Should you use your home loan to finance your startup?

One of the most accessible options, in many cases, in getting a startup off the ground is mortgaging - or re-mortgaging - a home.

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In the unpredictable world of startup businesses, however, this can be an extremely risky proposition. Bill Rawson, chairman of the Rawson Property Group, shares his insights on the pros and cons of this kind of finance, and gives his opinion on whether the rewards justify the risk.

“'Should I mortgage my home to finance my business' is a question I hear a lot from upwardly-mobile young business people,” Rawson begins, “but it’s not a simple question to answer – there are a lot of aspects to consider.”

Least expensive form of financing

On the positive side, Rawson explains that a mortgage is typically the least expensive form of financing available. “Because a mortgage is a secured loan – the property can be sold by the bank to cover its costs if something goes wrong – you’ll almost always be offered a far lower interest rate than any other type of financing, including a business loan.”

In addition to this, a mortgage is also usually much quicker to secure. “Business loans can be complicated to set up – you need to have comprehensive business plans and forecasts, and be able to convince your bank that your venture is highly likely to succeed. Mortgages, on the other hand, simply require proof that you can afford the monthly installments. That’s a lot easier and faster to provide,” says Rawson.

Negative aspects

Unfortunately, there are also a lot of negative aspects to consider before mortgaging your home to pay for your business. Most of these revolve around what would happen if things go wrong and your business fails.

“Business owners or founders usually structure things so that their business pays monthly loan installments to cover the cost of the mortgage,” explains Rawson. “If the business doesn’t do as well as expected, however, any shortfall will become the homeowner’s responsibility. If they can’t afford the payments either – which is highly likely if their income is derived from the struggling business – they could well face losing not only their new venture, but also their home. For someone just starting out, that’s incredibly difficult to bounce back from.”

Another danger is the temptation to spread the loan repayments over a longer-than-necessary period of time. “A mortgage may be the cheapest form of financing, but interest still adds up over the long term,” says Rawson. “If your business doesn’t pay off the loan as quickly as possible, you could end up paying more in interest than you would have done if you’d chosen a more expensive, yet shorter-termed, loan. It’s a far better idea to aim for your business to repay the mortgage over three or four years at the most – if you don’t think you’ll be able to manage that, mortgaging your home may not be the best idea.”

Other tell-tale signs that you shouldn’t be putting your home up as collateral for your business include an inability to afford potentially increasing interest rates, and a lack of sufficient cash or liquidatable assets within the business to repay the loan and protect your home in an emergency.