The Sydney Morning Herald

Essential Guide to

Financing your Investment Property

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Introduction

There are many myths surrounding property investment. But it is no longer just very wealthy individuals who become property investors. According to the Australian Taxation Office, there are 1.7 million private landlords in Australia. Over a quarter of these own more than one investment property.¹

The largest group of property investors are not on high incomes. In fact, they have a taxable income between $30,001 and $75,000.²

Together, these investors are not just growing their own wealth – they provide 22 per cent of homes for other people (up from 19 per cent a decade earlier).³

Successful property investment centres on having a personal strategy. It is not random, haphazard or uninformed. With reward comes risk, which must be managed intelligently.

We invest in residential property for many reasons:
- Wealth creation
- Retirement planning
- Capital growth
- Tax benefits

The step into residential property investment requires a substantial allocation of resources and usually a sizeable home loan.

Your goals might be long term, such as to fund an independent retirement, or short term, such as seeking capital gain during a housing boom. Generally, however, investors should be prepared to run their investment over a minimum 10-year term. This provides room to ride out the tough times and to see rent rise and capital grow. Tax planning is essential to property investment, and you should also consider obtaining advice from a licensed financial planner to tailor an investment strategy to fit your life situation and attitude to risk.

This booklet will help you on your way, with great tips and helpful calculations. You should, however, do your research, get expert personalised advice and proceed with prudent confidence.

¹ ATO personal tax statistics 2007-08. www.ato.gov.au
² ATO personal tax statistics 2007-08. www.ato.gov.au
³ ABS 2006 Census www.abs.gov.au
Chapter 1 | Get ready to invest!

Well before you even start looking at property you can get a fair estimate of how much money a financial institution will lend you. Look for an online “borrowing power” calculator.

While you can expect a more thorough investigation of your situation when you get around to making an actual home loan application, these calculators are a helpful guide in the early stages of working out what you can afford.

Illustration

**Household income**
- Jo $2500 per month
- Sam $10,000 per month

**Household expenses**
- Car loan $350 per month
- Rent and living expenses of $5000 per month for two adults and one dependent child

**Existing credit**
- Total credit card limit $10,000

**Loan particulars**
- Principal and interest (P&I), variable rate of 7.12% p.a., 30-year term

According to the financial institution presenting this online calculator⁴, Jo and Sam can borrow $410,000. Their monthly repayment will be $2761: see Figure 1.1.

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⁴ INGDirect.com.au
Using equity as a deposit
If you already own property you may be able to use existing equity instead of cash to provide the deposit on your new property acquisition. If you have equity of at least 20% – that is, a loan-to-value ratio (LVR) of no higher than 80 per cent – you may avoid having to pay lenders mortgage insurance (LMI), which represents a significant saving as premiums can be expensive.

Here’s how to get your deposit out of existing equity.

Illustration
Caitlin and Josh bought their home, a two-bedroom apartment, in 2004 for $450,000. They provided a 20 per cent deposit ($90,000) and borrowed the rest ($360,000).

Seven years later, their home is worth $550,000, and the loan is now $340,000. The equity in their home is $550,000 – $340,000 = $210,000 and the LVR is 62 per cent.

Caitlin and Josh are planning to purchase an investment property for $280,000. They have $20,000 in cash, which will pay a 5 per cent deposit ($14,000) and expenses.

They need a deposit of $28,000 (10%) or, to avoid LMI, $56,000 (20%), and hope to borrow a further 95 per cent of the property value ($266,000).

**Assets**

<table>
<thead>
<tr>
<th>Item</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Home</td>
<td>$550,000</td>
</tr>
<tr>
<td>New property</td>
<td>$280,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$830,000</strong></td>
</tr>
</tbody>
</table>

**Loans**

<table>
<thead>
<tr>
<th>Item</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Home</td>
<td>$340,000</td>
</tr>
<tr>
<td>New property</td>
<td>$266,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$606,000</strong></td>
</tr>
</tbody>
</table>

**Total LVR** is $606,000/$830,000 = 73%

Provided their incomes satisfy the lender, Caitlin and Josh are in a position to purchase the new investment property with only a 5 per cent deposit in cash, with a further 15 per cent deposit provided by equity in their home.

