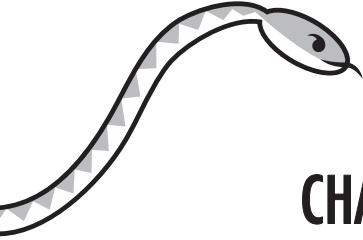
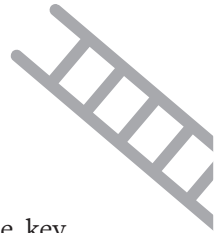


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14.

## CHAPTER TAKEAWAYS



Over the next few pages, I've provided summaries of the key takeaways from each chapter as a quick, easy reference for when you're arranging or rearranging your loans. They're the ultimate Rules of the Lending Game!

### **Why you need this book**

- Lending has changed dramatically over the past few years, and you now need to start planning at least six months in advance of applying for a loan. It's important that you're well informed so you can navigate the potential challenges.
- Setting up mortgages is deceptively easy. That is, it's easy to make a costly mistake, but not realise this until several years later. A little bit of knowledge will help you avoid the common errors.
- You must understand that a mortgage is an asset; used wisely, it will help you achieve your lifestyle and financial goals. Maximising your borrowing capacity safely is key to this.

- Building wealth is a game of finance – using other people’s money to help you build your own wealth. This book shows you how to win the game!

## **Chapter 1: The players**

- The mortgage industry has evolved over many years, but the Big Four still dominate the market. There are many smaller alternatives, but be aware of their pros and cons.
- The tightening of credit practices throughout 2017 and 2018 was the most significant change since the introduction of Aussie John in the early 1990s. Understanding the current landscape will put the mortgage application and management process in perspective.
- You must understand how a lender funds its mortgages, as this will determine how flexible they’ll be – and whether their flexibility is important in your situation. Matching the right lender with your application is key to success; don’t try to put a square peg in a round hole.
- Mortgage insurers have a great deal of influence on loan applications where you’re seeking to borrow more than around 80 per cent of a property’s value. Make sure you understand and plan around lenders mortgage insurance.
- Establishing a relationship with a trusted mortgage broker can save a lot of money, time and hassle, and they’ll focus on helping you achieve your lifestyle and finance goals.

## **Chapter 2: How much should you borrow?**

- Be cautious with your borrowing plans. Wealth-building isn’t a race, and it’s important to borrow safely.
- It’s critical that you know how much your living expenses are. Astute cash-flow management is imperative for successful wealth accumulation.

- To get a detailed understanding of your cash flow, download the past three months of your transactions and allocate them into seven categories. Analyse your spending in these categories and look for savings.
- I recommend you set up two bank accounts. One you use to receive all your income and to pay all your financial commitments. The other you use to pay living expenses from. Allocate a set amount into this second account each fortnight – and once it’s gone, it’s gone!
- Good cash-flow management doesn’t take a lot of time and isn’t a painful experience. The key aim is to reduce any unconscious spending that doesn’t have a meaningful impact on your standard of living.
- Once you know how much surplus cash flow you can save, you can work out how much you should borrow.
- See page 32 for a list of steps that you should take, approximately six months out from lodging a mortgage application, to ensure that you’re ‘borrower-ready’.

### **Chapter 3: How much can you borrow?**

- Three things will determine your borrowing capacity:
  1. Serviceability – which involves an assessment of your current cash flow to ascertain whether you can afford to repay the loan.
  2. Security – which relates to how much cash (skin in the game) you’ll contribute towards purchasing a property and/or how much equity you have in other property. A lender must ensure you have enough assets (security) that it will at least get its money back if you stop making repayments on your loan.
  3. Creditworthiness – do you have an unblemished record of making repayments on time, not overborrowing and generally conducting yourself well?

- Different lenders may assess your borrowing capacity very differently, so it might be important for you to consider and compare a large number of lenders, either yourself or via a mortgage broker.
- For your first property purchase, if you want to borrow more than 90 per cent of a property's value, you need to have at least 5 per cent of that value in genuine savings.
- On page 44, I list 13 things you can do to maximise your borrowing capacity – including minimising credit card limits, submitting a PAYG tax variation and minimising other financial commitments.
- If you find you're struggling to make your loan repayments at any stage, take decisive action as soon as possible. This might involve making temporary changes or contacting your lender.

