Squirrel

The beginner's guide to property investing

Keen to get into property investing?

Owning investment property isn't like winning Lotto. The not-so-secret truth is that successful investors put quite a lot of energy into making their investments work for them.

If you're into property investing you're probably already pretty financially savvy, so what can we offer? Quite a bit actually. Plus, we can support you when things don't go your way.

So before you get carried away with visions of taking over the world, soak up all the knowledge you can (and impress your friends with how clever you are).

Right, let's get into it.

Contents

Why invest in property?

You may have heard people talk about New Zealand's love affair with property.

For a huge number of New Zealanders – more than 130,000, in fact – owning an investment property is a key part of their wealth creation plans.

Whether it's a single property bought with the aim of creating a secondary passive income to help in retirement, or a growing portfolio that expands year by year, investing in homes just makes sense to many of us.

New Zealand needs rental properties, too. The number of households renting is increasing each year and the bulk of those are living in homes provided by private landlords.

An investment you can touch

For many investors, the appeal is that, when you're buying a rental property, it's an asset that you can see and feel.

If you want to know how your investment is faring, you can pop over and have a look (with adequate warning to the tenant, of course). Because we all understand how a rental property works, it can be easier to relate to investing in a home than in something less tangible such as shares.

Leverage your way to gains

Property investment is one of the few investment vehicles in which you can use other people's money (in this case, your lender's) to get to your goals.

It works like this:

Say you buy a $400,000 investment property with $100,000 equity or deposit.

When it then appreciates in value by 10 per cent in a year, you get the 10 per cent gain on the whole value of the property, not just on the $100,000 you put in yourself. You make $40,000 in capital gains, not $10,000.

The power of leverage over time means that you compound results year upon year that you could not have achieved otherwise. Not only are you in the market much faster than you would be if you had to save the purchase price outright, you're in a much better financial position, too. You can also borrow against the growing equity in your properties to buy more, creating wealth more quickly.

Compare that to your KiwiSaver account (which invests in shares among other assets). While these are solid investment options that can give great returns and grow in value significantly over time, you can only invest what you contribute yourself, and the returns on that initial investment. You usually cannot borrow money to invest in shares or managed funds.

But I own my own home...

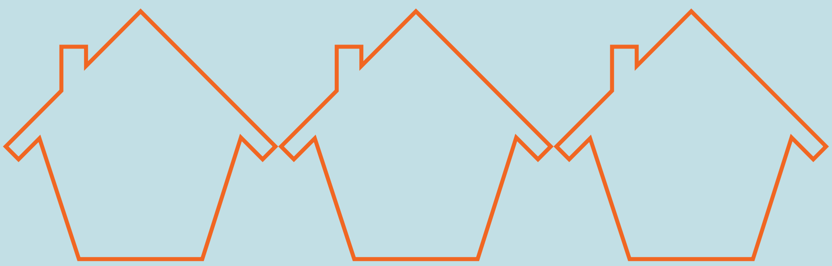
You probably think of your own home as an investment, but it is limited in what it can do for your overall wealth position.

You may have heard the saying "you can't eat your house".

If you want to free up significant capital, you need to sell and move to a significantly smaller property or a cheaper area to do so.

By comparison, capital gains on an investment property can be realised completely when the time eventually comes to sell the investment.

Property investments also provide holding income in the meantime, from the tenants living in them. Rents are rising steadily so the income you earn from your investments each year usually increases.



How much can you borrow?

If you've been scanning the "for sale" ads and eyeing up open homes, you're probably wondering what you can afford to buy. Investment properties can be anything from a one-bedroom unit in a small town through to a mansion in a big city, apartment block or even office tower.

What you can borrow will come down to how much equity or deposit you have to put in to the deal, and the income you will have available to service the loan (including rental income you'll receive once you own the property).

Different lenders will have different ways of assessing how much they think you can cope with. Squirrel works with all the main banks and non-bank lenders and your Adviser can help you work out exactly how much you can borrow.

Paying it back

A primary concern for the lender will be whether you have enough flex in your budget to manage the repayments.

Banks usually calculate a minimum surplus that they want to see borrowers have left over each month once their fixed costs are paid. How much they want this to be, and how much they think needs to be set aside for various expenses, depends a lot on which lender you're dealing with.

They'll usually be pickier about the details if you have less equity or deposit. Your Squirrel Adviser will go in to bat for you with the banks to ensure you get the best outcome.

Loan-to-value ratios

Lenders will also assess your loan-to-value ratio.

This is the value of your loan compared to the price of the house. Example: if you're buying a $500,000 house with a $400,000 loan, that's a loan-to-value ratio of 80 per cent.

The Reserve Bank controls how much the main banks have to request from borrowers via the loan-to-value restrictions it imposes – but banks also have their own criteria they have to meet.

When Covid-19 hit New Zealand, the Reserve Bank lifted the loan-to-value rules for a year. These had previously required a 30 per cent deposit from investors. The change meant many banks started to lend up to 80 per cent. But the market did not have the downturn that the central bank had expected and, at the time of writing, there were suggestions that it might re-implement the restrictions more quickly than initially expected. We'll keep you posted on that one!

You might already have more equity than you think

If you've owned your home for a while, or the market is improving quickly, you are likely to have built up equity in your property. You may be able to use some of this to buy an investment property.

The bank generally won't let you withdraw all the equity you've got to purchase another, but will allow up to a set level, such as 80 per cent. For example, if you have a $600,000 house and a mortgage of $300,000, you'll be allowed to use $180,000 of your equity to get you started on an investment.