AM I READY TO GO?

- Prepare budget
- Prepare statement of assets and liabilities
- Prepare income summary
- Employed: collect pay slips
- Self-employed: past 3 years’ tax returns
- 100 points proof of identity
- Choose a conveyancer/solicitor
- Choose a property manager
- Save for the expenses!

TIP

Look for financial institution websites with a quick online pre-approval to check your borrowing power.
The acquisition of an investment property is a competition waged within the framework of supply and demand.

At the end of 2010, only 16 out of every 100 home buyers were purchasing their first home – down substantially from highs of around 27 per 100 buyers a year earlier when government grants were most favourable.\(^5\)

The National Housing Supply Council has reported a staggering shortfall in necessary housing, estimated at around 180,000 dwellings.\(^6\)

There is also no doubt that tenants are finding it difficult to secure accommodation, particularly within the inner city and other desirable locations. One measure of this problem is the vacancy rate.

Figure 2.1 charts the overall vacancy rates for Sydney and Melbourne since 1980. A level of 3 is regarded as a reasonable equilibrium between the interests of landlord and tenant. When the level falls below 2 it means tenants will struggle to gain a lease agreement; above 4 and tenants are calling the shots.

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5 Real Estate Institute of Australia, 14 February 2011
Fig 2.1 – Vacancy rates

<table>
<thead>
<tr>
<th>Years</th>
<th>Sydney %</th>
<th>Melbourne %</th>
</tr>
</thead>
<tbody>
<tr>
<td>1980</td>
<td>3.0</td>
<td></td>
</tr>
<tr>
<td>1985</td>
<td>2.5</td>
<td></td>
</tr>
<tr>
<td>1990</td>
<td>3.0</td>
<td></td>
</tr>
<tr>
<td>1995</td>
<td>2.5</td>
<td></td>
</tr>
<tr>
<td>2000</td>
<td>1.5</td>
<td></td>
</tr>
<tr>
<td>2005</td>
<td>1.0</td>
<td></td>
</tr>
<tr>
<td>2010</td>
<td>0.5</td>
<td></td>
</tr>
</tbody>
</table>
Investors look for a rental yield of 4 to 5 per cent gross. This is the annual rent income divided by the property value.

**Illustration**

Lee buys an apartment for $420,000 and rents it out at $375 per week.

The rental yield is \((\$375 \times 52)/420,000 = 4.6\) per cent.

**Table 2.1 – Timing Your Investment**

<table>
<thead>
<tr>
<th>‘Wow! I'll invest now’</th>
<th>‘Oh no! I'll wait’</th>
</tr>
</thead>
<tbody>
<tr>
<td>Housing shortage</td>
<td>Signs of trouble: falling auction clearance rates; price reductions</td>
</tr>
<tr>
<td>Very low vacancy rates</td>
<td>Experts predict interest rate rises</td>
</tr>
<tr>
<td>Rents have been rising</td>
<td>Well-known businesses are closing</td>
</tr>
<tr>
<td>Reasonably stable economy</td>
<td>Rising commodity prices will fuel inflation and interest rate rises</td>
</tr>
<tr>
<td>China and the resources boom</td>
<td>Overseas experts tell us our residential property is overpriced</td>
</tr>
<tr>
<td>Wages are growing</td>
<td>Wages are growing</td>
</tr>
<tr>
<td>Inflation rate acceptable</td>
<td>Capital gains have slowed</td>
</tr>
<tr>
<td>Low unemployment</td>
<td>Tax benefits could change</td>
</tr>
</tbody>
</table>

There is no perfect answer and no perfect timing. Many investors find success by knowing their particular market well, having studied it over time, and by keeping within the limits of what they can afford.
Chapter 3 | Types of loans

Even if you have taken out a home loan before, it is important now to think as an investor about the best loan to suit your new acquisition and your stage of life.

New commitments – children, changing jobs, credit card debt – may give cause for thinking differently about the next loan. It is not your home this time. Your tax position may have shifted over time too.

