



MCP GROUP PROPERTY GUIDE

**YOUR GUIDE TO DEALING IN AND
TRANSACTIONING PROPERTY**

20/21



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1 OVERVIEW

PREFACE

Property touches all Australians at some level.

Whether you are: looking to purchase your first one, upgrading, downsizing or an experienced developer, property generates a lot of conversation and interest.

There are many components to the property journey. The search, the choices and comparisons, financing it, protecting it and generally dealing in it.

Edition three of our guide follows a journey through some of the things you may need to consider, and perhaps talk to your kids about too. In this last year, there have been transfer duty changes, falling interest rates and changing finance legislation.

There are some basic fundamentals and perhaps some topics you had not considered either or were too embarrassed to ask! Remember along the way to get some sound advice from an appropriately qualified group of people.

Whatever your journey in property, we wish you every success.

DISCLAIMER

The information provided in this document is not definitive and should be used as a guide only. All laws, duties and costs are relevant to the time of print.



2 FINANCE

2.1 THE FINANCE BROKER/BANKER

An appointment with a broker, bank or financial adviser will be one of your first steps in property acquisition.

A good credit assistance provider should:

- Help clarify your goals and objectives; and
- Help verify your initial cash flow position, including your income and expenses.

They would also provide a preliminary assessment on:

- Your capacity to service new borrowings and the resultant loan repayments;
- Your borrowing capacity based on your deposit or equity in other property; and
- Provide an indicative overview of lending structure that may suit your circumstances.

Your adviser is likely to undertake an initial summary which would include reference to having good character (supported by your previous credit history) and demonstrate capacity of both income and capital by way of a deposit and purchase costs.

Depending on the circumstances, you can then assess whether a formal pre-approval with a financier is required.

We would generally advise to obtain a formal pre-approval with a financier when:

- You are borrowing greater than 80% of the value of the property and lenders' mortgage insurance will apply (see later in this guide);
- You intend to purchase within the next 3-6 months; or
- You have any concern regarding previous credit conduct.

A note on pre-approvals. Financiers are increasingly reluctant to provide them, especially as they are both time consuming and based on limited information.

2.2 FINANCE STRUCTURE

The structure of the lending facilities, above all, is the most important consideration in establishing a mortgage.

There are options to have packaged loans, loans with offset accounts, loans with free redraw and a range of other features.

In all instances, start by identifying the optimal structure first, and then examine the financier and pricing arrangement that best supports you.



The structure adopted should be the one that allows you to best achieve your realistic goals that you may have in respect to debt reduction, also considering likely changes in the future. For example, the interest rate is important, though how the loan is operated will make a significant impact over the loan term.

Many examples of structures for mortgages are available from a good adviser.

The new *Best Interests Duty* legislation also provides specific governance around credit advice and stipulates a like for like comparison of products which is a good thing.

As a general comment, people often focus on immaterial aspects when conducting a mortgage. Additional repayments are the key, especially when there is a greater opportunity cost to doing this as opposed to other uses of cash flow.



2.3 TOOLS & RESOURCES

To help you assess, review and manage all aspects of obtaining finance and managing your finances, there are a range of financial tools and calculators available.

These tools should assist with determining a range of scenarios including:

- Borrowing capacity based on income;
- Borrowing capacity based on deposit;
- Comparing loans by using a comparison interest rate;
- Cost/benefit analysis of refinancing;
- Acquisition costs for purchasing property; and
- Loan repayment scenarios.

With innovation like open banking and data scraping, you can also analyse your historical income and expenses in a more holistic way.

2.4 DOCUMENTATION REQUIREMENTS

You will need documentation that is not just relevant to your loan assessment and application, but also to build a full understanding of your financial situation. Banks and brokers have a legal responsibility to understand and verify your financial situation, so the level of data is now more onerous.

If any of the applicants are self-employed, the income verification requirements are more substantial than a PAYG employee, and will generally include a two-year history of financial statements and tax returns for all trading entities held. This historical focus is now combined with an updated verification of your situation, which may include bank statements or Business Activity Statements.

Your bank or adviser has the responsibility to review this documentation to ensure that any advice is appropriate for your circumstances.

2.5 THE FINANCE PROCESS

The key milestones in the mortgage process include:

- Confirmation that all information is received;
- Conditional loan approval;
- Independent valuation of property used as security;
- Unconditional loan approval;
- Preparation and issue of mortgage documentation; and
- Co-ordination of settlement.

This process varies between funding institutions. You should seek advice when you have specific time frames that need to be achieved.

It may be helpful to maintain an overview such as this, to support you through the finance part of the property purchase or refinance process.

2.6 TYPES OF PROPERTY MORTGAGES

I) RESIDENTIAL PROPERTY

Basic Variable Rate Products

Typically, this low featured mortgage product may have limitations on the number of repayment options, limited redraw, provide no offset capability and may not facilitate direct credit of salaries into the loan account.

The benefit of this type of product is that they usually offer the lowest available interest rates.

Featured Variable Rate Products

These variable rate products will usually have a range of features, including a 100% offset facility and no restrictions on how the loan can be transacted. There may be a premium interest rate that will apply in comparison to the basic variable rate product, though this premium has diminished in recent times.

Fixed Rate Products

Financiers offer products where the interest rate charged on the loan is fixed for a period between one and ten years. There are typically several restrictions that apply to the transacting of these loan types. At the expiration of this term, the loan can be rolled over into another fixed term or it will otherwise default to a featured variable rate loan.

This product should be entered into with caution and consideration regarding specific circumstances.



Offset Account Loan Products

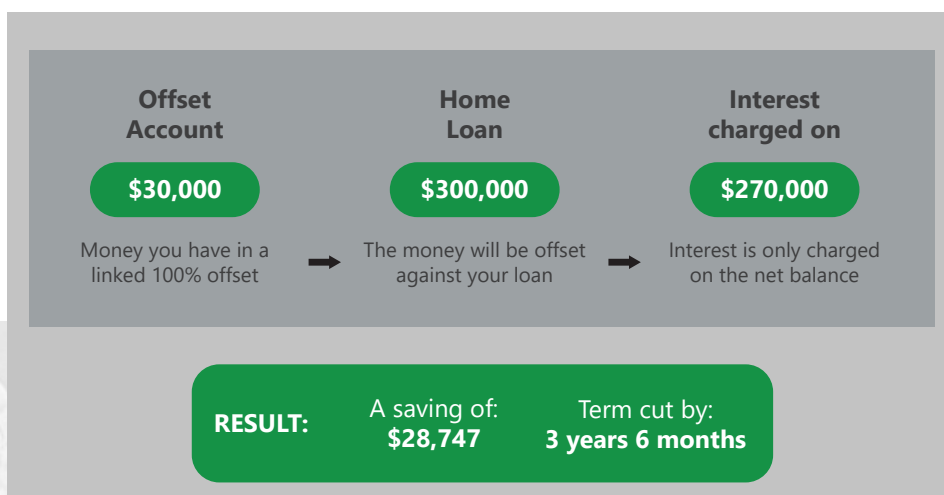
You can combine a home loan account with a transaction account. Typically, they allow the direct payment of a salary into either the actual loan account or a linked savings account. The effect being that all proceeds are “offset” against the principal balance of the loan.

The potential benefit of this product is to reduce the amount of interest charged on the loan on a daily basis.

Promotion of the benefits of offset accounts are shown in the example below.

When considering the use of offset accounts, it is important to note that these facilities work best where the loan amount is smaller and the customer’s regular income is higher. This way, the amount in the offset account represents a higher percentage of the total loan amount. At other times, offset accounts can be a more tax effective vehicle in the future.

In our experience, customers can often overstate the significance of these facilities; however, in recent times they have become a more standard loan feature that don’t command an interest rate premium. Get advice!



II) COMMERCIAL PROPERTY

Overdraft Facility

Typically, this represents a more short-term type facility to meet changing business working capital requirements. It is a flexible and expensive facility type with no set term or debt repayment arrangements, and as a result, overdrafts are generally not a suitable facility to use for purchasing property.

Term Loans/Fully Drawn Advance

Typically, a longer-term facility for capital expenditure or project development but can also be part of a balanced working capital strategy. The loan servicing structure can be either interest only or principal and interest with a fixed or variable interest rate.

Commercial Bill Facility

Typically, this is a short-term facility for large borrowing amounts. These facilities are linked to the market cash rates and the borrower’s commitment is to pay the face value of the bill at the end of the term. It is common for the facility to be renewed for a number of years at the lender’s discretion.

They are typically based on a variable (market) interest rate but can be arranged at fixed or capped interest rates.

