MORE THAN MORTGAGES

How to structure your property loans for maximum stability and control

Part Two

INTRODUCTION

Welcome to this Special Report for property investors. It explains how to structure your new or existing loans so you retain maximum control over your assets.

To make this Report easier to understand and digest, I've broken it up into 2 parts.

In Part 1 of this Report, we looked at 'cross-collateralisation' of loan securities and some of the ways it can potentially reduce the stability and flexibility of your loan portfolio.

Now in this instalment, we'll look at some potential solutions.

Again, I remind you – cross-collateralisation isn't a problem until it becomes a problem – and your first line of defence is avoiding crossed loan structures in the first place.

Successful investing,

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PART 2

How to Structure a new loan without crossing

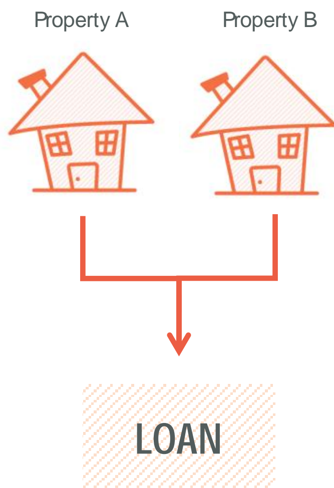
Let's return for a moment to our first example:

A simple example:

John owns **Property A** outright.

John wishes to buy **Property B** but has no funds to raise a deposit.

John buys **Property B** using a 105% loan and the Bank holds both Properties A and B as security against the loan for the purchase of Property B.



Here's another way for John to purchase the same investment property without crossing:

Finance Property A with Bank A. Finance it enough to cover the 20% deposit and 5% acquisition costs for Property B. ($100,000)

Then go to Bank B and borrow 80% for the new Investment Property B. Bank B will ask, 'do you have sufficient funds?' Providing them with a bank balance from Bank A will suffice.

Now John has one loan with Bank A and one loan with Bank B. Neither bank holds security over both properties and if John decides to sell, he doesn't have to answer to the other bank.

The maths:

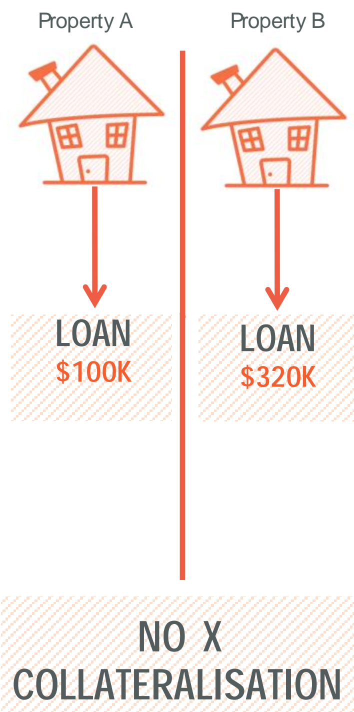
$400,000 Purchase price

$20,000 Closing costs – S/duty, rates adjustments, house insurance, legal's etc

$420,000 Total Acquisition costs for property B

$320,000 Less loan secured on property B

$100,000 Balance payable from Line of Credit on property A



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The above is a simple example. However, most investors don't use a new bank every time they buy a new investment property. They often start out on a professional package where there are interest rate discounts and a full banking solution offered. So how do you structure loans with the same bank without cross collateralising?

HOW TO STRUCTURE LOANS WITH THE SAME BANK WITHOUT CROSS-COLLATERALISING

Firstly, you need to know whether or not your bank will allow you to have stand-alone loans with stand-alone security.

Most banks do, but you must insist on it at application. You have to stipulate that you do not want your investment properties cross-collateralised, otherwise they will automatically do it. We ask for it every time and we still occasionally have to send documents back for reprinting.

Secondly, although as an investor it's possible to borrow up to 97% of a property's value as a stand alone loan, your approval is at the mercy of the Lenders Mortgage Insurer.

As an investor, it's sometimes better risk management to keep your Loan to Value Ratio (LVR) at or below 80% so that you're below the Lenders Mortgage Insurance threshold.

