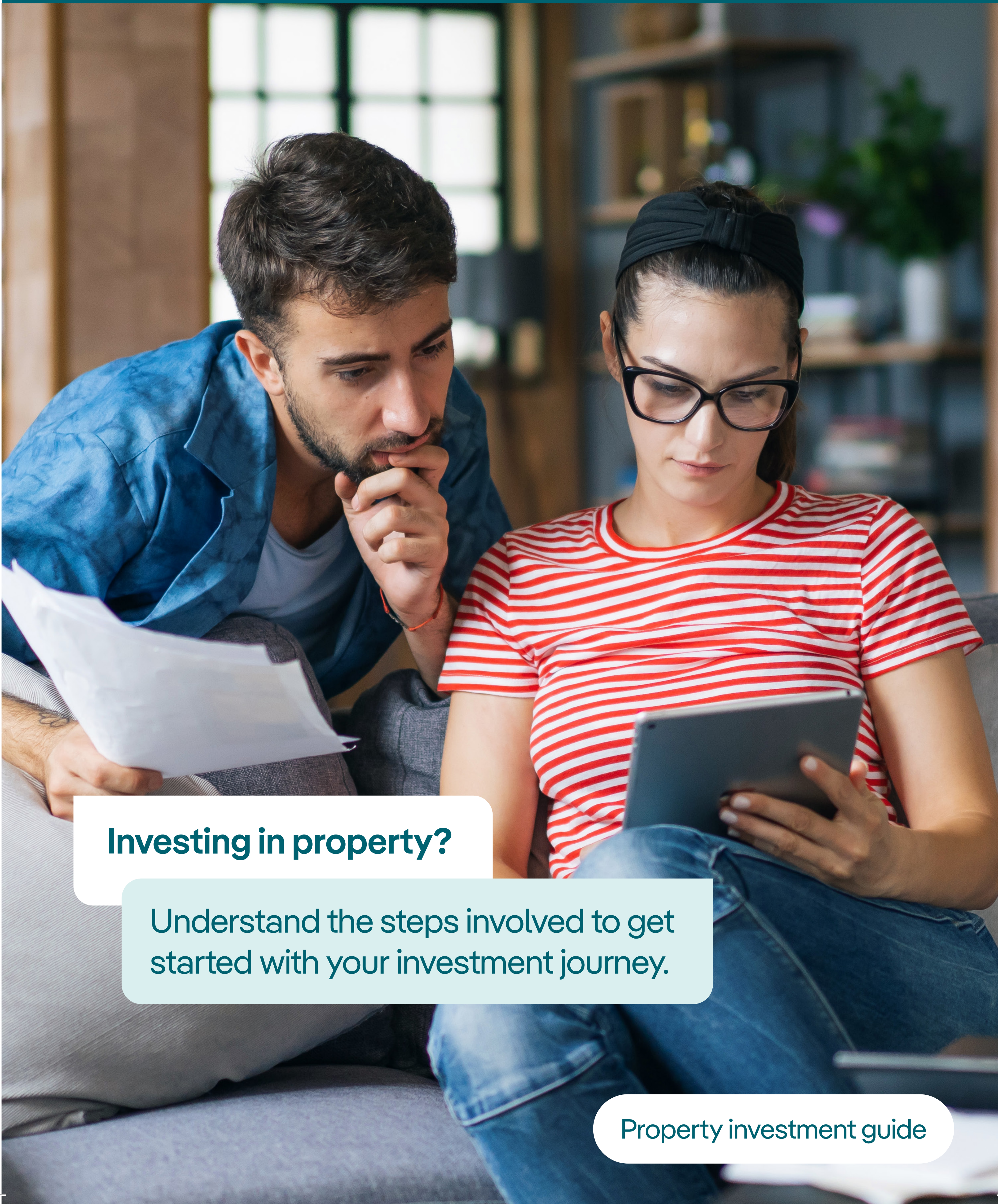
Mortgage Choice



Investing in property?

Understand the steps involved to get started with your investment journey.

