

How to get into **Property Investment**

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Introduction

‘Investment’ is an elusive and sometimes daunting word for those who don’t currently see themselves as investors. The reality is that it is often more associated with risk than it is with reward, when in fact those two things are equally the pillars of investing as a practice. In fact, the moment you put your first dollar in a savings account, you became an investor – at this point your investment vehicle was cash.

In New Zealand, it seems that generally our preferred investment vehicle is property, which is what this e-book is about, and aims to cover the basics necessary to give you an understanding of where to start and how to keep going.

It has long been a kiwi dream to own your own home, and further, to get into property investment – because it is such a safe business, and simple to understand. However, there is still a lack of knowledge when it comes to how you can get in the market, and this lack of understanding means lack of action.

When it comes to investing, making the first move early is key because returns end up compounding over time, and time – for the intelligent investor – is your best friend.

It has been proven, both locally and internationally that the path to fortune for the world’s most wealthy is most commonly earned through real estate.



Chapter One:

Where do I start?

What are your investment goals?

I was always taught - no matter what the subject, if you're looking to advance and make progress, the most important thing is to understand what your destination looks like – otherwise you may end up going nowhere fast.

Property investment is no different - you must first know what your goal is, because without a sense of direction you may end up at the wrong destination.

Decide what is important to you on your own journey before you make any steps. Do you want cash flow? Do you want to build a high net worth? Do you want a mixture of both? Be specific in terms of your goals and add a timeframe in which you'd like to get this achieved.

Financial freedom is typically a goal which many set out in search of when beginning investing in property – I know that's what I started with. Financial freedom is the ability to live from the income of your personally invested resources. It allows you to work, or not work – to work for joy instead of necessity - making your job an option and your dreams a reality.

Putting in place Buying Rules

Buying properties is likely to be among the biggest financial decisions you make in your life, so it is important you don't jump right in without doing your homework – therefore I would recommend putting in place some rules.

Creating buying rules for yourself is very important because unlike buying a home, this isn't

an emotional decision. Property investment is aimed at maximizing your future return, and therefore should be treated more like a business decision.

Property returns come in two main forms – cash flow (rental income) or equity (capital gains), which can usually be determined by the location and property type, and it is important to ensure that these things match your overall strategy. Ideal investments, or investment portfolios typically will have a mixture of both so that you are able to hedge your speculation of capital gains, with steady cash-flow.

Choosing a winning team

Choosing your team is of utmost importance going down the path of property investment. This can consist of many professionals, all who play an important part in ensuring you reach your goals.

Mortgage Brokers

Mortgage brokers can assist you in determining if you are ready to purchase a property, by assessing your servicing and equity position. Servicing or serviceability is purely another word for income – i.e. do you have the ability to 'service' the loan. Equity relates to your deposit, which is the 'hurt money' that you've got to put into the deal. Based on differing criteria between banks – a mortgage broker can typically assess where your maximum purchasing capacity is, and can get you 'pre-approved' for this amount. There are other important factors which banks consider when making finance offers, which I'd recommend reading up on. This finance offer from the bank will then serve as the guideline for you when hunting – and why I would recommend it to be the first step, after all if you don't know what you can buy, you may waste a lot of time looking at property outside of your price range. Brokers work on a commission basis and are paid by the banks, which means their service to you is totally free, it also means they're committed to getting you the best deal, because all of the work until settlement isn't anything they're being remunerated for.



Real Estate Agents

Also known as realtors, these individuals are critical in assisting you with negotiating with the vendor. Typically they can either be selling agents or buyers agents, and will act usually in the interests of the party they are committed to. Keep in mind that an agent

only gets paid when a property is bought/sold unconditionally, so they are motivated by getting deals done. Real estate agents can provide a wealth of knowledge about the area (due to the fact they usually specialize in one), from the price of houses, to the quality of the neighbourhood, local schooling, transport, shopping centres, etc. Draw from this knowledge as you begin your journey – you can never know too much.

