Partnersing with you to buy your home or investment property

Buying an Investment property
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Investment property expenses
To run a successful rental property you’ll need a detailed budget. Here are some of the expenses you might want to include:
- Advertising for tenants
- Loan interest
- Rates
- Insurance
- Professional services fees (such as an accountant or lawyer)
- Taxes and/or tax returns
- Body corporate fees – mainly for apartments and townhouses on shared land, and these can be quite expensive
- Property management fees – if you use a property management service
- Maintenance – floor coverings, interior and exterior painting, exterior cleaning (like gutters, decks, railings or water blasting slippery pathways) bathroom, laundry and kitchen upkeep, and don’t forget replacing appliances if they are part of the rental package
- Lawn and garden care – you might not want to rely on your tenants to do this
Investing in property is different from buying a property to live in and comes with a different set of considerations. Before you even begin looking, it’s important to consider what you want to achieve from the investment. Are you seeking capital gains from a quick make-over and re-sell, or would you like a steady income from rent? Your objectives not only influence what kind of property you look for and where, but it will also affect your budget and your financial structure.

Residential property is a popular choice for starting an investment portfolio, and it’s important to understand all the pros and cons of all the options available to you before you make a purchase, and have strategies lined up so that you can stick to your plans and make money from your investment.

Of course you’ve considered the benefits of owning an investment property, but have you considered the responsibilities? If you’re going to rent it out, you can either pay a managing agent or manage it yourself. It’s cheaper to self-manage, which is tempting, but you will need to do everything yourself:

- Marketing and leasing the property
- Collecting rent
- Maintaining accurate records of expenses for your tax return
- Conducting inspections
- Managing repairs and maintenance
- Resolve any complaints or conflicts with the tenant

If you have plenty of time and the appropriate skills then this might be the best option for you. If you don’t, it’s worth the extra expense of using a reliable managing agent. Agents’ fees will take a percentage (usually about 6–7%, which may be tax deductible) out of your rental income, but it’s worth it in terms of reducing your stress and avoiding the potential for mismanagement.

Owning an investment property is usually a long-term investment. This means you need to be able to ride through the financial lows so that you are still there to cash in when the market goes through an upward cycle.

When you’re working out how much you can afford to borrow to buy an investment property, it’s tempting to try to maximise your borrowing against the purchase price to make the most of tax advantages. Borrowing up to 95% or 100% can seem like a great strategy, but if the market drops or interest rates rise you could find yourself with a loan you can’t afford to repay, and a property you can’t afford to sell. Consider having a ‘buffer’ in your finances so that you know you can still cover payments if there’s a downturn, and you know you’ll do well if there isn’t.
Understanding the financial risk

As with any investment, research is all important before you commit. With investment properties, the key to success is continuous tenancy, as you’ll need the rental income to help cover your loan repayments. Make sure that you have the kind of property that will attract good tenants, who will look after the place and pay their rent on time and gear your marketing and price-point to them. Even the best properties can see gaps in tenancy, so you may also consider suitable insurance to cover any unforeseen circumstances that might affect your rental income.

There’s always a chance you could lose money, so taking the advice of an accountant, lawyer and financial planner is a good idea before investing in anything. Professional assistance in the investment process has helped many people achieve their financial goals through property ownership.

If you are investing in a unit, you may be able to simplify your research: a managing agency may have a complete history of the unit and the apartment block or, for a small fee you can get a strata search.

Market research

When you look for an investment property, you’re not looking for your personal dream home. Remember, if you don’t intend to live in it yourself, look at it with ‘investment eyes’ only.

Look at things like proximity to public transport, schools, shops and parks, and consider noise, neighbours and future growth plans in the area. Sometimes it’s a good idea to check with the local neighbourhood watch or local police to get an insight into the relative safety of the area. Nobody wants to buy an investment property in a high crime zone, and taking the time to ask questions will help you avoid this.

If you have the time and patience to look at a lot of properties, and your financial plans don’t call for an immediate start, then you might decide to wait for a bargain. They are rare but they do turn up – getting a top price may not be as important to the vendor as a fast sale.

Comparing different investment properties

When you’re choosing investment properties, one way to decide which is the better investment is to look at the yield. The yield is the return (expressed as a percentage) that you will get on the cost of the property after expenses but before tax. Don’t include the loan in this calculation, as the amount may differ depending on the property you buy. Your total return is the yield plus or minus any tax advantage, capital gain or loss, loan costs and interest.
If you already have renovation skills, or you’re willing to manage and pay for a renovation project, then buying a cheaper property that needs work might represent a real opportunity. The secret is in budgeting the renovation correctly and only undertaking smart alterations that will add value. These can give you an early increase in value and help you attract higher rent and better tenants. If you have the capacity to service the loan while the property is being renovated it’s a good option to consider.

If you need to spend money on renovations before you can rent a property out it’s particularly important to pay the right price in the first place. It’s easy to be tempted by a cheap ‘renovator’s dream’ but you need to be careful (especially in the excitement of an auction) that you don’t overpay. Build the cost of renovation and lost rent into your financial plan when you’re calculating how soon you will break-even or make a profit, and make sure you can cover the expense.

