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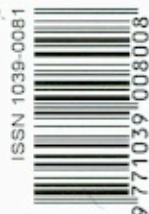
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Protecting

We've just been hit with yet another rate rise; there may be more on the way. Never fear – **Chris Gray** shows how you can insure yourself against changes in the economy or property market and be prepared for anything

With some property markets rising, some falling, interest rates at their highest levels in over 11 years and the possibility of more rate rises to come, many homeowners are wondering if they could have planned their property purchases and mortgages better.

But this isn't the time for owners to stick their heads in the sand. I, for one, can't afford any changes in the market to have a significant effect on yields and returns. As a professional property investor and expert on *MyHome TV*, my business and investments are tied up in this very market. I'm borrowing millions to finance my portfolio, and have too much to lose!

Developing a strategy to buffer external forces is crucial. A carefully planned property purchase and overall investment strategy can be immune to market and economic changes.

The three common external forces that can affect you most are:

- Increases in interest rates, which increase your costs
- A decrease in rental demand, which can mean less income
- A slump in property prices, meaning a decline in your equity

Let's see what you can do about them.

Buy well – the most important step

If you're an investor, you're very likely enjoying rising rents right now, but what

happens when vacancy rates rise? Will you be able to afford to keep your property?

Buying property well in the first place is probably the best way to counteract this. Buying well means buying property that will always be attractive to renters.

The property needs to be in a good location, and renovated so that it's clean and pleasant to live in. Ask any renter and they'll tell you that 99% of properties are so dirty and unloved they wouldn't let an animal live there. A complete revamp isn't always necessary – paint and carpet

Take the sleep test: if a few interest rate rises are going to keep you awake at night, then fix

will often transform the worst property into a reasonable one that will almost always rent.

Physical factors to look for when researching properties are good-sized bedrooms, off-street parking, good positioning and a uniqueness that sets the property apart from others in the street. These will ensure the property grows in value and desirability.

Other important things are proximity to public transport, leisure activities (parks, beaches and lakes), businesses and schools.

Buying well also means paying at, or below, the property's value. I can't stress enough the importance of having a home valued before you sign the contract.

I've seen so many people make excellent choices when buying their own home but poor choices when buying an investment property. When buying a property for themselves, they spend months comparing one home and its price against others, but they spend almost no time on the search for an investment property.

As an investor, you're opening a lifetime's savings on a property, so make sure you don't make a mistake. Without a valuer, you might agree to pay \$550,000 for a house that's only worth \$520,000 – and which might be worth less in the near future if you're put in a forced sale position. But with a valuation report in hand, you have enormous bargaining power with the vendor and agent.

Protect yourself from rising interest rates

We've had six interest rate rises in the last two years, the most recent just in February. Experts say another one could be on the way soon. To add to financial woes, the major banks in Australia have all increased their standard variable rates outside the official cash rates set by the Reserve Bank of Australia.

For most property owners, a mortgage is the biggest cost of owning a property

yourself

in challenging times

and far outweighs any other cost. A 1% rise adds \$5,000 in interest to a \$500,000 mortgage. When a property is already negative geared, that's a lot of extra money.

Are fixed-interest loans the answer? While they eliminate the worry about rate rises in the short term, this option may cost you more in the long run. As no one knows where rates will head in the future, banks add a premium to fixed-interest loans to ensure they won't be out of pocket. It's like paying for an insurance policy. Sticking with a variable rate should be cheaper, but then you're likely to worry about short-term rises. Another disadvantage of fixed loans is that if you wish to refinance with another bank to access more equity, it may cost you to break your agreement early. Take the sleep test: if a few interest rate rises are going to keep you awake at night, then fix.

If rate rises are still giving you financial stress, another option is to switch to an interest-only loan but continue to make the same monthly payments (principal and interest). The principal is seen as an additional repayment that can be withdrawn later or used to cover additional interest if you struggle to make the minimum repayment down the track.

Refinance your mortgage

If you have a \$500,000 property and a \$250,000 mortgage, miss a few payments and the bank may well come looking for



Chris Gray

its money, forcing you to sell if things aren't resolved. It's not something you can foresee, but it's a reality for many mortgagees who are at their borrowing limit in the current climate of rising rates. Other factors can also contribute. I can't count the number of people who have suddenly suffered from a serious injury and have been unable to work and therefore unable to pay their mortgage.

