

# 5 key questions you need to ask when buying an investment property



## Debt strategies tips

Buying an investment property is a big decision for anyone. There are many variables - some you can control more than others.

We believe that considering the following questions will help you make informed decisions about the right investment property for you.

1. What is my investment objective?
2. What does the cash flow look like?
3. Is the location right?
4. Do I have the skill set to achieve my objective?
5. Is the property at market value?



## 1. What is my investment objective?

The key to building wealth is to have a plan. Any investment you make should compliment your existing investments and align with your overall wealth building strategy. The first question you should ask yourself when buying an investment property is, "how will it fit with my current wealth building strategy?" The answer will dictate much about the approach you take to searching, selecting, acquiring, structuring, maintaining and selling (if that's part of your strategy) your property. All should be linked back to a plan to achieve your investment objective.

While investment objectives will differ based on circumstance and personal preference, there are some key questions everyone can consider such as:

- What sort of return am I looking for on this investment?
- How long do I want to own this investment property?
- How will I raise the finance?
- Am I comfortable buying property off the plan or do I want an established property?
- Will I need to rely on generating income from the property to live or am I able to sustain a negative cash flow if there is sufficient capital gain available on sale?

It can be a useful exercise to articulate your objective in writing and use it as the benchmark against which you can judge potential investment properties.



When setting objectives it's important that they are SMART - specific, measurable, achievable, realistic and timely. An example might be:

*"To make a 15% annualised return on my investment by purchasing a unit in the next 12 months for a maximum of \$350,000 in an inner city location, yielding 6% per annum over 10 years based on borrowing 80% of the value of the property."*

There are of course many assumptions you need to make but simply by articulating your objective (which should align with your overall wealth accumulation strategy), it will be a big help when trying to identify the opportunity that's right for you.

## 2. What does the cash flow look like?

When considering purchasing an investment property, determining the potential cash flow of the property is an essential piece of information that will help you determine if the property fits with your investment goal. The potential capital gain might look great in 10 years time but if you are planning on living off the rental income in the meantime and the cash flow is negative, you're in trouble!

The cash flow will be the net of the income you generate through rent less the costs you incur running the property. Interest on your mortgage is likely to be the largest of these costs. Other costs include real estate agent fees, body corporate and local authority taxes and repairs and maintenance. Estimating these costs is not easy as there are a number of variables you face.

For example, interest rates fluctuate over time which will impact the cost to service your mortgage, rental income is never guaranteed and vacancy can cause cash flow shortages, repairs can be unpredictable and sometimes costly. It's unlikely all these would happen at once, but you need to build this type of uncertainty into your decision making process, factoring in all potential costs and scenarios.



The cash flow of an investment property will be positive, negative or neutral. Positive means the income you receive from rental is greater than all the costs you incur running the property. When neutral, income equals costs and when negative, costs are greater than income. This is also known as gearing. If you positively gear your property, consider the income tax implications and ensure you factor these in when assessing your cash flow. If negatively gearing, you need to be sure you can spare this amount of money from your day-to-day life to keep the property. There are of course potential tax benefits to running a negatively geared investment property, but tax advantages should never be the sole driver of your decision and you should always seek the advice of a tax accountant before embarking on this type of strategy.



### 3. Is the location right?

It's become a cliché but nonetheless, location remains one of the dominant drivers of value in an investment property. Location drives demand which in turn, drives the potential value of both the rent and sale prices over time. Proximity to public transport, transport links, schools, recreational areas and restaurants are all considered desirable traits in an investment property. And when you think about it, these are the sorts of things you would be looking for if you were buying or renting so it makes sense to keep them in mind.

It's also worth keeping in mind that location can be fluid. A run-down, derelict area today could be the next trendy area five or ten years down the track. Equally, the great ocean view that exists today could be blocked forever by a large, high rise block that receives planning permission two years after your purchase. It's always important to do your research. Check with local agents and local authorities to see what the rules are around planning and if there is anything currently being proposed in the area that could affect your investment.

### 4. Do I have the right skill set to achieve my objective?

You don't have to be an expert in every aspect of buying a house to make your investment work for you. It's worth paying money to create a team that will contribute different skills to your venture; tax and legal advice, a good real estate agent, financial planner and mortgage broker. Any mistakes in these areas can be costly and can easily wipe out any profit you may have made for your investment property.

A good real estate agent can be worth their weight in gold. A well run property usually means less hassle for you and happy tenants which means regular rental income.

The legal issues around property can be tricky and you want to make sure that you call in the experts to do things like conduct title searches and check permission for development - if you want to renovate you'll want to know up front that you are allowed to do this. Your lawyer can research planning rules and provide advice in this area.

Given interest on your mortgage is likely to be your biggest cost, engaging a mortgage broker to advise on financing options and obtain the most competitive deal can be invaluable. Good mortgage brokers will review your circumstances regularly to ensure you continue to optimise your debt arrangements.



## 5. Is the property at market value?

It's an old adage in property investment but one that still holds true - you make most of your profit when you buy rather than when you sell. The point of sale is in the future and much uncertainty lies between now and then. The point of purchase though is the time when the buyer has more control over the situation - there is more certainty and therefore more opportunity for the astute investor to reap the benefits of good research.

The last thing you want to do is over-pay for your investment property. Ideally, you want to pay less than market value and try and lock in profit early. These days there are endless mediums through which you can research the value of property in the area you want to buy. Talk to local agents and local authorities to get a feel for where values in the area have been and where they may be going. Maybe there are new transport links being debated at state government, perhaps a local council is re-zoning an area. Use the internet to search sale prices. Your state real estate institute will be able to provide statistics on recent sales and land values.

Most importantly, consider the results of your research and determine what you think the market value is and avoid letting others influence you too much. This will determine your boundaries for negotiation and if remain focused, you will settle on the deal that meets your investment goal and not settle for second best.

**FOR FURTHER INFORMATION  
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