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Chapter **1**

Getting Ready to Buy Real Estate

Buying a first home or investment property can be a stressful time for many people. Chances are the purchase is going to be the most money you have ever spent on anything in your entire life! But worry not, because you are taking positive action and educating yourself beforehand via this book. The key to successful property selection — either for your home or as an investment property — is recognising that a one-size-fits-all approach is not possible. So, by learning about the different types of residential properties available, as well as some solid investing principles, you're setting yourself up to make savvy purchasing decisions with the potential for sound capital growth in the years ahead.

In this chapter, we take you through some of the basics about buying residential properties, and using your home as a base for buying your first investment property. We also outline some of the benefits of rentvesting — or buying an investment property while continuing to rent in your preferred location.

Purchasing Residential Properties

Residential property can be an attractive real estate investment for many people. Residential housing is easier to understand, purchase and manage than most other types of property, such as office, industrial and retail property. Either as a homeowner or a renter, you already have some level of experience locating the type of property you want to live in, working out how much you can afford, and maintaining that property.

If you've been in the market for a home yourself, you know that, in addition to freestanding (detached) houses, you can choose from numerous types of attached or multi-dwelling properties, including units, apartments and townhouses. In the following sections, we provide an overview of why some of these may make an attractive option for you.

Freestanding houses

From a long-term investment point of view, *freestanding* houses have usually performed better in the long run than attached housing, units or apartments. In a sound real estate market, most housing appreciates, but traditional detached homes tend to outperform other housing types for the following reasons:

- » Freestanding houses tend to attract more potential buyers — most people, when they can afford it, prefer detached dwellings, particularly for the increased privacy (and space).
- » Attached housing, or units and townhouses, is less expensive and easier to build — and to overbuild. Because of this potential for surplus properties on the market, such property tends to appreciate more moderately in price.
- » Land value is the major driver of property prices — so the higher the land content, the more likely the capital growth. And a freestanding house, in most cases, has a higher proportion of land content than attached housing.

Because freestanding houses are the first choice for most Australians, market prices for such dwellings can sometimes become inflated beyond what's justified by the rental income that they can produce. And even if you're buying the property to live in

yourself, potential rental income compared to purchase price is a good indication of whether the property is overprice.

Detached houses are likely to produce lower rental yields (rent as a proportion of current value, for the purpose of market comparison) than most other options, partly because of the higher purchase prices of houses versus units.

As the homeowner, you are responsible for maintenance and repairs of the property. If you're purchasing the property as an investment and you engage a property manager (as we always recommend), your manager will find the tradespeople and coordinate and oversee the work, while the fees for such work will come out of your returns. (See Chapter 3 for more on gathering your expert team.) Also recognise that, if you purchase a house with many fine features and amenities, tenants living in your property won't necessarily treat it with the same tender loving care that you might.



TIP

A primary rule of being a successful landlord is to let go of any emotional attachment to a property. But that sort of attachment on the tenant's part is favourable: The more tenants make your rental property their 'home', the more likely they are to return it to you in good condition — except for the expected normal wear and tear of day-to-day living.

Attached housing

As the cost of land around major cities has skyrocketed, packing more multi-dwelling units into a given plot of land keeps housing somewhat more affordable. Here, we discuss the investment merits of units, apartments, and townhouses — for owner-occupiers and investors alike.

Apartments and units

When you purchase a flat or apartment, you're actually purchasing the airspace and interior surfaces of a specific apartment as well as a proportionate interest in the common areas — the pool, tennis court, grounds, hallways, roof-top gardens and so on. Although you (or your tenants if you're an investor) have full use and enjoyment of the common areas, the body corporate or owners corporation (the collective owners of all apartments in the block) actually owns and maintains the common areas, as well

as the building structures themselves, which typically include the foundations, outside walls and doors, roof, and the plumbing, electrical and other building systems. Before purchasing an apartment, you should review the body corporate governing documents to check what's considered common areas, and take into account annual body corporate fees.

A unit, on the other hand, can be an attached or detached dwelling on a block of land, with shared common ground (such as driveways and gardens). Examples include two, three or more dwellings that have been built on a single block of land.

One advantage that apartments and units have over other property options is that most bodies corporate deal with issues such as roofing and gardening for the entire building and receive bulk-buying benefits. *Note:* You're still responsible for maintenance that's needed inside your unit, such as servicing appliances and interior painting. For investors, apartments tend to produce higher yields because of the lower purchase price points.

Although apartments may be somewhat easier to maintain, they tend to appreciate slower than houses and even units, unless they're located in a desirable urban area. This is in part because most apartment blocks lack the scarcity value of houses.

Townhouses

Essentially attached homes, townhouses are a hybrid between 'air space only' apartments and houses. Like apartments and units, townhouses are usually attached, typically sharing walls and a continuous roof. But townhouses are often two- or even three-storey buildings that can come with a courtyard or balcony and offer more privacy than an apartment. That generally means you don't have someone living above or below you.



