"Daniel really understands property and property investing, his straight approach will enable you to refocus and bring new found confidence in taking your next step into property." Lee Russell, National Corporate Manager, Price Finder

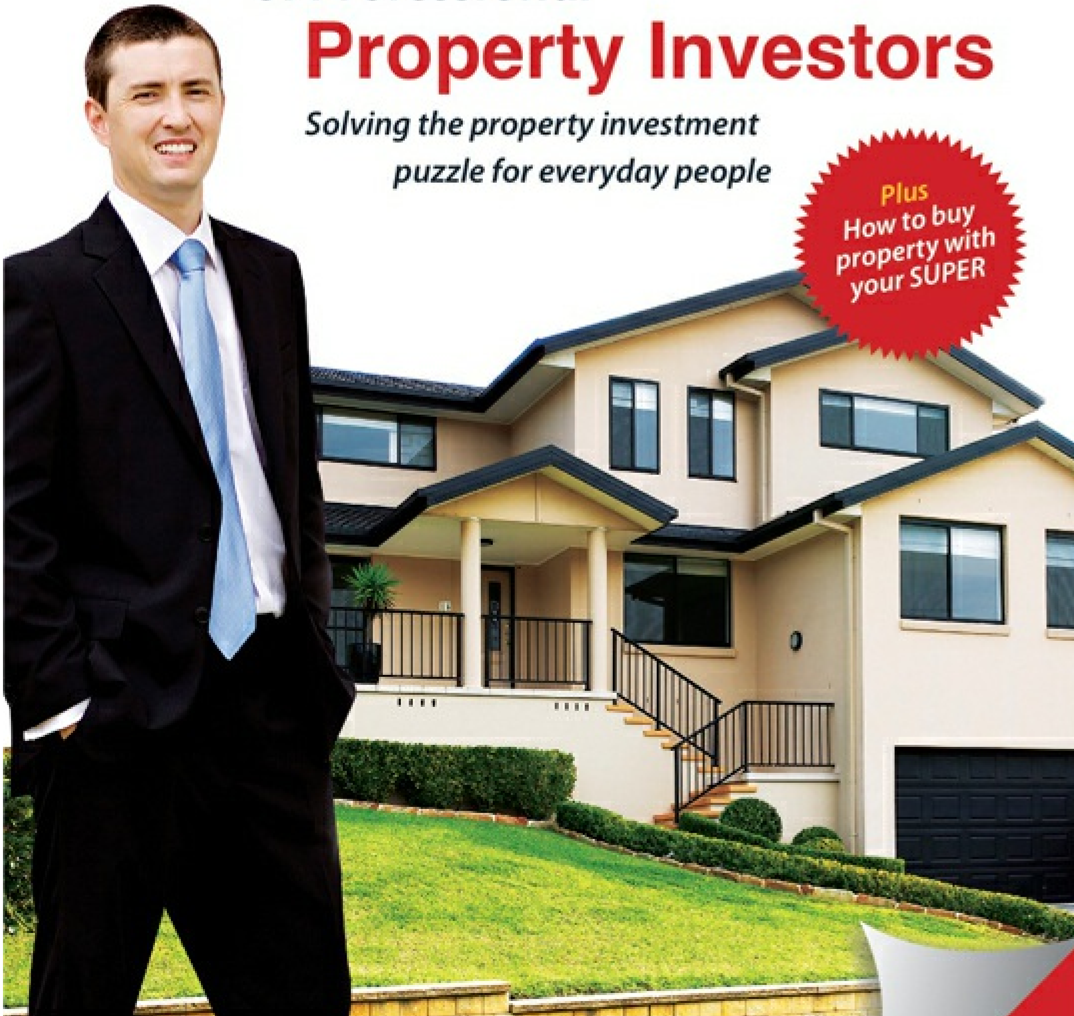
Discover the

10 Secrets

of Professional

Property Investors

Solving the property investment puzzle for everyday people



Daniel Goodwin

With contributions from Len Goodwin, Matt Woodards and Steven Paul

"**Daniel really understands property and property investing. His straight approach will enable you to refocus and bring new found confidence in taking your next step into property.**" Lee Russell, National Corporate Manager, Price Finder

Discover the 10 Secrets *of Professional* Property Investors

Solving the property investment puzzle for everyday people

Plus how to buy property with your SUPER

FREE DOWNLOADS INSIDE

Daniel Goodwin

With contributions from Len Goodwin, Matt Woodards and Steven Paul

Discover the 10 Secrets of Professional Property Investors
Solving the property investment puzzle for everyday people

Written by Daniel Goodwin
With contributions from Len Goodwin, Mat Woodards & Steven Paul

Editing - Hans Wesseling
Artwork and Design - Josh Halls

Published by
Prowealth Corporation Pty Ltd
PO Box 3733, Tuggerah NSW Australia 2259
Phone +61 2 43 530 664

First Published March 2009
© 2009 Prowealth Corporation Pty Ltd and Daniel Goodwin.
All rights reserved.
No part of this book may be reproduced without permission of the copyright owners.

Legal disclaimer for financial and investment advice
Please note that information provided in this book is general information only, is subject to change without notice and should not be relied on as a substitute for legal, financial, accounting or other expert advice. Whilst great care has been taken in its preparation, the authors, Prowealth Investments, and its subsidiary/parent companies disclaims all liability and responsibility, including for negligence, for any direct or indirect loss or damage suffered by any person arising out of any use of this book or any information or material available from it.

National Library of Australia Cataloguing-in-Publication entry

Author:	Goodwin, Daniel, 1978-
Title:	Discover the 10 secrets of professional property investors : solving the property investment puzzle for everyday people / Daniel Goodwin ; with contributions from Len Goodwin, Matt Woodards and Steven Paul.
Edition:	1st ed.
ISBN:	9780646509259 (pbk)
Subjects:	Real estate investment--Australia. Real estate investment--Australia--Finance. Real property--Australia.
Other Authors/Contributors:	
	Goodwin, Len (Leonard) Woodards, Matt (Matthew) Paul, Steven Matthew.

Dewey Number: 332.6324

To my family and the Prowealth team -

It’s taken some time but here it is!

Daniel Goodwin

Contents

1 Introduction

2 You

3 Property

3.1 A history of property

3.2 Property gearing strategies

3.3 Other strategies

3.4 Buying 'off the plan'

3.5 Using your super to buy an investment property

4 Finance

4.1 Bank, broker or specialist investment property lender?

4.2 LVR, LMI and DSR

4.3 Using a line of credit to pay for your investment property

4.4 Cross securitisation

5 Tax and asset protection

6 The final secret

7 10 secrets recap

8 10 important questions to ask your advisor

9 About Prowealth Investments and about the authors

10 Special offers for readers

Chapter 1

Introduction

Introduction

This book has been produced to give you an understanding of the world of property investment which can often be confusing and complex especially if you're a first timer! We have broken the book into 4 main areas, being

You,
Property,
Finance and
Tax

These are the crucial pieces in completing your investment property puzzle. Each chapter will give you an insight into the different strategies, techniques and secrets professional property investors use to build their portfolios. I encourage you to have a pencil ready, as you will need to jot notes and interact with our examples in order to get the most benefit from the strategies and techniques that we'll reveal. You will also need to jump on the book's website -

www.prowealth.com.au/10secretsbook

to download the free calculators and book updates.

To implement these strategies, you'll need an advisor, coach or mentor, someone who has done what you want to do, to show you how each strategy relates to your circumstances and someone to push you to take action. Fortunately, Prowealth Investments can do just that. So please read on, but at the end, make sure you take action by getting in touch with us to start or continue your journey to financial freedom through investment property.

Daniel Goodwin

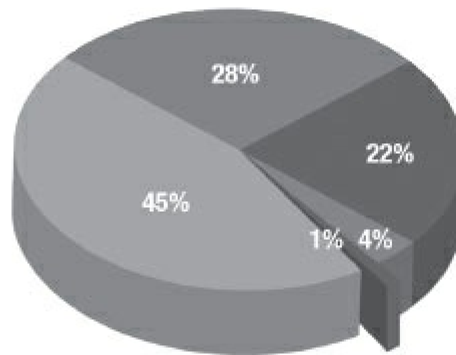
Chapter 2

You

You

If the thought of retiring or stopping work scares you, now is the time to act! Retirement, financial freedom, a holiday property, the kid's education, helping the kids with a deposit on a home – CHOICES.

The best reason to invest in anything is to have choices. Most people, although they love their work, would prefer to have the choice of when to stop working. The question is, could you live the way you want?



Do you realise by the time you are 65 there will be a
45% Chance you'll depend on family for financial help.
28% Possibility you'll rely on a pension.
22% Likelihood you'll still be working.
4% Probability you'll only meet your basic needs.
1% Chance you'll be financially independent.
Source - Trump University

We're going to get interactive early on which means it's time to take out your pencil and complete the following questions.

Activity

1 - What is your current income per year ?

____

Eg, If you earn $50,000 per year, you can write it in, or if you earn $500 per

week, simply multiply it by 52 weeks of the year.

2 - Assuming your home and other consumer debt was paid off, what amount would you like to have coming in every year to live off during retirement or when you stop work?

____

Eg, $60,000 per year.

Hint - Many people don't know how much they need or would like to live on, if that's you, we suggest using your current salary as a starting point.

The amount of money you will need at retirement or when you stop work will of course depend on your lifestyle choices, present and future commitments and the action you have taken already to build wealth. Now, take a look at our current age pension:

	Week	Fortnight	Year
Single	$260	$562	$13,488
Couple	$433	$939	$22,536

Australian Age Pension (Sept 08)

When we conduct this simple exercise at seminars and with clients, we find that nobody writes down a figure lower than the age pension.

Whilst this is a good thing, it shows you that it would be an enormous adjustment for you to give up the salary you wrote in question 1 (by your choice or your employer) and revert to the pension. Almost a third of our population will be forced to live on $22,536 per year ($13,488 for singles), so if you recognise that the age pension will be insufficient for you, you will need to take action and put in place a strategy that will enable you to hold a portfolio of income producing assets to provide the lifestyle you desire when

you stop work.

So how much will you need?
Below is a simple formula often used by financial planners to allow you to see how much you might need in income-producing assets to fund your retirement. Income producing means just that, your family home is excluded, as you don't derive an income from it.

Income per year to live on in retirement	Number of years retired	Income producing assets you will need
$30,000	20	$600,000
$40,000	20	$800,000
$50,000	20	$1,000,000
$60,000	20	$1,200,000

If you can plan in advance how much you want to live on when you stop work or retire you can plan how much you will need to have accumulated by retirement. Don't forget, you could be in retirement for at least 20 years.

As this table shows, if you want to live off $50,000 per year in retirement, you'll need approximately $1,000,000 in income producing assets. It is said that if you had the $1 million invested, earning an average return of 5%, it would give you your $50,000 per year. But wait, there are a few flaws in this calculation.

Firstly, it does not take into account inflation and is calculated in today's values. Put simply, inflation is when your money loses value over time, or doesn't buy as much as it used to. At a rate of 3% inflation, $50,000 today would only buy you around $36,000 worth of goods in ten years time.

Secondly, It does not take into account the effect of fees, taxes and payments to financial advisors. If you have someone else manage your investment, you'll be paying a fee. This could be your super fund or your financial planner and could result in thousands of dollars between now and retirement.

Finally, It also assumes you are only going to live for 20 years in retirement. Advances in medicine and technology, combined with healthier lifestyle choices, have resulted in an increase in life expectancy. Women are now expected to live to the age of 83 and men to the age of 79. This would mean if

we retired at 55, we've only put away enough money to live for 20 years, or until we are 75. So, unless you're planning on dying at 75, you may want a bit more! Finally, it assumes you will pay off your home and all other consumer debt like credit cards, personal loans etc before you retire. For many of us, this is simply not possible as we struggle with things like rising interest rates and cost of living throughout our lives.

So while the table above is not perfect, it's certainly a starting point.

In this book, we'll teach you the secrets that professional investors are using to achieve their retirement goals, through the use of a very unique asset class - property, and the finance and tax know how to make it work for you.

What's keeping you from moving forward?

Many of our older generation, and most financial planners, have a passive investor philosophy that often sounds something like this:

" …Work hard, make sure you're contributing extra to your super, if you own a home, pay off the mortgage as soon as you can, if you have credit cards, pay them off."

"Also, have a balanced portfolio of shares and when you retire, invest and live off your super and of course, diversify, diversify, diversify?…."

Whilst not exact, we're sure you have heard this comment - disguised as financial advice before. This traditional advice is good for the average investor, the person who simply turns over a bit of his or her money each month for someone else to manage. Many investors have been caught this way. How many news stories have you heard where average mum and dad investors have given money to an advisor or managed investment scheme and had it squandered through the poor decision making of the company? You need to know how you can do it yourself with the guidance and expertise of successful investors, but most of all, retain full control.

Mooring lines

Like any important decision, there's that little voice inside your head that sometimes second guesses you. We call these voices '*mooring lines*'. A mooring line keeps a boat safely anchored to the wharf, so that in the case of

rough seas, or bad weather, the boat remains attached to the jetty. Unfortunately, if these ropes are never released, the boat will never set sail. So just like a boat tied to the dock, you will never achieve your investment and retirement goals without releasing your mental mooring lines. The most common mooring lines are based around fear, hovever fear can be overcome with knowledge.

The top 6 mooring lines of fear

1. Fear of acting without sufficient knowledge – "I don't know anything about investing, so rather than find out about it or ask for help, I'd rather do nothing"

2. Fear of making the wrong decision – "What if I buy a property and a better one becomes available later? I'll keep waiting!"

3. Fear of being cheated - "I've heard that some properties are over priced in this market and many people have been ripped off - I won't buy anything in case I pay too much".

4. Fear of change – "My parents told me to reduce debt. I'd rather pay off my home as I don't want to borrow money and get into more debt".

5. Fear of looking bad to others – "My friends are telling me that property will drop in value. What if my friends are right?"

6. Fear of the past – "My mate bought a property and it went down in value"

So how do you overcome these fears? Firstly, acknowledge them. Everyone has these same fears but you must also identify your unique fears. What are your mooring lines? By identifying them early, you can focus on how to over come them so that when an opportunity presents itself, you'll be ready and prepared to make the decision and move forward. Secondly, you'll need to surround yourself with a team of professionals and take advice only from those who have done or achieved what you want to achieve. Finally, take action and stick to a plan that addresses and manages these fears.

Activity: My Mooring Lines

Write down 3 mooring lines that will stop you from taking action and how you could try to break them

Example - I'm into property investment but my partner is not, and doesn't want to get involved. ***Possible Solution*** - Take my partner to a few seminars or read property investment books (such as this one).

1 ____________________

Solution ____________________

2 ____________________

Solution ____________________

3 ____________________

Solution ____________________

3 reasons why people think investing is risky

1. They have very little financial education.

2. They invest in investments where they have no control, such as savings, the share market, managed funds and retail or industry super funds.

3. They take investment advice from sales people who also have no control over the investment.

Did you know?

• It takes more time to become a qualified hairdresser than to give advice as a financial planner, real estate agent or mortgage broker? (We've got nothing against hairdressers by the way!)

• Very few stockbrokers and real estate agents invest in the shares or location they recommend you invest in?

• Most financial journalists have very little financial training or real world investment experience, yet they are happy to comment on the market, influencing decisions of thousands of people?

• Many people invest off ‘hot tips’ – hot tips from poor people not rich people?

Developing a plan for your future
‘Fail to plan and plan to fail’ so the saying goes.

If you had to drive from Sydney to Brisbane you’d probably grab a map, look up the destination and then back track through the available roads and freeways.

Then, you would likely debate about flying or driving to the destination, flying being faster yet more expensive and driving being slower but a cheaper option for your whole family.

Together you’ll discuss (perhaps argue) about driving there in one day or stopping overnight along the way. The list of options and opinions goes on and on. This situation is the perfect analogy to investing in property for your future. There’s more than one way to the destination of financial freedom and you’ll be bombarded with hundreds of differing opinions as to which way is best, fastest and more effective.

Let’s look at this problem differently.

What if you had the same situation but you were equipped with a GPS navigation unit?

Firstly, you put in the destination. Tell it which options to take, e.g. fast route, scenic route, with or without freeways and tolls then GPS unit would then commence instructing you as to when to turn left and when to turn right. All you have to do is follow the directions based on your input. What if you took a wrong turn? The GPS would either tell you to turn around or recalculate the time and distance to the destination based on the new route.

By starting with a plan, either one you make yourself or with the assistance of

an advisor or mentor, you can work through your goals, set when you want to attain them, do the things you want along the way and follow it. It’s that simple.

This way, if you get off track, you can always refer back to it to put you on the right path, safe in the knowledge that if you follow the plan,you’ll reach the destination on your terms.

Secret No. 1

Don’t pretend that it will all be ok. Professional investors understand that they cannot rely on friends, family or the government to achieve what they want when they stop work or retire. By identifying their mental mooring lines early, they can put plans and goals into place then work toward achieving them, taking advice only from those that have achieved what they want to achieve, not those who stand on the sideline.

Chapter 3

Property

A history of property
Property gearing strategies
Other strategies
Buying 'off the plan'
Using your super to buy an investment property

A History of Property

Property in Australia has always been a key wealth builder for Australian families. In fact many investments are touted as 'safe as houses' – you don't hear 'safe as shares' that often, do you?