Commercial Property – Financing Considerations

The nature of financing available for commercial property generally has a different profile to residential property to reflect the perception of risk. Some material differences include:

- Higher interest rates
- Lower loan to value ratios (Say 65-70% of valuation)
- Less flexibility and loan features (no redraw or offset accounts)
- Shorter maximum loan terms (generally up to 15 -20 Years)
- Loan subject to ongoing review
- More limited scope for interest only terms



2.7 MORTGAGE MINIMISATION STRATEGIES

There are several books and articles that discuss methods to pay off a mortgage sooner.

Some proven techniques that can each help to varying degrees, include:

- Making fortnightly or weekly loan repayments, as opposed to monthly loan repayments.
- Use of an offset account facility as outlined above.
- Create a separate loan split and establish a goal for paying it off within a certain period.
- Obtain a principal & interest loan for a shorter loan term than the standard 30 years, forcing a routine of additional repayments.

Whilst all of the strategies recommended are perfectly valid, the key is finding the methods that work for you and your specific circumstances.

2.8 INTEREST RATE STRATEGY

Good advice should include the scenario of looking at your financial position if interest rates move up or down.

Whilst every circumstance must be looked at in isolation, as a general rule, fixed rates provide much less flexibility (in terms of extra repayment capacity and break costs. History also shows that whilst there are times that represent good value, statistics evidence that most people get the timing of these decisions wrong.

Currently, rates are all time lows. Whilst they may be at these levels for some time it is good not to be complacent.

One useful guide is to look at a "Rolling Average" of interest rate e.g. a fifteen-year period to see where interest rates sit against their recent trends.



A summary of rates extracted from our rates matrix database, is provided below and can be a useful guide.

In this example, fixed interest rates sit well below their rolling average, and may provide the first hint that their value is enhanced.

Significantly, most borrowers get their timing wrong when choosing fixed rates, specifically if they choose to lock in rates well after they have already increased and are at the end of a tightening cycle.

Again, the most important factor remains your individual circumstances and the longer-term plan for property holdings.

INDEX	2009	2020	ROLLING AVG#
Official Cash Rate	4.00%	0.25%	5.19%
90 Day Bill Rate	4.18%	0.17%	5.45%
Differential	0.18%	-0.08%	0.15%
Average Variable Mortgage	6.05%	2.90%	6.56%
Average 3 Year Fixed Mortgage	7.70%	2.60%	7.10%



2.9 COMPARING MORTGAGE PRODUCTS

The interest rates and fees should only be one determinant in selecting a mortgage.

It is more important you adopt a structure that will ensure that your goals are achieved. Too many people, in our experience, focus on the price of a mortgage rather than how they will plan to operate it.

Price is of course still a vital consideration, and borrowers should consider all costs when assessing different types of borrowing products. A useful process here is to calculate a "Comparison Rate" that calculates both the interest rate and fees and charges relating to a loan, expressed as a single percentage figure.

However, be wary of relying on standard comparison interest rates quoted in financial literature. These are based on a set loan amount and circumstances that are not tailored to your specific circumstances.

A tool such as the one below can achieve this.

A comparison interest rate calculator provides a useful guide to financial costs. As a key guide, for larger borrowings, interest rates are more critical. For smaller amounts, fees become more material.

In the example below, the loan product with the lower headline interest rate is not the most cost effective over the total loan term.

Comparison Rate Calculator			
Prepared For:	Ms A Example		
Loan Option 1:	XYZ Bank	Loan Option 2	ABC Bank
Loan Particulars		Loan Particulars	
Principal Amount (\$)	\$250,000	Principal Amount (\$)	\$250,000
Total Loan Term (Years)	20	Total Loan Term (Years)	20
Interest Rate (% p.a.)	2.65%	Interest Rate (% p.a.)	2.60%
Establishment Costs		Establishment Costs	
Application Fee	\$500	Application Fee	\$0
Legal Fee	\$150	Legal Fee	\$0
Valuation Fee	\$0	Valuation Fee	\$0
Ongoing Costs		Ongoing Costs	
Annual Fee	\$0	Annual Fee	\$395
Monthly Fee	\$0	Monthly Fee	\$0
Total Fees over Term	\$650	Total Fees over Term	\$7,900
Total Repayments & Fees	\$322,994	Total Loan Repayments	\$328,910
Interest & Fees Paid	\$72,994	Interest & Fees Paid	\$78,910
Comparison Rate	2.68%	Comparison Rate	2.86%

2.10 INVESTMENT PURPOSE MORTGAGES

In recent years, there have been a range of regulatory changes with the view of making financial institutions in Australia more accountable around the growth of lending for investment purposes.

In many respects, this is a return to some years ago where there was an interest rate premium for lending to purchase investment property.

These changes aim to discern between personal and owner occupied property purpose and investment. In essence, the impacts of these changes are:

- A premium interest rate charged for investment purpose mortgages;
- More stringent loan qualification criteria being applied; and
- Lower Loan to Value Ratios being made available.

The impact of these changes has also seen several mortgage customers look to "reclassify" their loans from investment to personal purposes (owner occupied status).

This change is part of a broader regulatory process that is looking to drive responsible lending practices. During 2017, regulators mandated that the banking industry take tangible steps to control the growth of investment purpose lending. This now imposes limits on the portfolio of financiers (e.g. growth to a maximum of 10%).

Whilst some of these changes have been relaxed it remains important that you adopt a structure that will ensure that your goals are achieved.

Most recently, lenders are decreasing the allowable level of rental income used in assessing affordability (as low as 70%).



2.11 INTEREST ONLY V PRINCIPAL & INTEREST REPAYMENTS

In addition to the investment purpose focus, an even larger area of attention for regulators has been the access to interest only loan repayments.

There are now comprehensive guidelines and credit justification required if you want an interest only basis of repayment into the future.

With this regulatory pressure, we have seen interest rates on Principal & Interest lending fall (both for investment, business and personal purposes) and interest only rates increase.

For many it will mean greater cash outflow, as the loan will “amortise” from the outset.

Though it is not all bad news, interest rates on P&I repayments will become increasingly lower than interest only loans.

Consider the following example on a \$500,000 loan:

At 5.0% Interest Only – Repayments are \$2,083 per month.

At 5.0% P&I – Repayments would be \$2,684 per month.

This is a substantial increase to cash outflow but it does build some equity in this asset too.

Now add in benefits of a reduced interest rate of 4.00%.

At 4.00% P&I repayments would be \$2,387 per month.

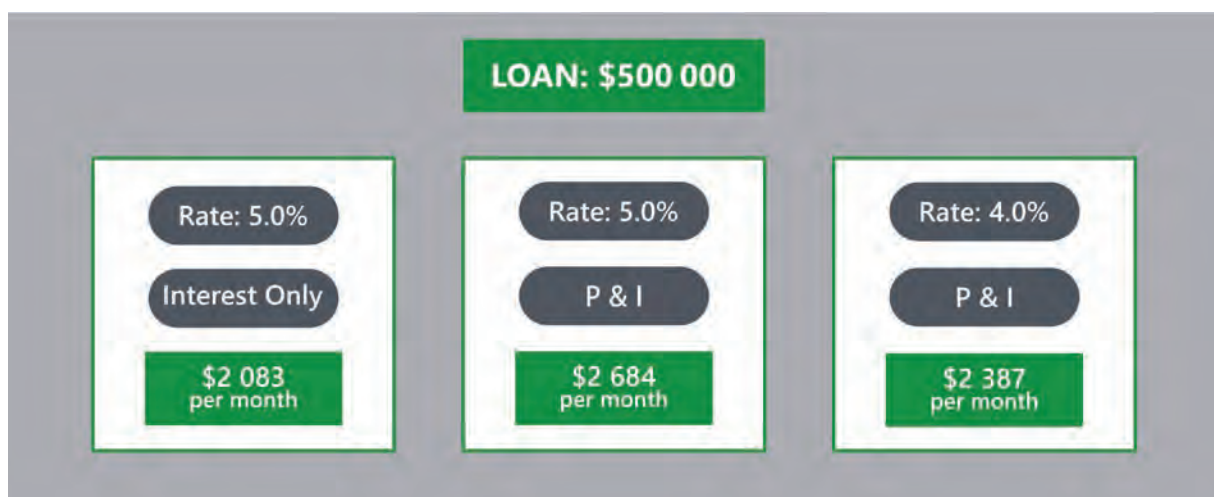
This is only a small premium above the interest only rate.

For business or investors, those in the position to choose between interest only and P&I must consider their opportunity cost. This is especially relevant in a low interest cost environment.

So, in the example above, is it better to invest the additional \$304 per month into the debt, or can you get a better return by conserving this cash flow and putting it to work elsewhere?

Seek advice of course, but it should not be a strategy that is dismissed, consider why you actually need interest only repayments.