Explore the new products and traditional home loans.
## Table 3.1 – Types of home loans

<table>
<thead>
<tr>
<th>Loan</th>
<th>What is it?</th>
<th>Advantages</th>
<th>Disadvantages</th>
</tr>
</thead>
<tbody>
<tr>
<td>Variable rate – standard</td>
<td>This is the standard property loan</td>
<td>You get the benefit of any fall in interest rates</td>
<td>You are vulnerable to any increase in interest rates</td>
</tr>
<tr>
<td></td>
<td></td>
<td>You are repaying the principal as you go</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>You can pay extra to reduce the principal further</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Useful features</td>
<td></td>
</tr>
<tr>
<td>Variable rate – no frills</td>
<td>A variable-rate loan without the extras</td>
<td>As above but with a lower interest rate</td>
<td>Some useful loan features may be missing, restricted or more costly</td>
</tr>
<tr>
<td>Fixed rate</td>
<td>The interest rate is set for a fixed period, usually from 1-10 years</td>
<td>You are protected against interest rate rises</td>
<td>Generally at a higher interest rate than for a variable rate loan</td>
</tr>
<tr>
<td></td>
<td></td>
<td>You know what your repayments will be for the fixed term and can budget accordingly</td>
<td>You miss out if interest rates fall</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>If you sell or refinance before the fixed expiry date you may have to pay substantial break costs</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Limits on additional payments</td>
</tr>
<tr>
<td>Interest only</td>
<td>Repayments are of interest only, not principal</td>
<td>Finances your property purchase at the lowest monthly cost</td>
<td>You are not paying down the debt</td>
</tr>
</tbody>
</table>

*Continued page 10*
### Loan What is it? Advantages Disadvantages

**Capped**
- A variable-rate loan with a ceiling on the interest rate
- The interest rate cannot rise above the capped rate
- This gives you protection against rising rates
- You still get the benefit if variable rates fall
- A higher interest rate is charged

**Split**
- The home loan is part variable-rate and part fixed-rate
- You can limit your overall exposure to interest rate rises
- You can pay down the variable part early
- You don’t get the full benefit of any fall in interest rates
- Expect a higher rate

**Line of credit**
- Your home loan is like a personal overdraft
- You can withdraw up to your limit at will
- It can be tempting to borrow more, and take longer to pay off the debt

**Investor package**
- A bundle of features based around a loan of at least $150,000
- Charges a lower variable rate of interest on the loan – a saving of around 0.5% p.a.
- You pay a single annual fee for all your banking
- Assorted other benefits
- Annual fee of several hundred dollars
- The loan interest concession rate may not apply to a line of credit or fixed rate loan
“Low-doc” loans suit the self-employed who lack the usual supporting documentation. You still need a good credit history.
“Non-conforming loans” are for borrowers who fail the standard lending criteria, such as those with a poor or incomplete credit history.

Choose your loan features

- **Redraw.** The redraw feature lets you withdraw money from the loan when you have repaid more than the minimum repayments schedule. You make savings on interest while you “park” spare money here. Check for fees for each redraw and limits.

- **100 per cent offset.** Interest earned on money deposited in an offset account is credited against interest payable on your loan. A 100 per cent offset account credits your balance with the same interest rate charged on the loan; a less effective version is a partial offset account, where you pay a higher rate of interest on the loan than you receive on your savings.

- **Low fees.** Check the fee regime fits well with the way you intend operating the loan: annual, monthly, redraw, late fees, early payout fees.

- **Salary deposit.** Will you be able to have your salary paid directly into the loan account?

- **You can make additional payments.** Some loans place no restrictions on paying extra off your loan above the minimum.

---

**WHAT PRODUCT DO I WANT?**

- **Interest rate structure**
  - Variable: standard or no-frills?
  - Fixed
  - Split
  - Principal and Interest
  - Interest only
  - Capped
  - Line of credit

- **Term**
  - 25 years
  - 30 years
  - 1, 3, 5 or 10 years fixed

- **Features**
  - Redraw
  - 100 per cent offset
  - Low fees
  - Salary deposit
  - Making additional payments

---

**TIP**

Websites such as ratecity.com.au and infochoice.com.au are a great resource for comparing products and interest rates.
Chapter 4 | Where can I apply?

Times have changed, and now the lender is found wherever you happen to be. You can walk into a traditional bank office or apply over the phone or online. There is no longer an excuse to be left floating in cyberspace or passed between managers. Insist on having direct contact details for a home loan specialist who will stick with you throughout.