The fact is that the property market tends to double in value every 7 to 10 years. How do we know this? - through history. The table overleaf shows the median house price for each capital city in Australia every year since 1970 (or since records were kept). Despite wars, depressions, interest rate rises, change in governments and many other factors, the market has continued to grow over the long term and it's this historical performance that forms the basis for using property as our investment vehicle. In fact, the trend is the same for well-located property all over the country. Of course there will always be high times and low times but if you keep the big picture and long-term trend in mind, you'll be able to profit from your portfolio in the future.

If you are looking for reasons as to why property will continue to grow, be in demand and be the dominant source of wealth for Australia's populations, we would be happy to recommend a number of sources and books that will explain this to you in greater detail but that's not what this chapter is about.

It's more important to us that you understand the fundamentals of property as an asset class, the different strategies you can adopt and how you can make money from each of them. That's what this chapter will focus on.

Take a look over the page at table 1. What was the best year to buy property and, since we can't time travel, when is the next best time?

Thats right - it's now!

Australian Capital Cities Median House Prices

Year	Adelaide	Perth	Hobart	Darwin	Canberra	Melbourne	Brisbane	Sydney
1970		17,500				12,800		18,700
1971	11,900	17,750	11,875			13,400		21,200
1972	13,225	17,500	12,600			15,000		23,700
1973	16,250	18,850	15,200			19,800		27,400
1974	22,200	18,850	20,500			25,500	21,500	31,800
1975	26,150	24,500	25,850			28,700	23,700	34,300
1976	29,800	33,000	31,575			32,900	26,275	36,800
1977	32,600	36,400	34,500			37,000	28,600	39,200
1978	33,100	38,575	34,000			37,600	29,975	43,200
1979	33,750	38,600	34,750			38,000	31,450	50,700
1980	36,000	40,350	36,250		44,675	39,500	35,475	68,850
1981	39,100	43,825	37,100		57,750	44,000	45,325	78,900
1982	42,850	48,225	40,325		59,025	46,750	55,125	79,425
1983	47,950	49,000	42,500		68,150	52,500	55,525	81,425
1984	61,250	48,175	44,750		84,250	65,000	58,950	85,900
1985	72,200	52,050	55,500		90,625	75,200	61,550	88,350
1986	73,500	58,000	56,725	87,500	91,175	82,000	63,000	98,325
1987	74,500	61,225	63,450	81,075	90,125	89,500	63,500	120,025
1988	80,400	78,000	67,950	86,000	101,250	109,000	71,000	141,000
1989	90,400	102,500	77,325	90,750	115,000	132,000	96,000	170,850
1990	97,200	101,125	82,000	101,500	120,750	131,000	113,000	194,000
1991	103,900	99,500	89,650	111,550	136,500	127,000	120,000	182,000
1992	108,300	102,500	95,825	126,125	155,250	125,000	129,000	183,300
1993	111,200	112,750	104,250	150,500	159,375	126,000	136,500	188,000
1994	113,500	123,125	110,500	157,875	160,850	130,000	143,000	192,375
1995	111,500	126,788	106,750	165,375	155,550	129,000	147,000	196,750
1996	110,000	126,625	108,000	164,250	152,375	131,000	148,000	211,125
1997	113,500	134,125	108,750	176,500	152,750	142,000	150,000	233,250
1998	118,600	141,000	107,250	173,500	155,500	155,000	159,500	248,750
1999	127,000	147,500	112,225	179,375	161,500	175,000	161,000	272,500
2000	132,600	156,700	117,800	186,800	180,825	249,800	149,000	309,500
2001	150,200	167,100	120,600	188,000	206,250	296,800	164,300	325,300
2002	177,300	187,200	137,200	202,300	234,150	327,500	193,400	458,300
2003	223,300	223,700	192,000	216,000	317,500	367,000	258,600	533,000
2004	260,800	256,300	252,000	256,500	350,900	366,000	307,800	553,000
2005	275,500	303,800	268,500	295,700	359,100	359,500	313,800	528,000
2006	321,000	455,000	243,000	332,000	424,000	352,000	339,000	523,000
2007	346,500	506,500	347,000	393,000	446,500	468,500	428,500	584,500

Table 1 - (source – Residex, ABS, APM, RPDATA and others)

Despite all the fantastic positives that property investing can offer, there will always be somebody either in the media, wider investment industry or well meaning friends and family arguing why now is not the right time to invest in property.

Be careful who you take advice from - have they achieved what you want to

achieve? Do the journalists have any real world investment experience or are they just theorists? Do your friends and family have an investment or retirement strategy in place themselves or are they just giving you the reasons they didn't invest?

The average price of a home in the major capital and major regional areas of Australia has continued to go up over time. What did your parents pay for their house? Who would not want to buy their parents home at the price they paid for it?

Imagine it was the year 1970, and the median house price in Sydney was $18,700 shown in Table 1. Suppose you read a book (just like this one) and the author explained that the same house would be worth over $500,000 in 40 years time. Do you honestly think you would have believed him?

It happened. The median house price in Sydney at the end of 2008 was $536,000 (*Source - Australian Property Monitors*).

What do you think the price will be in 40 years time (2048)?

If the trend continues and we believe it will, the median price in Sydney could be over 8 million dollars.

Do you really want to sit on the sideline?

Compound interest rule of 72
"The compound interest rule of 72" was discovered by Albert Einstein (1879 - 1955). Einstein is quoted as saying:

"It is the greatest mathematical discovery of all time"

and called "The compound interest rule of 72" the 8th wonder of the world as it can work for you or against you. This rule is a useful one to know when dealing with property growth over time. It's primarily used to determine the number of years it will take for your investment to double in value or the amount of growth (expressed as a percentage) you would require to have an asset double in value over a set period of time. It's best explained with a few examples.

Example 1 - How long before my property doubles in value?
You have a property worth $300,000. It gets 10% average capital growth per year. You would multiply the number 72 by the growth percentage (10%) and the result is 7.2. Therefore, it will take 7.2 years for your $300,000 property to be worth $600,000 at an average growth rate of 10% per annum. Remember, 72 multiplied by the growth percentage is the number of years it takes to double.

Example 2 - What is the average growth rate required for my property to double in value?
You want to know what average growth rate you would need to obtain to have your $300,000 property double in value to $600,000 within 8 years. You would take 72 and divide by 8 (years), which gives you 9 (percent).

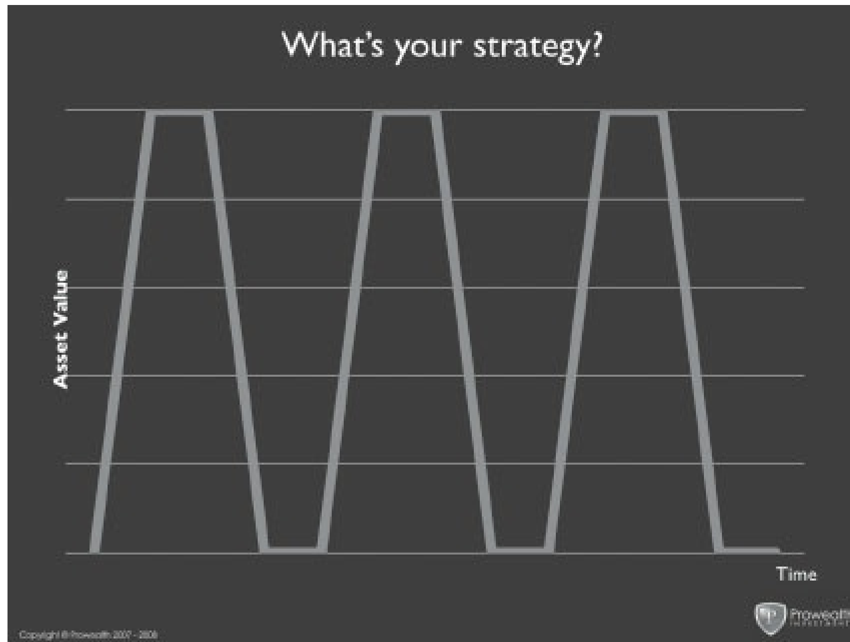
You would need a capital growth rate of 9% per year for your property to double in value within 8 years.

Understanding how to make money from property
The next few pages show graphs of performance of an asset over time. It could be shares, property or superannuation.

Graph 1
Shows the asset increasing in value to a peak and then falling in value to a bottom point, then repeating this pattern over a number of years.

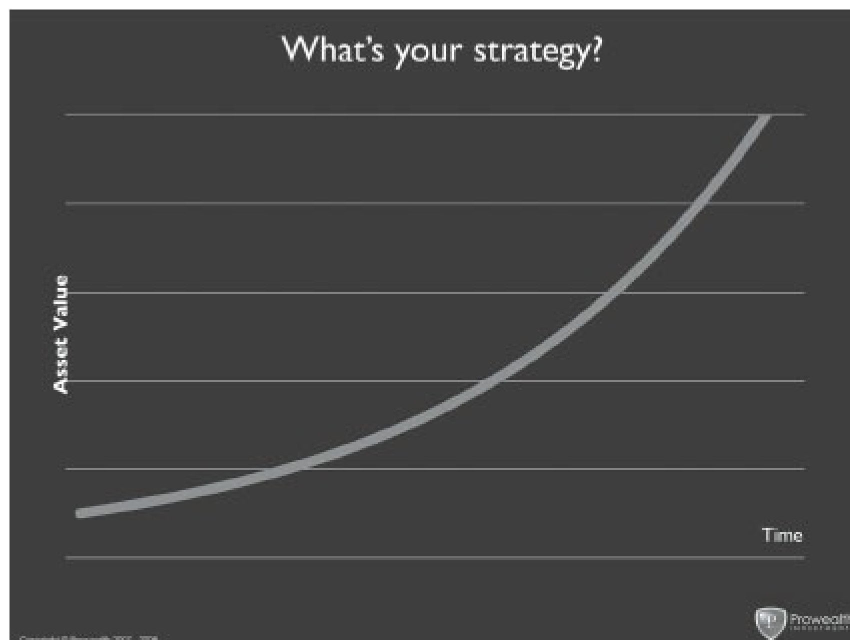
Graph 2
Shows an asset steadily increasing in value over a number of years.

When faced with an investment decision, you need to understand how to make money from the asset class you invest in.



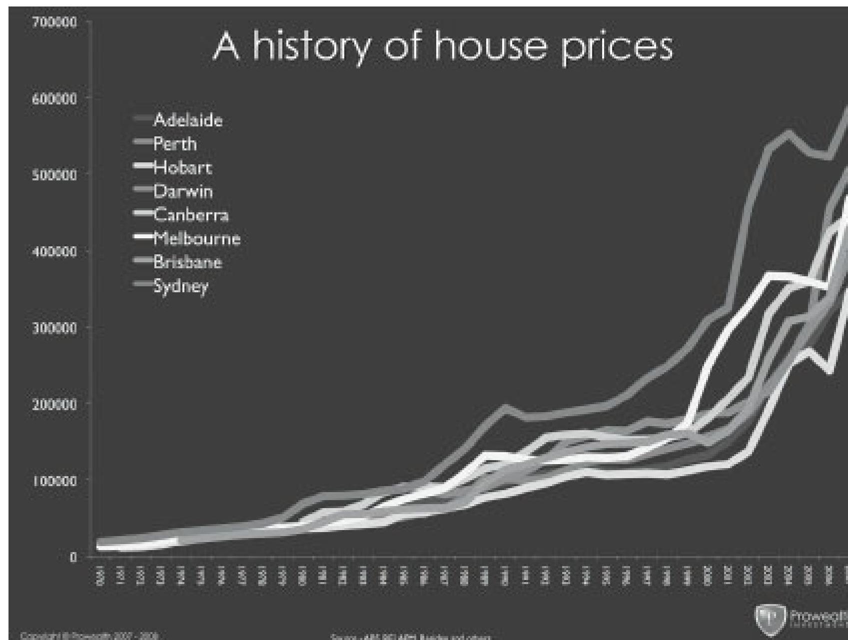
Graph 1

Consider the performance of this asset class over time. The best strategy to make money would be to buy at the low point and sell at the high point. The hard part would be deciding when the peak or trough had been reached. There would be no point in holding onto this asset over time as the performance is consistently up and down.



Graph 2

Now contrast the performance of this asset class over time and the best strategy to make money would be to buy at any point and hold onto the asset for a number of years. There's no need to try and pick a low point as the asset will rise in value over time. There's also no need to sell because the longer you hold onto the asset the more it will be worth.

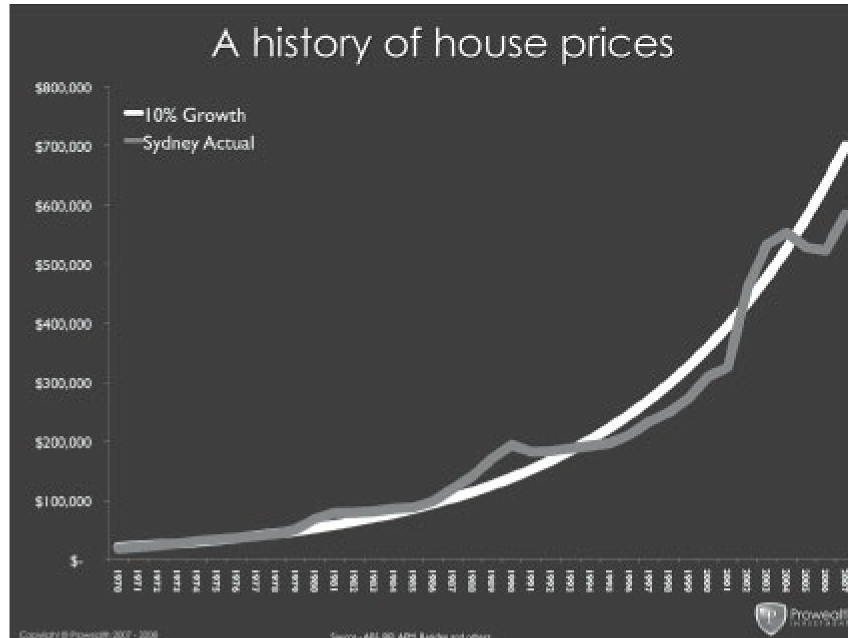


Graph 3

This graph shows the median house price of every capital city in Australia since 1970 through to 2007 from page 28 (where records exist). Compare the actual performance of our property markets to graph 1 and 2,

Which is it most similar too?
The answer is graph 2 with consistent growth over the long term.

Thus the strategy to make money in property is to buy (at any time) and hold for as long as possible to get maximum growth. Professional investors base property purchase decisions around this time proven fact. In all capital city markets shown, the median price has doubled approximately every 7 to 10 years.



Graph 4

This graph shows the median house price in Sydney since 1970 through to 2007 from page 28 plotted in dark grey. Behind it. plotted in white, is an annualised 10% compounding capital growth rate. Based on the '*Rule of 72*', the median value should double every 7.2 years. What's obvious is that the plot lines look pretty similar don't they? This proves again that the property market (in this case Sydney) has grown at the average rate of around 10% each year for the last 40 years. There are certainly ups and downs but the long-term picture is clear.

Start accumulating investment properties for future income.

Property has always proven to be a relatively safe investment form, as long as it is in the right area, has the right infrastructure around it, is professionally managed and you know in advance of the associated costs to hold it.

10 simple reasons why you should choose real estate as your investment vehicle.

There is no other investment class or asset that gives you as much control as real estate and control is the most important factor for any asset. As previously mentioned, many think investing is risky due to having no control over the asset

in which they invest. There is little control for the investor in shares, superannuation and managed funds. Here are the ten best reasons why you should choose real estate as your asset class.

1. Leverage – Banks will loan more money against real estate than any other asset class. Whilst lending criteria is tougher than it was a few years ago due to the global credit crisis hitting in late 2008, it's still possible to be able to borrow 90-95% of residential real estate's value. With shares, you'll be lucky if your bank loans you 50-60% of the value considering the recent poor performance of the share market (late 2008). Leverage and the ability to get finance will ultimately determine how rich you will be.

2. Cash Flow – Your money comes in every month. You don't wait a year to see if the company made a profit or if they intend to pay a dividend.

3. Amortisation – The tenant helps to pay off your debts over time.

4. Depreciation – The government offers tax benefits for real estate as the building, fixtures and fittings will need to be replaced over time. In reality, the government offers tax breaks to investors because they provide much needed housing, without which, they would have to provide themselves.

5. Creativity – You can improve the value of a property by being creative. This could be as simple as a renovation or more detailed, like a change in zoning or building units and townhouses on the block.

6. Predictability – Once the management and tenant are in place the result is predictable. The money comes in every month from your property manager. This sure beats watching the stock market for when to buy and sell. You can also choose to hire and fire the management of your property at any time.

7. Invest using pre tax dollars – By completing a Tax Withholding Variation you can get your tax return back in your pay each week. Your cash flow is better as you don't need to pay for your investment after having your income taxed. This means you essentially pay for it before paying tax. Read more about this form in the Tax and Asset Protection chapter of the book. *(Chapter 5)*

8. Capital Growth – Well-located property has doubled in value every 7 to 10 years since the 1960's. As the property improves in value, you can access that growth (called equity) to buy more property, spend or fund your retirement. All tax-free!

