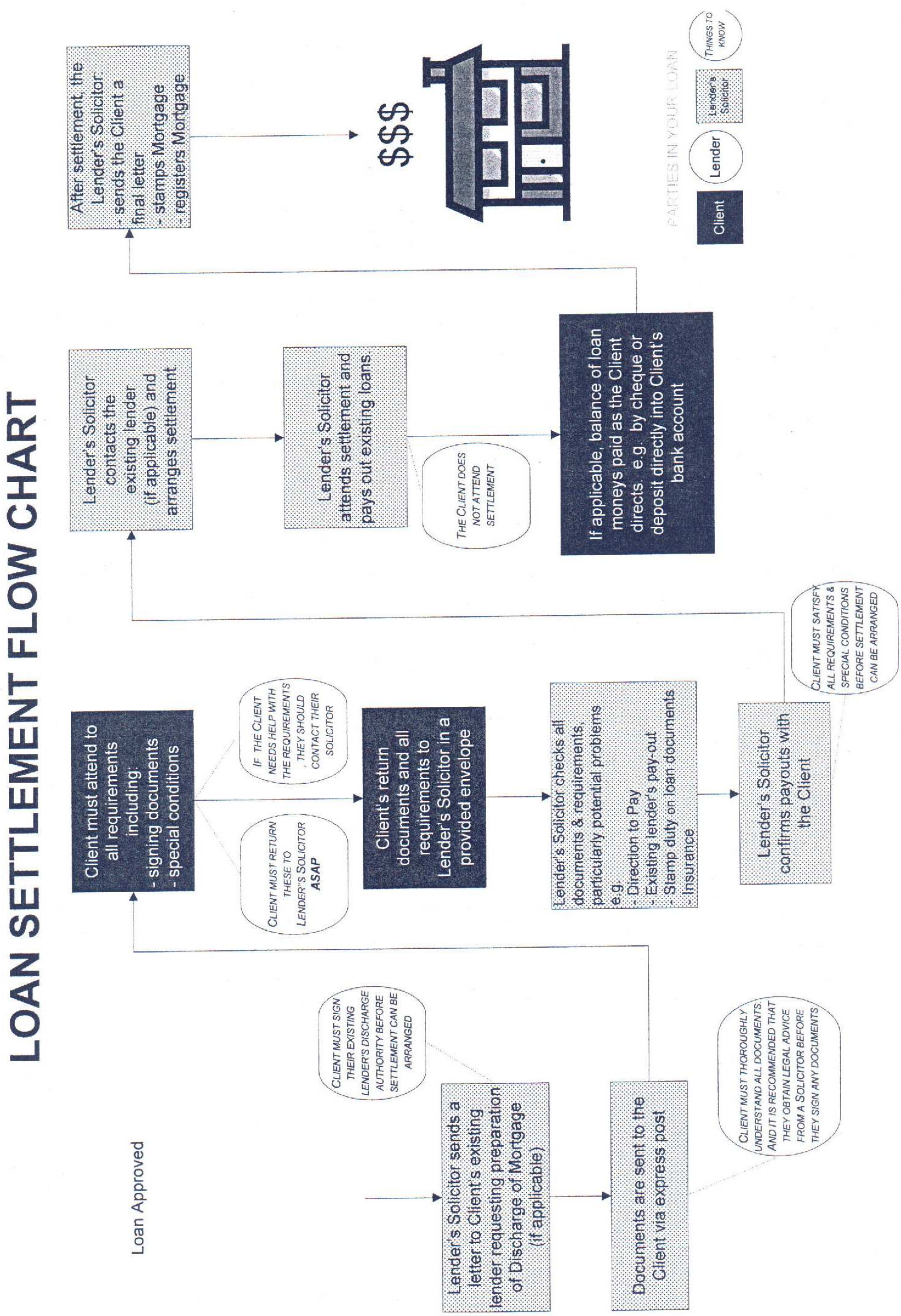
Finance Principles

CONTENTS

loan settlement flow chart



perform extreme finance due diligence

This process should begin well before your settlement date.

Use the telephone to contact a minimum of 10 financiers to obtain all information required to get the loan you want.

You can obtain the list of these lenders through newspapers the Internet, through various mortgage-based magazines available at any newsagent.

Only speak to individuals who can approve $1 million loans and above

Tell the lenders your true financial position… your current income, your liabilities and your net asset position. You then need to ask :-

a. Does your current financial status (income and assets) fits the financier's lending criteria?

b. Which valuers are accepted by the lender.. is your valuer on their panel?

c. Will the financier lend you monies based on the Contract Price or Valuation, which is the HIGHER?

d. Will the lender provide you a 90% LVR (loan to value ratio)?

e. Will the lender give you an Interest Only investment loan?

f. What are the lender's 5 and 10 year-Fixed Interest rates?

g. Is there a cheap honeymoon rate?

h. What are the fees (legal, Valuation and establishment costs)?

i. What are the mortgage insurance fees?

j. Get all the fees and commissions in writing!

perform extreme finance due diligence

Questions to ask before proceeding

What level of gearing do you want?

What level of debt can you handle?

What could happen if the interest rates rise by...?

Will the financier be willing to lend you monies for multiple properties?

Get verbal 'approval' from at least 3 lenders.

As long as everything you told the financier was true you should be able to obtain the loan as per your telephone "approval".

In most cases you are better off to approach a new lender other than your bank, because they will be more hungry and more flexible to win your business.

You will need to negotiate with the lender as a Professional Property Investor to obtain the finance deal you want.

Dress in an 'expensive' suit. Look like you can afford to purchase $1 million worth of property.

Discuss the reason you were able to purchase the property at such a 'low' price. You will have to convince the lender that you were able to obtain the 'deal' due to your skill and education. Convince the lender you are a skilled person with good back-up support, accountants etc.

Inform the lender of the higher prices paid by other purchasers within the suburb... further demonstrate your 'investor' skill.

Have all the financial information the lender requires prepared, neatly bound and ready for 'show'.

keys to success

- Identify exactly where you are today.
- Complete a full asset and liability statement.
- Access current spending habits and other commitments.
- Evaluate existing mortgages and debts including credit cards.
- Provide borrowing capacity for future planning from a bank or broker.
- Present alternative mortgage strategies.
- Consolidate and clarify position for increased cash flow.
- Provide property investment plan and strategy.
- Look at tax and related information with your accountant.
- Show benefits of debt reduction program and cost saving for increased cash income.
- Determine short term and long term goals. Be realistic with yourself.
- Put a plan together and get assistance with initiation from your advisor.
- Provide insurance Protection wherever you can and Superannuation assistance as required.
- Use qualified accountants and solicitors who are experts in their fields and cost effective. Clarify their fees upfront.