Will your work or family commitments prevent you from getting to the bank? Lenders will come to you or fit in with your convenience, in person or by phone or email.

MAKING THE RIGHT CHOICE

Look for a lender that:
- Has a great website with clear explanation of its loan products
- Provides a dedicated home loan specialist from application to settlement
- Provides a direct phone number and email address to your home loan specialist
- Has competitive interest rates
- Has loans with features that meet your needs
- Commits to a timeframe for loan approval

TIP

Ask the home loan specialist about a pre-approval so you can bid at auction with confidence.
Lenders include the major banks, building societies and credit unions, but also consider financial institutions that take applications online and by phone, or any union or professional association to which you belong.

Mortgage brokers can assist with comparing lenders and products. They get paid on a commission basis for arranging the loan so ensure you know the details before you commit. The broker should be:

• A member of an industry body such as the Mortgage & Finance Association of Australia or the Finance Brokers Association of Australia

• Registered with the Australian Securities and Investments Commission, and

• Holder of an Australian Credit Licence (or work as a credit representative of a licence holder)
Chapter 5 | Allow for the expenses

Set aside some money to cover the three categories of expenses.

First, there are finance expenses. Your lender might charge an application fee up to $600.7

Lenders mortgage insurance (LMI) is a requirement of most lenders where the loan-to-value ratio (LVR) exceeds 80 per cent (or less if there are concerns about the property or its value). The premium is expensive but, on the positive side, enables you to purchase a property with a reduced deposit.

The two main LMI providers are Genworth Financial and QBE LMI. Calculators on their websites provide premium estimates. Go to genworth.com.au or qbelmi.com.

Fortunately, mortgage stamp duty on investment property was abolished in NSW from July 1, 2008, for the acquisition of investment housing,8 and in Victoria from 2004.9

Second, there are expenses associated with conveyancing. These include pre-purchase building, pest and owners

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TIP

In some instances, mortgage insurance premium can be built into your loan and paid off over time.

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TRAP

Lenders mortgage insurance is not an insurance scheme to cover loan repayments if, for example, you lose your job or are ill and can’t work. It protects the lender against default by a borrower.

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TRAP

Before refinancing an existing loan, check if you will have to pay a fresh LMI premium on the new home loan.

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7 ratecity.com.au
8 osr.nsw.gov.au/taxes/mortgage/investmenthousing/
corporation (strata/unit title) reports. Allow $1000 for the reports.

Stamp duty – a state or territory tax – is charged on the transfer of property. Go to your state revenue office’s website and use the calculator to estimate duty: NSW osr.nsw.gov.au; Victoria sro.vic.gov.au. As a guide, the duty on a property transfer of $500,000 is $17,990 in NSW and $25,070 in Victoria. Discounts may apply for new property bought “off the plan”.

Third, with settlement of the purchase you take over responsibility for the property. Get an insurance broker to arrange landlord’s insurance, including cover for loss of rent and malicious damage by a tenant.

Negotiate with a real estate agent to manage the tenancy. Fees range from 5.5 to 8.8 per cent of the rent.

You should also plan for a period of vacancy between tenants or if a tenant defaults on their rent. Depending on the location and local vacancy rates, it is sensible to plan for up to four weeks each year without rent.

**THE EXPENSES**

- Application/establishment fee
- Valuation
- Stamp duty on the purchase
- Legals: conveyancing fees, inquiry costs, registration fees
- Lenders mortgage insurance
- Pre-purchase reports
- Landlord’s insurance
- Property manager’s fees
- Land tax

**TIP**

Make contingency plans to handle interest rate rises. A good guide is up to 2 per cent.
One of the keys to successful property investment is maximising your net income through the incentives available under the tax system.

These incentives include immediate deductions, spread deductions and capital gains cost base additions. There is also a substantial discount that may reduce capital gains tax (CGT) when you sell your investment property. Here is a brief rundown:

Immediate Deductions

Interest charged on borrowings used to purchase the investment property is tax deductible in the year it is incurred. Other deductible items include rates, strata/unit levies, insurance, managing agent’s fees, cleaning, gardening, advertising for tenants, pest control, bank fees and general maintenance.

