A Definitive Guide to Property Investment

Welcome

At Horizon Property Alliance we're passionate about helping people like you, to build wealth and financial security through sound property investment strategies.

With 25 years' experience, we excel at finding the right properties to meet our clients' personal and financial goals.

We understand that property investment is not a decision taken lightly. It calls for careful consideration and arming yourself with the necessary knowledge to make well-informed decisions.

You'll find this introductory guide to property investment a really good place to start!

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A Definitive Guide to Property Investment

The goal of any investment plan is to create a passive income.

Rental income is an example of passive income and has proved itself as a safe and secure way to achieve financial freedom.

You should always discuss your financial goals with your accountant or financial adviser before starting out on an investment plan. It's a really good idea to have a team around you that understands your financial goals.
In this free guide we cover:

1. Investment strategies
2. Fees and charges
3. The next hotspot
4. How to buy it
5. Finance
6. Property management
7. Self-managed super funds
8. Understand the lingo

1. Investment strategies

Road trip!

Setting out on your real estate investment journey can be likened to a road trip. Without a map, the right vehicle and supplies, you could lose your way!

An investment strategy is the map of your real estate investment plan and sets the path for achieving your investment goals.

There are several different real estate investment strategies to consider.

- Buy & hold.
- Buy, renovate & add value.
- Buy off the plan & sell before settlement.

Buy & hold

This method is straightforward. You purchase and retain a property for the long term. You may decide to reduce the debt associated with the purchase in order to create an increasing income stream from the rental return.

Alternatively, you may maintain the debt via interest-only repayments and rely on time to produce an increasing rental return. Interest-only repayments allow you to pay only the interest over the term of the loan, which is typically five years. You will then begin to pay off the principal when the loan term ends.

Buy, renovate & add value

Finding a property that you can renovate or add value to is a great way to create equity in your investment. Some properties are in obvious need of renovation. The kitchen and bathroom are a good place to start as you get a lot of bang for your buck if you renovate them correctly.

Another way to create equity in an investment property is to not only renovate but to remodel a property. Looking at the floor plan, you may see the opportunity to create another bedroom, instantly adding value to your investment. You may even see the potential to completely demolish the property and redevelop the site with more than one dwelling.

The trick with this strategy is not to over-capitalise. That is, don't spend more on the project than the return will bring you.

WARNING: Knowing how to spend on renovating comes with research. Look at other properties in the area and know your market values. If you work on existing market values and not on what you think the property will be worth in the future, factoring in current capital growth rates, you will be better off. You will also have to manage a builder or individual trades if you are not skilled enough to renovate yourself. Make sure you have enough time (and the patience) to get the best result.

Buy off the plan & sell before settlement

This strategy is included not so much for its rock-solid nature but more to cover the issues that surround it.

Buying off the plan is popular at the start of a growth period in the property market, but buyer beware. You are gambling on a price increase.

The scenario generally goes like this.

- You buy an apartment off the plan. The building will go ahead subject to the developer selling enough units to receive funding.
- You pay a 10% deposit. If you can, pay the deposit via deposit bond so that you are not tying up 10% of your cash for the period of time it will take to construct the building.
- A rental guarantee is often offered. Be cautious, as the total amount of the guarantee is often factored into the sale price.
- If you are buying via a financial planner, the developer will have to pay a generous sales commission to the agent and the financial planner. Do your research to make sure the numbers stack up.
- Most loan pre-approvals only last for 3 months. In some cases, the large banks will restrict their exposure to any one building.
- The bank will value your apartment based on its selling price on completion, not on what you paid for it.
- Many off-the-plan developments are sold to investors. This means you end up with a building occupied by far more tenants than homeowners, a factor that may not be attractive to prospective purchasers.
- You should check your contract to find out under what conditions you can sell the property. Until you settle, you only have an interest in the property, not ownership.
- You cannot sell the property until it settles. You can generally settle with the developer and your purchaser on the same day.

2. Fees and charges

It's important to know what you're up for.

