3 Must-Knows for First Time Property Investors

It’s no secret that Australians love property. You might even call it a national obsession.

It’s the focal point of many a backyard BBQ discussion or water cooler chat. In fact, the average Aussie spends more than 2 hours a week scrolling real estate listings.

This love affair must have something to do with the consistent way the Australian property market has grown. Even in ups and downs, over the long run it has performed well - the median Australian home has grown in value by 6.8% per year over the past 25 years.

The safety of ‘bricks and mortar’ has attracted many investors. Property is widely regarded as a stable and smart investment, so much so that banks are willing to chip in up to 90% of the cost.

Everyday we speak to people who are convinced of the opportunity presented by property investment but they are filled with questions and uncertainties.

Do I have enough money? Am I buying in the right location? Is now the right time? Will I get a fair price? Should I buy an investment property first or my own home?

By far the most common question we hear is:

Am I ready to invest?

Whether you’re buying your first home or your tenth home, both you and the bank are wondering if you’re in a position to get approved for a loan and cover the repayments. You want to know what you can afford to avoid going in over your head, while also not hesitating unnecessarily and missing out on opportunities.

Let’s get into the 3 C’s of finding out if you’re ready to invest in property.

1. CAPITAL

If you're saving with the hopes of buying a house, it's always good to get clear on how much capital you really need and where it can come from. All buyers need enough money not just for the deposit but also to cover the buying expenses, such as stamp duty, legal costs, and insurance.

How big of a deposit do I actually need?

Banks and lending institutions are generally comfortable with loaning up to 80% of a property's value, requiring you to have a 20% deposit. So if a house was $500,000, you would need to have access to $100,000 capital plus buying costs (we'll break down the buying costs below).

It can be possible to buy a house with only a 5% deposit. Using the same example of a $500,000 house, you may only need a $25,000 deposit plus buying costs. But accessing a loan of up to 95% of the house value is not without complications and won't be available to everyone. Eligibility comes down to factors including income, credit rating, and expenses.

When a buyer has less than a 20% deposit they will usually be required to get lenders mortgage insurance (LMI). This insurance is required by lenders to protect them against the possibility of you defaulting on your loan and the sale of the property not covering the full loan amount. LMI is paid as a lump sum at time of purchase and can add thousands of dollars to the cost of buying a home.

Breaking down the buying costs

You don't want to encounter any surprises when purchasing an investment property, so here are some of the expenses you need to be prepared for.

Stamp duty: the biggest expense on top of your deposit! This is a tax levied on all property purchases and paid by the buyer. Each state in Australia has varying rates, but generally you're looking at 4-5% of the property value. If you're a first home buyer sometimes there are exemptions which are worth looking into.

Legal fees: depending on your legal needs, the conveyancing process generally costs between $1000-3000. This covers the cost of having a licensed conveyancer review the contract, perform title checks, and draft settlement documents.

Insurance: this includes LMI for buyers borrowing more than 80% of the home, but many lenders will also require you to get home and building insurance to cover you in the event of fire, storm, or other damage. Budget around $1000-2000 per year for this, but remember the price will be impacted by a variety of factors.

Transfer fee: a fee levied by state governments for transferring the title of the house. There is a wide disparity between different states, for example the maximum amount you would pay in Victoria is $3609, while in NSW the fee starts at $146.40 and in QLD it starts at $195.

Mortgage registration fee: this varies depending on which state you are in and is another fee levied by the state government, generally costing less than $200.

Mortgage application fees: not all lenders charge this, but the fee generally starts at $150. This can also include a valuation fee of around $200-600.

Pest or building reports: the cost of this generally is upwards of $600 .

It is estimated that buying costs in Australia range from 6-8%, meaning on a $500,000 house you will need to set aside $35,000+ to cover stamp duty and the range of fees and costs.

Where can I get this money from?

As of 2022, the average Australian couple is expected to take 5 years and 8 months to save for a 20% deposit on an entry level house in a capital city. In regional areas the average time taken to save for a deposit is a shorter 3 years and 10 months. While knuckling down and saving hard will certainly help, it's also good to consider if there are any other creative alternatives to help you raise capital faster. Here are some ideas:

- Equity: refinance an existing property and use the capital growth as a deposit
- Using inheritance money
- Selling shares or other investments
- Go halves with a friend or family member for co-ownership
- Ask a family member to be your guarantor (to avoid having to pay LMI)

A word of reassurance

If you're feeling overwhelmed by how much capital you need to buy a house, don't worry - you're not alone! Rising house prices are making it difficult for young Australians to enter the property market.

Remember, don't limit yourself only to the kind of house or location you would like to live in. If you're priced out of the city you live in, there could be some excellent investment opportunities in other Australian cities or regions. This gives you flexibility to find an investment property in a reasonable and affordable price range.

2. CAPACITY

The next question you're dying to answer is: How much can I borrow?! A major factor in determining if you're ready to invest in property is discovering your borrowing capacity. Capacity goes hand-in-hand with capital as banks will be taking into consideration your savings, income, expenses, debt when deciding how big of a loan you can afford.

The factors that impact borrowing capacity

Each lender will determine your borrowing power by assessing your finances in a range of areas. You might be surprised at how much detail you need to provide, but the lender needs this personal information so they can make responsible lending decisions as required by APRA.

Income: to determine what mortgage repayments you can afford, the lender will review your income. This could include your annual salary before tax, as well as any other regular income such as rental return from investment properties.