For tax purposes, it often makes sense to secure more lending against the investment property, when you can. That loan interest can be offset against the income earned from the property when it's time to do your annual tax return. Your Squirrel Adviser can discuss this with you. More on this later.

Servicing rates

Servicing rates make a big difference to the success of your mortgage application, particularly in a low interest rate environment.

These are the test interest rates that lenders use to check whether a borrower can make their repayments. In mid-2020, these were between 6 per cent and 7 per cent even when advertised rates were hovering below 3 per cent.

That means that being confident that you can pay the interest rates advertised isn't enough – you also have to be able to show you can service the higher test rates, too. This provides certainty that you could cope if mortgage rates started to move up again.

Picking your loan term

You'll need to choose how long you need to pay back your investment loan.

Because the interest on an investment property's loan is an expense that can be offset against rental income for tax purposes, many people focus on paying off their owner-occupied homes first, and put their rental properties on longer loan terms.

You might, for example, reduce your own home mortgage to 15 years but put your investment property loan on a 30-year term to maximise your cashflow.

Some investors also opt for interest-only loans. These are loans where none of the principal is paid – you're only paying the interest owed. This improves cashflow because the payments are less. Some lenders only allow this for a set period of time. The problem is that you're no closer to clearing the loans as the years go past. If your strategy is to have mortgage-free properties earning rent, you won't get there with an interest-free loan.

You'll also have to consider whether you want to float your loan or fix – and what sort of fixed term might be appropriate. There's no right answer here, and accurate interest rate forecasting requires a functioning crystal ball, but the good news is that your Squirrel Adviser work out a sharp rate over a term that suits your budget and circumstances. You can choose to fix it all in one chunk, or divide it up over a range of terms, if you're worried about rates moving in the meantime.

Why Squirrel?

The loan application process is much easier when you have an expert on your side. As Mortgage Advisers, we can help you find the best deal for your circumstances, and help you navigate the purchase process. We'll also get to know you, and understand your goals so we can work out the best strategy to achieve them.

Here's a breakdown of what you get with Squirrel:

Better mortgage rates

We arrange about $1 billion of loans per year which gives us negotiating power and access to better rates.

More options

We have access to more banks than other brokers, and we can also offer access to our community of 1,500 plus peer-to-peer lenders looking to fund a person like you. More options add up to better solutions.

Our advisers are paid salaries, not commission

This means our advice is impartial, and you know you won't get pushed into anything you don't want, or can't afford.

Experienced property experts

When you're planning your property investment strategy, you need the very best advice. The devil is really in the detail and when we're talking hundreds of thousands of dollars, a fraction of a per cent change in interest can save you a packet. This could mean retiring to your super yacht a few years earlier than planned.

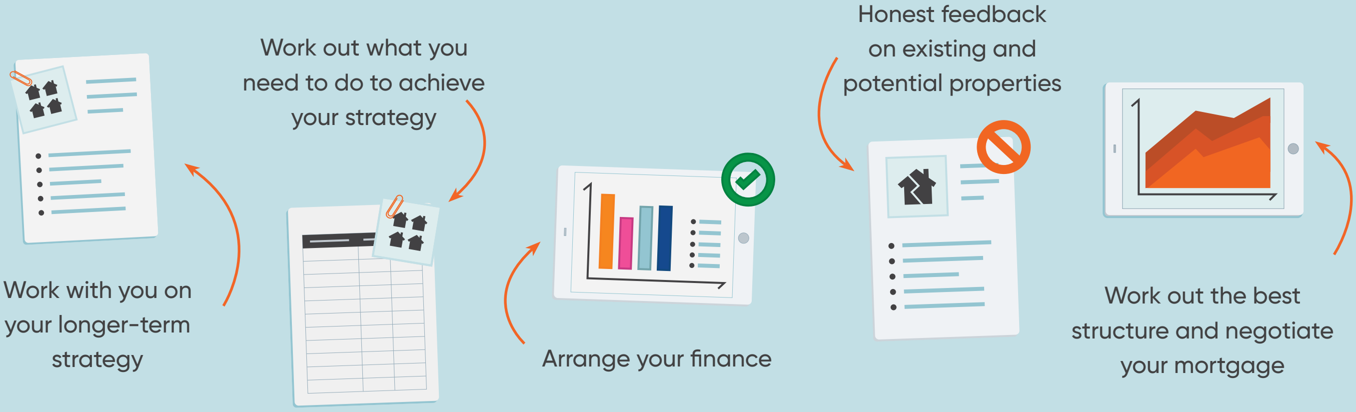
We're on top of the niggly stuff

Success in property investment is being adaptable to ever- changing rules and regulations with lending and tenancy services. We'll start by asking you the right questions to ensure that when you're ready to start negotiating, your preapproval fits the type of property you're after.

Best of all... in most cases our service won't cost you a cent

Not many things in life are free, but our service is because we get paid by the banks. In the rare case that we did have to charge (for an unusually complex scenario), we'd let you know up front how much and why.

Here's a few ways we make the whole process easier:



Choosing a place to invest

You know you want to be a property investor. But where do you want to invest?

Some people choose to buy investment properties in their own neighbourhoods because they know them well. They know which sorts of properties are popular, understand what tenants are looking for and know the things to watch out for when selecting a place to purchase. Buying an investment near your home can be helpful if you're planning to manage the property yourself, too.

