Owning an investment property.

Having a diversified investment property portfolio.

Property Guide for Investors

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Welcome to Citibank's Property Guide for Investors.

Australians have a strong track record in the property market. Buying a home is a goal we often aspire to, and not surprisingly, many of us follow home ownership with the purchase of one or more investment properties.

Despite our passion for bricks and mortar property, investors are often unsure of what's involved in selecting, purchasing and owning an investment property. This guide is designed to help you and provide you the information applicable to each stage of property investment, including which type of property to buy, where to buy and which loan is right for you.

In a well-developed property market like our own, investors have the option of choosing from a wide range of properties. To help you find the property that meets your goals, we have divided our Property Guide for Investors into several parts to show you why property has proven to be such a compelling - and successful - investment for generations of Australians.

Investing in property

Why invest?

Bricks and mortar has always been a favourite among Australian investors. More than ten percent of households own an investment property[1] – a far higher rate of ownership than the US, Canada or United Kingdom . There are several key factors that make property a sound long-term investment:

- Strong demand
- Scarcity
- Ongoing rental income
- Long-term capital growth
- Tax-friendly returns
- Portfolio diversification
- Gearing

It's worth taking a closer look at each of these.

Strong demand

Here's a fact. Australia's population is growing every year. In 2007/08, around 171,400 new migrants settled in Australia – the biggest migration program since the 1960s. In 2008/09, a further 203,000 new arrivals are expected to settle in this country[2].

All these people need somewhere to live, and historically around one in three Australian households rent their home[3], providing strong demand for rental properties.

Scarcity

Despite a burgeoning population, our rate of new home construction is declining. Industry figures show that just 140,000 new dwellings were constructed in 2008 – well below the 200,000 dwellings estimated to be required by the Commonwealth Treasury.[4]

[1] Source: RBA Bulletin, May 2004

[2] Source: Senator Chris Evans, Minister for Immigration and Citizenship, Media release: Migration program boosts economy and eases skills shortage, Friday 22 August 2008

[3] Source: Housing Industry Association Media Release 21 February 2008, Housing report highlights supply challenges.

[4] Source: Housing Industry Association Media release: 'Pain Persists For Housing Starts', 16 December 2008.

Ongoing rental income

Generally most investment properties can expect to earn ongoing rental income. One of the pluses of rent is that it is usually a very stable source of income. Residential tenants typically sign up for leases lasting 6 or 12 months though many tenants remain on a periodic (week to week) lease once the formal lease expires.

Capital growth

In addition to regular rental income, property investors can expect to earn long-term capital growth on their investment. As with rents, price appreciation will depend on a range of issues – with location and scarcity being key factors.

Industry bodies produce regular updates of movements in property values however it's worth remembering that property should always be regarded as a long-term investment – something you should be prepared to hold for at least five to seven years. This way your returns will be evened out across periods of market highs and lows.

Tax-friendly returns

If you have held onto a property for greater than 12 months, only 50% of any profit on the sale of the property is taxed.

Portfolio diversification

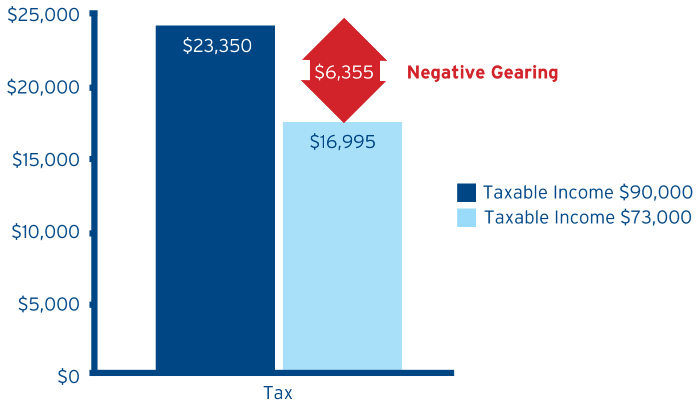
One of the golden rules of investing is not to put all your eggs in one basket. Property returns tend to be generally far less volatile than those of, say, the sharemarket and an investment in property can add valuable diversification to your portfolio.

