The 2017

Must Read Guide for all Property Investors

PRECISION FUNDING

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If you require any advice with regards to these matters, please contact our office for further information.

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Precision Funding is a boutique investment focussed mortgage broking firm which provides clients with strategic investment lending advice, helping clients grow their portfolios beyond traditional means through a holistic approach to finance.

Our services cover residential, commercial and business finance. Credit advice and financial advice including Self-Managed Super Funds (SMSF's) through our financial advice firm Precision Private Wealth

Visit us at www.precisionfunding.com.au and www.precisionpw.com.au for more helpful information, tips and advice on building and growing a property investment portfolio.

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Corey has a wealth of knowledge with property investing and structured lending solutions. He founded Precision Funding and it's predecessor XL Financial to be mortgage broking firms with a strong focus on providing finance solutions to the investor market. Corey has extensive experience in residential, commercial, small and large scale development and asset lending. As an active property investor, Corey has built a substantial property portfolio, getting hands on with renovations and buying under market value distressed sales.

2016 – A time of turbulent change

The last 12 months have seen the most turbulent times for investors looking to build a property investment portfolio in recent history. Significant government regulatory interference into investment lending through the Australian Prudential Regulatory Authority (APRA) has slowed and restricted some investor's ability to build their portfolio by substantially reducing borrowing capacities, ability to access equity and increasing interest costs.

Likewise growth in the Sydney and Melbourne markets in particular have seen those with existing portfolios grow substantial equity positions, whilst others are priced out of the market or having to purchase at higher prices relative to rents, at lower yields putting additional strain on their cash flow positions.

Meanwhile the other capital cities across Australia (outside of Perth) have continued to grow at what can considered a stable rate. Perth in comparison has seen significant rental and capital value decreases over the 12 months, off the back of slowing overseas and interstate migration, increased housing stock coming into the market and rising unemployment as the mining industry moved from an expansion to production phase.

Sydney and Melbourne markets in particular have seen those with existing portfolios grow substantial equity

Finance: Past, Present and Future

Finance is arguably the gatekeeper and most essential part in building an investment portfolio. The vast majority of investors heavily rely upon finance to purchase their properties and expand their wealth – so any changes have a direct and measurable impact on your ability to achieve your goals as an investor. Since the APRA interventions into the market from April 2015, the following changes have been implemented:

- Adjustments to borrowing capacity models – heavily penalising those with existing debt on properties (property investors)
- Increases in interest rates for investment loans
- Increases in interest rates for interest only loans
- Reduction in maximum LVR's for investment lending with certain lenders
- Reduction in maximum interest only terms and capability to rollover into further interest only periods
- Increase in minimum living cost estimates used within calculations

These changes culminated in a constraining of capacity for many investors with significant portfolios – reducing or eliminating their ability to continue investing. Likewise for many existing investors, this has meant they're facing a future potential time bomb wherein their interest only periods may not be able to renew under the new policies, resulting in their effective cash flow heavily reducing to the point which may require a reassessment of their portfolio and potential sell down of existing properties ahead of previous plans.

What is happening now?

The changes have not ended with progressive further ratcheting of credit policy and product rules. Already this month we have seen changes to stress testing rates with lenders, some lenders announcing they're reducing the amount of rent they accept in calculations (lenders traditionally calculated your ability to borrow based on 80% of the rental amount received, however some are now reducing it to 70-75%).

Due to cost of funding pressure, lenders are introducing increasing interest rates even further for investors, particularly with interest only mortgages as this subtype of loan has a higher cost for lenders to source their funds, so this is being passed onto borrowers. Likewise fixed rates over the December 2016-January 2017 period have resulted in fixed rates rising rapidly.

What does this mean for me?

Despite the rapid changes, it's not all doom and gloom. Investors who use a strategic lending plan to grow their portfolio will still maximise their ability to build their portfolios and continue investing far beyond the average Australia.

What might happen in the future?

