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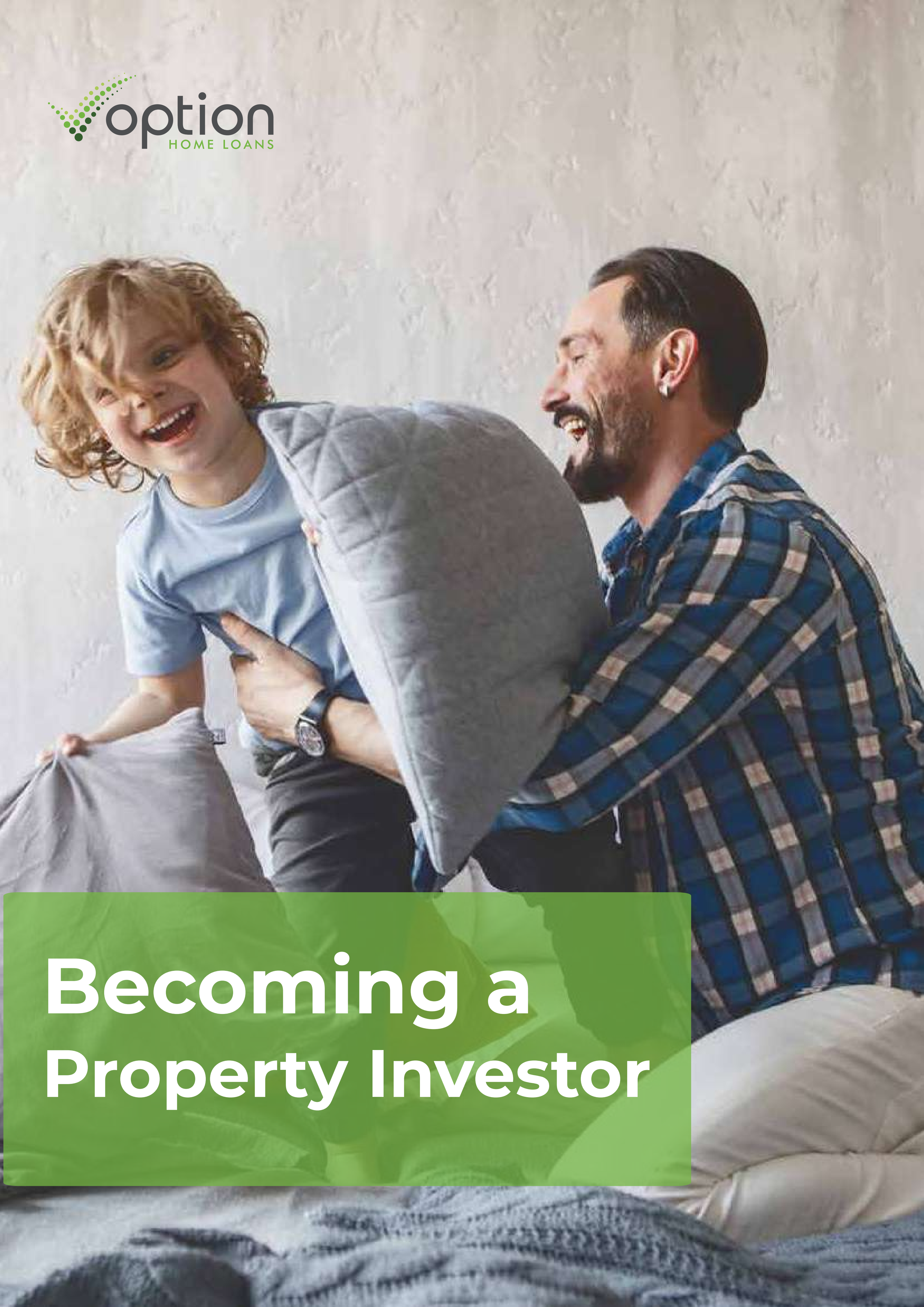

# Becoming a Property Investor

# Welcome to
# Option Home Loans

## Contents.

# Getting Started.

We have had extensive experience in the investment property market, and have developed deep insight into how the market works. We have created this guide to provide you with tips and insights which are designed to assist you when making the decision to invest in the property market.

We believe that one of the key pillars of creating a profitable property investment portfolio is to obtain the best loan and finance options.

