PROPERTY APPRENTICE

Beginner's Guide to Property Investment in New Zealand

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Contents

Chapter 1. Introduction to property investment in NZ

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Property investment is often such a popular topic of conversation in New Zealand that you'd be forgiven for thinking that just about everyone is an investor. The reality is a little different.

According to the New Zealand Property Investors Federation Website:

- There are approximately 270,000 landlords in New Zealand. With a total population of approximately 4.8 million that means less than 6% of New Zealand own rental properties
- Private landlords are the largest providers of rental accommodation in New Zealand with 87% of tenants renting from a private landlord or trust
- 57% of property investors have been in the business for 10 years or more
- In the 2016 financial year, the rental property industry paid tax on a net rental income of $1,444,000,000

Many property investors own only one or two rental properties. They mostly choose to invest in property in order to improve their financial position for their retirement years.

However, one property as a long-term investment is not going to do much for your financial future and is certainly not going to fund a comfortable retirement (unless perhaps that one property is a mortgage free, fully tenanted, commercial building in downtown Auckland, for example). In other words, property investors who own one rental property are likely to retire with equity, but little or no passive income.

Owning one rental property is also quite a risky position to be in. If something goes wrong with your one and only investment, it's a big deal because 100% of your investments are in trouble.

For example, if you own one rental property and your tenant moves out, you are 100% vacant in your property portfolio. If you own two properties and a tenant moves out, you are only 50% vacant, which is a much better scenario.

Clearly, the more properties you have, the less impact a spot of trouble will have on you – as long as you have the right sort of properties in your portfolio.

If across the board your property portfolio pays you money each week to own it (positive pre-tax cashflow), then vacancies have a much smaller impact on you than if you have a portfolio that you have to top up each week out of your own back pocket even when your properties are fully tenanted.

Why invest in Property?

Investment Level	Rental Portfolio	Passive Income	Financial Stress	
Educated Investor		$100K +		6% of NZ'ers
D.I.Y. Investor		$30K-100K		
Newbie Investor		$17K- $30K		
Work 'til you die	**Zero Rental Properties**	$0- $17K		94% of NZ'ers

Based on the median weekly rent of $450.00 (Tenancy Bond Centre Statistics, April 2018)

Why most investors only have one property

If it is better on both wealth creation and risk fronts, (which ultimately reduces the amount of financial stress in retirement), why don't more people have multiple properties?

We often see that people who have one rental property are "accidental landlords". In other words, they didn't necessarily make a conscious decision to purchase a rental property, but they ended up with one almost by default. For example, a couple who meet later in life might each own their own home. When they decide to move in together, they may decide to move into one of their homes and keep the other one (just in case!) as a rental property.

The other reason that most people who own rental properties stop at one or two, is that they don't know how to leverage their equity in order to purchase any more than that.

Generally speaking most of us have been led to believe that "The Secret to Success" is to:

- Go to school and get a good education
- With a good education you can get a good job
- A good job will give you a good income, so you can start saving for a home
- Buy a home and pay it off (become mortgage free) as quickly as you can
- Then perhaps buy an investment property and pay that off as quickly as you can

It takes most people approximately 30 years to pay off a mortgage. Therefore, under this plan it would take about 60 years to get to the point where you own one freehold investment property in addition to your own freehold home. Life just isn't long enough to create wealth using this method.

You simply cannot save yourself to wealth.

Many investors with more than one rental property tend to follow the following type of plan ***which is also deeply flawed***:

- They buy an investment property in an area they know, close to where they live (often because they are familiar with the area and believe that it will give them fewer problem tenants). The problem with this is that many of us live in areas where the rent is not high enough to cover the cost of the mortgage payments (not to mention any of the other expenses associated with owning properties), so these investors usually have to contribute a little (or a lot) of their own incomes each week.
- Or, they buy property from an "investment company" without having a good understanding of what type of property is actually good investment for their financial situation, because it seems to be "easier"
- This type of investment property generally grows in value over time, so it has a bit of equity in it. This allows the investor to go to the bank and borrow money to buy a second property. Again, they have to put in some of their income to pay that mortgage.