Before you choose a suburb, get a good understanding of what fees and charges you will be required to pay.

Buying

If you are buying an investment property, factor in the following:

- mortgage payments or interest repayments
- council rates and fees
- legal fees
- water rates
- insurance—landlord, building
- body corporate fees
- repairs and maintenance
- property management fees
- stamp duty
- land tax
- other tax (where applicable).

3. The next hotspot

It's the question on everyone's lips.

A lot of people dream of buying a property and seeing its value skyrocket to double what they paid for it within a couple of years. Is this possible? Maybe. But it would be the exception rather than the rule.

If part of your strategy is to find property that is expected to enjoy solid rates of capital growth, you should consider the following issues.

Research

Everyone has an opinion on where the next hotspot is. By doing your own research, you will be armed with the right knowledge to make the best decision for your situation.

Research the underlying fundamentals of the state you are buying in:

- economic growth (gross domestic product)
- unemployment rates
- household wealth
- consumer confidence
- population growth
- established housing market median house prices and average monthly clearance rates
- new housing starts
- major infrastructure projects.
- general area:
    - infrastructure investment
    - proportion of houses versus apartments
    - change in demographics and lifestyles
    - income growth
    - local council workings, strategic plan.
- suburb, street and price point:
    - rental yield
    - where the renters live
    - proximity to amenities like shops, transport, major arterials, medical centres and entertainment
    - crime statistics
    - development applications (is there a high rise tower going in next door?)
    - demographics of residents.

Where to find information

Australian Bureau of Statistics http://www.abs.gov.au/websitedbs/censushome.nsf/home/quickstats

Australian Government Statistics http://australia.gov.au/topics/economy-money-and-tax/statistics

The local council website will have a section that outlines their strategic plan, business and major projects plan plus the statistics and economic profile of the area.

The **Real Estate Institute** in your state will have information such as house prices by suburb and auction results.

There are also market reports by private suppliers available on the web.

4. How to buy it

Now that you have carefully considered what you are looking for and have decided on the area, how do you actually go about purchasing a property?

Naming entity

Whose name should the property be in?

This is an important question and definitely one you should discuss with your legal advisor and accountant. It is also a question that many people never think about, simply opting to purchase the property in their own name or together with their partner. However, careful consideration should be given to this in relation to your future plans, as it can have serious impact on how much tax you pay and can also be a factor in minimising your risk profile.

In considering this, you should address the following issues.

- Is your occupation considered 'risky' and should asset protection be a consideration? Traditionally people have used trusts to protect their assets. The property is owned by the trust but controlled by the individuals with any profits flowing to them. The trust is the legal owner and provides protection as it limits the potential loss to only the assets in the individuals' names, which could occur in any legal matters, such as being sued for negligence. An additional strategy could be to transfer ownership from one 'risky' spouse to the 'non-risky' spouse. Capital gains tax and stamp duty may be charged in this circumstance so caution should be taken.
- Is your situation likely to change in the future and what are the likely cash flows from the investment? For example, if you're married, will your and your spouse's income change in the future?
- In whose name are other properties held in relation to land tax thresholds? Land tax is affected by each individual's property portfolio. Principle place of residences are generally exempt from this tax, however additional properties are subject to it. Trusts have a slightly higher tax rate, which is another factor to consider for the long-term.
- If you want to transfer the property to a family member in the future, what are the stamp duty and/or capital gains tax implications?

You may not be able to completely match your long-term goals with the short-term ones.

For instance, there can be short-term benefits of negative gearing and the longer-term issues of capital gains tax, but it is important to be aware of all the issues and to plan for them when possible.

For more information on capital gains tax, refer to the **Australian Taxation Office**.
http://www.ato.gov.au/General/Capital-gains-tax/

Buying at auction

You may have seen the television programs that show the excitement and anticipation typically felt by many at an auction. But unlike many bidders on these shows, you should set yourself a maximum limit on the price you are prepared to pay for the property, and stick to it.

