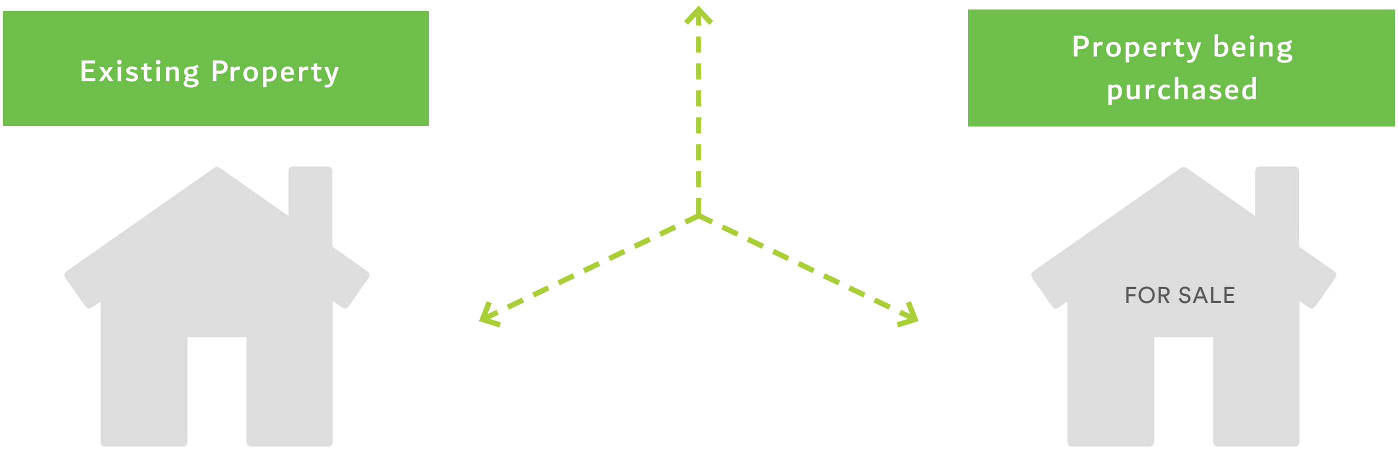
Cross Securitisation/Cross Collateralisation

Cross-securitisation, when used in the property sense, is when you effectively join 2 or more properties together to create one aggregate security for a loan to be secured against. In other words, it's the process of securing one loan against 2 or more properties. The main reason people choose cross-securitisation is usually because there is not enough equity in one of the properties to secure the loan. For example, if you're wanting to borrow $840k, and have an existing property worth $800k, plus are purchasing a property for $800k, there won't be enough equity to borrow the amount against 1 property on its own (it would be borrowing 105%), so you can look at the 2 properties together to give a total security value of $1.6mil. Some lenders also suggest this structure as a way of mitigating risk, or keeping the customer more "sticky" (i.e. makes it harder for them to refinance).

Below is an example of an $800k purchase using cross collateralisation

$840,000 Loan



Value of existing property - $800,000

Purchase Price $800,000

Purchase Price - $800,000	*Client Deposit (savings) - $0*
Stamp Duty & Solicitors Fees - $40,000	*Total Loan Required - $840,000*

Benefits of cross securitisation

You can avoid mortgage insurance if the total loan is less than 80% of the value of both properties

You can get greater tax deductibility if purchasing an investment, as the entire loan can be tax deductible

Your loans may be more manageable or easier to account for if you have one $840k loan as opposed to 2 loans (see next page)

You may have access to better rates as your overall loan size will be larger with the one bank

Disadvantages of cross securitisation

If mortgage insurance is payable (i.e. the loan is over 80%), the amount can be significantly higher as overall loan size is much larger

The bank can have greater control over your properties which can make it harder to refinance

The property values rely on each other which can make it difficult to use equity for future purchases

In most cases you are restricted to one lender, which means one set of rates, policies, features, etc.

At Peasy, our default position would be to avoid cross securitisation wherever possible although it's not always possible. See the next page for another way you can purchase a property using equity in an existing property