We've helped investors looking to get their first foothold in the market and helped others build multi-property portfolios

Our Lending specialists can save you valuable time by searching and comparing hundreds of loans from over 30 leading lenders including the big banks and our own award winning loans.

Our service to you is free, because we get paid commission by lenders. For first time investors and seasoned investors alike, we take the time to search you for the best finance options and then recommend a home loan that's right for you.

# The golden rules of property investing.

Investors tend to like property investment for three key areas of potential. Understanding each of these individually and how they work together is essential in planning your investment strategy. Successful property investment depends on planning and research.

## Capital Growth

Where you may benefit from the property increasing in value.

## Rental Income

Where you may benefit from an ongoing income stream.

## Tax Benefits

Where you may benefit from favourable tax treatment.

# Capital growth.

Historically, property values  have increased in over time. If you buy at one price and then sell at a higher price it delivers a profit to you.

Capital growth is the difference between your purchase price and increases in value over time.

While capital growth may seem like a sure thing if you look at recent activity in some markets, it's important to understand that when it comes to property, there are no guarantees. That's why your investment strategy should consider both sides of the story.

To make a capital gain on your property, its value will need to rise more than the costs associated with buying and selling. Costs include stamp duty, legal fees and the commission you will pay to the agent selling your property.

These costs can add up to tens of thousands of dollars. That is why capital gain should generally be considered a long-term benefit of property investing, not a quick win.

In the ten years to July 2016, property values across Australia's combined state and territory capitals rose by an average of 5.5% p.a

If you buy a two bedroom apartment close to the city for:

**$650,000**

You rent the apartment for:

**$550 pw**

Which gives you a return or yield on your investment of around:

**4% yr**

After five years, your apartment is valued at:

**$800,000**

Delivering Capital Growth of:

**23%**

The simplified scenarios shown here  demonstrate the importance of weighing up short-term yield with potential long-term gain. You need to find the balance between seeking capital growth and rental income that's comfortable for you and seek financial, legal and taxation advice before making an investment decision.

# Rental income.

Unlike capital growth, rental income is generally a more certain thing. Once again, a well located property in an area that's in demand by renters is most likely to deliver the returns you are after.

Once a tenant signs a lease, they are committed to paying rent for the duration of the lease agreement. Depending on the property and the rent you can attract, rental income may equal or even exceed your mortgage repayments.

When planning your investment strategy, you need to consider the rental yield of your property, not just the rental income. In simplest terms, yield is the percentage of the annual rent a property generates, calculated against its market value. Your net yield also needs to take into account your expenses along the way such as loan costs, agency management fees, council rates or strata fees.

It's a good idea to do your sums to ensure your investment won't place you under financial strain.

If you buy a two bedroom unit in a regional centre that costs:

**$300,000**

You rent the apartment for:

**$400 pw**

Which gives you a return or yield around:

**6.5% yr**

After five years, your apartment is valued at:

**$330,000**

Delivering Capital Growth of:

**10%**

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# Tax Benefits.

Property allows you to claim investment expenses as tax deductions, making your payable tax lower. This makes investing in property more attractive and affordable for the everyday Australian. While any investment should be chosen on its potential to generate returns and longer-term gains, tax benefits can play a very handy part in helping you to achieve your financial goals.

## Tax deductions

Landords can claim a wide range of expenses when properties are leased. You may be entitled to claim a wide range of tax deductions on your investment property.

We strongly advise that you seek advice from your accountant to see what you are eligible to claim.

**As a general rule, investors may be able to claim the following:**

– Advertising for tenants and property management fees

– Loan interest and ongoing loan fees

– Council rates, land tax, water and strata fees

– Building depreciation and depreciation of fittings and fixtures like stoves, carpets and hot water heaters

– Repairs, maintenance, pest control
and gardening

– Building and landlord's insurance.

## Negative gearing

When the associated costs of owning rental property exceed the rental income your property is negatively geared. The difference between income and costs may be offset against other income like your salary, allowing you to pay less tax overall.

There are many rules around what tax deductability, which is why it's best to seek professional tax advice.

If your rental income exceeds your costs, the property is positively geared and you can expect to pay tax on any profit your property generates.

Over time, the losses that allow for negative gearing will hopefully be outstripped by the growing value of your property.