Hint: It's easy to let nerves and the excitement of the auction get to you, but you must approach this as a business decision with a clear limit on the price you are prepared to pay.

- Remember, in most states there are no cooling-off periods allowed after the final bid has been made at an auction.
- Once accepted as the final bid on a property, the bidder is expected to pay the 10% deposit (unless another figure has been negotiated prior to the auction) and sign a binding contract.
- It is therefore imperative to carry out all due diligence on the property prior to the auction.

Private sale

Different to auction sales are private treaty contracts, whereby the property has an asking price and is sold by negotiation.

- In this situation, the real estate agent will act as a go-between until an agreed price is reached between you and the vendor.
- Remember too that the agent is there to work for the vendor—not for you.

This method of sale is considered less stressful than auctions.

Amendments to the contract can be made and you are protected by cooling-off periods (state-dependent). However, as a buyer you will not be aware of the other offers being made on the property and will have to rely to a certain extent on feedback from the agent. But as you would have already researched the property and the area, you will be in a position to know what the property is worth.

Appoint a trusted advisor to do the work for you

It's ok to ask for help. You may have a trusted accountant or financial planner but still want to work alongside an expert that lives and breathes the property market. An expert that loves property investing and will only offer property options that they would consider investing in themselves. They have done all the homework for you and negotiated directly with the builder/developer to sell the property to their clients. It's a perfect option for the inexperienced and the time-poor.

Buying in different areas

Some people choose to invest in the suburb next door to where they live or somewhere nearby. From an emotional point of view, perhaps they feel if the investment is nearby, they can keep an eye on it. They may feel more comfortable investing in an area that they are familiar with.

- If you choose to invest 'out-of-state', it's important that you understand the different legal implications and processes involved.

Surround yourself with professionals that operate in your state of choice and be guided by what needs to be done to ensure a smooth transaction.

5. Finance

Think before you sign.

Financing an investment property is similar to financing the purchase of your own home, but there are key differences.

- A lender will look at the return on the investment and each lender will have different lending criteria in place, which will determine your level of borrowings.
- Some lenders, for example, will only take into account 70% of the rental income when assessing your serviceability for the loan, whereas others are more generous.
- Similarly, in assessing your debt-servicing ratio, different lenders make allowances for different criteria, each of which will impact on your ability to qualify for the finance. This could be the key difference in getting funds for your purchase.

Make sure you get the right financial advice so that you don't experience any roadblocks.

Types of loans

There are different types of loans and loan features available to investors, which can make accessing the necessary investment funds easier.

- If you want to invest to grow your wealth but don't have the capital behind you to get started, then accessing the equity in your home can be a great solution. Equity is the difference between what your home is worth (your asset) minus what you owe on it (your debts and liabilities).
- Having the ability to switch between interest-only and principal and interest repayments is an advantage. An interest-only home loan allows you to pay only the interest over the term of the loan, which is typically five years. You will then begin to pay off the principal when the loan term ends. A principal and interest home loan is where the borrower pays the interest incurred monthly as well as a portion of the principal (the principal is the amount of money borrowed). This is especially handy when segmenting loans with tax deductible interest and those with non-deductible interest come tax time.

6. Property management

The aim of purchasing an investment property is for it to provide you with a vehicle for producing wealth. It should never be a worry or a problem. How do you ensure this is the case?

Self-management

Some people believe that they can save themselves money by managing their investment property themselves. This may be true in the short term. However, in reality, do you have all the resources, knowledge and support available to do the job properly? Managing the property yourself may prove to be a false economy, but if you have the time and inclination, the choice is available to you. You will need to:

- advertise your property for rent
- conduct inspections
- choose the tenants
- choose the tenancy period
- enter into a written residential tenancy agreement
- arrange payment of the security bond
- receive and deposit the security bond
- provide a property condition report
- provide tenants with documentation prescribed in your state
- ensure the property meets legal requirements, for example, ensure smoke alarms are installed
- conduct inspections
- resolve tenancy issues
- maintain the property on the inside and outside and respond to tenants' queries and emergency repairs
- invoice for service charges such as water rates (if applicable)
- ensure the property is insured, especially landlord insurance
- chase outstanding rent.

