PROPERTY INVESTORS GUIDE

Get an investment edge with our Property Investors Guide.

2018 ed.

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INTRODUCTION_

Property investment can be a daunting process. You not only have to deal with agents and negotiate contracts, as well as understand legal jargon, but you also have to know how to best manage your finances and newly acquired asset so that you can make a profitable return.

In fact, many try their hand at property investment and fail, or they never make it past their first property. Why? Well, these individuals often start investing in property without doing enough homework or background research, meaning they lack the knowledge, foresight and careful planning that can make their property investment a success.

However, the good news is that property investment doesn't need to be overwhelming. It can be very lucrative, and it can be life changing in terms of wealth creation. But, you need to invest wisely and understand the market in order to harness the power of property investment. This is where our 'Property Investor's Guide' comes in. This title gives you the opportunity to understand how property investment can work for you by explaining the principals of investment in simple terms.

The Property Investor's Guide defines how property investment is beneficial if you are seeking long-term investment that will enable you to build wealth. You'll learn about the principals of property investment, how these principals can enable you to find the right property for you, your budget and your circumstances, and how you can best manage your property. You will also be introduced to investment property loan types and what taxes and taxation benefits you can expect to encounter as an investor.

On the whole, this title takes the guesswork out of property investment and it makes the process of buying an investment property an easier transaction. As a result, you will feel more confident and you will be more willing to explore your options further and possibly look at starting, or increasing your own property investment portfolio.

So what are you waiting for? Let's see what the world of property investment is all about!

WHY SHOULD I INVEST?_

Property investment allows for wealth generation, it gives many people a real and tangible asset that they can touch and feel, and it brings with it added security for both the investor and their loved ones. Plus, for many investors it allows them to diversify their investment portfolio with relative ease.

However, before you start investing, it is recommended that you know why you are seeking to invest in the first place. This then allows you to set yourself milestones and goals and to get the most out of your investment portfolio. Knowing why you are investing also gives you more drive and conviction to make these milestones and goals a reality. Plus, it dictates to how you invest and to your overall investment strategy. Let's look at six of the most common reasons why people invest in property, so that you can then decide why you're seeking to invest.

1. Increased Security

You may be single, living with your partner or married. You may have young children or a grown family or even ageing parents. No matter what your family circumstances are, investing in property can improve your financial independence. Property investment typically does this by providing you with an asset that could appreciate over time. This means that you are not just relying on your income on a day-to-day basis, but instead, you are making your income work for you and building additional wealth, so that you can then use this to create the lifestyle that you wish to have. Plus, if you need additional funds for any unforeseen circumstances that arise then you can use the equity in your investment property, or even sell it to help you overcome any financial issues.

2. Retirement Savings

Investing in property can give you financial freedom and independence so that you don't have to rely on a government pension when you retire. This is created by:

- Collecting rent from properties that are positively geared where the rent paid is higher that the mortgage repayment due; and
- The selling of investment property at a higher value than the initial purchase price, which is referred to as increased capital value.

3. Increased Income

Owning an investment property can increase your income if your property is positively geared. Positive gearing occurs when the amount of rent you collect is higher than the outgoing cost of the property. The amount you are left with after expenses have been deducted is then added to your existing income so that you earn more. The amount that you'll earn from your investment property depends on the initial cost of the property and how much of the property is under finance, as well as the amount of rent collected and your ongoing costs.

4. Tax Benefits

Basically, your investment property operates like a business. Some expenses are deducted from the amount of revenue earned. In this case, the revenue you earn comes from the rent that you collect. Some charges and costs associated with your investment property are tax deductible, this includes the following:

- Bank charges and fees.
- Government charges - council rates and the emergency services levy etc.
- Service and maintenance charges - gardening, building and equipment repairs etc.
- Accounting and professional fees - estate agent, quality surveyor and bookkeeping.
- Insurances - property and mortgage.
- Advertising costs for tenants.
- Corporate body fees.
- Borrowing fees - stamp duty, brokerage fees, title searches and property valuations.
- Utility charges - water and the connection of any services.

