Property Investing Guide

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It's Smart to Ask

Why invest in property?

Historically, property has always increased in value over time. While there may be dips and plateaus, if you're in it for the long term, it is generally considered one of the more solid, less volatile forms of investment. Investors tend to like property for its:

- Potential capital growth (increase in value).
- Ongoing rental return.
- Tax benefits.

You don't need a big salary to get started...

Lenders consider the potential rental income you'll get from the property when calculating how much you can borrow.

So property is a viable investment option, whether you've bought before or it's your first time. If you already own your home, and have a reasonable amount of equity in it, you may not need to raise any cash to start investing. Many lenders will let you use that equity as a deposit for the investment property as long as you can comfortably manage the repayments on the loan.

But if you don't already own a property don't be put off. If you have a deposit saved, an investment might be a good way to get into the property market. Instead of getting the grants and concessions that may come with buying a first home, you'll earn a regular return on your investment property.

The return on your investment

As a property investor you can expect to earn two quite distinct types of returns. The first is "capital growth". This is where the value of the property rises over time allowing you to make a profit on the sale of the place. The second type of return is ongoing rental income, which you'll receive from the moment the tenant moves in.

There are a few important points to note about capital growth and rent. Firstly, in order to make capital gains on the property, it will need to rise in value by more than the costs of buying and selling the place. These costs include stamp duty, legal fee and agent's selling commission.

There is a good chance you will make a capital gain if you are prepared to hold onto the property for the long term (around five to seven years). But there are no guarantees when it comes to capital growth especially if you only intend to own the property for a short period.

Rental income on the other hand is far more certain. Once a tenant signs a lease they are committed to paying rent – at least for the duration of the lease term, usually six to 12 months.

The other aspect to consider is that it is unusual for a property to deliver both high rental yields (that's the annual rent as a proportion of the property's market value) and strong capital growth over the same period.

As a general rule, rental properties may earn a strong rental yield accompanied by low capital growth, or they will generate low rental yields offset by healthy capital gains. Inner city locations for instance, typically generate low rental yields though the long term capital growth can be very high. By contrast in some outer suburban and regional areas rental properties tend to earn high rental yields though the long term price appreciation can be very low.

The trade-off between rental yield and capital growth makes it important for you to consider an investment strategy before you even start searching for a property.

There are two types of strategies to consider:

	Capital growth	Rental income
Pros	▪ Big wins in the long term, with some investors doubling their money in a few of years. ▪ The short term losses being greatly exceeded by the long term gains. ▪ The tax relief that comes with *negative gearing**.	▪ Low repayments with more return. ▪ Unlike negative gearing, you won't lose money after each repayment. ▪ Won't need a lot of deposit to invest. ▪ Depending on the area, it can also have potential for capital growth.
Cons	▪ Other investors have over-extended themselves and been forced to sell at a loss. ▪ High loan repayments may see little return or even a loss for a few years.	▪ Profit when you sell might not be as great as it could be for a different type of property or a different location. ▪ Higher cash flow and high *yielding*** properties means that you'll pay higher tax on the income.
Examples	▪ A 2 bedroom inner city unit might cost $650,000 to buy, but attract a rent of around $550 per week - a return, or "yield", of about 4% a year. However after five years the property may have risen in value to $800,000 – giving you capital growth of 23%.	▪ A 2 bedroom unit in the suburbs might cost only $300,000 but will get tenants paying $400 per week - a yearly return of around 6.5%. However after five years the property may only be worth $330,000 – giving you 10% capital growth.

*Negative gearing is when the annual cost of owning your investment is more than your rent return. The federal government offers you some tax breaks when this happens. To find out more go to "Tax and your investment property" on page 7. **The property's "yield" is a measure of its return. Very simply it's the percentage of the annual rent a property generates calculated against its market value. For example, if a property worth $500,000 commands annual rent of $25,000, its rental yield is 5.0%. To best work out your actual 'net' (after expenses) return, you need to calculate the money in your bank account after all costs are sorted.

Additional costs to consider…

When selecting your investment strategy and what you can afford to spend, you should also consider the potential costs of ownership:

- **Interest repayments**
  If you get a variable loan, factor in higher repayments if rates go up.
- **Council rates and strata fees**
  The agent will tell you what these are per quarter but if you're buying an apartment it's a good idea to obtain a strata search so you'll know if there are any big special levies in the pipeline.
- **Repairs**
  If it's a house you'll be up for all the building repairs, but even in a strata block you'll be responsible for repairs to fixtures and fittings and any whitegoods and appliances you include with the flat.
- **Management fees**
  If you have the time and the inclination you can manage the property yourself, but if you get a managing agent count on paying around 7% of the rent.
- **Insurance costs**
  If you purchase a house you'll have to pay building insurance. It's also a good idea to get landlords insurance on either a house or apartment as this covers:
  - Any damage done by a tenant.
  - Your legal liability if a tenant injures themselves. Lost rental income if your tenant moves out without paying.

When doing the sums, factor in vacancy periods when you won't receive rental income. Allow at least four weeks of vacancy each year.