It is a great opportunity to litmus test your overall investment return.





2.12 DEBT TO INCOME RATIO

Debt to income (DTI) ratios have been a part of financial analysis for a long time.

So whilst not new, we are hearing them as a language in mortgage lending. Financiers have announced they will be reviewing applications that have higher than DTI ratios above prescribed thresholds.

So what is it? By definition, DTI takes into account the total borrowings of an applicant, regardless of the term or nature of a credit facility.

Let's look at the following example:

CUSTOMER 1		CUSTOMER 2	
HOME LOAN	425,000	HOME LOAN	700,000
INVESTMENT LOAN	600,000	INVESTMENT LOAN	0
CREDIT CARD LIMIT	15,000	CREDIT CARD LIMIT	35,000
		MOTOR VEHICLE LOAN	55,000
		PERSONAL LOAN	35,000
TOTAL DEBT	1,040,000	TOTAL DEBT	825,000
SALARY INCOME	175,000	SALARY INCOME	175,000
RENTAL INCOME	35,000	RENTAL INCOME	0
TOTAL INCOME	210,000	TOTAL INCOME	175,000
DEBT TO INCOME RATIO	5.0	DEBT TO INCOME RATIO	4.7

DTI simply divides Total Debt by Total Gross Income. In the example above, Customer 1 has a higher DTI than Customer 2 - $\$1,040,000 / \$210,000 = 5.0$.

Based on this limited information it is likely that Customer 1 has a superior monthly cash position.

So this measure ignores the cost or term of debt, and provides a more draconian measure of creditworthiness.

However it can also provide borrowers with a quick measure to assess their overall position with debt.



3 PROPERTY

3.1 THE SEARCH

The key to searching for a property is lots of research, not only on the internet but on the ground. Initially, you must be very specific in your requirements and locations, and establish some non-negotiable guidelines. You can always relax some of your less critical criteria to reflect your budget over time.

Talk to real estate agents or credible property specialists as they can be a very good source of information about properties in your chosen areas.

Precedent sales of similar properties in your area also provide a good foundation for research and setting your expectations. This data is now increasingly available.

3.2 PURCHASE METHODS

I) PRIVATE SALE

This method of sale allows you to negotiate the purchase of a property with conditions such as finance, building and pest inspection or a solicitor reviewing the contract.

Whilst inserting conditions is often the safest form of purchasing, be mindful that vendors will generally see your offer as less attractive, and may elect to go for another purchaser's offer that may be of a lesser amount but is unconditional.

II) AUCTION

Buying at auction means that if you are the successful bidder your offer is unconditional! The advantage of buying at auction is that other bids are transparent (whereas in private sale you cannot be certain if other offers are genuine offers or not).

The obvious disadvantage is that you are unable to secure formal finance before auction (as a bank valuation cannot be conducted) and if you wish to have a building and pest inspection, you would need to organise this well before the auction.

III) EXPRESSIONS OF INTEREST

Not as common as the first two; however, since the Covid-19 outbreak it has been popular with agents. It is similar to a private sale in many ways and is an invitation for buyers to put their best offers forward one time only. The vendor is still at liberty to decline all offers, or go back to some buyers and propose they increase their offers or alter their terms, to compete with other offers, such as a shorter settlement period. Generally, offers from buyers under this method will be unconditional.

Contract Review & Due Diligence

A term that we suggest you become familiar with is "Caveat Emptor", which is Latin for "let the buyer beware". This principle puts the onus on you as the purchaser to fully examine and be satisfied with the property before purchasing.

We generally recommend that you engage your solicitor to undertake a pre-purchase review of your contract prior to auction or offer. The issues that this review should consider, amongst others include:

- Specific commercial terms;
- Cooling off period;
- Deposit terms;
- Chattels;
- Vendor statement;
- Easements;
- Applicable GST;
- Purchaser and/or nomination clauses; and
- Owners' corporation.

These are discussed further in Section 5.



3.3 THE PURCHASER NAME

You can elect to have a different ultimate purchaser before settlement of the transaction.

There is a range of taxation, asset protection and related issues that may form part of your decision in determining the proposed owner of the property, and we strongly suggest that you obtain advice on this point particularly if your structure is in any way complex.

If you elect a company to be the purchaser, you may be required to personally guarantee the obligations upon your company under the contract.

Remember, property is an illiquid asset and changes to ownership in the future can be very expensive.

3.4 THE DEPOSIT

The deposit is generally payable at the signing of the contract and is normally 10% of the purchase price. An agent cannot take more than a 10% deposit.

The options available for raising this amount include:

- cash;
- redraw from existing mortgage; and
- deposit bond / bank guarantee (in some circumstances).

If you seek to make any alternative arrangements, discuss these with the vendor's agent. Their willingness to do this may vary depending on the nature of the sale process, and less likely, for example, at auctions in Victoria.

Deposit Bonds / Bank Guarantees

A deposit bond may be accepted in lieu of a cash deposit. The major advantage of a deposit bond is to avoid funding cash for a deposit. Also, for newly constructed properties including those sold off the plan (See Section 3.6).

In the event the builder becomes insolvent; your deposit is also protected from the builder's creditors.



3.5 AVAILABILITY OF FINANCE FOR PROPERTY TYPE

Ensure that the property you seek to purchase is one that is supported by a range of potential mortgagees. Some examples of property that may not be acceptable or be subjected to a lower borrowing threshold (LVR) include:

- Property located in remote or regional areas;
- Property that is smaller than 50 square metres in building area;
- Certain inner city apartments;
- Serviced apartments; and
- Property used for certain purposes or of a highly specialised nature.

3.6 PURCHASING “OFF THE PLAN”

Purchasing “off the plan” is a common entry point to the property market. Depending on the progress of the land improvements at the time you sign, you can save a significant amount in stamp duty as opposed to buying an established dwelling of the same price.

However, such savings are now restricted to properties being purchased as principal place of residence only, i.e. where you are planning to live in it, and stamp duty saving are not applicable otherwise.

There are advantages, but risks and considerations to keep in mind, given the (sometimes significant) time lapse between signing the contract and settlement. These include:

Valuations

Many lenders require the property to be valued either on completion or off the plan (most banks require a valuation no more than three months old). If you purchase well in advance you will be exposed to property market price movements. Lending is based on the lower of contract price or bank valuation, so if the value falls you may need to make an additional contribution of funds.

Credit Risk

The credit appetite and policies of lenders change over time. As you often cannot apply for finance for off the plan purchases until 3-6 months prior to settlement, there is a risk that the following may occur:

- Your own circumstances change (e.g. you become unemployed or interest rates increase) compromising your ability to obtain finance at settlement.



- The financier changes its lending policy and can no longer accommodate your lending requirements.
- Lenders can also limit their exposure to a development. For example, a lender may not take more than 25% of an apartment complex as security, so whilst you may meet the policy the lender can reject due to concentration risk. This will be of concern if your personal circumstances restrict your lending options.

Settlement Risk

Whilst the developer or agent may give you an estimated settlement date it is not uncommon for delays to occur. Always have a lawyer review the contract of sale and section 32 prior to signing to ensure you understand time frames and your obligations. If delays occur, ensure you understand what you are buying and any potential hidden costs (e.g. owners corporation fees or utility correction costs).

Clarify the level of stamp duty that is applicable.

Research and Negotiate

You should complete a thorough due diligence on the developer/builder before signing. Your investigation may include:

- History and experience. How long have they been developing property?
- Get a list of their prior projects. Take the time to view those properties and if you can, ask the owners what they think about the quality of the works.
- Research the market. You often pay a premium for new property like you would for a new car. Ask yourself if the premium is reasonable as you may need to research and price the inclusions.
- If the specifications are vague get the developer to clarify. Often the buyers' expectations versus the finished product can be vastly different. It is hard to envision the finished product correctly if you don't ask questions.
- Don't be afraid to negotiate on the purchase price or the level of deposit.

3.7 PROPERTY REPORTS

Several firms involved in property will subscribe to a real estate data searching tool.

These reports can be a great source of information on property, including a history of its ownership and recent comparative sales in the area.

This may also include an overview of the demographics in the area and a projection of future capital growth prospects.

3.8 PROPERTY OWNERSHIP FOR FOREIGN RESIDENTS

Supported by the Foreign Acquisitions and Takeovers Act 1975, the Foreign Investment Review Board (FIRB) examines proposals by foreign persons to invest in Australia and makes recommendations to Treasury.

Under the Act, foreign persons need prior approval to acquire an interest in certain types of real estate. An 'interest' includes buying real estate but can also include obtaining or agreeing to enter into a lease, or financing or profit sharing arrangements.

