Property Investing
Explained in simple terms

Elite
Loan Services

Dear Property Investor,

I am a Finance Broker and my area of expertise is in the lending section. I have in excess of 20 years banking experience and understand how to make your banking work for you.

From dealing with so many people bewildered with the jargon and technical nature of property investment, I identified a need for a simple, easy to understand, explanation of property investing. Aimed at the uncomplicated investor who wants to use property to expand their personal wealth or build towards retirement I created this Property Investment brochure.

If you wish to be an informed investor with a clear understanding of what is involved, the risks and how to mitigate these risks, where to start and what to look for, how to see through the jargon, and have an understanding of what your Accountant and Financial planner are saying, then this brochure will prove an invaluable source.

All the information in this brochure is freely available from the relevant departments, all I have done is bring it into an easy to understand and follow format, all the examples are based on known facts in January 2010 and so subject to fluctuations, such as interest rates and Government legislation, your personal situation or changes in Banking policy. So please use this as a guide only and refer to the relevant professional for more exact information.

There are a number of good web sites and sources of information to assist the property investor, some of these are **www.ato.gov.au**, your Accountant, Financial Planner and Elite as your Broker, the Planning Department of your local Council you are looking to invest in, **www.reiwa.com.au** your local Real Estate Agent and other people who have made investments in property.

Do you wish to be an educated investor or use professionals to seek out, negotiate, purchase, rent out and complete your Tax considerations? Either way this brochure will give you enough information to be able to help you understand the process and jargon coming your way.

After you have read through this presentation I invite you to give me a call to discuss any questions you may have.

Yours sincerely

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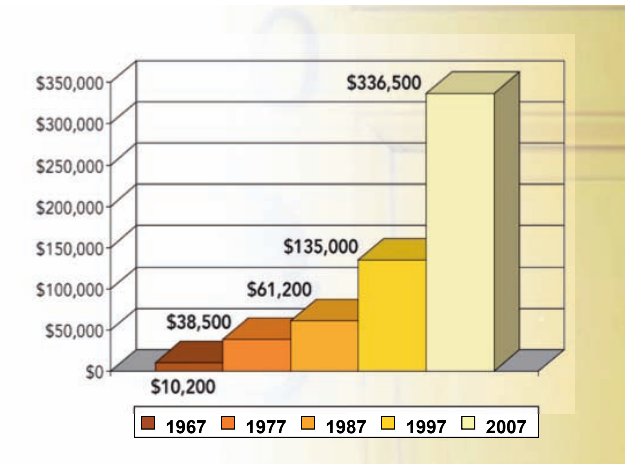
WHY INVEST IN PROPERTY?

The Real Estate Institute of WA (REIWA) and Real Estate Institute of Australia (REIA) data indicates that on average property doubles in value every 7 – 10 years, so a property investment strategy should look at approx 7yrs + to allow for market fluctuations, the last couple of years has balanced out the meteoric growth we have seen in the last 5 years, the growth over this time period was due to a range of factors like the mineral boom and unprecedented job growth in WA impacting on a shortage of properties for sale.

Based on history, property in Perth doubles every 7 to 10 years.



In short this created quick growth in property values but that is the exception rather than the rule, overall we see that steady property growth over time is the norm, meaning that property investment is not for the short term investor (unless they get very lucky).
So in theory the following scenario can apply, where you bought three properties in 1997 and sell 1 in 2007.

Purchase 3 houses at the medium price in 1997 and sell 1 house in 2007, allow 3% settlement costs with interest only payments over the term:

1997	**HOUSE A**	**HOUSE B**	**HOUSE C**
Purchase Price	$135,000	$135,000	$135,000
Loan Amount	$121,500	$121,500	$121,500
2007 Value	$336,500	$336,500	$336,500

2007	**HOUSE A**	**HOUSE B**
Value	$336,500	$336,500
Loan Amount	$0.00	$ 38,405

Owner occupied home – debt free with an investment property less than 10% mortgaged over a 10 year period. This is an example based on median Perth prices and does not take into account fluctuations or personal circumstances.

