The Property Investment Handbook

Accessing the Finance You Need

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Property Investment

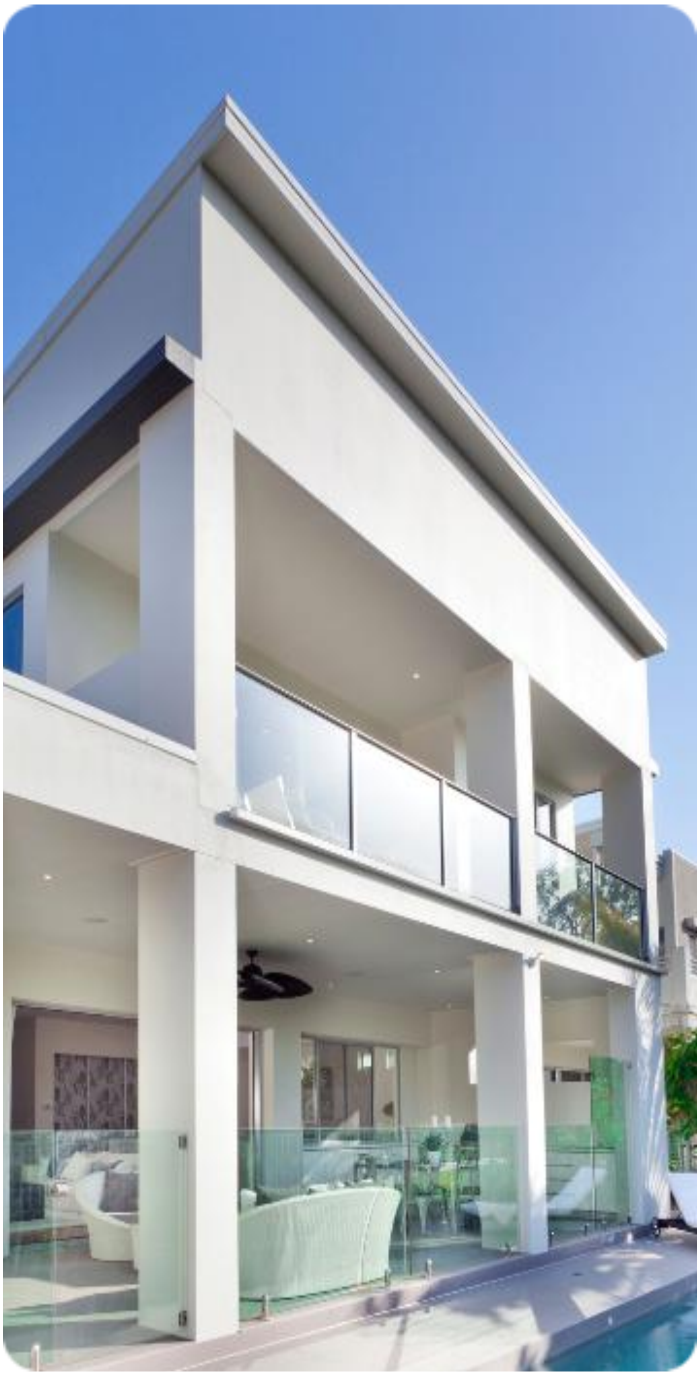
Many Australians have created wealth over the past decade, and longer, through property investment.

With low interest rates and the seemingly never ending upward spiral in property prices, it may seem property investment is a "surefire" way to create wealth.

However, before "taking the plunge," it is important to understand what is involved, not only with owning an investment property, but also the options available when it comes to finance.

Like any investment, property requires, careful research, planning and professional advice.

Whilst property investment can deliver tax benefits - they are secondary to building a quality property portfolio that will appeal to tenants and critically, provide sound long-term capital gains.



"Risk comes from not knowing what you are doing "

Warren Buffet

What Has Driven Property Prices?

- The sustained increase in property prices has been driven by a number of factors including:
- Record low interest rates
- High levels of migration over many years
- Investors seeking higher income and capital returns
- Offshore buyers
- Increasing property values becoming a self-fulfilling prophecy
- Finance availability
- Tax concessions available

Will Property Values Continue to Increase?