## **Chapter 4: Perusing the products**

- Determine which product and structure you need first, then consider which lender provides the best solution – don't choose the lender and try to make their products work.
- It seems like there are millions of different loan options but, in reality, most borrowers only need to choose between three products: a basic variable loan, a discounted standard variable rate loan within a package or a fixed-rate product.
- Package products allow borrowers to establish multiple loan accounts and offer an interest-rate discount based on total borrowings. Packages are typically the most cost-effective products for investors.
- Data shows that fixed-rate borrowers have been financially worse off 69 per cent of the time since the year 2000. The odds are stacked against you, although that's not necessarily a reason to avoid fixed rates. However, I caution anyone about assuming they'll be better off (i.e. will pay less interest) if they choose a fixed-rate product.

- Offset accounts are valuable for borrowers who have a home loan, as it allows them to reduce the amount of (non-tax-deductible) interest they pay.
- Data published by the Reserve Bank of Australia demonstrates that banks offer new borrowers lower interest rates than existing customers. Therefore, it's important that you (or your mortgage broker) review your interest rates regularly – at least annually.
- Setting up your investment loan with interest-only repayments gives you the most flexibility. It sets the minimum repayment amount at the lowest level, thereby giving you discretion over what you do with your cash flow. If you also have an offset account against the loan, you can park cash in this, saving yourself interest.
- Loans to construct a dwelling or dwellings are more complex and are set up differently.

## **Chapter 5: Structuring your loan portfolio**

- How you structure your loans can impact your tax deductions, your ability to make additional investments, your risk and your cash flow. So, it's important to get it right.
- The example featuring Karen and Richard, beginning on page 81, shows how to correctly structure your loans.
- You should review your loan-to-valuation ratio periodically and maintain it at as close to 80 per cent as possible to avoid giving your lender excessive security.
- Spreading your lending across multiple lenders allows you to establish a credit history with each of them, and this will likely serve you well in tighter credit markets.
- Avoiding cross-securitisation (i.e. where a loan is secured by two or more properties) provides many benefits. It can decrease property revaluation costs and increase flexibility,

it allows you to maximise your borrowing capacity, puts you in a better negotiating position with lenders, means that you can enter into fixed-rate products safely, allows you to control sale funds when you sell a property, and much more.

- Fixing a broken loan structure entails splitting out loans and ensuring they stand alone. There's an example of how to do this on page 85.
- Structuring loans effectively may allow you to minimise the cost of lenders mortgage insurance.
- Getting your loans and structure pre-approved by a lender could save a lot of time and heartaches after you purchase a property.

## **Chapter 6: Structuring loans in a company or family trust**

- It's important to get holistic and independent advice before you decide to set up a company or trust to own your property investments, as there are many implications to consider in areas like financial planning, legalities, tax and borrowing.
- When it comes to loans in a company or trust name, lenders will typically fall into three categories: 1) they will not allow such loans; 2) they allow the loans but charge higher rates or fees and/or they're not experienced with these sorts of loans, which causes errors, frustrations and delays; or 3) they're experienced with such loans and charge standard rates and fees. Of course, it's important to select a lender from the third category.
- To access a deposit, it's important that the deposit loan is in the trust's name. You can provide a guarantee so that the lender can secure the loan using the equity in your home (or another property).

- On page 108, I shared a step-by-step example of how to structure a loan in a trust's name.
- I recommend that investors avoid using hybrid trusts for a number of reasons, including the fact that few lenders will lend to them.
- If you're considering investing in property via a super fund (an SMSF), make sure you investigate all the pros and cons carefully, as compliance obligations have tightened dramatically and only a handful of lenders offer these loans.
- Do not agree to giving a lender a registered mortgage debenture over your company or trust.
- It's very likely that the directors of a company (including a trustee company) and/or individual trustees will need to provide personal guarantees for a loan to the company or trust.

### **Chapter 7: Tax matters**

- You only get one opportunity to establish the maximum tax-deductible loan, and that's when you first purchase a property. So, think very carefully before you contribute cash towards a purchase. If possible, borrow 100 per cent and deposit your cash in a linked offset instead.
- The property's ownership determines who gets the tax deductions; the names on the loan matter less. It's important to ensure that the loan repayments are made from an account in the owner(s) name.
- The loan purpose will determine whether it's tax-deductible or not. If the loan funds were used to buy an asset that will produce assessable income, it's likely the interest will be tax-deductible.
- Avoid using redraw facilities with investment loans, as any redraws are treated as new, separate loans for tax purposes.

