Home Equity:
What you need to know

Grimsey

Investing in property can be a great way to build wealth for the future and create a tax effective income. Clients often come to us for advice on how they can invest in property or begin to create a property portfolio. One way to begin your property investing could be to unlock the equity you have built up in your own home.

You might have thought of your home loan as nothing more than a series of very long monthly payments. However, what you have actually been doing is reducing your debt and, as prices in general rise, gradually building up equity – that is the share of your property value that you own.

What is equity?

Equity is calculated by taking the total value of your property and subtracting the amount you still owe. For example, if the market value of your home is $800,000 and the balance of your mortgage is $500,000, you have $300,000 equity built up. As the value of your property goes up, so does the equity.

What can I do with the equity?

The good news is that you can access the equity WITHOUT having to sell your home. Think of your home as an asset you can use for other financial purposes, such as investing, renovating, moving house or funding your next holiday. Lenders will often enable you to tap into your home equity to use as collateral for new loans. This is a very common strategy used by property investors who want to build up a portfolio. If you do it right, the results can be worthwhile, but you need to be aware of the risks.

What do I need to know about using my equity?

You can use your equity as a form of deposit. If you are looking to purchase an investment property, you can avoid having to save the amount required by using your equity. You will need a finance specialist to organise a valuation of your home and with this information they are able to work out how much equity you have to work with. However, just because you have $200,000 equity doesn't mean you can (or should) use it all. The process undertaken to release the equity will take into account your income, number of children, other debts etc. Lenders will usually only allow you release up to 80% of your equity, which is also subject to your ability to make the necessary mortgage payments.

You might be able to have mortgage insurance waived. When purchasing property, lenders will generally loan up to 80% of the value of the intended property, leaving you to find the additional 20%. Some lenders will allow you to borrow up to 95% if you are willing to pay mortgage insurance on the amount you borrow over the 80%. You may be able to use your equity as security against the additional 15% and because of this many lenders will waive the mortgage insurance costs.

We advise clients to pay down the non-deductible loan first. This means prioritise payments made to your mortgage before that of your investment property. The loans and any other payments related to your investment are tax deductible whereas your home is not.

Your home may not be your only source of equity. If you already own an investment property look at the equity you have in that first. Many property investors draw down the equity in their investments to help purchase the next property. This can help you build your portfolio more quickly without having to risk your home.

Consider renovating. Making additional payments to your mortgage or waiting for your property price to go up are not the only ways to increase your equity. Putting your useable equity towards renovation that will boost the value of your property is another option. With the right additions, you can increase the value of your property value even in a flat or down market. However, renovating can be costly so make sure you weigh up the costs against the expected value increase. Don't overcapitalise with upgrades which are over the top or won't improve your property value.

By considering these tips, using your home equity to invest in property can be a smart and rewarding strategy. However, remember to plan and budget right from the beginning of the process. Ensure you are realistic about all the costs involved and always speak with a financial specialist before making any decision. The Grimsey team can help you unlock your equity and devise a strategy which is right for you. Contact our office on **(03) 8341 8888** for a complimentary Borrowing Capacity Review today.