This is something no one can accurately predict. Indeed at the start of the COVID pandemic, one of the major Australian Banks suggested property values could fall by much as 32%! However, this did not occur and in fact, property values did the opposite!

History suggests that over the long-term, can be a sound investment. That said, history also shows there are periods where values fall or prices stagnate.

Should a downturn or shock event occur, the key is to not be in a position where you are forced to sell - to have a buffer to allow you to ride-out any difficult periods which may arise.

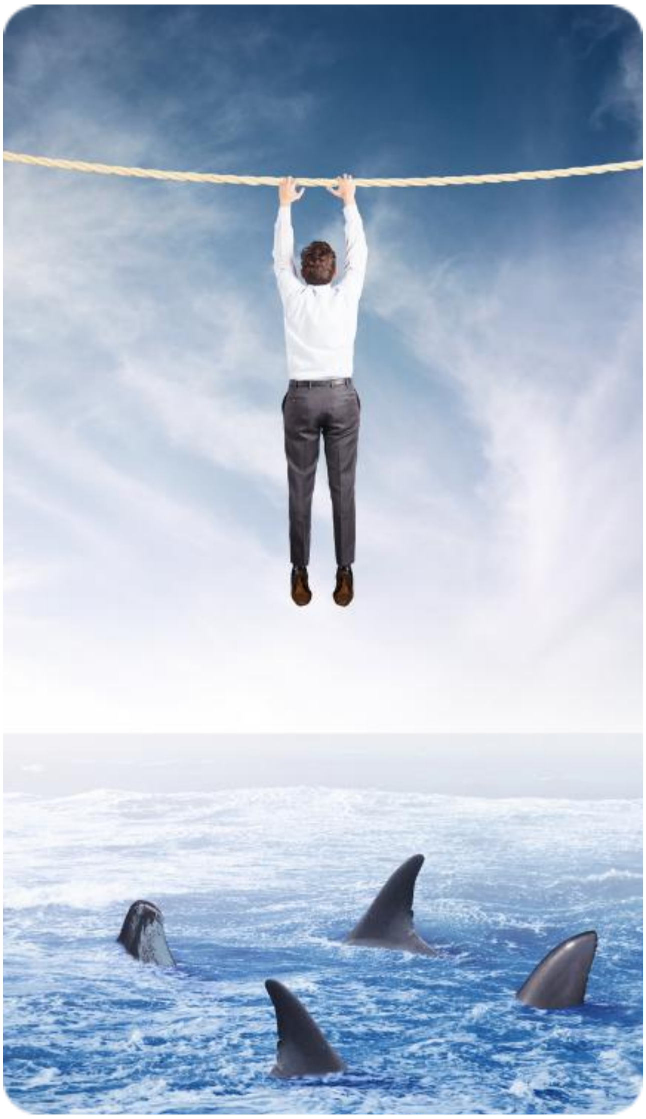
Why Choose Property Investment?

People choose to invest in property for a variety of reasons including:

- It is more tangible than some other forms of investment
- It is easier to understand
- Generally, it is less volatile than say shares
- To generate income
- To enjoy longer-term capital gain
- Take advantage of the tax benefits it can deliver

Property Investment Risks

- Whilst property has proven a sound investment over the past decade, there are risks that need to be considered:
- The quality & location of the property being purchased
- Tenancy vacancies - the need to cover lost income and advertising until new tenants are secured
- Increases in interest rates may present debt servicing difficulties
- Real estate is not as liquid if you need to sell quickly
- Capital loss in the event of an economic downturn/shock event



Seek Professional Advice

Property investment should be part of a well thought out long-term wealth creation plan.

Before embarking down this path, speak to your Accountant and/or Financial Planner - they can provide guidance around ownership, costs and tax planning - They can also help you work out what you can afford

Research to Avoid Regret!