- Lines of credit are very messy for tax purposes, so my general recommendation is to avoid them.
- Keep good records of when your loans were established, when the balances were changed, how loans were refinanced and so forth. These records will come in handy in years to come as your memory inevitably fades.
- Borrowing costs (bank fees) for up to \$100 are deductible in the year they are incurred. Fees greater than \$100 must be written off over five years.
- Prepaying interest is worthwhile if you expect your taxable income this financial year to be unusually high.
- An interest-only offset is a powerful product that allows you to reduce your interest costs without compromising future tax (interest) deductions. All investors need to be aware of this.
- Make sure you have a smart, proactive accountant who's experienced in property investing. It's good to complete last year's tax returns, but my advice is to spend the same amount of time discussing this year's tax-planning strategies.

## **Chapter 8: Borrowing more than 80 per cent of a property's value**

- If you borrow more than 80 per cent of a property's value, you'll have to pay lenders mortgage insurance (LMI). LMI is a one-off fee payable when your loan is established.
- LMI protects the lender from suffering a loss, not the borrower.
- LMI is charged as a percentage of the loan amount. The percentage charged depends on the loan size and LVR, but ranges from 1 to 5 per cent (see the table on page 136). Most states (except NSW and the ACT) charge stamp duty of around 11 per cent on the premium amount.



- LMI is tax-deductible – claim it over five years.
- Most lenders will lend up to 95 per cent of a property's value. For investors, mainstream lenders limit the maximum LVR to 90 per cent, but there are mortgage managers and non-conforming lenders that will lend 95 per cent.
- Lenders will allow borrowers to add the LMI premium onto the loan as long as the total loan amount does not exceed a 97 per cent LVR.
- Mortgage insurers may reduce their maximum LVR depending on the property's location and type (rural towns, high-rise apartments, etc).
- Mortgage insurance can be worth paying for, because it magnifies your equity and allows you to invest more, sooner. This might help you purchase a better-quality investment property and therefore generate better investment returns in the long run. There's an example on page 140 to demonstrate this.
- If you're borrowing more than 80 per cent, your application may need to be approved by the lender and the mortgage insurer separately. Mortgage insurers can have tighter credit policies than lenders and this can add time to the loan-approval process – so it's wise to arrange a pre-approval before you purchase.

### **Chapter 9: Battling bank valuations**

- Banks will independently value your properties when you purchase them and when you refinance or make changes to your loan.
- The difference between a good and bad valuation could make or break your investment plans: a bad valuation will retard your ability to implement your investment strategy.

- To determine a value, valuers will search for sales of properties that are comparable to yours. The sales must have occurred recently – in the last 6 months, or 12 months at most.
- There are three types of valuations: full, kerbside and desktop valuations. Depending on the state of your dwelling (i.e. how it presents), one type might be more favourable than the others.
- Low valuations can occur in four situations:
  1. You have an unrealistic impression of your property's value.
  2. There might not be enough comparable sales (as in 2018 and 2019, when sales volumes were at all-time lows).
  3. Properties in some locations take a lot longer to sell, so the bank will determine a value that will achieve a quick sale (this isn't very common).
  4. The valuation was of poor quality.
- While it is possible to challenge a bank valuation, it's rarely successful. So, if you get a low valuation, often the most expedient thing to do is switch to a different lender.
- You can do two things to maximise value:
  1. Keep on top of past sales data to ensure you have a realistic idea of what your property is worth. There are a number of online tools you can use (see the chapter for details) and your property manager should be able to help, too.
  2. Be strategic when you request a revaluation. Don't necessarily wait until you need to borrow more money – revalue property when there are plenty of helpful comparable sales.
- Maximising valuations is an important step in building a property portfolio. Be prepared to switch to a different lender if they give you a higher valuation. Most mortgage brokers are able to order free valuations with multiple lenders.