Gearing

The appeal of negative gearing

Negative gearing describes the situation where the costs of owning an investment exceed the returns it generates. The shortfall can be claimed as a tax deduction, which reduces the amount of tax you can expect to pay on other sources of income. Let's take a look at a simple example to see how this works.

We'll say Victoria earns a salary of $90,000. On this amount she can expect to pay tax of $23,350 (includes 1.5% Medicare Levy). Now let's say Victoria invests in a rental property. After taking into account mortgage interest, repairs, rates and other costs, the property generates a loss for the year of $17,000. This will reduce Victoria's taxable income to $73,000. On this amount she can expect to pay total tax plus Medicare of $16,995 – a saving of $6,355 generated by negative gearing[4].



Please note - an investment should always stand on its own merits, any tax benefits should be seen as a side benefit rather than the key motivator for investing.

Positive gearing

An investment is said to be positively geared if the rental income it earns exceeds the expenses associated with owning and managing the investment. One of the benefits of owning a positively geared property is that it provides an extra source of income – money that can be used to invest in additional assets!

[4] Based on 2008/09 personal tax rates.

And on the downside...

All investments involve risks, and property is no different. Gearing increases risk. Increased risk can result in increased losses. In this section we look at some of the key drawbacks of investing in property – together with ways to overcome these risks.

High purchase costs

When it comes to purchasing property – whether as an owner occupier or as an investor – buyers face a range of up-front costs. It makes good money sense to build these costs into your investment budget. Some of the key expenses are listed below:

Stamp duty

Stamp duty is a state government charge payable both on the purchase price of a property. The amount payable varies between locations. Go to your state or territory's website for the stamp duty applicable in your area – you'll find the web addresses below. Please note, the cost of stamp duty is added to the capital value of your property, so it will reduce the value of any capital gains tax you may pay on any profit made on the sale of the property.

Table 1 – Website details – Stamp Duty

State/territory	Website
New South Wales	www.osr.nsw.gov.au
Australian Capital Territory	www.revenue.act.gov.au
Northern Territory	www.revenue.nt.gov.au
Queensland	www.osr.qld.gov.au
South Australia	www.revenuesa.sa.gov.au
Tasmania	www.treasury.tas.gov.au
Victoria	www.sro.vic.gov.au
Western Australia	www.dtf.wa.gov.au

Lenders Mortgage Insurance

If you borrow more than 80% of the value of a property or if you have a self certified loan, you will generally be asked to pay Lenders Mortgage Insurance (LMI). This involves paying a one-off premium, though this type of cover protects the lender (not you, the investor) in the event that the property is sold and there is residual debt.

Miscellaneous costs

Purchasing a property involves other additional costs, which are listed below. One advantage of purchasing property as an investor is that many of these costs can be used to reduce the taxable income generated by the property. For example, borrowing costs can be written off (claimed as a tax deduction) over a period of five years. Other costs, like legal fees, are added to the cost of the property and used to reduce the tax you may pay on any capital gains.

- Borrowing costs
    - Loan application fee
    - Lender's valuation fee
    - Lender's legal fees
- Pest and building inspections
- Legal fees (also known as 'conveyancing' fees)

Holding onto your investment for the long term is a useful way to ensure growth in the property's value more than compensates for these costs.

Lack of access to your cash

Property is a non liquid asset, meaning it can take a while to access the funds tied up in your asset. To reduce this downside, always aim to have a spare pool of cash on hand for emergencies.

Additional risks

Loss of rent through periods of vacancy

Manage this risk by thoroughly researching the market to determine that your property offers broad tenant appeal. Seeking the opinion of property experts will help ensure the rent you are asking is fair market value.