Hint: Look at renting out your property and managing it yourself as running a small business and your tenants as your customers.

Appointing a property manager

If the idea of dealing with tenants is not for you, consider engaging a professional property manager.

They must be:

- registered real estate sales representatives operating under the supervision of a licensed real estate agent who is in charge of the agency.

Consider the following factors when choosing a property manager:

- their experience in property management. Ask about their current portfolio and the types of properties they manage
- their approach to managing your property, for example, the frequency of inspections, and how they advertise for and choose the right tenant
- the property manager's manner in dealing with people
- how they collect rent and pay accounts such as water and council rates
- what and how often they report to you, especially providing you with financial statements
- whether they would appear in court on your behalf in any disputes with tenants
- the fees charged and what they include.

Hint: As soon as you settle on your investment property, arrange for an insurance policy to ensure you are covered should something happen to the property.

If your property is strata-titled, the building may be covered by the body corporate insurance policy.

Landlord insurance will cover you for loss of rent, rent default and tenant theft, property damage, household contents and public liability. The policy is inexpensive to take out and no property investor should be without it.

7. Self managed super funds

An increasingly popular way to buy an investment property is via your self-managed super fund (SMSF).

But there are rules.

ASIC advice

The Australian Securities and Investment Commission (ASIC) advises that the property:

- must meet the 'sole purpose test' of solely providing retirement benefits to fund members
- must not be acquired from a related party of a member
- must not be lived in by a fund member or any fund members' related parties
- must not be rented by a fund member or any fund members' related parties
- borrowing in your SMSF can be done but under very strict borrowing conditions called 'limited recourse borrowing arrangements'.

For information regarding buying property via your SMSF visit **ASIC Money Smart**.
https://www.moneysmart.gov.au/superannuation-and-retirement/self-managed-super-fund-smsf/smsfs-and-property

8. Understanding the lingo

Being able to speak the industry jargon is part of the fun of learning about property investment. Here's a few terms you'll need to understand to get in the know.

DEPOSIT BOND	A deposit bond is an instrument that, by agreement with the vendor, can replace the need for a cash deposit. It is a convenient way of purchasing a property without the need to arrange a large cash deposit or immediately cashing in or selling an investment that may mature at some point in the future. The deposit bond is issued by an insurer to the vendor for all or part of the deposit required.
STAMP DUTY	A state government tax based on the sale price of a property and paid by the purchaser when ownership of the property is transferred. Fees vary between states and are calculated as a percentage of the purchase price of the home, newly built house or block of land. Some states charge stamp duty on land only and not homes.
BODY CORPORATE	The collective ownership of the common areas in a subdivision of land or buildings. It is responsible for the administration, upkeep and insurance of the common areas shared by all of the owners (the common property).
MEDIAN HOUSE PRICE	The median house price is the midway point of all the houses/units sold at market price (or sold amount) over a set period (monthly, yearly, quarterly, etc.
CAPITAL GAINS TAX	Capital Gains Tax is the tax you pay on any capital gain. Capital gain (or loss) is the difference between what you paid to purchase an asset and the amount you sold it for. If you make a profit on the original purchase price of your property (if you purchased it after 20 September 1985 when the tax came into effect), you may be eligible to pay capital gains tax.
NEGATIVE GEARING	When the costs of owning a property such as interest on the loan, bank charges, maintenance, repairs and capital depreciation, exceed the income it produces.

How Horizon Property Alliance can help

The team at Horizon Property Alliance possesses an in-depth understanding of the property investment market. They bring a powerful combination of experience and professionalism to their clients.

Our mantra is about customer service.

We work with you and your financial advisors or will introduce you to highly skilled experts who will nurture you through the process. It's your choice.

We start by spending time with you to understand your financial goals and personal dreams. We choose the best property to suit your circumstances and educate you on the whole process.

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