Leveraging the value of your home to acquire an investment property is a sound financial tactic, writes **Joanne Hawkins**

The benefits of equity

STRUCTURE OF LOANS IS CRUCIAL

WHEN Miriam Sandkuhler (left) bought her four-bedroom investment property in Preston, she used her home's equity to facilitate the purchase via an offset account.

"I had an offset account set up and I chose to fund 20 per cent of the purchase price plus costs from that account, while the remaining 80 per cent was secured against the property by taking out a stand-alone mortgage," she said.

Ms Sandkuhler, an experienced property investor and chief executive of property advisory firm Property Mavens, chose to finance the purchase this way to avoid cross-collaterising (where your investment loan is secured across both properties).

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"I'm not a fan of cross-collateralisation because if something goes wrong, then both properties are at risk," she said.

"If you are going to use the equity in your home, I advise people to use the equity in an offset account and then take out a separate stand-alone loan for the rest."

The Preston property, which she bought for $700,000 in October last year, is her latest property investment and was bought for both capital growth and its gross 5 per cent annual yield.

"Being a bit older and risk adverse, I was keen to pay down the debt as soon as possible, so the extra rental return made it a really good value proposition," she said.

Her advice to anyone planning to invest in property was to focus on the loan structure, the repayment structure in order to reduce the loan over time, and to get independent advice.

"While investing in property is a great wealth creation strategy, it is highly complex and it's easier to get it wrong than right," she said.

"So always seek independent and unbiased advice, for example from an investment-qualified buyers' advocate."

The benefits of equity

WE'VE all heard of the benefits of refinancing to get a better deal on your home loan, particularly a more competitive interest rate.

But what if refinancing could also help you buy an investment property?

"Borrowers may be able to refinance their existing home loan to access equity they may have built in their property, in order to buy an investment property," Mortgage Choice chief executive Susan Mitchell said.

She said that refinancing with the aim of buying an investment property could allow borrowers to grow their wealth, as, generally speaking, property was considered a safe asset class in Australia with decent returns over the long term.

"CoreLogic found that over the 10 years to June 2018, national dwelling values increased by over 40 per cent, a good return on investment," she said.

But she cautioned there were a number of costs associated with refinancing, so it was important borrowers made an informed decision before jumping in.

THE NUTS AND BOLTS

So, how does refinancing using equity work?

The Successful Investor managing director Michael Sloan explained that lenders would typically lend you 80 per cent of the market value of your home, less the debt you still owed against it.

"This is your usable equity as banks hold some back as security," he said.

"So, say, for example, you have a $500,000 property and a $200,000 loan. Your usable equity will be $200,000," he said.

As to what value investment property you could buy, Mr Sloan said a simple rule of thumb was to multiply your usable equity by four.

"But remember that one of the risks of property investing is spending too much," he said.

"You need to buy well below the median house price ($742,000 in Melbourne, according to CoreLogic), in fact you shouldn't be within $200,000 of it."

Ms Mitchell said the figure depended on how much a lender determined a borrower could afford to repay.

"Available equity is important but the key factor a lender needs to consider is how much a borrower can afford," she said.

"If a borrower does not have additional capacity to repay a proposed new loan, they may not be able to borrow, irrespective of how much equity they may hold," she said.

WHERE DO I SIGN?

And there's the rub: having equity in your home is not a guarantee you'll be able to access it.

"You can have a million dollars of equity but if you don't satisfy the institution's lending criteria, they are not going to loan you any money," Mr Sloan said.

"The bottom line is they will take everything into consideration: for example, how many children you have, as the more you have the less you can borrow, your work situation and how much you spend on everything from your daily coffee to the tyres on your car."

Lenders have also tightened their assessment procedures as a result of recent regulatory measures, such as The Australian Prudential Regulation Authority (APRA) imposing a 10 per cent benchmark in growth on investment lending last year.

This was introduced in a bid to curb activity in the housing market, Ms Mitchell said.

"These regulatory measures have resulted in lenders increasing their scrutiny of a borrower's ability to service a loan," she said.

"When deciding if an applicant can afford a mortgage, a lender will consider a borrower's available ongoing income and from this allow for existing debt commitments and living expenses," she said.

"Their decision will also factor in a buffer for potential increases in interest rates."

But it's not all doom and gloom. Ms Mitchell advised that borrowers could overcome the increased scrutiny by getting "financially fit".

"Get out of debt, spend your money wisely and adopt a disciplined savings strategy to show lenders you can service a loan," she said.

Air Mutual director Damien Lawler advised would-be investors to consult an independent broker who could access a range of lenders, which might have varying assessment procedures.

"Everyone is talking about the banks tightening up — which they are — but there are banks, particularly the smaller, tier-two banks, who are still lending," he said.

AND FINALLY ...

Mr Sloan said his No.1 piece of advice for would-be property investors was to play it safe and to have some funds in reserve if things go wrong.

"You should never buy (another) property if you have no extra money available to you after you settle, so you need to have a buffer. And protect what you are building with income protection and life insurance, if you have a partner," he said.