A proper professional plan with a tailor made strategy can get you to where you want to be sooner

develop a plan

- Having a plan of attack can make sure the process of finding the right loan flow more easily.
- Determine your present and future requirements.
- Measure the cost and fees of the same type of loan form various sources.
- Ensure that all features are disclosed in detail.
- Don't pay for something you don't need.
- Ensure there are exit strategies in case the market changes.
- Perform finance due diligence research.
- Obtain pre-approval for finance.
- Approach banks with a professional finance and cash strategy and research boutique lenders and brokers to get comparison.
- Approach multiple financiers, at least 5.
- Only deal with reputable companies.
- Look for the highest amount of money you can get, then discuss with your accountant or planner.
- If they will lend against valuation, will they lend against contract price and refinance?
- Don't pay brokerage fees for a banks FREE service.

prepare a professional finance proposal

Your professional finance proposal should include:

a. Valuation of the property and its rental potential from local agents

b. Positive market research in a professional presentation folder

c. Positive supporting media articles

d. Pictures of the property and its finishes, floor-plans and other relevant information relating to the property and local amenities

e. Obtain a professional financial analysis (prepared by an accountant) in regards to the property and your particular financial situation.

This analysis should include the following information:

a. the structure you will use to purchase the property (personal name, trust, company, etc.)

b. the property's depreciation schedule(s)

c. all the taxation benefits associated with the property and their effect on your overall holding cost. Some PAYG earners may be positively geared, and could be making money form the property.

d. a long-term (minimum of 20 years) financial protection for the property which includes the expected or estimated cash flow and capital gain projections.

Prepare an estimate of the property's rental potential

a. You need to obtain 3 written quotes form 'respected' local agents

b. Use agents with whom you have already established a good relationship and who are well known.

c. They will be more than happy to provide you with this estimate, as long as they consider they may have an opportunity to lease the property

d. Get them to provide you with a written quote

e. The bank will generally take 80% of the rental estimate into account and add this amount to your overall yearly income

f. You may increase your borrowing capacity by obtaining the real rental quote, instead of allowing the financier to pre-determine the rental price.

prepare a professional finance proposal

Demonstrate that you have done your homework necessary to ensure that the investment is safe and sound.

Obtain appropriate and adequate insurance.

a. Income protection insurance

b. Trauma and disability insurance

c. Term life insurance

d. General property insurance

e. Landlords' insurance

Establish rapport with your lending manager:

Tell the lender of your intentions to maintain a profitable, long-term relationship. A good relationship with your Banker is important to a professional property investor.

It can help minimise problems in the future by taking all notes down carefully in a diary.

It can be helpful when applying for finance in the future by referring to these notes.

Question the lender on all the terms and conditions of the loan, and all the associated costs.

prepare a professional finance proposal

Obtain a fixed time within which your loan will be formally and irrevocably approved, liaise with you solicitor.

Obtain a firm verbal commitment that you will be provided with a loan to suit your requirements, before you leave the lender's office.

Get the approval in writing.

The approval must be irrevocable, subject to conditions.

Do not allow the lender to check your CRA unless they have provided you with an irrevocable letter of offer and you have accepted it.

Your CRA should only be checked once you accepted the offer.

Every time your CRA gets checked (marked), it may be interpreted by other lending institutions that you are 'shopping around' or 'you have a credit problem'.

Pre-empt the financier by advising that your CRA is regularly checked due to the fact that you are always 'doing deals'.

Visit 3 lenders and obtain written, irrevocable letters of offer from each one.

Choose the lender, which you feel most comfortable with, based most importantly on your relationship with the lending manager.

Approach as many lenders as required to get the deal you want.

If you are purchasing more than one property at the same time, approach more than one financier for your loan.

This process spreads your risk, and may assist you in obtaining finance.

Lenders could be conservative with "new" customers.

It maybe easier to obtain 'Professional 90% LVR Loan Package'.

creative financing

A lack of money is no reason to put off building substantial wealth via property.

You can easily create a nothing down deal when you harness the power of OPM, which is an acronym for Other Peoples Money

Most property investors already use OPM in the form of bank finance for the bulk of their property purchases, however OPM can also be used for the deposit and closing costs too. Here are five strategies that you can use to buy property and create a low / no money down deal.

1. Redraw from existing equity

If you have equity in your own home or another investment property then you can borrow against this to fund the purchase of other investment properties.

Equity is the difference between what your property is worth and what you owe. You can increase your equity in two ways: either through capital appreciation andlor by paying off your mortgage.

It's relatively easy to access your equity either in the form of a mortgage redraw or by refinancing your loan with another lender.

The bottom line is that you don't physically need money in the bank to fund further acquisitions, only an ability to access any equity that's silently accumulating in the background.

2. Money partners

Just because you don't have money doesn't mean that everyone else is short of funds too. If the deal is good enough then you might be able to attract money partners who will share the risks and rewards of the venture.

You might be surprised to learn that there are a lot of time-poor money-rich investors who are eagerly awaiting someone with enough time to find a deal and then put it together.

When finding money partners, start with friends and associates who are professionals. The name of the game is referrals, so even if they aren't interested, seek recommendations of names of other people who may be.

Your success in terms of finding and negotiating money partners will increase if you can show evidence that you already have profitable deals under your belt.

A word of caution though... be mindful of the Australian Securities and Investment Commission laws relating to public offers, as well as State by State real estate agent licensing rules.

3. Vendor finance/second mortgage

You can always ask the vendor to leave some money in the deal if you anticipate coming up short of the funds required.

This might be in the form of carrying a second mortgage, or maybe the vendor is happy to wrap the property to you.

The terms that you offer/I accept are always flexible, but the real secret is to work towards a win-win outcome.

You'd be surprised, especially in commercial deals, just how common vendor terms and second mortgages are. All you can do is ask!

4. Long settlements

If the market that you're buying in is experiencing rapid growth then an effective strategy is a long settlement period with a view to refinancing before taking possession.

For example, let's imagine that you purchased a property for $250,000 on the basis of a 90% lend. You don't have the $25,000 + closing costs needed, so you negotiate settlement terms of nine months on a $5,000 deposit.

During that time the property increases in value to $300,000. The bank re-values the property and gives the green light to lend on the higher (current market) value.

You can access the EQUITY of $45,000 (90% of $50,000), which will pay for your deposit of $30,000 plus all the closing costs too.

Be careful though… the key here is to get the lender to finance based on the higher property value. Most lenders require at least six months to have elapsed before they'll look at doing this.

5. Improve and refinance

A similar strategy is to gain early access, renovate and then revalue,

Renovation here doesn't necessarily mean a full blown knock down walls and add a second level job. Often minor updates and cosmetic alterations will suffice.

For example, let's say you bought the same property as outlined under 4 above. Also included in your purchase terms was a clause saying that you had the right to early access to complete renovations.

