Loans outside the box

Nonconformity can be a good thing for borrowers who do their research, writes **Kate McIntyre**

Nonconforming lenders – the name seems to suggest risk, but is getting a home loan through a nonconforming lender really any less safe than borrowing through a traditional bank?

Exactly what are nonconforming lenders and how are they different from banks?

LENDER PROFILE INSIGHTS

Nonconforming lenders are non-bank lenders that specialise in offering nonconforming home loans, Canstar data insights director Sally Tindall says.

"A nonconforming mortgage is a loan provided to someone buying property who doesn't pass standard lending checks and balances," Tindall says, adding there are a range of reasons borrowers get knocked back from banks when applying for a home loan.

"A borrower might have a poor credit history, an erratic income, or a very small deposit with no clear track record of being able to save, which could cause the bank to hesitate when assessing their mortgage application."

In contrast to the big four banks and second tier lenders, non-bank lenders do not collect deposits from households and don't hold a banking licence from APRA.

About 20 per cent of the 110 home loan lenders in Australia are considered non-bank lenders and just a handful of these, such as Pepper Money, La Trobe and Liberty, specialise in nonconforming loans, she says.

WHICH BORROWERS DO THEY SUIT?

Mortgage broker and owner of PFS Financial Services Daniel O'Brien says nonconforming lenders fill a gap in the market to cater for some borrowers deemed unsuitable by the banks.

"They essentially specialise in the stuff that is outside of the box, like credit impairment, self employed borrowers with no, or limited, financials and investors that have reached their maximum borrowing capacity at mainstream lenders," he says.

In the case of credit impairment, a nonconforming lender can act like a "washing machine" by providing a path back to the property market or a way to consolidate debts, he says.

Further down the track, the borrower may be able to refinance to a mainstream lender.

"Quite often the non-confirming option isn't a forever option, it's a short term option to get them cleaned up," he says.

PROS AND CONS

Business success coach at Masters Brokers Group and former mortgage broker Mario Borg says nonconforming loans often come at a higher price because the borrower is seen as being "more risky."

"It is always going to be a higher interest rate," he says. "How high is it? Well, it depends on your situation."

In some cases, the interest rate is customised rather than being one size fits all and will depend on factors such as your loan to value ratio, whether you are self employed with little documentation and whether you are bankrupt.

Tindall says the higher cost of nonconforming loans should be weighed up carefully by borrowers. One nonconforming lender, Pepper Money, has rates ranging from 6.84 per cent to 11.84 per cent.

Canstar research shows a $600,000 loan over a 30-year term would cost more than $30,000 extra over five years if the interest rate is one per cent higher than the average owner occupier rate of 6.28 per cent.

An interest rate that is 2 per cent higher would cost over $60,000 while a rate 3 per cent higher would cost well over $90,000 in the same period.

WHAT IF THE LENDER GOES BUST?

Tindall says borrowers considering nonconforming lenders often wonder about the safety and financial stability of such an option, but the likelihood of being impacted by the lender going bust is minimal. "When it comes to home loans, it's worth reminding yourself they're the ones loaning you the funds," she says.

"If the lender went belly up, one of the more likely scenarios is that the lender's mortgage book would be bought out by a bigger institution and your mortgage would transfer across."

O'Brien agreed: "If a lender goes bust, a client wouldn't lose their home," he says. "The lender would either be bought out, so the client's mortgage is simply branded something different, or a client could refinance."

Top tips for nonconforming borrowers

data insights director Sally Tindall (pictured) says if you get knocked back from your bank, make sure you explore all your options before jumping into a nonconforming loan. She shares her top three tips below.

Don't assume: Not all self employed people or borrowers with small deposits have to go through nonconforming lenders, so it's always worth exploring your options with mainstream lenders first.

Don't jump in: It may be quite some time before you are able to refinance out of a high rate nonconforming home loan into a traditional home loan so don't take on an excessively high interest rate if you can't manage the repayments over the foreseeable future.

Compare your options: You may feel as though your back is against the wall, but there is likely to be more than one option available to you, so make sure you get advice from a trusted mortgage broker, financial adviser and accountant while talking to friends and colleagues who have been in a similar position.