Invest for Retirement

A really good question

If there is no pension, or it is so small there might as well be no pension, how will you live a good active retirement, with the average lifespan at 87, that's over 20 years in retirement.

Superannuation will play its part, but as you know this is still subject to fluctuations in the market place and recent times have shown that a reliance on this alone could see a significant portion of your Super disappear, where debt free property will remain until you sell it.

This leads to a choice:

Worry about it in retirement, let's face it you might not live that long? Or plan for a long life with a good balanced portfolio.

I prefer the second choice and plan to live a comfortable life in retirement, so with advice from my Accountant/Financial Planner I plan to either subsidise any Government pension or be fully self-funded in retirement.
This leads us to a good balanced portfolio.

How does this reflect through to Retirement?

- **Retirement**

- It's widely anticipated there will be no government pension in the future

- Property investment creates capital growth which equates to additional retirement funds

- Rental income provides and income stream in retirement

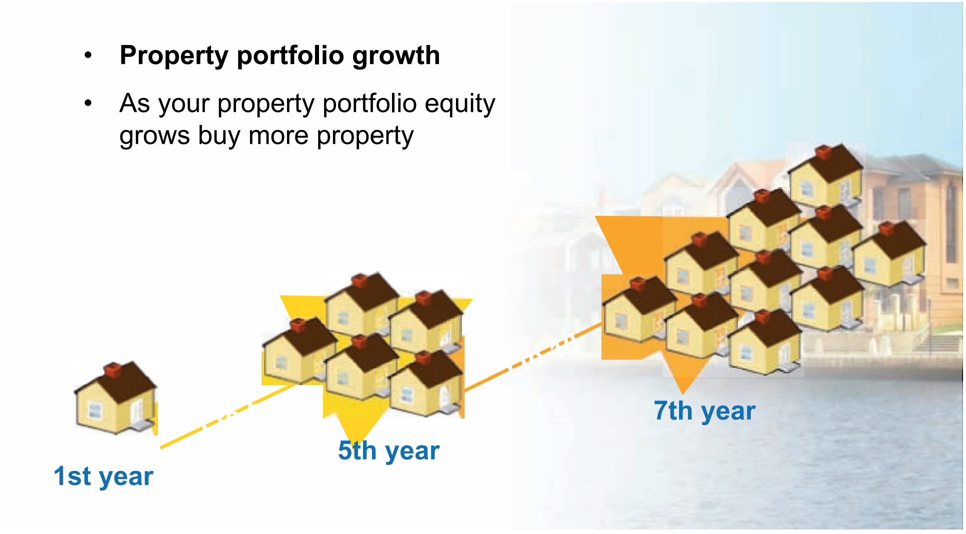
How to do it:

Don't forget your Superannuation, explain to your Financial Planner/Accountant that you intend to grow a property portfolio and ask them to review your Superannuation to achieve the best Balance.

Unless you have a Self Managed Superannuation most of your super is in the hands of others to control, your property portfolio is in your hands and you increase it or decrease it based on your own well informed decisions.

Building a Property Portfolio

In this example I use 10 properties as this is an easy number to follow and understand. For your average investor their portfolio may be 3 to 6 properties, and for the same reason I also use a purchase price of $300,000, although this will vary as it is unlikely you will buy them all at once or for the same price.

