How to prepare for your first investment property.

PROPERTY DUCKS

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If you're thinking about buying your first investment property, congratulations! Property investment continues to be one of the most popular ways to create wealth.

A successful property investment, however, is not guaranteed, and it can turn into a financial headache if things go wrong. The cost of managing and maintaining a property can be high, and, if you choose the wrong location or property, you may struggle to achieve consistent rental income or capital growth.

It's therefore essential you do plenty of research and seek the advice of experts before buying. Making sure you've got a clear understanding of your investment goals and budget will also help by narrowing down your options so you're in a better position to find the property that's right for you. And by doing that, you'll be able to benefit from the many advantages of investing in property, such as earning rental income, receiving tax deductions and owning a physical asset that is less likely to experience volatility than shares or other investments.

At Property Ducks, we're committed to making property investment seamless for first-time property investors. That's why we've created this guide to help you navigate one of the most important investment decisions you'll make. Here are our tips to help you prepare for your first investment property purchase.

As with many big decisions in life, it's important to think about what your goals are, and if property is indeed the right investment strategy for you.

1 Decide on your investment goals

As with many big decisions in life, it's important to think about what your goals are, and if property is indeed the right investment strategy for you. Having a clear idea of what you want to achieve will help you determine this, and define the type of property and location that is best suited to meet your financial and lifestyle needs. Unlike buying a home to live in, the goal of property investment is to make money, but the approach to this will vary for each investor.

Some properties may be better suited to generating positive income straight away, while other properties may be more expensive upfront, but experience a greater increase in value over a number of years, which could suit investors who plan on holding on to the property and then selling for a profit later on. This increase in the value of the property over time is known as capital growth, and is an important factor in determining the success of your investment.

In Australia, the average capital growth for residential properties is 6% per annum, so historically, most residential real estate experiences steady growth over the long term.

As with all types of investments, there are potential risks to be aware of. For property investing, these include:

- **Market risks:** The risk of financial loss due to market movements. This risk is not easily mitigated and can affect all asset classes. The best way to protect yourself from market risks is to hold onto the investment property over the long term.
- **Liquidity risks:** Liquidity refers to how easily a property can be sold if the owner needs access to funds to meet his or her financial obligations. In real estate, it can sometimes be difficult to sell a property quickly, which is why it's best to invest in areas with strong demand and limited supply.
- **Interest rate risks:** Rising interest rates for variable rate mortgages can significantly impact a property owner's ability to service a loan. Interest rates are controlled by the Reserve Bank and are influenced by a number of economic factors such as household spending, employment and inflation. This risk can be offset through a fixed-rate mortgage and appropriate cash flow management.

2 Get your finance in order

Before you start seriously looking at properties, organise your loan pre-approval with your mortgage broker or bank.

This will give you a clear understanding of your budget and put you in a stronger position when it comes to making an offer.

If you're buying at an auction, you'll need your loan formally approved ahead of time, as the contract you enter into at an auction is unconditional. Having this part of the process completed will also give you the confidence you need to be a serious contender in the negotiating and buying process.

During the pre-approval process, your mortgage provider will look at every aspect of your finances, including your income, any outstanding debt, your existing assets and how much your current lifestyle costs you. This includes how much you spend on things like education, childcare, entertainment, travel and even groceries, so ensure you provide realistic estimates so they can determine your ability to service the loan more accurately.

Every bank and mortgage provider will each have slightly different products, interest rates and fees. That's why engaging a mortgage broker can help you save time and money by sorting through the options, and providing recommendations that are best suited to your situation.

If this is your first investment property, having an expert set up the right financial structure from the start is essential.

If you already own your own home and are using the equity in that property (the difference between what you owe and its current value) to fund your investment, a mortgage broker will take that into consideration and organise an equity release before you proceed with the purchase.

3 Review your cash flow

In the first few years of owning an investment property, the rental income you earn may not be enough to cover your mortgage repayments and running costs. You could be out of pocket between $20 to $200 per week, depending on the property. It's therefore important to understand what your cash flow will be before committing to the purchase of the property, so you're confident you can cover any shortfall without running into financial stress. Interest rates on your loan are likely to vary over time, so factor in a higher interest rate when calculating your expenses, so you have a buffer in place.