Expenses are only tax deductible to the extent they are incurred in gaining or producing assessable income (generally, rent).

Spread Deductions

Certain expenses can only be deducted over time.

1. **Borrowing costs.** These include loan establishment fees, mortgage broker fees, title search fees, loan registration fees, valuation fees and LMI premium.¹⁰ They can be deducted over a five-year period.

2. **Depreciation.** You may be entitled to claim a deduction for the decline in value of assets in your investment property. The deduction is a percentage of the cost of

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the asset, and is calculated according to the effective (useful) life of the asset.

Suitable assets include the cooktop, oven, dishwasher, air-conditioner, hot water system, carpet, blinds, curtains and furniture.

3. Building allowance (also know as depreciation on buildings). When you build an investment property or perform construction works on an existing investment property, you may be eligible for a building allowance. This is a deduction of 2.5 per cent or 4 per cent a year, based on the construction cost and the construction commencement date. This allowance also applies to structural improvements such as a pergola, fence, retaining wall or carport.

**TIP**

The Australian Taxation Office publishes a list of rates and effective life of depreciable assets on its website.

**TIP**

Get a quantity surveyor to investigate whether an older building might still be eligible for building allowance.

**CGT Cost Base Additions**

You have to wait for the tax benefit on some expenses. Legal fees, stamp duty and other costs associated with the purchase of your investment property, together with any non-deductible capital costs (such as the cost of a new bathroom) may be added to the cost base of the property when you sell or otherwise dispose of it. This reduces the assessable capital gain.

**Negative Gearing and cash flow**

“Gearing” is borrowing money to amplify the effect of a rise in the value of the asset. Of course if the property declines in value, this gearing will magnify your loss too.

**Negative gearing** is when the available deductions exceed the assessable income derived by that property. For example, if rent for the year is $10,000 and allowable deductions amount to $12,000, you have a
tax-deductible loss of $2000 which can be offset against other income.

In other words, negative gearing can reduce your income tax and may improve your cash flow.

You should always consider the value of the extra tax deduction and cash flow against the additional interest costs. The benefit of negative gearing will vary based on your personal tax situation.

**Positive gearing**, on the other hand, is where the investment income exceeds the total expenses.

If you know in advance your investment property will run at a loss over the financial year, you can apply to the Tax Office to reduce the amount of tax taken out of your salary. This is called a **PAYG Withholding Variation**.

**Illustration**

Lana’s salary is $50,000 a year. She anticipates making a loss of $17,000 this financial year on her investment property. By successfully applying for a PAYG Withholding Variation she can have her employer deduct PAYG from her wage based on her earnings of $33,000 ($50,000 less $17,000). This is very effective as her marginal income tax rate drops from 30 per cent to 15 Per cent. This will help Lana manage her cash flow through the year.\(^{11}\)

According to the Australian Bureau of Statistics, 80 per cent of property investors claim a tax deduction for paying interest on their loans, while two-thirds are negatively geared into their property investment.\(^{12}\)

**Capital gains tax**

Capital gains tax is assessed on any increase in the value of your investment property above what you paid for it. It is payable when you sell or otherwise dispose of the property.

Properties acquired by a person before September 20, 1985, are not liable for CGT. Importantly, CGT may be halved on properties acquired after 11.45am AEST on September 21, 1999.\(^{13}\)

**CGT Illustration**

Charlie bought an investment apartment in October 2008 for $400,000, and sells it two years later for $466,000. His salary is

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11 ATO www.ato.gov.au
12 ABS, Australian Social Trends, March 2009 www.abs.gov.au
13 www.ato.gov.au
$75,000 a year. The apartment is rented at $375 a week. Charlie will also claim annual depreciation and usual expenses of $25,000 in his tax return.

First, calculate the cost base. This adjusts the purchase price by adding the costs of acquiring and selling the property (e.g. stamp duty, legals, agent’s commission) and then deducting any building allowance already claimed. Assume these expenses amount to $30,000.

- **Sale price**: $466,000
- **Less cost base**: $430,000
- **Gain**: $36,000
- **CGT discount available**: $18,000
- **Assessable capital gain**: $18,000

The $18,000 gain will be added to Charlie’s assessable income in his next tax return.

