

# UNLOCKING YOUR HOME EQUITY

Unused equity is like stashing your cash under your mattress – it sits there unnoticed and unused. So if you've built up some equity in your current property, why not make it work harder for you? **Debbie Williams** shows you how



**E**quity is unrealised value which, with property, we can borrow against (usually from a bank) to use for other means. But, before the bank can grant you this equity (by releasing more finance), it needs security and its favourite security is property.

In the context of using equity from property, the formula for working out your unrealised equity sounds complicated but in reality is quite simple. It's the residual value of your property once it has been sold and any outstanding costs, such as a mortgage, deducted.

For example, if your property is sold for \$500,000 and your outstanding mortgage is \$200,000, then your equity is \$300,000.

If you don't want to sell your property then you may have available equity, ie your property may be valued by your lender at \$500,000 and the most common amount to borrow is 80% of the value, known as the loan to value ratio (LVR).

That would mean that the bank would lend you a total of \$400,000. If you currently have a mortgage of \$200,000, the bank will lend you a further \$200,000.

### Calculating your available equity

Use the table above as a formula to work out how much equity you have in your property. If you have trouble with this formula, you can download a copy of the table from the members section at [www.equityfinder.com.au](http://www.equityfinder.com.au)

To work out the available equity in your property, the only information you need is:

1. Your property's value: an approximate value is fine to begin with. Should you proceed with a loan, the financier lending you the funds will organise a valuation which will determine your property value and the LVR
2. Your loan's current outstanding balance  
See the table for examples of the relationship of property values, outstanding debts and LVR.

### How you are assessed for your equity

Bear in mind that the financiers will often lend more than 80% of the value of the property but this money comes with more strings attached. As a borrower you will need to satisfy the conditions set out by the lender.

These conditions are fairly standard across lenders and include:

**1. Serviceability:** This is your capacity to repay the loan. Most lending institutions

## How much equity do you have?

Property value	Outstanding balance	Maximum LVR	Available funds
\$500,000	\$200,000	80%	\$200,000
\$600,000	\$175,000	70%	\$245,000
\$300,000	\$100,000	80%	\$140,000
\$325,000	\$25,000	80%	\$235,000
\$150,000	\$0	95%	\$142,500
\$2,000,000	\$427,500	70%	\$972,500

like to do fully verified loans. A fully verified is one that is supported by lots of documentation including bank statements, credit card statements and payslips. If you have a second income, Centrelink payments, other rental income or any other form of income, they'll want a copy of that information, too.

**2. Collateral:** What you have in the property. There was a time in the not-too-distant past that 100% loans were everywhere. A 100% loan is one where you can borrow 100% of the cost to purchase the property.

Remember that there are other costs involved in purchasing, so be careful about thinking the lender will pay everything – it won't.

A lender will want to know if you'll suffer pain should the deal go bad. Mostly, 100% loans are available on owner-occupied property rather than investment property, as a property owner is more likely to get a second or third job rather than lose their home where an investor is more likely to walk away.

**3. Character:** You, as a borrower, are important to the lender. The lender wants to know if you've had previous experience paying off debt. Some financiers spend more time on this part of the criteria than any other. Who you are is important!

### When accessing equity is beneficial

Whatever you do with your equity, remember that you're going to be using a large amount of money. Probably more money than you've saved in the whole time you've been working, so my best tip is to make sure you're educated.

Here are my top three suggestions as to what you can do with your equity, to get the most out of it.

### 1. Invest in real estate

Real estate is my preferred investment. I have studied it and become proficient. I've utilised mentors and worked with people for no money, just to learn from them. I haven't always made a profit from my property deals, but I did learn from my mistakes and haven't made them since. I now only take the good deals.

I started investing in real estate when I only had \$30,000 in available equity. With that, I purchased three properties. Then I ran out of equity.

Around that time I paid \$7,500 for a property investment course and did that blow my mind! There were so many different strategies for investing in property and I wanted to do them all. But first I had to find more money.

Fortunately, I started to understand that property valuations are subjective and, even though a property may have been purchased for a certain price, it could be worth more. I was able to revalue my properties and free up an extra 30% equity in the new properties I purchased only one month before. I went on to develop the property wizard to help others with the same process. With this money, I purchased my first renovation project.

Investing in real estate can be costly, so management of funds becomes crucial. If you're undertaking a renovation project or development, the cash just rolls out of your pockets faster than water until you finish, then... pay day!

The trick is to put more back than what was there to start with. This includes all taxes, settlement costs, sale costs, renovation costs, the cost of the loan while renovating, the cost of setting up the loan, and discharge fees and break fees of the loan, subdivision costs, building costs, and lots more.

If you're trying to do all that without any knowledge and skill behind you, then

watch out. Get educated and get support while you're doing the work.

Concern comes into play when the funds are used for personal gain. If the funds are going to be used for consumer items such as personal holiday, personal car, clothes etc, then not only are the funds not tax deductible but these items are never going to help you retire early.

Equity is best used when utilising the funds to invest in income and growth investments. Income investments increase your income on a regular basis; they can pay you like a job.

Growth investments grow in value and a good rule of thumb would be to have the growth on the investment at a minimum double digit return, ie above 10% pa.

The great thing about growth investments is the growth compounds.

If you don't overextend yourself financially, then using your home equity can surely help you fast-track your wealth creation goals

Compound growth occurs when your investment grows exponentially. A property that has been well bought fits this model beautifully.

Example: If a property is valued at \$500,000 and grows at 7.5% pa, after the first year it would be worth \$535,000 and after the second year your interest would grow in value by 7.5% on \$535,000, not on the original purchase price, thanks to compounding growth.

History has shown that property has doubled in value every seven to 10 years since records of prices began. Unlike the share market with leveraged managed funds, I've never heard of anyone getting a margin call on their property.