REMEMBER

As with apartments, it's extremely important that you review the body corporate governing documents before you purchase a townhouse to see exactly what you legally own. Townhouses are usually organised so that no limitations are stipulated on the transferability of ownership of the individual lot that encompasses each dwelling and often a small area of immediately adjacent land or air space for a patio or balcony. Courtyards are often exclusive-use common property, because, although the owner has sole use of the area, the body corporate still owns it. The common areas

are all part of a larger single lot, and each owner is a shareholder, in equal proportion, of the common area.

Deciding among the options

Choosing a home to live in yourself is a very personal decision, determined by many factors — including your own lifestyle requirements and the kinds of design elements you find aesthetically pleasing. From a pure investment perspective, my top recommendations for first-time investors are houses or well-located units that offer scarcity value (such as Art Deco design elements) or those with desirable attributes (such as water views).

Apartments make more sense for homebuyers and investors who don't want to deal with building maintenance and security issues. (See Chapter 6 for more on the ongoing costs of real estate.) Avoid shared-wall dwellings (particularly apartments) in inner-city areas where the availability of prime development sites (property allotments ripe for development) makes building many more apartment towers more likely. Apartment prices tend to perform best where nearby land has already been fully (or nearly fully) developed.



TIP

For higher returns as an investor, look for property where relatively simple cosmetic changes can allow you to raise rents, and so increase the market value of the property. Examples of such improvements may include, but aren't limited to:

- » Adding fresh paint and floor coverings
- » Improving the landscaping
- » Upgrading the kitchen with new appliances and new cabinet and drawer hardware

All the preceding changes can totally change the look and feel of the property.



TIP

Whether you're buying for yourself or as an investor, look for property with a great location and good physical condition but with some maintenance that the current owner has put off — for example, a property with a large yard but dead grass, or a two- or three-car garage but with peeling paint or a broken garage door. These cosmetic issues can help keep the purchase price down. Then you can develop a hit list of items to achieve maximum

results for minimum dollars. As well as fixing the paintwork, for example, you could also add a remote garage door opener to jazz up the property for minimum cost. You might be surprised how much aesthetic appeal and value you can add to a property owned by a burnt-out, absentee, or totally uninterested owner who's tired of maintaining the property.



REMEMBER

Unless you can afford a large deposit (20 to 30 per cent or more), the early years of property ownership may financially challenge you, depending on the type of property:

- » **Houses:** The early years of owning a property are usually the most difficult financially, particularly with houses. The reason: Land value. Houses sell at a premium, especially relative to the rent they command because the land itself has a lower rental value than the dwelling.
- » **Apartments or apartment buildings:** Apartments and apartment buildings, particularly those with many dwellings, are generally more affordable to purchase and, for investors, occasionally can produce a small positive cash flow, even in the early years of ownership.

See Chapter 2 for more on buying strategies once you have narrowed down your property options, and see Chapters 4 and 5 for more on financing your purchase and mortgages.

Using Your Home as a Base for Investing

The first foray into property purchasing for most people is a home in which to live. In the following sections, we not only cover the advantages inherent in buying a home for your own use, but also explain why a home and an investment property are essentially mutually exclusive purchases (except in the case of holiday homes). We also cover the implications of converting your home to a rental property, as well as fixing it up and selling it.



REMEMBER

An important concept to understand is that a 'home' is not an 'investment property' from the perspective of investing. The two types of assets have too many differences, particularly when it comes to tax treatment, for them to be talked about as the same thing. However, it is important to always consider every home

you buy as an investment because of the significant financial outlay that is required. In this book, when you see the word ‘home’, we’re talking about the dwelling in which you live (also known in tax terms as the *principal place of residence*). However, ‘investment property’ can pretty much cover any other property on which an income, usually rent, is earned.



REMEMBER

Although a home is not an investment property technically, for most people their home is the basis from which most investment property is bought. The equity that has built up, for people who have owned their own home for a few years and have seen the value of their home grow and their loan reduce, becomes the cornerstone from which real wealth is built. The equity can be used as security for other investments in property. Outside of a large cash deposit, banks see home equity as the best source of security for their customers to use to reinvest.

Why tax makes ‘home’ and ‘investment’ different

What separates the taxation treatment of homes from that of rented properties is the federal government’s intention that the principal place of residence (home) should not be taxed, whereas investment properties should be taxed on the profits or income made in the same way that all other economic investments are taxed.

The first major difference is capital gains tax (CGT) — a home is generally exempt from CGT when sold. How much money you’ve made on your home doesn’t matter. If the property has truly always simply been your home, you do not pay CGT on any profit you make. If you initially paid \$500,000 for your home, for example, and you sell it for \$2 million, you won’t have to pay CGT — not a cent. Making the same profit on an investment property is a different story. You do have to pay CGT. (For more information on CGT and how it’s charged, you can check out our larger title *Property Investing For Dummies*, 3rd Australian Edition, published by Wiley. You can also go to the website for the Australian Tax Office — www.ato.gov.au.)

