



**MORTGAGELAB**  
CO.NZ



# YOUR NEXT INVESTMENT PROPERTY

A Comprehensive eBook Guide



# YOUR NEXT INVESTMENT PROPERTY

Investment property has long been the favoured investment option for us Kiwis. The ability to buy your first property is viewed as almost a human right in New Zealand and this is reflected by many government policies favouring first home buyers.

And once you've owned a home for a while, the discussion inevitably turns towards purchasing your first investment property.

## In this book, you'll learn:

- The investment basics every property investor needs to know
- How to easily calculate the most important numbers in your head
- Who you need in your investment team
- What you'll need to get a mortgage





## LEVERAGED BORROWING

Let me start this book by picking a fight with every share broker and fund manager on the planet. Property is (I think) a better investment than the sharemarket because you can leverage your money to purchase a greater value investment. That's not to say KiwiSaver and Investment Funds aren't great investments. KiwiSaver is almost a leveraged investment because if you put money in, your Employer often matches your contributions.

But for the amount of risk that property poses (usually very little risk), you can gain a lot of leverage and, therefore, buy a lot more. For example, if you have \$200,000 to invest, you can either buy just \$200,000 worth of shares or, if your income allows, you can purchase \$500,000 of property (we'll talk more about deposit requirements later). If both investments go up by 20% over the next year, your shares have increased by \$30,000 and your property has grown in value by \$100,000.

A counter-argument to this is that, because property is a leveraged investment, you can potentially lose your entire investment much more easily. In the example above, it would only take a 40% drop in value (from \$500,000 to \$300,000) to lose your entire savings. Whereas, on the sharemarket, all shares in your portfolio would need to drop to \$0 for you to lose your entire investment.

It's important when investing to consider your timeline. Losses are usually only relevant if you have to sell. If your timeline is long enough, a temporary drop in value (i.e. the property market dropping) shouldn't affect your retirement plans.

“*You haven't bought too high,  
you just bought too soon...*”

In other words, because the property market trends upwards over a long time, you may have paid too much for your property this year but in 3 years time, it may be the standard price. With a long enough timeline, paying too much doesn't matter, as long as you stay in the market.



## TANGIBLE VALUE

But I think the real lure with property is that you can see it. You can paint it. You can mow it. You are in charge of improving it (if that's your thing). And that has some real psychological benefit over shares.

## SOME PROPERTY INVESTMENT BASICS

So, you're looking to purchase your first investment property. Or maybe this is your 12th property. Either way, there are a few key points you need to understand.

### LVR

The first thing a mortgage adviser or bank will calculate is your Loan to Value Ratio (LVR). Think of the LVR like this: What percentage of the house is covered by the mortgage... Or, in other words, what percentage of the house does the bank own?

#### Example:

If your house is worth \$400,000 and your mortgage is worth \$300,000, then your Loan to Value Ratio or LVR is 75% because the bank has lent you 75% of your house. If the value of your house increases to, for example, \$500,000, your new Loan to Value Ratio is

60% (because \$300,000 is 60% of the new value – \$500,000).

If you are looking to purchase an investment property, banks will lend up to 80% against the house you live in. Most banks will lend 70% against any investment properties you own.

If you've found a great investment property but don't have enough equity or deposit, consider looking at a non-bank lender for a year or two. They cost a little more, but can get you onto the investment ladder.





## HOW DO **BANKS** MEASURE LVR?

Initially, a bank will run what is known as a desktop valuation (sometimes called an AVM - Automatic Valuation Model). This is an electronic assessment of recent sales in the area for properties with comparable land sizes, number of bedrooms/bathrooms, and other important property characteristics.

At first glance, a Desktop Valuation sounds like a "dumb" report but, in actual fact, it has incredibly complicated algorithms running in the background and even involves machine learning to become more accurate.

The benefit of a Desktop Valuation is that it's instant, free (if the banks run it) and is accepted by the banks as a value of the property.

The downside is that it can't see the shiny new bathroom you put in the property last month. It can't tell that your kitchen has a scullery and your neighbour's house that sold last month had a kitchen last renovated in the 1970s.

If you disagree with the Desktop Valuation, your next option is to order a Registered Valuer's Report. A valuer will come to your property and walk through it, giving you a much more representative valuation.

Important: DO NOT order your own valuation. A Registered Valuer's Report must be ordered through the bank system to ensure it is independent.



TALK TO AN ADVISER



# CALCULATING HOW MUCH YOU CAN BUY (BASED ON EQUITY)

Here's a quick way to calculate how much equity you have available to purchase your next Investment Property (based on a 70% LVR requirement):

How much is your Owner Occupied worth:	(a) \$.....
<hr/>	
80% of (a) is:	(b) \$.....
<hr/>	
Total value of all your investment properties:	(c) \$.....
<hr/>	
70% of (c) is:	(d) \$.....
<hr/>	
Total up (b) and (d)	(e) \$.....
<hr/>	
What is the total of all your mortgages:	(f) \$.....
<hr/>	
(e) \$.....	Minus (f) \$..... = (g) \$.....

