# Accomplish

2021

# Are you thinking about investing

by Glenn Rodricks

**Chances are that you are one of the minority of people who** want to improve your financial situation by creating wealth. Not everyone has this desire, The vast majority of people will never do anything about financial growth and will go through life happy and content in their choice. This is not in any way judgemental, but I believe that it's because they have never had the opportunity to gain knowledge about money, wealth or personal finance. Once exposed to the excitement of learning about investment, many of these people may be motivated to actively pursue a strategy of wealth creation.

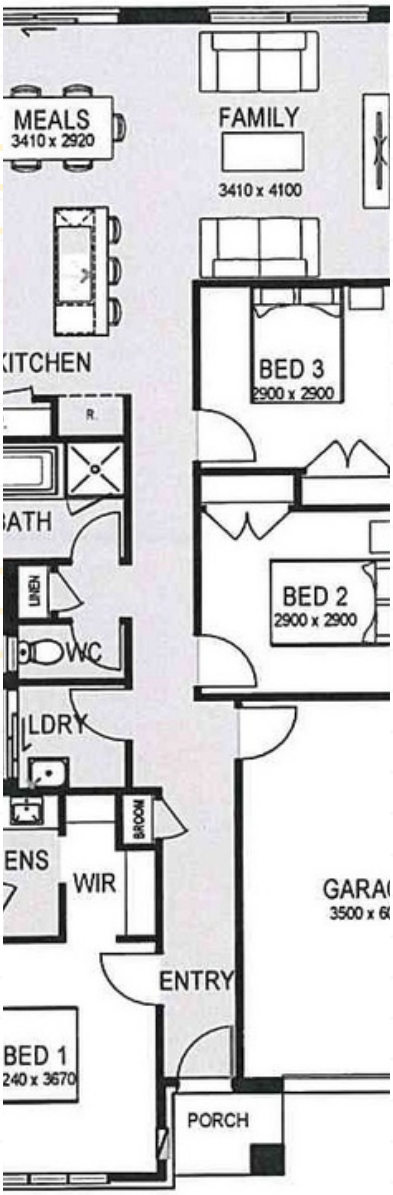
The reason I have introduced this right at the beginning, is because you will encounter opinions from family, friends and total strangers about the pros and cons of investment. I would ask you to listen to them, but with caution, as 'advisors' are also in two categories; the first being the vast majority of people who have never invested and therefore will possibly have a negative view of what you intend to do. They will caution you about the various pitfalls and disasters that await you around every corner. From my experience, many of these warnings are legitimate but can normally be avoided by gaining knowledge, which they have never pursued and therefore continue to be afraid and therefore have never taken the step towards wealth.

## Content



# Accomplish

2021




The second group of people are the investors, the ones like yourself who decided that there was something to be gained by investing and they have read books, asked questions and sought advice from various people. This group of individuals will cheer you on and will willingly share their knowledge with you.

A caution; don't replicate exactly what they have done or follow their investment journey too closely, you should seek to gain your own set of ideas and opinions before you make your initial steps towards creating wealth through investment in property.

> "When money realizes that it is in good hands, it wants to stay and multiply in those hands." **Idowu Koyenikan**

## Is this advice?

No, I am not permitted to give you advice, therefore all of the knowledge, ideas and experiences contained is this document should be considered educational and general information and you should seek you own Financial and Accounting advice from sources that you trust before you act upon any of the information presented in this document. I have taken care to be as accurate as possible how ever laws, banking regulations and tax incentives and regulations are constantly changing, therefore you must verify for yourself the accuracy of any information that I have provided. The objective of this document is solely to encourage, motivate, clarify, and share ideas that I have gained from 20 plus years of dealing with clients, banks, tax, builders, and investors.

Enjoy the read and I hope I can add some value to your life.

Glenn Rodricks
Director
The Great Aus Dream Pty Ltd
TA INVST AUSTRALIA

# Education

PROPERTY

# Understanding investment speak

by Glenn Rodricks

**Wealth:** is commonly understood to be when you have an abundance of something to use for yourself or share with others. In this context wealth is having adequate money to continue the lifestyle that you want to have in the future.

**Money or Capital**: this should be understood to be the funds that are available with you to pay deposits, fees, and other expenses towards buying your property. The capital is the amount of money you have to put towards buying your investment property.

**Asset**: is understood to be a property which is owned by you and has a market value that can be used when sold, or can meet a debt or a legacy. In this context an asset is a property that is suitable to be given as a security to a lender in return for a loan.

**Equity**: is best defined as the difference between the value of the asset and any debt. This equity can be accessed either when a property is sold and debt is repaid or when a debt is created against the asset allowing you to draw upon the equity. In the case where a property is sold, then the net equity will be the sale price, less any cost to sell, less the loan against the property.

