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Buying an Investment Property Our Top 10 Tips

Buying an investment property continues to be one of Australia's favourite ways to invest. An investment property should be about increasing your wealth – or securing your financial future. There is however, a common misconception that property investing always delivers positive returns. But this is certainly not the case. You need to keep in mind that managing your investment effectively will help ensure you reach your financial goals. Following are Mortgageport's Top 10 Tips for making the most of your investment property:

1. Choose the right property.

Investing in real estate is usually all about capital growth, so choosing a property that is likely to increase in value is the most critical decision you will make. Ensuring that you have a steady rental income stream is also vital because this cash flow will make the holding of the asset more affordable and provide much needed income.

Different classes of residential property – home units, houses and land - can outperform each other over time. For example, vacant land will provide no rental income but may appreciate more quickly if purchased in an area with limited supply. However, vacant land may not provide a tax deduction. Investing in a home unit might mean less maintenance costs than investing in a freestanding weatherboard house. Some areas offer higher rental yields, but it is important that you do your home work as often these properties provide lower capital growth opportunities. You also must consider the Strata Management Fees in your expenses. These can be extraordinarily high and may mean that a house offers a better investment opportunity.

It is also important that your property suits the demographics of renters in the area. For example, if it is near a university more bedrooms will be in greater demand than a big backyard for kids to run around. A family home that is close to schools and on a quiet street will be more desirable than one on a busy road.

2. Do your sums.

Investing in property is a proven path to long-term wealth, however you need to hold the property for the long-term if you are to benefit. Make yourself aware of taxes involved in property investing and add these into your calculations. Advice from your accountant is vital as tax law can change over time. Stamp Duty, Capital Gains Tax, Land Tax, all need to be taken into account.

You should also consider that banks only take 80% of the rental income into account when working out whether you can afford an investment loan. Banks factor in rental costs and potential vacancy periods that you may incur. From a personal perspective, you should also consider using this 80% as a rule of thumb for your own benefit.

Make sure also that you factor in insurance costs, especially landlord insurance. This will cover you for malicious damage, loss of rent and other things that may affect your ability to earn income from the property.

3. Find a good property manager and allow them to do their job.

They are professionals in the field and should be able to help you get the best possible value from your property. The property manager (or agent) should be able to give you advice on property law, your rights and responsibilities as a landlord – as well as those of the tenant. The manager should also take care of any maintenance issues, although you should approve all incurred costs (other than certain emergency repairs), in advance. The property manager will also help you find a good tenant and make sure they pay their rent on time. It is important also that you don't interfere with any issues to do with tenants. Do not go to the property unannounced and always go through your agent if you need to communicate with the tenant. But you should also make sure you keep your agent accountable. Record your dealings with them and get responses in writing if possible.

4. Understand the market where you are buying.

Consider what other properties are available in the area. Make sure you do your homework and consult professionals you can trust. For example, going to a source such as **RP Data** can give you information on average rents, property values and suburb reports. It is also a good idea to find out what changes may be happening in the area. For example, a major construction next to your property could make it harder to rent out. Or a planned by-pass may mean traffic will be reduced and may increase the value of the property over time.

5. Pick the right type of mortgage to suit you.

There are many options when it comes to financing your investment property, so get sound advice in this area as it can make a big long-term difference to your financial wellbeing.

Interest on an investment property loan is generally tax deductible, but some borrowing costs are not immediately deductible and knowing the difference can count. Avoid mixing up your investment property loan with your home loan, they need to be separate so you can maximise your taxation benefits and reduce your accounting costs.

Whether you choose a fixed rate loan or a variable rate loan will depend on your circumstances, but consider both options carefully before you decide. Over time variable rates tend to be cheaper, but selecting a fixed rate loan at the right time can really pay off.

Most investment loans should be set up as Interest Only (rather than Principal and Interest) as this increases the tax effectiveness of your investment. Interest Only loans ensure that you maximise your "tax deductible" debt. If you repay principal, your negative gearing benefit reduces. The best strategy is therefore to accelerate the repayment of your "non-tax deductible" debt, such as the loan on your residence.

6. Use the equity from another property.

Using equity in your home, or equity from another property investment, is an effective way to increase the leverage in your investment property. Equity is the amount of money in your home that you actually own. It can be calculated by working out the difference between what your property is worth and what you owe on the mortgage. For example, if your home is currently worth $1,000,000, and you have $500,000 outstanding on your mortgage, you have $500,000 worth of equity. Using the equity in your existing home can allow you to borrow more money against your investment property, which will increase your tax deductions.

7. Negative gearing.

Negative gearing can offer property investors certain tax benefits if the cost of holding their investment exceeds the income it produces. Australian tax law generally allows you to deduct your interest and maintenance costs on an investment property from your net rental income. If these costs exceed the net rental income received, then the "loss" will be tax deductible and should result in a tax refund.

So, while you are actually making a loss on the property, the advantage is that the loss can be used to offset your tax on your overall earnings. However, investors must be warned that they should not just buy an investment property to get a tax deduction.

Additionally, you will only receive a tax benefit if you earn taxable income in the first place. A good accountant should be able to assist you with evaluating this aspect of your investment.

If you are buying the property with your partner or another investor, take advice on whose name the property is should be held in and what percentage each investor owns. This will require a combination of Legal and Taxation advice. These decisions will also affect the results at sale.

8. Check the age and condition of the property and facilities.

Even with negative gearing, needing to replace the roof or hot water service in the first few months of ownership could make significant difference to your profits. It is therefore advisable to engage a professional building inspector before you purchase (and then once a year) to conduct a thorough inspection of the property to find any potential problems. It is also important to use a qualified tradesperson who is licensed to carry out the work and who has adequate insurance to protect you against poor workmanship. If you are buying a unit, check the body corporate's reserve fund for future capital works. Make sure there are sufficient funds to take care of any issues identified in the building report. You should also make sure annual levies are appropriate.

9. Make the property attractive to renters.

Go for neutral tones and keep the kitchen and bathroom in good condition. You should remember that how well the property is presented will impact on the quality of the tenant. Although that is not to say that a large rent equals a better tenant – nor the reverse. Another point that is subject to debate is whether you should buy a property that you'd be happy to live in yourself. Some people believe this will mean it is appreciated more. However, think about differentiating between your own home and your investment to avoid becoming overly involved; remember it is the home of your tenant and not your own.

10. Take a long-term view.

Remember that property is a long-term investment and you should not rely on prices rising in the short term. Therefore, the longer you can afford to commit, the better. Finally, remain aware that unlike shares or managed funds, you can't just sell part of your investment if you need the money. In short, be cautious, but consider that record migration levels and a rental property shortage are crucial factors favoring investing in property rather than shares or managed funds at this time. When it comes time to sell the property, make sure you plan the sale through tax minimising strategies. Talk to your accountant well before you sell as not doing so can greatly increase your capital gains tax liability.

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To discuss how you could become a property investor, please contact a Mortgage Consultant on 02 9466 8200 or email us at info@mortgageport.com.au. Our Mortgage Consultant will arrange to meet with you to work out which investment loan product suits you best. They can also help you calculate how much you can afford to borrow.