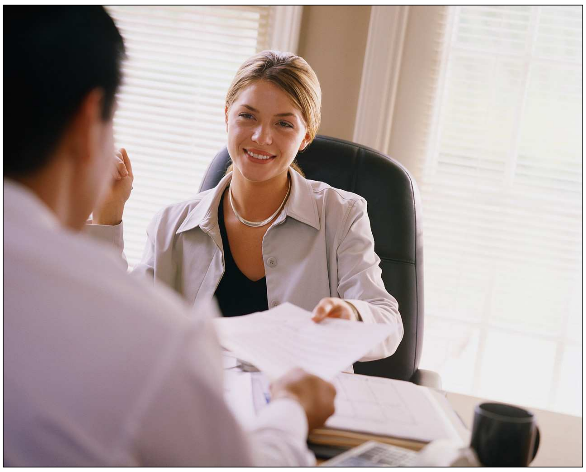
You then carry out renovation works during this settlement period (without paying any interest since you don't yet own the property) and then when the job is completed, get the lender to value the property on the post-renovation status. The property will then be worth more.

co-guarantor debt funding

If you need or want to obtain a traditional loan facility (80% LVR), but don't have the credit rating or debt capacity you might need, another party (with the correct income capacity) to guarantee your loan is required: ie family member, friend, a business colleague, etc.

Give your guarantor a profit share in the asset as an incentive to guarantee your loan.

You will need to demonstrate to the guarantor that you are a low risk because:



a. you have a safe job

b. your income is insured

c. you and the property are fully insured

d. the rental income from the property will cover most of the expenses

e. the gearing benefits should cover many of the out of pocket expenses

You can offer that if you default on the loan the guarantor can elect to purchase the property at the original purchase price and potentially make a profit.

The deal must be documented in an agreement between you and the guarantor.

Have a Professional Business Plan prepared, (the same as your finance proposal for the bank) and present it to your prospective guarantor as an opportunity to gain a share in a Blue Chip Investment.

Who wouldn't like to gain a share in a wholesale, maximised investment, without having to outlay a cent.

Promote it as a "business opportunity" to a potential investor.

co-guarantor debt funding

You could also approach your vendor for a Vendor's Finance deal. Offer to pay a higher interest rate – 1% to 2% above current market rates.

You may only need this type of finance for a short time, as you will refinance the loan and fully settle with the vendor as soon as your income is high enough to obtain a 'standard' property loan (80% 90%).

Seek legal advice to provide security for vendor financing.

a. Second mortgage

b. Request caveat

c. Personal guarantee

d. Equity position

equity based vendor's finance

If all else fails, you can ask the vendor to provide you with vendor's finance for a small component of the of the purchase price.

If you are short $50,000 on a $300,000 settlement, you will still provide the vendor with $250,000 obtained from the first mortgage financier.

You'll still owe the vendor $50,000, which will be secured by a mortgage over the property and your promise to pay.

The amount left owing is (in many cases) only the profit.

The vendor's profit could be secured by their own property.

Many property developers are comfortable and familiar with second mortgage funding.

Property vendors (especially developers) do not want the risk of 'non settlement'. It can negatively affect the vendor's construction lender or financier.

If you pay a high enough interest rate, you will most likely get the deal.

Ensure that the property is worth the risk when you are gearing yourself in this way. Definitely seek legal or professional advice. There may be a less risky deal around the corner that can benefit you more.

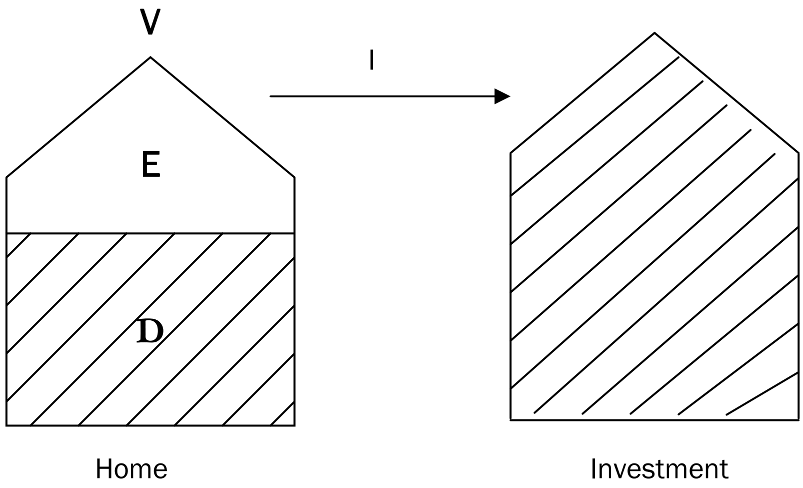
establish the size and price of the money you want to borrow

Consult your lending manager for details of their lending criteria

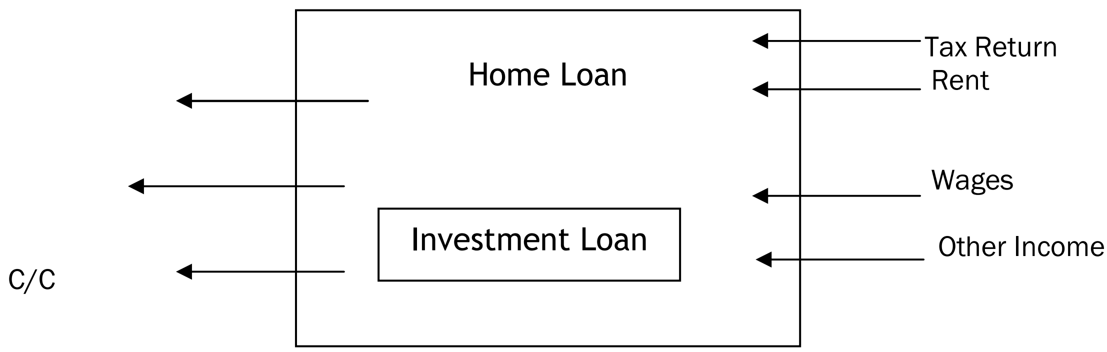
What level of gearing do you want?

What level of debt are you comfortable with?

faster home ownership



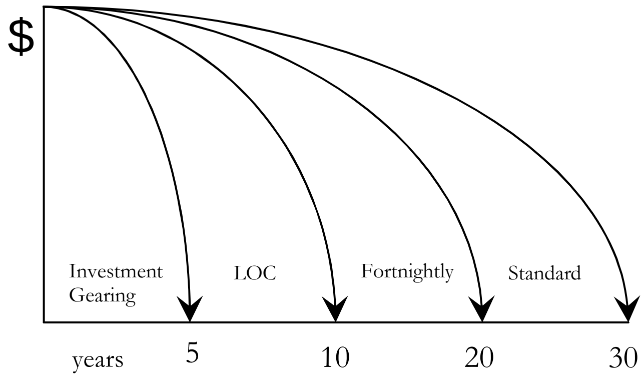
V	=	Value
E	=	Equity
D	=	Debt
I	=	Investment Property



bank busters

How much does a $250,000.00 home loan cost? Over a standard 30-year loan term, it can cost the same again, if not more in interest paid it back to the bank.

"There must be an easier way"



Keys to success

Don't just go out and get a loan. Find a loan that suits you and your budget.

Money management techniques and more frequent payments will shorten the term and save thousands of dollars in interest paid to the bank.

Line of credit or offset loans, where in theory, your home becomes the bank, which means all the money you earn, goes into your home loan first.

Use the income and tax benefits of your investments as extra payments into reducing your home loan debt first in a fraction of the time.

