PROPERTY INVESTOR HANDBOOK

Money

CommonwealthBank

Build wealth from bricks and mortar

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CAPITAL CITY HOME VALUES

CITY	HOUSES			UNITS		
	INDEX VALUE	CHANGE JAN-OCT	RENTAL YIELD	INDEX VALUE	CHANGE JAN-OCT	RENTAL YIELD
Adelaide	$428,650	3.74%	4.21%	$362,380	7.85%	4.85%
Brisbane	$474,109	6.57%	4.35%	$357,691	8.71%	5.06%
Canberra	$526,495	9.80%	4.83%	$434,636	15.67%	5.92%
Darwin	$517,331	10.58%	5.97%	$378,602	19.44%	6.15%
Hobart	$319,571[1]	5.60%	NAv	NAv	NAv	NAv
Melbourne	$509,987	14.92%	3.82%	$406,168	14.69%	4.42%
Perth	$505,954	5.94%	3.98%	$471,331	6.82%	4.41%
Sydney	$611,706	10.23%	4.27%	$457,966	9.02%	5.27%
National	$496,398	9.95%	4.13%	$426,167	10.36%	5.00%

Source: RP Data-Rismark Index National Home Results as at 31-Oct-09. Index value for all homes to 30-Sep-09. Each index is based on 40%-50% of all sales in the market

Australia's residential property market is experiencing an upswing. *Money*'s Property Investor Handbook has all the information you need to become a successful landlord

To help you make the most of a rental property, you need to discover the latest market trends and find out how to pick a winning property. Today's investors can take advantage of rising values, healthy rental yields and ongoing tax concessions to enjoy strong long-term returns from bricks and mortar.

According to research group RP Data, property values rose by around 10% nationally in the first 10 months of 2009. Rental yields were strong too: 4% for houses and 5% for units across state capitals (see table).

As our economy recovers to more normal conditions, many economists tip more interest rate hikes over the next 12 months. Tim Lawless, research director at RP Data, says higher rates could dampen the property market but we can still expect values to rise by 7% to 10% in 2010.

With the boost to the First Home Owner Grant now ended, Lawless says investors face less competition from first-home buyers, backed by strong rental demand that should keep vacancy rates below 2% to 3% in our state capitals.

Over the long term, two key forces – population growth and a shortage of new homes – will support residential property values.

In the 12 months to June 2009, Australia's population grew by 443,000 people including 285,000 new immigrants. Lawless says population growth on this scale "can be read as strong demand for property".

Moreover, this demand comes at a time of significant housing undersupply. Harley Dale, chief economist with the Housing Industry Association, says building approvals are "well short of the [number of] new homes required to meet Australia's rapidly growing population". This shortage is expected to put pressure on rents and home values, and that's good news for landlords.

Can I afford an investment property?

Investing in residential property requires sufficient funds to meet both the upfront purchase costs plus the ongoing expenses of a property, including mortgage repayments.

Deposit requirements vary between lenders, though you can typically borrow up to 80% of a property's value without the need for lenders' mortgage insurance (LMI). If you're prepared to wear this cost it may be possible to borrow up to 90% of the property's value.

It's not always necessary to stump up a cash deposit. James Sheffield, general manager of Mortgage Wealth at the Commonwealth Bank, points out: "Many investors use the equity in their family home or another investment property instead of a cash deposit."

Investors will need to budget for additional purchases costs such as conveyancing (legal) fees, building inspections and stamp duty, which can add 5% to a property's purchase price.

Calculate your borrowing capacity

For a guide to your borrowing capacity, take a look at the Commonwealth Bank Property Investor website at commbank.com.au/propertyinvestor. It features several calculators showing how much you can borrow, the upfront costs of a property including stamp duty, and the likely loan repayments.

Meeting the mortgage

Sheffield says lenders consider two key issues when determining whether to approve a loan on an investment property – an investor's credit history and their ability to repay the mortgage.

On the score of meeting mortgage repayments, rental income is taken into account. However Sheffield warns that lenders usually apply a small discount to the likely rent flow to see how well a borrower would cope with periods of zero occupancy or unexpected repair bills.