The key to successfully investing in property is to do your research:

- Understand the market/area - if you don't understand the market, don't buy
- Check recent and historic sales in the area
- Understand the profile of the area (use ID Data) - Does your ideal tenant live in the area?
- What rentals do different types of property command?
- Are there any current, or proposed, zoning changes which could affect the property, its value and appeal?
- To understand the appetite of Lenders towards the different types of property
- The likely costs of purchasing the property (Stamp Duty, conveyancing, legal or accounting fees, borrowing costs etc)
- Ongoing costs - insurance, repairs and maintenance etc.

View Through the Tenant Eyes

Before making an offer on any property also view it through a potential tenants' eyes:

- Are there positive elements that would appeal to tenants
- Do any negative elements exist - can they be remedied? What will that cost?
- What local amenities exist?
- Shopping?
- Services? (Schools, PreSchool, Childcare, Medical etc)
- Parking?
- Public transport?

Ongoing Costs

When you buy an investment property, ongoing costs to allow for include:

- Land Tax
- Council Rates
- Utilities (connection if needed)
- Repairs & maintenance
- Accounting Fees
- Property Manager Fees
- Strata Title Fees if applicable

How Much Can I Borrow?

This is the most common question we get asked.

The answer is, how much you can borrow will be a combination of:

- The equity you can contribute to the purchase
- Your ability to repay your total borrowings at today's rate PLUS a serviceability margin of 3%

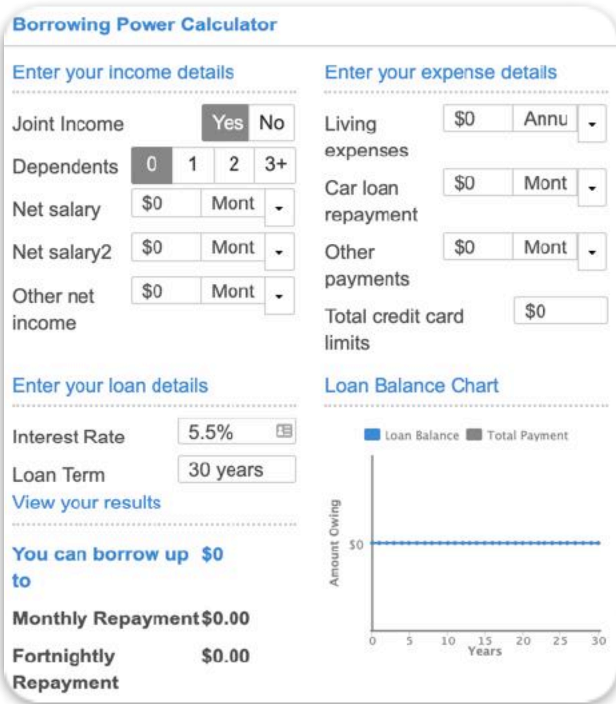
Total borrowings includes both existing and proposed borrowings and extends to:

- All personal and business borrowings
- Credit Cards
- Hire Purchase, Leases, Chattel Mortgages etc
- PayDay Schemes such as AfterPay if being used

Use Our Borrowing Power Calculator

As a starting point, it can be helpful to use our Borrowing Power Calculator get get a rough guide as to what you may be able to borrow.

(Don't forget to also include the ongoing costs associated with the property purchase)



What Equity Do I Need?

The amount of equity Lenders require will depend on the type and location of the property you are purchasing.

In general terms Lenders will be looking for a contribution of:

- 20% for houses located in the metropolitan and larger regional centres in Victoria (this may be savings or equity held in other properties)
- 30% for quality commercial property is good locations
- 20% for quality townhouses located in the metropolitan area and larger regional centres in Victoria
- 30% or more for apartments located in desirable locations in metropolitan Melbourne

The amount of equity needed will be driven by the location of the property, quality, and appetite of the Lender.

Purchase Costs

- When you apply for finance, Lenders will want to see that you have funds available to cover all the costs associated with the purchase:
- Search Fees
- Stamp Duty
- Legal and Conveyancing Fees
- Building and Pest Reports (important re cladding scandal)
- Loan Application Fees
- Mortgage Registration Fees
- Transfer Fee
- Insurance - Building, Landlord, Public Liability
- Lenders Mortgage Insurance (if required)
- Buyer Agent Fees - Will either be fixed fee or a % of the purchase price (Can range from a few thousand up to much more)
- The total costs will vary depending on the type of property purchased and location, however they will generally be around 5.5% to 6% of the purchase price.
- A helpful resource that can be used to estimate costs is the REIV Buying Cost Calculator:

REIV Buying Cost Calculator

Lenders Mortgage Insurance

If insufficient equity is held, providing serviceability is sound, Lenders may be prepared to provide finance subject to Lenders Mortgage Insurance (LMI) being take out.