The second major tax difference between your home and an investment property is in the treatment of expenses incurred in relation to a property. By *expenses*, we mean the ongoing costs of holding or maintaining a property, such as mortgage interest,

construction or capital-improvement costs, maintenance costs and government imposts. Usually, these expenses aren't tax-deductible for homeowners, but are deductible for an investment property. Tax deductibility makes a big difference to the real cost of an item. Homeowners who pay \$200 to change the locks on their front door get no deduction. But an investor who pays \$200 for the same work can have a proportion of the cost returned through tax (depending on the investor's marginal tax rate), which effectively reduces the cost of the same work.

Buying a place of your own

During your adult life, you're going to need a roof over your head for many decades. You have two options: Either buy a place to live in yourself or pay someone else rent to live in a property they own. Real estate is the only purchase or investment that you can either live in or rent out to produce income. Shares, bonds or managed funds can't provide a roof over your head — or anyone else's either!



REMEMBER

Unless you expect to move within the next few years, buying a property to call home probably makes good long-term financial sense. (Even if you relocate, you may decide to continue owning the property and rent it out.) Owning usually costs less than renting over the long haul (your loan gets locked in at the start and becomes progressively smaller in real terms as the years roll on, while rents continue to rise) and allows you to build *equity* in an asset (the difference between market value and loans against the property).

You can briefly consider your home as part of your investment portfolio when you use that home as the cornerstone of your wealth-creation plans. It's usually the biggest single investment that you make. It's also usually responsible for creating equity that you can later use to make further investments (such as buying investment properties). Many people move to a less costly home when they retire (known as *downsizing*). Downsizing in retirement frees up the equity you've built up over years of home ownership. You can use this money to supplement your retirement income and superannuation, and for any other purpose your heart desires.

Another way your home is similar to an investment is that your home usually appreciates in value over the years, and you can use

that money to further your financial or personal goals. You can also turn your home into an investment property if you decide to buy and move into another property. But at this point — particularly for tax purposes — the former home stops being a ‘home’ and becomes an ‘investment property’, and your new home gets the tax advantages and disadvantages of becoming your home.

Converting your home to a rental

Turning your current home into a rental property when you move or upgrade is one way to buy and own more properties. Holding on to your current home when you’re buying a new one can be advisable if you’re moving into a larger home or moving interstate. This approach presents a number of positives:

- » You save the time and cost of finding a separate rental property, not to mention the associated transaction costs.
- » You know the property and have probably taken good care of it and perhaps made some improvements.
- » You know the target market because the house appealed to you at an earlier stage of life.



WARNING

Many people hold on to their current home for the wrong reasons when they buy another. This often happens in a depressed market — even though they’re buying a new home at a lower price, at the same time they’re facing the prospect of selling their former home for a reduced price. If you plan to move and want to keep your current home as a long-term investment property, you can. But turning your home into a *short-term* rental is usually a bad move because:

- » You may not want the responsibilities of being a landlord, yet you force yourself into the landlord business if you convert your home into a rental.
- » You may have to pay some capital gains tax (CGT) — proportionate to the time you owned the property as an investment versus a home — on any profit when you do sell it.



TIP

If you own a property as a home but don't live in it — because you've moved interstate, for example, and are renting while you live there — you may be able to hang on to it for as long as six years before you incur CGT, even if you put a tenant into the property. This law applies only if you don't claim another 'home' as a principal place of residence in the meantime.



TIP

If you do convert your home into an investment property, you may be able to claim tax deductions for portions of the capital improvements that you made to the property while it was your home, depending on the relevant legislation at the time.

Considering Rentvesting

An increasingly popular investment strategy over the past decade is what's known as *rentvesting*. In essence, this strategy involves investors, usually first-time ones but not always, buying a property elsewhere while continuing to rent in their location of choice. High property prices in cities such as Sydney and Melbourne are no doubt one of the reasons this investment strategy has become so popular, because it enables people to invest their funds without sacrificing their current lifestyle. For example, they may only be able to afford to buy property in an outer-fringe city suburb or even a regional area. They can make this investment, and get started in the property market, while continuing to rent in their current location.

Rentvesting is becoming such a common investment strategy that, according to the 2022 Property Investment Professionals of Australia (PIPA) Annual Investor Sentiment Survey, 29 per cent of first-time investors are using it, with 45 per cent of all investors indicating they would consider rentvesting personally as well.

Generally speaking, young people can often afford to rent in locations where they would not be able to afford to purchase a property, so rentvesting gives them the best of both worlds so to speak — they are investing when they are younger while still enjoying all of the attributes of living in their suburb of choice.