Therefore once you have paid back the lender the initial loan, the balance is your money, this is considered net equity. In the case where you don't sell the property, but you still want to access equity, then a mortgage is created against the asset which allows you to draw money in cash. The mortgage will always be less that the value of the asset. Normally this loan is about 80% of the value of the asset.

# Guidance

PROPERTY

## Understanding investment speak

**Capital growth:** this is a market driven increase to the value of your asset. Over a period of time property prices increase, This increase is driven by demand for property and therefore is considered to be 'market driven'.

**Capital Gain**: when you sell an asset which was purchased for investment purposes, the net profit after all expenses and other add backs is considered to be a capital gain. The term 'capital gain' means that your capital or money invested has increased and this net increase is considered a capital gain.

**Capital Gain Tax**: means the amount of tax you will pay considering that you made a profit when your sold the property in that tax year. There is actually no such tax called Capital Gain Tax, it is actually part of your income tax and not a separate tax. You should seek professional advice from an accountant or speak to the ATO to calculate your estimated capital gain, It is advisable that you keep aside money from the profit you make to pay this additional tax.

**Capital Loss**: is the opposite of Capital Gain, it is when you have lost money after the sale of your investment, which means that you have invested capital but when you sold, the amount of capital you returned is less that the amount you originally invested. If you make a Capital loss there is no refund due from the ATO, but Capital losses can be offset against future Capital Gain.

*Note: this subject (Capital Gain/loss) is quite complex and there is a lot more information available from https://www.ato.gov.au/general/capital-gains-tax/*

**Depreciation**: in the context of property investment, this is best understood to be an accounting method acceptable to the ATO, by which the value of your asset is spread over a period of time. Normally the value of the structure of a home is considered to be spread of a period of 40 years.

# Tutoring

PROPERTY

## Understanding investment speak

A simple way to understand depreciation is to assume that after a period of 40 years the home will be completely without any value and therefore every year the home will lose 2.5% . (2.5% X 40 years is 100%)

But some components of a house, will not have a life of 40 years, such as the oven, the stove top, heating or air conditioning. Such items have a separate accounting method which allows them to be depreciated or value spread over a shorter period of time, such as 4 or 5 years. Practically this means that after a short period of time, say 5 years the heating unit may need to be replaced; therefore, the depreciation time is shorter.

**Depreciation** could be considered as a book loss or accounting loss not a cash loss. It is a loss of value of an item that you have paid for in cash and will have to pay for it again after a period of time has passed. During those years you will claim a portion of its value by an accounting method called depreciation. Depreciation is an important factor in property investment as it plays a major role in Negative Gearing calculation once you file your personal tax return every year after you have purchased your first investment property.

**Negative/Positive Gearing**: This is a tax calculation method by which you claim property related expenses while your property is income producing. In any tax year you can claim all the expenses associated with your investment property, including depreciation for the period when your property is producing an income. This means that you must be receiving rent every month against which you are claiming your property related expenses.

If your expenses are greater than the annual rent that you receive for the year, it is considered to be negatively geared and if the rental income is greater than the expenses for the year, then is it considered to be positively geared. There are many regulations around what can and cannot be claimed, therefore you will need to seek professional help from your tax accountant to calculate your tax obligation.

# Teaching

PROPERTY

## Understanding investment speak

**Depreciation schedule:** this is a report prepared by a quantity surveyor which clearly lays out the amount of depreciation you can claim on every part of your property besides the land. This report is divided into two parts, the first being the capital works, which is the structure of the home and is knows as DIV 43 for tax purpose.
The second part is the plant and equipment, which is a list of values of each item inside the house that will have wear and tear, this is know as DIV 40 for tax purpose. Having a Depreciation Schedule prepared by a professional company is recommended as it may give you the best possible result in your annual tax return.

> "Money is only a tool. It will take you wherever you wish, but it will not replace you as the driver."
>
> **Ayn Rand**

# Money matters

## BANKS & LENDING TERMS

# Let me shed some light on 'banking speak'.

by Glenn Rodricks

**To buy an investment property, you will need a bank to lend you** the money, or a large portion of it. Banks use terminology that can be confusing and intimidating, but don't worry, I have covered most of the terms that you will hear and when you need to apply for a loan, most of the 'banking speak' will be familiar.

I have spent more than 20 years dealing with loans, lenders and people and I have found that most people accept the sometimes vague explanations of terms used in lending without question, but this is not the way to start your investment journey.

I have tried to explain some simple and some very complex banking methods and terminology in ways that can easily be understood. Not everything has been covered, but most of the common 'speak' is here.