And the risks…

As with any investment there is no guarantee that you will get a healthy return on your property. Property prices can drop and good tenants can be hard to find. Do as much research as you possibly can before buying your investment property.

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Choosing an investment property

One of the great things about investing in property is that you should ideally have no emotional connection to the place you buy. That's quite different from choosing your own home where aspects like a building's character or a charming garden or proximity to friends, family or work can be the main drawcards.

When you're buying as a landlord it should be easier to take a more pragmatic approach to property - and location and the tenant appeal of the place should be two key aspects to consider though this will vary depending on whether you are adopting a capital growth strategy or a rental income strategy.

The main point is to set your emotions to one side in the buying process. Bear in mind that this is a money-making venture, so buy with your head – not your heart.

Capital Growth

If you're looking for a place with potential for capital growth, the experts believe you should aim for a place close to the CBD, because scarcity and demand will ultimately push values up.

Rental Income

On the other hand, if you're looking for a good rental return and a steady cash flow consider buying in the suburbs or regional centres. Prices in these areas tend to be cheaper so you'll get a better rental yield.

In both cases, there are some general things to keep in mind when deciding where to buy:

- Try to avoid places on busy roads or directly under flight paths.
- Waterside suburbs appeal to both renters and future buyers and they tend to at least hold their value.
- Look for locations with access to employment, public transport, schools and shops.
- You don't have to buy somewhere close to where you live but you need to be familiar with the pros and cons of a location.
- Keep an eye on vacancy rates, sales prices and rental rates.
- Look at the interest in the area, the current population growth and the projected population growth.

There are lots of websites out there to help you keep up to date with property market statistics such as RP Data.

Deciding between a unit and a house:

	Unit	House
Pros	▪ They tend to be cheaper and therefore can provide a higher yield. ▪ The upkeep is managed by a strata company and if things go wrong the cost is split between all the strata owners. ▪ They are usually well located and close to amnesties which appeal to investors.	▪ The extra land value can provide a greater chance for capital growth. ▪ There is good chance of finding a tenant as there are lots of families interested in having some extra room. ▪ Able to renovate to add value.
Cons	▪ Strata costs and council fees.	▪ Can be costly to maintain.

Other things to consider when buying an investment property…

- Look for properties with features that will appeal to as many people as possible e.g. second bathroom, balconies or lock up garage.
- Look for a property that will attract more than one segment of the rental market such as singles, couples, professionals, families or retirees. The needs of each segment will vary.
- Renovation and repairs can be costly but it should only be done if you think it will increase the value of the property.
- If the tenant complains about a fixture not working, it will need to be fixed.
- Find out if the place was rented in the past: how much it was rented for, if there were any vacancy periods, how long it was vacant for, and why, and whether there has been a high turnover of tenants.

To find out what is popular in the area you are looking at, talk to local rental agents and ask them about the types of properties in demand.

Choosing an investment loan

Property investment loans are not too different from regular home loans. As with other loans you can choose between:

- **Variable interest rate**
  Here the rate you pay fluctuates typically in line with changes to the official cash rate. This type of loan tends to have a range of flexible features like redraw however as investors can usually claim the loan interest as a tax deduction there isn't much incentive to pay off the loan sooner. So the features of a variable rate loan may not appeal to investors as much as they do to owner occupiers.
- **Fixed rate**
  A fixed rate is often very useful for investors as it provides certainty of repayments. This can be helpful because the rent payments on a property will be fixed during the lease term, and even if market interest rates rise the landlord may not be able to raise the rent until the lease expires. By locking into a fixed interest rate investors have more certainty about the returns from their property and a more manageable cash flow.
- **Split rate**
  Like home owners, an investor can choose to split their loan between fixed and variable rate components.

There are two types of loans that tend to be particularly attractive to investors...

- **Interest only loans**
- **Line of credit loans**

Interest only

With most standard home loans your repayments are made up of interest charges plus a small repayment of the loan balance. In this way you slowly chip away at the original amount borrowed over the term of the loan.

With an interest only loan the principal remains the same. You only have to pay the original amount borrowed when you finally sell the investment property (and hopefully make a profit – or capital gain).

This type of loan is useful for investors because:

- Your monthly repayments are less than they would be if you were to pay off principal as well.
- You can get a tax deduction for the interest payments, but not for principal repayments.
- It makes it easier to calculate the true returns from a property.

Line of credit

If you already own a property, a line of credit offers a way for you to tap into any equity you have built up in that property and, use it as a deposit for your investment property.

This type of loan is useful for investors because:

- A line of credit loan allows you to draw from a fixed amount at any time to pay for any additional expenses.
- It's kind of like a credit card with a big limit but the equity in your home acts as security for the loan.

Your local Aussie broker can help

With so many loan options available it is important to have the loan in place that best suits your needs and investment strategy. That makes it worth speaking with your local Aussie Broker who can compare hundreds of investment loans from our panel of lenders to help find the deal that's right for you.

Tax and your investment property

Investments should always be selected on the basis of the returns generated and how well the investment will help you meet your individual goals. However property investors can tap into some very useful tax benefits. These include the ability to claim a tax deduction for many of the costs of owning a rental property; the tax savings of negative gearing; and the availability of capital gains tax discounts.