Examine the case study on the following pages.

types of loans

Standard Variable Loan

- Interest is higher
- Rate can change
- Loan is amortised
- Termination penalties
- Features are limited
- Disadvantage/advantaged by market rate fluctuations

Basic Variable Loans

- Rates are lower.
- Less options available.
- Rates and repayments can vary greatly.
- Loan is paid off in a set time.
- Termination penalties may apply
- Disadvantaged by lack of features and inability to combine with other loan products

types of loans

Fixed Rate Loan

- Rate locked for a term
- Principle and interest only
- Will convert at the end of term
- Termination penalties are charged
- Disadvantage/ Advantaged by rate fluctuations
- 1 – 3 – 5 – 10 year fixed terms

Introductory Rate Loans

- Lower rate at the start, generally fixed for 6 – 12 months
- Affordability is greater, because of entry level
- Rate can be fixed or variable
- End of term rate reverts to agreement loan type
- You are able to pay more into loan while in the honey moon phase

Redraw Loans

- Variable interest rate
- All-in-one loan
- Access to extra funds
- Minimum cash withdrawals
- Cheaper than L.O.C

Offset Loans

- Involves a separate savings account
- Interest rate on savings is same as home loan
- Offset accounts have minimum balances set by the bank
- Fees are higher to provide more return for lender

Split Loans / Combination Loans

- Hedging against rate fluctuations
- Flexibility on mix
- Can lower cost over standard L.O.C
- Line of credit loans
- Rates are higher
- Rolls Royce of loans
- Generally up to 90%
- No requirement to draw down funds
- Interest repayments are minimum
- Personal/ Business use separation
- Can be open to misuse

Self-employed Lo-Doc loans

- Loans designed to meet the needs of the self-employed.
- Income not factored.
- Up to 75% (can go as high as 100% now).
- Higher interest rate.
- Declaration of Affordability.

Should you go for the cheapest loan?

The answer is always yes, provided it gives you all of the features you require. If you select a loan because it is cheaper but it does not give you the flexibility, then the cost will be enormous in the long run.

Lenders are rapidly introducing loans that give borrowers more options at lower costs.

lending criteria – who can borrow

Lenders have their own guidelines to minimise risk

Individuals – Australian borrowers (citizens and permanent residents) that are 18 years and older. Must be able to service the loan with income and equity as well as have a solid credit rating.

Self-employed – any individuals that have greater than 25% interest in a business.

Trusts and companies – Trustees of Australian Resident Discretionary Trust and Australian companies. In all cases the Contribution of the Company or Trust deed must be assessed by the lender's solicitors.

Origin Entities – Secured by FIRB approved property, without income verification and much lower LVR = 70%.

serviceability and expenses

In assessing ones capacity to service a loan you must include

- all your existing home loan and investment property loan payments
- any rent you pay if you are renting
- your monthly credit card repayments or 5% of the credit limit …
- whichever is greater.
- all other loan commitments
- any maintenance payments
- an allowance is deducted for the number of dependants
- rental income x 80%
- income (tax) x 35%

serviceability and income

- Forms of income and the verification are required for approval.
- Lenders have their own set formula to determine what percentage of income can be used to service a loan.
- Generally acceptable income is any form of legal income that is regular and predictable.
- All income must be capable of being verified.
- Self employed income can now be based on a declaration by the borrower of affordability.

LVR

- Loan to valuation ratios.
- This is the loan amount requested expressed as a percentage of the value of the security property.
- Acceptable security is generally any real estate property … improved or vacant land including:

  a. residential houses and land

  b. commercial building and land

  c. home units and apartments

  d. rural property

- Each lender varies the maximum LVR before they take out mortgage insurance (LMI).
- Most lenders will go up to 80% LVR before the borrower pays the LMI.
- With LMI, lenders will go up to 95% LVR.
- LMI is paid by the borrower however only protects the lenders against any losses.
- LMI premiums vary according to the LVR rate.
- Example of LVR is $\frac{\text{Loan} \quad \$100\text{k}}{\text{Value} \quad \$150\text{k}} = 66\%$ LVR

traditional banking operation

Husband's Salary

Wife's Salary

<u>Various Accounts</u>
Earning 3% pa

<u>Mortgage</u>
Bank Charges You 7% pa

Weekly Expenses
Shopping, Food,
Petrol, Clothing

Periodical Bills
Electricity
Rates, Gas

Why this system is unfair

<u>Savings Account</u>
Earnings 3% pa

You are lending money to the bank and they are paying you 3%.

<u>Mortgage</u>
Bank Charges
You 7% pa

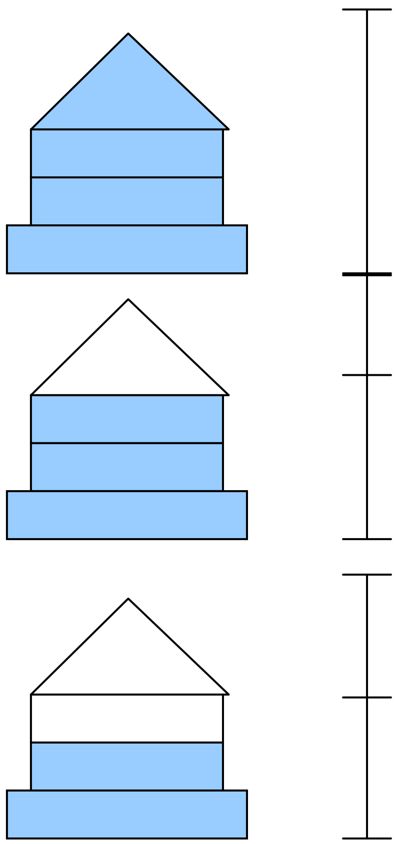
You are borrowing money from the bank and you are paying 7%.

Can you spot the problem?

gearing fundamentals

E = Equity = Cash   D = Debt = Liability

Debt To Equity Ratios As A Percentage



D 100% Debt = High Stress

E 25% Equity

Manageable

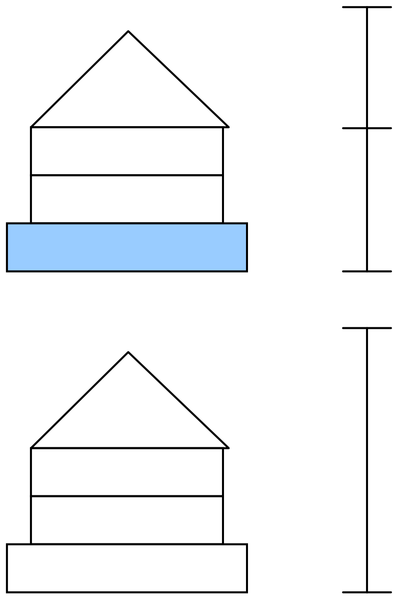
D 75% Debt

E 50% Equity

Less Stress

D 50% Debt

gearing fundamentals



E 75% Equity

Gearing

D 25% Debt

E 100% Equity = Wealth creation

The greater the equity in your property the more your personal wealth is calculated. You must reduce your debts as quickly as possible; this will eliminate financial stress and give you the opportunity to leverage the equity in your assets to build more personal Wealth.

how can I legally reduce my stamp duty costs?

