24 KEY QUESTIONS ANSWERED

Investing in property is a proven way to build long-term wealth. Our guide will point you in the right direction

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1 WHAT ARE THE BENEFITS OF INVESTING IN PROPERTY?

There are a number of advantages of investing in property – two big ones are that you can get both regular income and capital growth. If your property is tenanted you will get money coming in each fortnight or month. Sure, there may be times when your property is vacant but there are a few things you can do to limit these periods. Then, of course, there is capital growth. As long as you choose an asset in an area where there is demand, then the value of your property should grow over time. It won't necessarily grow every year and there will be times when the value may fall but over a five- to 10-year horizon there should be steady growth. The other bonus is that there are things you can do to help add value to your investment, such as renovating or developing the property.

Property in Australia also has a number tax advantages. Depreciation allowances, building allowances, maintenance, leasing and management costs and interest payments can significantly reduce the income from investment property, and therefore the tax payable on that income. Any loss can be offset against your other income, reducing the overall amount of tax you have to pay.

Another attraction is that it's tangible. You can see it and you can touch it. Unlike shares or funds, it exists and it's not just a price you look up on the internet. Finally, you have an element of control. You can choose how it is maintained and presented and who you will rent it out to.

2 WHAT ARE THE DISADVANTAGES OF INVESTING IN PROPERTY?

The entry costs are a major drawback. Unlike shares in a company, most property assets cannot be broken into smaller chunks, meaning you need a sizeable amount of cash or equity in other investments to become a landlord. As well as the deposit there are other costs associated with buying property, such as stamp duty.

Then there are ongoing costs such as loan repayments, paying a property manager and land tax. The fact that buying a real estate asset requires a big outlay makes it harder to diversify.

Property is also not very liquid. There is a lot of money allocated to one asset and if you suddenly find you need the money that is tied up in real estate it is not that easy to get your hands on it. You want to be able to time any sales so they take place in a buoyant market to maximise your price. In contrast, shares and units in managed funds are easily sold.

It can also be a hassle – there may be times the property is vacant, needs major repairs and has nightmare tenants which all dim the shine.

3 SHOULD I BUY MY FIRST HOME BEFORE INVESTING IN PROPERTY?

The great Aussie dream has always been to own a home but it's not always the best strategy, especially if affordability is an issue. A growing trend is something called "rentvesting". This involves renting where you want to live but still looking after your future by investing in property. "In simple terms if you could afford to buy in a location and the mortgage repayments were $4000 per month, yet to rent a similar property in the same location it was only $2000 per month, then you have a spare $2000 per month to invest in property," explains Ben Kingsley, from Empower Wealth. The goal is to build a property portfolio that grows in value and offers passive income over time and to maintain your lifestyle by living where you want instead of where your budget says you should.

As well as the lifestyle benefits and the fact that you're still building wealth, other advantages of rentvesting include the fact that you get regular income and there are tax benefits, so they ease the burden of meeting ongoing costs of owing a property.

There are a few cons, though. A big one is that you lose the capital gains tax exemption associated with owning your own home. Then there's the emotional cost – you miss out on owning your own home and being able to put a stamp on your home. As a renter you lose some control – you may have to move when the landlord wants it rather than on your own terms.

The dream of owning your own home is not always the best strategy

Kingsley says that for rentvesting to work you must actually invest the surplus money, otherwise more than likely you would have been better off financially with the buy-and-live option. "Rentvesting works best when there is a good-sized differential between what it costs you to buy versus what it costs you to rent," he says. "So if buying a property was costing 6% in interest and 1.5% of its value in holding costs to own – 7.5% versus renting the property, say, at 3.5% of its value – the differential is 4%. It's this differential that creates the financial benefit of rentvesting." A final point: because tax benefits can and do play a secondary role in assisting with initial cash flow and therefore holding costs, the higher the tax rate paid the better the strategy works, adds Kingsley.