Whilst no one owns a crystal ball, there are informed estimates that those in the industry do consider likely over the coming years for property investors – not limited to:

- Further restrictions to interest only renewals – requiring full credit assessment for any extension beyond the initial period (generally 5 years)
- Restriction or disallowance of interest only on owner occupied lenders – ANZ has just announced this measure for their higher LVR owner occupied customers
- Rising gap in interest rates between investment and owner occupied lending
- Rising gap in interest rates between principal and interest vs interest only repayments
- Greater emphasis on exit strategies/age restrictions on borrowers - One big 4 lender has come out in January requiring all applications for those 45+ requiring a 30 year mortgage to outline how they intend to support paying the mortgage until 75, which can require factoring in superannuation, other investments etc
- Lender restrictions on postcodes, States and property types dependent on market conditions – Western Australia and New South Wales have already received specific lender policies with some lenders restricting LVR's. This restrictions are likely to focus on 'higher risk' property types which can have value risk such as apartments or properties located in regional OR high density postcodes

What can I do today to start maximising my borrowing capacity? Most borrowers are not running their currently financial situation to the maximum effectiveness, so there is room to improve their borrowing capacity.
The most fundamental steps any investor can do today to maximise their borrowing capacity for 2017 are as follows:

- Review ALL interest rates with their existing lenders, negotiating lower wherever possible. This reduction in interest costs can see your borrowing capacity increase with a number of lenders immediately, whilst also improving your general cash flow position
- Ensure your structure is setup correctly – remove cross collateralisation of existing loans IMMEDIATELY, as the ability to have these structures untangled in the future is likely to become more difficult
- Ensure the correct lenders for your existing and future property purchases are being used – more often than not investors who are told by their lender that they are unable to borrow any further, do have further ability to do so. If you're being told you have no more borrowing capacity and you're still using Big 4 lenders in particular, it's time to speak with another finance strategist.

Continued…

The most fundamental steps investors can do today to improve their borrowing capacity – continued.

- If you have an owner occupied mortgage, put in a debt recycling strategy to accelerate the reduction in this bad debt in favour of tax effective investment debt. This strategy can increase your borrowing capacity by allowing the lender calculators to factor in further tax deductions on your portfolio. Get specific advice on how this can work for you from your tax adviser and finance strategist.
- Cancel any credit cards – whether they are used or not. Whilst this is an obvious one, the average investor still have credit card limits which are dragging down their borrowing capacity considerably. For every $10,000 in credit limits you remove, this generally will increase your borrowing capacity to purchase further investments by circa $40,000.
- Reduce non-deductible debt as much as possible. AVOID car loans/personal loans – if there are any existing facilities and there is no cash funds available but equity, potentially refinance these into a traditional 30 year term – whilst making the previous repayment levels on a voluntary basis. This will increase your capacity whilst retaining the same pay down rate on your lending.
- Review all rental income being received – speak with your property manager to confirm whether the rent being received is in line with the market and whether any works can be completed on the property to significantly increase your rental return. In the end, if you can spend $2,000 on a property and increase the rent by $40/wk – that is over a 100% return on investment per annum whilst increasing your borrowing capacity.

Did you know that?

1. Each lender calculates your borrowing capacity differently – with the variation between lenders as much as 100%+ more than others
2. The biggest variance in borrowing capacity calculators becomes apparent for property investors, as the treatment of investment debt varies substantially
3. Since APRA the Big 4 and many other mainstream lenders have had to alter the way they calculate borrowing capacity – whilst there are other lenders which haven't changed their policies at all and are offering substantially higher borrowing capacity lending options for investors.

The key fundamental for sound investing 2017

Understanding Supply and Demand.