Property investment guide

Seven reasons why property remains a smart investment

1. Property tends to perform well over the longer term

The PropTrack Home Price Index shows national home prices hit a new record high in February, lifting 0.45%, the largest monthly rise since October 2023. That brings prices up 0.82% so far this year and up 6.15% compared to a year ago, the fasted annual rise since July 2022.[1]

2. It's an asset that's generally easy to understand

Investing in property is much less complicated than analysing the share market. The information you need to make an informed decision is also much more readily available to you.

3. Property can give you higher leverage

Depending on your circumstances, banks can potentially lend up to 90% of a property's value, but only 50% of the value of a share portfolio. By borrowing more, you can invest more.

4. There's an element of control with owning property

You can add value to property you own by renovating, subdividing and developing it. You can also control the cash flow you may receive from your property by renting it out.

5. You may be eligible for tax benefits

Owning property usually allows you to claim many investment expenses as tax deductions, so you pay less tax. Seek expert advice about tax benefits.

6. You may be able to claim depreciation against your taxable income

A building can deteriorate over time and decrease in value. Any decline in the value of the building itself and on the 'plant and equipment' assets inside can be claimed on tax.

7. Stability

Property is usually more stable than other investments such as shares, which can often be volatile. It takes longer to buy and sell property, and upfront purchasing costs discourage short-term speculators.

1. PropTrack Home price Index Report – November 2023

Have a clear plan

What's your goal?

It's important to consider your complete financial position before taking on an investment loan. In considering whether you can afford an investment loan, ask yourself if you can:

- Bridge the gap between your rental return and your loan repayments?
- Afford to cover the inevitable periods of vacancy?
- Afford to make your repayments if something unexpected happens?
- Afford a quality property that attracts reliable tenants and solid returns?

How much money will you need for an investment property?

Property ownership can involve big upfront costs and ongoing expenses. See the following section for more details.

How much can you afford to borrow?

Know how much you can borrow to understand where and what you can afford. Do you need a cash deposit? If you own your home, you may be able to use home equity instead of a cash deposit.

What kind of property will you purchase?

Consider all the costs and have a back-up plan. It must be affordable, appeal to a broad spectrum of tenants and have the potential for solid capital gain.

How to know if it's affordable

If your property costs more than it earns in rent then this means it's negatively geared and could offer tax savings, but you will still need to cover expenses and any gap between the rent and your loan repayments.

A property is deemed a successful investment if it attracts quality tenants who pay on time. Aim for a location near transport links, close to employment and amenities, with parking and a good outlook.

Understand the purchase costs

Before you can work out how much you can spend on your property, you need to know the purchase costs and how much you can borrow. Buying an investment property involves upfront expenses and ongoing costs. You need to be able to handle both.

Upfront costs

Pre-purchase pest and building inspections

This is advisable to avoid nasty surprises. Allow about $500 for an inspection by a reputable firm.

Strata search

This is essential if you're investing in a unit, apartment or townhouse that has common property.

Stamp duty

Stamp duty is a State Government tax based on your purchase price. It's added to the capital value of your property and reduces any capital gains tax that may apply when you sell your investment.

Borrowing costs

These can include a loan application fee (generally up to $700) and a lenders valuation fee ($300 or more).

Legal fees

This includes having the property transferred from the vendor's name into yours. It usually costs around $1,500 to $2,000, depending on who you use and the complexity of the transaction.

Lenders Mortgage Insurance

Lenders Mortgage Insurance (LMI) is necessary if you borrow more than 80% of the purchase price. It's a single premium based on the amount you borrow relative to the property's value.

TIP: You may be able to roll your LMI into your loan

Some lenders will let you add the LMI cost onto your loan, but you'll pay more interest over time.

Ongoing costs

Ongoing costs include accountant/tax agent and body corporate fees, council and water rates, building and landlord insurances, letting and re-letting costs, and loan interest repayments.

The biggest expense is your loan repayments. It can take years to pay off the loan based on rental returns, which is why it's helpful to have a long-term financial plan in place.