- Purchase the land, not the final product.
- Purchase the entire project/ development.
- Use split land and construction contracts.
- Do not fund the builder with progress payments unless protected by a bank guarantee and a no-variation contract.

interest only or P&I loan

Interest only loans are normally appropriate for investment property.

Your property does not rise in value if you 'inject' any extra equity into the property.

The money which you would otherwise pay towards the equity loan can be saved and used as deposit monies to purchase more properties.

If you pay P & I, your monthly repayments will be higher, making it more difficult to service the debt.

Should I use a finance broker to arrange my loan

Try to secure the loan yourself.

The process of obtaining a loan will teach you how you can 'do it yourself' in the future. You'll establish your own relationships with key lenders.

He who has most to gain will always do a better job

If you don't have the time or the confidence to obtain your own finance, make sure you engage a broker who has a proven track record.

Make sure the finance broker is a residential property investor.

Ask the broker for a list of references and call them.

should I use a finance broker to arrange my loan

Make sure you obtain a service guarantee from the broker. If they can't obtain the pre-agreed, you pay nothing.

If you do engage the services of a broker, make sure you don't choose based solely on fees. The best don't work for peanuts.

If the broker provides you with the result you want and guarantees their performance, they should get paid a reasonable fee – fees range for 0.5% to 2% of the loan amount.

Don't focus on the brokerage fee, focus on the final result they will provide you. That's the important part.

Should I get a loan through the Internet

In order for you to get the best loan in terms of LVR, interest rate and fees you should see the finance managers of the lending company in person.

If you apply for your loan on the net or on the telephone, a computer will often process your loan.

a. you need to 'sell yourself'

b. you need to tell your story

c. you need to show your knowledge

d. you need to present your research

You can't do this over the Internet or phone.

Use the internet as a research tool only

long term, fixed or variable loan

- Obtain 5 or 10 year, fixed, interest only loans.
- You are running a long-term investment business. You need to know all your potential risks and costs up-front.

- Insure against any potential interest rate rises. Know your worst case scenario. Calculate your cash flow using higher interest rate calculations. The ‘Peace of mind’ is an important aspect of investment. As a professional investor, the last thing you want is to constantly worry about variables you can’t control, and panic every time the Reserve Bank makes interest rate announcement.
- The extra interest cost is a small price to pay to protect against the risk of rising interest rates. It’s the cost of doing business.
- If you want flexibility, fix 70% of your loan and have the other 30% variable.
- Calculate the time it will take you to pay out the 30% so you can be prepared for refinancing.

mortgage insurance

What is mortgage insurance and how much does it cost?

- Mortgage Insurance insures the lender against losses made resulting from a borrower defaulting.
- Mortgage Insurance normally allows you to borrow up to 95% LVR.
- Mortgage insurance does not protect you, it protects the lender, however it enables you to borrow more money and secure the deal.

non-recourse, no personal risk funding

- Non-recourse loans are usually used for large commercial property transactions and do not contain a personal promise to pay.
- The 'deal' is the key to obtaining the loan. The loan depends more on the quality and the financier's risk assessment of the deal, and not on your financials.
- LVR is 50% to 75%
- Speak to a commercial lending manager at the bank or financiers familiar with commercial non-recourse loans.
- It should be easier to obtain Equity or Debt Joint Venture partners, due to the 'low debt leverage'.
- 'Consolidate' multiple properties in your portfolio or purchase multiple properties using non-recourse loans.
- This method of funding may allow you to obtain substantially greater debt funding capacity.
- Because there is no personal liability, you do not have to list the debt as your liability on your balance sheet.

Using this method of finance you may purchase multiple properties with little risk.

the professional loan package

- Borrower can obtain a 90% to 100% LVR without having to obtain mortgage insurance and without the mortgage insurance fees.
- This 'special' loan is usually available to professionals such as doctors, lawyers, architects, teachers, etc.
- If you are a professional who meets this criteria, research several lenders and go over their lending opportunities.

purchase multiple properties with no personal debt risk

- If you have the equity but have limited borrowing capacity or you don't want to incur any 'debt risk', you should purchase all properties using debt partners.
- Find people who will become your joint venture partners (they don't have to put up any money).
- If properly structured, the debt partners may actually be positively geared, due to depreciation and deductibility of interest.
- Your debt partners should be professional with steady income streams and reliable jobs.
- Find debt partners who can obtain 90% LVR loans or have equity in other ASSETS.
- Act as a broker to obtain all necessary funding and equity for the deal.
- Only one property per person will minimize any potential risk.
- Charge a 'small' interest rate to the Joint Venture to obtain cash flow profits.

    a. E.G. $200,000 in equity may purchase a share in one or a number of other properties.

    b. in 5 years time, the properties grew by 50% in value. Your capital gain could be used to buy out your property partners.

    c. you can use a company structure and give a shares to your partners in the properties.

    d. you can use the new equity created to purchase other properties with new partners.

second mortgage funding

- You can borrow money from second mortgage lenders (financiers and solicitors).
- Second mortgage funds take second ranking security after the first mortgagee.
- You can often obtain first and second mortgage funds from the same financier.
- The interest cost is generally +2% above the current lending rate.
- Your expertise is critical to obtaining a lower interest rate.
- The interest may be tax deductible, check with your accountant.
- Borrow the money for 6 months with an option to renew the loan for a further 6 months without any penalties, fix the rate for this period.
- Refinance the second mortgage when the property value rises.
- Perform cosmetic renovations to increase the value of the property quicker.
- If the property is a rental property consider a furniture package to attract a higher rental income and improve cash-flow.

sell option contracts to obtain your equity

- If you purchase multiple properties within a development with an options contract, you may on-sell some of your units to other purchasers without incurring stamp duty or settlement costs.
- You only sell the option contract.
- Sell the option for an amount equal to the equity you require to settle the properties you wish to keep.
- Get the profit immediately after you sell the option. Do not wait for the property to settle.
- Option contracts work well if you are first in a new development in a rising market.
- There must be a high demand in the development for you to profit from this strategy.

target (new) properties sold by private treaty

- Easier to negotiate a better price with a business person than a real estate agent influenced by an emotionally attached vendor.
- Easier to negotiate a lower deposit.
- More likely to understand and accept bank guarantees and deposit bonds.
- Easier to negotiate longer term settlements including vendor finance settlements.
- Huge Stamp Duty Savings.
- Greater depreciation based tax benefits.
- Ability to value-add to the property (re-design) and thus increase the property's value.
- 7-10 year Building Guarantee.
- Opportunity for final quality inspection.
- Opportunity to negotiate VOLUME DISCOUNTS.
- Opportunity to re-sell (trade) the property with lower out-of-pocket costs.
- Easier to obtain 100% finance.

alternative finance strategies

What happens if you can't obtain 100%
first mortgage based finance?

Refinance 'Bridging Funding'.

If you can't get a financier to lend you money using your new valuation price, make sure that you have a refinance offer from the same lender or another financial institution 'running parallel' with your first mortgage deal.