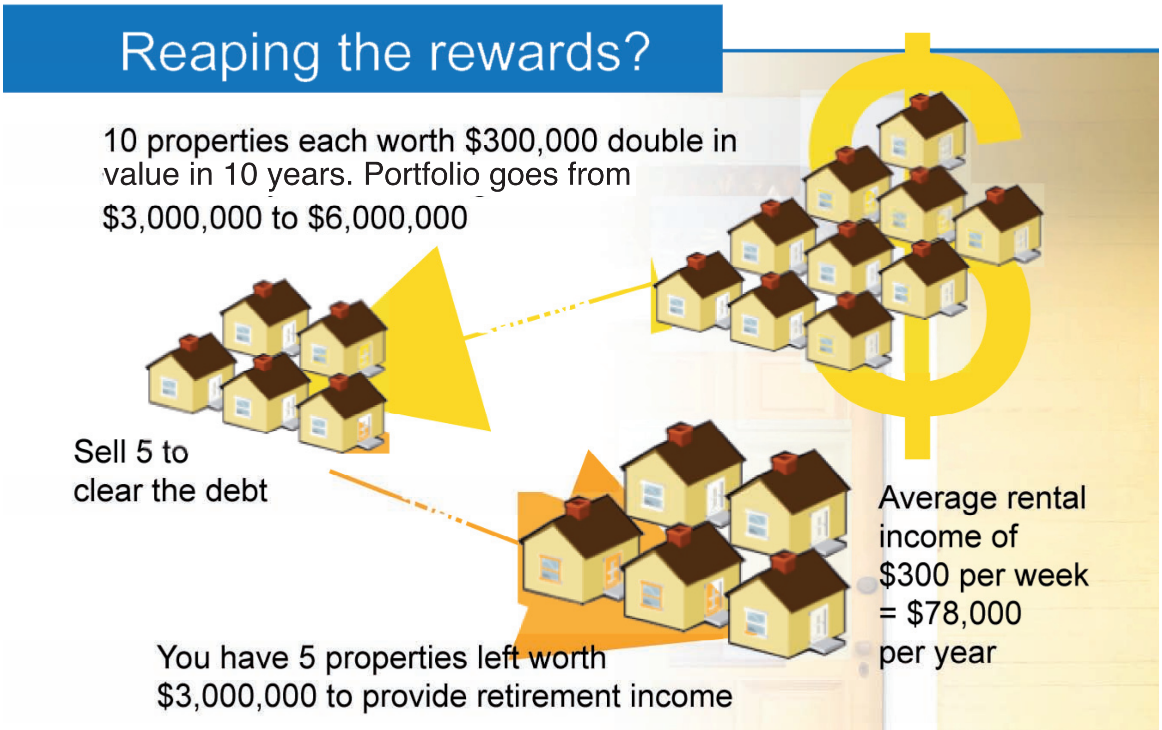


To purchase each property you will need 10% equity for each one, the table below shows how by spreading the deposit over many properties, the value increase required from each property reduces, meaning you can purchase the next investment property quicker.

Property	Value	10% Equity Required across all Properties	Equity already held from previous purchase	Increase value required from each Existing Property
1 purchased	300,000	30,000	0	0
2 purchased	600,000	60,000	30,000	30,000
3 purchased	900,000	90,000	60,000	15,000
4 purchased	1,200,000	120,000	90,000	10,000
5 purchased	1,500,000	150,000	120,000	7,500

The other consideration is affordability; we will cover this further on in this brochure.

Reaping the Rewards



This is a very simple scenario, and of course prices will fluctuate, you may even have to sell 6 properties to clear the capital gains or spread the sale pattern over a longer period to maximise your return. It is probably more likely that you will build up to 4 or 5 properties however the principal is still the same.

Once you have sold 5 properties and cleared the debt, the 5 remaining properties are worth $600,000 each with a rental return of $78,000pa. You can live off this as a pension supplement or sell a property and live off the $600,000 less capital gains. Which currently would be approximately 25% ($600,000 – $300,000 purchase price= $300,000 x 25% = $75,000) clearing $525,000. Which if you have a real good time travelling, new toys etc. will probably last you 4 years or longer if combined with other retirement income.

Property as we have already discovered from RIEWA data shows that property values double every 7 – 10 years. So it is reasonable to assume an increase over 4 years by on average 40% making each property now worth $840,000 and annual rental return $62,400. You can settle for this or sell another property and I would expect, even after capital gains, that this will last you considerably longer given your previous 4 years spending.

In this scenario you control the outcome sale or no sale, there is no debt, so no potential forced sale situation.

There are investment property advocates who state that you should never sell, and that the growing equity is borrowed against to meet your commitment and ongoing living expenses. This has the outside potential that property values don’t go up, or worse, go backwards and the Banks refuse to allow cash out for living expenses. This means that you will have to sell at a time and in a market that may not be suitable.