Exposure to rising interest rates

Always allow for the possibility of higher rates and higher repayments when determining how much you can comfortably pay for an investment property. If rate rises would be a serious problem, think about a fixed rate loan.

Exposure to property market downturns

All asset classes move in cycles, this is why property is generally recommended as a long term investment. By holding onto your asset for longer period of time you should smooth out the effects of any property market highs and lows.

Encounters with 'problem' tenants

The vast majority of tenancies run smoothly, however you can reduce the odds of encountering a problem tenant by using a property manager who thoroughly screens prospective tenants and maintains a regular program of property inspections.

It's also recommended and in some cases a legal requirement to take out landlord insurance for cover against damage or loss of rent through tenant disputes.

While it is important to be aware of these downsides, it is also worth pointing out that the vast majority of property investors enjoy strong returns, trouble-free tenants and a regular source of rental income. The key to this sort of success is to do some homework. The following sections are designed to help you know what to look for in a residential investment property.

A closer look at residential property

Where to buy?

Location is a key factor in residential property, so irrespective of the type of property you're thinking about investing in, it's worth aiming for the best location you can afford.

Look for an area that has strong tenant appeal, offering:

- Proximity to public transport
- Nearby facilities like schools, shops and hospitals
- Lifestyle options including cinemas and restaurants.

Maximising capital growth

With such a diverse property market, rates of capital growth around Australia vary widely. Even within one metropolitan area there can be 'markets within markets'. Take a look at the checklist below for ideas on how to pick an area with good growth potential:

- Does demand exceed supply?
- Does the area have low prices, which are expected to rise in the near future?
- Are neighbouring suburbs experiencing good capital growth?
- Are there developments happening, or planned for the area, that will have a positive impact on prices?

"The five year average return on property ranges between 15.7% and 25.2% in all capital cities except Sydney, and over ten years, the average return is in double digit figures for every capital city in Australia."

Noel Dyett
President – Real Estate Institute of Australia, 2008

Which type of property to invest in?

The question of whether to invest in a house, an apartment, a townhouse or a villa may be dictated by price. As Table 2 shows, apartments tend to be more affordable than houses though there can be exceptions to this depending on the condition and quality of the property, its location and the presence of unique features like views.

Ultimately it all comes down to thoroughly researching the area you would like you buy in, and matching the type of property with your investment budget.

Table 2 Median house and unit values - Oct 2008

	Sydney	Melbourne	Brisbane	Adelaide	Perth	Darwin	Canberra
Median prices - all houses October 2008	$564,124	$448,347	$448,756	$410,416	$484,580	$440,877	$477,641
Median prices - all units October 2008	$420,242	$358,092	$324,998	$345,159	$452,212	$316,680	$350,345

Source: RP Data - Rismark Hedonic Index Results 31 December 2008

How to buy?

Properties are advertised for sale across a variety of mediums from advertisements in local newspapers through to online agents' listings. However properties are generally purchased in one of two ways – through private treaty or at auction.

Private treaty involves negotiations between a buyer and vendor – often conducted via an estate agent, with a final sale price eventually being agreed on. At this point you will usually be asked to supply a cheque for 10% of the purchase price or a deposit guarantee.

Buying at auction is quite different. The auction tends to be fast and furious with bidding often over in just a few minutes. For investors it is wise to approach an auction with care. It can be easy to get caught up in a bidding war and pay more than you intended. Remember, when you buy at auction the sale is final once the hammer falls. There is no cooling off period - something you may be entitled to with a private treaty sale.

Rental income

The amount of weekly rent you can expect to command for a particular property will vary according to a range of factors including the property's location, the type of property (for example, a house versus an apartment), the number of bedrooms and the overall quality of the dwelling.

Additional points of appeal that can affect the rent returns include the availability of garaging/parking, security, modern appliances and the availability of features that enhance tenant amenity such as pools, gyms, saunas etc.

