ASK AN EXPERT

ONE POTATO, TWO POTATO, THREE POTATO, MORE!

BY W. RICK HARRIS, REIA

How to Use Existing Equity from Your Investment Rental Property to Get Your Investment Portfolio to Grow

When most folks find out I have investment real estate, the first question they ask is: "How did you get started?" The next questions are: "How many investment properties do you own, and how did you source funding to purchase more than one investment property?"

There are no definitive guidelines for using equity from your existing rental properties; each lending institution has its own rules as to how it will handle lending funds to you based on the equity that has grown in your existing rental property or properties. A general qualification requirement is that you are able to make the minimum down payment on your investment real estate. You should be able to qualify for the same mortgage rates and terms you would normally receive on a principal residence mortgage, including fixed, variable, and adjustable rates.

One thing to note: Some smaller financial lenders will not offer investment real estate mortgages unless you live in one of the units. You will also find that working with a smaller lender can cost you a premium in your mortgage rate.

For many of us, purchasing our first investment property is easier than the second and third property, and beyond. When my wife and I purchased our first investment property, we used the equity from our principal residence. This strategy of using equity from a rental property is really no different from using equity from your principal residence.

Can you use equity in your existing investment real estate to make purchasing other investment properties possible? The answer is yes. My wife and I have done this. The three methods we used at different times to access equity from our investment rental properties are a blended mortgage, a Mortgage Cash Account (MCA), and a new mortgage. I will explain these methods a little further in this article.

In the beginning when we purchased our first investment property, we were cautious about how we were handling the financing. To control our expenses, we went with a fixed rate and a five-year term. At the time, we didn't even think we would grow enough equity over the first five years of ownership to have any equity funds to access—we were wrong. These days, we're seeing similar properties around ours selling for a lot more money than we originally paid. Our equity was growing at a faster rate than we had anticipated, and the cost to access it was also on the rise.

Blended Mortgage

The bank was happy to remortgage our investment property, as we were borrowing more money, but it came at a cost. That is what's called a blended mortgage: combining a mortgage to include the balance of your existing mortgage and the amount of a new mortgage. With interest rates on the rise, and our desire to access more funds, you can understand why the bank did not have an issue in giving us a blended mortgage.

Mortgage Cash Account (MCA)

Rather than looking to add more costs that would come with doing a new mortgage, we found (through no skill or knowledge on our part) that we'd signed with a bank that had given us a mortgage with a Mortgage Cash Account option. We weren't sure what a MCA was, but our bank was happy to explain when we asked. This is the gist of what we were told:

- Your MCA represents money you've put toward accelerating your mortgage payments. This means that any additional payments or additional principal payments you make contribute to your MCA. For example, the bank calculates my repayment plan based on semi-monthly payments, but I chose a biweekly plan to match with my pay schedule. This means that every year I'm making two additional payments (52 weeks / 2 = 26 payments versus 24 semi-monthly payments) toward my MCA.
- Your MCA isn't a physical account, in the sense that there's no separate account number associated with it. It is simply a virtual account that keeps track of how much you've overpaid your mortgage (based on the original amortization plan).
- You can access these funds at any time and add the amount back on to your mortgage balance. Most banks set a minimum amount of $2,500 before you can access the funds.

New Mortgage

The third method my wife and I have used to access equity in our rental property involved waiting for our mortgage term to expire and then getting the property appraised. With principal paydown over five years and investment property appreciation, we were able to get a new mortgage and access additional funds from the rental property's equity. Over the five-year term, we also had some rental increases. Even if we ended up with a higher mortgage payment when borrowing more funds from this equity growth, we could offset the higher mortgage payments with the increase in rental income.

Of the three options I've outlined for accessing existing equity in your rental properties to purchase more investment properties, there will be one that will allow you to sleep at night and that will take away any of your nervousness.

In the next issue, I will discuss how to use equity growth funding to complete renovations and grow the value of your investment real estate portfolio.

W. Rick Harris, REIA, an active real estate investor since 2002, has developed his purchasing strategies and processes specializing in vacation and recreational properties, single-family homes, and condo rentals.