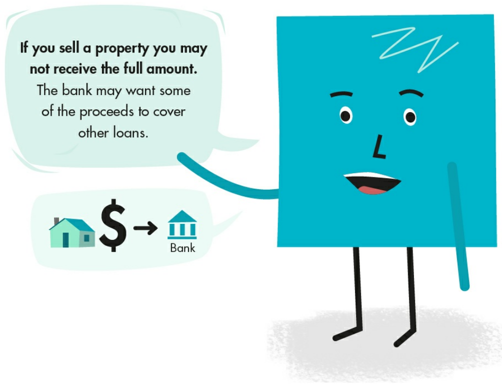
Freeing up capital

If you've got several mortgaged properties and sell one to free up capital, you won't necessarily keep all the proceeds from the sale after clearing the home loan.



When you sell a property with a mortgage, you can usually keep whatever money is left after repaying the bank loan (unless, of course, you transfer the loan to another property you've bought). Things are less straightforward, however, if the mortgage acts as security over more than one loan. In that situation, banks won't automatically let you keep the entire balance. That's a source of complaints, as this guide explains.

Existing and future lending

Most mortgages are what's called an "all obligations" mortgage. This means the mortgage secures all money the property owner may owe the bank, both now and in the future. The result is that it enables the bank to require you to divert the balance on the property you've sold towards reducing the amount owed on other loans.

For example, you have two properties. Property A has a mortgage of $300,000 and property B a mortgage of $600,000. Property A sells for $400,000. You want to repay the $300,000 and keep the $100,000.The bank, however, makes you put the $100,000 sale proceeds towards reducing your loan on property B from $600,000 to $500,000.The reason is that it must be satisfied property B provides sufficient security for its remaining loan. In this example, property B might have had a market value of $700,000, which the bank did not consider high enough in view of the $600,000 it was owed. This would have made the loan-to-value ratio 87.7 per cent, hence the need to reduce debt with the proceeds from property A.

Other reasons

A bank may have various reasons for directing that some or all of the proceeds from the sale of one property go towards the loan on another. One, as mentioned, is that the loan-to-value ratio may not be satisfactory on the second loan. Others might be that:

- The bank's lending criteria may have changed since it approved your loans (the loan-to-value ratio requirements being a typical example).
- Your financial situation may have changed, affecting your ability to make loan repayments.
- Property values may have fallen.

Before you sell

Talk to your bank first. That way, you'll be fully informed about how much of your borrowing it wants to be repaid. Bear in mind you may have to pay an early repayment charge if the bank makes you reduce your remaining loan and you have to break a fixed rate loan to do so. See also our Quick Guides:

- Early repayment charges
- Complaining about a loan decision
- Loan-to-value lending restrictions

Talk to the bank and get fully informed about how much of your borrowing it wants to be repaid before you sell.