- Depending on their income levels, they may be able to buy a third property or even a fourth property using this method. However, sooner rather than later, a large chunk of their personal income is going towards supporting those rental properties. Pretty soon the bank says, “You can’t borrow any more money or you’re going to have to get another job if you want to go on investing.”
- And so, their investing comes to a grinding halt because, let’s face it, the point of investing was to free up more time, not get a second job! (or worse, they lose their job and then soon after lose their investment properties and/or their home, as they are not able to keep up with their mortgage payments).

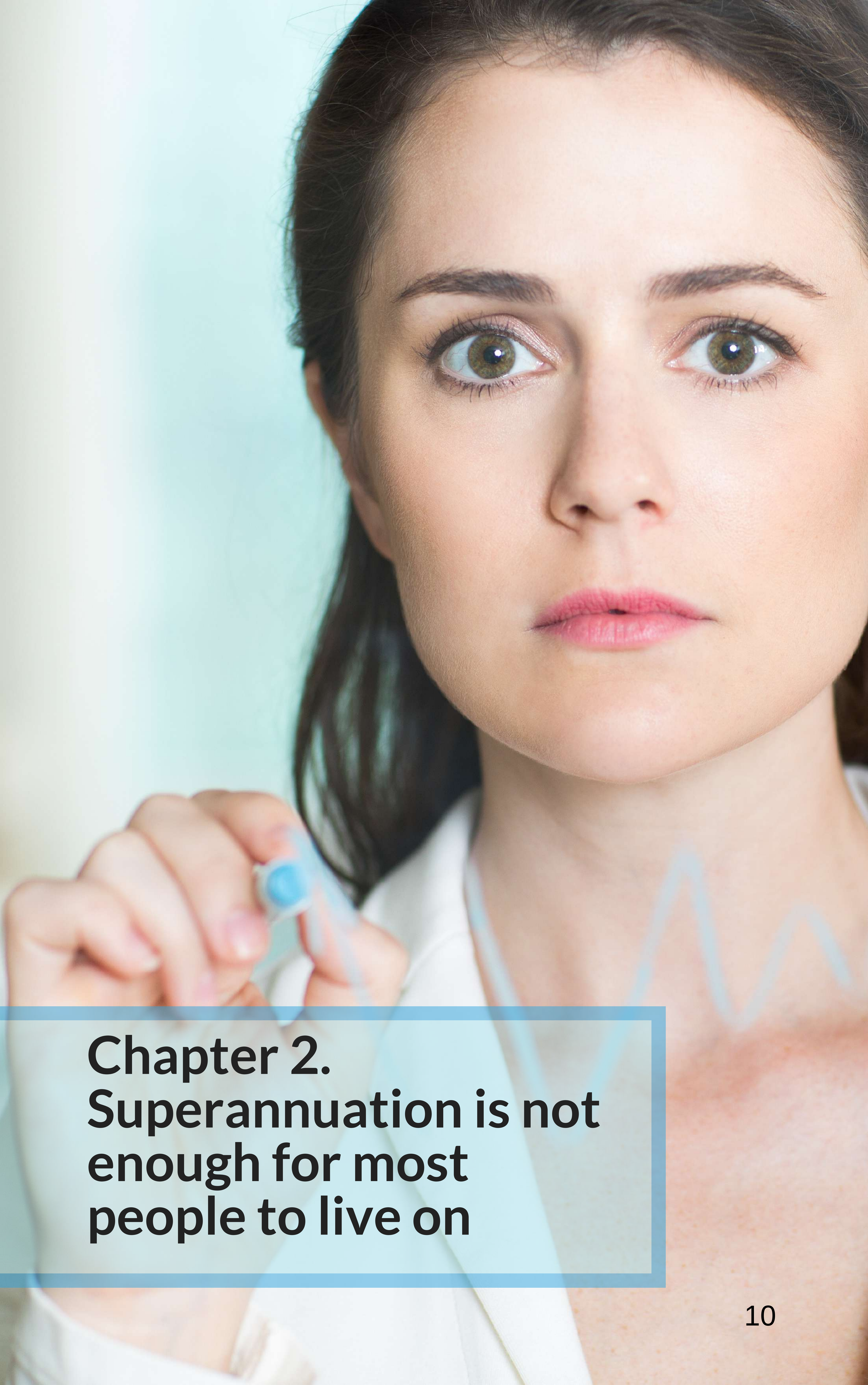
By the time these investors reach retirement, they generally have a good amount of equity, and certainly a lot more than they would have had if they had just been saving their surplus income.

