

The background of the top half of the newsletter is a photograph of a modern building's balcony with a glass railing, overlooking a turquoise ocean with white waves. The JLM Financial Solutions logo is centered over this image. The logo consists of the letters 'JLM' in a large, bold, black serif font. Below 'JLM', the words 'FINANCIAL SOLUTIONS' are written in a smaller, black, all-caps sans-serif font.

JLM

FINANCIAL SOLUTIONS

How to use home equity to buy an investment property.

When you buy a property, your initial 'equity', or ownership stake, is whatever deposit you put down to qualify for the loan, which is often 20%.

Typically, your equity rises as the years advance, through a combination of you paying down your mortgage and your property increasing in value, as this hypothetical example shows:

- You put down a \$200,000 deposit and borrow \$800,000 to buy a \$1 million owner-occupied property – so you have 20% equity and the lender 80%.
- Five years later, your loan has been reduced to \$700,000 and your home has increased in value to \$1.4 million – so you have 50% equity and the lender 50%.
- Five years after that, your loan has reduced to \$600,000 and your property value has grown to \$1.96 million – so you have 66% equity and the lender 34%.

So, after ten years, your equity has increased from 20% to 66%, or \$200K to \$1.3M. At this stage, your equity gain is paper wealth. But there are two ways it can be turned into actual cash.

- 1 **Sell** - The first is to sell your home, repay the mortgage and pocket the difference – but you would need to find somewhere else to live.
- 2 **Leverage equity** - The second is to borrow against the equity and use that money, including to fund the deposit on an investment property.

To continue the hypothetical example, you decide to leverage \$160,000 of the equity into a new \$640,000 loan, and use those funds to purchase an \$800,000 investment property.

So your equity in your home falls from \$1,360,000 to \$1,200,000, while your equity in the investment property is \$160,000, or 20%. Generally, when you ‘cash out’ equity in this way, lenders want you to retain at least 20% equity in the first property – which has been done in the hypothetical example.

The downside of your hypothetical investment property purchase is that your overall debt has increased from \$600,000 to \$1.40 million. However, your asset base has jumped from \$1.96 million to \$2.76 million. Also, your debt level is still conservative, because your overall loan-to-value ratio is just 51%.

‘Cashing out’ equity is a popular wealth-building strategy that many Australians have used over the years to create property portfolios. As part of the strategy, you’ll need to refinance or restructure your existing home loan, which means going through the standard mortgage application process once again.

I’ll help you with the entire process, from comparing home loans and providing tailored recommendations based on your situation. Ensuring correct structure for your loan and managing your application, to make it as smooth and stress-free as possible.

Get in touch
with JLM today. →

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