9. Liquidity – You don't need to sell your asset in order to get cash out of it. With shares you must sell them to be able to access your gains and when you do you'll pay tax and brokerage fees. With real estate you can simply get a line of credit against the equity you have built up, thus avoiding tax and agent fees. This makes property far more liquid than shares and especially superannuation, where you can't access the money until retirement. You will understand more about lines of credit in the finance chapter of this book. *(Chapter 4)*

10. Time – Real estate does not change rapidly. If you own shares, you'll have little notice that the share market is going to crash. It will just happen and then you'll need to react when its too late. A great, or should I say bad, example are the sudden falls in the share market toward the end of 2008. Very few people saw such huge falls on the horizon and it caught everyone by surprise. Real estate gives you the opportunity to see changing trends ahead of time (like hot spots, new infrastructure, rising interest rates etc) and make necessary adjustments to ensure you are well placed for the future – keeping you in control.

So what makes a good investment property?
'*Location, location, location*' we hear you say!

What makes a good location? Is it proximity to shopping centres, close to public transport options or hidden away from the hustle and bustle of city life? What about past or predicted capital growth performance? What about water, bush or city views?

The list goes on and on and a good location can be defined in many ways and will vary depending on whom you ask. Whilst all of these attributes are important your main focus should be on knowing in advance how to manage the cost of holding your investment properties before debating location.

If you can't afford to hold a property through a property cycle (usually 7-10) years, you should not buy it, as you will end up selling it too soon, costing

yourself thousands in taxes and costs, all because you bought on emotion rather then logic.

The best investment property is one based on your budget. Location and other attributes are important, but should be considered secondary.

The 3 most important factors to consider before purchasing a property:

1 – What are the 'out of pocket' costs? – After the rent and tax benefits come in, how much will YOU need to contribute towards the property to meet the loan repayments, council rates and other property costs? There's no point in looking at a property that will cost you $200 per week if you can only afford $100. This means you may need to select the next best location to keep in line with your budget or you risk over committing and having to sell your investment property before you achieve the growth you want. We'll talk more about these out of pocket costs in the finance chapter.

2 – How much will the bank lend you? - If based on your current commitments you could afford a $400,000 property comfortably, you should not be looking at properties priced at say, $450,000, no matter how well located they are. Always purchase within your budget and resist the temptation to spend more with the promise of cutting back on your lifestyle.

3 – How much deposit do you have? – Deposits can be in the form of cash or equity in another property. Depending on the amount you have access to, you may need to find a bank and seller who will accept the deposit you have (to get into the market now) versus trying to save a larger deposit and buying a few years later only to discover the property you wanted is now more expensive.

So remember, your new investment property must be affordable, obtainable and sustainable, delivering the long-term growth that will enable you and your family to achieve financial freedom.

Secret No. 2

Time. Professional property investors understand that what they are really buying is time. They know that if they can hold a property for a property

cycle, that it will likely double in value, just as it has since the 1960's. They put plans and strategies in place to make it to the next property boom where they reap the rewards.

Property gearing strategies

Cash positive
Positively geared
Negatively geared

Property Gearing Strategies

Cash positive
Positively geared
Negatively geared

Which is better?
When purchasing an investment property it is important you understand the effect of each of the three strategies, cash positive, positive geared and negative geared. Over the years many books and many opinions have been offered on the subject and truth be told they all have a role to play. Each is greatly dependant on market forces like rent, price and interest rates as well as tax advantages. Investors may use all three strategies in building their investment portfolio as each strategy may become available at different stages of a property cycle. These strategies are generally used over the long term. Our firm has seen all 3 of these strategies in action and has helped clients obtain a property in all of them. Below, you will find some examples of how the different strategies may work. Please note, whilst the interest rate shown may not be the same today, the concept remains the same. Don't get lost in the detail!

In the coming examples, we'll use the following numbers -

- **An individual in the 40% marginal rate tax bracket.**
- **An investment property purchased for $300,000.**
- **An interest rate of 6%.**
- **Property running costs (management fees, council rates, water, strata levies etc) of 1.5% of the purchase price.**

Cash Positive Property
Cash positive is a strategy that refers to obtaining an excess of income from your investment after outgoings are taken out and prior to taxation. While cash positive is a good form of bringing in some extra cash you do need to remember that you will be required to pay tax on this excess of income and these properties are becoming hard to find.

The main ways you can get a cash positive property are through:

1. **High market rent.**
2. **Renovation or development to improve rental returns.**
3. **Contributing a large cash deposit to lower borrowings.**
4. **Lower market interest rates, which you cannot control.**

Traditional cash positive properties are usually found in more regional areas. Therefore their capital growth is generally less than that of a negative geared property which is usually situated in city, major regional hub or coastal area. The easiest way to establish if a property is cash positive is to start with totalling the expenses of holding the property on a yearly basis. We'll use our example property -

Table 1 - Rent required to break even before turning cash positive.

Annual Expenses	
Interest ($300,000 loan @ 6%)	$18,000
Property Costs ($300,000 @ 1.5%)	$4,500
Total Expenses	**$22,500**
Weekly rent required to be cash positive *(Expenses of $22,500 divided by 52 weeks)*	**$432**

As can be seen in table 1, the $300,000 property would need to be achieving a weekly rent of at least $432 per week just to break even with the running costs and that's only if the interest rate stays at 6%. It's not everyday that you can find a property like this and even a slight change in interest rates can change the overall position very quickly.

Positive Geared Property

Positive gearing is a strategy that refers to the rental income falling short of covering the total expenses but breaks even or is positive after tax benefits are applied.

One of the main ways you can get a positive geared property is through high tax depreciation benefits, often found in new properties.

This time for our $300,000 example property, we'll use a realistic market *rent of $285 per week* and assume *tax depreciation benefits of $12,000* to the investor.

Table 2 - Income and Expenses

Annual Income	
Rent $285 p/w	**$14,820**
Less Annual Expenses	
Interest ($300,000 loan @ 6%)	$18,000
Property Costs ($300,000 @ 1.5%)	$4,500
Net Loss (income less expenses)	**$7,680**

Table 3 - Position before tax benefits are applied

Net Loss	
Tax Refund *(Net loss of $7,680 * 40% marginal tax rate)*	$3,072
Actual Cash Outlay *(Net loss from table 2 less tax refund from above)*	**$4,608 negatively geared**

Before tax benefits, the investment property falls short by $4,608 per year (table 3), so is in fact at this stage negatively geared. We'll now apply $12,000 worth of tax deductions to include in our calculation.

Table 4 - Position After Tax benefits applied

Net Loss *(from table 2)*	$7,680
Plus **Depreciation**	**$12,000**
New Total Tax claim *(Net Loss plus Depreciation)*	**$19,680**
Tax Refund *($19,680 * 40% marginal tax rate)*	$7,872
Actual Cash Outlay *(Net Loss less Tax Refund)*	**$192+ Positive Geared**

When the expenses of $7,680 is combined with the tax depreciation of $12,000 the investor receives a tax refund of $7,872 which is greater than the actual cash outlay of $7,680 resulting in a positive geared position of $192 per year. This is why it's extremely important to maximise every possible tax deduction in a property as it can lower the holding costs to you, the investor. In this scenario the extra cash created is not taxed as in a cash positive property.

More information on *Depreciation* is included in the Tax and Asset Protection chapter of this book.

Negatively Geared Property

Negative Gearing is a strategy that provides for writing off the losses incurred on an investment against other earned income resulting in less tax being paid or a tax refund. In regards to property, the Australian Taxation Office allows property investors to offset an income loss (where property costs are higher than property income) against any other income they may receive such as their salary. For this example we'll assume *market rent is $260 per week.*

Table 5 - Negatively geared property cash flow statement

Annual Income	
Rent ($260 p/w)	$13,520
Annual Expenses	
Loan Interest *($300,000 @ 6%)*	$18,000
Property Costs *($300,000 @ 1.5%)*	$4,500
Total actual expenses	**$22,500**
Net loss *($13,520 income less $22,500 expenses)*	**$8,980**
Plus **Depreciation** *(from table 4)*	$12,000
Total Tax claim *($8,890 + $12,000)*	**$20,980**
Tax Refund *($20,980 * 40% marginal tax rate)*	$8,392
Actual Cash Outlay *($8,980 Net loss less $8,392 Tax Refund)*	$588
Cost per week *(divide by 52 weeks)*	**$11**

In table 5, the property is negatively geared or costing the client $8,980 per year ($172 per week) before tax depreciation.

When the depreciation is applied the cost per year is cut to $588 or just $11 per week. This shows the effect depreciation can have on negatively geared properties. Typically, newer property will have the most deductions which can lower the cost to hold the property and greatly improve cash flow.

Secret No. 3

Cost to hold. Professional property investors understand that the cost of holding onto their investment properties is the most important factor in considering which property to purchase. That's why they use different strategies at different times in the property cycle.

Other strategies

Other Strategies

Property trading

Most property investors have a long-term strategy for future security or retirement. Trading is generally considered a short term strategy to help you enjoy life today, as you get in and out of the investment in a short amount of time. Whilst property trading is short term and can bring in some extra cash, we believe you must have some foundation properties (long term investment properties) in place first before trying your hand at property trading. We recommend it be used with caution by experienced investors as the wrong structure could cost you thousands in extra fees, taxes and loan costs. Some of the more common property trading options are below.

Put and call 'Option' contracts

Often used for '*off the plan*' purchases and for property development. An '*Option*' contract gives you the right but not the obligation to purchase a property for a set price at a pre determined date in the future.

For an off the plan purchase, the property may have a long construction time (say over 12 months) and whilst the property was good value when you first saw the plans, upon completion 2 years later the market may have dropped in value leaving you with an overpriced property. In such a case using an option contract, you could walk away from the purchase and incur a smaller cost (the option fee you paid) rather than lose your deposit, have a negative equity position or be unable to settle the purchase. The reverse is also true. If you believe that the property may increase in value during construction, you could lock the vendor in early at a good price before the property increases in value. This could enable you to on sell the property to another person, taking the profit without having to pay stamp duty.

In the case of property development, you may be eager to lock in a vendor before a development site is sold to someone else and you may not have the time to do your due diligence. If you used an option contract you could lock in the vendor but give yourself time to adequately assess the site and ensure you could build what you wanted on it – and if not, withdraw from the purchase and only lose the option fee paid. This is a great way to secure a development site but give you time to decide how to best use it to make the most profit.

Buy, renovate and sell
This could be used to describe a situation where you buy a run down property and add value by fixing it up. This could be in the form of new kitchens, bathrooms or as simple as a coat of paint. Once you have added the value to the property you can either sell it for a profit (market dependant of course) or hold the property and borrow against the increased equity. You need to be aware of tax implications if you intend to sell as you wont get a discount on your capital gains tax if you buy and sell within a 12-month period and make a profit. (Assuming you purchased in your own name - see the Tax and Asset Protection chapter for more).

Syndication
Syndication is a form of investment where more than one party will finance the purchase of a property. This can range from a simple structure involving a group of friends or family members to a more complex arrangement where an investment manager offers the public the chance to buy shares in a managed syndicate.

A key advantage of a syndicate is that you have experts choosing and managing the property. You are able to buy into these syndicates for a small outlay often as little as $5,000 but still benefit from being part of a group that may have access to better performing properties and those that you could not afford to buy on your own. Syndications are also often used to purchase development sites, resort or holiday apartments, off the plan penthouse units or even property management rights to a building such as a hotel/resort.

Buying and selling 'Off the Plan' without owning the property.
This is where you commit to purchasing a property before it is constructed. Then when the property is nearing completion you on-sell the property to someone else for a profit. An experienced investor should only use this strategy with appropriate tax strategies in place. Poor timing, a down market or an overpriced purchase to begin with could cause a lot of problems when you go to re-sell towards the end. '*Off the plan*' strategies are discussed in greater detail in the next chapter.

Buying ‘off the plan’

Buying Off the Plan

This is an area where an investor could make great capital gains while waiting for a development to be built yet not pay a mortgage along the way. The concept is to purchase a property, usually an apartment or townhouse, in a development that will take between 12 months to 3 years to build. You are buying the property at today's price but you don't have to settle and hand over the majority of your money until the project is finished. Usually the builder or developer will require a 10% deposit or deposit bond to secure the property but there is no need to get a loan to buy the property until it is approximately 3 months out from completion. If the build time is longer than 12 months, you can often ask the bank to take the new valuation price if it's higher than the purchase price you paid back at the start. This could mean you need less of a deposit as the bank recognises you are buying the property below market value. The main considerations for off the plan are discussed below.

Deposit

There are various ways to pay a deposit for an off-the-plan purchase. Most vendors will require the payment of a 10% deposit when you exchange the contract. However it can sometimes be negotiated to 5% or sometimes even a flat fee. It's important to remember that many developers or builders need to pre-sell a certain number of properties in a development before the bank will give them money to commence construction. This can be an advantage if you are one of the first to buy in as the developer may offer a reduced price to get a few quick sales so construction can commence. It can also be a disadvantage in that you could be waiting a while until the developer sells enough of the properties to start construction.

The simplest and cheapest way to pay a deposit is cash. If it's a long construction time. you need to keep in mind that you won't be able to use the cash in the interim as it will be held in a Solicitor's trust account. You should never release the deposit to the builder because if the builder goes broke and cannot finish the project for any reason, you will struggle to get your money back. All good solicitors will ensure that your deposit is never released. As simple as it is, very few people have a spare 10% deposit in cash readily available.

The second option is a '*deposit bond*' or '*bank guarantee*'. A bond (issued by

an insurance company) is basically a guarantee that you will provide the full deposit upon settlement rather than on exchange. A bond's cost will vary depending on the amount and the length of time you need the bond. Bonds may seem like the way to go on first look but they are not as easy to obtain for an off the plan purchase.

The bond issuer wants to make sure you will be in a position to provide the deposit on settlement. They will assess your borrowing capacity and asset position at the date of application rather than any assumed circumstance in the future. This means that if you cannot prove to the bond company that you can get the loan approved today, you won't get a bond – even if you plan to sell another property between now and the date of completion to give you the money.

The bond company is generally looking for five times the amount of the bond in equity in another property. For example, the purchase price may be $300,000, and a 10% deposit means you need a bond for $30,000. To be approved for a bond you would need to have approximately $150,000 in equity in other properties. Another problem with bonds is that the cost of the bond is partially determined by the maximum length of time it will take the builder to construct, otherwise known as a '*sunset*' clause (see below). For example, the builder may tell you that it will take 12 months to build, yet the contract allows up to 24 months to build. The bond cost is determined on the 24 months time frame not 12 months and will add significant cost to your bond.

Sunrise Clause
This is important as is dictates when the project will start. Many developers don't want to put this in their contracts as you can rescind or terminate the contract if they don't start on time. The clause will state that construction must start within a period of time from when you exchange contracts. If it doesn't, you can pull out of the purchase without penalty and get your money back. The reason to insist on this clause in a contract is that many builders must pre sell a quantity of the units before the bank will release the funds to start building the complex. Without this clause, had you purchased the first one and the pre-sales aren't achieved in a reasonable time period, you and your deposit are locked in the project permanently which may never actually start.

Sunset Clause

Similar to above but dictates the completion of the project. This clause gives you some protection that the project will be completed by a specific time. The sunset clause is sufficiently generous to enable the builder to complete the project within a reasonable time frame and protects the builder against delays in supplies or weather conditions etc. The reason to have this clause is it allows you to pull out of the project if it's not completed on time. Without this clause you are locked into the project until it is completed, even if the builder goes broke!. If you are paying the deposit by deposit bond the contract must have this clause to satisfy the bond issuer.

Quality of Finishes

You should always go over in detail the '*inclusions list*' of the property prior to entering into any contract to purchase. Don't rely on the display home/unit as they often have upgraded inclusions for extra cost. Make sure you check what it says about every item such as the color of the paint, stone or laminex kitchen bench tops, down lights or batons, floorboards or carpet etc. It is also a good idea to inspect one of the projects the developer/builder is currently building or has recently completed for the quality of workmanship and finishes.

Final Inspection

You should also conduct a final inspection of the property before settlement. If there are any outstanding issues your solicitor can communicate them to the builder's solicitor so they can be rectified before settlement. Alternatively you could have your solicitor hold back money from the settlement until the work is completed.

Using your super to purchase an investment property

Using your Super to Purchase an Investment Property

Self Managed Superannuation Funds (we will call them SMSFs) can now borrow money to purchase residential or commercial real estate. A SMSF investor can have just as much choice and control over investment properties purchased within a SMSF as they would in their own name.

