NEXT HOME BUYER MANUAL

SEVEN STRATEGIES FOR BUYING YOUR NEXT HOME IN NSW

Strategy 3. Bridging finance

JR MORTGAGES

John Ruddick's seven strategies for buying your next home in NSW.

Strategy 3. Bridging finance

PREFACE

If you need to borrow money to buy a residential property in New South Wales, I want to be your mortgage broker.

This manual is written for those of you who are 'next home buyers' in NSW. That is, you currently own a property, and want to buy your next owner-occupied property.

You may be selling your existing home, or retaining it as an investment property. But in either case, this manual assumes you need to borrow money for that 'next home' purchase.

There are countless reasons why you might want to move home. Your family may be growing—or shrinking. Your financial circumstances may have changed. You may want to live closer to a school or workplace. Or you might simply want a change of scenery or new neighbours.

Next home buying is the most common property transaction. But the process does have some complexity, and without a clear strategy it can become a frustrating experience.

This manual spells out the process, along with the advantages and disadvantages of seven different strategies to buying your next home. Adopting the right strategy helps eliminate risk and increases your chances of buying the right property at a good price—and with less stress.

Every individual and every mortgage application is unique. Since 2001 my passion has been to help borrowers properly structure their mortgage debt and, just as importantly, help them understand the strategy behind the structure.

A good way to start is to contact my office and make an appointment to discuss your circumstances. Even if you think you won't be buying for a year or more, it's still worth having a general discussion now.

The first step is to map out a plan, and then get pre-approval for finance around that plan. Once the finance is in place, you can begin the journey from your current home to your new home.

To apply for pre-approval, you can either contact a lender directly or speak to a mortgage broker. In recent years, more than half of all Australian mortgages have been taken out with the help of mortgage brokers.

Being a broker means I'm a mortgage specialist who can introduce you to products from many lenders, including all the major banks. And, like most mortgage brokers, I typically won't charge you any fees.

Feel free to get in touch with me:

- by phone: (02) 9955 1176 or 0412 129512
- by email: john@jrhl.com
- at my office: 10/50 Margaret Street Sydney NSW 2000.

Sound preparation

Over the years I've worked closely with several hundred next home buyers. And in that time I've learned that following these guidelines will put you in a much stronger position.

- Wear out some shoe leather looking at properties in the suburbs you‘re thinking of buying in. The more you look, the sharper you eye will be, and the better you can gauge a fair value for a property.
- Make sure you haven't been late for any mortgage repayments in the past year. If you have, it will make lenders more hesitant in approving your next mortgage.
- If you need to sell your existing property, it's important to get the best possible sale price. It may be worth getting quotes on what improvements you can make to increase its value, and what they will cost. Putting in a new bathroom, a new kitchen or even some new carpet or paint may increase your home's sale price by more than what you spend. And if you're planning to convert your existing home into an investment property, these improvements will probably increase your rental return.
- Think about the timing of your sale. The property market is typically busier in spring and summer than in winter. But that is not always the case—the winter of 2015 was as busy as any spring.
- If you're selling and buying, be selective about the conveyancer/lawyer you engage. The transaction will be more complicated than when you bought your first home, and so will require more sound legal advice.
- When you bought your first home, you probably dealt with the vendor's real estate agent. But if you're going to sell your current property you need to choose your own real estate agent. It's worthwhile inviting three or four agents around so you can discuss your plans and see which one is best suited to sell your property. While experience is usually a positive attribute, agents with less experience can sometimes bring more enthusiasm to the sales process and deliver a better result.

> Every person who invests in well-selected real estate in a growing section of a prosperous community adopts the surest and safest method of becoming independent, for real estate is the basis of wealth.
>
> **Theodore Roosevelt**

STRATEGY 3

Bridging finance

Imagine someone owns their home, and intends to sell it to help buy their next home. But before exchanging contracts to sell their current home, they find their perfect next home and simply must have it. They now want to exchange contracts to buy it, even though they haven't sold their current home. Can they do it?

Possibly yes, with bridging finance.

With bridging finance, their lender will loan up to the entire purchase price plus stamp duty, etc. for their new home.

Bridging finance is becoming less popular with lenders, and they're making it harder to be approved for this type of finance. Generally, bridging finance is only needed due to poor planning, and should be avoided. However, in some circumstances it can be justified.

Let's say Yuko's home is worth $800,000, and she owes the XYZ Bank $200,000. She's been thinking about buying a more expensive home for some time, but recognises that to do so she'd need money from the sale of her existing home.

One Saturday morning she walks past an 'Open for Inspection' for the property she always thought was perfect for her. The real estate agent tells her the property will sell for $1,400,000, and that the auction is in just two weeks.

Yuko decides to drop everything and get the finance approved ASAP so she can exchange contracts to buy the property. She comes into my office later that morning, where I tell her she can't exchange contracts on this purchase until she has an unconditional loan approval to do so. And the only way to get that unconditional approval (without an exchanged contract on her existing property) is with bridging finance.

Bridging finance will let Yuko borrow the entire purchase price and associated costs. But she must agree to sell her existing property as soon as possible, and use the money from the sale (minus the mortgage on the existing property) to pay down the new debt she used to buy the new property.

There are two key terms with bridging finance—'PEAK DEBT' and 'END DEBT'.

The 'peak debt' consists of the existing debt plus the loan used to buy the next home. In Yuko's case it's $200,000 + $1,465,000 … or $1,665,000 in total.

Yuko's peak debt is secured by two properties—her former home (worth $800,000) and her new home (worth $1,400,000). So the value of the properties securing the $1,665,000 debt is $2,200,000. When Yuko sells her former home for $800,000, pays the selling costs of around $20,000, and repays her $200,000 loan to XYZ Bank, she'll have $580,000 in cash.

XYZ Bank will insist she use that money to reduce the peak debt to $1,085,000. This amount of $1,085,000 is referred to as the 'end debt', and will be the ongoing mortgage.

So why do lenders dislike bridging finance? Because there's more opportunity for something to go wrong.

Once Yuko has settled on her new purchase, she'll have a debt of $1,665,000 that is accruing interest every day. Yuko doesn't want to lease her former home to a tenant to help pay the high interest repayments because it could deter potential buyers. XYZ Bank has given her a deadline to sell her former home, and if it isn't sold within that timeframe (usually between three and six months), the interest rate will rise significantly.

So Yuko is now under pressure to sell her former home … and bad luck seems to follow owners who have to sell their property quickly. The property market could go quiet, or a major dramatic event (such as a financial crisis or national convulsion) could come out of nowhere. Either way, that means fewer property buyers, and anyone who does want to buy her property may offer less than what Yuko assumed it was worth. The fact that she *has* to sell could also reach the market and attract the vultures.

For these reasons, some lenders simply don't offer bridging finance anymore. And those who do insist on the borrower having a particularly large amount of equity in their current home so the 'end debt' will be manageable even if the property market does decline. Some lenders even insist they must have sufficient income to afford 'peak debt' repayments, which requires a very high income.

Upsides

- You can buy a property before selling your existing property.
- You have up to six months to sell your former home before being heavily penalised.

Downsides

- You'll be paying interest on the 'peak 'debt'.
- You'll be under pressure to sell.
- It may well lead to a lot of sleepless nights.

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