But other people look further afield, particularly if they are investing in several properties. Diversification gives you broader exposure to the market and you may identify opportunities in areas that are a little further from home.

There are a few things to consider if you're deciding where you want to buy.

Who will pay the rent?

There are still some parts of the country that have very cheap house prices. While these may look like a great deal, there are some points to ponder before jumping in.

Consider the population of the area. Is it made up of young families, or mostly older people? Is the population noticeably ageing? This can affect the sort of property that people want to rent, how much they can afford to pay and the pipeline of future tenants.

What sort of employment is available locally? People usually want to live near their jobs (or where they are studying). If there is limited employment in the area, that may mean less demand for housing. If there is only one key employer, you may be vulnerable if that business was to decide to move out of town.

How is the local economy faring? We talk about the country as a whole but it's often a mixed picture between regions. Some might be booming while others struggle. You'll tend to see the best rental price growth and capital gains in places that have a strong local economy. Understand what drives it before you jump in.

Standard advice is often to look for a place that is near key public transport infrastructure and roads, with good access to local amenities. Being in a convenient location not only makes your property desirable to tenants but pushes up the value.

What does the future look like?

If you know there are key developments planned for an area, you could look to buy before others cotton on to the increasing opportunity. Good examples of this are areas where new roading or public transport connections are planned, or commercial hubs that will attract jobs.

Build new or buy existing?

You'll also need to decide whether you want to buy a new or existing home. There are benefits and drawbacks to each.

A new home should have very few maintenance issues, at least for the first decade or so. You can also pick exactly what you want and ensure it meets all the required regulations, and you'll have a warranty from the builder.

The benefit of existing homes, however, is that they tend to be more plentiful in the sought-after central suburbs of cities and towns.

You can also thoroughly check out what you're buying before you sign the agreement and won't get caught by any unexpected or expensive delays during the building process.

There is usually more opportunity to add value to existing homes than there is to new builds – you may be able to get an existing place that is a bit rundown at a sharp price and spend a bit of cash on it to significantly improve its value.

Capital gains, or yield?

One of the questions that many new property investors have to grapple with is whether to pursue an investment for its capital gains or yield.

> ***Generally, cheaper properties have higher yields. That is because the difference in rent between a cheap house and an expensive one is not as great as the difference in purchase price.***

In Southland, where the median purchase price was just under $340,000 in September 2020, the median rent on TradeMe was $340. In Auckland, the median house price was $955,000 and the rent $570. That means the yield on the cheaper house is much higher.

Yield is calculated as the annual income of a property divided by its purchase price. The catch is that capital gains are usually better on more expensive properties.

Even if all the houses in a city increased in value at the same rate, one that is worth $500,000 will only increase by $50,000 if prices go up 10 per cent, while one that is worth $2 million will gain $200,000. It's often the case that more expensive areas have stronger value increases, or have less weakness in downturns.

Whatever your strategy, it's a good idea to think through why it's appropriate for you and what you hope to achieve.

Eligibility for buying property in New Zealand

In 2018, the New Zealand Government passed legislation to prevent most overseas buyers from buying real estate in New Zealand. The legislation was designed to slow down foreign capital pouring into an already overheated housing market.

If you are a New Zealand citizen living overseas, or a permanent resident residing in New Zealand, then the new law doesn't apply to you and you are free to buy property. If you are overseas and need to borrow money, the property will be deemed for investment and the maximum loan to value ratio will be 70 per cent, meaning you need a 30 per cent deposit.

The same is true for Australian and Singaporean citizens who can purchase in New Zealand due to free-trade agreements with both countries.

Developers can apply for an exemption for their developments and foreigners can buy into these developments.

Mortgage finance for overseas buyers is hard

As far as borrowing goes, banks are typically hard to deal with when it comes to foreign based income. They will only accept PAYE income and from reputable employers in reputable countries. If you are self-employed or a contractor, then it becomes very difficult to satisfy bank criteria even if you are a New Zealand citizen.
Rents in New Zealand will be too low to demonstrate servicing purely off that income so there will be reliance on offshore income to meet bank criteria.

Banks will shave foreign income by 20 per cent to 30 per cent before they calculate servicing and in New Zealand the ability to service a mortgage is tested at the servicing rates of 7 per cent we talked about earlier.

You are likely aware that LVR rules have changed recently and most banks are now considering up to 80 per cent lending for property investments, however for overseas purchasers this is deemed higher risk and banks still have a minimum of 30 per cent deposit required.

Banks will be difficult to arrange finance through, so foreign buyers who are not citizens and that need to borrow some of the purchase price will need to get funding through non-bank lenders. This is typically at mortgage rates of 3.39 per cent to 7.5 per cent.

Non-bank options can go as high as 80% LVR for New Zealand or Australian citizens working in Australia and the servicing criteria.

Checklist for foreign buyers

1. If you are buying an existing property you will need to be a New Zealand citizen (or Australian or Singaporean citizen.)
2. All foreigners can buy newly developed property that has an exemption to the rules.
3. You should have a minimum 30 per cent deposit
4. To borrow from a bank your foreign income must be PAYE from a permanent job (not self-employed and not a contractor)
5. Are you all over the latest town planning rules?

If you have questions about the above or want to chat through your own situation give us a call on **0800 21 22 30** (within NZ) or **+64 09 376 9688** if you're calling from overseas.

Owning an investment property - what to expect

So you're a property investor. Now what? One of the first things you'll need to get to grips with is managing the financial side of your new property investment business.

Get out your calculator and plot our what you can expect to earn and spend on the property each year.