Let's take a closer look at how each of these tax benefits can work for investors.

Tax deductions

As a landlord you can normally claim a tax deduction for a wide range of the expenses related to your rental property including interest on the loan. It should be noted that these expenses can usually only be claimed if the property is tenanted or available for rent.

Your tax adviser can give you a clear picture of what you can claim for your personal circumstances. Though in general the following expenses can normally be claimed on tax:

- Advertising for tenants and property management fees.
- Loan interest and ongoing loan fees.
- Council rates, land tax and strata fees.
- Building depreciation plus depreciation of fittings and fixtures like stoves, carpets and hot water heaters.
- Repairs, maintenance, pest control and gardening.
- Building and landlord insurance.
- Stationery, phone costs and any travel to inspect the property.
- Accounting or bookkeeping fees.

The above is not a full list of what you can claim. Always get proper advice from a tax expert before putting in your return.

Negative gearing

"Negative gearing" refers to the situation where the costs of owning your rental property exceed the rental income. The difference, which represents a loss, can normally be offset against your other income like salary and wages.

So, say your income is $60,000 a year but your property costs you $15,000 a year, you'll only need to pay income tax on $45,000.

This way you'll pay less tax, but don't be mistaken, it is still a loss that hopefully will be more than made up for by an increase in the property's value over time. The main advantage of negative gearing is that it makes a rental property much more affordable as the tax savings can be substantial.

Investment properties don't have to be negatively geared. If the rent outweighs the costs of owning the property, it is said to be "positively geared" and you can expect to pay tax on the profit the property generates each year.

Capital gains tax

The time may come when you choose to sell your investment property, and if you make a profit on the sale you are said to have made a "capital gain". This gain is taxable - the profit is added to your regular income in the year you made the sale, and the tax will be determined accordingly. However there are important capital gains tax concessions available to property investors.

Firstly, the cost base used to calculate the capital gain includes the price you paid for the property plus buying and selling costs like stamp duty, legal fees and agent's selling commission. This helps to reduce the profit for tax purposes.

In addition, if you have held onto the property for over 12 months you are entitled to claim a 50% discount on the capital gain at tax time. Put simply, if you made a profit of $100,000 on the sale of the place but you have owned it for over one year, you will only pay tax on a profit of $50,000. This represents a significant saving of tax for investors and it offers a good incentive to own the property for the long term.

Managing your investment

As a property investor you can choose a hands-on approach and manage the property – and the tenant, yourself. Or you can opt to use a professional property manager. It's a decision you need to weigh up carefully because while a DIY approach can be a money saver, there are also important legal responsibilities you must meet as a landlord, and it is critical to get these right.

A professional property manager will usually charge a management fee of 5% to 7% of gross rent though this is normally negotiable. In return for this, the manager will take care of the majority of work involved in running the property. These duties include:

- Advising you of the appropriate rent to charge.
- Securing quality tenants, which involves:
  - Advertising the property to let, organising 'Open for inspection' viewings, taking tenant applications, checking tenant references and interviewing tenants.
  - Drafting a formal lease agreement.
  - Lodging the rental bond with the appropriate agency in your state or territory.
  - Organising a written report from the tenant confirming the condition of the property prior to the start of the lease.
- Collecting rent on a regular basis and chasing up late payments.
- Dealing with tenant requests for property repairs or maintenance.
- Providing monthly and annual statements for your tax return detailing the rent received and the total of associated property costs.

Dealing with difficult tenants including attending any tenancy tribunal hearings on your behalf.

The bottom line is that some investors get a great deal of satisfaction from managing their own rental property. But if you are a first-time investor or you are pressed for time, it can make sense to use a professional property manager. For the management fee that you pay, you'll have the benefit of a hassle-free investment and you won't have to deal directly with your tenants, which is the option many investors prefer.

Why Aussie?

Buying an investment property is an exciting step! As a landlord you'll be building wealth in a proven asset – residential real estate.

Just as it's worth taking the time to choose the right rental property, it's also important to select the loan that helps you make the most of your investment.

That's where Aussie can help.

Meet with your local Aussie Broker

Your local Aussie Broker will compare hundreds of loans from a panel of lenders including the big banks, to find the deal that's right for you.

Aussie can offer:

- A quick and easy service.
- A free mortgage broking appointment.
- Loan recommendations fully personalised to your needs.
- Fully accredited and diploma qualified expert Aussie Brokers.

Or, choose an Aussie loan

Aussie has a great range of loans designed for property investors that let you take advantage of:

- Low rates.
- A wide choice of loan options.
- No hidden fees or charges.
- Flexible loan features.
- Fast application processing.

Choose from up to 19 lenders...*

Award Winning Mortgage Broker

Aussie has won AB+F Mortgage Broker of the Year 6 years' running.^

MORTGAGE BROKER OF THE YEAR 2008 – 2013
AB+F AWARDS WINNER

Talk to Aussie today.

Call 1300 44 55 66 or click here to book your free appointment.

*Not all lenders lend in every state or territory.
^Aussie awarded Mortgage Broker of the Year in 2008, 2009, 2010, 2011, 2012 & 2013 by AB+F Magazine.