In the meantime, the tax savings can make owning your rental property much more affordable.

Therefore, it could be worth looking for a property that you're confident you can negatively gear.

## Capital Gains tax

Should you decide to sell an investment property, you may be subject to capital gains tax.

The net proceeds you receive from selling your property,is compared to the total cost you originally paid to purchase the property. The difference between the two total amounts is the net profit, or 'capital gain' you've made.

In your tax return this is added to any other income you've made in that financial year, and then the marginal income tax rates apply to the combined amount. If you own an investment property for more than 12 months, generous tax concessions may work in your favour. You may be entitled to claim a 50% discount on your capital gain, which means only half of the net profit from the sale is taxed.

It's one more good reason to think about hanging on to your investment property for the longer term.

# Choosing your investment property.

## Where are you heading?

Choosing an investment property is different from finding a home of your own. You are investing as a moneymaking venture and that's what should be informing and inspiring your property choice.

If you were considering a share market investment, you would have a vast array of choices all very different. Mining or banking, manufacturing or technology? When it comes to property investing, you also have many choices – house or unit, town or country, off the plan or a character classic? The point is, with an investment property you can take a more pragmatic approach.

Most people want the location and the property to be appealing to the rental market, but that's where your emotional connection can end. The investment strategy that you've decided will work best for you — either capital growth or rental income — will also play an essential part in your decision.

## Tenant apeal

No matter how affordable a property is for you, it will not be a successful investment if it doesn't attract quality tenants.

Several factors can enhance tenant appeal including a location with good transport links, plenty of local amenities like shops, schools, entertainment facilities and proximity to employment opportunities.

## Best areas for capital growth?

Markets can be hard to pick and even regional pockets can deliver rewarding results. As a general rule, however, if you're looking for capital growth, it's worth aiming for properties close to busy CBDs. As population and demand grow, values can be pushed up.

## Best areas for rental income?

On the other hand, if you're looking for steady cash flow and good rental returns, consider investing in suburbs and regional centres. Look for areas popular with young families or regional centres with universities where the demand for rentals is strong. You may also be able to invest for less as prices in these areas tend to be cheaper.

# What type of property?

Deciding between a house or unit is just the start of your property choices. Do you buy an established property or off the plan?Are you looking for holiday renters or permanent tenants? Here we look at some of the ins and outs of your options. You may even be looking beyond the residential market to commercial properties, offices or shops.

## Buying a unit

- ✓ High rental demand in innercity areas
- ✓ Cheaper than residential homes
- ✓ Cheaper maintenance costs - strata costs
- ✓ Costs of certain repairs or upgrades may be split between all owners
- ✓ Council rates are generally lower than for houses
- ✗ Strata fees in addition to council rates
- ✗ Sinking fund contributions

## Buying a house

- ✓ The extra land value may provide greater capital growth
- ✓ Houses are in demand from growing families
- ✓ Future renovation potential to add value
- ✗ Maintenance can be costly
- ✗ Gardens and lawns may need upkeep. Can you count on tenants?

## Off the plan or new construction?

- ✓ New properties may attract higher/premium rents compared to older properties
- ✓ New builds tend to have lesser maintenance issues
- ✗ Initial outlays may be higher(off the plan or new construction)
- ✗ Construction delays could be costly
- ✗ Unexpected / unforseen expenses
- ✗ You face the risk of developer or builder insolvency

## Buying for holiday rentals vs. permanent tenants.

- ✓ Great holiday locations, can command higher rents year round.
- ✓ You could charge additional rent premiums during peak seasons
- ✓ Holiday rentals are short term, & you can access for personal use
- ✗ Seasonal incomes may not cover annual loan repayment costs
- ✗ Higher management fees for holiday rentals
- ✗ Advertising costs associated with promotion. Travel costs to inspect if purchasedinterstate

# The investor checklist.

Whether you're looking for capital growth or steady rental income, here's a handy list of things to consider when you're looking for the right property. There is more to investing in property than choosing the place that seems right for you.