The team at Property Ducks can provide you with a comprehensive Property Investment Analysis (PIA) to estimate your outgoing costs from day one. We typically overestimate costs in our analysis so we can account for market fluctuations when estimating future profit. For example, if current interest rates are 3%, we'll run the analysis with a higher interest rate of 3.5%.

A mortgage broker can help you determine the upfront and ongoing costs you'll incur such as mortgage repayments, council rates, body corporate fees, land tax, insurance and property management fees. Then, with their help, or the help of an accountant, you can calculate how much extra cash you're likely to need on top of the rental income. As the size of the mortgage is reduced, and rental income (hopefully) increases, you'll eventually break even, then start to make a profit.

Depending on your situation and the type of property you buy, you may also be eligible for government incentives. Speak to a mortgage broker or financial adviser to find out if any apply to you. A financial adviser can also help you work out a budget and advise you on how much you can allocate to your property investment strategy.

4 Do your research

Before deciding on the location and type of property you should buy, research is vital. Websites such as Property Value (formerly RP Data), Domain and Real Estate can provide you with useful insights into properties and locations, including where demand has increased and decreased, how a specific suburb has performed over time, and property market trends. However, there is also a wealth of information available that's not easily accessible, and that's where a good property partner is invaluable. They'll provide you with information such as future infrastructure spending, population growth and private investment in the region.

Consider the following aspects when researching your potential purchase:

- **Location:** Is it in a desirable location that has adequate amenities such as transport, shops, parks and schools? You might also want to consider aspects such as crime rates or whether there's any major developments planned for the area (e.g. a new motorway, shopping centre or train line). Check with the council and local news or community groups.
- **Vacancy rate:** Vacancy rates refer to the percentage of properties in a particular location that are available for rent, but are currently without a tenant. A low vacancy rate indicates there is demand for rental properties, but a potential undersupply of rental properties. This is an ideal scenario for investors, as it means that a property shouldn't stay vacant for long, which will reduce your holding costs. Conversely, areas with high vacancy rates can mean it could take longer to find someone to rent your property.
- **Rental yield:** Rental yield refers to the annual rent you earn as a percentage of the property's market value. You can work out the rental yield of a property by dividing the annual rental income by the value of the property, and multiplying by 100 (annual rent ÷ property value x 100). For example, if your property is worth $600,000, and you expect to receive $30,000 in rent a year, then $30,000 ÷ $600,000 x 100 = 5%. A higher rental yield indicates better cashflow, so it's an important consideration when making property investment decisions.
- **Demographics:** Are the people living there mostly families, single people, couples or retirees? This will affect your choice of property. For example, an area which predominantly has families with young children would most likely be interested in renting a house with a secure backyard that's close to schools, as opposed to a one-bedroom apartment near a main road.
- **Property market:** How have property prices increased or decreased over time? How long does it take to sell a property in a particular suburb? Have there been major population shifts in the area? Look into what the main sources of employment are in the region. The closure of an industry (such as mining), or the relocation of a major employer, can significantly impact the popularity of a region, and consequently, property values.

> 'Look at areas that have a high demand from renters but a low supply of rental properties. That makes it much easier to find a tenant and could lead to higher rental prices.'
>
> — Property Ducks Team

5 Consider the different property types

A low-maintenance residential property is the firm favourite for first-time investors. However, there are a number of property types to consider:

- **Established properties:** Older properties in blue chip suburbs (suburbs with typically strong, ongoing demand) often experience slightly higher capital growth, but the growth rates between rental income compared to purchase price can be disproportionate. This property type is more suitable for higher income earners who can comfortably pay the difference.
- **Fixer-uppers:** You may be thinking about purchasing an older property that needs renovating before it can be rented out. While TV shows like The Block have made this approach seem appealing and potentially lucrative, this is one of the riskiest strategies for first-time investors. Unless you have the required renovation skills and knowledge, you might be buying a property with lots of hidden problems that can be expensive to rectify. On the other hand, if the property only needs a few cosmetic updates, such as new paint, carpet and window coverings, then you can easily add value to the property without breaking the bank.
- **Apartments:** Apartments can be split into two categories: high-rise multi complex buildings with a large number of apartments and small boutique buildings with a smaller number of apartments. The latter is more attractive to downsizers and owner occupiers, helping to achieve higher rental rates and yield than larger complexes. Larger complexes may also have more facilities such as lifts, a pool or a gym – leading to higher body corporate fees. Another thing to keep in mind is that apartments have zero land value compared to houses, so you won't necessarily be able to reap the rewards of increasing land values in certain areas.
- **Off-the-plan:** Buying a brand-new apartment, or purchasing a property off-the-plan, requires plenty of research. In recent years, there have been a number of cases of new apartment developments being affected by major structural issues, developers rescinding on contracts, or even going bankrupt before construction has been completed. While the government is promising to crack down on these issues in the building industry, there is still a long way to go. Do as much research as possible on the developer's other projects, and, if you decide to purchase off-the-plan, ensure you read all the fine print in the contract of sale, and have a conveyancer or solicitor look over it too.
- **New homes:** New homes in growth corridors are what our clients typically purchase – and for good reason. They are attractive rental properties for all occupancy types – young professionals, families and retirees. Rental yield and capital growth are steady and the costs associated with ownership are lower compared to apartments and older properties. For example, you don't need to factor in costs such as body corporate fees as you would for an apartment.