Real estate covers acquisitions of many types of property acquisition in Australia, both residential and commercial.

The rules that govern this process are considerable, including a focus on the type and proposed purpose of the property being acquired.

There are also purchase thresholds that apply that dictate the level and nature of property acquired.

A comprehensive guide to the regulations in this area are outlined at <http://www.firb.gov.au/>.

Stamp Duty Surcharge - Foreign Purchasers

The Victorian State Government introduced a 3.0% transfer duty surcharge on foreign buyers purchasing residential property from 1 July 2015, to be applied against the full purchase price of the property at time of contract.

The surcharge is in addition to the current transfer duty that all purchasers pay on the transfer of Victorian properties. Since 1 July 2016, this additional rate has been increased to 7.0%.



4 ACQUISITION COSTS & CONSIDERATIONS

4.1 STATUTORY & LEGAL COSTS

There are several cost components when purchasing property. These upfront costs make it critical to make good decisions! It is expensive to regularly transact property.

Costs include, government land transfer duty, government registration fees, conveyancing fees, disbursements, bank fees, property adjustments, moving costs, property service connection costs etc. **Such costs normally account for up to 6% of the purchase price.**

For first home buyers buying a property (for owner occupation) for \$750,000 or less, the cost is substantially reduced or exempt from duty due to the concessions available.

Each state and territory of Australia has varying duties and levies that apply to property. They are generally very complicated, based both on the type of property purchased and the status of the purchaser.

For example, property acquisition costs under different scenarios are outlined in the examples below for the State of **Victoria**:



PURCHASE TYPE	PURCHASE PRICE	TRANSFER DUTY	TOTAL COSTS*
Established Property - Home	\$600,000	\$31,070	\$32,564
Established Property - Home	\$900,000	\$49,070	\$51,266
Established Property – First Home	\$600,000	\$0	\$1,494
Established Property – First Home	\$900,000	\$49,070	\$51,266
Established Property - Investment	\$500,000	\$25,070	\$26,330
Established Property - Investment	\$900,000	\$49,070	\$51,266

*Transfer duty and titles office registration costs

The structure of stamp duty in the lower purchase thresholds is now more complicated. Refer to Section 4.3 for further information.



4.2 LENDERS' MORTGAGE INSURANCE

When borrowing more than 80% of a property's value lender's mortgage insurance (LMI) applies - the borrower pays a once off premium representing a percentage of the loan amount.

LMI only protects the lender in the event of loss. For example, in the event of repossession where the sale proceeds are not sufficient to satisfy outstanding principal, unpaid interest and legal fees – the financier could register a claim to the insurer.

How much could the premium cost?

The premium cost will depend on the loan to value ratio (LVR), the loan amount and financier. Cost is generally between 0.50% and 4.00% of the loan amount. The premium can generally be financed or capitalised on top of the mortgage insured loan, so you do not necessarily have to fund this yourself.

First Home Buyer Qualification for Mortgage Insurance

Most mortgage insurers generally require what is referred to as "genuine savings" evidenced over the most recent 3-6 month period, demonstrating the borrower's ability to hold or save 5% of the purchase price.

Genuine savings are defined by:

- A liquid asset such as cash, shares or managed funds.
- Evidence must be in the form of 3-6 months' bank issued statements, and internet statements are only accepted to supplement the time between the last Bank Issued Statement and recent 4-week period.
- Acceptable assets must be held or saved over a period. Savings must be reasonable and in line with the borrower's income (e.g. where savings are a high percentage of income this may be scrutinised).
- Proceeds from asset sales (such as cars or personal effects) which borrowers use to make up the 5% during the recent "genuine savings period" are usually not acceptable.
- Items such as the First Home Owner Grants, gifted funds from parents, rent paid, or other assets are not counted as genuine savings.
- Mortgage Insurers are relatively strict on the genuine savings rule in the current environment and an exception around this is proving difficult.

Minimum Contribution required if you fund at 90% (with Mortgage Insurance)

Should you seek LMI a minimum contribution of 10% of the purchase price, plus costs (say 6%) is required. In total, 16% of the purchase price less any available grants or concessions.

4.3 PROPERTY GRANTS & CONCESSIONS

I) CONCESSIONAL TRANSFER DUTY

Transfer duty on property has recently been subject to significant legislative change, particularly in Victoria.

You should always check the State Revenue Office (SRO) for the respective states and territories of Australia, to clarify current legislation.

Using Victoria as an example, first home buyers purchasing properties valued below \$600,000 will be exempt from paying stamp duty. In addition, first home purchases between \$600,000 and \$750,000 will receive a concession applied on a sliding scale. It will be available for both new and established home purchases.

There are no geographic restrictions for any of the above changes; the guidelines will apply whether the property is in regional Victoria, Melbourne suburbs, inner city or CBD.

II) PRINCIPAL PLACE OF RESIDENCE (PPR) CONCESSIONS

All home buyers may be entitled to the PPR concession if:

- You have purchased for more than \$130,000 and less than \$550,000;
- You use the property as your PPR within 12 months of becoming entitled to possession of the property (which usually occurs at settlement); and
- Reside in the property for a continuous period of at least 12 months.

The benefit will vary depending on the purchase price but can provide you a stamp duty saving of up to \$3,100 on the current rates.

To calculate your possible entitlements for a further reduction please use the calculator on the SRO website: <http://www.sro.vic.gov.au>.



III) FIRST HOME OWNER GRANT

For people buying or building a **NEW** home valued up to \$750,000, purchasers are still eligible for the First Home Owner Grant of \$10,000.

In regional Victoria, this grant was increased to \$20,000 on 1 July 2017 and this has been extended.

IV) OFF THE PLAN - INVESTMENT PURPOSE DUTY

There are changes to stamp duty treatment for 'off the plan' (OTP) purchases. Previous concessions will now only apply to buyers purchasing an OTP property to occupy as their home (principal place of residence) with a dutiable value under a certain threshold.

This also means that because of the proposed change, the concession will no longer be available for OTP purchases of a holiday home, investment or commercial properties.

V) FIRST HOME SUPER SAVERS SCHEME

Home owners are now able to salary sacrifice extra contributions into their existing superannuation account, up to a maximum of \$30,000 in total and \$15,000 in a single year.

This is in addition to the existing compulsory contributions.

As of 1 July 2018 they have been able to withdraw that as cash, along with any associated earnings.

Contributions and earnings will be taxed at 15%, rather than at marginal income tax rates, and withdrawals taxed at 30% below their marginal rate.

Example provided by the Federal Government:

Michelle earns \$60,000 a year, and salary sacrifices \$10,000 of her pre-tax income into her superannuation account, boosting her balance by \$8,500 after contributions tax.

After three years, she can withdraw \$27,380 plus earnings on those contributions, and after tax leaving her with \$26,029 for her deposit.

This works out to \$6,458 more than if she had saved in a standard deposit account.



4.4 INSURANCE (PERSONAL & PROPERTY)

Personal and property insurance should always be considered in the context of property ownership.

I) MORTGAGE PROTECTION

Mortgage protection is an insurance product providing payment of your mortgage should any of the following events occur:

Death or Total Permanent Disability

Preventing you from ever generating an income again.

Temporary Disablement

Preventing you from generating an income through sickness or injury.

Involuntary Redundancy

Preventing you from earning an income when you lose your job.

II) LIFE INSURANCE

Life or term life Insurance pays out a lump sum if you pass away before a pre-agreed date (the term). This provides protection for your family and dependents with the objective of a lump sum being enough to provide for paying out debt in full or in part, and otherwise to provide your family's long-term financial requirements.

It is therefore important to obtain some advice regarding the level and type of cover that you may require from someone qualified to do so.

III) INCOME PROTECTION INSURANCE

Income protection is a monthly benefit that generally pays you up to 75% of your income if you are unable to work due to an accident or illness or major trauma.

It pays you up until you return to work (after your waiting period). Income protection is generally tax deductible and is designed to ensure that you can continue to pay the mortgage and carry on financially until you return to work.

It is generally recognized as a more rounded product than mortgage protection insurance as it focuses on the protection of income as opposed to just the mortgage repayments.

IV) STEPPED VERSUS LEVEL INSURANCE PREMIUMS

In relation to risk and personal insurance, stepped premiums are the most widely used in the insurance industry, representing about 70% of all policies written. Level Premiums are rarely advertised, but what are stepped and level premiums?

One important consideration in considering Personal Insurance is whether to structure the policies on a Stepped or a Level Premium.

Stepped Premiums

Insurance premium is calculated on your age and increases every year at each policy renewal. i.e. the younger the individual, the cheaper the cost.

Level Premiums

Insurance premium is calculated on an average premium, meaning you might pay more when you are younger, but less when you get older.