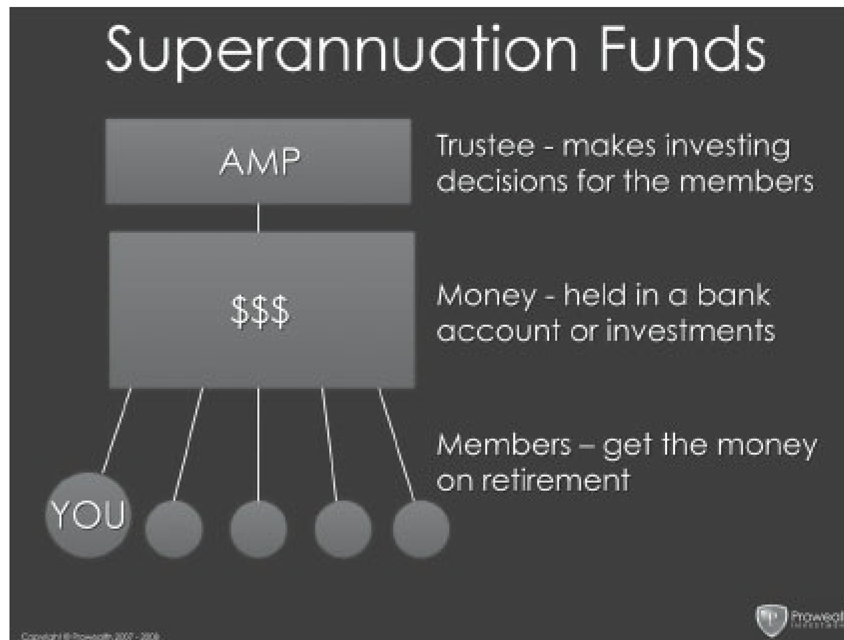
Until recently this had not been possible because of restrictions on superannuation funds borrowing and using the super assets as security for loans. The Superannuation Industry Supervision Act (SIS Act) was amended in September 2007 to allow SMSF's to borrow money so long as a special structure is used.

Many Australians have significant money in superannuation and more and more are establishing their own Self Managed Super Funds.

In fact the Australian Taxation Office reported that over 31,000 new SMSF's were formed in the month of June 2008 alone, with a further 20,000 to 30,000 being formed each month on a consistent basis.

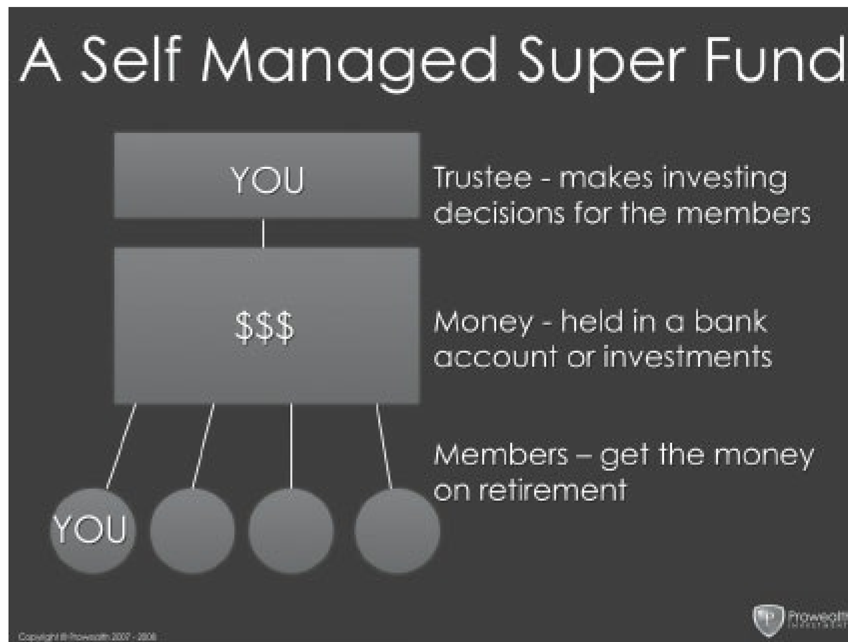
The best part about the changes is that you now may be able to include real estate in your super fund's investment portfolio by setting up your own SMSF.

How does it work?



Above - A 'normal' Super Fund

Your employer pays 9% of your salary into a super fund (in this example, we are using AMP as the super fund). The super fund makes investment decisions as to how to invest the money. You have little say, other than perhaps a 'high growth', 'low risk' or similar tick box on your super statement. You cannot specify what shares to buy, which managed fund to invest in or which property to buy as an advisor from the super fund handles everything. Your spouse is often in a different super fund to you, limiting the amount that could be invested into an asset class. Most super funds also charge fees to manage your investments regardless of the performance of it.



Above - A Self Managed Super Fund (SMSF)

You set-up this structure with your accountant. You, (and your spouse if you have one) instruct your current super fund to '*rollover*' the balance of your money from your existing fund to your SMSF's new bank account. You also instruct your employers to now pay 9% of your salary into your SMSF.

You now have a combined super balance that you can choose to invest in virtually any asset class you like providing it's within the SIS Act rules. You can decide to buy specific shares, invest in specific managed funds, and buy specific property, even art and antiques. The key is **you** can now choose how **your** super is invested, not an advisor. In essence, a Self Managed Super Fund allows you to take control of the decision making process by allowing you to decide on how and where you will invest the money for the benefit of all super fund members (usually you and/or spouse) at retirement.

The top 7 reasons why you should consider buying a property with your SMSF.

1. It's a physical asset you can see. You can drive past your investment property and actually see your super working for you. Do you know where your super is right now? - Most people do not.

2. You don't need the full purchase price of the property in your fund, only enough for a deposit. Generally, you'll need at least a 30% deposit plus purchase costs to enable you to buy a property.

3. Pay no tax with a SMSF. Until you're 60, you're taxed at only 15% on income (versus up to 45% in your own name) and only pay 10% capital gains tax. When you're over 60, you pay **NO** tax on income and **NO** capital gains tax.

4. You have absolute control. You can decide what your super will be invested in. This means you can have some in property, some in shares – it's up to you. If you choose property as part of your strategy you can see it, touch it or even drive past it!

5. Your employer helps pay for the property. By law, employers put 9% of your salary into a super fund. Why not have those contributions go to your SMSF to pay off the property?

6. You can combine Super balances. A SMSF allows you to pool the balance of your fund with your spouse, parents, children or other family members. SMSF's can have up to 4 family members which means that between a few of you, there may be enough for a deposit on a property.

7. It's not as hard as some would have you think. Whilst it's true that SMSFs have compliance rules to follow, your accountant or planner will attend to the majority of compliance for you. So as long as you act in the best interest of the members you should be fine.

Let's look at an example couple.

Tim earns $80,000 per year and currently has $90,000 in an industry super fund. Jane earns $30,000 per year and currently has $60,000 in an industry super fund.

Tim & Jane, both aged 50 decide to establish a SMSF and wish to purchase an investment property as they have been disappointed with the performance of their current super funds and want the safety of 'bricks and mortar'.

By combining their individual super balances into their new SMSF they have a combined balance of $150,000. The property they want to buy is $300,000 so they do not have sufficient funds in the SMSF to purchase the property outright.

To purchase the property the lender requires a 30% deposit which in this case is $90,000 and will get a SMSF loan for $210,000. They'll also need to use another $10,000 to cover purchase costs like stamp duty and legal fees.

Table 1 - Amount of Super required for deposit and costs

Property Deposit	$90,000	30% of $300,000
Property Purchase costs	$10,000	(Stamp Duty, Legals)
Total required from super	$100,000	Balance of super : $50,000

Tim and Jane will need to use $100,000 of their $150,000 SMSF balance as deposit and purchase costs on this property.

They now need to work out the cash flow of the property within the fund. On top of the rent received the SMSF will also have 9% of Tim and Jane's salaries contributed to the fund on their behalf. Employer contributions and rental income are taxed at the rate of 15% until retirement at age 60. The total income to the SMSF is shown in table 2.

Table 2 - Income to SMSF per year, including rent of $280 per week

Rent *($280 per week)*	$14,560	
Tim	$7,200	9% of Tim's $80,000 income
Jane	$2,700	9% of Jane's $30,000 income
Less Tax	-$3,669	15% contributions tax paid by the fund.
Total Income to fund	$20,971	Rent plus contributions

As you can see above, the SMSF will have $20,971 per year in income but it must also pay the running costs and expenses of the property purchase as shown in table 3.

Table 3 - Property expenses to the SMSF per year

Loan Interest	$14,700	$210,000 loan at rate of 7%
Property Costs	$4,500	Council Rates, Insurance, Management Fees. (approx 1.5% of $300,000 property value)
Total Expenses to fund	$19,200	

The interest rate will of course vary, unless it's a fixed rate, and we have assumed property costs will be approximately 1.5% of the property's value. We've excluded depreciation to keep the numbers simple for the example but in reality the fund will get some benefit in that regard as well.

Table 4 – SMSF cash flow position for year

Income	$20,791	
Less Expenses	$19,200	
Position	$1,591	Cash flow positive

Once the expenses are subtracted from income, the SMSF will have surplus cash flow of $1,591 per year or about $30 per week.

This means that Tim and Jane's SMSF can purchase the $300,000 property and never have to contribute anything themselves toward paying for it!

The property is being totally funded by the rent and employer contributions. Don't forget that we only used $100,000 of the $150,000 fund balance so Tim and Jane still have a further $50,000 to re-invest as they see fit.

Tim and Jane can now sit back and let the property grow in value for the next 10 years which, based on history, should see the property double in value to be worth around $600,000 when they hit age 60.

Table 5 – Property Value at age 60 (ten years after purchase)

Property Value	$600,000
Debt	$210,000
Equity	**$390,000**

Tim and Jane now have a substantial amount of equity ($390,000) built up in the property and we have assumed they paid interest only for the whole 10 years. They may decide to divert the positive cash flow of the property into reducing the debt. We'll assume they don't repay any of the debt during the 10 years, so that they still owe the original amount of $210,000 shown in table 5.

Since they have hit retirement age, they choose to sell the property, knowing that because it was purchased in a SMSF they will pay **ZERO** capital gains tax.

This means that aside from paying a real estate agent to sell the property (say $20,000 in commission and fees), they will walk away with $370,000 tax-free from their initial $100,000 investment ten years ago.

Had they purchased this property in their own name the result would have been markedly different as table 6 shows.

Table 6 –
Comparison of tax payable in own name or in a SMSF after age 60

Purchased in	Own name	A SMSF and sold after age 60
Purchase Price	$300,000	$300,000
Sales Price	$600,000	$600,000
Net Gain	$300,000	$300,000
Taxable Gain *(50% discount if purchased in own name)*	$150,000	$0
Tax Payable	$69,750 (46.5%)	NIL

If they had purchased in an individual name Tim and Jane would have lost approximately $69,750 in tax as the gain would be taxed at the highest marginal rate of 46.5%, even after the 50% capital gains tax discount.

Having instead purchased in a SMSF, the tax saved can be used towards Tim and Jane's retirement plans rather than boosting the tax office coffers.

Table 7 - Maximum tax rate payable on income and gain for assets purchased in a SMSF.

	Before age 60	After age 60
Income	15%	NIL
Capital Gain	10%	NIL

Clearly, the goal of purchasing any asset in a SMSF (in this case property) is to hold until you reach retirement age where you can sell if desired and pay no tax, or keep the asset and pay no income tax.

Compare the pair

Establishing an SMSF to borrow money and invest in a low tax environment can have a significant impact on your retirement balance primarily because you're leveraging your smaller individual super balances into a higher valued asset. The sooner you start, the more time you have to obtain capital growth.

Lets '*Compare the Pair*' as John Woods says in those Industry Super Fund TV ads and see what difference leverage makes assuming the same return on a 'normal' super fund and an investment property.

We'll use a 7.2% growth rate for both assets classes to keep it fair and if you recall the '*Rule of 72*' discussed earlier in the book, you'll understand that this means that the asset values will double in value every 10 years. To demonstrate the real power of leverage, we'll assume Tim and Jane purchased the property in their SMSF at age 40 and kept it for 20 years till age 60.

See the next page to see the result.

Table 8 - Compare the Pair

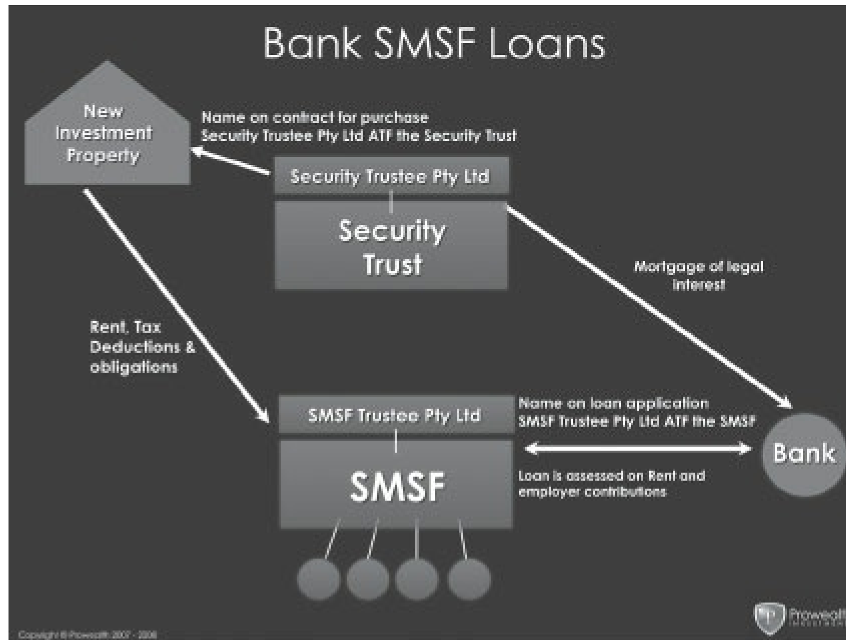
Tim and Jane age 40		
	A typical Super Fund	An SMSF
Starting Super Balance	$150,000	$150,000
At age 40 they can invest in either	Shares / Managed funds worth $150,000	Deposit + costs of $100,000 on property worth $300,000. Balance of $50,000 into Shares / Managed funds.
Rate of growth	7.2%	7.2%
Asset value at age 60 *(Assets have doubled in value twice)*	Shares / Managed funds worth $600,000	Property worth $1,200,000 & Shares / Managed funds worth $200,000
Less Debt	$0	$210,000
Fund balance at age 60 *(20 years later)*	**$600,000**	**$1,190,000**
A lifetime of difference		

(This example excludes any fees for simplicity)

It's easy to see that for the savvy SMSF investor, leveraging your super into property as soon as practical can provide a fast track way of preparing for retirement. Most people are familiar with property and have the confidence to invest in an asset class that they may have many years of expertise in.

It is imperative to seek the advice of a qualified adviser that specialises in property transactions for SMSF's to ensure the strict compliance rules and bank-lending criteria are adhered to.

How does a bank SMSF loan work?



Above - The common SMSF lending structure

Refer to the above diagram as you read through the steps to buying a property with your SMSF.

1. **You and other members establish a Self Managed Super Fund**, in this case called 'SMSF'. You and other members instruct your previous fund to transfer the balance to your SMSF bank account.
2. **You will also need to establish a 'Security Trust', also know as a 'Bare Trust'.** Technically speaking, a '*Security Trust*' or '*Bare Trust*' is a special type of trust whereby a trustee holds an asset for the absolute benefit of the beneficiary. This basically means that a special entity is established to hold the property on trust for the Self Managed Super Fund. The SMSF is the only beneficiary of the trust and is the only entity that can benefit from the property.
3. **You (the SMSF) locate a property you wish to purchase.**
4. **You see your specialist investment property broker** to find out how each bank handles the mortgage process and apply for a loan in the name of *'SMSF Trustee as Trustee for the SMSF'*.

The bank requires a Security Trustee to hold the property while a loan is in place, in this case *'Security Trustee Pty Ltd As Trustee for the*

5. *Security Trust'*. This name must appear on the Contract for Sale. The SMSF can now pay the deposit from its bank account to the vendor's solicitor along with purchase costs such as stamp duty etc.
6. **The loan is settled**, rent is now received by the SMSF and it makes repayments to the bank in the ordinary way.

Features of a SMSF loan

There are a limited number of lenders to choose from when deciding to purchase a property with a SMSF. Generally all SMSF loans have these basic features in common:

- You can choose virtually any kind of property including residential, commercial, retail, and holiday units subject to bank approval.
- The lender has no recourse to the other assets of the SMSF, providing the SMSF with absolute protection for its other investments. This means that, should the SMSF default on the loan, the bank cannot get access to any of the SMSF's cash, shares or other property to repay the debt. This represents strong asset protection for the fund and its members.
- SMSFs can deal with the property however and whenever they like, in the same way as investors can deal with "normal" investment properties. For example, lease, renovate, repair, or sell.
- All rents are paid direct to the SMSF. Loan repayments are made in the ordinary way from the SMSF bank account.
- The SMSF can pay out or reduce the mortgage at any time, subject to the terms of the relevant loan.

How does my SMSF purchase a property?

The SMSF (You) chooses the property, in which it wishes to invest in the ordinary way. Residential property must be purchased from an arm's length vendor (someone who is not related to you in anyway). Non-residential property can be purchased for full value from related parties so long as the property is let for business purposes.

1 . The SMSF obtains a loan approval from a lender. You will need a specialist broker. such as Prowealth Money, because the average bank or mobile broker will have little to no knowledge of how to structure the loan in

accordance with tax office requirements.
2. The SMSF's own (your own) lawyer/conveyancer acts on the purchase in the ordinary way.
3. The SMSF pays the deposit, the legal costs, and stamp duty in the ordinary way from the combined member funds.
4. On completion of the purchase, the Security Trustee (You) mortgages the property to the lender.
5. The SMSF then manages the asset in the same way as you would with any other real estate investment.

Can I occupy the property?

No. If a member of the SMSF occupies the property the "*in-house asset rule*" would be breached. This rule dictates that a member cannot receive any benefit from the SMSF assets until they reach retirement, so living in it would clearly violate this rule. The SMSF can buy a property that a member intends to live in after retirement if you transfer the property from your SMSF to yourself after you retire.