Money coming in

On the income side of the ledger, you'll have rent.

Even with a property in a popular spot, you should allow room in your budget for some level of vacancy throughout the year.

On a good year, you might have the property tenanted 52 weeks, but it's safer to plan for two to four empty weeks each year.

You should assess your rent against the current market rent each year to ensure that you're still charging a price that is in line with what the place is worth. A property manager can help you to do this, if you aren't DIY-ing.

Expenses going out

The rent doesn't just go straight to your pocket.

From that rental income, you'll need to cover all your costs. These are deductible against the property's rent when it starts to turn a profit.

Work out how much you'll be spending on the interest on your home loan (you cannot claim the principal payments as an expense), your property management fees, rates, insurance, any body corporate fees and the fees you pay your accountant.

> ***Don't skimp on the amount you put aside for maintenance, either. It's helpful to keep on top of things that need doing as they come up, to avoid a bigger bill down the line.***

What's your yield?

You'll have heard about yield, and it's something that has been discussed here already.

The gross yield is simple to calculate – it's just the amount of rent you receive each year divided by the purchase price or value of the property.

The net yield also takes into account the cost you incur by owning the property – except for the home loan. To work it out, take your annual rental income, subtract your annual expenses and then divide the resulting amount by the property value or purchase price.

These are helpful calculations to ensure that properties you're buying are a good bet, and as part of your rent calculations. But what will really make or break your property investment journey is your cash flow.

Aim to structure this in a way that allows the rental income to take care of the expenses as they happen – if you're likely to have some cash sitting around between bills, you might choose to use a revolving credit facility to temporarily offset borrowing.

Common questions

More than ever, the current economic crisis has highlighted the importance of **having a clear investment strategy** and **managing your risks. Here are some common questions to consider:**

What does your risk management strategy look like?

For example, have you got the money to cover three months' home loan payments if your property lies empty or the rent is unpaid for a time? It's a good idea to have a flexi overdraft home loan account for say, $20,000 to cover unforeseen expenses and gaps in income.

What happens if your tenants cannot pay the rent?

For the majority of us, a property manager can be well worth it. They will both increase your capacity to own more and reduce the worry and pressure that can come with owning multiple properties.

Body corps sometimes have a loss of rent included in the insurance as long as you are meeting the inspection requirements and have done credit checks and collected bond, vetted tenants and reference checks up front.

Explore the option of having landlord inspection insurance.

Should you rent to family?

Only if you are going to hold them to the same standard as a tenant. If you make the rent too cheap then IRD may consider you are depriving yourself of income and that discount may be subject to taxation so ensure you are within an acceptable and comparable range of like properties. You can be at the low end, but not $200 a week for a $400 a week property. Ask youself: when family don't or can't pay, what are your rules?

What happens if you sell a property and the bank keeps all of the sales proceeds?

Ensure you are educated and informed prior to settlement day of your rental property and that you have engaged with your mortgage adviser. The bank is fully entitled to request all proceeds of the sale. Any residual loans you have are also considered by the bank because they want to ensure you can still afford the loans that you want to keep.

Sometimes investors have many properties plus their home, with multiple loans. The investor attributes a loan to a property whereas the bank looks at all your lending and security. This means you don't always have to pay down the loan you took out for that particular property. There may be a loan with a lower break fee or a combination of reductions that can be applied to the settlement scenario. Be sure you have a plan on the way in and on the way out that is both understood and supported by your lender.

What happens when you come off interest-only and the bank forces principal-and-interest payments because your property value has changed?

The banks have to subscribe to a responsible lending code which means they have approved your loan for 25 or 30 years. So for example if you have been paying interest only for 5 years then you only have 20 years to pay off a 25 year loan meaning your payments could be substantially higher.

Interest-only is basically renting your money from the bank. If your plan is to have passive income in retirement then you need to work towards paying the loan off in time. The most efficient way to get there is a principal-and-interest strategy from day one.

A reduction in value would only matter to the bank if there was a sale. It might assess the loans you want to retain and the value of the securities the bank has, coupled with the reserve bank LVR policy of the day.

Interest-only is a strategy for cashflow efficiency and that's it.

What if you see the deal of the century and the banks says no?

Firstly, why is the bank saying no?

If it's affordability then you need to ask yourself whether the bank might be right. Can you really afford it and does the bank understand your income and expenses fully from all sources?

It might be a no because of the quality of the security if there are unconsented works or improvements on the property. This could be a granny flat with no permit, no firewall for a kitchen, load bearing walls removed, the list is endless. You'll need to understand the insurance risk around the issue and if you still want the property then you can negotiate some time and allocate some funds to get a COA (certificate of acceptance) from the council and insurance company and present that to the bank with a quote of all and any work that needs to be done to make it compliant.

If it's a plaster house and there could be weathertightness risk, or issues that may mean the property may not be able to be legally tenanted, you may need comprehensive testing to provide evidence to the lender the home is ok. If it needs a reclad then full costs and quotes will be required and assessed for affordability as well.

If after all your considerations you still want it and banks are saying no, then there are non-bank lending solutions that range in price. There is often a Yes out there but it comes with a price such as bigger deposits or multiple securities. Your mortgage adviser can explain the total cost and pathway into and out of these things as you need to be clear on what is required of you and what is your exit plan back to main bank and best priced lending.

Tips to help grow your portfolio

Getting started

Everyone has to start somewhere, so rather than launching straight into building a 5-storey apartment block complete with underground parking and tennis courts, it's smarter to start out a bit smaller and closer to home.