Know how much you can spend

Work out your borrowing capacity

Along with your wage or salary, lenders will also consider the potential rental income you'll receive, which increases your total income and borrowing capacity. Each lender will use a different percentage of the rental income to determine your capacity to service a loan.

Your local mortgage broker can advise which lender might suit your current circumstances. You can always use online calculators – including Mortgage Choice's – to help you determine what you may be able to borrow.

Use your equity

If you already own a home, you may have built up equity, which is the difference between your home's market value and the balance of your loan, and it may be possible to borrow against this.

If your home is worth $800,000 and you owe $300,000, you've built up a $500,000 equity. If you satisfy other lending criteria, many lenders will let you use up to 80% of that equity, in this example $400,000.

If this is your first property purchase, it's worth considering an investment property as an alternative to a home purchase. Discuss your financial circumstances and goals with us.

TIP: A mortgage broker can help give you an exact figure for your borrowing capacity

While online calculators are a great tool, your local mortgage broker can give you a more reliable figure by taking into account different lender policies and your individual circumstances.

Find the right loan

It pays to choose the right loan for your investment property. Two key questions to consider are:

1. Is the loan flexible enough and does it work for you and your future plans?

- Do you want to be able to make extra repayments?
- Do you need to be able to change the loan down the track?
- Do you plan to sell in the next five years?

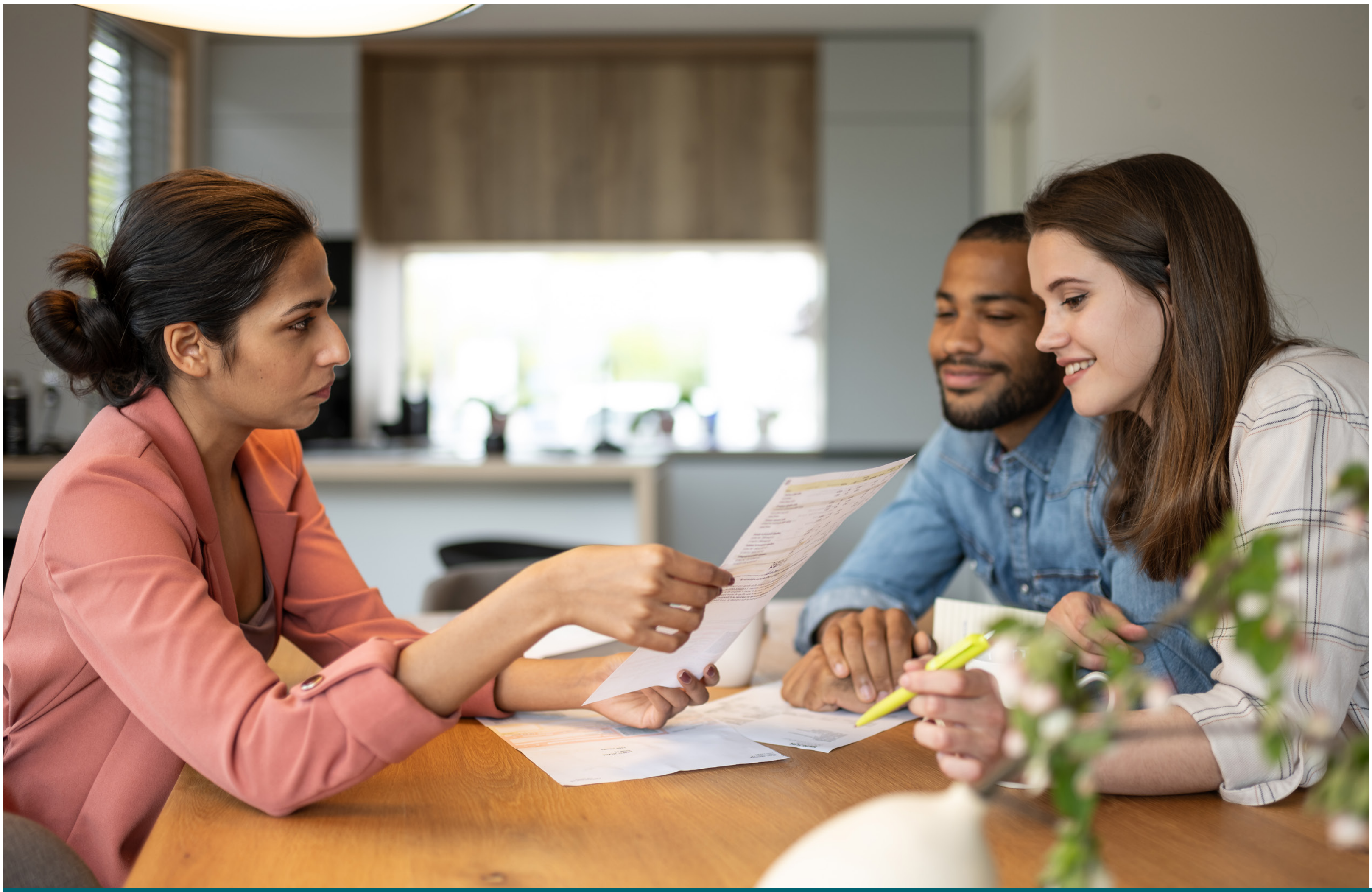
2. Does the loan make financial sense?