Glenn Rodricks
Director

# Money matters

## BANKS & LENDING TERMS

# Understanding your loan

**Loan Structure:** is the type of loan, with its limitations, lock-in period, annual costs, break cost and term of loan. All these components of your loan may have some influence and or limitations upon your strategy, As an investor you want to have the most suitable loan to take advantage of the opportunities that may come your way on your investment journey. The cheapest interest rate is very seldom the best possible loan for an investment portfolio.

**Ownership**: the property can be owned in varying degrees of ownership. In most unconsidered investments, the property is purchased 50-50 under the Joint Tenant structure. In this case the property is owned equally and therefore tax claims are also in line with ownership. But, in a considered structure the ownership structure could be Tenants in Common, which then allows you to structure the ownership in unequal proportions for tax purposes.

**Collateral**: this is the security given to your bank to guarantee your loan. In the unlikely circumstance that you default on your loan and cannot make the repayments for a period of time, this collateral is what the lender will sell to recover their loan and other any other losses. Collateral for an investment loan is always a real property, either vacant land or a home.

**Cross Collatera**l: this means that the lender has more than one property held as security for your loan, it could be your home plus the investment home that you have purchased or another investment home plus the new purchase. Sometimes the lender may have multiple properties held as collateral. This is an important aspect of your loan structure and I will always spend time to establish the best possible collateral structure for each investment..

# Money matters

## BANKS & LENDING TERMS

## Understand your lending

**Interest only:** in most investment strategies, an interest only loan will feature as a recommended requirement. This means that you will only pay the lender the interest for the money you have borrowed, meaning that the principal amount borrowed will not reduce over the interest only term.

There are a few reasons why interest only loans are recommended, The two most obvious are; the ATO will only consider the interest amount as an expense when you file your tax return, which means that any principal that you may have paid cannot be claimed as an expense.
The second is to manage monthly cash flow, As an investor the ideal investment is one that is not costing you from your pocket every month. This means your investment is neutral as the expenses are less or balanced by the rent received.

**Fixed or variable**: when deciding upon a loan one of the important factors is choosing a fixed term or a variable loan. A fixed term is when the loan is locked into an interest rate for a fixed period of time, which means that irrespective of interest rate changes your loan interest will not fluctuate, The other option is to have a variable interest rate, which means your rate will increase or decrease as the interest rates change. There are pros and cons for both, and it is an important decision to be made at the time of finalising your loan structure.

**LVR (loan to value)**: this is a ratio based on how much money you are borrowing as compared to the value of your property. The amount of money you borrow against your property is part of your investment discussion and should be made after consulting and understanding the financial measures and investment return ratios.

# Manage

PROPERTY MANAGEMENT

# How to manage you investment home

by Glenn Rodricks

Now that you have decided to buy your first investment there are a few more steps to take to ensure that your home is well managed and you take the necessary steps to mitigate any risks associated with investment property ownership.

Having a professional and responsible Real Estate Property Manager to care for your property is important. After all you have just paid a lot of money for a home, therefore paying a reasonable management fee should not be in question. People who self manage an investment property, unless experienced may encounter in problems in time to come.

This document explains some of the important aspects around managing your investment property successfully.

Glenn Rodricks
Director

# Manage

BANKS & LENDING TERMS

## Manage your investment

**Management:** this is the cost of having a Real Estate Property Manager to look after your property. Every investor should keep the tenant at arm's length by appointing a Property Manager to find your tenant, manage the tenant and collect rent every month. The Property Manager will not only collect the rent but will also ensure that the property is cared for in a reasonable manner to protect your investment.

The Property Manager will report to you periodically with inspection reports and also manage any emergency repairs if required. If the property is not being cared for in a suitable manner, then it is the Property Managers responsibility to call the tenant to step up and maintain the property as per the lease agreement. By having a good Property Manager, you can ensure that your investment property is well cared for.

The cost of management is normally a percentage of the monthly rent and can vary from 4% to 10% of the rent, depending upon the service and or rental guarantee that may be part of the Management agreement.

**Insurance**: normally the lender will require you to insure your investment property for the replacement amount required by them. I recommend that you also have Landlord insurance, which is easily available from all the major insurance providers. This insurance covers many areas of possible loss;

> **Rent:** this can stop due to various circumstances that may occur. Break of lease is when a tenant may walk away from the lease and therefore you will need to find a new tenant, this insurance covers you for this loss and expense to find a new tenant, or a tenant who does not leave the property and may require a court order to repossess the home. The death of a tenant, or hardship that may legitimately cause your tenant to not be able to pay the full or part of the rent.