Property Managers

Property managers will assist you in assessing the market rent for the investment you are about to purchase. Using someone independent of the real estate agent (and their agency) would be my recommendation to ensure you achieve an unbiased representation of the proposed rental return, particularly if it is going to form part of the basis of your decision. A good property manager will ensure they find a good tenant by using varying measures of quality control – from credit checks to reference checks. In addition, property management is becoming a more regulated industry and managers are having to adhere to minimum standards of professional development. Personally, having a property manager to me isn't an option – the decision is more around who I work with. The reason I say this is because it is becoming harder to be a landlord, and there are more rules we must follow – keeping up with which can be very difficult, particularly if you also have a job. In addition, I'd prefer to pay someone a small percentage of my rent to ensure I'm not the person my tenant calls at odd hours of the night about a blocked pipe, or the like.

Lawyers

Solicitors are professionals who assist you in the legal side of property ownership. This can cover a myriad of things; from explaining the nature of the property – i.e. freehold (fee simple), cross-lease, leasehold, etc. They will also do a title search for you and find out if it is clear, or if there are any encumbrances which should be noted, explain any conditions (and assist you in writing some for your offer) on the Sale & Purchase Agreement, and explain your responsibilities in relation to this as a purchaser. Lastly, they will assist in conveyancing, which is the transfer of ownership from the vendor to you as the purchaser (and new owner) on settlement day.

Accountants

A great property accountant is a must-have. They can assist you with ensuring your properties are purchased in the appropriate entities – from Look-through-companies (LTC's), to Family Trusts, Investment Trusts, or other. Property typically has tax-breaks associated with ownership and maximizing these could make your investment more effective at putting more into your back pocket – as accountancy and tax is a specialized profession, I would urge you to get advice here. The best advice I've ever been given when it comes to professional fees, is that you get what you pay for – so I wouldn't suggest cutting corners here, because poor advice can be far more costly.

Insurance Brokers

It is important to work with a good insurance broker who can assist in ensuring you're adequately protected when buying a property. There are two major types of insurance – Fire & General, and Risk. Fire & General covers things such as house, contents, car, landlord, etc. House insurance covers the replacement value of your home in the event of disasters such as fires – and there are no lenders in the market who will lend against a property without insurance. Landlord insurance can protect you in many circumstances including things like loss of rent, and is another thing I would recommend as a must-have. Risk insurance is typically more specialized and deals with your personal insurances to ensure you and your loved ones are protected in the events of death or disability. Purchasing a property is a big move and will typically change your financial position drastically, prior to settlement I would recommend seeing an insurance broker about your personal risk insurance requirements.



Chapter Two:

Making moves

You have the appropriate team at your side, and you're now ready to start hunting.

Getting Pre-Approved

Typically at this stage you will have went through the exercise of assessing affordability with your mortgage broker, and understanding what you can get with your deposit.

In the current market under restrictions set by the Reserve Bank of NZ (RBNZ) through our main-banks you can have 80% lending on your home (property you live in) and 65% on investment properties. This figure is typically referred to as LVR – or Loan-to-Value Ratio. For example, if you have a home worth $1m you can borrow up to 80% LVR, or $800k from the bank – however if it is an investment, you can have 65% LVR, or $650k – and you've guessed correctly, you need to come up with the difference in equity or cash.

That being said, you don't always need a 'cash savings' as a deposit. It is in fact possible to 100% fund an investment property purchase if you already have a property with equity in it to top-up against.

It might pay to add in here that if this isn't suitable for you there are other options which can extend further lending on investments to make things work for you – these lenders are typically a bit more expensive than banks – but could be the difference in you making things work. Due to the complexity of these options and how specific they are to personal situations, it is best to discuss it with a mortgage adviser.

The next side of the equation is your servicing capacity. Serviceability relates to your income relative to your fixed and discretionary expenses – and what surplus you have

left over at the end. The larger the gap, the more you can borrow. It is important to look long term and take an approach that allows you to ride through market (interest rate) fluctuations so that you're not over-committed.