Should you sell your house or keep it as a rental when you move?

Making this decision should be based on some goals and a good strategy. Ask yourself honestly: does my house fit the bill? Is it likely to yield good results or go up in value? If the answer is no, then you're better off selling up and using the money to buy a better investment.

A granny flat under your house can be an easy way into property investment.

They make sense on so many levels and can also help you buy in an area you might not otherwise afford. It's a great idea to look for actual grannies to live in your granny flat. They tend to value the security of having a family close by, are reliable and quiet and much more tolerant of family noise than other types of tenants. Good old nan.

Make sure you're buttoned down with the rules about Granny flats

Ensure when you're considering buying or developing that it's permitted and consented as either a home and income or home and granny as different rules apply around separate tenancies. Any additional utility rooms like kitchens and bathrooms need to meet the appropriate council requirements and be signed off. Failure to do this often invalidates your insurance and makes the property unacceptable security to a lender.

It might feel like you're adding value and cashflow to a property but if it's not done right, it can reduce the value and appeal of your property as it won't meet bank criteria. Banks won't count two rental streams from one property if it is not legally recognised as two places of residence on the legal description.

Don't rely on the market to push the value of your properties up

You need to add value to your properties so you have more equity to borrow against. Home and income properties are popular and perform well in every market as long as they are compliant.

Choose equity over rent

Sacrificing higher rents in the short term can be a hard decision, but it's much smarter to invest in a lower quality property where you can own more equity. This is the old "location, location, location" thing. Good school zones and proximity to public transport and shops will always perform better than poorly located isolated properties.

Get rid of non-standard properties

These are apartments of less than 45sqm and properties with more than 3 incomes. Get rid of them, even if they're cheap and give you good rents; banks will typically only lend up to 70% of their value (if that), so they'll hold you back from borrowing what you need. Same with serviced apartments and student accommodation – these can absorb more of your home's equity than you realise.

Make sure you have the right tax structure

You'll want to put as much into your investment property as possible so it's tax efficient. The way to do this is to sell your existing home to a Look Through Company or an LTC, which you own. The LTC buys the home at a fair market price and then borrows 100% against it. You then provide a personal guarantee to the lender using your new property as additional security.

You use the proceeds of the sale to clear the mortgage on the old property and put any extra into your new home. In this way you can move the equity from your old property to your new home.

In 2020, we no longer qualify for actual tax returns based on the losses on your rental property but they do accrue and stay in the entity until it becomes profitable. Then once those losses are fully absorbed your rental property can become taxable income. This is based on surplus income after all the expenses of rates, interest, insurance, body corp etc.

In practice you can sometimes have a tax bill on surplus rent over expenses while you still have a mortgage at home.

NB: the principal portion of a rental property mortgage is not a deductible expense. We avoid the language of tax deductible now and prefer tax efficient.

Keep on top of town planning rules

Town planning rules artificially drive land values, so it's worth understanding them and keeping up to date. For example, under the current Auckland plan, land that has changed from commercial or residential to mixed-use can significantly change the value of land.

How to lift your rental yield on an investment property

The average gross rental yield in Auckland is hovering between 2.8 per cent to 4 per cent. Most of the rest of New Zealand (on average) is slightly higher. Of course there are a few areas getting more than these numbers but let's work on the averages for now.

With the Reserve Bank LVR changes (and generally below par rental yields) now is the time for investors to be looking at ways to maximise their existing portfolio and increasing its return where buying more properties is not an option. As the old saying goes, we need to "spend money to make money".

A great example of where this has worked well is with a client of ours, James G from Ronovationz property group.

James purchased a house in Forrest Hill on Auckland's North Shore, for $630,000 (CV $570,000). The property was in a run-down condition ready for a full renovation. After an "extreme makeover" renovation which cost $63,000 and included adding a third room, the property was revalued at $860,000 which translates into a net equity increase of $167,000 for two months' work. Not bad! More than that though, it took the expected rent from $450 per week up to $620 per week which increased the yield from 3.6 per cent to 4.3 per cent (based on purchase price plus costs).

Not out of this world numbers, but a simple way to increase return in a highly sought after area. Looking for ways to add income sources is an effective way of increasing both property value and yield.

Most successful investors will have multi-income properties with two or three incomes per property. If possible, a minor dwelling or converted garage will give the ability to add a second tenant and significantly increase the overall yield.

There are plenty of options out there that to ensure you do not overcapitalize. With changes to the unitary plan, you could have more opportunities than you think.

While James was able to add a bedroom without too much hassle, this isn't always possible, but a simple cosmetic renovation can do the trick and bring in tenants who are willing to pay a bit more.

Completing these renovations in a sensible way, with timeless and effective updates, can be a great way to lift the value and get you back in buying mode.

Invest in the areas of the property that will attract tenants.

Simple upgrades to the kitchen and bathrooms can bring life to a dated property, but these areas can also be where investors over spend. Whilst matte black tapwear could be the 'in thing' right now, it's an unnecessary expense that looks great brand new, but will need replacing the minute the tenants move out – if not before. It usually makes sense to keep updates as simple and neutral as possible.

When should you stop buying property and start paying it off?

So you're constantly buying bigger and bigger properties using your equity, and never seem to get stuck into paying the actual mortgage. Is that a problem? Or should you keep going as you are and worry about the debt later?

It's really about setting financial goals. The answer to that question will come out of what you're planning to achieve in the next five or 10 years.