The cheaper stepped premium option will of course be more attractive in the short term, and are typically quoted in the media. But when looking deeper, level premium cover can provide a greater long term saving in terms of insurance cover paid over a life time.

In terms of research, claims history indicates that when we most need insurance (ages 40 to 55) the cost of insurance can sometimes be too expensive to keep. By taking a level premium, your insurance premium will not increase every year with your age, so in these later years, you will still be able to afford it, and likely benefit from a significant overall cost saving.

This example shows a stepped vs. level premium projection as a cumulative total to indicate the overwhelming benefits of a Level premium long term.

Age: 38 years old

Occupation: Clerical

Life & TPD Cover: \$650,000

Cumulative Stepped VS Level Premium Paid to age 65

Stepped: \$193,106.50

Level to age 65: \$38,980.64

The difference in total premiums paid is significant.



V) PROPERTY INSURANCE

It is obviously important to ensure that the appropriate building insurance is arranged to protect your property investments. You may consider cover immediately after signing a contract of sale to protect your interests during the settlement period.

You should also make sure that your ongoing level of building insurance is appropriate to reflect any renovations or improvements to your property.

VI) LANDLORD INSURANCE

Where you are holding a property as an investment, you can take out landlord insurance to protect you against damaging tenants, and those that fail to pay their rent.





4.5 TAX CONSIDERATIONS

Transfer duties and levies are governed by the individual states of Australia, though the broader taxation aspects of capital gains and income tax are the domain of the Federal Government.

As an overarching comment, always seek professional advice from your accountant or financial adviser before making decisions about property ownership.

Most advisers would also recommend to never buy a property for the tax considerations alone, which unfortunately we have seen many people do.

There are several issues which should be taken into consideration including:

What are my objectives in purchasing a property?

Are you seeking long term capital growth, or a strong income yield through rental return? Generally, there is an inverse relationship between the two.

Based on the borrowing levels, will the property be negatively or positively geared?

Who should own the property?

If you have a partner/spouse this can be a vital consideration. For example, if the property has a positively geared profile that generates additional marginal income, the person with the lower level of income may be more suited to own the property and receive that additional income.

This profile should also be considered when planning the sale of the property with any likely Capital Gains Tax.

Converting owner occupied property to an investment property

Many people plan the purchase of their first home with a long-term view to acquire again and make their old home available for rental.

With tax treatment of debt, there may be merit in some circumstances to obtaining an interest only home loan, with an attaching 100% offset facility and directing all repayments to the offset account.

This way, funds in the offset account can be used to purchase a new home where non-deductible debt can be minimized and the first loan (now tax deductible) can be restored to its original amount.

Capital gains tax (CGT)

Other than your principal place of residence, CGT is generally payable when you dispose of any property interests.

In some circumstances, a property may have initially been your main residence, before it was made available for rent. In these circumstances, and depending on the timing, you may be eligible for an exemption or liable for capital gains tax on real estate on a pro-rata basis.

Again, specialist advice should always be sought in respect of taxation matters. Spending money upfront for good advice can pay dividends in the longer term.



5 CONVEYANCING

Conveyancing is the process of transferring the title of a property from one party to another.

A typical conveyancing transaction contains milestones including the exchange of contracts (whereby equitable title passes) and the completion or settlement stage (whereby legal title passes).

A property purchaser must ensure that they obtain a good and marketable 'title' to the land and that the seller is the true owner.

The vendor's statement (or 'section 32') sets out to a potential purchaser the details affecting the property's title, such as any mortgages, leases, caveats, easements, the zoning, rates and so forth. If the seller is aware of anything from other parties that may have an impact on the value of the property, such as roadworks or acquisition for public housing, this must also be disclosed in the vendor's statement.

In Australia, this process is supported by a system of land registration to assure purchasers of land are taking good title.

At the time of writing, the process of conveyancing is undergoing substantial change, through a bank and government supported system known as 'e-conveyancing', or electronic conveyancing, and all hard copy titles are being converted to electronic, or digital, titles.

5.1 WHAT YOU NEED TO KNOW

1 Specific Commercial Terms

You should confirm the particulars of sale are accurate.

2 Cooling Off

In certain circumstances a cooling off period after signing can apply (but not if a property is purchased at or near auction).

3 Finance

You should ensure you can finance the transaction if finance is needed, prior to signing a contract otherwise in certain circumstances you can seek to make the contract conditional upon finance approval. This will not apply if the property is for auction.

4 Deposit Bond

In certain circumstances you can explore utilizing a deposit bond instead of paying cash for your deposit (this will be subject to vendor's consent, which should not be unreasonably withheld).

5 Purchaser and/or Nomination

You can elect to nominate a different ultimate purchaser before settlement of the transaction.

You may need to be careful to ensure not to elect a nominee that does not exist at time of signing the contract, or double stamp duty issues can arise.

If you elect your company to be the purchaser, you may be required to personally guarantee the obligations upon your company under the contract (which is standard commercial practice in these matters).

6 Identity of Land

You should check the identity of the land is identical to that noted in the certificate of title/plan of subdivision. You can do so by engaging your own independent consultant.

7 Caveat Emptor

Caveat Emptor is Latin for "let the buyer beware". This principle puts the onus on you as the purchaser to fully examine and be satisfied with the property before purchasing. It particularly applies to any buildings on a property.





8 Building and Pest Inspections

A building inspection report provides a written account of the condition of a property. It should tell you about any significant building defects or problems such as rising damp, movement in the walls (cracking, safety hazards or faults). An independent pest inspection can similarly assist with informing you of any pest problems with the property, including termites.

We recommend you obtain a building report and pest inspection report before you exchange sale contracts (or at worst shortly thereafter so any problems with the property can be identified which, if left unchecked, could prove costly to repair.

If there are any issues you want to be fixed prior to settlement, a special condition may be included in the contract to specify the requirement.

9 Penalty Interest

Usually, there is a penalty interest rate and associated costs if the matter does not settle on time, by reason of a delay caused by the purchaser or their financier (as is standard in all conveyancing transactions).

10 Chattels

The chattels sold with the property are outlined in the particulars of sale in the contract of sale. If you are agreeing to buy additional chattels from the vendor this needs to be communicated to your conveyancer. This can be relevant to the stamp duty payable on the purchase.

11 Deposit

The deposit is generally payable at the signing of the contract and is normally 10% of the purchase price. In certain circumstances this can be negotiated.

12 Planning

You may wish to contact your local planning authority to discuss any proposed plans indicated in a vendor's statement.

13 Easements

We suggest the property be thoroughly checked for easements.

14 GST

We recommend you speak to your accountant in relation to GST. For example, purchasers are now required to collect GST at settlement, in relation to all new off the plan transactions, on behalf of the Australian Tax Office.

15 Owners Corporation

With respect to strata title properties, you should read and understand the owners' corporation body corporate rules. Please also note any minutes of meeting indicating special levies may be struck.

16 Foreign Owner Withholding Tax

Where a vendor is a foreign owner, the purchaser must withhold 12.5% of the purchase price at settlement, if the purchase price is \$750k or more.

To prevent this occurring in the case of an Australian resident vendor, the relevant certificate must be obtained from the Australian Tax Office.

17 Financial Advice

It is of course prudent to obtain financial, accounting and/or business advice prior to signing the contract.

Conveyancing is an important part of the property acquisition sale or purchase process, and as with all areas of property, you should seek professional advice and support.

5.2 INNOVATION & CHANGES

The property transfer and conveyancing industry is currently undergoing significant process changes.

Electronic conveyancing or e-conveyancing is now being introduced to simplify and digitise the complex process of property exchange. Instigated by the Council of Australian Governments, it is built around an online network of members supported by Property Exchange Australia (PEXA).

PEXA is an online property exchange network and it assists members – such as lawyers, conveyancers and financial institutions – to lodge documents with land registries and complete financial settlements electronically.

To ensure the integrity of the network, the Australian Registrars' National Electronic Conveyancing Council has developed a regulatory framework, under which PEXA operates. Industry safeguards include the participation agreement, verification of identity and digital certificates which is changing how we deal in the transfer of property.

E-conveyancing is currently live in five states (with more to come) and is a collaboration between many industry participants, including financial institutions, land registries and the Reserve Bank of Australia.



6 LEGAL CONSIDERATIONS

6.1 ASSET PROTECTION

When contemplating a property acquisition, asset protection must be an important consideration.

There is a growing realisation that for many people running their own business or who are in a position of responsibility, their personal assets are highly exposed as their personal liability increases. Protecting property assets includes determining the most appropriate structure to hold your business. Once there is a threat to assets, it is likely to be too late to put in place the appropriate asset protection structure.