At some point in an investor's life they will eventually hit a wall of either equity or servicing, and ensuring you are able to further your limits over time is important – this can be done by ensuring a mixture in your portfolio of capital gains and cash-flow focussed properties.

Making Offers

Now that you're pre-approved, you have a grasp on what level you can purchase up to, and are able to begin making offers. There are two major types of property you can invest in – residential, which are houses – like the ones you live in, and commercial, of which the three main types are retail, office and industrial. Commercial properties typically have different LVR rules, and the purchasing process is a bit different. Typically – most 'mum & dad' investors will be looking in the residential space.

At this point is where you have a very close relationship with real estate agents. I would suggest that before doing too much due diligence (research on a particular property) it would make sense to have your offer accepted – so that you don't waste your time analysing something that someone else ends up purchasing. Making multiple offers can be made safe by inserting appropriate clauses in your offer so that you are able to walk out on the deal if something comes up that isn't to your satisfaction. Something that assists here is having an appropriate Due Diligence clause which is typically all-encompassing in terms of your needs, from builder's reports, to finance, valuations, etc. Basically, it allows you to walk out on the deal before the timeframe ends (usually 10 working days) without having to give a reason.

In Matthew Gilligan's Property 101 Book you can find a great sample Due Diligence (page 320) clause to assist in making offers. I would strongly recommend reading this book if you are serious about learning the 101's of property in more depth.

During your due-diligence period you may assess the growth of properties in a particular area to determine what your likely capital growth is going to be over a period of time based on historical results. While history is a great teacher, the future isn't certain, so I personally would use historical data as a guideline rather than a bible.

Good fundamentals are the key to any successful property investment, and in the property realm this is based on – but not limited to – the following key indicators: Affordability, serviceability/indebtedness, interest rates, migration, supple-demand balance, consents & house sales, housing supply, house prices vs rents. All of the above are gauges which can (and are likely to) influence the value of property.

Gross & Net Yields

Assessing the numbers from a yield perspective is also key in working out whether this property is going to be right for you. Yield is just another word for income produced, relative to the value of the asset – for example, a $1,000,000 property returning $50,000 a year would have a 5% gross-yield. The formula is (annual income/asset value). Once you take away the expenses of holding the property (rates, insurance, property management, maintenance, etc.) from the $50,000, you are left with the net income. Using this figure, over the asset value, will give you the net-yield. For example, if your holding costs were $5,000 per year, your net income would be $45,000, and your net-yield would be 4.5%. Your net yield is important because it is this figure that either goes into your back pocket – or, if you have debt it will go toward paying your mortgage. As you may have figured out, the higher the net-yield, the more likely that if you have a mortgage, it will be covered by the rental income.

I have found in my experience as a general rule of thumb that typically smaller-towns have higher yielding properties, and larger towns or major centres have smaller yields.

If the yields are smaller and you have a mortgage, you may want to calculate the likely difference between what you earn from the property, and what you'll need to pay in mortgage repayments to own it – because if this figure is quite large, you'll want to ensure you have sufficient income to support this – particularly if rates are low – because when they rise you may be caught out with an unaffordable investment.

If the yields are higher, it may pay to double check the area you're investing in and ensure that the figures you've got on paper will actually be achieved – if for example you find yourself looking in a very small-town, you may have one employer responsible for a lot of the incomes in the area – if that employer were to move, what would it do to property values, and would your tenants be able to pay the rent? It's one thing having a great yield on paper, but if you are either vacant, or your tenant isn't paying rent most of the time, what's on paper becomes useless. Again, stick to the fundamentals.

Going Unconditional

Once your offer has been accepted you can begin ticking off the items on your Due Diligence Checklist, within the timeframe you've given yourself. At the end of this period you will then 'go unconditional'. Basically, this is when you instruct your solicitor to confirm you are happy to proceed with the property and are now committed to settling the property upon the specified settlement date. At this stage, you will be paying your deposit (usually 5%-10%) to the solicitor to secure the purchase. The deposit to secure the purchase is not to be confused with the deposit requirements set by the RBNZ in relation to LVR's.