Exceptions to this rule include things like capital improvements, like a renovation expenses of a property. This is why it is important to obtain tax advice from your accountant so you can ascertain what you can and cannot claim before you start carrying out any renovations. If your investment property runs at a loss, you may be able to offset your losses against other income at tax time. This is known as 'negative gearing'. For example, let's say you earned $83,000 last financial year, and you own three investment properties that all ran at a loss of $5,000 each. You would then be able to claim a $15,000 loss at tax time and this would reduce your taxable income to $68,000. In some cases, this can reduce the amount of tax that you pay significantly, especially if your reduced income places you in a lower tax bracket, which means that you paying less tax per dollar.

The Australian Government is currently reviewing 'negative gearing' legislation and may make changes to what investors can and cannot claim as a tax deduction. For more information on changes to negative gearing call the ATO on 13 28 65.

5. Capital Growth

Have you ever looked at historical property prices and noted how much they've changed over time? For instance, in the 70s you could have bought a property in Sydney for $80,000, now the same property could be worth $700,000 or more. The difference between the purchase price and the sale price of a property is referred to as the 'capital growth', where the value of the property has appreciated over time. As a property investor, you will want your purchase price to be the lowest that it can possibly be and the sale price to be as high as it can. This then gives you the most capital gain. For example, the capital growth on the Sydney property we mentioned earlier would be a minimum of $620,000 over the years of ownership.

6. Rental Return

Rental return, also known as rental yield, is typically the amount of rent that you collect expressed as a percentage of your property value. For example, a property purchased for $255,000 and rented for $355 per week would return a rental yield of 7%. In fact, most property professionals recommend that for your investment to be worthwhile, it should produce a rental return of at least 5% per annum. For instance, if the $255,000 property we mentioned earlier was rented for $215 per week then you would be getting a yield of 4.4% pa. Most investment professionals would advise against buying this property, as the return is not high enough for it to be a viable investment.

If you're unsure of how to calculate rental return on a property you are looking at buying, then go online and type 'rental return calculator' into a search engine. This will make your task so much easier.

HOW CAN I CHOOSE THE RIGHT PROPERTY?_

The right investment property will have a high occupancy rate, give you an ongoing rental return and will be appreciating in value. To find a property that can deliver these factors, you need to consider a number of aspects when you are looking to buy. These are as follows:

1. Market Research

You want to buy a property that is an area that has a growing population or is marked for future growth. This will then deliver a higher return on your investment. To find this type of property you need to firstly consider where you wish to buy and then you need to look at:

- **Historical data** - this allows you to see how property prices have increased. To get your hands on the latest information, visit CoreLogic, PropertyData, Domain.com.au, Realestate.com.au, Residex or the Australian Real Estate Institute.
- **Local, state and federal government plans** - this will give you an indication of what is proposed for an area and just how long before plans will be implemented. To find this information, firstly find out what the regional council area is named in the area you are interested in. Then visit their website. Most local councils and other government organisations have all of their plans for development listed under a 'community' tab or something similar.
- **Demographics** - the median age, marital status, average earnings and the numbers of individuals who are renting. The Australian Bureau of Statistics (ABS) is the best place to find this information.
  Simply visit *www.abs.gov.au/census* and then type the name of your location of interest in the 'QuickStats' search box. For more detailed information, click on the 'Community Profiles' icon and then type in your location of interest in the search box.

2. Location

Where the property is located will dictate the amount of rent that you can collect and how high your occupancy rate is. A good investment property is one that appeals to tenants. Therefore, when you go in search of the right property, you need to think like a tenant, not as an investor. For instance, not all tenants have cars, so your property should be near public transport. Let's explore this in greater detail.

The general rule of thumb when it comes to buying an investment property is that the majority of tenants want everything at their fingertips. This means finding an investment property that has the following attributes:

- Close to public transport.
- Near shops, medical facilities and amenities, such as parks, libraries and the post office.
- A short distance from restaurants, cafes and beaches.
- Schools and other educational facilities are not far away.

Another consideration, in terms of location, is manufacturing and industry. Know how many major employers there are in an area. You want multiple industries, not just one such as mining. Why? Well, a single industry typically has a predetermined longevity and this means that after this time has expired, it is highly likely that the industry will finish-up and will no-longer employ staff. If this happens then usually population numbers dwindle, as people move on to other locations in order to find work.