Investing in property is about trade-offs. If you borrow too much in the short-term you limit yourself in the future. Figure out what you want for your future. If we look beyond your goals, work out what's important to you e.g. if it's better school zones or a better lifestyle then you'll continue to build up equity anyway. You might eventually downsize or sell later in life and then you'll move your equity elsewhere.

One important thing regardless of what you're doing with your investment portfolio is to make the most of KiwiSaver. Then when you get to retirement you'll have equity in your investment properties but also have other investments. It's always best to diversify your risk.

So in short, it all comes back to having a plan. We can't say this enough. Don't invest without a clear strategy.

Doing a subdivision

For many investors, a big step in their investment career is to move from purely purchasing properties to conducting their own developments.

The most logical place to start when dipping your toes into the property development space is with subdividing a property. But although it might be a sensible move, it's not going to be easy or cheap. We share our tips and valuable lessons from the University of Life below.

Subdividing a property is a great way to instantly add value, but it's expensive.

Councils will see you as a way to cover their budget shortfall with a "development contribution." These fees average around $20,000 per dwelling. Councils will also sting you with a bunch of compliance-related costs. In Auckland, for example, you'll pay from $12,320+ GST per lot just to connect the water.

To subdivide a property, first you need to:

1. understand what you can and cannot do according to council zoning rules
2. do a land survey.

When looking at a property you could subdivide, consider:

- How steep is the section?
- Is the section in the front or back? If it's on a back section, how long is the drive?
- Is the place you'll have to dig on rock or soil?
- Is there already drainage, water, storm water and power nearby?

Case study

JB's subdivision in Mount Albert, Auckland

We don't just sit here and tell other people what they should do; there are a few seasoned investors within Squirrel, the obvious one being the chief, JB. Here he discusses his experience of moving a house (literally picking it up and moving it to another location), why he did it and what he learnt.

This project features a property on Hendon Avenue in Mt Albert in 2012. Background is that the property was sold by Transit NZ as surplus, to do with the new State Highway 20 Waterview extension. The area was set to get a lot of investment in the future as the streets and parks were developed as a consequence of the motorway. The motorway would also eliminate much of the through traffic that used Hendon Ave as a shortcut from Mt Roskill.

JB purchased the place for $551,000 (remember this is 2012). RV at time was $590,000. It was 754sqm.

He then purchased a baby villa (from Mt Eden) which he moved on to the back of the site. The Villa cost $75,000 incl GST which included delivery and piles. That's a lot, but perfect for a small site and it had already been rewired, relined, reroofed and painted.

All JB had to do was put in a new kitchen and bathroom.

This is the photo of the team moving the house on to the back of the site. The wooden boards over the roof are to catch power lines and flick them over the house! We collected a few trees along the way and the guys had to wake up a number of people in the middle of the night to move their cars. With all the rain the truck quickly turned the area into a mud bath.

Here it is in its final position and finally some sun! It was an awesome little house and something unique, bringing a bit of Mt Eden to Mt Albert.

Be careful trying to do a relocatable

Lots of people like the idea of a relocatable house. Good in theory but much more costly in practice. What you need to know is:

- The bank won't fund them so you need to have sufficient security or cash to buy them outright.
- You also need to be careful who you use to relocate; make sure you are clear on what you are paying for, and be clear on what they will do and won't do.

For example this contractor got the house on site and was fairly impressive to this point but getting the house on piles was not so great. The quality of the finish was below what we'd expect and there were lots of hidden extras in terms of cost.

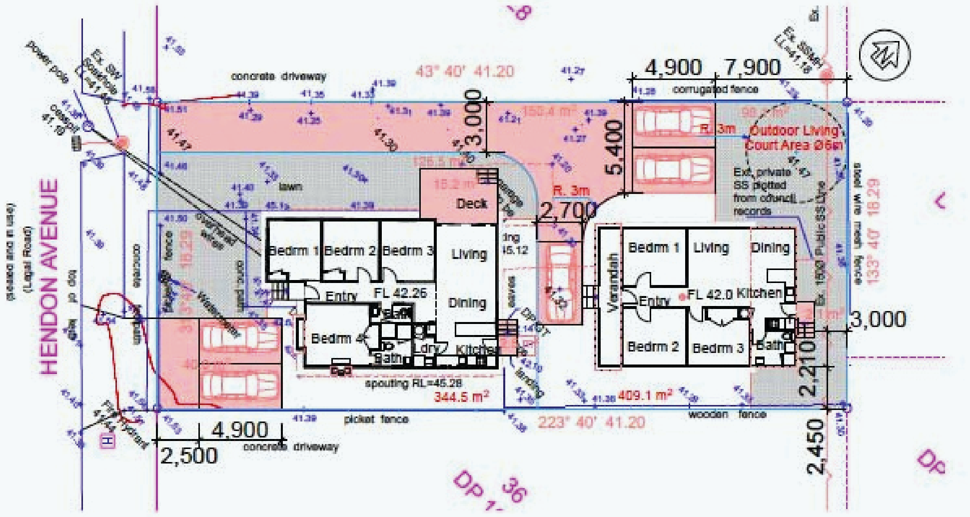
- The price quoted included foundations but excluded replacing the bearers or for fixing to the foundations.
- A lot of damage was done to the electrical wiring under the house and most of this needed to be redone.
- JB paid extra for new bearers but this still excluded the verandah.
- They wanted to pour the piles and lower the house on the same day. Luckily JB had an inspector handy who forced the issue and they had to wait for the piles to set properly and lower it the next day.
- Getting the house on site was quick. Getting it down and fixed took another five weeks.
- This isn't normal but highlights the problems of paying the whole cost upfront.

