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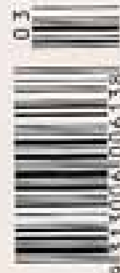

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How to do it

You need to know all the angles before borrowing on your home

THE VALUE DIFFERENCE between what your property is worth and what you owe is your fortune waiting to be accessed. Yes, have home, could borrow! But it's a strategy that should never be undertaken lightly. How you structure your loans is just as important as what you invest in. The key to building wealth responsibly starts with a sound financial structure.

It is possible to create wealth without putting pressure on your family home. Just don't expect your bank to divulge this information too easily.

"You'll find that lenders are delighted to assist you with one particular structure as it makes it harder for you to leave them," says Jane Slack-Smith, an avid real estate investor herself and director of Investors Choice Mortgages.

The "particular" structure that Slack-Smith talks about goes something like this:

You use the equity in your home to help fund your investment, whether that be shares, managed funds or another property. Investors seeking to claim any deductions on the investment loan need to keep this funding separate from the non-tax-deductible home loan.

Let's say, for example, you want to invest in property. You draw the equity out of your home for the deposit and costs in the form of, say, an equity access loan. Your lender would then add on an investment property loan to make up the rest of the purchase price. Now here's the trap! You may have separate loan accounts – a home loan, an equity access loan and an investment loan – but they're intertwined when it comes to securing the three loans.

This is called cross-collaterisation – it's a term you should get familiar with and something to avoid if possible.

Put simply, cross-collaterisation is when the bank uses all properties mortgaged with it as security for your outstanding loans.

"You want to maximise your wealth-building potential, while protecting your home and other assets," says John Fitzgerald of Investloan, a finance broker and mortgage manager specialising in residential investment property loans.

Fitzgerald should know a thing or two about using the family home to build wealth as he has bought, sold and developed over 5000 properties. "We advise strongly against using your own home as collateral security for your investment property," he says.

While there are a number of reasons for doing this Fitzgerald says: "None of them is for the benefit of the client." Although you could avoid mortgage insurance under a cross-collateral set-up.

His concerns, and rightly so, become apparent if things go bad, and they can! In a default situation and under cross-collaterisation, your bank has the right to decide which property it will sell to recover its money. "It doesn't have to be the investment property," says Fitzgerald. "It could be the family home."

While Slack-Smith says many very successful property investors started this way, she is quick to add: "Over time you may find that lenders invariably start dictating terms which you may not be comfortable with."

Because your home is directly linked to your investment property and the lender takes the title over your home to secure the new loan, as well as the title over the new property, Slack-Smith says you can be restricted in capitalising when one of your properties has good capital growth but another is not performing well.

Her example: "Imagine you have a house in Perth and over the last few years the value has risen from $250,000 to $300,000, meaning you can tap into greater equity. Now let's assume you also have a two-bedroom unit in western Sydney which was worth $250,000 five years ago, but today is only worth $200,000.

"Your portfolio is stagnant as it's still worth $500,000, despite the individual prices of houses changing."

Slack-Smith says most lenders would be reluctant to allow you to access the equity in your Perth property, as looking at your portfolio you have no new equity to tap into.

"If you do have this structure, it is not the end of the road – it can be messy but it's possible to separate your loans." Slack-Smith should know as she has helped plenty of clients in such a situation and now runs property investment courses around Australia.

> "You want to **maximise your wealth-building potential** while protecting your home and other assets"

Other concerns about cross-collateral set-ups include that if interest rates or fees are raised, you're affected on all loans. Plus you're relying on one bank's valuation policy for assessing and reassessing your equity growth. So if your lender has a very conservative valuation, your wealth building will be restricted.

What does Fitzgerald of Investloan suggest when you've decided to buy an investment property?

- Your owner-occupied property (the family home) is not cross-securitised with any investment property.
- Each property is financed by a different lender and relies on its own valuation.
- If a lender introduces a new fee or increases rates, you are not affected across all loans.
- You can access the equity in each property individually.

- Any new purchases are valued separately – not propped up by existing properties, so you will not be duped by unscrupulous property marketing companies.

Putting things into practice it could be as easy as redrawing any additional repayments back out of your home loan or asking for a top-up if the value of your property has increased. This equity would fund a deposit plus any costs. Again you'd keep this loan separate, either as an equity access loan or an investment loan.

Then you go to another lender to get finance to buy your investment property. This approach works only if your lending valuation ratio (LVR) is below the 80% mark, of course.

You've used the equity in your home to fund the deposit and costs, but each property stands alone as security for each loan (see the table, Way to go).

You'd need a greater deposit if you're investing in shares or managed funds, as LVRs in these asset classes are tighter.

Fitzgerald says once you've built up equity

WAY TO GO

OWN HOME	
Property value	$600,000
Mortgage owing	$320,000
Available equity = 80% of value less mortgage owing	$160,000
INVESTMENT PROPERTY	
Property value	$300,000
Deposit needed – from your home loan	$60,000
Separate investment loan	$240,000

Stamp duty and legal fees may cost $10,000; $60,000 + $10,000 is taken from the $160,000 of home loan equity – this is secured by the home; the investment loan is secured by the investment property.

in your investment loan, you can copy the process over again, without putting any more pressure on the family home.

Technically you could apply the same approach if you want to invest in shares or managed funds, but it's always wise to seek professional advice before you jump into any one investment option. Property, shares and managed funds all have varying benefits, tax advantages and levels of risk.

Slack-Smith says, because of the global financial crisis, there has been a dramatic update to the strategy of accessing equity in the past six months. "Most lenders now will not allow a new loan to be set up against a property without a definite defined purpose, especially at lending valuation ratios above 80% [ie mortgage insurance is involved].

"Stating the purpose of the funds as 'for growing my future property empire' is not enough. Many lenders require actual contract of sale documents before they will release funds and, furthermore, most lenders have restricted the amount you can take out without purpose. Some lenders are restricting funds to 20% of the value of the property, or to $100,000 maximum."

Having said that, it is a lot easier accessing equity if you just want to renovate for profit. Increasing an existing loan, redrawing any additional repayments out of a loan or refinancing would suit such home owners.

That's because, just like your home loan, a loan to fund renovations on your principal place of residence is non-tax-deductible debt. So by keeping all your borrowings within the same loan, your affairs remain simple. Increasing your loan or refinancing will involve some costs, but you should be able to negotiate them. See page 56 for details. Be aware that if renovations are on a grand scale your lender may require quotes before allowing you to draw down any equity.