The right loan for an investment property is not necessarily the same loan you would take out for your own home. Our financial specialist can help you to select the best loan option and structure to meet your investment needs.

Interest only loans are often useful for investment properties if you still have a loan against your principal residence. During an interest-only period, you only pay back the interest that your loan incurs, so any spare cash flow can be used to reduce your home loan debt which, unlike the interest on an investment property loan, is not tax deductible.

We can help
To help you with your research, BOQ Specialist can provide specific information including monthly national property market reviews supplied by independent valuation companies. Ask for a financial specialist on 1300 131 141

Insurance considerations
Compared with the insurance you might be used to as a home owner, the insurance you need as a landlord needs to take other things into consideration. These include:
- Loss of rent if your property becomes uninhabitable due to some insurable loss (such as a fire)
- Loss of rent because the tenant left without giving notice or you had to evict them
- Theft or loss of your own possessions from the property
- Deliberate damage or vandalism to the property or your possessions – standard home insurance will normally only cover accidental damage

If you’re thinking of using the equity in your family home to help buy an investment property, you should also review your life insurance. It is important to be sure that you have enough money to cover the mortgage should something adverse happen to you or your investment property.
Owning an investment property is like running a business and, as with any business, income (in this case, rent) is taxable. This means you’ll have to include your rental income in your tax return each year.

On the upside, legitimate expenses relating to the property are normally tax deductible. These are usually payments you have made during the tax year for things essential to the management of your investment property. These things include the interest you pay on the investment property loan, and normal repairs and maintenance. Capital improvements to the property, such as renovations that add to its value or increase the rent you could charge, are not tax deductible.

Tax laws can change at any time and as your investment property could be a mid- to long-term investment, you need to keep this in mind when you make your calculations. For this reason some property investors don’t rely on tax savings in their financial plan, but simply treat them as a bonus when they occur.

When you decide to sell your investment property you may be liable for capital gains tax. If you have had the property for longer than 12 months when you sell the rate is reduced, but it is still an expense you need to consider.

For detailed and current information on the tax treatment of investment properties, we recommend you visit the Australian Tax Office website at ato.gov.au or talk to your accountant or tax adviser.

Positive and negative gearing
You’ve probably heard the phrases ‘positively geared’ or ‘negatively geared’ in relation to investment properties. A positively geared property means that the rental income you receive from your investment property is greater than all of the costs of owning it, including interest rates, insurances, body corporate fees, maintenance and so on. With a negatively geared property, the expenses are greater than the income, and you are reliant on tax deductions or future equity to make it worthwhile.

Sometimes the rent a property earns will always be less than the ongoing ownership costs (such as the interest on the loan) and management costs (such as the agent’s fees), and you will need to make up the difference from other sources of income.

The loss you make on the rental property may reduce the tax you pay on your other income, but this is not guaranteed. If, over the years, the property does increase in value, you will only see a return on your investment after the property is sold, or if you decide to borrow against the equity.

You may be happy to put your own money into the investment in the expectation that the property will increase in value and compensate you in the long term.
The easiest way to influence the gearing of a property is by adjusting your expenses. Normally the one major expense you can change is the interest, usually by either borrowing more or less where possible.

**Depreciation**
You can also claim a depreciation deduction for items such as furniture and some appliances that you have purchased for an investment property. Depreciation works by writing off the cost of the item over a set number of years (known as the effective life of the asset). For properties constructed after July 1987 you can also claim depreciation of the building itself.

*It’s a good idea to start talking to a quantity surveyor or a depreciation specialist early so you make full and correct use of the available depreciation deductions. If you’re using negative gearing, the higher your depreciation bill is, the more you can offset against your income.*

Ownership structures

There are many different ways you can own an investment property, and the ownership structure can make a difference to the way taxes are calculated and managed. Different structures also offer different levels of separation between the property investment and your other possessions and businesses if things go wrong. Some of the more common structures are personal or joint ownership, or ownership through a trust or a non-trading company.

- **Individual or joint ownership** is where you buy a property in your own name or joint names. Any rental income you have left over after expenses is added to your personal income/s and is taxable. If your investment property makes a loss because the expenses are more than the rental income, it might be possible to deduct that loss from your other sources of income. This can reduce your total taxable income and therefore the tax you have to pay. It won’t recover the entire loss, just a percentage of the loss up to the total of any tax you have paid.

- **Ownership through a trust** helps separate the income or loss from the rental property from the rest of your commitments. Trusts have separate accounts and tax returns, which can add to your accounting costs. Trust income can be shared by the members of the trust, which can make it easier to share the proceeds of a rental property with others, such as family members.

- **Company ownership** is where you establish a company and the investors in the property become the company’s shareholders and directors. The rental property is owned by the company and the income, loans and expenses are all in the company’s name.

It’s important to get advice from your accountant, lawyer and/or financial planner before deciding which structure would best suit your requirements. For the most up to date information on investment income tax visit the Australian Tax Office website at ato.gov.au