When purchasing a new property, it is therefore important to:

- Where possible, ensure that capital injections into the business or property acquisition, generally in the form of loans, are secured over those assets of the business venture or the property.
- Ensure personal and business assets are not at risk from creditors.
- Where possible, avoid the provision of spouse/personal/director guarantees, which expose personal property assets.
- Ensure the above measures are relevantly documented.

A common property protection strategy is for the partner/spouse to hold assets in their name only, as the spouse 'less at risk'.

Other structures that can assist with asset protection include family trusts and self managed super funds.

6.2 FAMILY TRUSTS

Property can be held in a variety of structures, which generally have tax considerations, asset protection impacts, or both.

When not in individual names, a common structure to use is through a discretionary or family trust. This is where property is held by a trustee for the benefit of others (i.e. beneficiaries), and can be effective entities to hold and protect assets.

Generally, a beneficiary of a discretionary trust does not have any right to the assets of the trust until the trustee exercises his discretion to distribute its income or capital to a beneficiary stipulated in the trust deed. Accordingly, the property and other assets of the trust are not usually exposed to creditors.

If a trust is established for the purpose of asset protection, it should not generally operate a business or engage in any other risk related activity from this trust.

6.3 RELATED PARTY TRANSFERS

In Victoria, there is no stamp duty chargeable in respect of a transfer of property between those in a marital relationship or genuine de facto relationship. However, this exemption now only applies to owner occupied, and not investment property.

Stamp duty may also apply where there is a subsequent transfer to a trust, notwithstanding it may be controlled by the transferor, if the beneficial ownership of the assets change.



6.4 PROPERTY TITLE TYPES

I) TORRENS TITLE

Torrens title is a system of land title where the register of land holdings maintained by the relevant central authority guarantees an indefeasible title to those included in the register. Land ownership is transferred through registration of title instead of using deeds. This was introduced to simplify land transactions and to certify an absolute title to real estate.

II) STRATA TITLE

Introduced in 1961, Strata title is a form of ownership devised for multi-level or horizontal subdivisions with shared areas. This terminology refers to apartments being on different levels, or 'strata'.

Strata title schemes are composed of both individual lots and common property. Lots, which are typically apartments or car parks, are each shown on the title as being owned by a 'lot owner'.

They are registered under the Torrens system described above.

III) COMPANY SHARE

This type of property title constitutes a company, incorporated specifically for the purpose of the property ownership, as the registered owner of all the land and the whole of the building in a development.

Accordingly, ownership is recognized through a shareholding in the company which gives a person the right to occupy a portion of the building.

A purchaser does not obtain title to the portion of the property they occupy, and legal advice should be sought before committing to a property of this type.

These types are becoming less and less common.

6.5 FAMILY LAW

Family law is another area that impacts on property ownership, particularly in respect of any financial separation of married or de facto partners.

To learn more please see our Family Law Guide on our website or ask us for a copy.



7 ESTATE PLANNING

Whilst it may not seem a priority, (especially for younger people) estate planning is an important part of the property acquisition process.

We have outlined some very basic information below in respect to the relevant issues.

For further and more detailed information, please see our Estate Planning Guide on our website or contact us for a copy.

7.1 WILLS

It is strongly recommended that all people (especially those with a property) have a valid will, and the purchase of a new property can be a good time to arrange this.

This is the best way to ensure that your assets are left to your loved ones; making life easier for those you leave behind.

Your assets will therefore not be managed by the state government who in certain circumstances will deal with estates where there is no valid will.

7.2 POWERS OF ATTORNEY

Many people also decide it is appropriate to have 'powers of attorney'.

A power of attorney is vital if you want someone to take care of your financial and legal affairs or want someone to take care of your affairs if you have an accident or sudden illness which leaves you incapable of doing it for yourself. This includes facilitating medical decisions on your behalf if you become unconscious or otherwise incapable of making those decisions for yourself.

7.3 ASSET PROTECTION AND ESTATE PLANNING

Aspects of asset protection often tie in to estate planning issues, with respect to how assets are owned prior to death.

Most legal advisers can assess your current position in this regard and advise of the steps that are available to protect your assets.

As a general estate planning consideration, property is a class of asset that is impacted by either survivorship or full estate administration.



For survivorship, jointly held property becomes completely the property of the survivor by law, requiring a small application to the Land Titles Office to reflect the change on the title. In other words, it doesn't form part of the estate of the first person who dies but will pass automatically to the surviving person.

7.4 CGT CONSIDERATIONS UPON TRANSFER AFTER DEATH

If the dwelling is owned in your name (that is, not the name of a company or trust), there should be no CGT payable when it passes on to your 'legal personal representative' (LPR) or a beneficiary of your estate.

If your LPR or beneficiary sells the dwelling and the contract settles within two years of your death, they should be able to claim the main residence exemption (and therefore pay no CGT because of the sale) if the following circumstances are satisfied:

- You acquired the dwelling after 19 September 1985 (i.e. it is a post-CGT asset), it was your main residence immediately before your death and it was not then being used to produce assessable income; or
- You acquired the dwelling before 20 September 1985 (i.e. it is a pre-CGT asset), regardless of whether it was used by you as your main residence.

There is no need for your LPR or beneficiary to use the dwelling as their main residence during the two-year period from your date of death. Even if the dwelling is rented for a period after your death, the main residence exemption can be claimed if the dwelling is sold within two years of your death.

The main residence exemption may still be available if the dwelling was, from your date of death until the date it is sold, the main residence of one or more of:

- Your spouse (provided you were not permanently living separately from each other at the date of your death); or
- An individual who had the right to occupy the dwelling under your will; or
- The person to whom the dwelling passed on as a beneficiary.

7.5 LAND TAX CONSIDERATIONS AFTER DEATH

Upon death, you have three years to dispose of a principal place of residence before the exemption from land tax ceases.

You should consult your accountant if you wish to learn more about tax related matters.





8 FAMILY GUARANTEE & BORROWING WITHIN SUPERANNUATION

8.1 HOW A FAMILY MEMBER CAN ASSIST YOU

Purchasing a property is usually a significant financial challenge. The challenge could be saving for the deposit, especially if you are a first-time home buyer.

Obtaining finance via a 'family guarantee' policy could assist you by giving you a head start with assistance from certain family members. You may be able to utilise the family guarantee policy to purchase a home or invest in residential property.

A family guarantee also allows certain family members to utilise the equity in their home as additional security for a portion of your loan amount. This could mean that purchasing a property with the help of a family member could reduce or avoid paying lenders mortgage insurance and maximize the amount you can borrow.

What are the requirements?

- Guarantors can be a parent/s, parent-in-law or step-parent. Grandparents and siblings will also be considered.
- Available on most mortgage loan products.
- The guarantor can determine what portion of the loan they would secure (they do not have to provide a full guarantee covering of your home loan).
- The borrower must complete a loan serviceability credit assessment for the total loan amount.
- The guarantor to complete a partial serviceability assessment for guaranteed amount.
- The guarantor is required to seek independent legal and financial advice.
- Standard guarantee release conditions apply.

Additionally or alternatively, parents are increasingly coming forward to lend their children money to assist with purchasing property, as a second lender behind the children's bank.



8.2 OWNERSHIP OF PROPERTY WITHIN SUPERANNUATION

An option for certain clients is to consider owning property within the superannuation environment via a 'self-managed superannuation fund (SMSF).

This can be achieved directly by the fund (provided it accords with relevant legislation). On the other hand, for investors that do not have sufficient funds to purchase a property outright, they can use an investment vehicle that effectively allows the SMSF to borrow to purchase a property, and pay it off over time while building the superannuation fund's equity in the property.

We strongly recommend clients seek professional financial advice before making any commitment to the above strategies, as there are many factors that need to be taken into consideration.



8.3 WHAT ARE LIMITED RECOURSE BORROWINGS IN SUPER?

In 2007, federal legislation was passed whereby super funds could effectively borrow to purchase property in Australia, subject to certain conditions.

This is achieved through the investor paying an initial installment together with a borrowing of money to fund the remaining amount required to acquire the asset.

The borrowing is repaid by the investor making further installment payments.

The investor obtains an interest in the underlying asset that provides an entitlement to the income from the asset (e.g. dividends in the case of shares). The investor's interest in the asset is provided as security for the borrowing the investor has made. If the investor defaults on the borrowing, the lender may only have recourse to the asset acquired. The lender has no recourse to any other asset of the investor, within their super.