Tax Deductions and how they impact your investment property

Tax: How does it effect you with an investment property

Tax Deductions

Advertising for tenants	Land tax
Bank charges	Pest control
Body corporate fees	Property agent fees or commissions
Borrowing expenses	Repairs & maintenance
Council rates	Stationery
Decline in value of depreciating assets (make sure you claim this)	Telephone
Gardening & lawn mowing	Travel undertaken to inspect the property or to collect rent
Insurance	Water charges & ?????

(ATO website 11/02/2008)

You need to be open and honest, there are costs associated with owning property.

The good news is the ATO says that with an investment property expenses are tax deductible. This means that these costs can come off your annual income, or in the case of set up costs, these can be deducted from your sale price reducing your capital gain.

The Tax Office run seminars. I have found that they are very approachable and they recommend you contact them with your questions as you would be surprised at what people don't claim. Having said that, a Professional Accountant or Tax Specialist should also be able to answer any questions.

The ATO advise that one of the biggest items not claimed is depreciation (this is the drop in the value of items as they age). There are depreciation specialists, who for a small fee, will do a depreciation schedule for you, that way you maximize your non cash deductions.

You should talk to your accountant or financial planner as they are your tax experts in this area. I am providing a very generic overview that does not take into account your own personal circumstances.

Gearing – What Is It?

Negative Gearing:
This is when your expenses exceed your rental income (usual situation when you are working) creates tax deductions.

Positive Gearing:
When your rental income exceeds your expenses (usually in retirement). This adds to your taxable income.

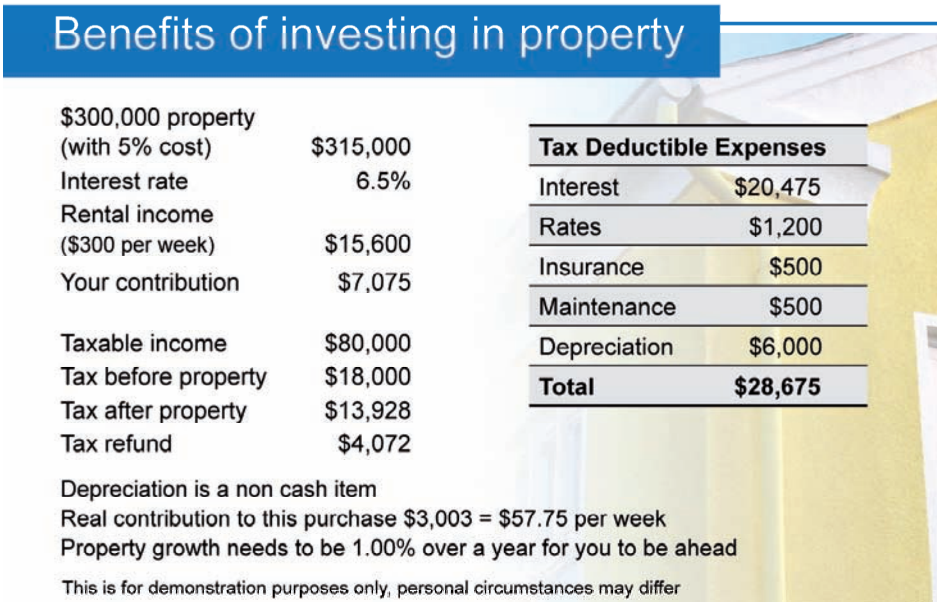
Capital Gains:
Sale price exceeds the original purchase price + claimable expenses.

Current legislation means that if you have owned the property for longer than 12 months your capital gain is halved.

Affordability

You would be surprised at how many people perceive the cost to be the same as their owner occupied property. So how does the average person afford to buy an investment property. The answer is with rental and tax refund assistance. There is a gross cost, which is your expenses less your rental income, then your net cost which is the cost after your tax refund.