(g) is the amount of money you have to use as a deposit for your next investment property.

## Deposit or equity required for Investment Properties

[30%]  
Existing Properties

[20%]  
"New" Properties





# CALCULATING THE RETURNS ON AN INVESTMENT PROPERTY (YIELD)

## GROSS YIELD

You will most often hear the gross yield of a rental property simply because it is the easiest to calculate.

**Example:**

A \$500,000 property may have a 5% gross yield meaning it receives \$25,000 per year in income.

This is a good basic calculation because the main cost of an investment property is the mortgage. If a mortgage interest rate is 3%, you can quickly see that the 5% property is going to leave you a bit of profit to pay for the other expenses - insurance, rates, maintenance etc. The example above would have \$15,000 of interest p.a., so we know very easily that we have \$10,000 to play with per year.

### TIP

The rent per week to get \$25,000 of income is approximately \$500 (assuming 2 weeks vacancy per year). This is 1/1000th of the price (\$500,000 : \$500 rent). For a 5% gross yield, the rent will be ~1/1000th of the price.

Rent = \$365 per week, offer \$365,000 = 5% gross yield

Rent = \$413 per week, offer \$413,000 = 5% gross yield

## NET YIELD

Gross yield is a quick, back-of-the-envelope calculation that people can use to filter a property. But net yield is the amount of profit after all expenses. It is the true measure of an investment property's cashflow.

To calculate net yield, start with the total yearly income - in the example above, \$25,000 - minus the interest costs, council rates, water rates, insurance and expected maintenance. At the end of all this, you may have a loss per year of \$2,000. This means you are going to need to pay ~\$40 per week yourself to pay for everything. The property is technically "cashflow negative" (although in this case, not by a lot!).





## PURCHASING AN INVESTMENT PROPERTY

It is worth noting that purchasing an investment property should be significantly easier than purchasing your own home. The decision should be purely about the numbers. Here are some questions you may like to ask yourself when you're looking for an investment property:

### Is it tenant-proof?

- Rental properties need to be a little more bulletproof than an Owner Occupied property. Beautiful stained glass windows, for example, are not recommended. Highly manicured gardens will inevitably be left untended to if your tenants don't employ a gardener.

### Has the property been insulated?

- Rental properties are now required to be insulated. Failure to have proper insulation results in a fine of \$4,000. You will need to factor the cost of insulation into the purchase price before renting it out.

### Does the property have consent?

- Home and income properties often have higher yields but the 2 units need to be properly consented by the council or you run the risk of not being covered by insurance.
- Look for things that look unusual like fireplaces with a chimney too close to a neighbour's house or lean-tos. A Sale and Purchase Agreement should have unconsented works disclosed in it.

### Is the property near facilities?

- Properties rent to families a lot easier if they are close to schools or city hubs.

A lot of investors upgrade where they live and keep their old home as a rental. This is not always a great strategy. Does your previous home meet the investment questions above? Does it have a good yield? Is it tenant proof? Consider selling your old home and buying a rental-specific investment property.



TALK TO AN ADVISER



## HOW TO STRUCTURE AN INVESTMENT MORTGAGE

Whole books could be written on how to structure your mortgage properly. They wouldn't be very interesting books but, nevertheless, there is a lot to consider.

Although deductions for interest on existing rental properties were removed in April 2021, the rules have now been reversed and you can once again claim 100 per cent of your interest costs. If you have both a personal mortgage and an investment mortgage, it still makes sense to focus on repaying the personal loan first. Most advisers recommend keeping the investment loan on an interest-only basis so that, should deductibility change again, you will preserve the maximum possible tax deductions. Paying down the investment portion offers little advantage while the prospect of future deductions remains.



You can see in the image, both mortgages are \$900,000. However, the top mortgage is paying Principal and Interest on both accounts; the \$300,000 personal (yellow) and the \$600,000 investment (white). This is slowly reducing both accounts and means in future years, there could be less interest to claim as an expense on the investment property.

A better option is the bottom mortgage. They are paying exactly the same per month but all of their Principal payments are going towards the personal mortgage (\$300,000) while their investment mortgage is on Interest Only. This means the \$600,000 investment mortgage will continue to have maximum if the rules change back to allow for interest expense deductions.

The reason so many mortgages are poorly structured is because the last few steps of purchasing a house tend to be rushed and can be stressful. It's important to make sure you understand the potential benefits of paying extra onto your personal mortgage and keeping your mortgage on Interest Only. It could literally mean the difference of thousands of dollars per year in tax benefits.