Make sure this doesn't happen to you. You can get out of this kind of financial stress by increasing your loan facility and creating an emergency buffer zone. This is a good idea even for those who have spent the last 10 or 20 years paying down their mortgages. A separate line of credit could become a life saver if used properly. For a \$500,000 property, the bank gives you an 80% loan or \$400,000. You would still owe the same \$250,000 as before, but you would have a separate facility of \$150,000. If you did lose your job, interest rates rose, rents dropped or there were some other disasters, rather than being a forced seller, you could use that spare equity to pay the interest on the \$250,000 loan.

Refinancing in this way is similar to increasing your credit limit on a credit card – so you need to be disciplined. Taking this step shouldn't cost you a cent if you don't withdraw any of the money. But it will give you enormous flexibility if times turn tough. You may have to pay an administration or valuation charge, but it will be tiny in comparison to the protective effect it gives you. You could think of it as an insurance cost. Your debt would be increasing but at least you wouldn't be forced to sell in a hurry and would still have somewhere to live.

Create instant equity

Even if you're mortgaged to the limit, you can create instant equity through some quick renovations. You could then borrow against the equity that will give you an emergency buffer zone to cover unforeseen expenses in the future. Consider the following property improvements and then ask the bank to re-value your property:

1. A fresh lick of paint does wonders to any property
2. Strip the floorboards or re-lay some carpet – a few thousand dollars makes the world of difference
3. Tidy the garden and repaint the fence
4. Install new curtains or blinds
5. De-clutter and sell off anything you haven't used for 12–24 months



Chris's top 10 tips to maximise your equity – fast

- 01 **Be prepared and act early** – you'll have more time to put an emergency plan into action.
- 02 **Pay for expert advice** – sometimes you have to spend money to make money.
- 03 **Always have an emergency buffer zone, be it cash, equity, credit cards or a parent** – weigh it up against the cost of being a forced seller.
- 04 **Ask your bank or broker about your ability to refinance to create a buffer zone.**
- 05 **Create instant equity** with some simple renovations.
- 06 **Remove the emotion and concentrate on the numbers** – numbers give the true picture.
- 07 **Speak to other investors** about what they do.
- 08 **Look after your tenants and property managers.**
- 09 **Read more books on the subject.**
- 10 **Buy well** in the first place.

A carefully planned property purchase and overall investment strategy can be immune to market and economic changes

6. Replace the kitchen cupboard doors – the 'shell' is often fine and doesn't need replacing

Re-sign your tenants

Once leases have gone over their initial six- or 12-month term, many landlords are happy to continue letting the property on a month-by-month basis. But if you're worried about potential mortgage stress, consider tying your existing tenant down to a new 12-month agreement. This will guarantee your rental income no matter what happens to interest rates.

To maximise your rental income, consider renting out your property on a 12-month lease from summer to summer – especially if it's near the water. There's greater demand for property on a sunny day in summer than a rainy day in winter – which pushes up rental prices.

Develop some good habits

There are many things you can do beyond your property to protect yourself against market forces. One is to create a realistic personal budget and stick to it. It's important that you're living within your means outside of your investments and mortgages. No matter what you earn, you'll always spend it if it's sitting in your account, so work out what is reasonable to spend and put the rest in a hard-to-withdraw savings account. Transfer the money the day you get paid.

Information is power, so start reading more books, magazines and newspapers. This will keep you up to date with government, economic and market changes, so you can foresee dangers and are less likely to be forced into a sale. Many people's financial stress could be avoidable but they simply don't know what's possible.

Borrowing large amounts of money and investing in property can be risky if you don't know what you're doing, so make sure you get advice from qualified mortgage advisors, accountants and solicitors. The best ones are often those who invest in property themselves, as they understand the bigger picture. **YM**

Chris Gray is the property expert on Channel 9's MyHome TV and author of Go For Your Life: How to Turn Your Weekdays into Weekends Through Property Investing. He builds property portfolios for property investors – finding, negotiating and renovating properties on their behalf. For more information and to read chapters 1–3 of his book for free, go to www.goforyourlife.com.au