A drop in population can spell disaster for an investment property. Occupancy rates decrease as there is no longer as much demand for the rental property. Rental prices typically fall as more properties are now available to rent. Plus, the value of your property will often depreciate as there is no longer a demand for homes in the area.

3. Property Type

Depending on your financial circumstances and on your investment goals, there are many different types of property that are suitable for investment. These are as follows:

- **Established** - These are older properties that tend to be located in more sought after areas that are situated closer to central business districts. These properties also come with added value such as pools, landscaping and designer fixtures and fittings. These extras can add more resale value to a property and drive-up demand. Plus, you can ask for a higher rental fee.
- **New** - Newly built homes are often more attractive to potential tenants. They have compact, easy to manage yards, and more luxurious living. They also attract higher levels of depreciation as the fixtures and fittings in the property are new, which means you can claim the full amount of each item over its life expectancy, and this then reduces your taxable income. These properties tend to be located in outer city suburbs and regional areas of growth where more affordable living is often available.
- **House** - This type of property is a bigger home with 2, 3, 4 or more bedrooms with a yard. A house is normally more expensive to buy and maintain, but they can accommodate larger families, give you higher rental yields and, at times, higher occupancy rates.
- **Unit** - A smaller, more compact home that usually has 1, 2 and 3 bedrooms with a courtyard. These are a cheaper investment option, in most cases, and can be highly sought after if located near universities and other student orientated venues.
- **Residential** - Houses, home units, flats, townhouses and other dwellings that individuals and families rent as their home. The initial buying cost is affordable for most investors and capital value rises and falls depending on housing market conditions. Residential leasing terms and conditions, as well as laws, differ to commercial or business property.
- **Commercial** - Offices, warehouses and shops that businesses lease. These types of investments can be more expensive and are affordable for some investors, but the overheads can be less, due to how leasing terms and laws are structured.

4. Investment Purpose

Another important consideration when buying an investment property is the suitability of the property for its intended purpose. Consider who will be renting the property and what they do or don't need to have. For instance, you don't want to buy a property in a mining region for workers, which is fitted with white carpets and expensive fixtures and fittings, otherwise it is highly likely that you'll be paying more to replace items within the house. Buy smartly, so you can make the most amount of profit.

5. Financing Ability

Your ability to gain finance is often referred to as your borrowing power. Your borrowing power is enhanced by your ability to repay any proposed loan. Your gross income if single or your combined annual income if you have a partner and your expenses and other loan commitments as well as the number of dependants you have all play a considerable part in how much you can borrow. Basically, the general ruling is the higher your disposable income and assets the better your borrowing power. Debt also includes child support payments, HECS liabilities, credit cards and other lines of credit.

6. Cash Flow

Cash flow is based on the amount of rent you collect and, the cost of your mortgage and other outgoing expenses. Successful property investors will try to make sure that their cash flow is as high as possible.

HOW DO I MANAGE MY INVESTMENT PROPERTY?_

When it comes to property investment management you have two choices, you can either manage the property yourself or you can hire a property manager. If you manage the property yourself, then you need to be well organised and up-to-date with laws and legislation. However, if you elect to hire a property manager, then you need to make sure you can communicate well with this person and that they have a good tenant database, can screen and interview tenants and can conduct routine inspections. Let's look at both of these options further.

Managing Your Property

Property managing can be time consuming, especially if you have more than one or two properties. You also need to have good communication skills, patience and be confident. If you're thinking of managing the property yourself, consider these points before you get started:

1. Finding Tenants

The best way to find suitable tenants is to advertise in the local paper or to list your property on websites, such as Gumtree, Domain or Rent.com.au. This will allow you to keep within budget, have direct contact with your target market and allows you to screen your prospective tenants before you meet in person. A good property advertisement should list the basic property details - the number of rooms, bathrooms and car parking spaces - as well as any special features such as a pool. You also need to include the rental price, property location and your contact number. Once you've placed the ad, you then need to be prepared to answer calls and to make yourself available to answer questions and possibly show people around the property. You will need to be confident conducting interviews and discussing your rental terms and conditions with prospective tenants.