4 HOW MUCH DEPOSIT DO I NEED TO BUY AN INVESTMENT PROPERTY?

At the very least you'll need 10%. "For an owner-occupied loan, you can borrow as high as 95% of the value of the property with a large number of lenders, so the deposit required is 5%," says Anouska Linz, online sales manager at State Custodians. For an investment property your contribution is going to double this at around 10% as there are very few lenders that will lend above 90%

for investment properties." In fact, some lenders have reduced how much they would lend to 80% or even 70% of the value of the property, she adds.

"If you have received a gift and not saved this money yourself, the amount you borrow may be restricted to less than 85% of the purchase price," says Linz.

If you are borrowing more than 80% you will probably need to pay lenders mortgage insurance (LMI), which protects the lender (and not you) if you are unable to meet your obligations in repaying the loan. This will generally be about 1.5% to 2% of the loan amount.

5 I OWN PROPERTY ALREADY – CAN I USE THE EQUITY AS A DEPOSIT?

You certainly can – this is probably the easiest way to buy without actually saving a deposit. There are two main ways you can do this – one is to increase your existing loan and use the increased borrowings for the deposit and the other is to cross-collateralise, where your home and the new property are used as security on the new loan. There are pros and cons associated with both these options. See the article on page 62.

Revenue neutral means income is roughly equal to expenses

6 I'VE HEARD ABOUT NEGATIVE GEARING AND CASH FLOW POSITIVE – WHAT IS THE DIFFERENCE?

Negative gearing is simply what happens when you make a loss on an investment because the costs exceed the income. You can then offset the loss on your investment against other income such as your salary.

Positive cash flow is actually a form of negative gearing but what happens here is the deductions are so good they give you enough tax back to pay the shortfall and then some, so you actually don't have any out-of-pocket expenses.

Low interest rates have created a situation where many investments are "revenue neutral", where the income from the investment is roughly equal to the expenses. Low rates might even make it possible to find property that is positively geared, where the income from the investment is higher than the expenses, so you are making an annual profit rather than losing money and claiming a tax benefit. The article on page 28 goes into more detail about all the gearing options.

7 WHAT IS DEPRECIATION?

Depreciation is essentially a tax deduction available to property investors. It's a great deduction largely because you don't actually have to spend the cash to get the benefit – the deductions are built into the purchase price of the property.

There are two types of depreciation allowances available – depreciation on plant and equipment, and depreciation on buildings (known as a building allowance).

A quantity surveyor can prepare a depreciation schedule that provides a detailed description of your property and outlines the claimable deductions you're entitled to. Tyron Hyde, from quantity surveyor Washington Brown, offers more information on how you can benefit from depreciation on page 122.

There are other tax benefits associated with owning an investment property, including being able to claim a deduction for many property-related expenses such as borrowing costs, bookkeeping, council rates, insurance, land tax, advertising for tenants, mortgage interest, garden and lawn mowing, pest control, property management, repairs and maintenance and strata levies. H&R Block's Mark Chapman gives a detailed rundown on property and tax on page 118.

8 WHAT TAX WILL I HAVE TO PAY?

You will have to pay tax on the rent you receive but this can be offset by the expenses on which you can actually claim a deduction. You will also have to pay capital gains tax (CGT) on any profit you make when you sell the property.

You can add the buying costs such as stamp duty to your cost base and take out selling costs such as real estate agent's fees, which will reduce your profit and therefore the amount on which you need to pay capital gains tax.

CGT is charged at your marginal rate but if you own the property for more than 12 months you become eligible for a 50% discount.

9 DO I HAVE TO BE WEALTHY TO INVEST IN PROPERTY?

Not necessarily. Owning an investment property may seem a luxury of the rich, but most investors earn less than $80,000, according to the tax office. Once you take into account the rental income and the tax benefits, buying an investment property is more affordable than many realise. On page 70 you'll find plans to get you into the property market even if you have a small budget. It may even be possible to find a property that costs you nothing each week.

10 WHAT ARE THE COSTS ASSOCIATED WITH HOLDING AN INVESTMENT PROPERTY?

There are plenty of expenses that you'll need to budget for. The biggest will probably be your mortgage repayments and these will obviously be higher if you choose to pay principal and interest.