It is important to note, LMI protects the Lender in the event of default. It does not protect the borrower.

If you default, the insurance protects the Lender against loss - you remain responsible for repayment of the loan.

The cost of Mortgage Insurance can be capitalised - that is; it can be included in the amount borrowed.

LMI costs between 1% and 4% of loan value.

How Lenders Assess Applications

Lenders assess your capacity to repay over normal commercial terms being, 30 years for residential property and 20 years for commercial property.

To ensure you can repay the borrowings should interest rates rise, they will also add a serviceability buffer, currently 3%, to the actual interest rate.

Note: The serviceability buffer is also added to all other borrowings you may have at the time of application.

(Excluding in most instances, Motor & Equipment Finance which has fixed rate for the life the loan)

The Finance Broker Advantage

When you use a Finance Broker - instead of seeking quotes from just one or two Banks, you will have access to our panel of Lenders - which includes all the major Banks!

This market access provides you far more choice and delivers the benefits that comes from Banks competing for your business!

Other Key Serviceability Elements

When seeking finance for an investment property, other key serviceability issues to be mindful of include:

Credit Cards

Even if not used, most Lenders will assess credits cards as if they were fully drawn at 3.80% per month.

If you have multiple cards, this can seriously impact the amount you can borrow. For example a card with a $25,000 limit would be assessed at $950 per month or $11,400pa.

Rental Shading

To allow for potential periods of vacancy and expenses, most Lenders will shade Property Rentals by 20% for debt servicing purposes.

For example, if the rental property generated income of $31,200 per year - this would be reduced to $24,960 for debt serviceability purposes.

Pay Day Schemes

Payday services such as AfterPay have become immensely popular over recent years - however they work against you from a debt serviceably perspective.

When you apply for a loan, Lenders will go through your Bank Statements in granular detail for the past 3 months (in some instances 6 months).

If they see Payday services have been used, even only occasionally, from a debt serviceability perspective, they will assume this will be ongoing - which ultimately could reduce the amount you can borrow.

Interest Only Loans

Interest Only Loans have historically been favoured by property investors to preserve cashflow and maximise interest deductibility.

However, regardless of whether an interest only period has been sought, Lenders will still assess the application on a Principal and Interest basis.

Further, if you have enjoyed an interest only period of 3 years, they will assess your capacity to repay the borrowing over the remaining normal commercial term - in this example, 27 years.

(Note: Over recent years we have seen an increasing number of investors moving their loans from Interest Only to P & I to build up equity whilst interest rates are at record low levels)

Variable, Fixed, or Split Loans

When you take out a mortgage, you will usually have the option of choosing a variable rate loan, a fixed rate loan, or even a split of fixed and variable.

Variable Interest Rates

These are adjusted with the market, if interest rates increase then you will pay more, if they decrease the reverse applies. (Although we suggest maintaining your repayments at the pre-existing level to pay your loan off sooner.)

One benefit of Variable Rate Loans is that you can attach a Mortgage Offset Account to the Loan - which is not possible for Fixed Rate Loans.

Fixed Interest Rates

As the name suggests, in this instance the rate is fixed for an agreed period. If rates move up or down you are not effected until the fixed term expires.

Fixed rates are normally higher than variable rates but can provide certainty.

However, if you want to break the fixed rate contract before expiry and/or make additional repayments, there are usually additional costs .involved.

Split Loans

In this case you can choose to have part of your loan fixed (which provides peace of mind re rates) and the balance variable.

Choosing the right option will very much depend on your personal circumstances, income and goals.

Negative Gearing

Negative gearing occurs when the costs of maintaining an investment exceed the revenue it generates in a year.