I thought super funds could not borrow or use their assets as security for loans. Is this correct?

That was correct until amendments to the Superannuation Industry Supervision Act 1993 (SIS Act) made in September 2007. Under the new section 67 of the SIS Act, SMSFs can borrow providing the following conditions are satisfied -

- The borrowed funds are used to purchase an asset (e.g. real estate). For example you could not use your super to pay off your car loan or go on a holiday.
- The asset is held on trust for the SMSF by another entity. In our example, it is the '*Security Trust*'. This is a legal requirement which separates ownership and control of the asset.
- The SMSF must have the right to acquire legal ownership of the asset by making payment. In other words, your SMSF can't make payments for an asset that it can never actually own. By making loan repayments, the property will eventually be owned by the SMSF when the loan is paid off.
- The lender's recourse against the SMSF must be limited to the underlying asset (i.e. the purchased property). The lender must not have a right of recourse against other assets of the fund. This is an important feature,

because, if you were to default on a property purchased in your own name, the bank could come after any other properties you owned, your home, cash in bank accounts, your car. The list is endless. If you borrow money with your SMSF and you default on your payments, the bank can only sell the asset for which it lent money. This means the bank cannot take cash, shares or other investment assets from your super fund. The bank must write off the loss and that's why there were very few banks willing to lend to SMSFs in the early days of the legislation. Many banks do however ask you to personally guarantee super fund borrowings against your personal assets.

What other restrictions apply?

SMSFs must comply with all regulations applying to superannuation funds. SMSFs may acquire up to 100% of the fund's total assets in the form of real property but must ensure that the level of investment in real property is in line with the fund's investment strategy, including diversification of assets, liquidity, and maximisation of member returns in the fund. Where a fund invests 100% of its assets in real property, trustees (you) must ensure that the fund continues to meet these requirements. For instance, you must ensure the fund has sufficient liquidity to meet its liabilities (such as pension payments). The government has also made it clear that super funds investing in these types of investments must have appropriate risk management measures in place and must understand the risks of investment.

Who pays what and when?

The SMSF is responsible for paying all the usual amounts that you would expect to if you had bought an investment property in your own name rather than your super fund. Your SMSF will be required to pay Council rates, water rates, land tax (if any), interest and other loan repayments, lender's fees, repairs, property management costs, and any insurance premiums.

What about land tax?

As the SMSF is the beneficial owner of the property, land tax is payable if the total land values exceed the proscribed amount in each state. Check with the *Office of State Revenue* in your state.

How can I transfer the property?

The SMSF (You) can direct the Security Trustee (You) to sell the property to

any third party (subject to paying out the mortgage loan and any other amounts which might be outstanding).

How do I get a loan for my SMSF?
You will need to speak to a specialist broker like Prowealth Money and ask for a SMSF loan available from a limited number of banks. You should also be aware of other lending methods known as '*Installment Warrants*', often organised by accountants and financial advisors. Most traditional '*Warrant*' type structures have high establishment costs and high ongoing costs as the warrant provider pays a commission to your financial advisor every year. This is something you must avoid as it will erode your Super for little benefit.

Essentially, new SMSF loans fall within existing credit policies and procedures for most banks. An important feature of these loans is that individuals (the SMSF members) are allowed to find their own properties. This is an important point as it differentiates bank SMSF loans from many other advisor products that are sometimes linked with developers to sell residual stock (which may be overvalued) using traditional installment warrants. Thus the decision to invest is entirely that of the SMSF. Like all bank loans, all properties are required to be independently valued by 3rd party valuers ensuring you are paying fair market value.

Secret No. 4

Self managed super. Professional property investors use property as the vehicle to financial freedom. With changes to legislation allowing SMSF's to borrow money, an investor can now leverage available super into a higher valued asset of real property in a low tax, asset protected environment.

Chapter 4

Finance

DSR, LVR, and LMI
Using a line of credit to pay for your investment property
Cross securitisation

Finance

Bank, Broker or Specialist Investment Property Lender?

Where you get your money to fund an investment property purchase is just as important as the property itself. The wrong choice of lender or bad advice from the person behind the counter may cost you thousands of dollars over the life of your investment. That's why it's important to use a specialist in investment property.

A bank will only be able to offer you the loans available at their particular bank. You may think you are getting the best product or interest rate that suits your needs. However, you will never be sure as one bank cannot offer you a loan from another bank. When it comes to investment property finance, the person behind the counter may not have the experience to ensure your loan is structured in the best possible way for tax purposes and asset protection. Bank staff are not accountants, real estate agents or financial advisors so how can they possibly take into account your total picture?

A broker has the ability to offer you a loan from a wide variety of banks that may better suit your needs. A good one will be able to assess your personal situation and give advice on what product will best complement your investment strategy. A broker is usually a better option than a bank but you should be aware that brokers earn a living by writing loans. Some banks or lenders pay more commission than others so they may be influenced toward a certain product and may not understand tax implications when structuring the loan.

A specialist investment property lender like Prowealth Money operates similarly to a broker. In addition to having access to a wide range of banks and non-banks, specialist investment property lenders like Prowealth Money also have their own products specifically designed for the property investor. A specialist investment property lender should work hand in hand with your real estate agent, advisors and your accountant to ensure that you have :

- the best chance of getting your loan approved,
- the best product and rate for your circumstances and
- the best asset protection and tax structure possible.

If you are going to become a property investor it makes sense to see a specialist broker/lender who can give you advice or suggestions in all of these

areas.

What will it cost me?
The cost of your loan can be affected by your credit history, type of security property and the ability to verify your income. When assessing the total cost of a loan you need to consider some of the hidden fees like:

Up-front/ Establishment fees – Sometimes charged when you setup a new loan and is usually under $1,000.

Lender's Mortgage Insurance (LMI) – This is a fee you pay when you borrow more than 80% of a property's value. We'll talk more about LMI in this chapter. This cost could add thousands of dollars to your loan.

Interest rate – The lowest rate may not be the best rate especially over the longer term. Many lenders offer a 1 to 3 year discount or honeymoon rate where you are charged a cheaper interest rate for the period. After this period ends the rate will revert to the bank's standard variable rate which can often be a lot higher and cost you more than if you had taken a standard package from the beginning. This means you could have 1 good year, then 29 bad years of interest rates!

Account management/Transaction fees – These are fees to keep your account open and range from around $6 to $20 a month. Over 30 years they can add a significant cost to your loan.

Facility set-up charges (e.g. redraw) – If you over pay your home loan and wish to redraw funds to spend, many lenders charge a fee to do it. This fee could be $30-$50 per redraw so its important for your bank, broker or specialist to analyze how you will be using the loan to minimise this fee.

Early repayment fees – If you decide to break your loan by selling your property or moving to another bank, some lenders will charge an early repayment fee often called a '*Deferred Establishment Fee*'. These costs range from a few hundred to a few thousand depending on how early you repaid the loan and what type of loan it was. These costs vary from lender to lender and your lender should be able to tell you what they are before you sign for the loan.

How will my loan work?
You will have to live with your loan account for a long time. Over 30 years your life circumstances will change many times so you will need a loan that is functionally strong and very flexible. Many basic loans offer low honeymoon rates but lock you into inflexible loans with no long-term price advantage. Some of the features you may want to consider looking for are :

The ability to have multiple loan splits or sub-accounts at no additional charge – For example, you may wish to make some of your loan fixed and some variable. This would require two loan splits Some banks will charge an account fee per split!

Change payment frequency – being the ability to pay either monthly fortnightly or weekly depending on what you desire or when you are paid which may save interest.

Change payment day/date or make additional loan repayments at anytime without paying a penalty.

Redraw funds when you are in advance on your loan. If you pay more than the minimum payment on your loan it would be nice to know if you can get the money back if you need to.

Use a cheque book – you may prefer a cheque book to make payments from your loan rather than access loan information using the internet or phone.

Change loan structure and features anytime after settlement – This could be switching from variable to fixed rates or from principal and interest repayments to interest only.

These are the main areas you need to consider before you apply for a loan for your new investment property.

Secret No. 5

Just as you would seek the advice of a solicitor if you wanted to sue somebody and seek an accountant for tax advice, professional property

investors use specialist investment property lenders to ensure that the finance strategy applied is the best one for current and future goals of the investor. They know that the person behind the counter at the bank is unlikely to understand their future goals and the advanced finance strategies that will be applied to achieve them.

DSR, LVR, and LMI

How much deposit do I need to buy an investment property?

This will depend on the value of the property, where it's located and how much the bank is willing to lend you for that type of property. Most banks and brokers suggest that you need a 20% deposit to avoid something called '*Lenders Mortgage Insurance*'. We are going to discuss this later in this chapter.

No matter what deposit you decide you use, many people fail to take into account the purchase costs involved in buying a property. To illustrate, we'll assume you would like to buy a $300,000 investment property.

Table 1 - Amount of cash or equity needed to purchase a $300,000 investment property with a 20% deposit.

Deposit *($300,000 * 20%)*	$60,000
Conveyancing/ Solictor & Council adjustments	$2,000
Stamp Duty (NSW)	$8,990
Total	**$70,990**

Conveyancing and/or solicitor's costs are generally around $1,500 with a solicitor usually costing a little more. There will also be various council adjustments for portions of rates and water bills paid depending on when you purchase the property. We've allowed another $500 for that. Then, of course, there is state government *Stamp Duty* which is different in each state. In NSW it adds $8,990 to our purchase costs for a total amount of $70,990 as shown in table 1.

Most people we know don't have anywhere near this amount of money sitting around in cash which means they need to use equity that they have in another property.

How much equity do I have in my home?

This is an important question. Many people don't fully understand how to release equity from a property. Equity can be looked at in two ways, *'actual equity'* and *'available equity'*.

For our examples, we'll assume you have a home worth $300,000 and owe

$200,000 on it.

Actual Equity – Put simply, this is the difference between the current value of the property and the amount of debt secured against that property. For our example home, the actual equity is *$100,000* as shown in table 2.

Table 2 - Actual equity in your home

Your Home Value	$300,000
Current Debt	$200,000
Actual Equity	**$100,000**

Available Equity – This is a better way to look at equity as it represents how much of the '*actual equity*' you can draw out and use.

Your '*available equity*' is determined by two factors, being your *'Debt Service Ratio'* (DSR) or serviceability and your '*Loan to Value Ratio*' (LVR).

We'll discuss both of these now.

Debt Service Ratio or DSR

The bank will also consider your serviceability when it comes to giving you a loan. Serviceability is often expressed as a ratio being your '*DSR*' or '*Debt Service Ratio*' as the bank calculates whether they believe you can afford to '*service*' or repay the loan. The ratio determines how much of your income will be needed for you to be able to repay the loan.

The most common types of loans are –

'Full Doc' – where you prove your income and expenses to the bank.

'Low Doc' – where you nominate how much you earn in order to service the loan without providing traditional proof of income such as pay slips. Instead you would generally supply your personal or company financial statements.

'No Doc' – where you declare to the bank that you can meet the payments for the loan without having to prove what you do or don't earn. As of 2009, these loans are virtually non-existent due to the financial crisis experienced in late

2008.
(*Doc means documentation or evidence*)

Many factors can influence your serviceability, the most common being:

Your job – Are you fulltime, part time or casual? how much do you earn? How long have you been in your current job?

Your other income – Do you have any other income like rent from investment properties. or government benefits like family tax allowance?

Your expenses – What are your current loan commitments such as home loans, investment loans, credit cards and personal loans?

Your marital status and do you have children? - Banks factor in more expenses if you are married and have children.

Current interest rates - Are they likely to rise in the near future and what effect will a rise have on your abilty to meet repayments on all of your loans?

Of course there are many more factors that can apply in different situations.

Banks brokers and specialist lenders use a loan '*serviceability calculator*' to tell if you will meet the banks criteria for serviceability before you go to the trouble and expense of applying for a loan.

In many cases banks also factor in the following :

1. Only 80% of the estimated weekly rent (of the new purchase) is used for additional income, just in case the new investment property doesn't achieve the rent you've stated or the market suffers a rental downturn.
2. An interest rate of 2% above the standard variable bank rate, to ensure you can still meet repayments if rates rise.
3. All repayment calculations based on Principal and Interest repayments, as the loan balance will reduce over time. Something the bank likes to see happen.

These three factors help ensure that you can meet your commitment comfortably. Australian banks have some of the tightest credit policies in the

world so if you have been truthful in your application (not over or understating your existing commitments) and the bank says you can afford the loan, you should have no problem in servicing the loan over the long term.

Loan to Value Ratio 'LVR'

The LVR is the percentage of the property's value that is in debt. Most banks and financial institutions are willing to lend you up to 80% of the property's value (80% LVR).

Table 3 - Available equity at 80% loan to value ratio (LVR)

Your home value	$300,000
80% of home value	$240,000
Less existing debt	$200,000
Available Equity	**$40,000**

Evidently, there is a great deal of difference between the actual equity of $100,000 (table 2) and the available equity of $40,000 (table 3). Therefore using the strategy of a 20% deposit would mean you would not have enough equity to purchase the $300,000 investment property. We worked out earlier we needed $70,990 (table 1) to cover a 20% deposit and purchase costs. So at this point your property investment goals come to a screaming halt unless you consider some more advanced finance strategies.

Lender's Mortgage Insurance (LMI)

Lender's Mortgage Insurance or LMI can allow an investor to use less deposit when purchasing a property but can also be used to obtain more of your '*actual equity*' by increasing the LVR on properties you already own.

In both cases, the bank will charge you LMI for the privilege of borrowing more than 80% of the properties value. LMI is an insurance premium you pay on behalf of the bank for the bank to get insurance in the event you can't pay your loan. Many people believe LMI covers them in the event they default on a loan – it does not. It only protects the bank. If you were to default the bank would get the money from the insurance company and the insurance company would come looking for you!

It's for this reason many banks and brokers advise against going above 80%

LVR, as they believe it's an unnecessary expense. However, the smart investor uses LMI as a tool which enables them to expand their portfolio faster by using less money for each purchase. LMI can also be tax deductible over 5 years when the money is being used for property investment.

So let's go back to our proposed purchase of a $300,000 investment property to see what would happen if we used LMI to lower the deposit required.

Table 4 - Total equity or cash required when depending on deposit used.

	With a 20% Deposit	With a 10% Deposit	With a 5% Deposit
Deposit	$60,000	$30,000	$15,000
Conveyancing & council adjustments	$2,000	$2,000	$2,000
Stamp Duty (NSW)	$8,990	$8,990	$8,990
Lenders Mortgage Insurance*	$0	$4,600	$6,300
Total Deposit + Costs	**$70,990**	**$45,590**	**$32,290**

**LMI is an estimate and varies between insurers.*

As can be seen in table 4 we could pay a 20% deposit and be up for $70,990 in total which would avoid paying any LMI premium but if we did not have that amount of cash or equity available, we could choose to use a 10% or even 5% deposit which lowers the overall deposit substantially.

Many people may baulk at paying a $6,300 LMI premium for using a 5% deposit which is understandable. What the professional investor considers is the time cost of this money. A 5% deposit will allow you, the investor, to buy an investment property by using only $32,290 to cover the deposit and purchase costs (table 4). If you wanted to avoid paying LMI by waiting until you had 20% deposit and costs, you would either have to save a further $38,700 or wait until your home had an increase in available equity of this amount. In both cases, it could take a number of years for that to happen, during which time you would be missing potential growth oppurtunity on the purchase. It's also likely that by the time you saved this extra amount in cash or equity, the price of the property will have increased, meaning you will need even more deposit anyway.

Let's consider the effect of LMI on equity available in our home. If you recall,

our example home is worth $300,000 and we have a debt of $200,000 owing on it. We may be able to obtain the following equity at a higher LVR by using LMI as demostrated in table 5.

Table 5 - Amount of equity in our example home at increased LVR.

$300,000 Property	80% LVR	85% LVR	90% LVR	95% LVR
Maximum Loan	$240,000	$255,000	$270,000	$285,000
Less Debt	$200,000	$200,000	$200,000	$200,000
Available Equity	**$40,000**	**$55,000**	**$70,000**	**$85,000**

Based on the above and depending upon serviceability and the usual finance checks there is between **$40,000 and $85,000** available to you by increasing the LVR. This equity can then be used to pay a larger deposit on your new purchase (lowering or eliminating LMI for the new purchase) or could be used to buy more than one property.

Now that we know we can potentially obtain $85,000 of the equity in our home, we can consider how much of a deposit we should pay for the new investment property purchase.

From our earlier example in table 4, we needed :
$70,990 using a 20% deposit plus costs
$45,990 using a 10% deposit plus costs, or
$32,290 using a 5% deposit plus costs
for our $300,000 investment property purchase.

If you used the highest amount of equity from your home of $85,000 (table 5) you could choose to pay the 20% deposit and costs of $70,990 which would avoid paying mortgage insurance on the purchase. With only $14,010 in remaining equity you would not have enough to buy another property until your home equity increasd again over the next few years.

A smarter option is to use the least amount of your money for each purchase which will allow you to buy more property sooner.

Two for the price of one
Rather than use the majority of your equity on a single purchase to avoid paying LMI, let's consider a better option.

You could draw up the full equity from your home of $85,000 but this time only use a 5% deposit and costs on the purchase.

