STRAIGHT TALK ABOUT FINANCING YOUR RENTAL PROPERTY

"If you want to be a millionaire, first borrow a million dollars and let someone else pay off the loan"!

We've already discussed in a previous article how we can have both the tenant and the Tax Department assist in paying towards the costs of running a rental property business. In this article, we will have a look at how you can finance your rental property,

Getting started is always the most difficult part of starting any project, and buying your first rental property is no different! In a previous article we talked about gearing up a smaller amount of money (the deposit) to achieve the purchase of an asset.

We always suggest that to be prudent, and to manage risk, you keep your borrowings at a maximum of 80% of the value of your home.

In an example of purchasing a property of $300,000, this would mean a deposit of $60,000.

So….. where to get this deposit from? Let's look at some different options.

1. You can save it up.
2. You can borrow against the equity in your existing home.
3. You may receive a payout from employment.
4. A windfall such as an inheritance, an insurance payout, or similar.
5. Self-managed superannuation Funds.

Taking these in turn:

Saving

There is no substitute for a regular savings plan. One of the best things parents can do for their children is to teach them the habit of regular saving! I had my kids pay some board and lodging as well once they started in full-time employment.

Check out Brad's story on this web site as a great example of regular saving. True, it took twelve years to get his first deposit, but he was only 28 years old. With that first deposit, he was on his way and today owns his own home outright, plus two more rental properties.

Borrowing against equity

This is what most people do to get started buying rental properties.

What this means is that as the value of your family home increases over the years, you can access it by borrowing against this extra capital growth that has occurred,

Using our example of a purchase of $300,000, you could borrow the $60,000 deposit needed against the family home (making sure that the debt remains also under 80% of the value). You then borrow the remaining $240,000 against the rental property.

Effectively, this scenario would mean you have borrowed 100% of the purchase price. All of the interest is then tax deductible against the rental income.

Please note, however, that the interest paid on any existing loan on the family home is NOT deductible.

You may receive a payout from employment or wind-falls.

When large sums of money are received from whatever source, great care should be taken in how this is managed. I would always recommend getting some professional advice from a properly Licensed Financial Planner to work out how to best look after a windfall to suit your circumstances the best. There are a lot of considerations, taxation being one of the most important.

Some or all of these funds can be used towards the purchase price.

Self-managed superannuation Funds

Changes to the Superannuation laws have meant that Self-Managed Super Funds can now borrow money to buy rental properties. This is a highly complex area, but can be very powerful for some people.

I intend to provide more information on this in a future article.

So what about the Banks?

Since the Global Financial Crisis, Banks have become very prudent about their lending policies.

Not only do they want sufficient equity in the value of the properties to lodge their security against, they also take your personal income into account.

Some will also take the rental income into account, some won't.

The key here is to shop around, or use the services of a good Finance Broker who accesses a number of different institutions.

As always, careful preparation is the key.

Please note that the information in this article is of a general nature and you are advised to seek professional assistance before proceeding with any investment purchase.

Kevin Hodges