Here is a simple example of cost calculations for an investment property, your Accountant or Financial Planner will give you a more detailed breakdown:



Benefits of investing in property

$300,000 property (with 5% cost)	$315,000
Interest rate	6.5%
Rental income ($300 per week)	$15,600
Your contribution	$7,075
Taxable income	$80,000
Tax before property	$18,000
Tax after property	$13,928
Tax refund	$4,072

Tax Deductible Expenses	
Interest	$20,475
Rates	$1,200
Insurance	$500
Maintenance	$500
Depreciation	$6,000
Total	**$28,675**

Depreciation is a non cash item
Real contribution to this purchase $3,003 = $57.75 per week
Property growth needs to be 1.00% over a year for you to be ahead

This is for demonstration purposes only, personal circumstances may differ

Tax calculation is Income + Rent – Expenses = Taxable Income

Depreciation is one area the tax office identified as not being claimed. We have averaged here, based on the property value, but this will alter based on the age of the property. Construction costs in some cases can be amortised for depreciation over 40 years. The idea behind depreciation is that you put aside a certain amount to replace items as they reach the end of their life cycle, e.g. a hot water system may be designed to last for 10 years, so the cost of that hot water system can be written down over the 10 year life span, that way in theory you have the money put aside to replace it. In order for this property to be a good investment its value must increase by more than it is costing you, in this case by more than 1% per annum.

Property growth is the real cost to you after tax deductable property expenses, divided by the property value, in this case $300,000

This is the key to successful property investment and it's not as difficult as you might think.
The market is literally bombarding us with information, so start at the beginning:

- Is it going to impact your lifestyle, clearly if you know your family income is going to change then you need to consider this?
- It is not for the short term, so are you comfortable with a long term investment strategy?
- In any investing there is risk, property values may not go up, you may not be able to get a tenant, while there is a risk these can be easily mitigated by borrowing 3 months worth of payments and hold this in reserve.
- Buy in the right place at the right time good locations are near water, shops, transport and schools.

Always remember your goals:

- that the property goes up in value
- that the property is rented out

Who can supply the information to help me?

- The planning department of the local council in the areas you are looking at.
- The sale section of the paper. Over time you will see properties that are moving quickly and those that are not. You will see area's that are starting to grow in price, news on crime area's or industrial changes. Blue collar areas do exceptionally well when the Mines do well.
- Real estate agents keep their eye on the market so can be a great source.
- Other investors want to tell you how clever they are, so listen.
- Web sites such as REIWA and REIA are great sources.

How do you make your purchase?

The first two questions are:

1. Can I afford it? You need to do a budget so you know in your own mind that this is affordable, the Banks will not consider your personal lifestyle in their decision.

2. I need a deposit? If you have cash that is straight forward, the amount needed will vary as the finance institutions change the amount they require you to have, i.e. in the mid 2000's they would lend you 100% of the purchase price as long as you covered the fees, by the end of the 2000's they required you to demonstrate 5% genuine savings for your deposit.
   If you already have a property, they will allow you to use the equity you have in that property as the deposit:

EXISTING HOUSE		INVESTMENT HOUSE	
Value	$500,000	Purchase Price	$500,000
Loan	$300,000	Fees	$ 25,000
Equity	$200,000	Loan required	$525,000

You then combine the values of both properties and the loans for both properties and divide the loans by the values, $825,000/$1,000,000 = 82.50% Loan to Value Ratio (LVR).
We will cover this more in the Finance institutions section.

The Finance Institutions (BANKS)

First understand that these are business's responsible to their shareholders first. They are not charities and so give nothing for nothing.
In times when their profit margins are good, they will loosen their credit policies and chase after every loan, in times when the profit margins are low; they will tighten credit policy and lend less money.
The effect on you is that while last year you may have been able to borrow whatever you wanted, this year you may not be able to. This does not mean that you shouldn't do it, rather that you should review your portfolio or wait until a better borrowing time.
The Finance Institutions will always have formula's to work out what your borrowing capacity is. In years gone by it was pretty straight forward, your repayments could be up to 30% of your gross wage. In recent times, with the introduction of credit scoring, they use a points based matrix that allocates points for everything on an application, borrowing capacity has become far more complicated and very difficult to fully understand and even more difficult to explain. The best way of ascertaining this is to call your Broker (Elite) or log onto the web site www.eliteloanservices.com.au and enter your income information.
The next step is to get a pre-approval, that way you will know that the Finance companies will assist you with your purchase.