Finalizing Finance Structures

By this point your finance offer will be unconditional (all conditions on the banks finance offer to you should now be checked off), and you will work toward ensuring the funds are ready in your solicitor's trust account on settlement date. This part of the process will be finalizing the structure of your mortgage with your broker, which can include loan terms, repayments types, fixed or floating terms.

Loan Terms

Typically, I would recommend always working with a 30-year mortgage term – this would mean that the mortgage repayments can be set at the lowest possible amount if necessary. The reason for this is that it doesn't mean you have to take 30 years to pay off your mortgage, in fact you can still pay it off in a shorter term which you can decide upon. All you need to do is use an amortization calculator to the desired amount of years you'd like to pay your mortgage off in, and set your repayments to be on that level – until such a time

you choose to either increase them again, or reduce them back to the minimum – this way you have the option to continue repaying this amount, rather than the obligation. If you choose a fixed rate (see below) you will need to keep this repayment amount the same for at least the period in which you fixed, before you can revert to the minimum again).

Principal & Interest (P&I or Table) vs. Interest Only (I/O)

Principal & Interest

If your repayment type is P&I your regular payments are the same each time (they may vary slightly due to days in the month) unless interest rates change. At first most of the money goes towards the interest you owe, but as the term of the loan passes more of each payment goes towards the principal.

The total amount of interest that must be paid over the duration of the loan is added to the principal, and then divided into equal repayments over the term of the loan.

The advantage here is that you build equity in your property as you reduce your loan, but the downside is that your repayments are higher than they would be if they are interest only.

Interest Only

An Interest Only loan is where you pay only the interest owing, but nothing off the principal. These are usually short-term loans (up to 5 years) which assist with cash-flow (because the repayments are lower). You still have to repay all the outstanding loan at some stage during the loan term. The principal is paid off in full at the end of the loan period or gradually paid off when you switch the loan to a principal and interest loan.

Because you are not paying off principal over the term of the loan, interest only home loans are only suitable for building equity if you expect the property itself to go up in value.

The advantage here is that lower repayments put an ease on cash-flow, which helps when wanting to allocate money elsewhere, such as, but not limited to:

- Renovating or building
- Bridging to purchase another home
- Making payments on other mortgages

What is best varies significantly dependent on your personal situation, however, for the most part:

- I would recommend going P&I on your Owner-Occupied property, so you can build equity in your most important asset.
- Interest only loans are popular amongst investors because it reduces the cash-flow costs of owning residential investment property and therefore allows the extra cash to be allocated elsewhere, such as putting it into the principal of their own home.
    - They are also popular because interest costs are usually tax deductible, which is a discussion to have with your accountant

Floating vs Fixed

Fixed interest rate loans

With a fixed rate home loan, the interest rate we pay is fixed for a period from six months to five years. At the end of the term, we can choose to re-fix again for a new term or move to a floating rate.

The advantages of fixing your mortgage is that you're able to buy certainty for a period - you know exactly what your repayments will be over the fixed term. It goes without saying that the more certainty you buy (the longer the term) the more you pay (the higher the rate). It also means, if you fix well, you can fix a low rate while the market rates rise.

The disadvantages however, are that fixed rates often have limits on how much you can make in additional repayments or make extra payments. If you'd like to do so, in many cases there are charges applicable. Additionally, if we choose to sell our property and/or break a fixed loan we may be charged a 'break fee'.

Floating rate (or variable rate)

In this instance, lenders will lift or lower the interest rate as interest rates in the wider market change, normally linked to the Official Cash Rate (OCR). This means our repayments may go up or down.

The advantages are that we have more flexibility to make changes without penalty, such as paying off the loan early or changing the loan term. The intelligent management of repayments here might mean that although you pay a higher rate, you may end up paying less in interest.

The disadvantages however, as stated are that floating rates have historically been higher than fixed rates and because of the variable nature - when rates go up the repayments also go up, putting a squeeze on our budget.

A mix of fixed and floating

We can split a loan between fixed and floating rates which gives the best of both worlds and lets us make extra repayments without fees - on the floating rate portion.