If you hire an agent to manage the property you will need to pay those fees. You'll also have to pay land tax, council rates, bank fees, insurance, water rates, bank fees, body corporate fees, repairs and maintenance. It's not a bad idea to have a buffer in your savings for periods when the property is vacant.

11 IS AN INVESTMENT LOAN DIFFERENT FROM A HOME LOAN?

Investment loans these days tend to be much the same as traditional home loans offering the same features but investors are paying more than owner-occupiers since the regulator APRA cracked down on investment lending. The average difference between investor and owner-occupier rates is 0.34%, says RateCity.

"When looking for an investment property your goals are different to when you are looking for a home to live in so what you are looking for will be different in some areas and the same in others," says Linz.

Finding a great rate should be a priority whether you're looking for an investment loan or home loan. You may not, however, need all the bells and whistles such as redraw. See page 52 for tips on choosing a loan.

Have a savings buffer for periods when the property is vacant

12 DO LENDERS INCLUDE RENT PAYMENTS WHEN WORKING OUT IF I CAN SERVICE A LOAN?

Generally yes but they are usually discounted to account for periods when the property is vacant and for expenses such as council and strata fees, says Linz. "Typically it is discounted by 20% so only 80% of the rent is added to your income," she says. It's worth checking with the lender to see how they treat rental income.

13 SHOULD I PAY PRINCIPAL AND INTEREST OR INTEREST ONLY?

The advantage of taking an interest-only loan is that the repayments will be lower, making it more affordable. The extra cash can then be used for other goals.

On the flipside, though, some lenders charge a higher rate on interest-only loans and most lenders limit the number of years a loan can be interest-only. When that time is up you can try extending it or you will have to revert to principal and interest, which could mean quite a big jump in repayments.

With interest rates currently so low it can make sense to pay off some of the home loan principal now, so if rates rise in the future you will be paying those higher rates on a reduced loan size, says Canstar.

The right decision will vary depending on your personal circumstances. If you have non-deductible debt such as a home loan, then you might consider using the savings you have made by paying interest-only to pay down that debt.

WHAT IS NRAS? 14

The federal government's National Rental Affordability Scheme (NRAS) began in 2008 to encourage the supply of 50,000 new affordable rental dwellings. The government is offering annual guaranteed incentives for 10 years. In return, investors must provide the residences to approved tenants at a rate at least 20% below market rent. The incentive for the 2016-17 financial year is $11,048.

The scheme will end for new investments on June 30, 2016, although owners of NRAS properties will continue to get the tax incentives for 10 years from acquisition.

15 JOINT TENANTS VERSUS TENANTS IN COMMON

A joint tenant arrangement, usually by married or de facto couples, is where the property is held in equal shares. If one of the joint tenants dies their interest automatically passes to the other owner.

Tenancy in common is the most common way to buy a property with two or more people who are not either a married or de-facto couple. This type of ownership allows the property to be split any which way, not necessarily into equal shares. Three people can all buy a third or it can be divided in other ways. Under this arrangement your share of the property can be left to the person of your choice when you die.

16 WHAT IS A RENTAL GUARANTEE?

It is when a developer or marketer guarantees a certain rental for a period of time and, of course, it can sound very attractive. It's important to be aware, though, that there are generally strings attached. The cost of the guarantee, and often more, is normally factored into the purchase price. So in effect you are paying the developer upfront for the rent they will repay you over the next few years. That is if they are still around to honour the guarantee. Proceed with caution if you're offered a rental guarantee and consider getting an independent valuation to make sure you're not overpaying.

Investors have been burnt by dodgy land banking schemes

17 WHAT IS LAND BANKING?

Land banking is the process of securing future property development sites today at the current price. The idea is that the land will appreciate in value and you can add value by obtaining property development approvals.

It's popular among big developers but it can work for small developers too, says Michael Yardney, director of Metropole Property Strategists. And you don't necessarily have to buy vacant blocks of land. "I buy old houses close to their use-by date on well-located blocks of land, with property development potential in top suburbs," says Yardney.

"While the rent I receive partially offsets my holding costs, I add value to my site by obtaining property development approval (DA) and then over time proceeding with the property development."

Not all properties make good development sites so you need to do your homework.