The refinance will happen immediately after the property has been settled. The funds should be loaned against the new valuation price.

If you don't have the equity to settle the property, you may be able to borrow the 'equity' from bridging finance companies.

If you have an Irrevocable Letter of Offer to refinance the property, you may be able to obtain short term bridging finance from financiers or a private investor.

The best party to approach for bridging finance is the existing vendor.

If you pay interest at a rate higher than they would earn from a bank, it costs the vendor nothing to provide you the bridging money, because all you are doing is 'short-settling' the property- (settling less than 100% of the total purchase price).

In many cases, the shortfall will be the vendors profit, as their debt to their bank should have been paid out by your settlement.

Offer the vendor a bonus fee at a higher rate of interest on the bridging finance – up to 15% interest p.a. on the outstanding monies.

The vendor may prefer to wait another 30 to 60 days to get 100% of the money, plus a bonus fee or a higher interest rate, instead of having settlement problems, forcing them to resell the property.

If you have bad credit there are still financiers who will consider lending you money on the right deal (solicitor funds, No-docs lenders etc).

These lenders may lend you 65% to 75% of the valuation price. They will charge you higher fees and interest.

You may be able to obtain the difference required between your first mortgage loan and the purchase price using Second Mortgage Funding or Investor Equity.

If you obtain a non-traditional loan you should ensure that you have a 20% GAP between your purchase price and your valuation price.

The poorer your credit rating, the harder you need to work to get the best deal.

work smarter not harder

If you want to become richer.

If you want to improve your financial position in life and get out of the rat race, there are really only two main ways to do it:

- Work Harder to earn extra money and pay more tax
- Work Smarter and make more effective and more efficient use of your resources.

The following is a case example showing how Bob and sally Rich have learnt to work smarter to reduce the term of their home loans and save tens of thousands of dollars in interest in the process – without making extra repayments.

Not only have they saved thousands in interest, they have also saved thousands in wages and tax.

EXAMPLE

PROFILE
Name: Bob and Sally Rich
Income: $39,000 per year
Home Loan: $100,000
Term of Loan: Reduced from 25 years down to 12 years 7 months
Interest Savings: $93,773

Bob and Sally started with the A $100,000 loan. Their repayments were $908.70 per month.

Instead of the standard 25-year bank loan they originally chose to change to a line of credit facility to reduce their home loan from 25 years down to 12 years 7 months without making extra repayments. Saving 12 years and 3 months.

Bob is a motor mechanic in his forties on an income of $34,000 per annum and his wife Sally works part time and earns $5,000 per year.

Originally, their bank had told them their existing home loan of $100,000 would take them nearly 25 years to pay off. After investigations they realized there were more choices available than they first thought.

Their last home loan statement showed that they had only reduced their home loan by $1,127 in the first 12 months even though they had paid a total of $11,572 in repayments to the bank in that year, a situation they were fed up with and wanted to improve upon.

Some of Bob and Sally's friend were getting ahead quicker because they had been given different advice. they realized if they did not change they could end up poor and waste hard earned money and time unnecessarily.

The Old Way

$39,000.00 income per year x 25 year home loan
= $975,000.00 of earned income to pay out a $100,000 home loan. (Think of all that hard work)

The New Way

$39,000.00 income x 12.7 years = $495,300.00
$39,000.00 income x 12.3 years = $479,700.00 Saved Income

Bob and Sally saved $497,700.00 of working income by paying their home loan out earlier.

NOTE:	*88% of people today are still on this old system.*

Here's what they did to improve their situation…

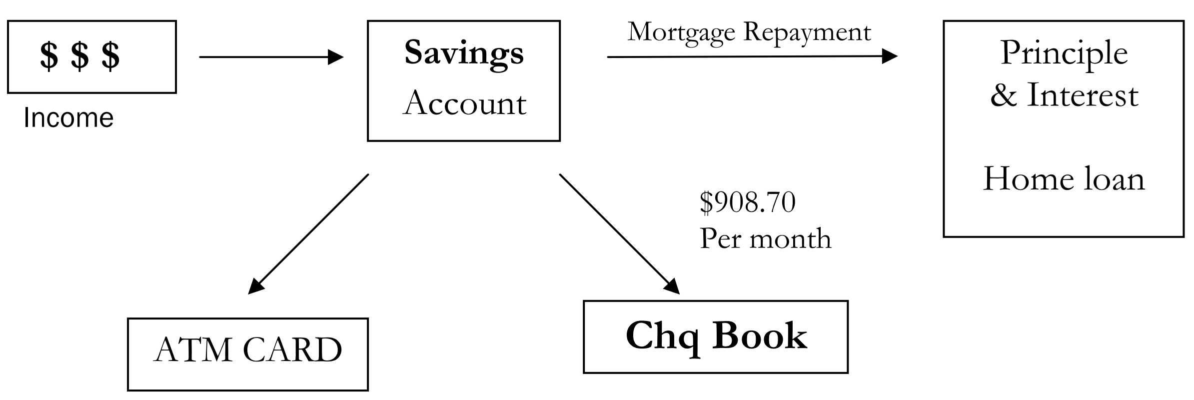
The Old Way

In order to service their original Principle and Interest loan, Bob and Sally – like most Australian families – had structured their finances as advised by their bank, in the same way their mum and dad had, and would probably teach their children the same way.

Bob and Sally's income went into a savings account.

The bank automatically deducted their monthly home loan repayment from their savings account to service their home loan.

The amount left in the savings account was then used for living expenses and the rest of the money stayed in their savings account for "Emergency use" e.g.



work smarter not harder

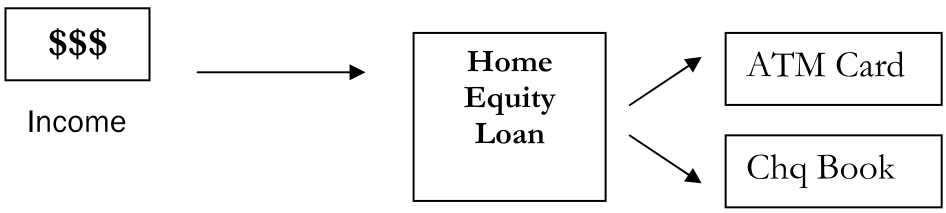
If you are making your home loan repayments in the same way as Bob and Sally were, then you are not making the most efficient use of your money. That's because the money that sits in your savings account for living expenses and "Emergency Use" is dead money as it earns very little interest (around 0.5% - 3%), which in turn is taxed at your marginal rate.

A better alternative

Bob and Sally wanted to work smarter, not harder. They found a type of loan, which helped them to maximise our Key Principle to their advantage, and consequently changed their repayments structure from a P&I loan to Home Equity Loan (also known as a Revolving Line of Credit).

This type of loan enables them to have all their income paid directly into their home loan, thus having the effect of immediately reducing their loan by the amount of income that into it. It also gives them the flexibility to withdraw their money 'at call' without incurring any costs.

Basically, we are talking about a home loan into a day-to-day transaction account with an ATM card and chequebook access, e.g.