If you currently own Investment Property and are paying down Principal and Interest on both your personal and investment mortgages, it is reasonably easy to correct. Talk to your Mortgage Broker and Accountant to restructure your mortgage.





## BUILDING VS BUYING AN **EXISTING** PROPERTY

We are often asked which we think is better: building a new property or purchasing an existing property.

Deciding between a new build property and an existing property is a personal decision. There are a lot more existing properties than new (literally every house that currently exists!) so you have a much wider choice. But newer houses can go without maintenance for years and have greater appeal to renters.

Add to this the fact that you can borrow up to 80% of the purchase price for new build properties (compared to 70% on existing properties) and that, for now, it seems the interest on your mortgage is deductible for new-builds but not for existing properties, it seems like new builds are the obvious choice from a numbers perspective.

If you are the type of person who loves to renovate and can do so economically, an existing house that requires some renovations may be a better investment for you. If you couldn't paint a room to save your life, then a new property may be more for you.

In summary, consider both options depending on your situation and skills and don't let anyone tell you any different. Just because your best friend loves buying newly constructed apartments, for example, doesn't mean they're right for you.





## WHY MOST INVESTORS ONLY OWN **1 OR 2 PROPERTIES**

Since the 1990s, owning a property investment portfolio has been the subject of many books, TV series and pricey mentoring courses. The dream: to retire with a collection of cashflow-positive properties and minimum debt that will fund a comfortable, if not luxurious, lifestyle.

It's a good strategy (although savings schemes such as KiwiSaver and investment funds should be included in this strategy). So why is it that, according to MBIE statistics, 77% of Kiwi investors own just one investment property?

Logistically, self-managing more than one or two investment properties becomes time-consuming and, with the new tenancy protection rules in place, is incredibly complicated. We are a nation of DIYers and often overlook the value of a professional property manager until something goes wrong.

But, mostly, investors simply don't have enough income to meet the bank's servicing criteria. The banks put your income through a series of stress tests to protect applicants from future interest rate increases and this materially affects how much someone can borrow.

Take as an example a couple with a combined income of \$150,000 and an extra \$25,000 per year from their current investment property. If they owe \$1 million on a 30-year-mortgage, they might be paying about \$50,000 in interest and about the same (in the first year) in principal payments. Roughly a total of \$64,000 per year in mortgage payments. Quite a lot, but manageable given their income.

But the bank calculates their affordability at around approximately 3% above what they are paying in real life and, for the investment property mortgage, over 25 years not 30 years. That increases the calculated payments by almost \$30,000 per year. The bank then scales the rental property income by 50%-75% to allow for vacancies and other costs meaning over ~\$6000-\$12,500 less "usable" income. Then the bank assumes that the applicants will max out their credit card limits (even if they pay them off every month) and requires 3% of the credit card limit to be taken off their income.





## WHY MOST INVESTORS ONLY OWN **1 OR 2 PROPERTIES**

To clarify, the bank adjusts these numbers to protect applicants from future upsets and rightly so. But you can see how quickly a couple with what looks to be ample income to make another purchase runs out of usable income at the bank.

So, if you want to grow a property portfolio, what can you do? The first thing is to appreciate how much secondary debt (credit cards etc) affect your ability to borrow. A \$10,000 limit means about ~\$46,000 less mortgage borrowing capability so cancel credit card debt and overdrafts where possible. Avoid the short-term hire purchase/lay-by debts at all costs.

Secondly, look for positive cashflow properties. Ideally, properties that you can renovate and grow both the capital value and the rent on. These may be quite

different to the type of house you would live in yourself which is a difficult concept to get your head around.

Thirdly, increases in your salary means the ability to borrow a lot more. A raise of just \$5 per hour is around \$10,000 per year and means you could borrow around \$100,000 more on a mortgage. An increase in your salary has much more of an effect on your borrowing capability than a rent review because of how the bank scales rental-property income by 50%-75%. Having said that, review your existing rents to make sure they are in line with the market.

As you build your portfolio, equity should be an easier thing to build but income will become harder to prove at the bank. Stay vigilant with expenses and increase your income if at all possible.





## YOUR INVESTMENT PROPERTY TEAM

A lot of investors underestimate the importance of gathering a good team around them when purchasing an investment property. Often, they can think that owning 1 rental property doesn't require professional advice.

Paying for good professional advice is one of the best things you can do at any point in the buying process and this has become even more true since the complicated tax deductions around existing and new investment properties..

Let's look at who you might need in your team.

### SOLICITOR

You will always need a Conveyancing Solicitor when you are purchasing a property; however, many of investors leave this until the very end, which is a mistake. A Solicitor should also cast their eye over any Sale and Purchase contracts and check a property to make sure everything is correct with it.