Our advice would be to not deal with a house-mover that requires 100 per cent payment before the job is done as you lose any control of the process. Until the house is down, you're kind of stuck.

What JB did with the total site

The existing house at the front of the site was a three-bedroom bungalow. JB extended this to create an open plan kitchen and lounge on the north-side, and four bedrooms and two bathrooms (check out the site plan and floor plan below).

JB allowed $150,000 to renovate both properties plus $30,000 for hard landscaping and $40,000 for contingency. The cost of services is captured in the subdivision cost previously mentioned.



The numbers

Cost-wise the subdivision cost $85,000. Here's a break-down of this below (don't forget we're still back in 2012 here).

The surprise was storm water. The area has no storm water system so JB had to put soak holes in. Drilling highlighted solid rock trapping a high water table in the area (minimal soakage) JB had to put in retention tanks at an extra cost of $10,000.

The cost of subdividing could have blown out another $20,000 or so but JB had an exceptional project manager. He had quotes on drainage varying between $20,000 and $60,000.

It pays to shop around!

Description	Cost incl GST	Notes
Reserve Contribution	$26,000	
Consent Application	$3,000	
Surveyor	$5,000	
Architect	$2,500	Need to show a compliant dwelling on the site
Soakage/Engineer	$4,000	Test for stormwater soakage
Services	$15,000	Power/Water
Clear Site	$3,000	
Construction	$20,000	Driveway
Other Consent Fees	$2,000	
Lawyer	$4,000	New titles
Total Cost	**$84,500**	

The cost of the total project (subdivision and building) is between **$900,000** and **$950,000.**

The end value will be **$1,150,000** and maybe **$1,200,000** once the area settles down.

The plan was to keep the properties long-term. That didn't happen in the end, but that's another story.

Rent wise in 2012 JB could get $1,150 a week across both so a 6.50 per cent yield on cost and a $200,000-$250,000 capital gain in six months.

Buying tactics for investors

Having the right tax structure

The debt on a rental is tax-efficient so you'll want to put as much debt against your investment property as possible. IRD rules only allow the interest expense to be tax efficient if it was used for the purchase and improvement of the income generating property.

Therefore don't assume you can keep loading up the investment property with tax-efficient debt just because it has gone up in value.

The way to do this is to sell your existing home to a Look Through Company or an LTC, which you own. The LTC buys the home at a fair market price and then borrows 100% against it. You then provide a personal guarantee to the lender using your new property as additional security.

You use the proceeds of the sale to clear the mortgage on the old property and put any extra into your new property. In this way you can move the equity from your old property to your new one.

Use multiple lenders

According to the *NZ Property Investor* survey, roughly half of property investors still think it is smart to have all their lending with one bank. Maybe they can negotiate a better deal, or squeeze out another loan by giving up all of their security. And it's easier than dealing with multiple banks.

However, splitting debt across lenders is one of the smartest things an investor can do to control the conversation with lenders. It is naïve to assume the lender values you as a borrower.

In a growth market, lenders will chase your business and might even show some flexibility. But when the credit cycle turns, as it now has, the focus is entirely on reducing credit risk exposures and any 'flexibility' disappears fast.

Tip: Don't put all your eggs in one bank.

Second-tier lenders (non-banks)

Whilst banks are the cheaper option (usually an all up funding rate around 7 per cent to 8 per cent) there are some real benefits to second tier lenders that can help alleviate this disparity.

You tend to be able to secure a greater amount of funding from a second tier which is often the primary driver behind engagement.

Responsible Lending

Now is a good time to talk a little about New Zealand's Responsible Lending standards and what this might mean for a property investor.

What's important to consider is that these standards have been put in place for the best interests of New Zealanders. However, like anything that is done by the government, they can often carry unforeseen circumstances.

The rules do not just apply to people taking out loans for the first time – if you are refinancing or adjusting your borrowing structures, you may find that you are assessed against these rules.

Borrowing more

Not long ago it was pretty simple to gear your assets up further. More or less a bank just wanted to know that there was a slim risk of loss (asset prices were going up, what was the worry?!) and that you could service the debts as they stood.

Now however, the banks require a lot more information and complete extensive due diligence:

- **Purpose:** why are you borrowing the funds? This is where the government determines if the funds are being used as a method to launder cash.
- **Account conduct:** banks now scrutinise bank statements very closely, searching for hidden debts, lavish expenses and even gambling habits. If something is amiss you may miss out on that loan.
- **Value of the property:** banks now in most cases require you to get an updated valuation on the property you are purchasing. They also dictate who that valuer must be – a result of some crooked operators inflating asset prices to appease lenders.
- **Serviceability:** banks are now very focussed on your capacity to service debts in the event of a seismic shift in the lending landscape. Sensitised interest rates are the norm now and sit 2 per cent above the current carded market floating rate. The current carded market floating rate itself usually sits about 0.75 to 1 per cent above the real rate most borrowers achieve. This means banks are assessing loans at almost twice the rate they end up on.

Interest-only loans

Banks now often require a full assessment of your portfolio before rolling any loans onto interest only. The banks are required to ensure that over the remaining term of the loans, that you have the capacity to repay the debt. Often this means that people are required to move onto principal-and-Interest terms for their loans and this can result in some really tough decisions for investors.