Australia has seen new homes in growth corridors experience significant capital growth and rental increases over the past 10 years.

Other benefits of buying a new home include:

- New homes have additional financial benefits and incentives, such as reduced stamp duty and the First Home Owners Grant.
- If it's an investment property, you can claim depreciation over the first few years as a tax deduction.
- Quality new builds are generally built to higher standards for energy efficiency and are less likely to be affected by maintenance issues (and any issues that do arise will generally be covered by warranty).
- You have some creative control by being able to customise the house design and fittings.
- It's a more affordable way of securing a turnkey home, and there is usually less competition from other buyers.

A low-maintenance residential property is the firm favourite for first-time investors.

6 Understand your tax obligations

Before committing to an investment property, it pays to have a basic understanding of your tax obligations and deductions, from upfront taxes such as stamp duty and land tax, to capital gains tax that's payable when you sell your investment property. If your investment property costs more to run than the income it produces, then the difference can be deducted against your overall taxable income in what's known as 'negative gearing'. Many property investors use negative gearing as a strategy as it can be used to reduce the size of your taxable income, thereby reducing your tax bill. If this strategy could apply to you, speak to a financial adviser or accountant as there are rules and potential risks around negative gearing.

Expenses that can be claimed as tax deductions include advertising for tenants, body corporate fees, council rates, cleaning, insurance and interest on loans – as long as they were incurred for the purpose of producing rental income.[1] You may also be able to claim a deduction for the decline in value of certain assets (known as depreciation) but the rules around depreciation are complex. More information can be found on the Australian Taxation Office (ATO) website, or from a depreciation specialist or accountant with experience in property investment.

7 Engage a property manager

The majority of investment property owners will engage the services of a local property manager to manage the property. This is highly recommended unless you're experienced in this area.

A property manager will look after all aspects of finding tenants, renting out the property, dealing with any repairs and managing any issues that might come up.

While they will charge a fee for this service (usually a percentage of the rent paid), it's money well spent as you don't have to worry about the day-to-day management of your property.

Beyond these services, a good property manager will also advise you when they think you should review the rent (to keep up with market fluctuations), organise routine inspections, provide advice on other products or services you might need such as Landlord Insurance, conduct reference checks on tenants and manage any urgent repairs in a timely manner. At tax time, you'll also want them to provide a summary of rental income and expenses incurred for that financial year, so you can claim the relevant deductions.

[1] Rental expenses, ATO, Available at: https://www.ato.gov.au/Forms/Rental-properties-2021/

If you're ready to take the first step on your property investment journey, we're happy to help.

While investing in property is very popular in Australia, it's important to take the emotion out of it, and see it simply as a vehicle to grow wealth. Generally speaking, buying an investment property should be looked at as a long-term investment rather than a short-term money-making strategy. The longer you can hold on to it, the more value the asset can provide as property prices tend to increase over time. And, as you build up equity in your property, you can potentially use that equity to fund another investment property – enabling you to start building a property portfolio.

A good property partner will guide you through the entire process and help you achieve your goals. Key to the success of your first investment property is having the right team of experts in place. Property Ducks can connect you with a carefully curated and vetted team of external and independent advisers, including financial advisers, insurance brokers, building inspectors, conveyancers and property managers. Part of the Property Ducks service is making sure your advisers are all on the same page and working together to ensure your first property investment is seamless and successful.

If you're ready to take the first step on your property investment journey, we're happy to help.

Visit **propertyducks.com.au** or email us at **hello@propertyducks.com.au**

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