Mortgagee Insurance: this is an insurance that protects the Finance Institution, it does not help you. If you don't meet your commitments then the mortgagee insurance company pays out your Loan, sells your house to recoup its loss and comes after you for any shortfall. Unfortunately, if you need to borrow more than 80% of the properties offered as security, then you will have to pay mortgagee insurance. The higher this percentage the more insurance fee you have to pay.

As to who is the best Financial Institution, this will vary depending on many factors, i.e. what sort of loan you are after, the location of the property you are buying, whether it is fixed or variable, whether you prefer a branch network or electronic access, the type of property you are looking to buy, the current appetite of the Finance Institution.
I can almost hear you saying how do I keep up with this, it's all too confusing and sounds like an awful lot of work. The answer is yes it is, so you can just go back to the same Bank you have always used and take what they offer you, or you can spend the next 6 weeks contacting every finance institution you can reach, then try to work through the jargon and structural differences to work out who will suit you best. Or you can contact your Elite Broker who is a professional Licensed Credit Broker and able to access over 22 finance institutions and narrow down the one from their panel of lenders that's going to suit you best. Your Broker will then provide the structural set up to make your life a whole lot easier, will do all the leg work in getting the application organised, liaise with the Finance Institution and help you through the contracts and signing.

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PROTECTION

We have all heard the horror stories relating to Investment properties.
It is important to note these and understand what went wrong. In most cases it is simply emotional attachment to a property. Remember this is a business decision for investment purposes.
A few of the things that can go wrong:

- Damage to the property by storm, flood, fire or freak natural accident
- Damage to the property done by Tenants
- No one to rent the property
- Loss of yours or your Partners life
- Loss of yours or your Partners income
- Rising interest rates

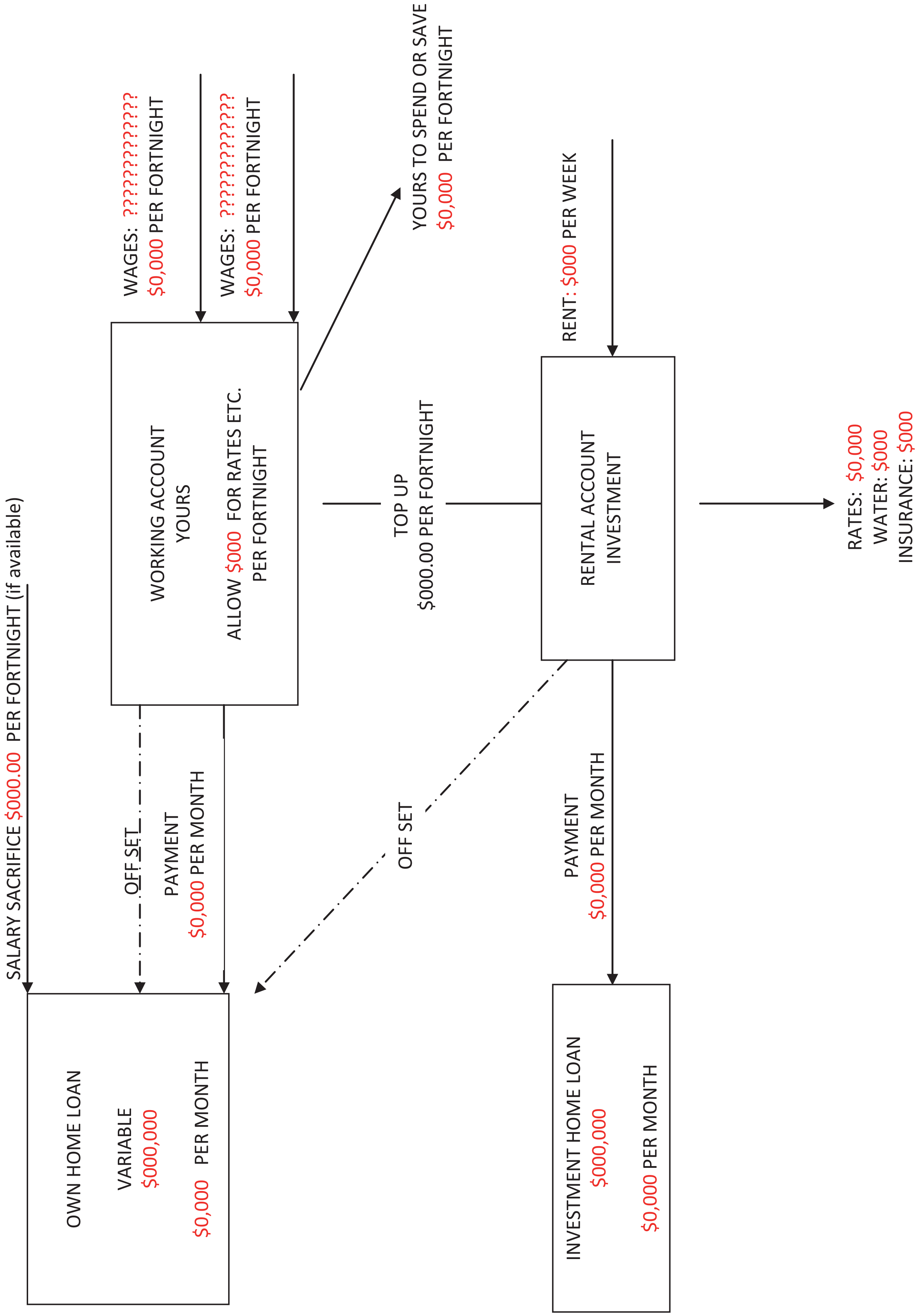
It is important that you have the right property insurance, your life and income insurance is adequate to cover your investment debts, you have a Will in place and that you are getting advice by trusted professionals in each relevant area.
To keep it simple make a checklist of everything that you have heard or could imagine going wrong, then ask your relevant professional to make sure you are protected for each potential event.