- **Salary**: $75,000
- **50% capital gain**: $18,000
- **Rent**: $19,500
- **Total income ...**: $112,500
- **Less depreciation, loan interest and other expenses before the sale**: $25,000
- **Income for tax**: $87,500

Note: The above example is only a simplified version. Please obtain expert tax advice relevant to your personal circumstances.

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**SIX TAX TIPS**

1. Get a quantity surveyor to prepare a depreciation schedule and to advise on capital allowance.
2. Keep receipts.
3. Ask your property manager to prepare an annual property report showing all income and expenses.
4. Plan ahead for when you might sell your property to avoid tax timing pitfalls.
5. Don’t mix personal and investment income or deductions.
6. Get advice about a PAYG Withholding Variation.

Chapter 7 | What makes a good investment property?

The buyer’s rule, “location, location, location”, holds true for rental property too. Location factors remain paramount, including proximity to:

- public transport
- schools and universities
- shopping centres
- recreation facilities (beach, park, sports fields)
- large employers

Two other issues always attract strong opinions: whether to buy a new property or an established one, and whether to aim for a house or apartment.

Table 7.1 – New versus old?

<table>
<thead>
<tr>
<th>New property</th>
<th>Old or established property</th>
</tr>
</thead>
<tbody>
<tr>
<td>You can maximise depreciation tax deductions</td>
<td>You avoid extras in the purchase:</td>
</tr>
<tr>
<td></td>
<td>• Builder’s profit</td>
</tr>
<tr>
<td></td>
<td>• GST</td>
</tr>
<tr>
<td></td>
<td>• Premium for ‘new’</td>
</tr>
<tr>
<td>Maintenance costs should be lower</td>
<td>Building defects should be obvious or cured</td>
</tr>
<tr>
<td>Appliances are under manufacturers’ warranties</td>
<td>Appliances may be due for replacement or expensive repairs</td>
</tr>
<tr>
<td>Maximum rent initially</td>
<td>Established rental history</td>
</tr>
</tbody>
</table>
House vs apartment

Some surveys show that houses enjoy greater capital gain than apartments; others suggest the reverse is true. It comes down to the property and its location.

Rental yield is often higher on an apartment than a house. There are more prospective tenants at the affordable end of the spectrum. But you have to follow the by-laws.

You can do more with a house and land should you ever want to develop it further. This is hidden potential in your investment.

When you consider purchasing an investment property can you foresee:

• Adding new rooms?
• Going up an extra storey?
• Building a lock-up garage?
• Changing the floorplan?

Finding the right tenant

The majority of tenants do not sit still. From the 2006 Census we know that 63 per cent of tenants were living somewhere else five years previously. The most mobile of all are in the 18 to 24 age group.

Only 15 per cent of all private renters come from high-income households. This group, too, tends to be younger.

The message here is that if you want to attract the greatest number of potential tenants, you need to provide the type of accommodation they want at a price they can afford. Aim for your target renter. Be prepared for turnover.

TIP

Don’t be passive! Discuss each prospective tenant with your manager. Inquire about references, previous renting history, income and job security.

15 ABS Australian Social Trends, 2008 www.ausstats.abs.gov.au
Chapter 8 | Tips for managing risk

All investment involves risk. The question is: How are you going to manage it?

Borrowing large amounts of money increases your exposure. Your insurances may be out of date, and should be reviewed when you make a major investment. This is part of strategic planning.

Here are seven tips for managing risk:

1. **Get ahead with your repayments.** If your loan has an easy redraw feature, consider paying more than the minimum, building a buffer.

2. **Cap the rate**

3. **Fix the rate** for part of the loan

4. Don’t neglect to **secure your employment** and your wages

5. Take care with **selection of a tenant**

6. **Get insured.** Don’t let a disaster derail your investment strategy. Do you have income protection and life insurance? Landlord’s insurance? Contact a broker.

7. **Have money in reserve.** An urgent repair can mean no income for a month. Consider establishing a line of credit or increasing the limit on a credit card to smooth out the cash-flow bumps.

What will an extra $100 per month do for my loan?

