

Investors Choice Mortgages Director, Jane Slack-Smith, explains how the right loan structure can enable you to buy an investment property earlier and increase your earnings.

The Australian way: buying a home and investing later

'Most Australians purchase and pay off their home loan before thinking about investing,' said Ms Slack-Smith.

'They either believe they cannot afford it or are afraid their family home will be at risk by using it to finance an investment property.'

'However, if your finance is structured correctly, then the family home will never be used to secure an investment property.'

Structuring your loans correctly

'There are many ways to structure loans and access equity to buy an investment property,' says Ms Slack-Smith.

'Cross collateralisation is the most common structure used by lenders. Simply put, this is when a lender uses equity from an existing property to secure the purchase of a new property.'

'However, this could do two things; firstly, it could restrict your future borrowings, and secondly the lender may introduce new, restrictive terms when a number of loans are cross collateralised.'

'By far the better alternative is to access equity from your home for a separate loan to cover the deposit and costs of purchase, such as stamp duty.'

'Once this equity is secured, the balance of the funds required for the purchase, usually around 80% of the purchase price, is then secured solely against the new property.'

'And don't be afraid to play the field, so to speak! I personally have many investment properties and encourage my clients to spread their risk, not just with the type and location of their investments, but also their lenders.'

'By having loans with multiple lenders, you have exposure to different rates, fees and, more importantly, since the global financial crisis, different lending policies.'

'So where one lender is greatly restricting access to equity for future investment another lender is not, hence you can access funds to invest. The lender also likes this as they are not the only party at risk if you default.'

It's all in the numbers

Ms Slack-Smith says if properties in Australia double in value on average every 10 years, it makes sense in getting access to that growth today and investing now.

We asked Ms Slack-Smith to demonstrate by way of example. The first sets out if you were to focus on paying off a single asset; the family home. The second sets out using equity from your asset to purchase an investment property.

Example 1

The table below shows net gains over a 10-year period on a home purchased for \$500,000, with a mortgage of \$280,000, and an extra \$800 paid per month above the minimum repayments (ie. the equity achieved).

| | Value (\$) | Debt (\$) | Equity (\$) |
|----------------|------------|-----------|-------------|
| Year 1 | 500,000 | 280,000 | 220,000 |
| Year 10 | 1,000,000 | 80,000* | 920,000 |

Note: Example 1 assumes the minimum monthly repayments of \$2069 plus \$800 in extra repayments with an interest rate of 7.5% over 25 years.

* If only the minimum repayments had been made, the debt after 10 years would be \$223,000 and the equity would be \$777,000.

Source: www.yourmortgage.com.au advanced calculator

'With this strategy of paying down your debt, after 10 years you are still three years away from paying off your home and entering the investment market.'

Example 2

Continuing example 1, the table below shows how your extra repayments can be used to purchase another property worth \$500,000 (ie. using equity only). The possible portfolio increases, debt and equity changes over a 30-year period are presented.

| | Portfolio value (\$) | Debt (\$) | Equity (\$) |
|--------------|----------------------|-----------|-------------|
| Yr 1 | 1,000,000 | 800,000 | 200,000 |
| Yr 10 | 2,000,000 | 743,000** | 1,257,000 |
| Yr 20 | 4,000,000 | 623,000 | 3,377,000 |
| Yr 30 | 8,000,000 | 520,000 | 7,480,000 |

Note: Example 2 assumes the purchase of the property by accessing \$120,000 from an existing property and \$400,000 from a lender, which is secured against the new property. Capital growth is calculated at 7% per annum and the investment loan is refinanced every 10 years to ensure interest only. Monthly repayments are \$3265 with an interest rate of 7.5% for the \$400,000 component, and 7.65% for the \$120,000 component and the base minimum interest of \$2069pm for the home loan. NB note that at a 4.5% rental return the rent on the property at Yr 10 would be \$3750 per month, ie higher than the investment mortgage.

**As the loan usually remains at interest only, the calculation assumes that the extra repayments that would have been made on the home are transferred to the investment.

Source: www.yourmortgage.com.au advanced calculator

'The examples show that having two or more properties growing in value will exceed the gains you might make from paying off your home loan earlier.

'Using those extra funds to finance a second property can have major advantages if your loan is structured correctly, albeit your debt will be significantly higher.

'After 20 years your net position is \$1.38 million healthier by funneling your extra repayments into buying an investment property.

'This only begs the question, how much might you make if you had the capability to buy two or more investment properties?

'So, you could wait to start investing, or you could structure your loan in this way and capitalise on your investment earlier,' Ms Slack-Smith concludes.

Jane Slack-Smith is founder and Director of Investors Choice Mortgages and was voted Mortgage Broker of the Year in the Your Investment Property 2009 reader's choice awards.

In 2010, Jane has teamed up with another successful property investor and will be running property investing courses around Australia. Class sizes are restricted to 20 to ensure that everyone who attends walks away with the tools to be able to put their learnings into practice straight away. Visit <http://www.stepbysteppropertysuccess.com.au> to register and get early bird specials.

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