years which then convert to principal & interest for terms for up to the remaining 25 years.

Only exception to the above is "Lines of Credit" (LOC) which are typically variable rate, interest only repayment facilities for the life of the loan. LOC's work similarly to a working overdraft (expensive, interest only repayments on the outstanding liability for periods up to 30 years) and are not a Lenders preferred finance product on offer.

Loan to Value Ratio (LVR) & Mortgage Insurance:

Banks & financiers are looking to secure their loan facilities with a first ranking mortgage over acceptable real property assets (residences, commercial & industrial property).

A 'first ranking mortgage' gives the bank the highest level of security over the property in the event that a borrower is unable to repay their loan.

The term LVR noted about is the percentage that banks and other financiers are willing to lend against acceptable real property assets:

- Standard Residential. Up to 80% LVR for Australian residents,
- 80% for Australian expatriates.
- Commercial & Industrial. Up to 70% LVR for Australian residents, 60-65% for Australian expatriates.
- SMSF. 70-75% on standard residential and 60% for commercial & industrial assets.

When there is a reliance on expatriate income for loan servicing (refer comments below) financial institutions may also discount LVR's on residential loans. The discount varies from bank to bank & is also a function of contractual repayment arrangements around interest only or principal & interest.

Mortgage Insurance is a policy taken out by the lender to insure against potential loss on a residential loan. Premiums are based on the LVR from 80% - 95% and are only available to Australian resident citizens.

Foreign Currency Loans:

For those of you wishing to avail the services of an offshore lender to fund your Australian property, Foreign Currency Loans (FCL's) may be offered.

These loans are available in major currencies at interest rates aligned to these currencies.

Whilst the interest rates available on FCL's may be attractive, borrowers take on a risk in the loan product where there is an asset (Australian denominated property), liability (Loan-FCL) mismatch. Adverse currency movements may see the Lender exercise its right to seek calls from the borrower (in the form of loan paydown / repayment) when LVR thresholds exceed documented levels.

During the global financial crisis the vast majority of borrowers with FCL's saw their loan liabilities on a "mark to market basis" significantly increase in AUD terms eroding their equity & leading to LVR breaches with Lenders.

Lenders subsequently issued "calls" which required borrowers to paydown their loans in order to reduce LVR's back to original or documented LVR loan positions.

An example of an FCL could be:

- A property is bought for AUD 1,000,000
- A loan of USD 600,000 is borrowed which is equivalent to AUD 750K @ a USD/ AUD exchange rate of 0.80:1 when the loan was drawn.
- The agreed LVR limit on the loan was 75%
- In the future the USD/ AUD depreciates to 0.75:1.
- The "mark to market" depreciation of the AUD sees the value of the USD loan increase relative to the security value, That is a move in USD/ AUD to 0.75:1 sees the value of the USD loan increase in Australian dollar terms to (USD $600,000/ 0.75) AUD 800,000.
- This is a LVR of 80% which exceeds the agreed loan maximum LVR of 75%

In this situation the borrower would be required to paydown the loan by an equivalent AUD 50,000 to maintain the agreed maximum LVR of 75%.

We strongly recommend you seek appropriate financial & legal advice prior to committing to such loans.

Treatment of Foreign Income for Repayment Purposes:

One of the largest challenges facing expatriates in dealing with Australian Bank & financiers, and a general lack of understanding these institutions have in treating your foreign sourced salary, bonus & allowance income.

These institutions will typically discount the attributable value of salary, bonus & allowance (schooling, transport & housing) income by 20-100% depending on their contractual nature.

Identifying suitable financiers who respect the nature of your income is a source of frustration & intrigue for many expats and the challenge remains identifying those institutions which understand & value the expat market.

As an example, an Australian citizen expatriate took up an investment home loan prior to taking up residence in Singapore with a new employer.

On drawdown of the facility he was left with the impression that the Bank would happily lend a further > $1M for another similar purchase.