For the new property purchase you will need to use $32,290 of it (table 4). This means you could afford to buy two new investment properties for a total of **$64,580** and still have **$20,420 left over.**

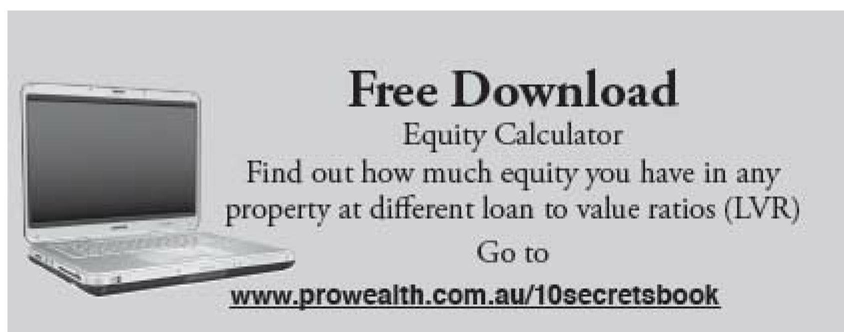
The big picture is now you have two properties, worth a combined $600,000 ($300,000 for each property). In ten years time, you would have a portfolio of two investment properties worth **$1.2 million dollars plus your home.**

Had you avoided mortgage insurance as advised by many banks and brokers you would have a portfolio of only one property worth $600,000.

You have effectively doubled your potential wealth simply by understanding the three letter acronyms of Loan to Value Ratio (LVR) and Lender's Mortgage Insurance (LMI).

Secret No. 6

Pay mortgage insurance. The professionals use less deposit per purchase and pay the LMI. This gives them maximum leverage by using the minimum amount of funds for each purchase and can result in the ability to buy two properties with the same equity that regular investors use to buy only one.



Using a line of credit to pay for your property

Using a Line of Credit to pay for your property.

A Line of Credit (LOC) allows you to pay the holding costs on your investment properties without using your cash or savings. Essentially a LOC can be established when you have left over equity between what you needed for your purchase and what the bank was willing to lend you. Let's revisit the earlier tables where we worked out how much equity might be available in our $300,000 home.

Table 1 - Amount of equity in our example home.

$300,000	80% LVR	85% LVR	90%LVR	95% LVR
Maximum Loan	$240,000	$255,000	$270,000	$285,000
Less Debt	$200,000	$200,000	$200,000	$200,000
Available Equity	**$40,000**	**$55,000**	**$70,000**	**$85,000**

We also know that we need to use a certain amount of equity for our purchase. Here's that table from earlier

Table 2 - Equity needed to purchase a $300,000 investment property.

$300,000 Property	With 20% Deposit	With 10% Deposit	With 5% Deposit
Amount	$60,000	$30,000	$15,000
Conveyancing/ Solictor & Council adjustments	$2,000	$2,000	$2,000
Stamp Duty (NSW)	$8,990	$8,990	$8,990
Lenders Mortgage Insurance (approx)	$0	$4,600	$6,300
Total	**$70,990**	**$45,590**	**$32,290**

We decided to take the maximum amount of equity from our home of $85,000 (table 1) and use the minimum amount of deposit for the purchase of two investment properties as shown in table 3.

Table 3 - Equity remaining after purchase of 2 properties.

Maximum equity from home	$85,000
Less new Property 1 (*5% Deposit, Costs and LMI*)	$32,290
Less new Property 2 (*5% Deposit, Costs and LMI*)	$32,290
Remaining Equity	**$20,420**

It's this remaining equity that we can ask the bank to establish as a Line of Credit. It functions much like a giant credit card.

- The bank tells you the limit, which in this case is $20,420.
- You won't pay any interest on the money unless you spend it.
- Unlike a credit card, there's no payment required when you do spend, so long as you still have credit available.
- The money is tax-free when you do spend it.

This means your line of credit can be used for virtually any purpose but we are going to focus on using it to help fund the holding costs of one of your new investment properties.

In the Property chapter, we talked about positive geared, cash flow positive and negative geared property, with negative geared property being the most common. This is where you may have had an out of pocket cost to pay for your investment.

To demonstrate how a LOC could be used to fund your investment, we'll assume the ***out of pocket cost is $80 per week per property.***

Remember, the goal of buying an investment property is to buy time. This allows the property sufficient time to grow in value to a point where it historically doubles in value. As you now know, this is usually a 7-10 year cycle.

Based on your budget, $80 per week for one property is affordable but you may struggle to find another $80 per week for the second one. This is where a Line of Credit can help. We are actually going to use our Line of Credit to pay this second $80 per week for as long as possible. Whilst the calculation is a

little more detailed than what we'll demonstrate, you'll get the idea. Firstly, you'll need to work out how much you need to cover the shortfall per year.

Table 4 - Annual out of pocket costs

Per Week Cost	$80
Per year cost (x 52 weeks)	**$4,160**

Then, because we will be taking this money from our LOC, we will be paying interest on it but only as we spend it.

Table 5 - Annual out of pocket costs

Amount of credit used per year	$4,160
Interest on money used per year (assuming 6% rate)	$250
Total amount of credit needed per year	**$4,410**

Now that we know how much of our LOC will be used over a year it's simply a matter of working out the number of years credit that we will have available.

Table 6 - No. of years available from equity

Total Credit Available *(from table 3)*	$24,420
Divide by the amount of credit used per year *(table 5)*	$4,410
Number of years available	**5.5 years**

As you can see, the LOC will be able to make the payment every year, including interest, for just over 5 years. Other options include:

- You pay part of the holding cost, say $20 per week on the second property and let the LOC pickup the rest
- You pay all of the holding cost whenever you can, only using the LOC during periods of low cash flow. For example, at Christmas or even if you lose your job temporarily.

Don't forget that over five years the rent will increase on the property which will reduce the holding costs as time goes on. After five years both properties may turn from being negatively geared to positively geared therefore not

costing you anything.

What happens when my LOC runs out?

This is a common question and relates to the fear of getting into debt. When looking at this situation many focus purely on the debt and forget about what would have happened to the property values over the 5 years.

By looking at table 7, you'll see that the properties have also increased in value, not just the debt. The growth in value of your home over five years will result in $135,000 of new equity and the two investment properties will have generated another $240,000 in equity between them. Your total equity position is now $375,000 and don't forget that you paid absolutely nothing from your own pocket to hold the second investment property for the whole 5 years!

Table 7 - Equity position in 5 years, assuming a 7% capital growth Rate.

Property	Home	2 x New Investment Properties
Initial value	$300,000	$600,000
Original Debt	$200,000	$600,000
Additional Debt after 5 years *(Deposit, Costs & LOC for one property)*	$85,000	$0
Total Debt	**$285,000**	**$600,000**
New Property Value after 5 years	$420,000	$840,000
New Equity after 5 years	**$135,000**	**$240,000**

Assumes no principal reduction made to home loan, interest only on the investment loan.

We recommend you setup a Line of Credit with your remaining equity whenever possible as it can also act as a safety net. For example you could use it to pay for both properties for a short period of time if you lost your job, could not find a tenant, interest rates go up or any other unforeseen circumstances occur.

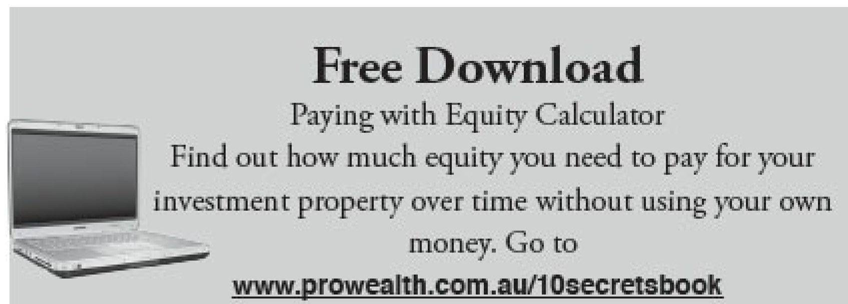
In summary a Line of Credit can really grow your portfolio much faster than what you could otherwise afford from your own pocket.

It's also an excellent way to hold more property if cash flow is an issue and an

ideal way to ride through the peaks and troughs of the market which buys time and time is what you need to obtain growth.

Secret No. 7

Debt can service debt. Professional investors use other people's money to build wealth and that's using debt to service debt! They don't rely on their own personal cash flow to finance their investment properties. They use other people's money – in this case the banks.



Cross securitisation

Cross Securitisation

Cross Securitisation (also known as cross-collaterisation) occurs when a bank lends against the total of your property values combined rather than individually. They can lend up to 95% (the LVR) of this value or more often they lend at their normal lending margin which is usually 80% (LVR) excluding mortgage insurance.

By cross-securitising your properties you are grouping your properties but can have as many loan splits as you like. Therefore your loans are separate but the securities are linked together.

Many people believe that because they have a separate loan statement for each loan their properties are not cross securitised. The only way to tell is to look in your mortgage documents that you signed when you first got your loan. Mortgage documents are that huge pile of legal paperwork the bank had you sign which you probably never read. In the documents there will be a section which names the property being used as security for the loan. If there are two properties listed you have a cross securitised loan. If just the one property is listed you may still have trouble in the future through the banks universal *'all monies'* or similar clause.

This is a clause somewhere in the mortgage contract that says the bank may recover money from any assets you have with them such as other properties, cash, shares etc if you default on the loan. This clause means the bank effectively controls any assets you have with them. So in essence it can have the same effects as cross securitisation.

The only way to limit the bank's control over your assets is to have each loan with a different lender. Let's cover what could happen if you keep all your lending with the one bank.

Assume you have the following properties-

Table 1 - Your property portfolio from your point of view

Property	Value	Debt	LVR
Home	$300,000	$240,000	80%
Investment Property	$250,000	$200,000	80%

If these properties (from table 1) were cross securitised, the bank would say that your total security value is $550,000 (table 2) and the total debt is $440,000. They will allow you to have two loan splits so you will still have two loan statements, one for $240,000 and one for $200,000. However they are secured by the total property value of $550,000. They do not recognise each property as a stand-alone loan, just one entire loan as shown in table 2.

Table 2 - Your property portfolio from the bank's view

Property	Value	Debt	LVR
Home + Investment	$550,000	$440,000	80%

Some advisers and certainly most banks will advise that you should cross-securitise your properties and therefore keep all your loans with the one bank.

Banks will always want you to have all your lending with them. They are a business and as such want as much business as they can get. They argue that by having all your business with one bank you will have benefits such as a lower interest rate (due to your overall lending exposure), less paperwork and a good rapport with the bank making future lending more favourable. Whilst these benefits can be true they fail to tell you the other options.

As far as interest rates are concerned most banks are very similar and having all you eggs in one basket does not necessarily mean that you will get a better rate by leaving all your lending with them. In reality all banks want your business and by spreading your lending with multiple banks you can still get the best rates in the market.

The paperwork is the same as you have a separate statement for each loan. As for rapport, will the bank be grateful for all your lending when things go bad?

The bank knows that it is a difficult task to leave by refinancing your loan especially when you have several properties with them. This is the position they want to be in - holding all the cards. It's difficult to do anything without

the permission of your bank and should your bank's lending policies tighten or interest rates rise, you will have a difficult and expensive task in refinancing.

When you get into trouble

The most important consideration when deciding to leave your lending with one bank (cross-securitise) or to use multiple banks, is giving due consideration as to what would happen should you default on your loan. This could be through losing your job, having a baby, getting injured and can't work, your tenant failing to pay rent or your investment property becoming vacant. All of these can affect your ability to meet your loan repayments.

Should this happen to you and you default (miss repayments) on your loan, having your properties cross-securitised is very dangerous. You are giving the bank complete control over your assets and should the situation worsen they can opt to place you into a *'mortgagee in possession'* situation to recover their debt. Now of course this could happen even if you had properties with multiple lenders but it's that lack of control you have by having them with one lender that makes cross-securitisation dangerous. Since the bank has control over all of your properties they can choose to sell one or both of your properties regardless of the one you defaulted on, as the decision is theirs.

This means the bank may sell your family home even though it's the investment property that you have defaulted on. The bank will sell whichever property it believes will recover its debt and both if necessary.

Had you spread your exposure across multiple lenders and struck financial difficulty you may choose to sell the investment property without defaulting on your home loan. The bank that has your home loan will be oblivious to what is happening on your investment loan. This gives you the control to sell the investment property rather than yous home.

Let's put this into a practical situation. We will use the same example properties that we used in table 1 and assume a few years have gone by and the properties have now increased in value.

Your home which was worth $300,000 has now increased in value to $340,000 and your investment property has now increased to $280,000 as shown in table 3

Table 3 - New increased property values (all loans with same bank).

Property	Value	Debt	LVR
Home	$340,000	$240,000	
Investment Property	$280,000	$200,000	
Total *(Cross Securitised)*	$620,000	$440,000	70%
Equity available 80% *(80% of $620,000 less $440,000)*		$56,000	80%

You decide to start a family and thought you could manage the repayments. You're down to one income and the investment property has just had its second repayment default as the tenants moved out and new ones don't move in for some time. You have however managed to stay up to date with your home loan repayments.

As far as your bank is concerned, you are in default on the investment property which means they can now charge a higher default interest rate, usually between 3 – 4% higher than your current rate. Since the properties have increased in value you decide to ask the bank to increase your loan to give you some extra funds *(equity of $56,000 as a line of credit in table 3)* to help offset the repayments until you have two incomes and a tenant again.

The bank that you have done your banking with for many years and was rewareded with all your lending will say NO, as your investment loan is in default.

You have now changed from a highly valued client to a risky and somewhat troublesome client and you'll now be high on the watch list for potential future problems. It will also tarnish your ability to get a loan increase in the future, even when you have two incomes and a tenant because of the payment default history on your investment property.

Remember, when cross securitised the bank considers your total lending exposure and repayment history to them, not per individual property.

Staying out of trouble

So what would happen if you had used two separate banks for your properties

and had the same situation?

Your investment loan would have still defaulted. However the bank with your home loan would have no knowledge of your investment loan default (as long as it had not been listed on your credit report). Since you have met all your repayments, you could ask this lender for a small increase in your loan of $32,000 which is equity from your home in table 4. This extra line of credit would repay your missed repayments as well as providing extra funds to get you through until two incomes and/or a new tenant are in place.

Table 4 - Your home with a different bank. You ask the bank for a Line of Credit

Property	Value	Debt	LVR
Home	$340,000	$240,000	70%
Total *(80% of $340,000)*		$272,000	
Line of Credit *($272,000 less $240,000)*		$32,000	80%

The bank should look favourably on this application because you have a strong repayment history with them and they have no knowledge of your repayment defaults on your investment property. You always need to control the decision-making process and by having loans with multiple lenders you retain maximum control over your assets.

Increased costs

Contrary to what the bank may tell you the costs can be substantially higher should you keep all your lending with one bank especially when you intend on building a property portfolio. The most common is when you want to borrow further funds. Using our original example we'll assume that you want to purchase another new investment property, being your third property. With the increase to the values of the original properties, you decide to go back to the same bank so you can access the equity to use as a deposit.

Table 5 - A third investment property purchased for $400,000. All properties with the same lender.

Property	Value	Debt	LVR
Home	$340,000	$240,000	
Current Investment Property	$280,000	$200,000	
New Investment Property	$400,000	$400,000	
Total *(Cross Securitised)*	$1,020,000	$840,000	82%

Your overall LVR would be 82% ($1,020,000 / $840,000) which means you would be liable for Lenders Mortgage Insurance (LMI) as you went over the 80% limit that we talked about in the LMI chapter.

Unfortunately, because you cross securitised the loans by going back to the same lender as your two current properties, the LMI cost is based on your complete portfolio of loans, not just the new one.

You would have to pay mortgage insurance on $840,000 which would cost around $8,000 depending on your bank's mortgage insurer as your entire portfolio is over 80%.

Had your properties been with different banks you could go back to each bank and ask them to release the equity you have in each property through a line of credit.

Table 6 - Your home, with bank 1

Property	Value	Debt	LVR
Home	$340,000	$240,000	71%
(80% of $340,000)		$272,000	
Equity from home		$32,000	80%

Table 7 - Your current investment property with bank 2

Property	Value	Debt	LVR
Home	$340,000	$240,000	71%
(80% of $340,000)		$272,000	
Equity from home		$32,000	80%

You have now released $32,000 from the equity in your home (table 6) and $24,000 from the equity in your current investment property (table 7) for a total of $56,000 without going above 80% and thus avoiding mortgage insurance.

The $56,000 equity will cover a 10% deposit plus purchase costs for your new investment property, as shown in table 8.

You could now go to a third bank and fund your third property at say 90% LVR by getting a loan of $360,000 (table 8).

Table 8 - Your new investment property with bank 3

Property	Value	Debt	LVR
New Investment Property	$400,000		
Loan (90% of $400,000)		$360,000	90%
Deposit Required (10%)		$40,000	
Purchase Costs		$16,000	
Total required to complete		$56,000	

Because the new investment property is with a different lender to your home and current investment, it’s the only one with a LVR higher than 80%. LMI would now only be payable on the new property and would cost approximately $4,500, a saving of $3,500. The cost savings can increase substantially as you build a larger portfolio but best of all, you retain control over each property with one bank not knowing what the other bank is doing.

Equity trap

Another problem with cross sercuritisation is something we call the ‘*Equity Trap*’. This occurs when one of the properties increases in value and the other property decreases in value when both properties are with the same lender. Let’s take a look at the original values of our properties.