We have had several buyers who have been saved from costly clauses in their contracts, particularly with new build contracts, by consulting their solicitors. Some construction contracts have additional costs over and above the "base" cost of the contract. Sometimes called Provisional Sums, it is important that you are aware of these costs and understand their implications.

Sunset clauses are another example of something that should be checked by a Solicitor for new build properties. While not inherently bad, they need to be checked to make sure they are in your favour, not the developers.

Existing properties can have unconsented works which are difficult to pick up on or there may be disclosures (especially regarding what you can do with your property) that your Solicitor will make you aware of. A Solicitor will walk you through all your options from an unbiased point of view. The cost of a Solicitor will seem very small if they save you from a clause that will hamper the growth of your investment.





# YOUR INVESTMENT PROPERTY TEAM

## REAL ESTATE AGENT

In the United States, there are buyer's agents and seller's agents. As an investment property purchaser, you would work with a Buyer's agent and they would search out a good property for you.

In New Zealand, one Real Estate Agent will usually act as both a buyer and a seller. A good Real Estate agent will take their time to understand your requirements and search their company database for a suitable property, even if they are not selling it. In most of the major cities, there are 4 or 5 major brands that cover 90% of the market. Find an agent you like in each company and ask them to search their database. Once they have done this, ask them to introduce you to the listing (selling) agent at any properties you like. This doesn't add anything to the cost of your purchase but does mean

that the referring agent you've been working with will be remunerated if you purchase.

One frustration that property buyers have is that they tell an agent they are looking for a certain type of property and the agent keeps sending them properties outside of that specification (eg: looking for a 3 bedroom house and they keep sending 4 bedroom houses). Sometimes this is because there is not enough listings that match those criteria but, often, Real Estate Agents see buyers who have their heart set on a certain option (like 3 bedrooms) who then end up purchasing something completely different. If an Agent sends you a property, even if it is outside of your specifications, it would pay to look at it and consider whether you can make it work. Some of the best bargains are the ones that everyone else is ignoring.





## YOUR INVESTMENT PROPERTY TEAM

### BUILDER

It's always good to get a professional builder to walk through the property if you don't have a good knowledge of construction. They will spot possible unconsented works or areas that may need urgent attention. They should be able to provide a rough cost to repair, which can help with negotiations or your overall decision to buy.

Some builders charge a nominal fee to walk through and give a verbal report on the property. It is unusual for a bank to require a written Builder's Report unless a problem has been identified or the property is classified as at risk of being "leaky".

### PROPERTY MANAGER

The rules around managing tenants have never been more complicated than they are today. The notice period for tenants vary depending on the reason for removing them from the property. Insurance may not fully cover damages if regular inspections aren't done. And there are dozens of other pitfalls that could cost landlords thousands of dollars.

Having a rental property manager has moved from a "good to have" to an absolute must in the past few years. There are very few regulations required to set up a rental property agency however so interview the manager and make sure you are happy with their processes. A company with good automated systems is the sure sign of a good property manager.

### MORTGAGE ADVISER

We would say that though, wouldn't we?

A good Mortgage Adviser or Mortgage Broker, will be able to tell you which bank is the most suitable for your situation. It may be that you have reached your income limit with one bank, but not another. It may be that the

type of property you are purchasing is not acceptable to one bank but is perfectly fine with another. A good adviser should always work for what suits you best while working to get you the finance you need.





## WHAT DOCUMENTS WILL YOU NEED FOR AN INVESTMENT PROPERTY MORTGAGE

Below is a list of documents that you may need to complete a mortgage application:

- Payslips (3 most recent)
- Financial Statements for self-employed (2 years worth)
- Often the most recent financial statements shows the previous year so you only need to show the most recent set of accounts
- 3 months worth of bank statements showing your income and spending habits • 6 months worth of mortgage bank statements
- Trust Deed if you are purchasing in a Trust
- Company Certificate if you are purchasing in a Look Through Company

Once you have found the property you want to purchase, you will need:

- A copy of the Sale and Purchase Agreement
- A rental assessment

This can be completed by a Real Estate Agent. If there is a range

- e.g. \$400-\$450 per week, the bank will use the lowest in the range (\$400).

Note: a Registered Valuation will only be needed on a few occasions. It isn't required by default.

## WHAT TO DO NEXT:

If you're excited to purchase your next investment properties, here are the next steps that we suggest you take:

1. Talk to a Mortgage Adviser and find out what you can afford.
  2. Get a Solicitor, Accountant and some Real Estate Agents and start to talk to them
  3. Go to at least 20 open homes for properties that meet your criteria
- After 20 open homes, you will know exactly what a good property vs a bad property looks like in your price bracket. From then on, you'll know when you walk into a good deal.

[CONTACT A MORTGAGE LAB ADVISER HERE!](#)