A local real estate agent will be able to give you an indicative guide of the rent you can expect to charge for an investment property. At present, Australia's residential rental market is very strong. Metropolitan vacancy rates are among the lowest ever recorded – less than 2% in many cities. This is pushing up rents in many areas, and the situation is likely to continue. Table 3 provides a guide of rental yields on houses and units in late 2008.

Table 3 Houses and units rental yields - October quarter 2008

	Sydney	Melbourne	Brisbane	Adelaide	Perth	Darwin	Canberra
Houses Oct Quarter2008	4.58%	4.22%	4.53%	4.17%	4.06%	6.50%	5.29%
Units Oct Quarter 2008	5.75%	4.79%	5.21%	4.85%	4.65%	6.97%	5.89%

Source: RP Data – Rismark Hedonic Index Results 31 December 2008

Capital growth plus ongoing income

Over long term periods, quality well-located properties can generally deliver both regular rent and capital growth to investors. No one can predict with accuracy the returns investors can expect to earn in the future, however, Table 4 shows that historically, over very long term periods, the before-tax returns on residential property have stacked up favourably against other mainstream asset classes.

Table 4 Long-term returns - residential property versus other investments

	Residential property	Australian shares	Listed Australian property	Fixed interest	Cash
Gross (before tax) return - over 20 years to 31 December 2006	11.7%	11.1%	13.2%	10.0%	6.8%

Source: ASX/Russell Long term investing Report Highlights April 2007

Ongoing costs

As a landlord, you will be expected to pay for a range of expenses associated with owning and maintaining your property. Some of the regular costs you may expect include:

- Accountant's fees
- Bank charges
- Body corporate fee
- Strata levies
- Book-keeping costs
- Council and water rates
- Insurances
- Lease expenses – including legal fees for drafting leases
- Land tax (Refer to your state government website as per table 1 on page 6)
- Letting and re-letting costs
- Management fees paid to real estate agents
- Maintenance
- Mortgage interest / principal reduction
- Repairs / upkeep
- Tenant advertising costs
- Cleaning costs

While this list may seem extensive, it's worth remembering that these expenses may typically be claimed as a tax deduction if the property is rented out (or available for rent). For investors on the highest personal rate of tax this may have the effect of virtually halving the costs involved (take a look at "The appeal of negative gearing" on page 5 to see how this works).

There is also a range of non-cash expenses that property investors may be able to claim. Landlords may be able to claim up to 12% annually on the cost of depreciable assets like fixtures and fittings, and also in many cases may be able to claim 2.5% of the building cost (not the value) of residential properties built on or after 18 July 1985. Depreciation may also be claimed on the cost of improvements made after 26 February 1992 to older properties.

Managing your property

Selecting the right property is just one part of maximising your investment return. The way you choose to manage the property on a daily basis will also affect both your enjoyment of the investment and the annual returns.

It is possible to manage a property yourself – advertising for tenants and collecting weekly rent. However an easier option is to hire the services of a professional property manager – possibly the same estate agent you purchased the property through.

Property management fees are generally about 7.0% of gross rent though this is negotiable. Managing a rental property yourself can mean saving on management fees, however landlords need to comply with a range of laws and regulations. Even simple oversights such as not lodging rental bonds on time could result in a 'please explain' from the Residential Tenancies Tribunal. Using a professional property manager can streamline the whole process of investing in property.

Look for a property manager with:

- **Strong local knowledge** – this will let you set a realistic market rent, plus the agent may have a pool of prospective tenants to help minimise vacancies.
- **Clear management process in place** – where possible ask to see copies of standard forms or checklists used to manage tenants and properties.
- **Screening systems for new tenants** – a good property manager will thoroughly check tenant references.
- **An active approach to management** – how often are investment properties routinely inspected? Do they have a list of local tradesmen if the property requires repairs?

Now, take a look at page 18 for some of the loan options that can help you get started as a successful property investor.

