Understanding Equity

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What is Equity?

Purchasing a property is often looked at as a way of securing a stable place to live, in a location that suits you, but it can also be a valuable investment. Here, we explain the term equity, and how this may relate to a property you own as well as its potential uses. Since you purchased your property, it may have increased in value and is now worth more than what you bought it for. If this is the case, then the difference between what it is currently worth and what you still currently owe is referred to as equity. You may be able to borrow a portion of this equity from your home loan provider which can be used for a range of purposes, such as putting it towards the purchase of an investment property, or investing in other assets such as shares.

How is Usable Equity Calculated?

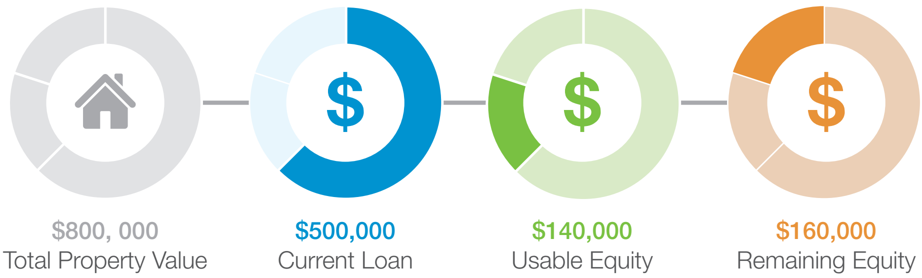
When you first purchased your property, you would have only been able to borrow a percentage from your home loan provider, and would have been required to contribute the rest as a deposit from your savings. For standard home loan applications, you are usually allowed to borrow up to 80% of the value of the property without the need to pay Lender's Mortgage Insurance (LMI), the same may be true once your property had appreciated in value.

Of course, to find out the exact amount of usable equity that you may have, your property will need to undergo a valuation, and you should speak to a home loan specialist about your borrowing capacity.

To help explain how this works, beside is an example of a situation in which a couple has calculated their rough usable equity in their family home.

Example

- Bruce and Rachel purchased their family home for $650,000. At the time, they borrowed $520,000 (80%) from their home loan provider, and provided a deposit from their savings of $130,000 (20%).
- 2 years later, their property has increased value to $800,000. They have also paid down their loan to $500,000.
- This has given them equity of $300,000, taking the current value of the property, and subtracting what they still currently owe on it.
- Their home loan provider will allow them to borrow up to a total of 80% of the current value of the property ($800,000) without needing to pay LMI. This means that they may be able borrow additional funds referred to as usable equity provided they have sufficient income and approved financial circumstances for additional borrowing from their home loan provider.
- Their usable equity was calculated by making the following estimate: $800,000 (current value of property) x 80% (percentage allowed by home loan provider) – $500,000 (existing loan) = $140,000 (usable equity).



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Using Equity for an Investment Property

If you are able to borrow additional funds against your existing home, these may be used towards the purchase of an investment property.

If you have sufficient borrowing capacity, this may mean that you could borrow the full purchase price of the new property meaning you may not need to use your savings, like you would if it was your first property purchase.

Bruce and Rachel have decided to access their $140,000 usable equity from their family home to purchase an investment property. Here are a few points to summarize the image below of their purchase.

Example

- The new investment property has a purchase price of $400,000.
- Instead of providing savings for a deposit, Bruce and Rachel will be using their usable equity to supply a 20% deposit of $80,000.
- They will borrow the full $400,000 needed for the purchase. This consists of $80,000 (usable equity) + $320,000 (loan secured by investment property).
- After the settlement of the investment property, they will have a loan of $500,000 for their family home, and a loan of $400,000 for the investment.

Please note, that the cost of stamp duty, legal fees and other associated costs should be considered in your total required funds.

Property A: Existing Owner Occupied Home
$800,000 Total Property Value

Property B: New Investment Property
Purchase Price **$400,000**,
Investment Loan $400,000