- What loan features will help you save money?
- What loan structure will be the most tax effective?
- What other loans and liabilities do you have, and will these affect this new loan?

How does an investment loan differ from a home loan?

Investment loans often come with a higher interest rate than a standard home loan, depending on the lender and the property, and there may be different standards for the loan-to-value ratio (LVR).

Just like a home loan, investors can choose between a basic loan or one with added features.



Choose the right property

Money earned on an investment property is a combination of two returns: rental income and capital growth. It's important to decide whether you'll focus on one or the other before buying.

Yield strategy

In simple property-related terms, 'Yield' refers to how much rent you receive as a percentage of the capital investment. Knowing a property's yield lets you compare the annual return between properties, and against other types of investments. It's also helpful when it comes time to review the rent you'll charge.

If your aim is to generate a good yield, you should buy a property that has high rental return relative to its cost. And the rental income should be greater than the costs.

You can calculate your gross rental yield by dividing the value of your annual rental income by the value of the property. Most properties generate a rental yield of between 2.5% and 4.0%.

Capital growth strategy

The right property in the right location at the right price can enjoy high capital growth over time – this means your property is likely to significantly appreciate in value.

What is a quality property?

There are three characteristics to look for when purchasing properties in a period of high demand and short supply:

- **Scarcity.** This includes scarcity of land and dwelling style. The features and location of the property should be highly desirable.
- **Building value that's less than 50% of the property's overall value.** Land appreciates, buildings depreciate! High land value, compared with the value of the building on it, is essential in driving long-term capital growth.
- **A long and stable history of above-average capital growth.** Look at past sales of the property as well as nearby properties that are directly comparable to it.

Comparing strategies

Properties with high capital growth are generally found in areas where demand exceeds supply. Often this is in capital cities in suburbs that are:

- Close to work opportunities
- Have good amenities
- Close to public transport
- In areas with the right infrastructure.

The market value will be high compared with the rent you can charge and it's likely it will be negatively geared for a long time. To achieve good capital growth, you'll need to hold onto the property until you see a solid rise in its value.

Both strategies are equally valid and will depend on your financial situation. Ideally, you should talk to a financial adviser when determining which property investment strategy is right for you.

Tax advantages

Another benefit of investment properties is that they enjoy generous tax concessions that can put them ahead of other asset classes – it's one of the reasons property is favoured by investors. But it's important to seek tax advice from a qualified professional. Three golden rules: keep good records, keep expenses for your own home separate, and hold onto receipts for any expenses you plan to claim.

Tax deductions

Investment property expenses you may be able to claim can be categorised into four types:

1. Borrowing costs

Repayments on your investment loan are tax deductible, as is interest on finance taken out for improvements. Other costs you can claim include bank and valuation fees, and LMI.