Some properties are no longer tenable for some investors as they cannot afford the additional payments associated with principal. This can result in semi enforced sales, refinances and rethinking from investors.

Some investors are being left in quite a predicament having acquired and grown their portfolios during a time of different credit criteria and now finding their portfolio doesn't fit the new norm. Anyone with a medium-to-large size residential portfolio should engage a mortgage adviser and start forward thinking about the next five years. Get ahead of these discussions.

As with anything, strategy is everything.

Interest rates and terms

We mentioned above the interest rate sensitivity that banks are now applying for the assessment of mortgages.

What's also happening now is a higher cost to investment property.

Reserve Bank standards now require banks to classify residential investors (if a client has more than a certain number of properties, usually three or four) as 'active investors' which classes their debts as a form of business debt. This carries with it an increased capital allocation for a bank and therefore a higher cost to them.

Right now the landscape is certainly an interesting time for investors and developers alike making it more important than ever to get your strategy in place.

Case study

Building up a property investment portfolio

Jo Chen is a Squirrel Adviser with extensive experience investing in more than two dozen properties to date.

Here's her story.

"There were a number of factors that drew me to property investing, including the flexibility and freedom it gave me. Not only financial freedom, but I could fit it around my busy schedule being a mum, allowing me precious time to spend with my kids. A big driving factor for me personally. Being a former Actuary, I was also good at calculating risk."

Although it's not just risk you need to factor into your property investment strategy.

My number one piece of advice for building your investment strategy:

See where you sit on the scale between equity (either cash in the bank or from an existing property) and income. You need both to succeed and it becomes a balancing act between these two.

- If you have a good amount of equity, but not a lot of income, you need to buy a decent rental property so you can generate more income. If you're in Auckland, forget the Milfords and Takapunas of the world in this scenario. Here, you want to follow the Village People and go West (although South Auckland would be equally good).
- If you are at the other end of the scale, with a good income but not a lot of equity, you need to buy a property in an area with good property growth. This is where Milford or Takapuna becomes a good option (both high-growth Auckland suburbs).
- Basically, it becomes a sliding scale between income and equity. You need to accumulate assets in the area you are trying to strengthen to try and balance out your position.

So that's exactly what I did. I bought my first property in Pakuranga with the help of my parents and within a year I had my second property - this time in central Auckland.

I built up a significant portfolio of properties by myself, but it got to the point when I needed to enlist the help of a professional to help me smash through the glass ceiling I seemed to have reached. Someone who really knew what to do, how to manage my mortgages to my advantage and shape my future strategy. Enter John Bolton (JB), head of Squirrel.

Three top tips for finding the perfect investment property

Tip number one.

Never buy a property just because you like it. That perfect little nook to sit and read your book on a winter's day is probably not going to help you in terms of building your investment strategy. You need to remember to look at it like a business. Never, ever fall in love with your investment property. All that love should be focused on your own home instead.

Following on from that, you need to be prepared for a loss or potential damage to the property. Set aside an amount each year to help cover these losses. This is where it can get really tricky if you love the home you are renting out. Any damage done to the property will be that much harder to deal with.

Tip number two.

Start off slow. Then, when you get enough experience and you know exactly what you're looking for, you can move really quickly. I've managed to get this down to a fine art. I can walk in, inspect a property, make up my mind and make a cash offer - getting in and out before others have even decided where they might like to hang the painting they got as a wedding gift. This way, you get in before everyone else. But as I said, start slow, it takes time to get to where I am.

And tip number three.

Remember that any property is a long-term investment. Most properties will double in value every seven to ten years, even faster in places like Auckland. You will never be able to save as fast or as much as the capital gain on a property, if you buy well. So, once you have that property, and if you're able to afford it, hold onto it. Only sell if you have to. That way, when you actually need the money, it will be there waiting for you.

And that's it. My top three tips for finding the perfect investment property.

10 mistakes to avoid in property investing

1. Don't buy because its cheap.
2. Don't rely on lender-provided reports and disclosure; do your own research and due diligence.
3. Don't be pressured into moving too fast, the deal of the century comes around once a week.
4. Don't take interest-only because it's more affordable. Aim to pay a property off and have a loan strategy.
5. Don't fix on the lowest interest rate if your own household income has potential to change and put you at risk.
6. View in person or have a trusted person view if buying remotely and get an external opinion.
7. When buying an ex-rental to rent out, ensure you are fully informed of insurance requirements. If it's compliant, do a toxicology report if it's an ex-rental. Not knowing is not an excuse in a tenancy tribunal if a neighbour tells your new tenant that drugs were manufactured there.
8. Don't buy and sell too quickly.
9. Don't rely solely on the property market to increase your rental property's value.
10. Don't jump in without having a considered property investment strategy.

A property investor's checklist

So, you reckon you're ready to take the plunge? Before you get down to business, here's a checklist to help you quickly figure out if you've got all your nuts in a row and you're bank ready.

- **1.** Have you got a strategy? If not, talk to an experienced Mortgage Adviser who can help.
- **2.** Start small
- **3.** Ditch non-standard properties that can restrict your lending
- **4.** Check you've got the best tax structure
- **5.** Are you all over the latest town planning rules?
- **6.** Make improvements to your properties to increase rental yield
- **7.** Use multiple lenders
- **8.** Get the balance between income and equity
- **9.** Don't fall in love with your investment property
- **10.** Invest for the long-term

Get in touch with a Squirrel Adviser to sharpen up your long-term property investing strategy.

Squirrel.co.nz

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