Splitting a loan can give us a balance between the certainty of a fixed rate and the flexibility of a floating rate – and the best part is that you can choose the amount you want in each portion.

Settlement

Now that the structure is finalized with your bank, the loan documents will be generated and sent to the branch and/or solicitor – for you to sign prior to settlement. Your solicitor will typically explain this documentation to you when you meet, and once settlement date reaches, your solicitor will let you know once the property has been settled – and is legally yours.



Chapter Three:

Where to from here?

Congratulations, you've now purchased your first investment property!

Now that you've learned the answer to "How do I get started in property investment" – how do you continue investing in property to build a portfolio?

Again, the most important points here will be your borrowing capacity, which is based on serviceability and equity. Assuming you have the serviceability component to borrow more money, which usually comes from a strong income position (which is relative to your commitments, rather than the actual dollar figure – for example I have seen clients with average incomes and portfolios of 20+ properties).

Assuming your commitments are low relative to your income position, your next step will be looking at building equity to provide the new deposit you require to purchase another investment, and here is where you will be trying to 100% fund (or as close as possible to) your new investment purchase.

Depending on what stage of the property cycle you bought in, building capital will be more (or less) dependent on your own actions:

In a rising market, you can often 'ride the wave' and reap the benefits of capital growth without much work required.

If, however you're buying in a down market – it is often more of a buyers' market and you definitely want to be making low offers. With investing, you make your money when you buy, not when you sell.

In any case, regardless of the market, another option for increasing value is renovating your property to ensure it is aesthetically pleasing. This is going to be important from a 'sales' and a 'rental' perspective. The better your property looks, chances are that the

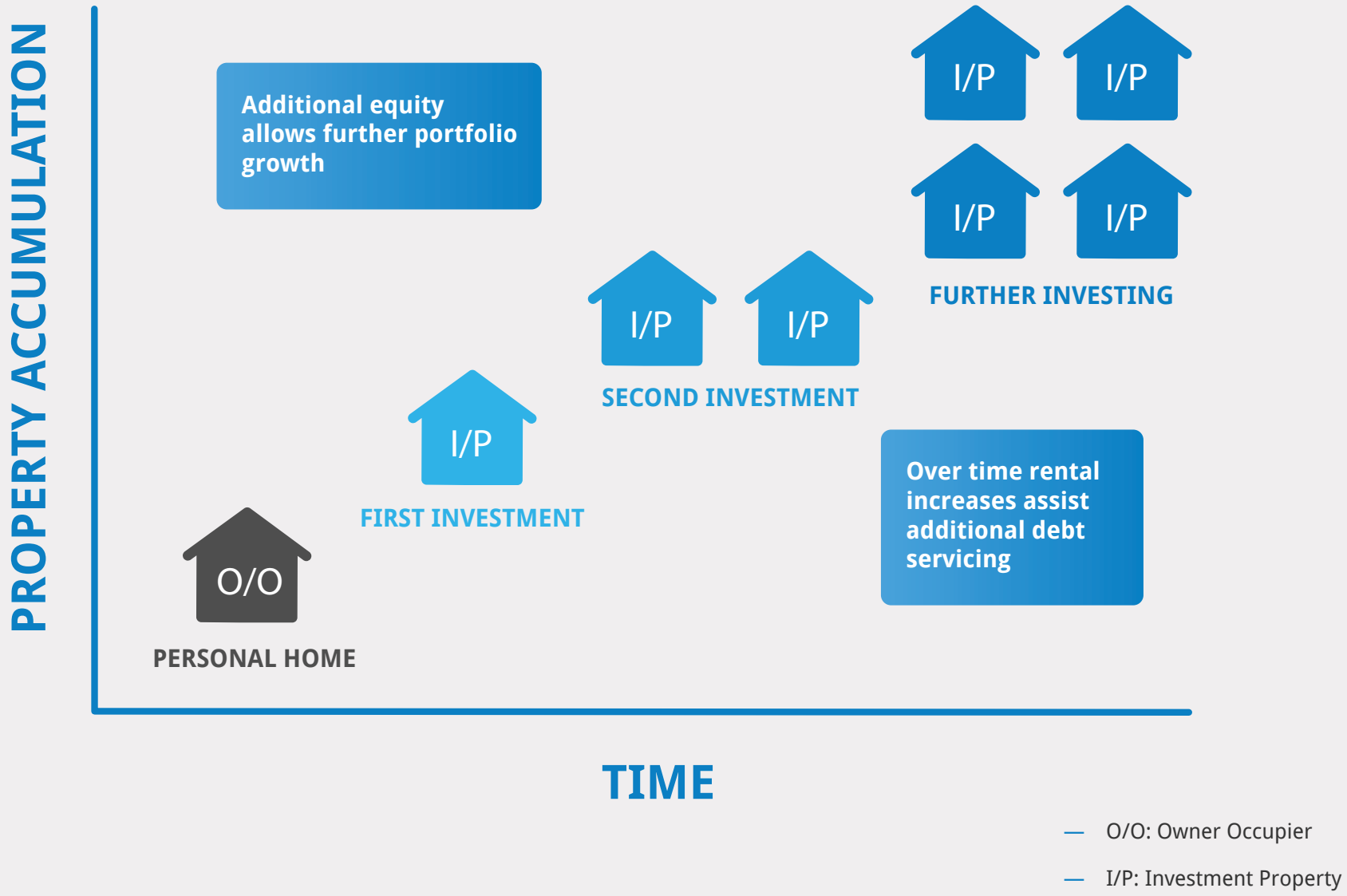
registered valuation report will show a figure that is more reflective of the effort you put in renovating it.

