Investing in property

Investing in property can be a great way to build wealth and generate income, but it also comes with its own set of risks and challenges. Research & having the right people to help you is the key when investing in property.

Why invest in property?

Australians are among the most active property investors in the world, with an average of one in every three new mortgages each month arranged for investors. Most of these investors are ordinary people with ordinary jobs earning ordinary incomes. So, why is property investment so popular?

Capital growth. Capital growth is the increase in value of property over time and the long term average growth rate for Australian residential property is about 7% a year. Importantly, because property markets move in cycles, property values go through periods of stagnation as well as decline. This is why taking an investment view of at least 10 years is important.

Rental income. Rental income, also known as yield, is the rent an investment property generates. You can calculate this by dividing the annual rent by the price paid for the property and multiplying it by 100 to produce a percentage figure. As a general rule, more expensive properties generate lower yields than more moderately priced properties. There is also usually a direct inverse relationship between capital growth and rental income. Those properties producing a lower rental yield will often deliver greater capital growth over the long term. As a rule of thumb, between 6% to 8% is considered to be a good level of rental yield.

Tax benefits. The Federal Government allows you to offset against your taxable income any losses you incur from owning an investment property. For example, if the amount you receive in rent from tenants is $5,000 less than the cost of servicing the interest on the mortgage, and paying rates, water and other fees associated with the property, at the end of the year you can add that $5,000 to the amount of income on which you don’t have to pay tax. If you work as an employee, with income tax automatically deducted from your pay, this means you’ll receive a refund from the Australian Taxation Office (ATO) after the end of the financial year.

Low volatility. Property values generally fluctuate less than the stock market. Many investors say they experience greater peace of mind for this reason.

Leverage. Property enables far greater leverage than many other investments. For example, if you have $100,000 in savings, you could invest it in a portfolio of shares, or use it to buy a property worth $500,000 by taking out a mortgage for $400,000. If shares go up by 10% during the year, your share portfolio would be worth $110,000 and you would have gained $10,000. If property goes up by 10% during that same year, your property would be worth $550,000 and you would have gained $50,000.

You don't need a big salary to invest. If you are buying to invest, lenders will take rental income as well as your own income into their assessment. If you already own your own home and have some equity in it, you may be able to use this as a deposit, meaning that you can buy an investment property without having to find any additional cash. If you don't own your own home and feel you may never be able to afford one, buying an investment property may be a good stepping stone to one day being able to afford your own home.

Unit or House?

House prices often increase in bigger strides than units, offering more potential for capital gain over time. But a rental home also comes with added responsibilities, including gardens and lawns (and sometimes a pool) to maintain.
A unit or townhouse may not increase in value as quickly, but they are generally easier to maintain and may even be easier to rent for that very reason, depending on location, condition and size.

Location

Location can mean different things when it comes to rental properties. Renters are often looking for maximum convenience so consider properties near schools, major shopping centres and public transport. Spend plenty of time researching target areas, including recent property price movements and future predictions, rental vacancy rates and any proposed infrastructure improvements. You should also do some scouting as if you were a renter to get a first-hand look at the local market.

Remove the emotion

One of the worst mistakes you can make with any investment is to buy with your heart instead of your head. Remember, your rental property is not your 'home sweet home'. A well-presented property is desirable, but think sensible, not swanky. Ideally, you want a neutral interior colour scheme, serviceable and resilient flooring and window coverings, a low-maintenance yard and good storage. And if buying an older style unit, look for one with an internal laundry, a garage or car space and few stairs (unless there's a great view to be had higher up, which can add to the property value).

Don't forget the extras

An investment property requires regular financial commitment beyond the loan repayments. Make sure you have the capacity to cover land and water rates and any maintenance and repair costs. Tenants are entitled to repairs or replacements as quickly as possible under their rental agreement, so you will need to have the means to pay. Apartments or units also come with body corporate fees, which can run to thousands in some modern complexes with professional landscaping and shared amenities, such as swimming pools.

Cover your investment

Make sure you take out landlord's insurance. This will cover you for damage caused by a tenant and unpaid rent if a tenant skips out, in addition to other standard risks, such as a house fire or a storm. If you invest in a strata title property, make sure the body corporate has sufficient building insurance to cover the cost of rebuilding the complex in today's prices. It's often hard to work out what you need to cover versus what the body corporate covers. A good rule of thumb is everything from the wall paint inward is yours and everything outside of that is covered by the body corporate.

Any interest?

Many property investors take advantage of interest-only loans because interest payments are tax deductible. That means you're taking a punt that the property's value will increase over time, leaving you with a financial gain in the long run.
This is a good strategy for high income earners who are taking advantage of negative gearing. If you choose to positive gear your investment (i.e. generate a profit from the rental income after costs), you might want to consider a principal and interest loan and use the profit to shave off the principal. Just remember, you will pay tax on any income from your investment.

Taking ownership

Couples taking advantage of negative gearing should put the investment property mostly or fully in the name of the highest earner to reduce their taxable income. If you need both incomes to be considered in the lending equation, speak with your broker to get the right advice on the best ownership equation for your circumstances.

Appreciate depreciation

The ATO will give you a discount off your tax bill for wear and tear on property. It's known as depreciation, and can be a very handy windfall for investors, especially if you buy a new property. The formula is quite complex and depends on the age of your property, building materials and the various fittings. That's where a professional quantity surveyor comes in. For a fee (often around $600), they'll assess the property and complete a Tax Depreciation Schedule, which your accountant will incorporate in your tax return.

Manage your investment

Managing a property takes time and energy. If you don't have much to spare of either, you should get a professional property manager to advertise the rental, screen and select tenants, collect and pay the rent, co-ordinate repairs and maintenance, provide condition reports and manage any disputes. Ask other local landlords for referrals for reputable managers. You should also conduct twice-yearly inspections yourself. Any associated costs, including travel and accommodation, are tax deductible. If you decide to self-manage, you will need to be well-versed on tenancy laws and prepared to organise repairs, including those that arise after hours.