Living expenses: Lenders will estimate your expenses based on the Household Expenditure Method (HEM). But you will also be asked to self assess your living expenses, such as rent, groceries, childcare, transport, medical, entertainment and more. Bank statements must be provided to confirm this estimate. The lender will then generally take into account whichever number is higher.

Family size: You must declare the number of your dependents so that lenders can accurately calculate your expenses and disposable income. It is assumed that the bigger your family is, the higher your living expenses will be.

Deposit size: The larger your deposit, the larger your borrowing capacity. The size of your deposit in relation to the value of the property will usually help determine how much you can borrow. This could be in the form of savings or equity in an existing investment property.

Assets: Existing assets such as vehicles, investment properties, and/or shares can improve your borrowing capacity and demonstrate your ability to earn and save money.

Debts: Any outstanding debts you have will lower your borrowing power. This could include debts like personal loans, car loans, credit cards, student loans and more.

The property: Even if you have secured pre approval, the amount you can borrow will be impacted by the value of the property you are looking to purchase. An independent property valuation will take place to give the lender full confidence that you're paying a fair price.

The lender: Ultimately, each lender has the discretion to only loan you the amount they are comfortable with. It's worth exploring different options to see how your capacity might vary depending on which lender you're speaking with.

Home loan pre approval

The best way to get a firm number on what you can borrow is to go through the process of 'home loan pre approval'. This stops you getting put in the unfortunate position of having an offer accepted on a house, only to discover you can't afford it.

Get your paperwork in order

Any bank or lender is going to require accurate information about your financial situation, it's a good idea to sort it all out so you're ready to complete your application. This will vary depending on the lender and on your circumstances, but here's a guide.

Application document checklist:

- Proof of identity
- Proof of employment and income
- Bank statements which show saving and spending
- Proof of ownership of assets
- Proof of liabilities (debts)

Get your paperwork in order

Be an investor, not an owner/occupier
Often property investors will be able to borrow more than owner/occupiers. That is because the lender is taking into account the income that will be generated from rent, on top of your regular income.

Stay in the same job (for now at least)
Some lenders might reject an application if you are new to your job. You might need to wait until you've been in your position for at least 3-6 months before seeking home loan approval.

Cut back on living expenses and debt
If you can lower your personal expenses in the lead up to applying for a home loan this will show the bank you can afford to make regular mortgage repayments. Getting rid of personal debt as fast as possible will also help.

Save up for a bigger deposit
If you're trying to get a loan with a less than 20% deposit you may face some challenges, so keep saving as lenders will look more favourably on a larger deposit.

3. CHARACTER

The third and final thing that lenders will take into account when helping determine if you're ready to invest in property is your financial character. This essentially refers to your credit history, which is a record and rating of your ability to repay debts. You might have the capital and capacity to buy a house, but if you have a history of not paying your bills on time a lender could reject your mortgage application.

Understanding credit reports

If you have ever applied for credit or a loan, then you have a credit history. This history will comprise details about any and all credit products you've held in the past two years, such as:

- Credit card
- Home loan
- Personal loan
- Business loan

It will also include information about the credit provider, credit limit, opening and closing dates, repayment history, and missed payments.

If you have ever defaulted on a utility or phone bill of more than $150, this information can be passed on to a credit reporting agency and remains on your credit report for 5-7 years.

Other details that will appear on your credit history:

- Credit you have applied for
- Credit you have guaranteed
- Bankruptcy and debt agreements
- Any credit report requests that have been made by credit providers

All of these factors are taken into consideration to provide you with a credit score.

Understanding credit reports

Each credit reporting agency has its own metric, but generally you will be given a score between -200 to 1200. The higher the number, the better your credit score and the less risky the lender will consider you.

The below table gives an estimate as to how a bank may view your score, but as always this varies depending on individual circumstances:

Credit Scores		
Green Light	800 - 1200	Great
Orange Light	400 - 700	Average
Red Light	<400	Poor

Understanding credit reports

Most people have no idea what their credit score is. You are able to access your credit report free every year. The main credit reporting agencies in Australia are:

- Illion
- Experian
- Equifax

Act quickly if you notice any mistakes or discrepancies in your credit history by asking the agency to investigate the error.

How to improve your credit score

The first and most important way to have a good credit history is to: pay your bills on time! Some other ways to work on improving your credit score is to correct errors, keep paying off your debts regularly, limit how many applications you make for credit, and lower your credit card limit.

If you have a bad credit score, don't feel defeated. It won't stay with you forever - if you make these positive changes you will see your score increase.

MOVE FROM UNCERTAINTY TO CERTAINTY

Buying property is a popular investment choice. In fact, over 2 million Australians are property investors, meaning 20% of households have purchased an investment property. Purchasing and holding on to a property in many cases can guarantee capital growth and a solid return on investment.

But while property investment might seem like an obvious choice, it's anything but easy.

Even if you get clarity on whether you're in a financial position to invest, you're still left wondering:

HOW should I invest?

While 20% of Australian households own an investment property, the vast majority fail to grow their portfolio beyond one investment property. At Inspire Realty we equip you with the tools to make confidence purchasing decisions. Our experience, connections, and knowledge helps you to invest like a property master. Grow your wealth and property portfolio to meet your unique goals.

3 simple steps:

1 Schedule a discovery session

2 Invest with confidence

3 Multiply your portfolio

In our obligation free discovery session we help you answer these questions:

- Am I in a position to invest now?
- What kind of property should I buy given my circumstances?
- What could my investment pathway look like?

Schedule a call today and get a personal investment sounding board in your corner. We do all the research for you and find the best investment property opportunities out there!

inspirerealty.com/discovery-session/