FinanceCorp™
Finance Made Easy

How to make the most out of your investment

Property Investment Guide

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Getting Started

In Australia, investing in property is still considered a sound long-term investment due to steady and consistent increases over time.

Our FinanceCorp home loan experts have extensive knowledge of the property market and stay up to date with the latest trends and forecasts. We've helped many clients get their foot into property investment for the first time or build extensive property portfolios.

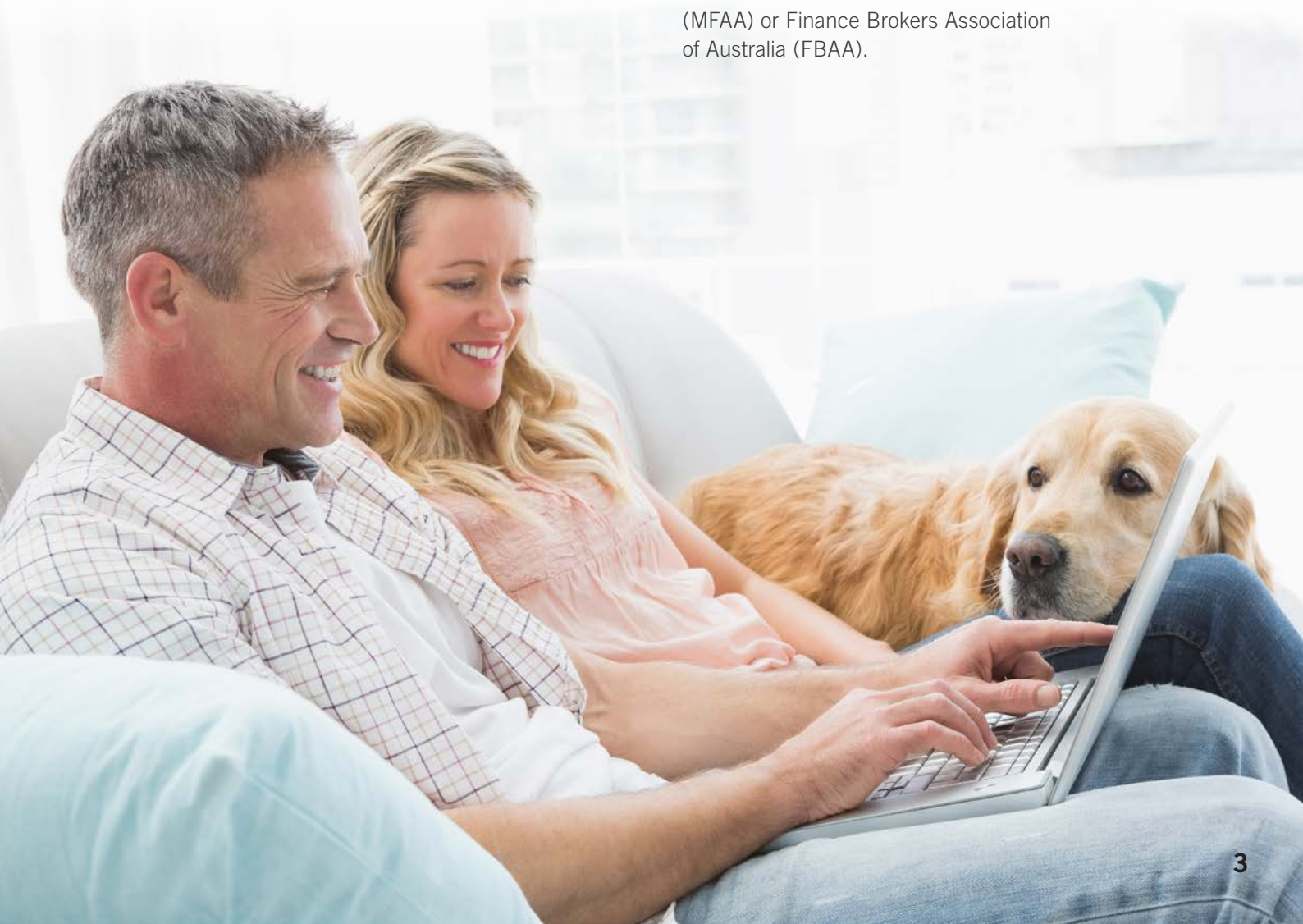
As mortgage brokers, we save you time and money by comparing hundreds of home loans from over 25 lenders. And by finding the right loan, you'll make the most of your property investment.