Such a property was identified, and it soon became apparent to the expatriate couple that whilst their base renumeration was 150% greater, bonus income 100% greater and their after-tax servicing was significantly enhanced from that 12 months beforehand, the financier was struggling with servicing.

Unbeknownst to them the lender had:

1. Discounted contractual base salary by 20%;
2. Discounted bonus income by 100%;
3. Failed to recognise contractual rental & education allowances and
4. Assessed net income (adjusted for above) at Australian tax rates.

Banks will adopt Australian tax rates for servicing purposes however an understanding of the Banks discounting criteria as it impacts servicing will assist applications during the approval process.

Also, without providing specific tax advice to foreign buyers, please note that higher Australian capital gains tax rates apply to the sale of real property by non-residents of Australia.

Please ensure you consider the impact of tax and obtain proper advice from one of our well qualified E Team specialists.

Expat Borrowers Service Curse:

Australian Lenders have a preference to deal with borrowers via mobile bankers and their web sites.

Australian expats domiciled offshore struggle to meet Lender domicile and domestic approval conditions whilst offshore. Australian expats & their families generally earn foreign income, are domiciled outside of Australia and have no direct contact point with their Australian Bank which all conspires to make property acquisitions & their finance difficult.

This point is best illustrated by an example of an Australian expatriate family domiciled in Hong Kong for the last 3 years.

The professional husband and wife with 2 children under 5 approached their bank of 15 years for an investment home loan of $1,100,000 to assist with the purchase of a residence in Melbourne for $1,600,000. The couple had no other loans/ liabilities & were viewing the property as their potential primary residence in the future.

After a series of emails & phone discussions it became evident that the borrowers Home Loan Centre was discounting HKD salaried income and making no allowance for annual bonus income of $200K pa (in AUD terms).

Fortunately, in this case the couple were referred to us from an existing customer and on receipt of all information a conditional approval was sourced in 72 hours from a first tier Bank at competitive interest rates.

Loan documentation was sourced and sent to the borrower directly who then arranged execution of the same at the Australian Consulate in Hong Kong.

The Lender had their own policies for identification purposes however the Borrower relied on the Consulate to certify ID's. Being domiciled outside of Australia does not necessarily mean the process can be difficult.

For expatriates who are not Australian and have no credit history in Australia, working with experienced professionals in advance of your arrival is the key.

When it comes to new resident expats to Australia (Non-citizens of Australia) it is highly unlikely you will be able to buy a landed property.

That does not mean however that work cannot be done with a buyer's agent to identify the type of property you would like to buy so that upon arrival in Australia with the appropriate visa you can begin owning your first Australian home.

AT A GLANCE

- Consider whether Expatland Banks may be able to meet your needs or whether an Australian Institution who can co ordinate your needs from Australia should be engaged.

- Carefully examine the risks of borrowing funds offshore via FCL's and seek appropriate Financial & Legal advice to understand such product risks.

- Consult real estate agent specialists, buyer's agents, valuers, legal & accounting experts to best understand & structure your needs before suitable real property assets are identified.

- If a suitable property has already been identified, always sign Australian contracts with ... And/or nominee and insert a "subject to finance" clause. Obtain financial advice for tax & structuring needs if not already done so.

- Appoint a Lender or 3rd party who understands your needs & support you during a change in circumstance.

- Always consider a change in your circumstance. What will happen if you repatriate back or accept a change to another Expatland jurisdiction sooner than planned.

- Appoint an advisor who understands the local market you wish to purchase in, is independent, understands the market & finance options and can actively manage your needs with Australian Lenders.

- If you are an Australian based overseas recognise that your income and bonuses are likely to be discounted.

- If you are not a resident of Australia and you buy Australian property, please note that you are likely to pay a higher rate of capital gains tax if you sell the property whilst a non-resident of Australia.

- If you are not an Australian citizen, then you can do a lot to prepare to buy a property in advance of the appropriate visa being issued to you.