In the case of just not being able to get a tenant, it is important, where possible, to have 3 months worth of loan repayments held as a backstop so if you are struggling to get a tenant you do not have to cover the full loan repayment.

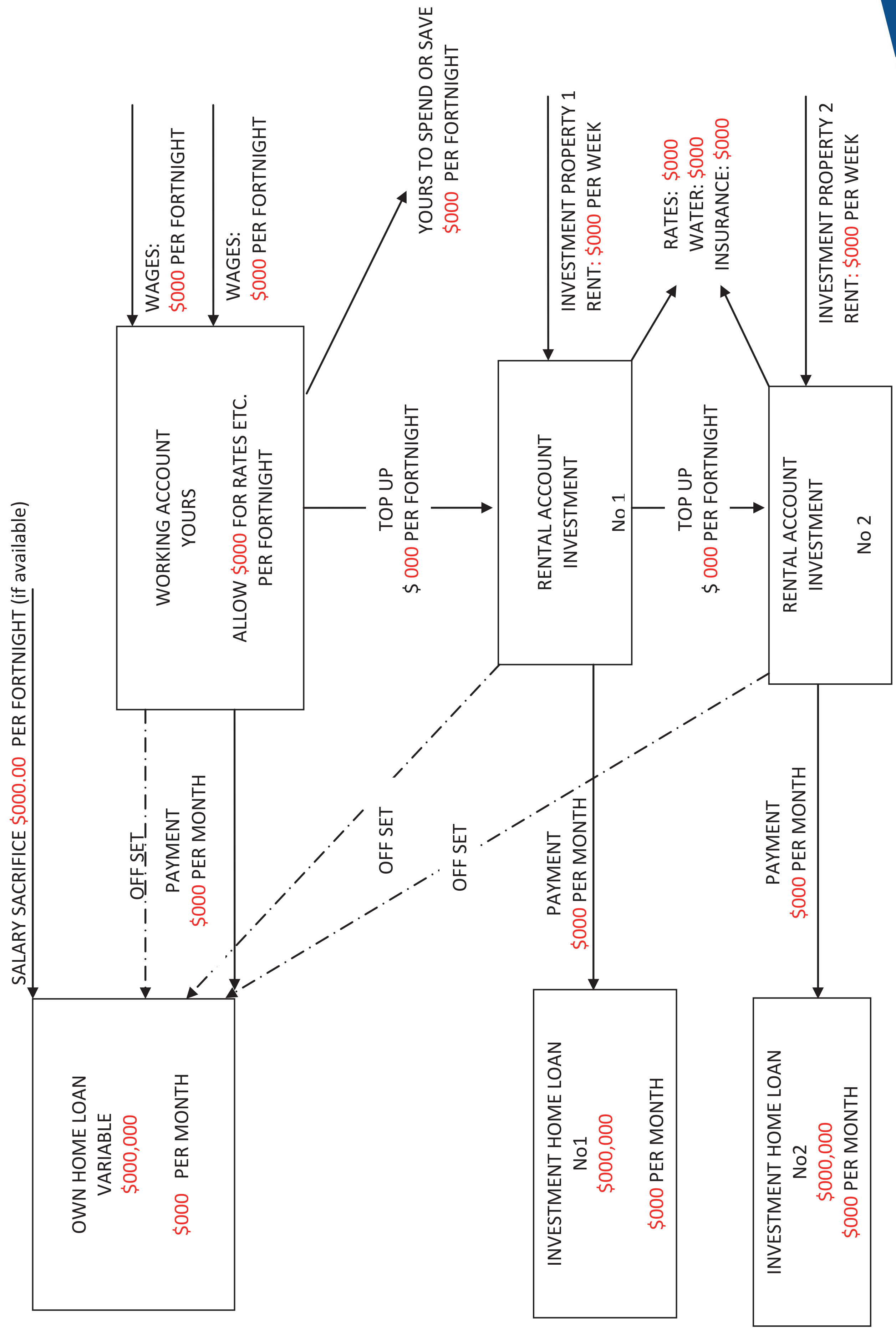
In most cases your costs for protection is tax deductable.