I’ve said it before, and I’ll say it again - it is impossible to “save yourself to wealthy”.

However, what these investors often find is that although they have done better than most, they still don't have sufficient passive income to live on. Some of these investors sell their rental properties to cash in on the equity that they have generated over time. This might allow them to pay off any remaining mortgage they may have on their own home and give them some extra money to help fund their retirement. However, the problem is that this money will eventually run out, and often the money runs out before the lifetime does.

So how do people manage to have five or more properties, and create wealth through property investment? They follow a different plan to most people. I am going to explain what that plan is.

But first, let's look at why property investing should be a consideration at all.



Chapter 2. Superannuation is not enough for most people to live on

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Statistically, if we took 100 New Zealanders and followed them to the age of 65:

- 24 of them will have died before reaching their 65th birthday, so they don't have to worry about how to fund their retirement. If only we knew whether we would be in this 24% though, right?! Best we plan to still be alive until a ripe old age, and then our worst-case scenario will be that we will have something for our surviving loved ones to inherit.
- 54 are on welfare
- 16 are still working
- 5 are financially independent
- 1 is financially secure

Only six percent of new Zealanders aged 65 are financially independent or secure. ***Six percent!***

This is alarming. Why is it happening? Mainly because most people get their financial advice from well-meaning friends and family – people that often don't actually know what they are talking about. The very people that are going to end up somewhere in the 94% majority, rather than the people who are in the top 6% of the population who are financially secure or wealthy by the time they reach the age of 65.

If you want to be in the top 6%, you clearly have to do something different to the remaining 94%, right? But the question is: How?

The first step on the path to wealth creation is to formulate a plan and set some goals.

I know this, because I can honestly say that if it hadn't been for planning and goal setting there is absolutely no way that my husband, Paul and I would have achieved what we have. We bought our first property in 1999, and soon after that decided that we needed to get educated about the business of property investing. You see, we were not high-income earners. Paul was an electrician by trade, and I was a Medical Laboratory Technologist.

By the time I got pregnant with our daughter (who was born in 2005) we knew that we needed to kick things up a level pretty swiftly. We could not afford for me to quit my job, and my job had also changed in that I was now working for a company that supplied hospital and laboratory equipment, and part of my job meant that I had to travel around New Zealand teaching people how to use the equipment. I was away from home one week out of every month, and Paul was working 60 – 70 hours per week. We had no family that lived close, and there was no childcare facility that could take a child for 60 – 70 hours per week!

So, we got stuck in to property investing, and that has given us some choices that we would not otherwise have had.

By the time our daughter was born, we were in a position that we could afford for me to reduce my work hours. By the time our daughter turned two, I was able to quit my day job completely.

Having the freedom to choose how much time we work it is one of the reasons we are so passionate about property investment, and passionate about teaching people just like you, how you can use property investment as a pathway to creating financial security for yourself and your family and providing choices that you might not otherwise have.

Was it easy? Absolutely not! We worked our tails off! Was it worth it? Definitely, and I would do it again in a heartbeat.

We believe that you should not get advice about whether a particular property is a good investment for you, from anyone who has a vested financial interest in you purchasing that property.