What to expect when you meet with FinanceCorp

Our motto at FinanceCorp is ***Finance Made Easy!*** All of our Finance Managers are fully qualified and have extensive experience, so you can be sure you'll be getting expert advice. And because we're paid commission by the lenders, our service and expertise comes at no cost to you.

We do everything we can to ensure a hassle-free home loan process. This even means meeting you at a location that is convenient for you and taking the time to get to know your situation and objectives, while explaining the steps involved.

We're also full members of the Mortgage and Finance Association of Australia (MFAA) or Finance Brokers Association of Australia (FBAA).



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 9% 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. Note: if your investment property increases by 7.5% a year, over a 10 year period it will double in value.

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.

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Tax benefits

In Australia, there are a range of tax benefits that come with investing in property.

Leasing

For example, if leasing your property, you may be able to claim a range of expenses such as council rates, building depreciation, pest control, repairs, advertising, landlord's insurance and more.

Negative Gearing

If the cost of owning your rental property outweighs the rental income you receive, then your property is negatively geared.

This can benefit you at tax time, as the difference between the rental income and costs can be offset against any other income you receive, which means you will pay less tax overall.

For example, if the amount you receive in rent from tenants is $5,000 less than the cost of servicing 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.

In time, if your property's value increases enough, this will outweigh any losses you experienced. Until that time, negative gearing can enable you to still afford the property.

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.

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 accountant to get the right advice on the best ownership equation for your circumstances.

Capital Gains Tax

If you have made a profit, or a 'capital gain' on your property, this is added to any other income you received in the financial year and unfortunately will be taxable.

However, by holding on to your investment property for over 12 months, you may be able to claim a 50% discount on your capital gain, which means only half of your net profit would be taxed.

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.

Choosing a Rental Investment Property

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

Of course, you've heard this before. But 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 swank. 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 into 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.

Ideally, you want a neutral interior colour scheme, serviceable and resilient flooring and window coverings, a low-maintenance yard and good storage.

Choosing the Right Home Loan

As an investor, you have access to all the regular loans. Your FinanceCorp Finance Manager can do all the legwork to help you decide on the investment loan that's right for you.

Here's a quick refresher on the types of loans available.

Interest only loans

Many property investors take advantage of interest-only loans because the 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.

Principle and Interest Loans

If you choose to positively 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.

Variable rate loans

The term variable rate refers to the interest rate. In a variable loan the interest rate can 'vary' over the life (or term) of the loan. If you decide to take out a mortgage that has a variable interest rate, the rate of interest that you pay can vary every month. This means that there will be some uncertainty around your repayments. If you think that interest rates are likely to decrease in the short term then it is quite likely you will gain from choosing a variable rate mortgage. However, you must be prepared and able to service your loan should the repayments increase.

Fixed loans

If you take out a mortgage that has a fixed interest rate, you will be locking yourself into a rate of interest for a certain period of time. This can offer many advantages. Firstly, you will know what your monthly repayments will be throughout the period that you have locked in your rate. If interest rates move up, you will be ahead as you will only be paying the lower rate. However, if they decrease, you may miss out on potential savings. There are also other factors that you may need to take into account with a fixed rate mortgage. For example, there may be additional costs involved in breaking the loan. Your mortgage broker can talk to you about what you need to consider.

Introductory rates

Having your home loan set at an introductory rate means that the interest rate is typically lower than the standard rate. However, this introductory or 'honeymoon' rate is typically set for only a short period of time, usually between twelve to twenty four months. This is often used to help home owners adjust to their home loan as they settle in to making repayments. However, this introductory rate can be a trap as you become used to making repayments at a lower rate and when the honeymoon rate reverts to the higher rate, you need to be certain that you can then afford these often higher repayments.

Combination Loans

A combination or split home loan allows you to take advantage of both the fixed and variable interest rates. You can decide how to split your home loan, for example splitting it 50% into fixed and 50% into variable. This can protect you against rising interest rates but also allow you to benefit from variable changes that may see interest rates lowering. What is important to remember with this type of loan is the potential to pay additional fees with this type of loan. You may be required to pay two sets of application fees and in some instances you may be charged a fee every time you renegotiate a new fixed portion of the loan.