You also need to watch out for land banking schemes, as people have been burnt by developers and promoters selling blocks of land.

ASIC warns that the schemes are often unregulated and investors have little protection if something goes wrong. Visit moneysmart.gov.au and search for land banking to read about what could go wrong and the checks you should undertake.

18 WHERE DO I GO FOR ADVICE?

If you want advice about shares you see a stockbroker, if you want help with your retirement planning or superannuation you see a financial adviser, but where do you go if you want advice about property? Buyer's agents are one option – they can help you identify opportunities. Another is property advisers. Just make sure they are accredited. If you're serious about property investing it's a great idea to have a panel of experts at your disposal, including an accountant, mortgage broker and solicitor, for example. For more hints see page 32.

19 HOW DO I SPOT A PROPERTY SPRUIKER?

Dodgy seminars and free flights are usually a dead giveaway but some property spruikers may be more subtle in their approach. Empower Wealth's Bryce Holdaway says one sign is that they are recommending properties that have been heavily marketed away from the local area. Another sign is rental guarantee. "To me that is a huge warning bell. Because if you are buying an investment property and it is in demand by tenants in the local area, why do you need a rental guarantee?" he says. Another sign is a heavy emphasis on tax. Holdaway says you shouldn't get seduced by the tax; just see it as a bit of a bonus.

20 WHAT INSPECTIONS DO I NEED WHEN I HAVE FOUND A PROPERTY I WANT?

A building inspection that looks at the condition of the property, including the roof, plumbing and wiring and general structural issues, and can identify problems such as rising damp is a must. You'll also need a pest inspection, which will identify if there are any termites. The cost depends on the size of the property but as a guide you're looking at anywhere from $600 to $1000-plus for the two.

If you are buying a strata title property you should also get a strata report done. This costs about $300.

21 DO I NEED A PROPERTY MANAGER?

Sure you can save the cost of the agent's fees and deal directly with your tenant but be prepared for calls when things break down and you'll need to have a good source of tradespeople you can call on for repairs. A good property manager can make holding an investment property much less of a headache and you won't have to deal with all the minutiae that come with being a landlord. Most experts agree that hiring a property manager will be money well spent. Just make sure they're a good one. See page 128.

22 WHAT INSURANCE DO I NEED?

There are two main types of cover you need for your property. One is building insurance, which will protect you for damage to the actual building from things like fire, storm damage, earthquakes, etc. The other is landlord's insurance, which should cover you for malicious or intentional damage to the property by tenants or guests, accidental damage, theft, loss of rent if a tenant defaults on payments, public liability and legal expenses you may have to pay if you take action against a tenant. The article on page 126 contains more information.

You don't want to lose the investment property if you're off work sick for an extended period and can't afford repayments, so consider income protection. And if you own the property with someone else you don't want to saddle them with all the repayments if you were to die, so taking out life insurance can help you avoid that situation.

"In seven to 10 years the property should have doubled in value"

23 WHEN SHOULD I SELL AN INVESTMENT PROPERTY?

Property is generally a long-term investment, unless you have started out with a plan, say, to renovate and "flip" the property for a profit. "Ideally never sell an investment property but hold onto it for life. At a minimum an investment-grade property should be held for seven to 10 years, in which time it should have doubled in value," says Paul Nugent, director, Wakelin Property Advisory. "However, you want to exit from a poor-performing property far sooner. If after three or four years a property is delivering weak growth, sell it and reinvest elsewhere." For more on selling see page 136.

24 WHAT IF I WANT TO LEAVE PROPERTY TO MY CHILDREN?

You can leave it to your children in your will but if there is still debt outstanding you might consider if they will be able to afford the repayments. There may also be some capital gains tax implications for them if they sell the property. Another option is to transfer the property to your child or children. This might be done as a simple property transfer, although some experts say a contract for sale may offer greater protection. It's worth discussing the options with the conveyancer or solicitor to decide the right approach. There may be tax implications associated with transferring property to family members. For example if you acquired the property on or after September 20, 1985, you may be hit with capital gains tax. The other issue to consider is stamp duty. *M*