This is one of the reasons that Property Apprentice does not (and never will) sell properties.

In order to set yourself a plan, the first step is to be honest and ask yourself these questions (even better, take a few minutes and write the answers down before reading any further):

1. How much longer do you want to work for?

2. What do you want to have or do when you retire? What sort of lifestyle do you want (e.g. live in a mortgage free home, travel, spend time with family etc.)?

3. In today's dollars, how much income do you think you might need per week for this sort of retirement?

It is important to know the answers to these questions before you get started on a plan of wealth creation, because your answers to those questions will help you to determine a plan of how to get to where you want to be in the timeframe that you want to be there. Obviously, this means that no two plans will be the same, right?

Property investment and wealth creation is not a "one size fits all" strategy.

There are a number of things that need to be taken into account in addition to what your long-term goals are, such as what level of risk you feel comfortable with, how much surplus income you have, and what your starting financial position is.

Do you know how much you would get per week if you retired on the superannuation today?

As of April 1, 2018, the New Zealand superannuation for a single person is $400.87 per week (after tax).
A single person sharing accommodation will receive $370.03 per week.
Couples will receive $308.36 per week per person.

We'd hazard a guess that your answer to question 3 was significantly more than this.

And if that's not bad enough, the environment is changing in New Zealand. At present, for every tax payer in this country, we are supporting two to three people who are on the superannuation.

The Department of Statistics has previously predicted that between 2011 and 2031 New Zealand's population will grow by 16.3%. Of that, 7.1% will be people of working age, and a whopping 83% will be over the age of 65.

In other words, there could be a significantly higher number of people who will be relying on a smaller number of taxpayers to fund their superannuation payments!

To fund future superannuation payments, it is likely that the government, at some stage, and probably sooner rather than later, will decide that one or more of these three things will need to happen:

1. Increase taxes
2. Decrease super payments
3. Raise retirement age

No matter what they decide, government superannuation probably won't result in the retirement of your dreams.

So, who are you going to rely on to fund your retirement?

There is only one answer that you should have for this question, and the answer is this:

You should rely on YOURSELF to provide for your own retirement, as you are the only person that you can control when it comes to making decisions for your future.

So, can you "Save" as much as you need in order to fund the lifestyle that you want to have for your retirement?

You can't save yourself to Wealth.

The average lifespan for New Zealand is approximately 85 years, so that means that on average, we need to be able to fund a good 20 years in retirement.

If you want to have $500 per week (pre-tax) to live on, then you would actually need to have $520,000 in a savings account that paid 5% interest. That way, you could live off the interest in your savings account.

In order to save $520,000 you would actually need to save $290 every single week for the next 20 years (or $760 per week for the next 10 years), and put that money into a savings account that paid 5% interest.

"Small problem"... interest rates aren't paying anywhere near 5% on savings accounts at the moment. If interest rates were paying 4% by the time you retired, you would actually need to have saved a total of $650,000 in order to generate the $500 per week (pre-tax).

If you wanted to have $1,000 per week (pre-tax) to live on, then you would need to have saved $1,040,000 into that savings account that paid 5% interest.
That's $780 per week savings for the next 20 years, or $1,525 per week for the next 10 years. If interest rates were only paying 4% when you retired, you would need $1.3m in your savings account (an extra $260,000)!

It seems that many people today have "Winning Lotto" as their retirement plan, as they simply can't see any other way. So, if you can't "Save yourself to Wealth" and bearing in mind that the odds are really stacked against you for winning Lotto, then what does that leave? We believe that property investment is the best solution for most people.

Let's look at the reasons why we believe that.

Chapter 3. Why we believe property is the best pathway to financial freedom

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There are three main ways to create wealth: business, the share market and property. Let's look at each of them in turn.

Business

A significant number of those that make it onto the Forbes Rich List are business people, so clearly business is an option for building wealth. However, there are considerable risks involved; borne out by the fact that approx. 85% of businesses fail within their first five years.