Table 9 – Original cross-securitised position

Property	Value	Debt	LVR
Home	$300,000	$240,000	
Investment Property	$250,000	$200,000	
Total Cross Securitised *(Home + Investment)*	$550,000	$440,000	80%

Now let's assume that your home increases in value from $300,000 to $350,000 but for whatever reason the investment property decreases in value from $250,000 to $200,000 as seen in table 10.

Table 10 – Increase and decrease in values, new position

Property	Value	Debt	LVR
Home	$350,000	$240,000	69%
Investment Property	$200,000	$200,000	100%
Total Cross Securitised *(Home + Investment)*	$550,000	$440,000	80%

The overall LVR is still 80%. However, although your home has increased in value you cannot access any of the equity as your overall position is being dragged down by the decrease in value of your investment property.

This would mean that you would not be able to access any equity in your portfolio (that of your home) without paying mortgage insurance as your portfolio would have to go over 80% LVR.

Had the properties been with different lenders, you could have gone back to the bank with your home and asked them to 'top up' the LVR to 80% again giving you the cash out as a line of credit as seen in table 11.

Table 11 – Equity available in home if different banks were used

Property	Value	Debt	LVR
Home	$350,000	$240,000	69%
Total (80% of $350,000)		$280,000	80%
Equity Available		$40,000	

In this case the investment property is not even considered by the first bank as they have no control over it.

Keeping your loans separated to different lenders allows you to keep building your portfolio, provided at least one of your properties is improving in value. Decreases to the value of your properties will not affect your ability to borrow equity from the good performing ones.

This keeps you out of the cross securitisation *'Equity Trap'*.

Can I un-cross securitise my properties?

When we teach clients about problems with cross securitisation they tend to feel upset that the bank failed to tell them about these future problems and their first response is generally to want to break the hold the bank has over them.

Unfortunately, this creates even more costs!

Let's assume you've decided to "un cross-securitise" your loans by refinancing your investment property to another bank.

Firstly, bank A may charge you break costs to leave. This could range from a few hundred dollars to thousands in the case of a fixed rate loan or some non-bank lenders.

They will also charge you to revalue your home (a few hundred dollars) to ensure that by you taking your investment property to another bank, they still have adequate security for the money they have lent you.

They will want to make sure that you home's LVR will not exceed 80% and if it does they'll insist that you pay down the mortgage to this level.

Bank B could also charge you an application fee, ongoing fees and much more as we discussed earlier.

This is why it's extremely important to setup your loan structure correctly from day one by using an experienced investment property lending specialist. If it is indeed too late and you already have a few properties with the one bank, you may have to wait until there is sufficient equity in each of them to be able to move each property to a new lender.

Secret No. 8

Professional property investors avoid cross securitisation whenever possible by having a different lender for every loan. Cross securitisation

gives a bank far too much control over your properties and puts all the power in the hands of the Bank.

Remember, control is one of the most important aspects of any investment, including property.

Chapter 5

Tax & asset protection

Tax and Asset Protection

Protecting your wealth now and in the future are factors that apply to every person. The accumulation of assets for enjoyment, income or retirement is pointless if the assets are lost as a result of litigation or, if upon sale or death, part of the assets are eroded away by taxes.

Many investors and families often overlook the protection of assets.

Even families with modest assets need to devote some energy to managing their assets properly. All too often the main effort seems to be minimising income tax and /or maximising current or potential social security entitlements.

The main goal should really be to maximise the family's wealth, to protect its assets and to provide financial security for members of the family. A number of crucial factors need to be considered when reviewing what type of structure should be used when buying the Property.

Factors to consider would include:

• Who should have the right to receive income and/or capital gain, both now and in the future?

• Are you a high-risk person where the asset should be protected against possible future creditors?

• Are there family concerns as to who should own the asset or receive income from it in the future?

• Are there statutory requirements governing which structure should own the investment?

Ownership Structure

How you structure your investment will have a significant impact on your potential returns and future growth. Many people rush out and buy a property then ask their accountant about how they should structure the purchase - this is most often too late. Effective structuring can allow you to own nothing but

control everything. This means that you will be able to enjoy the benefits of asset ownership but with the knowledge that it will be extremely difficult for creditors to take your assets away from you. This can only be achieved if you establish your structure BEFORE you invest.

Amongst other things, a good accountant should be able to tell you:

- The difference between buying in your own name, joint names, a company or a trust.
- The different types of trust structure and how to use them effectively to protect your assets.
- How a self managed super fund may be of assistance to you.

One of the best books we've seen on tax and asset protection is *'How to Legally Reduce your Tax'* by Ed Chan and Tony Melvin. We highly recommend you take a look at this book for greater detail on this area. When purchasing a property, your accountant will generally advise you to purchase the property in one of the following structures.

Purchasing as Joint Tenants (Equal shares)
This is the most common form of property ownership and is generally a husband and wife each having a 50% ownership.

It is a structure most commonly used by first time investors. The advantage is that this structure is free to establish and is easy to understand and operate. The disadvantage is that tax deductions are limited to the percentage of the ownership you actually own. As a simple example, if there are $12,000 in deductions for a property the husband and wife can only claim $6,000 each. If the husband was the only income earner this limits his ability to claim maximum deductions whilst the deduction to the wife would be wasted as she has no taxable income.

Purchasing as Tenants in Common (in unequal shares)
To get around the above problem many people have been advised to put the majority percentage ownership into the name of the highest income earner, For example 99% Husband, 1% Wife.

The long term problem is that as the property becomes positively geared or is sold many years down the track, the income or profit is allocated as per the

ownership percentage and could result (in this case) in the husband paying more income tax or increased capital gains tax.

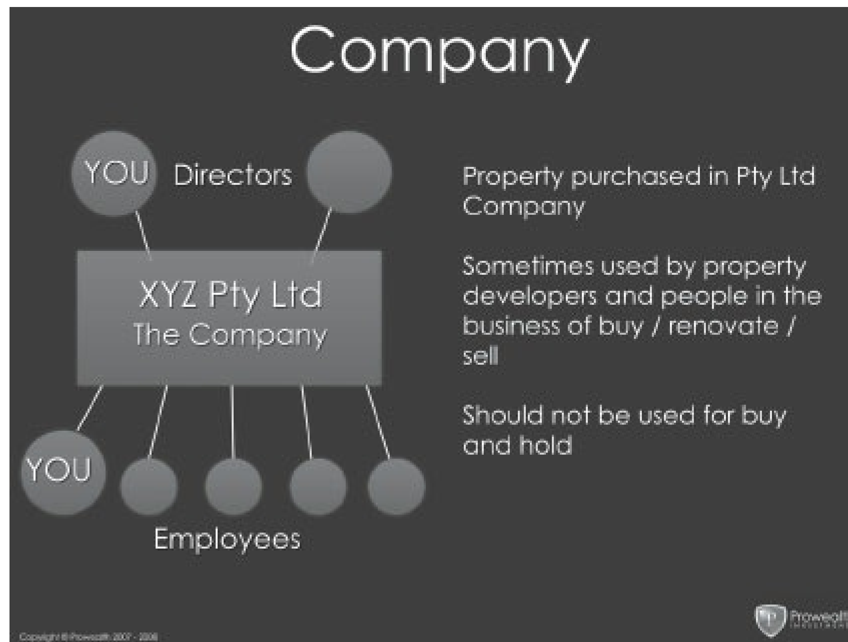
Company Structures

A company is a completely separate legal entity which is treated differently to an individual.

A company is subject to different tax laws. One of the main differences is the tax rate. A company pays tax at 30% (2009) whether it earns one dollar or a million dollars. This could be of benefit to an individual paying the highest marginal rate of 45% (2009). It is

generally recommended that a company structure be avoided if your investment strategy is to purchase a property and hold it for long-term growth. It is likely that a company will end up paying more capital gains tax if you sell your investment property as, unlike other structures, a company pays capital gains tax on the entire growth of a property when the property is sold. Other structures will only pay the tax on 50% of the growth.

While generally not the most effective structure for an investor looking for long-term growth, a company can be useful for property developers or people in the business of renovating and selling the properties. Investors falling into this category are not eligible to receive the 50% capital gains tax exemption we mentioned earlier. Instead the profit they make on their project is reported as income in their tax return. By operating as a company the tax payable on the development will be limited to the company tax rate of 30%.



Trust Structures
A trust can be one of the most effective structures for investors and business owners alike. Unfortunately they are commonly misunderstood. We find when we first speak to our clients about structures most of them have a fair understanding of what a company is. They have heard friends and colleagues talk about these all their lives. They understand that a company is an entity that they control which is treated separately from themselves. When we mention the word *'trust'* there is often silence or a look of fear. This doesn't need to be the case. By obtaining the correct advice about setting up and using a trust you will find that they are not so daunting after all.
A trust is a set of legal documents. These documents state that someone "the trustee" will look after an asset "the trust assets" for the benefit of someone else "the beneficiary".

There are many different types of trusts and they are all used for different purposes. It is crucial to obtain advice about which type of trust suits your circumstances before setting up the trust. No matter which type of trust your accountant or solicitor sets up for you, just remember that it is based on the concept of a trustee looking after an asset on behalf of a beneficiary.

"I don't want someone else looking after my assets?"

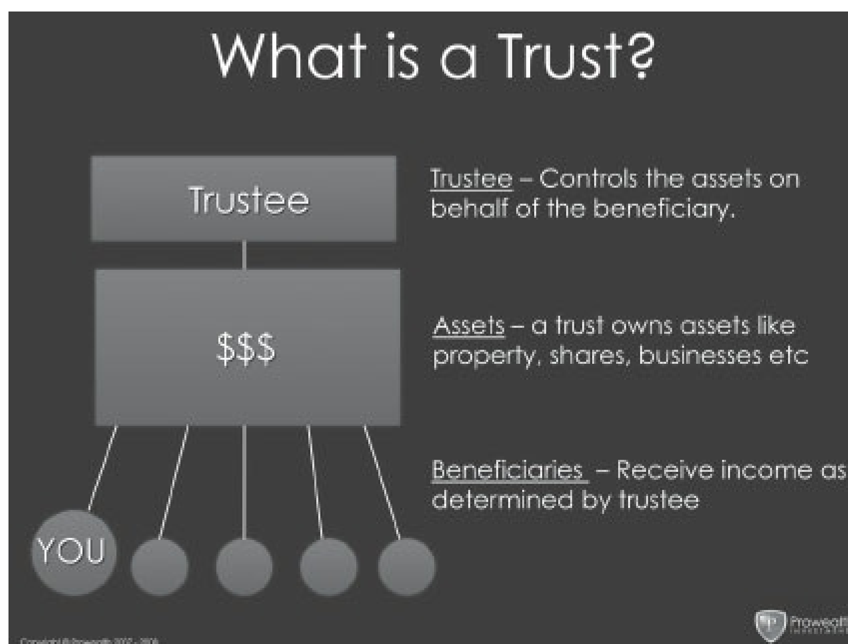
Don't worry. The trustee and the beneficiary can both be you. So a trust could

be YOU looking after YOUR assets for YOUR benefit.

The Austrlian Taxation Office (ATO) has been very active in recent years in reviewing trusts.

The ATO is concerned that some trusts are established purely to provide tax advantages to the taxpayer and do not offer any real commercial benefits. The ATO have indicated that it will deny some or all of the tax deductions that have been claimed by these trusts. We are not suggesting that you no longer consider using trusts. There are still trusts available that will pass an ATO review provided they are used correctly. We strongly recommend that if you do want to use a trust for property investing that you discuss with your accountant and/or solicitor how the trust that they will establish for you will satisfy any ATO scrutiny.

A Trust Structure



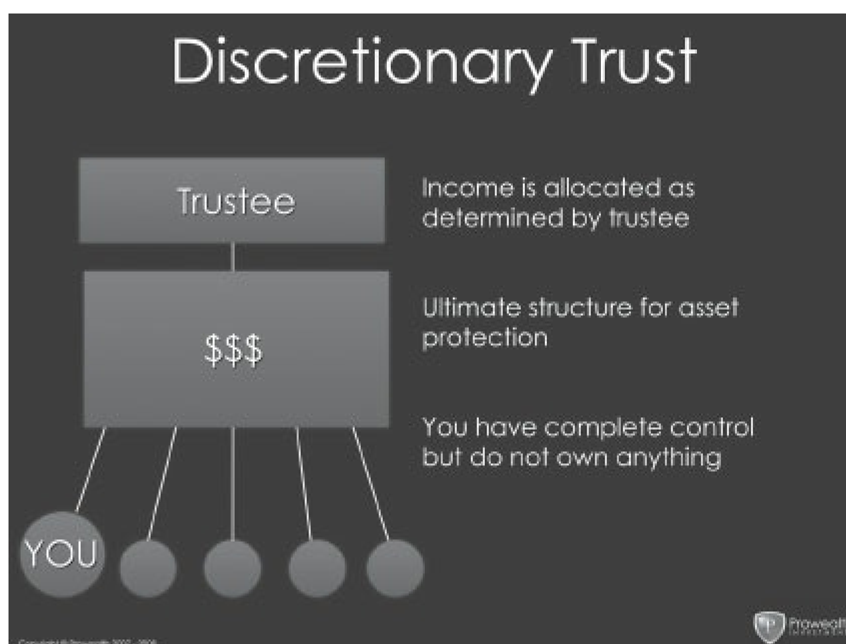
You’re probably thinking “*why am I going to this much effort for ME to look after MY asset for MY benefit?*”.
The main reason is asset protection. By taking on the role of trustee and beneficiary and holding your asset in a trust, what you are really doing is moving the ownership of the asset away from yourself. If you are ever sued

personally for any reason it is difficult for the other party to take your assets away from you because the asset is owned by a trust not by you. The beauty is that you enjoy all the benefits of owning the assets without the risk that someone will take it away from you. Another reason that property investors have used trusts in the past is that traditionally there were significant tax advantages available.

Below is a brief outline of some of the more commonly used trusts:

Discretionary / Family Trust

A discretionary trust is probably the most flexible trust and arguably is the trust that offers the most secure asset protection. At the end of each year the trust calculates its net profit i.e. the difference between the income it has received, such as rent, less any expenses it has paid, such as rates and repairs. The trustee then decides how it will distribute this income. The trustee can use their '*discretion*' and distribute to different beneficiaries each year.

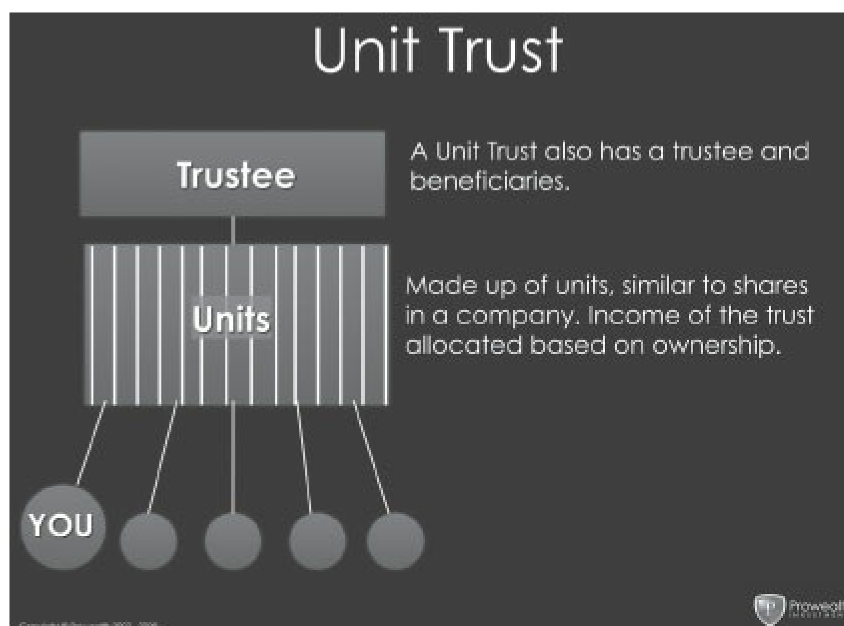


Discretionary trusts are commonly used by investors who purchase properties that are positively geared. They are not a good choice for investors with negatively geared properties. When a property is negatively geared its expenses are greater than its income. This is called a net loss. Unfortunately

any losses made by a trust cannot be distributed to beneficiaries. This means that the investor is unable to obtain the benefits of negative gearing in their own tax return if they invest using a discretionary trust.

Unit Trust

A unit trust is made up of units of ownership. This is similar to a company that issues shares to its owners. In a '*unit*' trust the owners are called '*unit*' holders. Each '*unit*' holder is entitled to any income and capital generated by the trust in proportion to the number of units owned. For example, if mum and dad both own 50% of the units of a unit trust, each year they would both be entitled to 50% of the income and capital generated by the trust. Unlike a discretionary trust there is no flexibility to change the way the income and capital are distributed each year.