2. Collecting the Bond and Rent

Before you find the right tenant for your property you'll need to decide on how you want your bond and rent paid. Your tenant can make cash payments to you in person at your home, or you can call around to collect the rent, as long as you specify a day and time to do so and that this is the same each visit. Alternatively, your tenant can post you a cheque before the date that rent payment falls due or directly deposit the funds into your bank account via an automated payment authority. The choice is entirely yours and the method of payment should be easy and convenient for both you and your tenant.

The bond on a rental property is typically 4-weeks rent and it is acceptable for you to ask for 2-weeks rent in advance, under current legislation. However, you'll need to discuss these terms with your tenant so that they fully understand how much they will need to pay you when signing their rental agreement and collecting the keys.

3. Adhering to Laws

Residential property laws are complex and ever changing. Therefore, it is recommended that you check legislation prior to renting your property, and regularly thereafter. The basic rules when leasing a residential property are as follows:

- The bond should be equivalent to 4-weeks rent for properties rent at $250 per week, and equivalent to 6-weeks rent for property rent at over $250 per week.
- You can ask for 2-weeks rent in advance.
- You must give your tenant notice before you visit the property.
- Bonds must be lodged with 7-days of collection with Consumer & Business Services or the equivalent government body in the state the property is located in.
- All bond lodgements and refund forms, and other useful landlord forms and information can be found online at the Consumer & Business Services or the equivalent government body in the state the property is located in.

Overall, your tenant is entitled to live in comfort, peace and in privacy. This means as a landlord you have limited rights. To ensure that you adhere to these rights, please visit the state government Residential Tenancies Authority in the state where your investment property is situated. Here you will find numerous fact and information sheets and other forms that you can download.

4. Managing Repairs and Property Maintenance

Typically, when a problem arises with an investment property the tenant will contact you. At this time, arrange to meet your tenant at the property so that you can assess the problem and then arrange for repairs to be carried out.

When it comes to property maintenance, such as painting and general garden care, then you will need to arrange times that are suitable with the tenant for you to visit the property. In most instances, you will need to give 7 to 14 days' written notice of your intentions, before you can enter the property. This can be done via email or SMS.

If you're unsure of whether or not you are cut out to manage your own property or if you don't think you have the necessary skills or the time, then hire a property manager. Overall, a property manager can take the stress out of owning rental property.

Hiring a Property Manager

Finding a good property manager takes time and dedication. You need to not only get on extremely well with each other, but the manager also needs be knowledgeable, ensure the tenant is looked after, and keep all legal documents in order. In addition, your property manager should also ensure that the property is well maintained and the rent is collected on time, every time.

It is also important that the property manager is local. This way they understand the market and are able to set realistic rental prices, as well as find suitable tenants. Your property manager should be a licensed real estate agent. This ensures that they know, understand and adhere to property rental laws. Typically, a high quality property management service will cost you between 6.5 and 8 percent of the rent collected. You can find cheaper services, but just make sure that you are getting value for your money and a full-service for this fee.

A good property manager should carry out the following duties:

- Conduct regular rent reviews.
- Provide you with rental comparisons.
- Conduct regular property inspections.
- Monitor lease dates to reduce vacancy periods.
- Ensure rent is paid on time.
- Pay you your portion of the collected rent.
- Arrange for property maintenance to be carrying out by professionals.
- Know and understand the Residential Tenancies Act.
- Have access to a database of potential tenants if a vacancy presents itself.
- Able to use cost effective methods to find new tenants.
- Have experience screening, interviewing and selecting tenants.
- Conduct final inspections.
- Act professionally on your behalf.
- Have the ability to deal with authorities in relation to bond lodgement, corporate bodies or if any other issues arise with your tenant.

WHAT TYPE OF RETURN CAN I EXPECT ON MY INVESTMENT?_

Property pricing typically follows a 10-year ebb and flow cycle where it increases in value and then decreases and levels out, before increasing all over again. This is why many property investment experts will recommend that you seek to hold an investment property for a minimum of 7 to 10-years. This will allow you maximise your return on investment.