Most people can't save this kind of money. If you're a PAYG earner, there's very little chance you're going to be able to save this regularly and this much.

## 2. Using your equity to invest in the share market

Due to the latest volatility in the financial markets at the moment, investors need to think long and hard before putting their money on the share markets. It's imperative that you get thorough and independent advice due to the complexities of the share market processes and terminologies.

While savvy investors are able to make money whichever direction the stock market goes, novice investors need to play it really safe, especially when investing in a bear or a down market.

Many finance brokers are associated with financial planners. The latter can offer investments in managed funds. A financial planner cannot recommend the purchase of a specific property and you will not find many that recommend you invest in property.

Call me cynical, but if a financial planner recommends a property investment it is likely they'll receive ongoing commission from it.

There's a trend to tap into equity and the borrowed funds to borrow more funds, and invest the funds in managed investments.

This is a fantastic strategy until the share market slumps. If you have investments like this, you could be asked to make a margin call, ie to put in some extra funds to keep the borrowed portion balanced with the unborrowed portion.

Watch out, though. Remember that the unborrowed portion is still borrowed from your equity.

If you've been following the recent news on the financial markets, you'll know that a lot of companies and high-profile individuals have been burnt by this method. If you are risk averse, it's best to avoid this strategy.

## CASE STUDY

Jarrad had been working as a contractor in the building trade for some years. He and his girlfriend Emma had built a house in 2004.

The house was now valued at \$450,000 and their loan was \$202,000. The bank would lend them 80% of the value of their property, now \$360,000.

They could now borrow the difference between the available funds (\$360,000) and the current debt (\$202,000). That gave them \$158,000 to play with.

The bank would go to a loan of 90% but Emma and Jarrad's current income would not support the serviceability for such a loan.

Jarrad decided to use his current knowledge and skill to branch out and start his own business.

He found a business coach, and did a viability and cash flow projection on the business. As all that looked great, he



set up an offset account with his loan to maximise the funds available until he required them.

Jarrad worked diligently in his business and used the funds from the loan to subsidise his income until he had enough work.

He also used the funds to cash flow the consumer items required for his business. Often, in the building trade, you don't get paid for more than 60 days.

The loan reduced on a regular basis for six months until work picked up, then over the next year they proceeded to pay off a further \$50,000 on the loan.

### 3. Start a business

The business could be based on an idea you've had for a long time, making sure the business is viable and you get support from mentors and other business owners.

Buy an existing business, ensuring the business is supported by your accountant and there is good opportunity to improve the business's cash flow. Purchase a franchise. If you haven't owned or managed a business before, this can be a great way to start, with ongoing support and business systems already in place.

### CASE STUDY

I was working with a guy who cut lawns for a living. He had managed to purchase a rundown house on a huge piece of land in the metro area. He was looking for capital to invest in his business to purchase a ride-on mower, new slasher, and other various high value items.

After visiting a mortgage broker, he was placed on a managed fund investment. Not only did he not have the cash flow to be able to support the borrowed fund investment, but he has also been hit with a number of margin calls. Now he has to refinance his home loan again just to keep the investment afloat.

Please be careful when borrowing funds to invest. He did the right thing getting business advice but went into an investment that didn't suit him. Although the funds were to build his business, with encouragement he was led into a situation that has now put pressure on him to work harder.

The best thing to do if you are in this situation right now is to ride it through. The share market will eventually come back.

Any loss will be realised if you sell.

### Warning

Many people are reluctant to access equity in their own home because they think they're putting everything on the line. If something goes wrong, they could lose their home, the roof over their head.

The same could be said if you don't do anything. What opportunities are you letting slip through your fingers by thinking that you don't have the funds to invest?

We look at our parents who have played it safe, worked a steady job and paid off debt all of their lives, and see them on Centrelink payments, maybe barely able to survive.

Then I see those who have left it a bit too late and are throwing their money at everything. Investing is great, but if you're going to take money out of your property, it needs to return money back again. Be careful, because the equity in your home can be a huge open chequebook.

### CASE STUDY

I worked with a couple recently who are in their 70s. They watched my husband and I renovate and develop property over a number of years and finally wanted to get in on the action.

I took them to the bank and organised a loan for them.

The land they purchased was fantastic. It was a 1,200m<sup>2</sup> piece of land and able to support at least two houses. They tapped into their equity and got a loan of 70% of the value of their home, which freed up \$455,000. With these funds they could pay cash for the new property which was only \$225,000.

Even though the loan was set up as a line of credit, which means they only pay interest on the portion withdrawn, the amount of money was too much for them to contemplate.

They went back to the bank and reduced the loan from \$455,000 to \$250,000 which gave them enough to purchase the land and pay all the associated costs.

What they didn't consider was the building cost for the new building, and when they went back to the bank neither of them was working anymore.

Their finance was refused, putting immense pressure on the relationship.

All these issues wouldn't have existed if they'd been prepared to continue with coaching.

When the fear factor comes in, it can be very crippling for the inexperienced and faint hearted.

To finish the story, the couple ended up selling their home, moving in with family members and are building with the cash left over. Now they've invested the funds in a high yielding investment which supplements their income.

The investment property has now become an owner-occupied property.

This case study highlights the importance of:

1. Having a plan for your funds
2. Sticking to the plan for your funds
3. Having an exit strategy if the plan you have chosen isn't working
4. Getting *help* if you don't know what to do
5. Paying for the help you get

All kinds of things could go wrong when using the equity of your home or property to invest.

The key is to ensure that you keep your monthly repayments at a level that you know you can manage.

If you don't overextend yourself financially, then using your home equity can surely help you fast-track your wealth creation goals. **YM**

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