## Chapter 10: Borrowing buddies

- Investing in property with a family member or friend will help you pool your borrowing capacity, but it's not without risk. Documenting such arrangements will help you navigate the inevitable changes in circumstances and markets.
- Typically, when two or more people apply for a loan together, lenders will aggregate their income and expenses in order to determine their overall borrowing capacity. However, some lenders' policies and products allow each partner to apply for their share of the loan separately.
- The most notable risk with a partnership is that each borrower is jointly and severally liable for the total debt. This means that if one partner stops making repayments, the remaining partner(s) are legally responsible for making all repayments.
- Buying property with a partner will have a negative impact on your personal borrowing capacity, as lenders will normally account for 100 per cent of the debt but only your share of the income from a partially owned asset. This can materially decrease your standalone borrowing capacity.
- One solution for avoiding the joint and several liability issues is to raise your own funds separately; for example, you might borrow against an existing asset to fund your share of the acquisition.
- The best way to approach joint borrowing is to understand that it's a shorter-term arrangement – lasting, say, 5 to 10 years – and planning accordingly.
- Owning the property in a unit trust may perhaps assist partners to change ownership percentages in the future without incurring stamp duty. You must obtain professional taxation advice in this regard, however.

## Chapter 11: First-time property buyers

- The first property that you buy is arguably the most important, because if you select it well and it increases in value, it'll create more opportunities for you to build wealth sooner – and the compounding benefits of this can be enormous.
- It's not important whether your first property is a home or investment. Selecting it as if it *were* an investment (i.e. making sure it has the strongest investment attributes) is the key thing.
- Understand that, depending on your current financial strength, you may have to trade your way up the property ladder to your dream home – that is, you may need to buy, improve and sell a few times.
- Two things determine whether you're ready to buy your first property: firstly, you need to have a stable and reliable surplus cash flow to make loan repayments with, and secondly, you need to have a sufficient deposit.
- You may be able to use either a family guarantee or the First Home Loan Deposit Scheme to assist you if you're income-rich but deposit-poor.
- Understand that your first property is unlikely to be your 'forever' home, and therefore, employing an investment approach (and ignoring lifestyle considerations as much as possible) will serve you well.
- Getting into the property market as soon as it's safe and prudent to do so is typically a good financial decision, particularly if you plan to purchase an investment-grade asset.

## Chapter 12: Developing a financing strategy

- A well-known Australian property adviser says that property investment is a game of finance rather than real estate.

The reason for that is that borrowing capacity is a scarce resource, and if you can maximise it, you can afford to safely invest in more property and therefore build more wealth.

- It's far more efficient to build your property portfolio by funding your property deposits from equity than by saving after-tax dollars. You must proactively maximise borrowable equity in order to achieve this.
- Compounding capital growth will do all the heavy lifting in the long run – that's why it's absolutely critical to select the best investment-grade property you can afford. Get advice in respect to this.
- Debt is a wonderful servant but a terrible master, so always borrow within safe limits. Building wealth is a marathon, not a sprint!
- The best product to use to access equity is a variable loan in a package with interest-only repayments and an offset account.
- There are two types of refinance: internal (with the same bank) and external (with a different bank). The most important factor will likely be the valuation – go with the lender that gives you the highest valuation.
- You should develop a financing plan that sets out how you can maximise your borrowing capacity and successfully implement your property investment strategy.
- You must consider how you will repay debt or at least reduce it to a manageable level after you retire. I shared five strategies for doing this on page 182.
- An experienced, professional and ethical mortgage broker can help you safely maximise your borrowing capacity and your borrowable equity, by comparing valuations from multiple lenders, if necessary.

## Chapter 13: Considering commercial finance

- Commercial mortgage products are very different to residential mortgages. They typically have less features.
- Commercial LVRs are lower than residential LVRs: normally, the maximum LVR is 70 per cent.
- Commercial loan terms are shorter, too – the maximum is typically 15 years.
- Commercial loan applications are assessed primarily on the strength of the commercial asset, with less emphasis on the borrower. Considerations include the type of property, the LVR and the strength of the tenant and lease.
- Commercial property fees can be a lot higher, with application fees ranging from 0.25 to 1 per cent. Borrowers must pay for valuations.
- If you want to purchase a commercial property and you have a lot of equity in your residential properties, sometimes it's best to use a residential loan to raise borrowings to fund a commercial acquisition. However, this depends greatly on your circumstances.
- Given that the commercial lending market includes many fringe lenders that have niche specialisations, it's best to engage the services of a commercial broker, as they'll likely save you a lot of time, hassle and money.