Definitions-

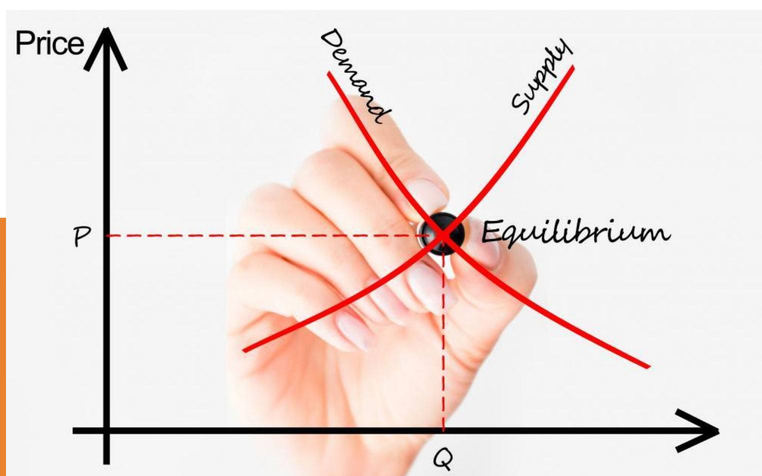
Supply: The amount or availability of a product (in this case property, or type of property (houses, townhouses, units, land, apartments)

Demand: The amount of demand or need for a particular product (in this case property)

When supply is low and demand high, this creates higher (rising prices), likewise when supply high and demand low, this creates a market with lower (falling prices). An example for rising prices would be the traditional blue chip inner suburbs freestanding homes where there is no capability to build further supply due to a lack of undeveloped land, where on the inverse is the current situation with apartments where there is near on unending supply available and limited demand.

Other areas can be near equilibrium (supply matches demand) and will see prices moderate, however as incomes increase this increases capacity to pay which helps moderate long term growth.

In general expansive new housing estates provide lumpy growth – if there is not a significant demand greater than the supply of new allotments, the continual oncoming supply tempers prices and makes established houses in the developments have to compete against new builds, in many cases resulting in them being worth less than their original cost to build.



Supply/Demand is just as relevant for rents- areas with increasing supply without a corresponding increase in demand will see rents fall as people compete to secure tenants. Likewise areas with no increase/falling supply and stable/growing demand will see rents rise rapidly. Examples for both – houses/townhouses/apartment rents in Perth in recent times have reduced significantly due to decreased demand but more importantly a rapid increase in supply from a rapid expansion in developed property in the city since 2010. Other hand is early stages of mining towns where large demand comes into a market with little supply, resulting in massive increases in rents (what was 100k houses with 100wk rent, go to 1mil houses with 1.4k per week rent). Mining towns also show how the equation can punish just as much as reward, when said towns then build sufficient new houses to cater to the mine and then house prices and rental values crash.

Make sure you factor in supply/demand in your investment decisions. Expecting rental/capital value growth is not guaranteed, unless the property has the right supply/demand ratio over the long term. By focussing on areas which have strong fundamental demand and constrained supply will help shield against negative growth in rents or capital values, whilst also positioning your investments for long term growth.

Apartments and the supply/demand equation

Suffering from significant supply issues – apartments do not have a strong demand (interest in Australians buying the properties), whilst developers are building ever increasing new stock to try secure significant profits.

What affects the Supply/Demand equation?

1. Council Policy – Land release
2. Population Growth
3. Development
4. Localised Employment Opportunities (mining
5. Government Incentives (Grants for First Home For specific properties or stamp duty

In recent history a significant amount of the sales for this type of property stock has been to overseas investors which are limited to new builds – however with recent changes in the lending landscape has seen finance options for these investors dry up to a tiny fraction of what it once was. Developers are now finding it more difficult to find new local buyers and contracts to sell properties to overseas investors are falling over in significant percentages, leading to some developers going into receivership/bankruptcy. With the fundamental issues with ongoing supply coming online and relevant dismal demand to take up the stock, investors will need to be careful when considering this as a property type in the current environment.

Other things for investors to consider

Borrowing Capacity

If you've been told by your lender or broker that you have insufficient borrowing capacity to continue to keep investing – get a second opinion. With the large variance in lending calculators for each lender and lenders that each broker works with – you may find that you may still have options still available to continue growing your portfolio.