When used in conjunction with a personal budget, this method can substantially shorten the term of a home loan because every cent you deposit in your home loan works to save you interest by reducing your Daily Balance.

NOTE: *The more you put in the faster you can reduce and eliminate of your mortgage.*

Let's look at how Bob and Sally's Home Equity Loan worked for them…

Step One:

Jan	1	**Mortgage Owing**		**$100,000.00**
	2	Income Deposited	-	$ 1,200.00
		Mortgage Balance	=	**$ 98,000.00**

Bob and sally Rich took out a Home Equity Loan on the 1st of January for $100,000.00 at an interest rate of 10%. They immediately put their fortnightly income of $1,200 into their home loan – which reduced it down to $98,000. Remember our Key Principle – Interest is calculated on the Daily Balance, So from now on (until they withdraw any money), the interest will be calculated on the daily Balance of $98,000.

Step Two:

Jan	2	Mortgage Owing		$100,000.00
		Income Deposited	-	$ 1,200.00
		Mortgage Balance	=	**$ 98,800.00**
Jan	3	Withdraw Budgeted Weekly Expenses	+	$ 270.00
		Mortgage Balance	=	**$ 99,070.00**

On the 3rd of January, they withdrew $270.00 for their weekly budgeted living expenses and their Home Loan Balance increased to $99,070 – interest is now calculated on this Daily Balance.

Note: *Each time they withdraw money from their home loan, it increases the amount they owe. And whenever they deposit money into their home loan, it decreases the amount they owe.*

Step Three:

Jan	3	Mortgage Balance	=	$99,070.00
		Withdraw Budgeted		
		Weekly Expenses		+ $ 270.00
		Mortgage Balance	**=**	**$99,340.00**
	16	Income Deposited	-	$ 1,200.00
		Mortgage Balance	**=**	**$98,140.00**

On the 10th of January they once again withdrew their weekly expenses of $270, which increased the home loan to $99,340. And on the 16th of January, their regular fortnightly income of $1,200 was deposited into the home loan, which reduced it to $98,140 – and the interest was calculated on this daily balance until the next transaction takes place.

Step Four:

Jan	16	Mortgage Balance	=	$98,140.00
	17	Withdraw Weekly Expenses+		$ 270.00
		Mortgage balance	**=**	**$98,410.00**
Jan	24	Withdraw Weekly Expenses+		$ 270.00
	30	Withdraw Money for Bills+		$ 250.00
		Income Deposited	**-**	**$ 1,200.00**
		Mortgage Balance=		**$97,730.00**
Jan	31	Mortgage Balance=		$97,730.00

The process of income going in and expenses coming out of their home loan continues until the end of the month when the bank deducts $839 in interest from the Rich's Home Equity Loan.

At this stage I need to point out some major characteristics of this type of loan. Firstly, you are only required to make the interest payments in a Home Equity Loan – which is calculated on the fluctuating Daily Balances throughout each month. This is unlike a P&I loan where you are required to make set regular payments.

Secondly, it is the surplus funds left in the Home Equity Loan, which reduces the principle of the loan. As you can see, this couple has decreased the principle of the loan by $1,161 after only the first month – remember on the 1st of January they owed $100,000.00, but by the 31st of January they owe $98,839.00.

This $1,161 "reduction" at the end of January is achieved by: having all their income deposited into their Home Equity Loan, only withdrawing their budgeted living expenses, and leaving all surplus income in the loan. Which instead of sitting in their savings account earning them 0.5-3% interest, their money is now working harder for them by reducing the interest payable on their home loan at the rate of 10% - tax free! Remember saving interest is equivalent to earning interest.

Again, here is what happened in January:

Total Income:		$3,600.00
Total Budgeted Living expenses	-	$1,600.00
Interest deducted	-	$ 839.00
Surplus income for January	+	$1,161.00

Therefore, $100,000 - $1,161 = $98.839.00

(The Home equity loan balance at the end of January).

Let's have a look at what happens in the second month (February)...

February

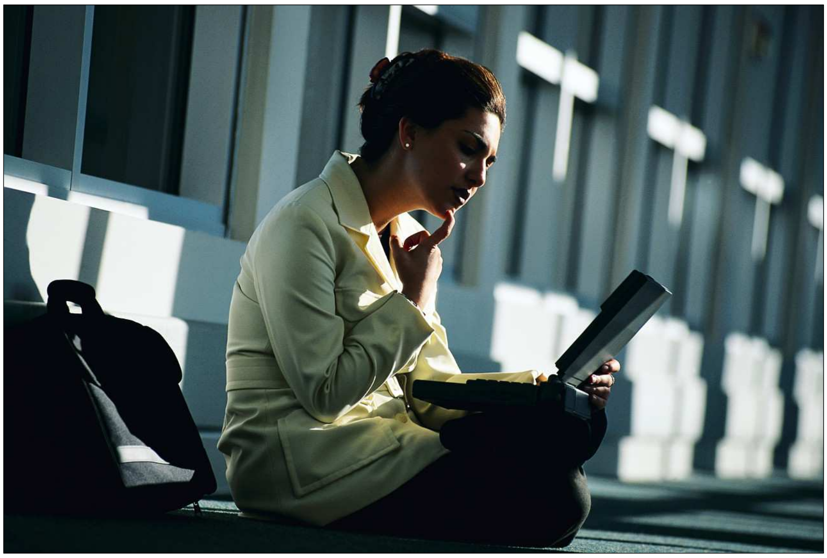
Feb	1	Mortgage Balance	$98,839.00
	7	Withdraw Weekly expenses	$ 270.00
		Mortgage Balance =	**$97,109.00**
Feb	13	Income Deposited	$ 1,200.00
		Mortgage Balance =	**$97,909.00**
Feb	14	Withdraw weekly Expenses	$ 270.00
		Mortgage Balance =	**$98,179.00**

As you can see, by the end of the second month, this couple have reduced their home loan by $1,757 – that's more than they had been able to achieve in the previous year.

What's more, they have not changed their lifestyle and are still living on the same amount of money they were used to.

Although we have only shown the first two month's budget for Bob and Sally Rich, their outgoings do fluctuate due to periodic expenses such as bills for electricity, telephone, gas, etc… By maintaining their current lifestyle and using a Home Equity loan repayments method, Bob and Sally will be able to reduce their 25-year P&I loan to 12 years and 7 months – without making extra repayments.
(Saving 12.3 years: that's a long time!)