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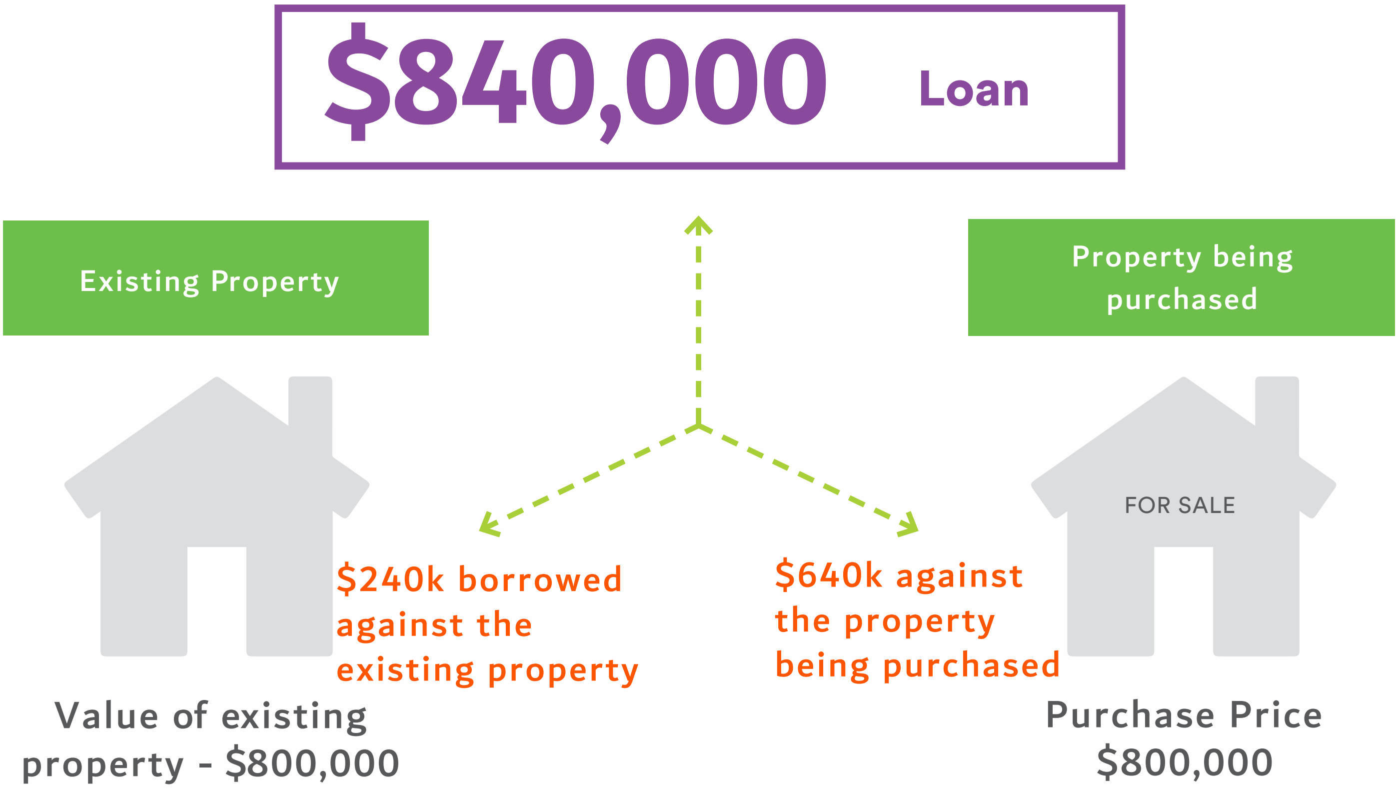
Extracting equity for another purchase

Much the same as cross-securitisation, extracting equity for an investment purchase is about using the equity in an existing property to reduce the overall loan to value ratio (LVR). The key difference is that where cross-securitisation is usually one loan against multiple properties, extracting equity is done by increasing the existing loan and using this for a deposit of the purchase. In the case where you have an $800k purchase, to keep the loan under 80% and avoid lenders' mortgage insurance, you would need 20% of the property value plus costs (approx $240k). If you have an existing property with enough equity, you could borrow this amount which would negate the requirement of using savings.

Below is an example of an $800k using the equity extraction method



Purchase Price - $800,000	*Client Deposit (savings) - $0*
Stamp Duty & Solicitors Fees - $40,000	*Total Loan Required - $840,000*

Benefits of equity extraction

You can avoid mortgage insurance if the total loan is less than 80% of the value of both properties

You can get greater tax deductibility if purchasing an investment, as the entire loan can be tax deductible

You can use separate lenders for the purchase and the existing property which can give better borrowing conditions.

Keeping the properties separate means you have more control over your properties which could include selling or refinancing in future

Disadvantages of equity extraction

If the lender charges application fees, there may be 2 fees for the increase and the purchase, as opposed to one if cross collateralising

Some lenders insist on cross collateralisation for certain transactions (e.g. family guarantee or commercial properties)

There is a little more paperwork required due to the 2nd application

Some people may prefer the accounts to appear "cleaner" and just have the existing loan plus the purchase loan