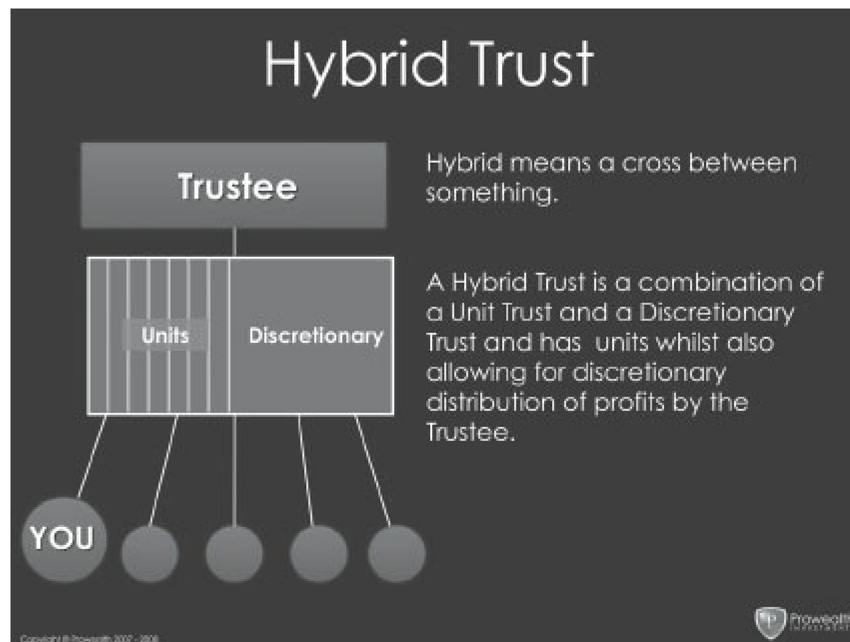
Unit trusts are commonly used when two or more unrelated parties purchase a property together. Care must be taken if there are to be more than 20 unit holders as there are additional reporting requirements placed on the trust.

Hybrid Trust

As the name would suggest, a hybrid trust is a mixture of different types of trusts. It is normally a trust that contains elements of both discretionary trusts

and unit trusts.

In years gone by these have been very popular amongst investors purchasing negatively geared properties as they offered the asset protection of a discretionary trust along with the ability to transfer the benefits of negative gearing to the individuals tax return.



These are the trusts that are undergoing a substantial amount of review by the Australian Taxation Office for their use. The ATO are concerned that investors are using hybrid trusts for the primary reason of gaining a tax advantage and not for any other commercial reason.

The ATO has stated that it will deny some or all of the deductions made by a hybrid trust if there is not a commercial reason for using the trust. For this reason we advise that extreme care is taken when setting up and investing through a hybrid trust. We believe that if hybrid trusts are used correctly they will satisfy any ATO scrutiny as well as providing the asset protection advantages that property investors require. You just need to ensure that your accountant or solicitor is fully up to date with how to use these trusts.

Bare Trust

A bare trust or security trust is a type of trust that operates differently from the

other trusts we have discussed. In a bare trust the trustee must follow the direction of the beneficiary. Some bare trusts do not have to have names and they were traditionally used when the purchaser did not want others to know who they were.

Today bare trusts are commonly used when a self managed super fund borrows to purchase an investment property. This was discussed in detail earlier in the book.

Depreciation

When considering making an investment property purchase decision depreciation can often be overlooked and is often misunderstood by property investors.

While many investors consider location, purchase price and tenanting ability when contemplating an investment property purchase they often overlook depreciation as an important factor. Depreciation can aid cash flow resulting in the investor having thousands of additional dollars each financial year.

Our tax legislation lets you claim a deduction for the wear and tear on an investment property each year. We are alarmed at the number of property investors that we see who have not been claiming this often substantial deduction. More often than not the accountants who prepared their tax returns had not explained this benefit to the investor. If you are concerned that you may have overlooked a deduction for depreciation in your previous tax returns, it may be possible to lodge a new return called an '*amended return*' to claim those deductions now.

Many investors don't realise that it is not necessary to lodge a tax return to receive a refund from an investment property. Instead, these costs can be refunded throughout the course of the year in the investor's pay cheque.

To take advantage of this benefit, you need to lodge a form called a *'Income Tax Withholding Variation'* or ITWV. This is a mini tax return where you estimate what your income and expenses will be for the next 12 months. After reviewing your estimates the ATO will then write to your employer and instruct your employer to deduct less tax from your pay each pay cheque. At the end of the yea you still lodge a tax return as normal. This will take into account

the difference between the income and expenses you estimated on your ITWV and your actual income and expenses for the year.

The tax you save will vary on which property you buy and the ownership structure in which you make the purchase. This greatly improves your cash flow and lowers the cost to hold your property on a weekly basis.

To maximize tax depreciation benefits there are several factors a professional property investor considers -

The age of the property
Both new and older properties will attract some depreciation deductions, although a property with an age between 1-20 years will provide higher depreciation than an older property.

The type of property
If the property is part of a strata complex or community title development, each unit is entitled to claim common property benefits in addition to the unit's depreciation benefits. This can add a substantial amount of deductions in large-scale developments that feature lifts, pools and entertainment areas for the tenants. More common property in a development usually results in higher depreciation claims.

The amount of plant and equipment
These are generally inclusions and are items that can easily be removed from the property, as opposed to items that are permanently fixed to the structure. Items such as light shades, stoves, air conditioning systems, blinds, carpet and ovens are the most common and can be depreciated at a higher rate. This adds significantly to the depreciation claim. More inclusions generally means higher depreciation claims.

Secret No. 9

Considering the tax implications of a purchase. Rather than debate house versus unit, they look at the bigger picture and how tax benefits may aid to lower the holding cost of a property. Professional property investors seek expert accounting advice before they purchase an investment property. This

allows them to legally minimise tax and put appropriate layers of protection around their assets so they are protected for the long term benefit of their family.

Free Download

Find out how much tax you paying

Go to

www.prowealth.com.au/10secretsbook

Chapter 6

The final secret

Secret No. 10
The Final Secret

Professional investors take firm decisive action once knowing the facts. They understand all that they have just read, then immediately take action following the guidelines and principles they have just learned.

You're now out of excuses so it's time to get started.

We'll see you on the road to financial freedom.....

Chapter 7

10 secrets recap

10 Secrets of Professional Property Investors Recap

Secret 1

Don't pretend that it will all be ok. Professional investors understand that they cannot rely on friends, family or the government to achieve what they want when they stop work or retire. By identifying their mental mooring lines early, they can put plans and goals into place then work toward achieving them, taking advice only from those that have achieved what they want to achieve, not those who stand on the sideline.

Secret 2

Time. Professional property investors understand that what they are really buying is time. They know that if they can hold a property for a property cycle it will likely double in value, just as it has since the 1960's. They put plans and strategies in place to make it to the next property boom where they reap the rewards.

Secret 3

Cost to hold. Professional property investors understand that the cost of holding onto their investment properties is the most important factor in considering which property to purchase. That's why they use different strategies at different times in the property cycle.

Secret 4

Self managed super. Professional property investors use property as the vehicle to financial freedom. With changes to legislation allowing SMSF's to borrow money, an investor can now leverage available super into a higher valued asset of real property in a low tax, asset protected environment.

Secret 5

Just as you would seek the advice of a solicitor if you wanted to sue somebody and seek an accountant for tax advice, professional property investors use specialist investment property lenders to ensure that the finance strategy

applied is the best one for current and future goals of the investor. They know that the person behind the counter at the bank is unlikely to understand their future goals and the advanced finance strategies that will be applied to achieve them.

Secret 6

Pay mortgage insurance. The professionals use less deposit per purchase and pay the LMI. This gives them maximum leverage by using the minimum amount of funds for each purchase and can result in the ability to buy two properties with the same equity that regular investors use to buy only one.

Secret 7

Debt can service debt. Professional investors use other people's money to build wealth and that's using debt to service debt! They don't rely on their own personal cash flow to finance their investment properties. They use other people's money – in this case the banks.

Secret 8

Professional property investors avoid cross securitisation whenever possible by having a different lender for every loan. Cross securitisation gives a bank far too much control over your properties and puts all the power in the hands of the Bank.

Remember, control is one of the most important aspects of any investment, including property.

Secret 9

Considering the tax implications of a purchase. Rather than debate house versus unit, they look at the bigger picture and how tax benefits may aid to lower the holding cost of a property. Professional property investors seek expert accounting advice before they purchase an investment property. This allows them to legally minimise tax and put appropriate layers of protection around their assets so they are protected for the long term benefit of their family.

Secret 10

Professional investors take firm decisive action once knowing the facts. They understand all that they have just read, then immediately take action following the guidelines and principles they have just learned.

You're now out of excuses so it's time to get started.

Chapter 8

10 important questions to ask your advisor

10 Important Questions

Listed below are the 10 most important questions that should be asked when deciding whether to invest in any asset. If you are seeing a number of companies and/or financial planners, it might be an idea to use this as an agenda to your meeting as it will save you time, provide structure and help you determine the most suitable business partner for you.

1. What do you know about the company you're talking to and how long has it been established?

2. Can the company and staff be contacted easily and does it have a physical office you can visit to get advice?

3. Does the staff of the company invest their money in the same asset classes as it advises their clients e.g. property / shares / superannuation? Just ask them.

4. Can the company discuss with you property, finance and tax implications all under the one roof or will it refer you out to third parties with conflicting advice?

5. How much does the company charge to help you? Does it charge an annual fee or ongoing fee or retainer?

6. Do you have to pay the company up-front before you get a result?

7. In the case of property, does the company offer you a choice of property both locally and interstate? What criteria does the company use to select property to offer clients?

8. In the case of property, can the company provide independent price and rental valuations as to market value?

9. In the case of property, has the company worked with a particular builder or developer before and can it show examples of previous work?

10. In the case of property, can the company provide you a list of developments that have been sold to past and current clients?

Additional Questions

Make a note of additional questions to ask them here.

Chapter 9

About Prowealth Investments

About the author

About Prowealth Investments

Your Property Investment business partners

Over the past decade, we have been guiding our clients on the path to financial freedom through property. This 'holding your hand' approach has seen many of our investors purchase multiple properties at their own pace as well as paying their home loans off in record time.

We have always taken the approach that for us to succeed we must make sure you are successful. Successful investors surround themselves with people who have more knowledge than themselves in this field. They gain knowledge and are guided through the whole range of property investing options by people who actually do it themselves.

Every member of the Prowealth team owns investment properties – in the same locations and developments as our valued clients.

We like to think of ourselves as your business partners in building a strong financial future for you and your family, by utilising our extensive knowledge in the full range of investment property options.

Within the company, we also offer full specialist investment property lending through our Prowealth Money division and complete accounting, tax, asset protection and self managed super service through our Prowealth Accounting team. For more about Prowealth Investment's complete range of services visit -

www.prowealth.com.au

or call

1800 13 22 64

About the authors

Daniel Goodwin
Director of Prowealth Investments
Director of Prowealth Money

Daniel Goodwin is one of the Directors of Prowealth Investments and Prowealth Money. He is also a licensed real estate agent and holds a degree in Business from the University of Newcastle. At 31 years of age, he has bought, traded and held just over 1.7 million in residential property in the past 5 years and he hasn't stopped. Daniel previously owned two Century 21 franchise offices at Terrigal and Erina on the NSW Central Coast and was awarded Century 21 New South Wales Rookie of the Year in 2004. This added to an already impressive list of awards including the Century 21 Masters Club, Auction Golden Gavel, Platinum Sales award and his Terrigal Office was a finalist in the Central Coast Business Awards for 'Best Real Estate Office 2004'. This solid real estate background means Daniel can provide all the answers when it comes to residential property investing. Foreseeing the need to bring all aspects of property investment 'in house', he formed specialised investment property finance company called Prowealth Money in 2007 with fellow Directors and contributing writers Len Goodwin and Matt Woodards. In 2008, after researching effective tax structures for wealth building, he also brought tax and asset protection services 'in house' with the formation of the Prowealth Accounting division, headed by contributing writer Steven Paul.

"To be a successful investor, you need to surround yourself with the most knowledgeable and skilled people. Hence the reason to bring finance and accounting services in house – I want to make sure our clients receive the right advice on these crucial areas of investing".

Daniel has also appeared in 'Your Investment Property' Magazine on the important issue of cross securitisation of loans and has been interviewed on Central Coast radio station 2GO about the new laws relating to self managed super funds. He also records and produces the entire range of audio CD's, DVD's and software for Prowealth's educational products. As an avid property investor, Daniel actually follows his own advice (something that can be rare in this industry) and is happy to share his stories with his clients. Daniel also speaks and presents at all Prowealth Investments' seminars.

Contributing Writers

Len Goodwin -

Director of Prowealth Investments
Director of Prowealth Money

Len Goodwin founded Prowealth Investments in 1994. He started the business because he is very passionate about property and he couldn't find any one company that could help and assist him with all his property investing needs. Len has used most of the strategies himself in property investing so therefore is teaching what he has experienced first hand. To date Len has helped well over 1300 clients into the many forms of property investing and trading. Len is a licensed real estate agent and business coach. He has a Diploma in Business Management and Marketing, a Diploma in Financial Services and is a certified finance lender with many of the major lending institutions. Len started his first business at the age of 16. Since then he has had over 28 years of experience in owning, operating and developing various businesses. Len understands the importance of 'doing it right' for his customers so that long-term relationships can be built with them. This has been his philosophy for Prowealth Investments from day one.
"I love what I do and it is rewarding when you see the same clients coming back time and time again to get us to direct them into the next stage of building their portfolio. I now have my clients' children attending our workshops and they are fast becoming the property investors of the future".

Matt Woodards

Director of Prowealth Money
Matt has been in the finance industry for 20 years, starting out with the Commonwealth Bank and later with St George Bank. As a former bank manager, he has worked in NSW, ACT, QLD and SA and has seen all types of finance applications. Matt specialises in residential home loans, including finding the right lending structure but has also had extensive experience in leasing/equipment finance, commercial loans and development/construction finance. After running his own business for 5 years, Matt joined forces with Prowealth Investments to form Prowealth Money, looking after the lending interests of the Prowealth Investments' client database.

Steven Paul

Director of Prowealth Accounting
Steven has been advising property investors and small business owners in the areas of tax and accounting for over 13 years. He is a member of the Institute of Chartered Accountants in Australia, a registered tax agent and also holds a Bachelor of Commerce from the University of Newcastle. Steven is an active property investor and is passionate about helping his clients accumulate and protect their wealth. He has worked in both large and small firms in Sydney and also spent 18 months working as an accountant at a high profile London university.

In 2003, Steven established his own business to offer his expertise to clients. Then in 2008, Steven joined his business with the Prowealth group to establish Prowealth Accounting. Prowealth Accounting is a specialised accounting practice that assists property investors to build and protect their wealth. This is achieved by continually staying abreast of changes in tax and super legislation and ensuring their clients are in a position to take advantage of any opportunities that may arise. Prowealth Accounting believes that its clients are best served by giving them an understanding of how the law affects their individual circumstances. This allows our clients to make informed decisions about tax, asset protection and superannuation. Of course, Prowealth Accounting also strives to provide its clients with the best possible tax outcome at year end. Outside the office, Steven’s favorite pastime is spending time with his family. He is also a keen supporter

Chapter 10

Special offers for readers

Special Offer for readers

Offer 1

Mail this coupon to Prowealth Investments and we'll arrange a complimentary appointment for a personalised property, finance and tax strategy **worth up to $750** absolutely free.

Prowealth can meet with you at your home, business or via telephone conference to discuss your personal situation and how you could become financially free through investment property. It will be the most valuable hour you will ever spend.

Simply complete the form below and we'll contact you to make arrangements -
Mail to - Prowealth Investments
PO Box 996 Gosford NSW 2250
or Fax to - 02 4322 2247

Your Name ____

Phone ____

Email ____

Mailing Address ____

Special Offer for readers

Offer 2

Mail this coupon to Prowealth Investments and you'll receive a complimentary audio CD, DVD, sofware or book from our educational range **worth up to $119**. Please allow up to 3 weeks for delivery.

Mail to - Prowealth Investments
PO Box 996 Gosford NSW 2250
or Fax to - 02 4322 2247

Your Name ____

Phone ____

Email ____

Mailing Address _____________________________________

Also Available

Prowealth Seminars and Educational Products.
We believe that the key to any successful investment is knowledge and information. We back this statement by holding regular property investment information nights for new and existing clients. We discuss various topics on property investing and keep you up to date with any new trends or taxes that will affect property investors. We also have a range of CD's, DVD's and specialised software that will continue your education long after you've left the seminar.

Visit our online store at www.prowealth.com.au and see how you can continue your property investment education from the comfort of your lounge room or while in the car.

Don't forget

Sign up for free e-mail newsletters, special offers and alerts. Join our hot list at

www.prowealth.com.au

Prowealth TV

www.youtube.com.au

Search for the channel

"Prowealth Investments"

Subscribe for free video news, lessons and tips.

Table of Contents

Front Cover 1
Title Page 2
Copyright 3
Dedication 5
Contents 6
1 Introduction 7
2 You 9
3 Property 18
- 3.1 A history of property 19
- 3.2 Property gearing strategies 29
- 3.3 Other strategies 35
- 3.4 Buying ‘off the plan’ 38
- 3.5 Using your super to buy an investment property 42

4 Finance 57
- 4.1 Bank, broker or specialist investment property lender? 58
- 4.2 LVR, LMI and DSR 61
- 4.3 Using a line of credit to pay for your investment property 69
- 4.4 Cross securitisation 75

5 Tax and asset protection 86
6 The final secret 98
7 10 secrets recap 100
8 10 important questions to ask your advisor 104
9 About Prowealth Investments and about the authors 107
10 Special offers for readers 112