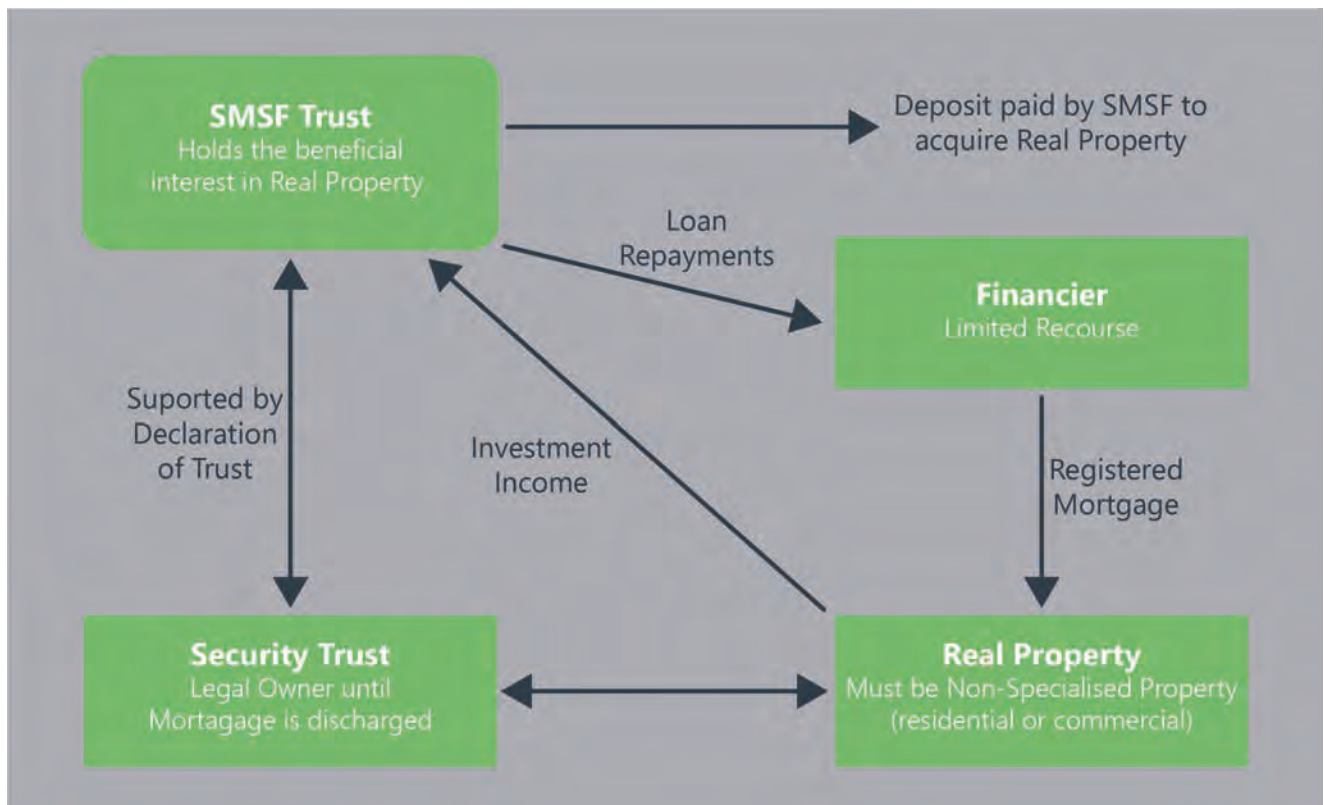
This structure has become very popular with investors and business owners across both residential and commercial property.

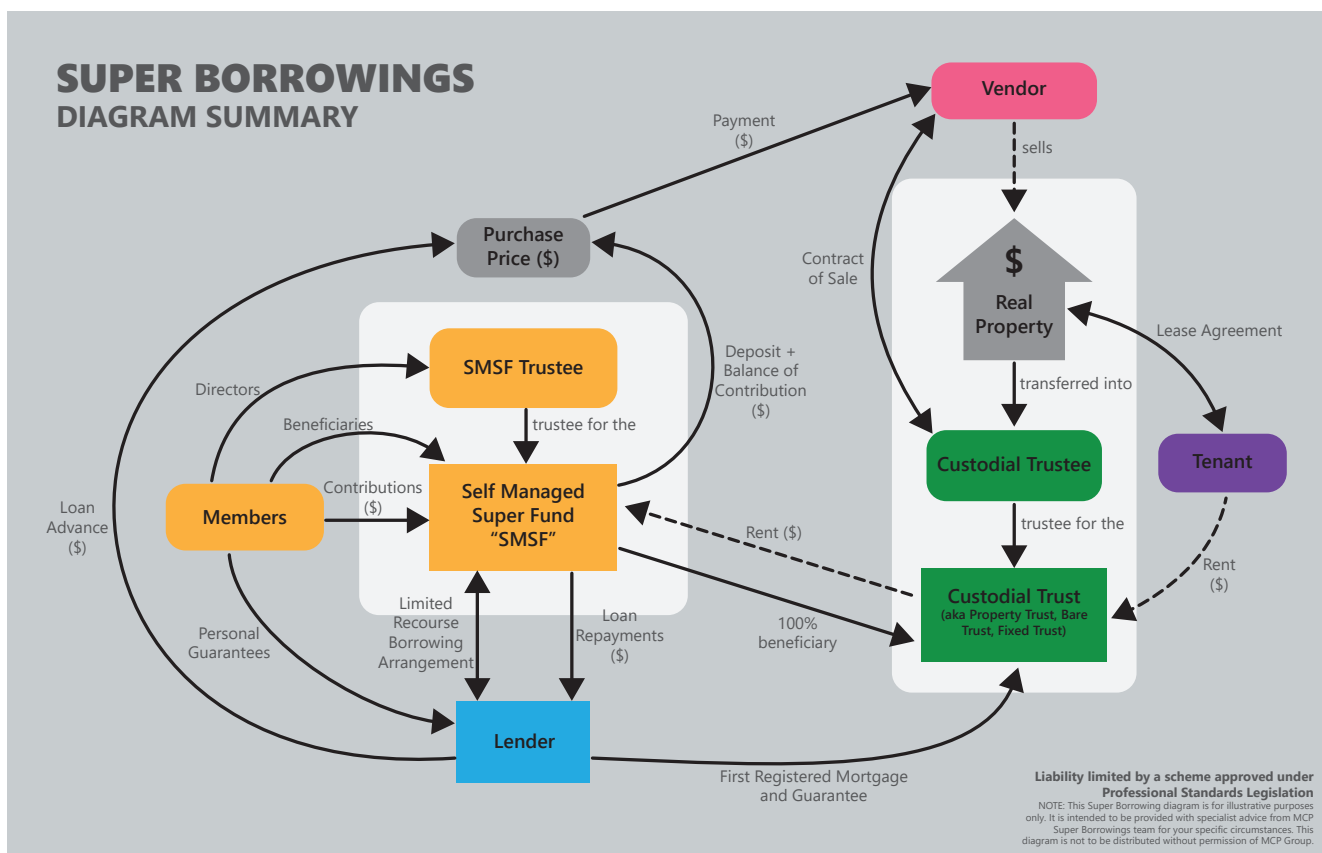
This area is subject to legislative changes, and continues to evolve in its application.

As an example, at the date of writing, many financiers have withdrawn their support for financing residential property through superannuation.

Specialised advice should be sought when looking to enter arrangements involving this structure. Our experience is that many people have entered into these arrangements without a complete and full understanding of whether there is a net benefit in the long term.

An example of the legal structure, including the parties involved, is outlined below.





A more detailed diagram of how super borrowing works is shown in the above diagram.

The arrangements of the above must generally satisfy each of the following criteria:

- The SMSF has the right to acquire full legal ownership of the asset by making one or more payments after acquiring the beneficial interest.
- The finance is used to acquire an asset which the fund is not prohibited from acquiring.
- Any recourse that the financier has under the arrangement against the SMSF is limited to rights relating to the asset acquired.
- The financier takes a guarantee from the security trustee, and the members personally supported by a mortgage over the real property.
- SMSF holds a beneficial interest in the property with the right to have legal title to the property transferred to the SMSF once the borrowed funds are fully repaid to the financier.
- Income from the property flows from the security trust to the SMSF. All expenses, including interest, are met by the SMSF.
- The rights and obligations of the SMSF and the security trustee in respect of the property are set out in the security trust deed.

This is a complicated area. MCP can provide further advice and information with respect to this area, upon request.



9 PROPERTY INVESTMENT CONSIDERATIONS

9.1 OVERVIEW

The right property investment option usually depends on your personal circumstances.

Typically, options include residential and commercial established and off the plan properties, development sites, industrial or holiday accommodation.

These may be intrastate or interstate, and be negatively or positively geared.

The following general information aims to outline some of the issues you might consider when purchasing property.

9.2 CAPITAL GROWTH

Capital growth is defined as the increase in value of an asset or investment over time, measured based on the current value of the asset or investment, in relation to the amount originally invested in it.