Note too, lenders don't normally take any tax savings into account when determining whether you can afford the loan repayments so when you do your calculations, make sure you allow for this.

Tax-friendly returns

Part of the appeal of property is that it offers valuable tax savings both on rental income and long-term capital gains.

Negative gearing

Negative gearing is a term widely associated with property, and it simply means that the costs of owning the investment outweigh the rental income. In other words, after taking into account costs such as maintenance and mortgage interest, the investor is left with a loss. This loss can be offset against other personal income, including your regular wage or salary, to provide valuable tax savings.

To see how this works, let's say Mike owns an investment property which generates a loss of $10,000 each year. Mike earns an annual salary of $90,000, on which he pays income tax plus Medicare of $23,000. By offsetting his rental property loss against his salary, Mike's taxable income is reduced to $80,000 ($90,000 less $10,000), and his personal tax bill falls to $19,050 – a tax saving of $3950.

A wide range of property-related expenses can be claimed on tax including:

- Bookkeeping
- Borrowing costs (can be claimed immediately if they total less than $100, or over five years if the combined cost exceeds $100)
- Council rates
- Insurance
- Land tax
- Letting costs
- Mortgage interest
- Property management fees
- Repairs and maintenance
- Strata levies

You will need receipts to claim these costs so good bookkeeping is essential. Non-cash expenses such as depreciation are a valuable plus, reducing personal tax without the need for additional spending.

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The cost of fixtures and fittings such as carpets, light fittings, hot water heaters and dishwashers can be claimed over their useful life. You may also be able to claim depreciation on the cost of the building. Residential buildings constructed between 1985 and 1987 can be depreciated at 4%pa. Those built after 1987 can be depreciated at 2.5%pa.

A series of fact sheets providing detailed explanations of the deductions associated with an investment property can be downloaded from the Australian Tax Office website at www.ato.gov.au.

Positive gearing

Not all investment properties are negatively geared. It is possible for a rental property to generate positive returns, or be "positively geared", either from day one or after several years.

RP Data's Lawless believes that if interest rates rise in 2010, "the number of suburbs offering opportunities for positive gearing will fall away".

However growth in market rents increases the likelihood that investment properties will generate a positive cash flow over time.

Profits made on the sale of an investment property are also favourably taxed.

If an investor holds onto the property for over 12 months, only half the capital gain on the property is taxable.

FREE Property Value Guide

The Commonwealth Bank Property Value Guide is a useful starting point to evaluate a suburb. Visit commbank.com.au/propertyvalueguide and enter the suburb's postcode to view:

- Up-to-date house and unit prices
- Demographic profile
- Details of local amenities

Pick a winning property

The ideal investment property delivers strong capital growth and healthy rent returns. The type of property and its location will have a major impact on whether your property achieves these goals.

Lawless favours inner-city suburbs for investors, citing the abundance of lifestyle facilities, employ-

Negotiate a rate discount

Investors who package their investment loan and residential mortgage with the same lender may be able to negotiate an interest rate discount.

ment options and good transport options, all of which appeal to tenants.

Suburbs fringing the inner city can offer better affordability while still providing lifestyle appeal for tenants, plus the prospect of capital growth as the rise in values radiates from city centres.

Investing in the outer suburbs calls for a bit more research to achieve decent long-term returns.

Good transport links are essential. Be mindful of future housing developments, which add to the supply of homes potentially dampening future price growth.

Commonwealth Bank has a great checklist to take along to property inspections. Check it out at commbank.com.au/propertychecklist.

House or unit?

Houses have traditionally enjoyed better capital growth than units. However in recent years the pendulum has started to swing in favour of apartments and many of today's buyers are opting for the lower price tag and more convenient locations of apartment complexes. The earlier table shows that in the 10 months to October, 2009, unit values nationally rose by 10.36% compared with 9.95% for houses.

New apartments offer noteworthy benefits over their older counterparts.

They are virtually maintenance free, are in solid demand by renters and offer important depreciation benefits. Older units can have larger floor spaces and lower strata levies and, if the location is good, older apartment blocks also offer future development potential.

Funding your investment

Successful property investing involves both sides of the ledger, and researching the type of loan is just as important as locating the right property.