The problem is that there are so many variables when it comes to running a successful business, and often the startup costs are very high.

So, although business has the potential to generate a lot of money, it's definitely at the riskier end of the scale and may not be a viable option for the many people.

Shares

Some people make a lot of money from investing and trading in the share market. One of the main advantages of investing in shares is liquidity – you can decide when to purchase and when to sell, and it can all happen very quickly.

However, a significant issue with the share market is the lack of control, which adds a degree of risk. Yes, you can choose when to buy and sell, you can do due diligence on the company, the directors, and the market, but something else could happen that affects the share price and you have no say about how the company deals with it.

If, for example, you buy shares in a company which "goes bust", then your shares can fall to zero in value. This means you could potentially lose all of the money that you have invested. It can also be very difficult to borrow money to invest in the share market, which means that, generally speaking, ***you can only invest the amount of money that you have saved, without being able to leverage the amount of your investment by borrowing money from the bank.***

If you can borrow from a bank to invest in the share market, it is unlikely that the bank will lend you more than 50% of your total investment.

Property

One of the two main reasons we like property is it's a great way to create wealth by using this thing called "leverage", and we'll discuss how a little later. The other reason we prefer property is because it is relatively low risk and secure.

Of course, there is no such thing as a risk-free investment, but with property you can significantly reduce, if not completely eliminate, the risks involved. Let's have a look at some of those risks, and how they can be dealt with.

Risks associated with property

1. **Natural Disasters**

   Events such as earthquakes and floods can threaten the very existence of a property and are in the forefront of many people's minds after what many areas in New Zealand have suffered in recent times. There's nothing you can do to stop them, but you can reduce risk by:

   - Having adequate insurance cover.
   - Using due diligence to reduce the risk of buying property in high risk areas for natural disasters e.g. flood risks, earthquakes etc.

2. **Recession, market trends, property cycle**
   The market and the economy go through changes, and these can adversely affect uninformed or overcommitted property investors. To counter such issues:
   - Be aware of what the market is doing.
   - Purchase investments knowing the fundamentals are sound, no matter what the economy or market does.
   - Ensure the property has good equity in it by buying at a discount (below market value), adding value, and getting some growth over the long term.
   - Make sure that your property portfolio is cash flow positive so the rent coming in pays all outgoings. In other words, you may (and should) have a balance of capital growth property as well as cash flow positive property, but your portfolio as a whole should pay you to own it.

- Aim to hold property over a long period of time rather than trying to predict peaks and troughs in the market.
- Understand the property cycle. There is growth in value over time, but it is not linear, so the cycle naturally goes through stages of boom and bust. Know which strategies to use in each stage. Only buying properties that are negatively geared, meaning you have to top them up with income from your own pocket, is too high risk for my liking.

If a recession hits and you lose your income, what happens? You end up with a big problem, possibly having to sell your properties for a loss.

Buying sensibly, on the other hand, keeps you safe in a changing environment.

I will show you how in my opinion, property investing can actually reduce your financial risk in situations such as job loss.

3. **Zoning**

The council plans for your area can affect property values. What if a motorway is planned to go through your back garden or an enormous apartment block might be built next door?

To reduce or evaluate this risk, check with the local council and research to see what is planned for the area before you buy.

Zoning changes can be a risk, but if you know what's planned, they can become wonderful opportunities for you to capitalise on.

4. **Housing Oversupply**

An oversupply of houses brings prices down, a scenario that is not ideal for investors because they build their wealth (net worth) through increasing values over a period of time. However, Auckland is currently so far behind from a supply point of view that the risk of an oversupply happening within the next decade is, at least in my opinion, fairly remote.

This is also true for many other areas across the country. We are simply not building enough houses to keep up with population growth, and we had a shortage of property before we even started this period of high population growth.

It is for this reason that we are not expecting a significant decrease in values in Auckland, or indeed in many other centres across New Zealand where there is a shortage of property, even during the downturn in the property market.