Interest charges can be claimed on a loan used to buy a rental property, make repairs, or fund renovations and extensions.

If you've personally used the property, you can't claim interest incurred during that period. If you refinance and use part of the funds for personal use, that portion of the loan cannot be claimed.

2. Maintenance and repairs

The cost of repairs and maintenance you make while your property is leased is usually immediately tax deductible. A repair is classified as work that returns a damaged feature to its original state, including replacing a broken window or repairing electrical appliances.

Maintenance is work done to prevent deterioration or fix existing issues, including cleaning a swimming pool. Repairing original defects will need to be claimed as improvements.

3. Improvements

Most improvements made to your property can be claimed, but they're not immediately deductible in full. They need to be depreciated and claimed over their effective life and are subject to a number of rules. An accountant can help clarify what you're entitled to claim. Improvements include capital works (e.g. a bathroom renovation), capital allowances (e.g. a dishwasher) and initial repairs (e.g. fixing floorboards). The property must be available for rent to claim.

4. Other expenses

You can also claim an immediate deduction for other expenses related to your rental property. This can include leasing costs, such as agent fees, and the costs of owning your rental property, such as council fees, body corporate fees (for properties on a strata title) and insurance. Your accountant will be able to provide you with tax advice.

Depreciation

Depreciation generally falls into two categories. The first applies to fittings and fixtures such as stoves, hot water heaters, light fittings and carpets. The second relates to depreciation of the building itself. Check the ATO website for a list of rates and the effective life of depreciable items.

Capital gains tax

CGT is charged on the profit you make when you sell a property (the difference between the selling and purchase prices). CGT only applies to properties bought after September 1985. Those bought after October 1999 may be eligible for a capital gain discount of up to 50%.

Gearing

Gearing is a term used to refer to borrowing. Most investors use some form of gearing to fund their rental property.

Negative gearing

This is when the cost of owning a rental property is more than the income it generates each year, creating a taxable loss. This can be offset against your other income to provide tax savings. If you know you're going to record a loss, you can apply to the ATO to reduce the amount of tax taken from your salary. Speak to your tax adviser or accountant for details.

Case study

Bill owns a rental property generating $25,000 in rent each year. His costs are $30,000. Bill's taxable loss is $5,000, which he can potentially use to reduce the tax payable on his income.

Positive gearing

Positive gearing is when you earn more in rental income than it costs to own the property. You need tax and financial advice before buying to be across all the pros and cons. Your mortgage broker can work with your advisers to help you understand the full financial picture.

Case study

Bill's property generates $20,000 in annual rent but he only spends $15,000 on it. He's made $5,000 in profit, which is taxable. He'll need to set funds aside to cover the tax.

Ownership options

Getting the ownership structure right when you buy avoids the costs of altering title deeds later.

Investing as joint tenants

Ownership, income and expenses are split equally between two or more people.

Investing as a sole (private) purchaser

Property is registered in one name only, with income and costs offset against that person only.

Investing through a company

Companies can be costly and have strict rules, but they offer advantages. It can be easier to sell shares if an owner wants to exit, and the company tax rate is lower than the top personal tax rate.

Investing through a trust

A trust can be suitable for a positively geared property, allowing you to distribute income in a tax-effective way, but trusts can be complicated to establish and maintain.