(Conversely positive gearing is where the income exceeds expenses)

Where a property is negatively geared, the resultant loss is normally tax deductible against other income earned by the property owner(s) in that tax year.

Learn More

Whilst negative gearing can deliver tax benefits, it is important to not lose sight of the fact that any loss generated will still need to be funded.

if you know in advance that a loss may arise, it is possible to apply to the Tax Office for a PAYG Withholding Variation and reduce the amount of tax taken out of your salary.

Learn More

Rental Expense Deductions

- Generally, the costs of maintaining an investment can be offset against the revenue it generates in a given tax year.
- This can include items such as:
- Interest on loans related to the property
- Advertising for tenants
- Repairs and maintenance
- Insurance
- Council & Water Rates
- Land Tax
- Depreciation on items purchased less than $300
- Property Agent Fees
- Note: Money spent on upgrading the property (extensions for example) are depreciated over a longer term, depending on the type of construction and when it took place.

Learn More

Important

Speak to your Accountant before purchasing the property to understand exactly what can be claimed and when.
Also, what can’t be claimed.

Serviceability - Information Needed

PAYG Applicants

The information PAYG applicants need to provide includes:

- Group Certificates for the past two years
- Two recent Payslips
- A breakdown of income, salary, overtime, commissions, allowances and bonuses - with supporting evidence of same
- A copy of Bank Statements confirming crediting of salary
- Last three months Bank and Credit Card Statements
- Statement of Assets and Liabilities (include all loans, credit cards, hire purchase, etc. Limit, balance & monthly repayments, etc.)

Self Employed Applicants

The information Self Employed applicants need to provide includes:

- Business, Trust and personal Tax Returns for the past 2 years
- Tax Office Notice of Assessment for the past two years
- Copy of Trust Deeds (if applicable) to confirm distributions
- Explanation for any significant variances in income
- Last 3 months Bank and Credit Card Statements
- Statement of Assets and Liabilities (include all loans, credit cards, hire purchase, etc. Limit, balance & monthly repayments, etc.)

Important!

Ensure projected income and expenses in your Monthly Budget align with “lived reality” as shown in Bank and Credit Statements.

Monthly Budget

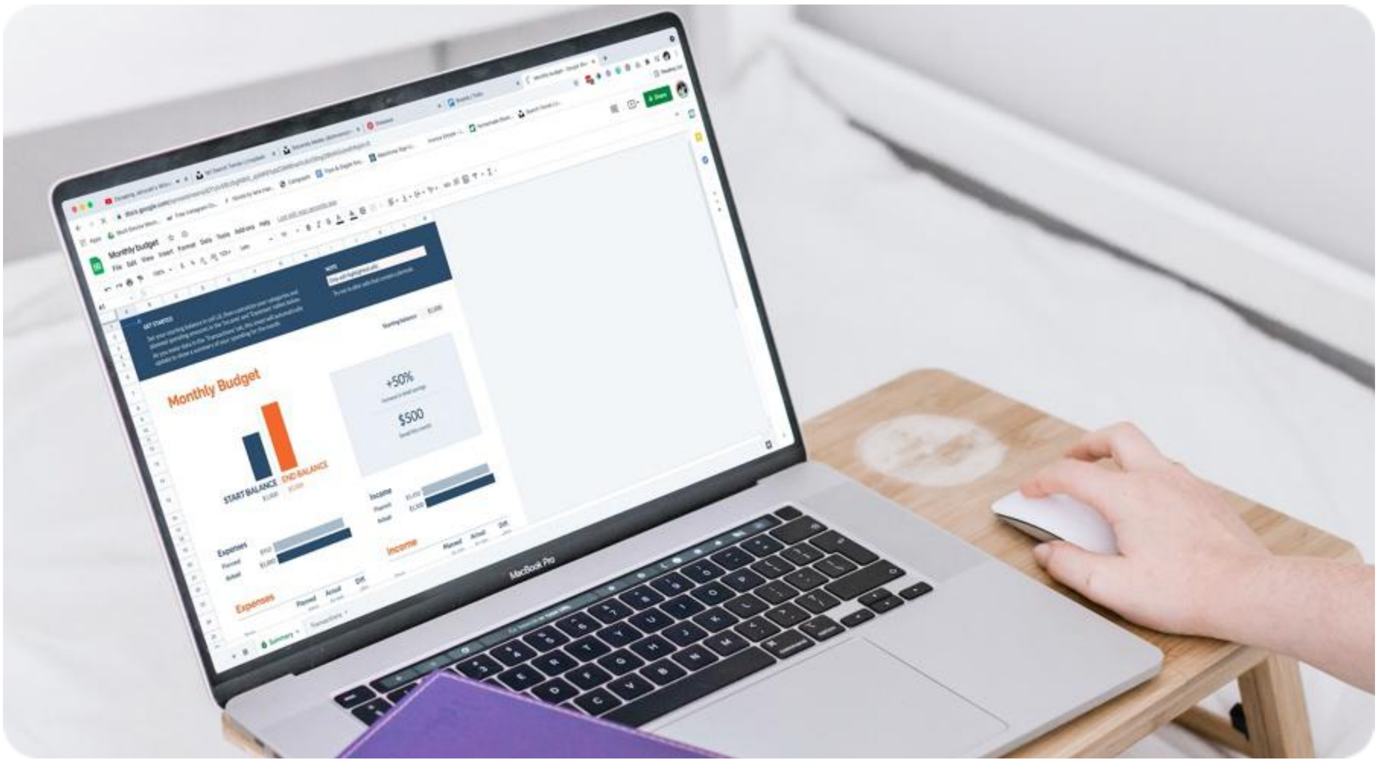
As part of the loan application process, you will be asked to complete a monthly budget that includes all income and expenses.