Does that mean though, that we should worry about house prices falling at some stage in the future? Absolutely not! In fact, I would suggest quite the opposite.

More property millionaires are created in a slump than in a boom.

Why? Because for astute investors, it is as if the entire country has just gone on sale! Have you heard the phrase "you make your money when you buy"? This is absolutely true. Professional investors do not pay more than a property is worth, in fact they very rarely even purchase property for full market value. If a property can't be bought at a discount, we move on to the next deal.

Does that mean then, that you should wait until the property market slumps before you start to invest? Absolutely not! If a deal is good, it is always a good time to buy.

The important thing to remember is that there is a lot more to property investing than simply buying property. Warren Buffett said, “A rising tide lifts all ships, but it is not until the tide goes out that you see who has been swimming naked”. What this means is that if you make a mistake in a booming market (or buy the wrong type of property for your financial position), you might not realize it until after the market turns, and by then it is too late.

Warren Buffett also said, “Be fearful when others are greedy, and be greedy when others are fearful”.

As property investors it is important to remember the fundamentals of property investing, and not get carried away with the buying frenzy that is often associated with a booming market. In any event, buying wisely and for the long-term, as discussed in the previous point, will counter the risk of a property market correction (or market slump), and will enable you to continue to invest regardless of what the property market is doing. Likewise, during a slow market (slump or downturn), as there is less competition from other buyers, you have more opportunity to negotiate a better deal.

5. **Interest Rates**

Because buying property generally involves borrowing quantities of money, increases in interest rates pose a real risk for property investors. There's nothing you can do to prevent this from happening, but you can dramatically reduce the impact such an increase will have.

- Manage interest rates by fixing the loans over your portfolio in such a way that you are not overexposed. You do this by fixing some short-term, some medium-term and some long-term, so the average interest rate for your portfolio is generally somewhere close to or below the long term average.
- Analyse the numbers for a potential investment property using the long term average interest rate of 7%. Never make decisions based on historically low interest rates.
- Get help from independent mortgage advisors. We recommend our sister company www.miteam.co.nz as they are the mortgage advisors we have personally used for well over a decade.

In the previous boom (prior to the Global Financial Crisis), there was a rate war between banks on the two-year rate, with all banks offering exceptional deals. A lot of (uninformed) investors grew substantial portfolios and fixed all of their loans so they were cashflow neutral for two years at around 6%. However, two years later those rates had risen to 9%, and these investors had to refinance their entire portfolios at the new rate, which hurt a lot of them in the back pocket, forcing many of them to sell their portfolios in order to survive financially. By crunching the numbers at a long-term average interest rate, and then by spreading the expiry dates of their fixed rate mortgages, this risk could have been greatly reduced. At the time of writing, interest rates are currently available below 4%! Don't repeat the mistakes of the past.

6. **Capital Gains Tax**

Although New Zealand doesn’t have capital gains tax (CGT) at present, it has certainly been discussed, and we expect it will be introduced at some stage. The threat of CGT may seem to add a degree of risk to property investing on the surface.

However, in other countries where it has been introduced, CGT hardly changed the investing landscape at all. Those property markets still have booms and slumps.

At the end of the day, if and when CGT is introduced, it will be absorbed like any other new tax change – which is exactly what happened when the New Zealand government removed depreciation on buildings. Governments change tax laws all the time, so it will just end up being another tax property investors have to deal with. It won't change the fact that property is a good investment.

What we do expect is that the introduction of a CGT will push rents up, due to an exodus of some uninformed property investors, creating a shortage of rental properties. This is exactly what we are currently seeing with some proposed changes relating to tax benefits and the Tenancy Act Reform.

Fear of change always creates good opportunities for astute purchasers, as other buyers will "wait and see what happens" before they think about entering the market.