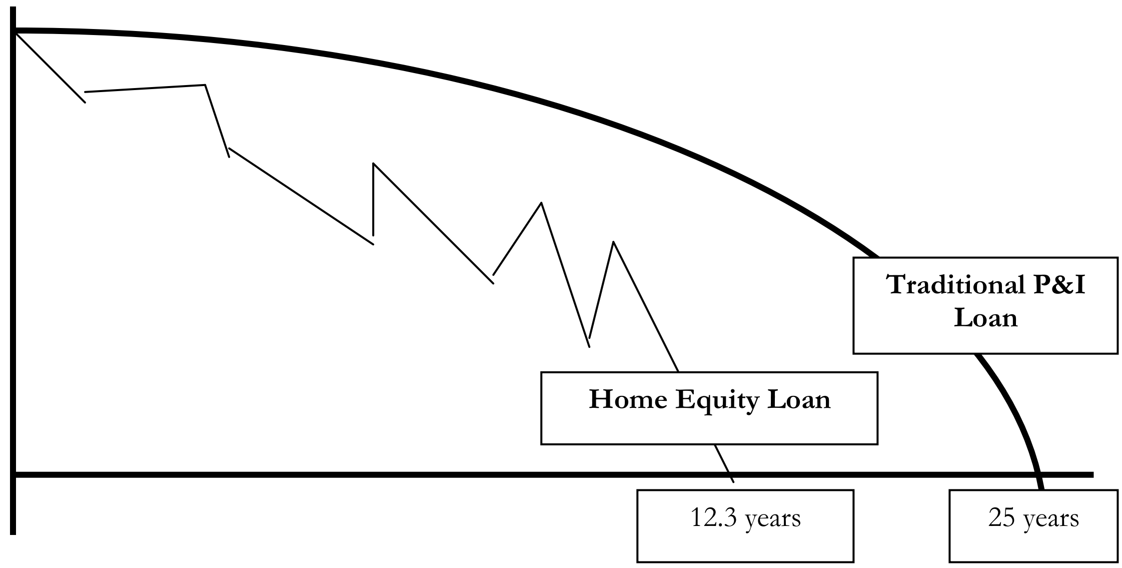
On the following page is a comparison of their original P&I Loan with Home Equity Loan repayment method.



Comparison of Original P&I Loan with Home Equity Loan

After Year	*Loan Balance (Original P & I)*	*Loan Balance (Home Equity Loan)*
1	$99,035	$97,150
2	$98,007	$93,682
3	$96,851	$89,516
4	$95,574	$84,566
5	$94,164	$78,738
6	$92,606	$72,011
7	$90,884	$64,336
8	$88,983	$55,604
9	$86,983	$45,694
10	$84,562	$34,473
11	$81,998	$21,791
12	$79,166	$7,484
13	$76,037	$0
14	$72,581	$0
15	$68,763	$0
16	$64,545	$0
17	$59,885	$0
18	$54,738	$0
19	$49,051	$0
20	$42,769	$0
21	$35,829	$0
22	$28,162	$0
23	$19,693	$0
24	$10,337	$0
25	$0	$0

The flexibility of a Home Equity Loan



A Home Equity Loan gives you the flexibility to withdraw your money up to the original amount of the loan or, to leave these funds in the home loan to pay off sooner.

Important

The amount by which your home loan can be reduced using this repayment method will depend on three things:

- The size of your home loan – which will dictate the amount of interest you, will be charged each month.
- The size of your income.
- The amount of living expenses you have and how often you withdraw money for them.

The key to saving money is that interest is calculated on the Daily balance – so you want to aim at having as much money as you can sitting in your home loan for as long as you can – thereby reducing the amount of interest you have to pay.

However, even if you were to spend all your surplus funds and only leave in the Home equity Loan the repayment amount you are currently making towards your existing loan, you would still pay your home loan off sooner and save interest using this type of loan. That's because for the days that you have not withdrawn all your money, the interest charged will be less. Even leaving your money in the home loan for just a few days each month can have a substantial effect of saving you interest, and reducing the overall term of you home loan.

About Equity

This type of loan is called a Home Equity Loan because it allows you to borrow against the 'equity' in your home – which is the percentage of your home that you actually own.

For example, if your home is worth $100,000 and you still owe the bank $70,000, then you have $30,000 (30%) equity in your home.

The formula the bank uses to calculate what percentage of equity you have in your home is worked out as follows:

$$\left(1 - \frac{\text{Amount Owed}}{\text{Value Of Property}}\right) \times 100 = \text{Percentage Of Property}$$

Working the amount of equity you have is important because to qualify for a Home Equity Loan, you will need to have at least 10% equity in your home.

However, if you are a first home buyer and you have at least 5% deposit/equity then you can qualify for a similar type of home loan.

> Note: This type of loan can work for the majority, however all strategies require discipline. If you have a genuine desire to get ahead financially you may need to look at your current spending habits and identify where you can improve and stop the wastage. Every time you buy something should ask yourself "do I need this" or "do I want it" and could I go without it to improve my current financial position…

Summary

There are two ways to get ahead in life – work harder, or work smarter. Unfortunately, most people have been trained to think that the only way to pay off their home loan earlier is to work harder; this is a thought process that poor and middle class Australia has become used to.

work smarter not harder

There are certain types of home loans available to borrowers that enable them to have their money work smarter for them, thereby allowing them to cut years off their home loan and save tens of thousands of dollars in interest, without having to make extra repayments. Rich or wealthy people adopt different strategies with their money.

These loans are commonly called Home Equity Loans (or revolving Lines of Credit). They enable borrowers to have all their income deposited into their home loan, and withdraw their living expenses as required, at call.

In effect, this transforms a home loan into a day-to-day transaction account enabling borrowers to take full advantage of our Key Principle. That's because now, every dollar that is left in the home loan reduces the Daily Balance of the loan, thereby reducing the amount of interest charged. As your home loan decreases your equity position increases. Later on we will see if you can use this increased equity for greater gearing.

Spending Habits

Attached is a spending habit sheet. I designed this sheet so you can identify what your habit of spending money is over a 30-day period. Maybe you need more than one sheet if you have many transactions - however please spend the next 30 days without changing your habits and write down everything you spend, i.e.: petrol, clothes, car tolls, lollies, cappuccino's, lunches, cigarettes, alcohol, sport, home loan, credit card etc... Add these amounts in the 1st column on the right (cost). Next go through and write down the 2nd column the luxuries, e.g., cigarettes, alcohol, cappuccinos, lunches, etc, etc. An extra column has been added to keep an eye on GST payments.

In summary this simple system is a powerful way of showing how much of your hard earned money is working for you and where it is going. The major difference between rich and poor people is how they spend or manage money. All we need to do in taking the first step towards being richer is redirect our funds smarter. (How much are you wasting)?

There is no doubt that the first steps ahead are best taken when you truly know and understand your starting point. It is of major importance that you know exactly how much you are worth today so you can plan the best strategy ahead to get "you" where "you" want to be. Remember that if you want to change, you must make the necessary changes, because if you go back to your old habits, then all the work and effort will be of no use. I think its like going on a diet. You change your exercise routine and eating habits, lose weight, look good, feel good, get great compliments and then go back to the old ways. Guess what the result is?

work smarter not harder

Monthly Spending Habits:

Day:	Description:	Cost:	Luxury:	G.S.T:
	TOTALS:			

What is meant by finance due diligence?

What is LVR?

Have you done an assets and liability form and if not construct one now.

Ask your accountant or financial advisor for a financial plan and assistance.

What is co-guarantor funding?

Explain 3 ways you can get money if you don't have enough.

Explain 3 ways you can pay your loans down faster.

List 3 types of finance packages that would suite your needs from reading this module

List 3 ways you can work smarter after reading this module