By using the increased market value of the property, post-renovation, you can then 'top-up' to 65% again, and use the difference in funds to fund a new investment purchase, for example:

For example, let's say your investment was purchased for $400,000. You have renovated this property (and bought well) and it is now worth $550,000, post-renovation. Initially, your 65% loan was $260,000, but now if you look to top-up to 65% of $550,000, you are able to have a loan against this property of $357,500. The difference between these two figures ($97,500) is the top-up portion, which becomes your new 35% deposit requirement. You then take this $97,500, and get pre-approved for a loan for the other 65% (with a separate bank) of $181,000, and purchase a property (100% financed) for $278,500.

You will then repeat this process, as many times as you wish to continue building a portfolio. If you have bought well, while you focus on each new property, over time your previous investments are also appreciating in value – building more equity. At some point you'll hit either an equity, or a servicing wall (which means you've hit your limits based on your situation) and you'll need to decide whether some properties are to be sold, or if this is the end of your investment journey – temporarily.

PROPERTY PORTFOLIO GROWTH STRATEGY



— O/O: Owner Occupier

— I/P: Investment Property

Buy and Hold or Trade?

Deciding whether to hold or sell is important from a long-term perspective. The key differences are as follows:

Holding:

- Equity can be released up to LVR limits imposed by the reserve bank, topping up against the registered valuation figure will be where your deposit funds come from to proceed.
- You have passive income being received from the property
- You will have continual holding costs

Trading:

- Equity is realized through sale – your net proceeds are then taxable in most cases, and what you are left with will be your deposit funds for your next investment.
- The return is one off
- There are no continual holding costs
- You will have tax and GST to consider in your numbers here

Your portfolio should always be reviewed to determine if the investments are performing adequately, or if they need to be culled and replaced with other investments.



> **Unless you change how you are, you will always have what you've got. Life is a unique combination of "want to" and "how to" and we need to give equal attention to both.**
>
> — Jim Rohn

Summary

Finally, it must be said that property investing isn't as difficult as most people think. When asking how to get started in property investment, the key is beginning with knowing what you're aiming to achieve, and then getting the right team around you to ensure you're able to follow the path you've chosen. Your current financial position will dictate where your limits are and understanding these will help you make more informed choices and narrow down your search. That being said, your financial position is a picture of where you currently are, but definitely can be altered over time – where you are, is not where you have to stay.