Repayment features

It is important to understand how your home loan is repaid. The repayment features can vary from loan to loan. For example, some home loans may place restrictions on making additional payments. If you have the capacity to make additional repayments, this can reduce the amount you owe on the principal and can impact both your repayments as well as the term of the loan.

Your home loan may also have restrictions regarding early pay out. This may occur if you sell your property or you decide to refinance with another lender. Often there will be penalties around this and you should consider these carefully before you make a decision regarding your home loan.

Costs to factor in

When investing in property, you'll need to factor in these costs:

Stamp Duty

This is the big one. All other costs are relatively small by comparison. Stamp duty rates vary between state and territory governments and also depend on the value of the property you buy. You may also have to pay stamp duty on the mortgage itself.

Legal/conveyancing fees

Generally around $1,000 – $1500, these fees cover all the legal rigour around your property purchase, including title searches.

Building inspection

This should be carried out by a qualified expert, such as a structural engineer, before you purchase the property.

Your Contract of Sale should be subject to the building inspection, so if there are any structural problems you have the option to withdraw from the purchase without any significant financial penalties.

A building inspection and report can cost up to $1,000, depending on the size of the property. Your conveyancer will usually arrange this inspection, and you will usually pay for it as part of their total invoice at settlement (in addition to the conveyancing fees).

Pest inspection

Also to be carried out before purchase to ensure the property is free of problems, such as white ants. Your Contract of Sale should be subject to the pest inspection, so if any unwanted crawlies are found you may have the option to withdraw from the purchase without any significant financial penalties.

Allow up to $500 depending on the size of the property. Your real estate agent or conveyancer may arrange this inspection, and you will usually pay for it as part of their total invoice at settlement (in addition to the conveyancing fees).

Lender costs

Most lenders charge establishment fees to help cover the costs of their own valuation as well as administration fees. We will let you know what your lender charges but allow around $600 to $800.

Moving costs

Don't forget to factor in the cost of a removalist if you plan on using one.

Mortgage Insurance costs

If you borrow more than 80% of the purchase price of the property, you'll also need to pay Lender's Mortgage Insurance. This is covered in more detail on the following page. You may also choose to take out Mortgage Protection Insurance. If you buy a strata title, regular strata fees are payable.

Ongoing costs

You will need to include council and water rates along with regular loan repayments. It is important to also take out building insurance and contents insurance.

Your lender will probably require a minimum sum insured for the building to cover the loan, but make sure you actually take out enough building insurance to cover what it would cost if you had to rebuild. Likewise, make sure you have enough contents cover should you need to replace everything if the worst happens.

Account keeping costs:

There can be ongoing costs associated with some loans. These include:

- monthly loan account keeping fees;
- fees that cover access to special features such as offset accounts and redraw facilities;
- fees that may be payable if you switch between different types of products after the settlement of your loan;
- early repayment fees;
- loan discharge fees.

Lender's Mortgage Insurance (LMI)

LMI is an insurance policy that your lender may require you to take out to insure them against the possibility of you defaulting on your loan.

There can be many reasons for your lender requiring you to take out LMI. Each lender has particular policies that it must adhere to. Factors that get taken into consideration are:

- the type of loan,
- the amount of deposit compared to how much you wish to borrow,
- the value of your property and,
- other factors such as perceived risk of default.

For example, if you are borrowing more than 80% of the property value, you will be required to take out the insurance policy on behalf of your lender, which your lender will organise. You will pay the cost of the premium which will vary according to the amount that you are borrowing. The more you are borrowing, the higher the premium cost.

Who pays for it?

The lender takes out the policy on your behalf. The full premium amount including the GST on the policy is your cost. Once it has been paid it is non-refundable.

LMI is a one-off premium, upon settlement of the loan. In some circumstances the premium can be added on to your mortgage.

How does it work?

The LMI policy, like most insurance, is only drawn upon if something happens. In the case of LMI, the policy comes in to effect if you default on your loan. After a default, the bank may not recover enough from the leftover proceeds after the sale of your property default. The LMI policy allows them to make a claim on the policy for the outstanding amount.