Citibank can help

Citibank has a range of competitively priced mortgage options which can help you invest in a slice of Australia's property market.

Residential mortgage options:

- **Standard variable mortgage** – Our Standard Variable mortgage is a popular choice for investors offering plenty of useful features plus a competitive interest rate. It can also be linked to an offset account, reducing your overall interest.

- **Standard fixed rate loan mortgage** – Enjoy the surety of a fixed rate for a given period – usually, from 6 months to 5 years. A fixed rate makes budgeting easier and is a real plus if rates rise.

- **Basic variable mortgage** – This mortgage is simple to understand and easy to use, yet packed with the features you need in a loan, it offers a highly competitive rate.

- **Citibank's line of credit** – Mortgage Power – interest is calculated daily only on the amount owing, and balances can fluctuate up to your credit limit at any time.

- **Self Certified loan** – requires a declaration and BAS statement. They usually come with a higher interest rate. Citibank offers a broad range of self-certified loans, which are ideally suited to self-employed people unable to provide evidence of income.

- **Professional package loan** – Professional packages are usually available to eligible borrowers taking out loans over $200,000. Professional packages like Citibank's Mortgage Plus combine a mortgage and credit card with special discounts.

- **Suite of insurance products** – Our comprehensive and competitively priced suite of insurance products, can safeguard and protect your investment. Landlord insurance offers you the added security of protecting the investment property and rent should a defined event occur. In addition, we also offer Home Building, Home and Contents and Strata insurance.

Citibank can help

Useful loan features

Maximise the returns on your investment with our useful loan features – providing flexibility and cost savings.

- **Interest-only options** – Maximise the cash flow on your property with our interest-only loan options.
- **Offset account** – A great way to save on interest costs. The interest charged on your loan is calculated on the difference between the outstanding balance and the funds in your savings account.
- **Portability** – Enables you can take a loan with you between different investment properties. Enjoy cost savings plus convenience.
- **Redraw** – Provides access to funds where you are ahead with mortgage payments on certain loans. This may have tax implications. Not available for fixed rate loans.
- **Split loan** – Enjoy the best of both worlds by fixing part of your loan while leaving the rest at a variable rate.

Jargon buster

Become an expert with our property investment jargon buster.

Gazumping – Occurs when a vendor agrees to sell a property, but then sells it to another party offering a higher price.

Gearing – Also known as 'leverage', gearing is a measure of the debt against the equity (ownership) you have in a property.

Land tax – An annual tax levied by state governments, the rate of which is determined by the assessed valuation.

Notice of termination – Notice given either by a landlord or tenant that they want to end the rental agreement and vacate the property in compliance with the terms and conditions of the lease.

Outgoings – The expenses incurred in generating income – typically rates, insurance, repairs and maintenance and management fees.

Rent review – A periodic review of rent under a lease using a predetermined method. It may be in line with the Consumer Price Index (CPI) or in accordance with a market valuation.

Residential Tenancies Tribunal – Specialist bodies that exist in most Australian States and Territories to resolve disputes between landlords and residential tenants.

Residential Tenancy Database – Used by real estate agents to identify tenants with a history of breaching tenancy rules.

Yield – The percentage return of a property calculated by dividing the net income by the opening market value or price.

Useful links

Take a look at the websites below for further information on investing in property.

- Australian Securities and Investments Commission consumer website – **www.fido.gov.au**
- Real Estate Institute of Australia – **www.reia.com.au**
- Property Council of Australia – **www.propertyoz.com.au**
- Housing Industry Association of Australia – **www.hia.com.au**
- Property Investors Association of Australia – **www.piaa.asn.au**

NOTES:

Let Citibank help you grow your investment portfolio!

For more information on Citibank Mortgages, simply:

- Call us on **1300 361 922**
  (9.00am to 5.30pm AEST, Monday to Friday) or
- Contact us online at **www.citibank.com.au** or
- Contact your mortgage broker.

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