While the process may be simple, mistakes can be costly, so I would also recommend educating yourself by reading as much material you can on the subject to assist you as you get further and further into the game. I started on 'Rich Dad Poor Dad' – by Robert Kiyosaki, and another great place to start is 'Property 101' by Matthew Gilligan.

The purpose of this e-book is to assist those who would like to begin a life-changing journey in property. I hope to provide education, and hopefully inspiration by showing that none of this is as difficult as you may think. On action & education, my favourite quote is by Jim Rohn which goes as follows: *"Unless you change how you are, you will always have what you've got. Life is a unique combination of "want to" and "how to" and we need to give equal attention to both."*

At Kris Pedersen Mortgages and Insurance we work with those who are just starting out, and also with seasoned investors. We offer free finance strategy meetings to help you answer the finance questions you will need to know on your property investment journey – and also can assist with generic property queries.

Feel free to be in touch if we can assist – contact details are available on our website.

About the authors



Kris Pedersen

Director, Mortgage Advisor

Kris has had experience in many varied areas of finance beginning in consumer finance where he was responsible for a team that was lending over $40m per month to over 3,000 customers. Kris project managed initiatives that had been employed overseas, which were light years ahead of the NZ market at that time which he still uses today when searching for new and innovative financing techniques. Kris then joined the market leading non-bank lender who had introduced products such as 100% lending and low-doc loans into the NZ mortgage landscape.

Kris is now the third ranked mortgage advisor in New Zealand, and a regular on the property investment speaker circuit and contributor to NZ property investment publications.

Kris Pedersen is a registered financial adviser and regulated by the Financial Markets Authority. You can view this on the FMA's financial service providers register by visiting the New Zealand Government's Company Office website.



Ryan Smuts

Key Account Manager

Ryan has worked as a lending underwriter for Kris since 2014, learning lending policies and internal processes to ensure applications are handled in a streamlined fashion. In this time he has developed an in-depth understanding of bank lending criteria amidst a changing market and the overall mortgage process.

Recently transitioned into a newly established KPM position, Ryan is a Key Account Manager for Kris' valued clients. His role involves a number of aspects centred around his expertise with numbers such as the provision of annual financial reviews, obtaining lending where required, initiating contact to demonstrate how we can assist in terms of financial advice, risk management and other basic property investment advice for his portfolio of clients.

He has been working with the KPM team since the completion of his Bachelor of Business Studies (BBS) at Massey University, with a double-major in Accountancy and Marketing .

Property is his passion and Ryan currently owns two rental properties which he continually pursues ways to advance his real estate portfolio and develop his property investment knowledge.

Ryan Smuts is also a registered financial adviser and regulated by the Financial Markets Authority. You can view this on the FMA's financial service providers register by visiting the New Zealand Government's Company Office website.



About Kris Pedersen Mortgages and Insurance

Kris Pedersen Mortgages was started by Kris Pedersen in 2007 after seeing areas in the residential lending market where clients were either being told 'no' (when he knew a solution was available), or given an answer which was not in their best long-term interests.

After witnessing many new clients being set up in ways that were more beneficial for the bank than the actual clients, Kris set out to change this and quickly gained a reputation for finding property funding solutions where others couldn't.

By drawing on his personal property investment knowledge and armed with experience working at a market leading non-bank lender, Kris developed outside the box lending structures that allowed more applicants to get deals across the line.

Kris is now the third ranked mortgage adviser in New Zealand, and over the last 10 years he has rapidly become the choice for investors who are serious about wanting to grow their portfolio and utilise market leading advice.

Kris maintains an active role in the New Zealand property market and frequently speaks at property events around country while regularly being asked to contribute to the NZ Property Investor Magazine and other publications each month.

Kris stongly believes his clients need to be dealing with specialists, that's why Kris Pedersen Mortgages offer specialist brokers for First Home Buyers, Commercial Property & Business Finance and Risk Insurance Cover.

Kris' specialist property team are available to help you whether you're just starting on the property ladder, are a sophisticated investor, or a large scale property developer.

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