Does this policy cover me too?

No, it does not. It covers the lender against the risk of you not meeting your repayments when they fall due. Even if you default by not making repayments, you are still required to repay the whole loan amount to your lender. It is often confused with Mortgage Protection Insurance, which covers you for loan repayments in the event of an unexpected situation occurring e.g. unemployment, disablement, or death.

Other insurances which may also benefit you and provide peace of mind are income protection, trauma, and permanent disability. Don't forget that you will be required to take out building insurance and it is strongly recommended to insure your contents as well.

If this policy does not cover me, then how does it benefit me?

Without LMI, the bank may not agree to provide you with the loan. It may also mean that you may have to wait until you have saved the right amount of deposit i.e. 20% in most cases, which may cause a delay in you owning a property, possibly for quite some time. Sometimes the benefit of paying the LMI will outweigh waiting, especially as it may be easily be offset by the capital growth in property that may occur over that same amount of time.

Still confused?

Remember, if there is anything that is not clear or that you still find confusing, you should speak to your FinanceCorp Finance Manager. They are here to help you feel comfortable at every stage of the process.

Why Choose a Mortgage Broker?

In this age of technology where an endless amount of information is available at our fingertips, it's easy to think we can do all the research and investigation that it takes when it comes to home loans.

However, the reality is quite different. Unless you have weeks of spare time and energy as well as the capacity to store and sort through the hundreds of home loans on the market and consider other variables such as fees and conditions, it pays to let a specialist do the legwork.

Here's some of the top reasons it makes sense to choose a mortgage broker.

1. In most instances, your mortgage broker's service is free. This is because lenders pay mortgage brokers a fee when they connect them to borrowers.
2. Mortgage brokers work for you, not the lender. We all know that banks and other lending institutions are keen to sign you up to their products to increase their profits. Alternatively, a mortgage broker will put your financial needs first and find you the loan that will best match your circumstances.
3. Spoilt for choice. You can rely on a mortgage broker to give you plenty of options. They have access to hundreds of different loans from a host of lenders, in fact far more than you will encounter if you choose to go it alone. You'll also find that mortgage brokers have access to some of the more boutique and wholesale lenders who typically don't advertise. These lenders have fantastic products and are eager to gain your business.
4. By enlisting the services of a mortgage broker, you can let them do the legwork when it comes to the loan application process. Not only will this make life easier for you but it can give you a better chance of gaining quick approval. This is because mortgage brokers know what individual lenders require and will make sure your application is correct before submitting it.
5. Service when it suits you. One of the great benefits of using a mortgage broker is that they can come to you at a time that is convenient for you.
6. Perfect match. It is a common misconception that banks don't like mortgage brokers. In fact, banks usually enjoy dealing with brokers as they will typically put forward applicants who are going to meet their criteria. This can be good news particularly for higher-risk borrowers as it can avoid them being rejected and having a red flag on their credit history.
7. Avoid the pitfalls. It is typical for lenders to use terms to entice borrowers to choose their products. These can be terms such as honeymoon offers, no ongoing fees and no account keeping fees. Your mortgage broker will carefully consider your special circumstances and work through all of the various lenders' products. They will assess specifics including establishment and long term fees as well as terms and conditions to ensure you are not paying more than you should over the life of your loan.
8. Borrowing within your means. When you use a mortgage broker to obtain your home loan you are less likely to be over-stretched and find yourself in financial difficulty later on. Some lenders may allow you to borrow to capacity or even offer a loan that may not be quite right for your situation, whereas a mortgage broker will always recommend the loan that makes the most financial sense to you.
9. Switching is simple. Your mortgage broker can undertake all of the investigation and paperwork for you.
10. Get a health check on your current home loan. The home loan market can change frequently with the move in interest rates. At any time you can ask your mortgage broker to simply take a look at your home loan, your personal circumstance and the home loan market and give you an update. This may simply be recommending that you stay with your current loan or that you move lenders or change products. Whatever the outcome is, you can feel relaxed knowing that you have been given a recommendation based on current information.

Finding the right home loan for your property investment is a straight-forward process with FinanceCorp. We'll help you find the right loan so that you can make the most out of your investment.

For more information on property investment home loans, visit www.financecorp.com.au or call us on (08) 9417 5550.

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