



Paul Clitheroe

Paul Clitheroe is a founding director of financial planning firm ipac, Chairman of the Australian Government Financial Literacy Board and chief commentator for Money Magazine.

residential property investment - good, but can be costly

A growing number of Australians are investing in property, buoyed along by a market that is delivering good capital growth. But bricks and mortar also come with significant costs, and it's worth doing the sums to be sure you can handle the outgoings.

Housing finance figures for December 2009 show demand for investment loans rose for the second consecutive month. Many investors will be attracted to property by the steady price growth we're seeing in virtually every capital city.

According to the Australian Bureau of Statistics, house prices nationally grew by an average of 13.6% last year. Melbourne values came up trumps, rising 19.7%, with Darwin (up 13.6%), Sydney (12.8%) and Canberra (12.4%) all enjoying strong price growth. Adelaide (5.1%) was the only city that failed to achieve double digit growth.

The capital gains seen in most of our cities last year is very appealing for would-be landlords. However one of the downsides of property is very high transaction costs.

Stamp duty, legal fees, loan application fees and pest/ building reports are all additional costs associated with property. Depending on the type of property and the price you pay, these buying costs can add an extra 5% onto the initial

cost. That could mean outlaying an additional \$25,000 on a property worth \$500,000.

Later on, when you go to sell the property you'll be up for agent's commission (typically around 2.5% of the sale price), legal fees (to prepare the mortgage and exchange documents) and possibly early mortgage payout charges. If we assume these selling costs total 3% of a property's value, all up your investment needs to rise in value by at least 8% (5% plus 3%), plus inflation, just to break even over the period you have held the property.

That's why property is generally regarded as a long-term investment. In addition to the vagaries of the market, it can take significant time just to recoup those hefty buying and selling costs.

The cash outflow doesn't stop with the purchase and sale of the investment. With an asset like shares, you hand over your money, then sit back and wait for the returns. Property is a bit different. You hand over the money...and then you hand some more...and then you hand over some more. Just like your own home, a property investment can be a constant source of expense.

At this point you may be thinking, "Yes, but I can claim plenty of these expenses against my tax". That's

true. A wide range of ongoing costs associated with rental properties are tax deductible. But you have to be able to meet the cost before it can be claimed on tax.

That means being able to fund a new hot water heater when the tenant calls to say the old one has broken down. Or paying a plumber to make urgent repairs on a weekend, or meeting any number of expenses when they arise.

Don't get me wrong, I'm certainly not saying property is a poor investment. However, most landlords could be out of pocket for the first couple of years of the investment, so a very important question to consider is: what other source of income do you have to make up the shortfalls - and how secure is that source of income?

A good residential property investment provides long-term capital growth and healthy rent returns, and if you are properly set up for it, I ordinarily recommend it. But if the upfront and ongoing expenses associated with property will put a strain on your personal cash flow you need to think very carefully about investing in bricks and mortar. It's a big financial commitment, and you have to be able to cope with, sometimes, big outgoings and occasionally, financial pain, along the way.

Paul Clitheroe's 'Making Money' for the week beginning 22 February 2010



Disclaimer: The material contained herein is of a general nature only and is not intended to be relied upon as a substitute for professional advice. ipac has not taken individual circumstances, objectives or needs into consideration. Before acting on any advice, you should consider whether the advice is appropriate to your individual circumstances. You are advised to seek independent professional advice. While ipac believes that the information contained in this publication is correct, no warranty of accuracy, reliability or completeness is given, and except for liability under statute which cannot be excluded, no liability for error and omissions is accepted. ipac securities limited ABN 30 008 587 595 AFS Licence No. 234656.

ipac securities limited Level 31 Grosvenor Place 225 George Street Sydney NSW 2000 Australia
Sydney Office Locked Bag 15 Grosvenor Place NSW 1220. DX 10328 Sydney Stock Exchange.
Telephone 02 9373 7000. Facsimile 02 9373 7111. Adviser Services 1800 812 950. Investor Services 1800 624 542.