Basic loan A basic loan is similar to a standard variable mortgage, though with fewer features and a slightly lower interest rate.

Standard variable loan Based on Commonwealth Bank data, around 65% of investors opt for a standard variable rate mortgage.

Although very flexible, the repayments will vary in line with market interest rates, affecting cash flow and rental yield.

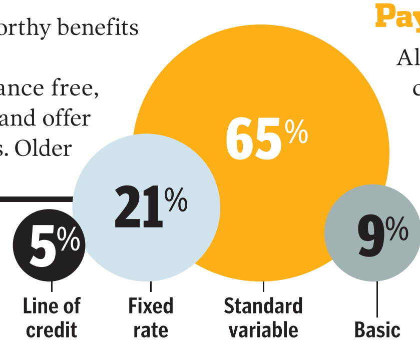
Fixed rate Around one in five investors (21%) opts for a fixed-rate loan, typically fixing for 12 months.

Along with certainty of cash flow, a fixed rate offers special appeal for investors, who can use this type of mortgage to prepay up to 12 months worth of interest before June 30 each year and bring forward their tax savings.

Line of credit A line of credit loan lets borrowers withdraw funds up to a certain limit at any time, with monthly repayments usually covering at least the interest charge.

This type of loan is very flexible, though discipline is required to avoid dipping into the funds too often.

LOANS FAVOURED BY PROPERTY INVESTORS
PERCENTAGE OF INVESTORS



Source: Commonwealth Bank of Australia, based on Commonwealth Bank customer data as at November 2009.

Payment options

Along with the type of loan, investors can also select a variety of repayment options:

- **Principal plus interest** Repaying both principal and interest will ultimately mean owning the property debt free.
- **Interest only** Making interest-only payments can free up cash for repairs or improvements to the property. This option is usually only available for one to five years.

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Top pick

RP Data's Tim Lawless recommends Brisbane as the top city for investors. He says: "Brisbane is currently lagging the property cycle but growth should pick up in 2010, boosted by strong population growth in south-east Queensland and an abundance of local infrastructure projects."

Life as a landlord

Make the most of your investment property with regular maintenance, good management and adequate insurance.

Regular maintenance does more than simply protect the capital value and rent yield of your investment. Landlords face a legal obligation to provide a safe residence for their tenants.

Holding a buffer of spare cash will help meet maintenance or repair bills when they arise.

Professional property management fees range from 7% to 9% of gross rent. A separate letting fee (usually one or two weeks' rent) may be charged each time a new tenant moves in.

Managing your own rental property can save money, but being a hands-on landlord is not always easy.

In addition to the host of regulations, you'll need to screen tenants, collect rent, organise repairs and possibly deal with difficult tenants. For many investors that makes a professional manager worth the expense.

When selecting a property manager, be sure to shop around and compare commissions, and look for a manager who:

- Thoroughly screens tenants
- Carries out regular property inspections
- Uses reputable, licensed tradespeople for repairs.

Protecting your investment

There are several types of worthwhile insurance:

- **Building insurance** Building cover will insure your rental property against a range of mishaps including damage or destruction by fire, wind and hail (though not usually flood).
- **Contents insurance** If your rental property is furnished, contents insurance will cover any damage and replacement costs.
- **Landlord insurance** This offers protection against tenants defaulting on the rent as well as the cost of damage by tenants.

Premiums on the above types of cover can be claimed as a tax deduction for your rental property.

- **Income protection insurance** This provides a valuable source of income if illness or injury prevents you from working and will be particularly important if your investment is negatively geared. Premiums can normally be claimed as a personal tax deduction.

Staying in the know

It's important to stay abreast of what's happening in the property market. Find all the latest tips and tools on the Commonwealth Bank property investor website at commbank.com.au/propertyinvestor. In addition to information on property investment, insurance and managing tenants, you can sign up for a free quarterly newsletter on property investment. Other useful websites include: ***Money* magazine** www.money.ninemsn.com.au; **Real Estate Institute of Australia** www.reia.com.au; **FIDO** (consumer arm of the Australian Securities and Investments Commission) www.fido.gov.au; **Building advisory service, Archicentre** www.archicentre.com.au

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