When it comes to investment properties, return on investment (ROI) is generated via capital growth and rental return. Some investors are lucky enough to have both, but in most cases, a property will either have a high capital growth or a high rental return. This is because properties that have a high capital growth are usually situated in more sought after locations, such as near beaches or in the city, therefore they cost more to buy. Whereas properties with a high rental return are usually situated in regional areas or in outer suburbs. Let's look at capital growth and rental return in greater detail, before discussing equity.

Capital Growth

While there may be price dips and plateaus in the property market, you may also experience capital growth. A common strategy to realise capital growth is to buy and hold onto the property for at least 7 to 8 years, this may generate long-term wealth, providing that you buy and sell at the right time for the right price. The costs and risks associated with capital growth are as follows:

Costs

- Buy your investment property when the property market is at its lowest or has stagnated. This will give you better negotiating power so you pay less.
- Sell the property when prices are at their highest and demand for property is high, this will allow you to sell your property for
  the most.
- Properties that have more scope to realise capital growth are generally more expensive to buy.
- Good financial planning and advice is recommended.
- You'll need a financial buffer in place that will cover any unforeseen expenses or events. This should be equivalent to at least 12-months of mortgage repayments for every investment property that you own, so that you reduce your financial risk.

Risks

- Never over-extend yourself financially. Always assess your own ability to repay any proposed loan and have residual cash flow.
- Higher loan repayments may mean that you won't see a return on your investment for a number of years.
- You have to contribute to ongoing costs.
- If interest rates go up too much, too quickly, or you lose your job or a tenant, then you may not be able to afford the property.
- You may have to sell the property when the market has stagnated or is at a low.

Rental Return

Capital growth doesn't often come hand-in-hand with high rental returns. Properties with a higher rental return are generally found in more affordable regional and suburban areas. Some properties can enjoy an above average capital growth due to unique circumstances such as mining or tourism booms. If you are seeking to generate additional income, then a high rental yield property may be a better option.

Costs

- Properties are generally more affordable than those with high capital growth.
- Always review rents annually and raise them accordingly. This will allow you to keep up with inflation and to keep your costs below your profit.
- Make sure you set aside some of the rent collected to cover any unexpected expenses, such as hot water system replacement. This way you'll keep your property in good order and your tenant happy.

Risks

- Risks are reduced when the property pays you more than its associated costs.
- Higher rental return reduces your initial financial outlay. This typically appeals to younger investors and those seeking lower risk.

If you have a mixture of capital growth and rental return properties then you might mitigate the advantages and disadvantages associated with these types of investments, as diversification minimises your risks. Properties that have both strong capital growth and rental return are available, but they are hard to find. Usually, these properties have a feature that can be converted to add value. For example, an outdoor area may be enclosed and lined to create an extra bedroom or a flat that can then be rented separately. Some properties can also be sub-divided to generate greater return.

Equity

Equity is the difference between the amount that you owe on a property and its valued price. For example, let's say you bought a house for $250,000 in 1990 and then had it valued in 2012. The property's value in 2012, was assessed to be $670,000. Over the 23-years of ownership you've paid $210,000 off the property, therefore you have $630,000 in equity.

Properties with strong capital growth, over the term of ownership, will have an increased value in equity. This equity can then be used to purchase other investment properties. Generally speaking, lenders will allow you to use up to 80% of the equity in any given property. Therefore, using the example above, you would be able to access $496,000 of the property's value for investment purposes, if you wished to.

Costs

- Make sure you can afford the higher interest repayments if you elect to use the equity in the property.
- You may have to refinance the property the use the equity. This may mean additional bank fees and charges.

Risks

- There is no guarantee you'll get a return on the equity you've used.
- Property prices can drop and if you've used the equity in your property, then you may find you owe more than the property is worth.
- Interest rates can rise and mortgage repayments can become unaffordable.
- If you use the equity in a property to secure another property's purchase, then this will make it difficult to sell the property that is used as security at a later date. This is because your lender has a vested interest in the property beyond what is owed on the property's mortgage.

WHAT ARE MY INVESTMENT LOAN OPTIONS?_

Investment property loans are similar to home loans in that you can choose from fixed and variable loans, interest only and line of credit loans, as well as split interest loans when it comes to financing options. One of the most popular loans for investment properties is interest only loans, but there are several other options to consider. Let's compare each of these loan types.