If you've definitely run out of borrowing capacity for residential property – consider your other investment options. Commercial lending for property can assist those with insufficient borrowing capacity to buy a commercial investment property. Whilst it is a very different environment and knowledge level to residential property investing, if you leverage off the right professionals with experience in this area can allow you to open up to new opportunities.

The Greater Picture

The average investor focusses on their investment properties and expansion of their portfolio, but often will not consider their greater financial picture. With the restricting nature of growing your portfolio in the current environment, it's incredibly important to all investors to look at all aspects of their financial wellbeing. Form a budget, review your existing insurance policies on your properties and assets, bring down your costs which can free up cash flow to reduce non-productive debt. Outside of your assets ensure your superannuation is setup effectively for your life circumstances, protecting you, your family and your portfolio from adverse events.

Finally, invest in yourself. The greatest fundamental differentiator for investors is the income they have to work with. Increasing your income within the workplace will add significantly to your cash flow, ability to save and borrowing capacity – in yet it's usually at the bottom of most people's lists on things to work on. Consider your income and how this can be improved over time, as any growth in income has a corresponding growth in capability.

Bonus Contribution: DT Property

4 Things Investors Should Do To Maximise Their Investment

We all invest in property to make money, we don't do it for awards or medals. At the end of the day, if there was no money in property investment then we wouldn't do it. By the same token, we should be seeking to maximise our returns. Here are a few ideas on doing that:

Make sure you have a depreciation schedule in place. Some property managers have a relationship with depreciation schedule providers and so can get their clients a discount. It's worth noting that if you do a renovation between tenants then they can write off the remaining value of the items that have been replaced, and start depreciating the new items. See your tax adviser for more detail on how that works, but it can be quite beneficial to your overall return regardless of whether you're positive or negatively geared.

Make sure your property is clean when you list it for rent. Professionally cleaning doesn't cost all that much, is generally tax deductible and has benefits t There's 2 main reasons for this

- The property looks nicer in both the photos and at home opens. If a property looks clean then it looks more inviting and is likely to attract a tenant sooner, which means cash flow starts rolling in sooner.
- Once a tenant is found, the state of the property starts the tenancy off on the right foot. If the property is spotless beforehand, then there's the expectation it'll be kept that way and handed back that same way at the end.

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Take advice from your property manager in regards to features in the property. A good property manager will be taking feedback from everyone who enquiries or comes through your property. If you want the property to be rented as soon as possible (again maximising your cash flow), it makes sense that the target audience (tenants) are the best people to consult on that as they're the ones choosing a property to live in. There's two:

- Firstly, if quite a few property say that the property is too expensive, or doesn't have X feature (We get asked about dishwashers and built in robes all the time in the areas we manage), then that's worth taking on board. A collection of people saying the same is much likely to be correct than just a once off person saying it, right?
- It's possible the property isn't right for that person, but based on their feedback we have another property on our list that is a good fit for them that we can slot them into. This all goes towards minimising vacancy time and maximising cash flow.

Look into whether a 4th bedroom can be created. In some areas (especially Adelaide where we're based), 3 bedroom properties are very predominant, making 4 bedroom properties rare and therefore rent at a premium. Depending on your floorplan, it might be possible to add a dividing wall half way through the lounge room for example (which is fairly cheap to do). My only caution is not to do this on properties under 110sqm, as you might be doing more harm than good if it is too squashy.

You can find more tips and information from Adelaide based property management company DT Property at www.dtproperty.com.au

Have any questions or need assistance in making you're in the best position to invest in 2017? Precision Funding is here to help.

Precision Funding assist hundreds of investors each year to build their investment portfolios through our holistic view on strategic investment lending. With access to unique products tailored for investment lending, we can provide options that most other brokerages cannot offer.

Whether it's your first property purchase or your 20th, we have the capability and experience to deliver the desired results for your finance needs.

To find out more about Precision Funding and our advice arm, Precision Private Wealth, connect with us at:

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