Capital growth is one of the most fundamental investment objectives for investors and allows for flexibility with investment decisions when achieved.

In the long term, there are generally two key considerations on property investment:

- Growth does not happen in a uniform manner.
- There are generally higher establishment costs (government charges) when purchasing property compared with other investment alternatives.

These two factors suggest property investment can be a long-term investment with time in the market being a critical factor for your success.

9.3 CASH FLOW

Cash flow through rental income is a significant part of your investment. Your cash flow planning should be realistic and allow for a range of scenarios including:

- Periods of vacancy
- Maintenance costs
- Owners corporation fees (if applicable)
- Building insurance
- Council and water rates
- Property management fees

- Landlord's insurance to protect your asset in case of vacancy or non-payment of rent. Allow for 46 weeks' tenancy per annum
- Estimate an interest rate of at least 6.0% (even though at the time of writing we are experiencing record low interest rates).
- Another factor that can bring certainty is to fix your interest rate – which we have discussed previously in this guide
- Income protection. To protect your cash flow, you need to protect yourself. If you are not working and receiving income all the calculations go out the window as your gearing benefit often relies on the tax savings you make

Can you achieve both capital growth and positive cash flow from property investment?

Yes, but often an investment property can be categorized by the potential to be likely to grow in value (capital growth) such as a property with a large land component in a premium area or a cash flow property such as a holiday accommodation. It is important to ensure the appropriate property selection with the appropriate rental returns.

9.4 USE OF GEARING

Unless you can pay cash for your property, financing some or all of the cost of the investment will result in some level of 'gearing'.

There are three types of gearing:

1. Positive Gearing

Where property income exceeds direct costs, including interest, and produces a taxable profit.

2. Neutral Gearing

The draw! Income is equal to costs including interest from your loan.

3. Negative Gearing

Where income is less than all the resultant costs of property ownership.

Many consider property investment so that they have an asset base and income in retirement. Gearing enables the leverage of returns with the associated level of risk.



9.5 PROPERTY TYPES

I) RESIDENTIAL PROPERTY

The risk profile generally suits investors with a lower risk tolerance. Naturally, vacancy rates, damage by tenants or the location becoming less popular can affect the viability of your investment. It still remains relatively illiquid compared with other asset classes.

II) COMMERCIAL PROPERTY

Generally suits investors with a high-risk tolerance and lower disposable income. The levels of vacancy can be more frequent and for longer periods. As a result, landlords often entice tenants with rent-free periods and associated incentives. As a general comment, commercial property can be more affected by the general state of the economy.

III) VACANT LAND

This category can suit investors with a high-risk tolerance and strong disposable income, as there is generally no income (rental) generated from vacant land. Investors in vacant land are relying on capital gains to offset both acquisition and ongoing costs.

IV) HOLIDAY APARTMENTS, SERVICED APARTMENTS, HOTELS AND MOTELS

Suits investors with a medium to high risk tolerance and medium disposable income. The appointed manager has complete control over these sites, and the valuation is therefore linked to the success or failure of the business.

V) PROPERTY DEVELOPMENT

A more complicated area for property investment, and will suit investors with very high risk tolerance and a high disposable income. Risks are several, including delays in completing development, opposition for planning permits, unforeseen changes in location such as a withdrawal of service or inability to sell finished dwellings.

9.6 SUBDIVISION

Subdivision can provide the opportunity to improve the dwellings on land and maximize profit, though it can also represent the most complex and time-consuming property investment option!

Specialist advice should be sought, including a feasibility study, outlining all profit margins and contingencies.

The first step in getting approval for your subdivision is to provide a plan to council for approval.

If the plan meets all the council's requirements a permit will be issued, or may not be required.

If there is a conflict, a planning permit will be required in which case some of the considerations may include:

- Is the subdivision appropriate to the location?
- Does the development match the future vision of the council?
- Will the development affect infrastructure expansion?
- Is there sufficient open space? An open space tax based on land value can be charged per land allocation.
- Are there defects that the development needs to overcome?

Strata plan requirements include but are not limited to:

- Proposed easements
- Details of public open space
- Proposed owner corporation
- Boundaries
- Stages of subdivision
- If there is a land acquisition it must be certified by the council and be accompanied by written advice from a licensed surveyor (signed and dated).

Developers submit the plan for certification to council and later it is lodged for registration with the titles office and issuing of new titles. If they wish to construct buildings on the land they must also provide engineering plans to council for approval and obtain a building permit.



9.7 VALUATION METHODOLOGY

Perhaps the best way to determine the value of a property is to appoint a certified property valuer to undertake a professional valuation. You may also choose to do your own calculations based on the following methods.

I) SUMMATION

This involves estimating the land value based upon recent sales processes. It is possible to estimate the land value on comparable land when an established property was purchased and the dwelling demolished.

Once the land value is established then estimations are made on improvements such as:

- The main dwelling such as a house, shop, warehouse etc.
- Other buildings; sheds, garage, carports etc.
- Other improvements; driveway, irrigation systems, garden, fences etc.

The estimations are based on full replacement value less depreciation, which is determined, by the condition of the improvements. New properties with a builder's guarantee attract a premium over older properties without structural guarantees.

II) COMPARATIVE VALUE

Commonly used, this method focuses on supply and demand rather than replacement costs and improvements. This method relies on recent sales of comparable properties. The accuracy of this method relies upon the number, proximity and date of recent comparable property sales.



9.8 NEGOTIATION

In our view, successful negotiation is one of the keys to obtaining the best return on property investment.

Some guiding rules include:

- Establish a fair market price based on a valuation and property inspection checklist.
- Plan the negotiation, including:
 - ↳ Maximum purchase price
 - ↳ Minimum settlement time
 - ↳ Special conditions such as building inspections, finance approval, development approval or subdivision approval
- Research the vendor's reason for selling.
- Ask your solicitor to search copies of the title for mortgage details as several mortgages may indicate difficulties in servicing the loan. Speak to the agent, neighbours and the vendor directly if possible to establish reasons for selling.
- Curb your initial enthusiasm, especially around the agent.
- Identify and focus on the weak aspects of the property. All properties have areas of improvement that can be brought to the attention of the vendor or his agent. Any indication that the purchaser is attracted to the features of the property will be taken as buying signals.
- Research external factors to use as leverage such as:
 - ↳ Possible interest rate increases
 - ↳ Unemployment increases
 - ↳ Slowdown in market
 - ↳ Closure of local and regional factories
 - ↳ Planned developments with negative impacts
 - ↳ Possible school closures.
- Indicate you have several properties in mind (don't disclose which ones as this will give a good real estate agent an opportunity to sell against them).
- Be prepared to walk away from negotiations if the best price and conditions are not met. This may force the vendor to indicate the bottom price they are willing to accept.
- Property investment should not be an emotional decision. Pre-planning and being well informed on price and local issues gives you the best possible chance of a successful negotiation.

Division 42 allowances such as building fixtures or fittings and furniture depreciate over time at different rates; a qualified quantity surveyor should create a depreciation schedule that reflects this for each property.



9.9 BUILD YOUR PROPERTY INVESTMENT TEAM

As a summary, and considering so much so far, you need to build a team of trusted advisers around you.

Your team needs to be made up of:

Property Strategist/Adviser/Financial Planner

Works with you to understand where you are and where you want to go (at a pace you dictate. Maps out a plan with a personalised solution.

Lawyer

Advises on building contracts, handles transfer of ownership (conveyancing and sets up company structures and trusts, if required. Protects your assets.

Property Manager

Ensures high quality tenants and manages the day-to-day maintenance of your property.

Finance Broker

Helps to deliver the right finance structure, suitable flexibility and competitive interest rates.

Financial Planner

Ensures you have the right personal protection in place, and may provide advice if purchasing in self-managed super funds.

Accountant

A good accountant is crucial for maximizing your financial benefits, recommended purchasing structures and complying with tax office requirements.



10 CONTACT US

10.1 AND NOW...

So, where to from here? For the less experienced, hopefully you have gathered a few key ideas and concepts that will be a catalyst for more questions.

For the experienced, we hope that you can take at least one action point that may help in future.

From that point, talk to your adviser team to harness your ideas and see what is possible, and remember - we are here to help you.

ABOUT THE AUTHORS

From its origins in 1994, MCP Group offers independent finance broking, property and legal services, conveyancing, estate planning, financial planning, insurance broking and business advice.

Much of our experience in property has been generated through relationships with Accounting Firms, Financial Planners, related professional groups and most importantly our clients.

We love all aspects of property and ownership, from finance, conveyancing, insurance, contract reviews, property agreements, entity formations and other support.



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