Interest Only Loans

You pay just the interest and nothing off the principal of this loan. Most interest only loans are only available for 1 to 5 years.

Advantages

- Monthly repayments are lower than interest and principal loan repayments. This can improve your cash flow and/or borrowing power.
- You may be able to deduct the interest you have paid from your tax if there is a loss from the investment, but you cannot deduct any principal payments.

Disadvantages

- The amount you owe on your loan will not begin to reduce until you start paying more than the Interest being debited to your loan, for example when you sell the property or change your repayments to principal and interest.
- Your interest expense remains relatively static whilst your loan is on an Interest only repayment basis because you are not paying anything off the amount you borrowed.

Principal and Interest Loans

You pay off the principal and the interest of your loan over the term of the loan.

Advantages

- Your Interest expense reduces over time as more of your repayment is paid off the principal.
- You are more likely to reduce the amount that you owe the lender when it comes time to sell the property as you would have paid more off the principal.
- Your level of debt is reduced over time, which will help you build equity even if property prices remain static.

Disadvantages

- Monthly repayments are higher than the equivalent interest only loans.
- You cannot claim the principal paid as a tax deduction.

Line of Credit Loans

If you own a property with equity then you can use this equity to set up a line of credit, which you can then use when and where you need. A line of credit loan allows you to withdraw an amount up to a predetermined credit limit, this is similar to a credit card facility. Interest charges and the repayment you'll need to make are linked to the amount of credit you've used.

Advantages

- You can draw out as much or as little as you like from your account at any given time.
- You can use the money to pay for whatever you want.

Disadvantages

- If not managed properly, a line of credit can be an expensive option.
- If the value of the property with the line of credit falls, then this can mean that you owe more than the property is worth.

Variable Loans

The interest rate of your loan varies with the fluctuations in the mortgage market. Changes in the cost of funds and variations in the cash rate set by the Reserve Bank of Australia are some of the things that influence the interest rate on variable rate loans.

Advantages

- Repayment amounts do not change over the fixed term.
- Standard variable loans come with features - redraw facility, honeymoon rates and additional repayments.

Disadvantages

- Payments rise with interest rates.
- Greater uncertainty on the cost of the your mortgage and your ability to maintain your budget.

Fixed Loans

The interest rate of the loan is fixed for a term of up to 5-years.

Advantages

- Repayment amounts do not change over the fixed term.
- Budgeting is easier.

Disadvantages

- Interest rates won't fall if the official cash rate goes down.
- Additional repayments can be limited.
- Significant 'break costs' may apply if you want to sell the property and payout the loan during the fixed rate period.

TAX AND YOUR INVESTMENT PROPERTY_

Tax Law is a complicated area and you should obtain professional advice when you decide to invest in a property. The three obvious areas you should consider are:

1. Capital Gains Tax

This is a tax that is charged on the profit you make on an investment property at the time of sale. Therefore, capital gains tax is based on the difference between the price you bought your property for, plus anything you've spent on improvements or renovations, and the sale price. Capital gains tax is complicated; therefore, you are advised to seek advice from your accountant prior to selling a property, so you know what you are up for.

2. Negative Gearing

This occurs when the annual costs of your property are more than you are collecting in rent. Therefore, costs, such as mortgage repayments, property repairs and maintenance are higher than your rental income. A negatively geared property then allows you to deduct your losses from your annual income, which means you'll pay less tax. This will only be possible if you have structured your investment and loans correctly.

3. Tax Deductions

Under current legislation, you can claim some your investment property is returning a profit or a loss, you can claim some expenses as tax deductions that relate to your property over its rental term. These expenses may include:

- Cost of borrowing such as loan establishment fees and mortgage insurance.
- Depreciation.
- Stamp duty.
- Legal fees.
- Building and landlord insurance.
- Property management and maintenance.
- Council rates and fees.
- Corporate body fees.
- Utility connections.
- Bank charges and fees.
- Loan Interest.

NOTES_

General advice warning: The advice provided is general advice only as, in preparing it we did not take into account your lending objectives, financial situation or particular needs. Before making a decision on the basis of this advice, you should consider how appropriate the advice is to your particular lending needs, and objectives. Terms and conditions, fees and charges, normal lending criteria apply.

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