Rising interest rates is a fact of life, as property is a long term investment it would be reasonable to assume that interest rates will rise and you need to be able to meet the additional expense. Having the nest egg of 3 months worth of repayments means you can meet even unexpected rises while you adjust your rent or own contribution. The aim here is to minimise the impact on your short term cash flow.

Loan Structure Flowchart



Loan Structure Flowchart



Family Budget Planner

Most of us like to think that we will be able to pay our home loan off ahead of time. How much ahead of time depends on how much you plan to borrow, the type of loan you choose, what you earn and what you spend. By completing the following Family Budget Planner (and sticking to it), we can prepare a Home Loan Simulation Model tailored just for you. This will give you an estimate of how quickly it will take to pay off your home loan and help provide you with the information needed to make your home loan choice.

Expenses	$ per month
Living Expenses	
Food, groceries, etc...	
Housing	
Council, water rates	
Utilities	
Telephone, internet	
Mobile Phone	
Maintenance	
Rent	
Motor Vehicle / Transport	
Public transport, taxis	
Fuel	
Parking	
Repairs & maintenance	
Registration & licence	
Insurance	
Car, home, contents	
Health insurance	
Life, income protection	
Superannuation	
Family	
Clothing, shoes, cosmetics	
Education, fees	
Medical, pharmaceutical	
Child care	
Pet food, maintenance	
Donations	
Gifts (Christmas, birthdays)	
Entertainment	
Restaurants, movies	
Sport, gym, hobbies	
Holidays	
Magazines, newspapers, books	
CDs, DVDs	
Alcohol, cigarettes	
TOTAL (A)	$

Expenses cont.	$ per month
Credit Commitments	
Mortgages / Rent	
Line of credit	
Personal loans	
Lease payments	
Credit cards	
Store accounts	
Other	
TOTAL (B)	$
TOTAL EXPENSES (A) + (B)	$
Income	
Net Pay (1)	
Net Pay (2)	
Investment income	
Rental income	
Board	
Superannuation	
Pension income	
Family payments	
Maintenance	
Other income	
TOTAL INCOME (C)	$
LESS TOTAL EXPENSES (A) + (B)	$
EQUALS TOTAL SURPLUS (LOSS)	$

NOTES	

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