Back to John:

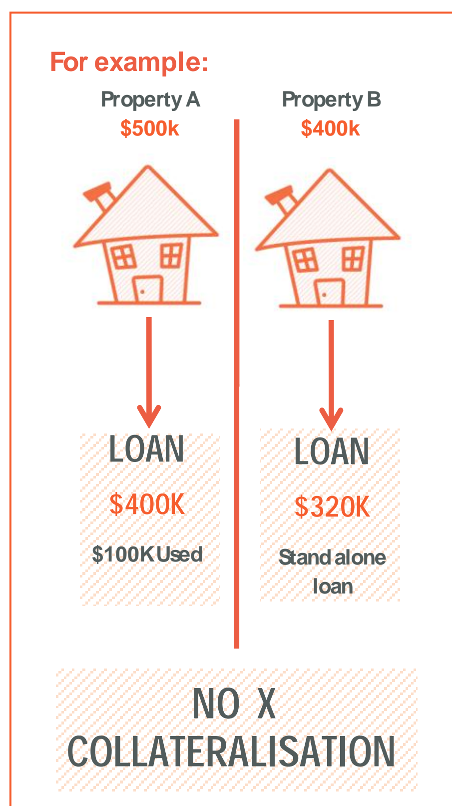
Let's say Property A is worth $500,000 and Property B worth $400,000.

Step 1: Finance Property A with Bank A onto a Line of Credit up to $400,000. (80% of its value) as a stand-alone loan.

Step 2: Then take the deposit and closing costs from this account to contribute to the purchase of Property B. This is usually 20% deposit plus 5% closing costs, so that's $100,000.

Step 3: Finance Property B also with Bank A with a 10-year Interest Only term loan for 320,000 (80% LVR, Loan to Value Ratio)

Here's how that would look:



Then when John buys his second investment property, Property C, he again takes his deposit and costs from the Line of Credit secured against Property A. He'll end up with three stand-alone loans that are 80% against each security.

John's property portfolio now looks like this:

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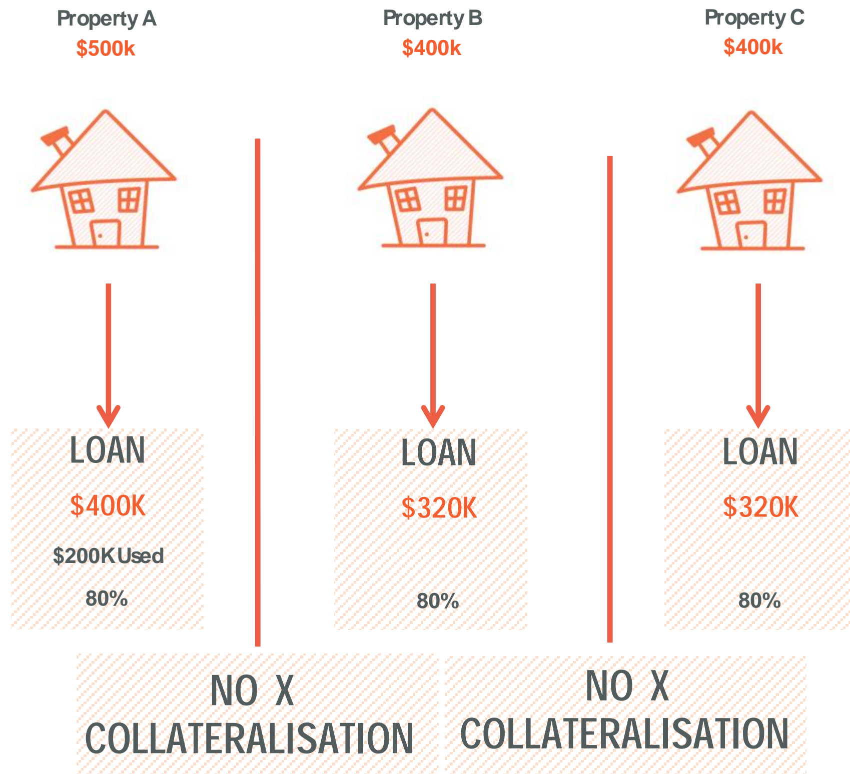

Using a similar strategy to John, you can increase the loan balance or 'top up' any loan without having to have any of your other investment properties revalued or revisited.

If you do this, it's likely none of the 7 problems mentioned in part one will affect you.

'BUT MY LOANS ARE STILL WITH THE SAME BANK – THEY STILL HOLD ALL MY SECURITY ANYWAY'

You could argue that since your loans are still with the same bank, they effectively hold all of your security anyway, and you're right.

However, the loans and properties are not intertwined with each other and each of your loans is at or below 80% Loan to Value Ratio. If at any time you needed to sell one of your investment properties or refinance one you should not need to go back through the credit approval process for all of the other loans. You should only have to deal with one loan and one property. That gives you more control over your assets – and cuts out a whole lot of unnecessary and time-consuming paperwork.

Also by doing this you can do other cool things in the future like a substitution of security, a very handy tool when you want to keep a loan alive but reduce the amount of security holding it, or avoid potential exit fee's with a fixed rate loan.

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