- Search for locations where employment is steady with good accessible public transport connections.
- Are there schools, shops, community and sporting facilities nearby? If your potential tenants are families, focus on their immediate needs.
- Undertake significant research and sign up to property monitoring sites such as CoreLogic,RP Data and Domain property. They are a great source of property data, analytics and insights.
- If the property has been rented previously, try to find out more about its rental history – type of tenants, rents they paid, tenancy periods and turnover.
- Consider the condition of the property. Most properties will require some maintenance or repairs at some time. As a landlord you'll be obliged to provide or pay for repairs.
- Reconsider, the costs associated with purchasing 'run-down' property. Renovations can be costly and you could be at risk of overcapitalising.
- Understand the area in which you intend to invest in. Keep an eye on the going rates and availability for both rentals and sales. Talk to local realtors and ask about demand, sales trends etc.
- A focus on yield can be useful if you don't want to borrow heavily, or if you are seeking a source of additional income to live on. In some regional areas,rental yields can be as high as 10%, which is an exceptional return.
- Properties that will appeal as much to families as retirees or professional couples as singles, increase your likelihood of finding tenants easily.
- Look for property features that are likely to have broad appeal – a second bathroom, a leafy outlook, a lock up garage or balcony.
- Consider purchasing interstate or in areas where future growth trends are likely. But do your homework on any location you're not yet familiar with.
- Seeking written pre-approval for a loan makes good sense. It sets a clear limit on the price you can afford to pay, which will narrow down your property search, and lets selling agents know you are in a position to buy today.

# Choosing the right investment loan.

## Option can help you with your homework.

Investment mortgages may come with a slightly higher interest rate though this will depend on the lender, the area in which you buy and the type of property you select. Broadly speaking however your investment loan will work in much the same way as a home loan – as a rule, you will be required to make repayments based on the loan principal, interest rate and term.

Property investment loans are not too different from regular loans and give you all the usual choices between fixed and variable rates or a combination of the two.Like choosing the right investment property, it pays to do your homework and choose the right loan for your circumstances. At Option we'll do the homework for you.

## Interest only loans.

Interest only loans tend to be the type favoured by many investors. With most standard home loans, repayments are made up of interest charges plus a small repayment of part of your loan principal.

Over time, you slowly chip away at that original amount. If you opt for an interest only loan, your loan principal remains the same for the agreed period unless, of course, you decide to make extra repayments.

Not all lenders offer these loans and those that do will offer a set period for interest only payment; often between five and ten years. After your agreed period, you will need to renegotiate another interest only period or start making principal repayments as well as interest.

## Fixed rate loans.

Many investors choose to fix their mortgage interest rate, and there are good reasons to do this. With a fixed rate loan, the annual interest charge for each year is known upfront. This means landlords can prepay up to 12 months of interest each year (if the lender permits this) - a cost that may be claimed as a tax deduction.

### Why interest only loans work for investors:

– Because you're not paying off principal as well, your monthly repayments are lower

– Without principal repayments you may have better cash flow to build other investments or start looking for your next property

– You may be entitled to a tax deduction for the interest payments. Deductions don't apply to principal repayments.

# Ownership options.

## How to invest

Real estate can be held through a variety of titles owned in your name; through a trust; a company; or a self-managed super fund. It is important to get the ownership structure right at the time of purchase as it can be costly to alter title deeds later on.

## Investing as joint tenants

Ownership of the property is split equally between two or more people, with income and expenses divided the same way. The arrangement usually works best if all owners expect to receive similar annual taxable incomes for the foreseeable future otherwise the tax benefits of negative gearing can be diluted.

## Investing as sole purchase

Here the property is registered in one name only. Under this arrangement, rental income is received by you only, and expenses relating to the property can only be offset against your income.

## Investing through a trust

A trust may be a suitable ownership structure for a positively geared property as trusts can be useful for distributing income in a tax effective manner as well as offering asset protection. However trusts can be complicated to establish and maintain, and it is critical to speak with your accountant for tailored advice on whether a trust could work for your property investment.

## Investing as a company

There can be advantages to using a company structure for a rental property especially if there is a large number of co-owners, and the property will generate fully taxable profits. It is easy to sell shares if one owner wants to exit the arrangement and the company tax rate is lower than the top personal tax rate.

However, companies are very costly to set up and maintain, and they must be run in accordance with strict legal requirements.

If you require more help, try reading our other useful guides.

**www.option.com.au/needhelp**

Buying Your First Home

The Option Guide to Refinancing

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