Let’s go back to the illustration of Jo and Sam (Chapter 1). How much interest would they save on their home loan if they paid a little extra each month?

The details of the loan are: loan of $410,000, P&I, variable rate of 7.12% p.a., 30-year term. Monthly repayment: $2761.

Paying an additional $100 per month will take three years and two months off the term of the loan, representing a saving of $75,415 if they were to stay in the property all the way until the loan was paid off (Figure 8.1).

Figure 8.1 – Paying an extra $100 per month
This also assumes that interest rates remain constant for 27 years – which, of course, they won’t.

Let’s look at what happens if after the first two years they find an additional $400 per month, perhaps due to wage increases. This will reduce the term by eight years and three months, saving a massive $178,797 in interest (Figure 8.2).

Figure 8.3 shows how interest rates have moved since 1990. Importantly, note how standard variable-rate housing loan rates have danced around the three-year fixed rate product.
Variable is not always cheaper. For example, the three-year fixed rate undercut the variable rate in November 2010 and continued into 2011. Back in 1994, the two rates were 1.5% apart.

What does it mean when fixed rates approach variable rates? This is an indicator that variable rates are peaking. It also can mean lenders are competing hard for market share. Conversely, when fixed rates are rising, seek advice about whether to lock in part of your loan to manage your risk exposure.
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mortgage.com.au or yourmortgage.com.au

Interest rates
Rate City – ratecity.com.au
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Obtaining your credit report
Veda Advantage – mycreditfile.com.au
Dun & Bradstreet – dnb.com.au
Tasmanian Collection Service – tascol.com.au

Government, financial and property market information
Australian Securities and Investments Commission – asic.gov.au
Reserve Bank of Australia – rba.gov.au
Real Estate Institute of Australia – reia.com.au
RP Data – rpdata.com

Associations and dispute resolution
Credit Ombudsman Service Limited – cosl.com.au
Financial Ombudsman Service – fos.org.au
Chapter 10 | Glossary of terms

AAPR Average Annualised Percentage Rate – a form of comparison rate that bundles together the nominal interest rate of the loan, along with some fees and charges, into a single interest rate figure.

Break costs The financial loss the lender incurs as a result of the fixed-rate loan being paid out early, being partly repaid or where there is a change in the loan type. Break costs can be substantial.

Capital gain The increase in value of an asset above what you paid. An asset can also experience capital loss.

Conveyancing The process for transferring property ownership in law.

Equity The value of a property after deducting the debt owing.

Interest In the property context, interest is what the lender charges a borrower for the use of its money.

Joint tenants A form of property ownership by two or more people in equal shares. When one joint tenant dies, their share automatically passes to the surviving joint tenants.

LMI Lenders mortgage insurance.

LVR Loan-to-value ratio. This is the amount you can borrow divided by the value of the property and expressed as a percentage.

For example, a loan amount of $200,000 against a property valued at $250,000 represents a LVR of 80 per cent.

Mortgage A loan secured against real estate.

Mortgagee The lender.

Mortgagor The borrower.

Negative gearing The situation where the costs of owning the asset (e.g. loan payments) exceed the income it produces (e.g. rent).

p.a. ‘per annum’, meaning yearly.

P&I A principal and interest loan where the borrower pays off principal along with interest over the term.

Principal The amount you borrow.

Stamp duty A state government tax payable on the transfer of property.

Tenants in common A form of property ownership by two or more people where, when one dies, their share passes according to their will, not automatically to the surviving co-owners. Tenants in common can own a property in equal or unequal shares.

Term The period of time the home loan is set to run, at the time you take it out.

Vendor The seller.
Chapter 11 | A final word

It’s an exciting stage of life when a person feels confident enough to move beyond passive investment – employment superannuation, a few sleeping shares – into active wealth creation.

Residential property investment is testing and involves risk but can also be rewarding. In Australia, it is a well-trodden path, and experienced assistance is readily available.

Build a team to support you and to help develop your investment strategy. Form a working relationship with your lender, don’t hesitate to seek personalised advice from a tax specialist and a financial planner, and take steps to manage risk. It is not a “get rich quick” scheme.

There is also much pleasure to be gained from successfully running a residential property investment.

Enjoy seeing your investment strategy come to life!
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