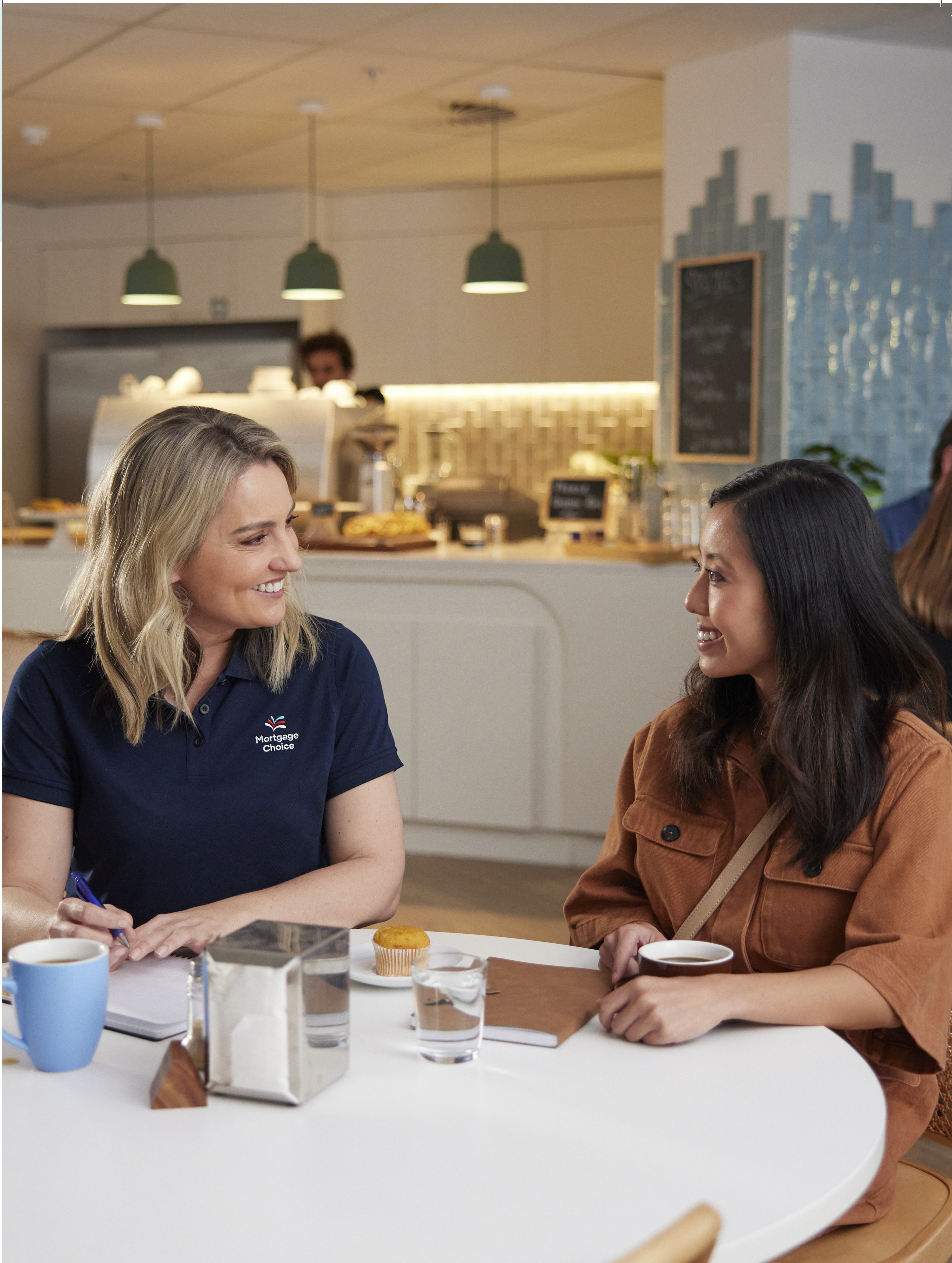
Investing as tenants in common

Ownership is divided into units and not all tenants have to have the same or equal number.

Ready to become a property investor?

Below is a checklist to help ensure you're ready to embark on your investment property journey.

- You've prepared a budget and can afford the initial and ongoing costs of a property.
- You've drafted a personal balance sheet showing what you owe and what you own.
- You have a clear idea of which investment strategy is going to work for you.
- You've studied the market and locations and know what you want.
- You've spoken to your mortgage broker and understand your borrowing capacity.
- You have the information you'll need for a loan application – ID, pay advices – and a letter from a real estate agent stating likely rental returns.
- You've chosen a conveyancer/solicitor.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Mortgage Choice

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