# Manage

BANKS & LENDING TERMS

## Manage your investment

**Contents:** Your property could be damaged due to malicious damage by the tenant, the tenants guests, the tenants pets, flood damage, water damage, glass breakage, storm damage and various other factors that may leave your property in a condition which limits you from leasing the property. This insurance covers you for the repairs to bring your home back to a tenantable condition.

**Domestic fixtures and fittings**, i.e. built in air-conditioners and heaters, plumbed-in dishwashers, garbage disposal systems, cook tops, built-in cabinetry, doors, walls, windows (and glass), tap ware, hot water systems and shower screens,

**Building:** this is also covered by some insurance and it covers all the structural areas of your property. These are some of the items that can be covered by this insurance.

**Structural:** domestic improvements such as paths, driveways, garden borders, your proportion of fencing, gates, retaining walls, in-ground swimming pools and spas (including attachments which fit into their filter systems), Awnings, pergolas, fixed rainwater tanks, solar panels and their fixed accessories (e.g. inverters), TV antennae, satellite dishes and letter boxes, Fixed floor coverings such as linoleum, floor tiles and parquetry, (but not carpets), Fixed light fittings which are hardwired to the building,

Tennis courts, and Underground services such as plumbing, sewerage, water and electrical which are located on your property.

# Manage

## BANKS & LENDING TERMS

## Manage your investment

**Water:** the cost of supply of water to the home as well as the storm water removal is part of your cost, the tenant pays for the usage of water.

**Rates**: Every City Council has a levy that is calculated as a percetage of the value of your property. This covers the cost of waste management, municipal charges and a contribution towards  more than 100 services that are provided by local government.

**Body corporate fees**: this funds building insurance, common area maintenance, and building works and repairs. The fees you and other owners pay annually form the body corporate budget, distributed between an administrative fund and a sinking fund for capital works. This is a cost only when you purchase an investment in a unit development, townhouse development or an apartment complex. With apartment buildings there may be other fees associated with owners, therefore it is important to ask the question if you are considering an apartment as an investment.

# The Numbers

PROPERTY ANALYSIS

## How to analyse your investment property

by Glenn Rodricks

Deciding if your property is the most suitable home you can buy at this time should not be based on emotions, Instead it should be a decision made on the Financial Measures and the Investment Return Ratios.

To help you understand some of the more important ones I have listed them with explanations as to their interpretation. Some are easy to understand but some may need further clarification.

These can be discussed at our next meeting.

Glenn Rodricks
Director

# The Numbers

## PROPERTY ANALYSIS

## How to analyse your investment property

**Break-even ratio (BER)** Its purpose is to estimate how vulnerable a property is to defaulting on its debt should rental income decline. There is an old saying that when your outgo exceeds your income, your upkeep will be your downfall.
***Mortgage repayments + operating expenses / rental income***

**Cash flow before taxes (CFBT)** To calculate a property's cash flow, you simply take all of the inflows and subtract all of the cash outflows during the relevant time period. For the calculation of cash flow, it is irrelevant if the cash item is considered a taxable income or not; and whether cash outflows are tax deductible. An example would be the treatment of mortgage payments. For cash flow purposes the entire mortgage payment is counted while for tax purposes only the interest portion is actually deductible. Further, cash flow does not include depreciation expenses as they are not actual cash expenses.

**Cash on Cash Return:** The cash-on-cash is the ratio between the property's cash flow in a particular year (usually before taxes) and the amount of the initial capital investments. It is expressed as a percentage.

**Internal Rate of Return (IRR)** is probably the rate-of-return measurement most widely used by real estate professionals. It allows you to take into account both the timing and the magnitude of cash flows produced by your income-property investment.

**Profitability index (PI)** The profitability index calculates the ratio between the initial investment and the present value of future cashflow. If the initial investment and the present value of future cash flow are exactly equal, the index is 1.0. This means that with PI of 1.0 your investment achieves exactly the rate of return you aimed for; or simply that your internal rate of return (IRR) equals your discount rate set in the calculation of present value. If it is above 1.0, you have exceeded the rate of return goal. However, if your ratio is under 1.0, this means that you have not reached the goal and your internal rate of return is lower than your discount rate.

# The Numbers

PROPERTY ANALYSIS

## How to analyse your investment property

**Net Present Value (NPV)** Let's say that you require a 10.5 % rate of return on your investment. When you discount all of the expected future cash flows back at that rate, the PV result is the amount of cash you need to invest at 10.5 % to achieve those future cash flows - with exactly the same timing and amount that you predicted.

**Gross Rental Yield:** This is a market indicator of the relationship between median house prices and rental return. It should be used to confirm that rental projections in the financial projections are not exaggerated.