It is very important to ensure the expenses you record match what is recorded in your Bank and Credit Card statements.

Don’t overlook:

- Subscription services that you use
- Use of PayDay services
- Periodic payments (Rates, insurance etc)
- Ongoing costs associated with the property being purchased

(The Lenders will go through your Bank and Credit Card Statements in granular detail. If they find discrepancies in your monthly budget, it can seriously damage your creditability)



Property Valuations

Both Bank and external Property Valuers, are conservative when it comes to Property Valuations.

For construction loans and "off the plan" purchases, our experience has been the valuations can come in below the contract price.

Due to supply and quality issues, Banks also tend to dislike:

- High density greater than 3 stories
- More than 30 apartments in a complex
- Apartments smaller than 50 square metres

Whilst it is still possible to obtain finance for such properties, the equity contribution may need to be a lot higher to mitigate the potential risks.

Note - Even when the valuation is provided, Banks will usually shave it further to determine what they are prepared to lend!

Summary

Property investment has been used by many Australians to create long-term wealth.

That said, property, like most investments, is not without risk, so it is important before embarking on this journey, to do your research.

Ensure you understand the market and how all the property ownership, finance and tax elements work.

To avoid expensive mistakes, speak to your Accountant, Financial Planner and Finance Broker early in the process

Find Out More

Property Report

If you find a property you like, before making an offer, get in touch and ask about our Free Core Logic Property Report

Why The 500 Group

At The 500 Group we have assisted many clients create long term wealth through property investment. We understand what is needed to help you achieve the outcome you are seeking.

By using a Mortgage Broker you open the door to far greater choice. Through greater choice, you enjoy better leverage and negotiating power.

Our panel of Lenders includes all the major and second tier Banks. We also have access to Lenders that specialise in property investment.

All Lenders have slightly different policies, pricing, structures and appetites to lend.

We can help you source the finance you need, explain the differences between the options available and critically, save you a considerable amount of time.

Together
creating opportunities and building wealth!

Carlo Colangelo

I have a background in Mortgage Broking, Senior Relationship Management and Private Banking of more than 30 years.

I was attracted to Mortgage Broking by the ability to offer clients greater choice and through this, deliver better outcomes.

I enjoy working closely with my clients to understand their needs, undertaking research and delivering solutions that will work both in the short and long term.

Finance can be complex. Headline interest rates are just the "tip of the iceberg" - Assisting clients deal with this complexity is something I truly enjoy!

I strive to build long-term relationships with my clients and to be there for them as their needs change and evolve.

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