7. **Borrowing**

To buy property you'll generally need to borrow money from the bank. Borrowing always carries a degree of risk, but there are ways and means to minimise it such as:

- Spread your lending across several banks so if something happens to one property and it turns into a disaster, it won't have a dramatic effect on the rest of your portfolio. If you have everything with one bank they will cross-secure all your properties, including your family home, which can put you on very dangerous ground. This is something that a good mortgage advisor can help you with.
- Isolate your family home by structuring your borrowing so that even if you are using the equity in your family home to fund investment deposits, there is no cross-security with your rental properties. Better yet, ensure that the mortgage on your family home is the only mortgage that you have with that bank. Again, this is something that a good mortgage advisor can help you with.
- Talk to professionals about asset protection and using different entities and trusts to reduce your risk. Professional property investors do not own anything in their personal names.

8. **Tenants**

   Now we come to what many people say is arguably the biggest risk of all when it comes to property investing – tenants. What happens if they trash your property or turn it into a P lab? Positive cash flow investment properties are often located in lower socio-economic areas, and people often think that this increases the likelihood of getting a bad tenant. Let us assure you, there are bad tenants in every area. There are also great tenants in every area. However, in New Zealand, I would suggest that there are far more good tenants out there than there are bad ones.

   So yes, the risk is there, but there are lots of things you can do to minimise that risk, including:

- Use a good professional property manager.
- Have landlord protection insurance, which insures against malicious damage, vacancy, and loss of rent.

One of our rental properties (to give you an example of when having the right insurance cover helped us) had 10,000 litres of water flood the kitchen within a 12-hour period because the tenants left a tap dripping overnight. The water damage was horrendous. We had to replace all of the kitchen cabinets, half of the flooring and all of the vinyl floor covering. How much would you expect to have to pay for that?

It cost us our insurance excess (a few hundred dollars). We ended up with a brand-new kitchen in the property, which not only improved market rent for that property, but also increased the value of the house! Now, although we certainly don't "hope" that these things will happen, it is not necessarily the end of the world. In our case, it ended up being a positive result!

We've discussed the main risks with property investing and how they can be overcome or minimised. Now let's look at the advantages of property investing.

Advantages of property

Property has the ability to build wealth in a sustainable way if you invest wisely.

This is because of its four main benefits: capital growth, leverage, cash flow and tax benefits.

1. Capital growth

Residential property grows in value over the long term due to inflation, population growth and demand. As a whole, the property market is driven upwards by the emotional decisions of homeowners (not investors who prefer to buy at a discount).
Although property values in New Zealand increase and also decrease at different stages in the property cycle, property values do tend to increase over the long term (as long as you are not investing in small towns “in the middle of nowhere” with shrinking populations). NZ is a relatively young country, and we have not been collecting real estate data here for as long as the UK for example, but there are records of real estate transactions in the UK for the last 900 years, and the average growth there works out to be 10% per year.

However, I believe that if you use a more conservative expected capital growth rate for the long term (of let’s say 5%) and the figures still work, then anything higher than a capital growth rate of 5% will be a pleasant surprise.

We can’t control the capital growth rate, and we can’t control any tax changes, so why would you make your purchasing decisions on two factors that you can’t control?

I prefer to make my decisions based on things that I can control. Some of those things are purchase price, rental return, and equity in the deal and Return on Deposit.

2. Leverage

You can leverage a smaller amount of cash or equity you have (your deposit) with money borrowed from the bank to buy property. This is not hard to do (as long as you have sufficient equity and provable income) because banks generally love property. This is evidenced by the fact that if you apply for a business loan, one of the first questions the bank will ask is what property you own that can be used as security. Sometimes in an economic or property market downturn banks clamp down a bit and tighten their lending criteria.

Sometimes the Reserve Bank steps in and imposes restrictions on what the main banks can do with regards to lending in an effort to control the economy and protect the housing market from a large over-correction.

As property investors we must learn to roll with the punches, keep calm, and carry on.

So, there may be times they won't lend you money, but in general banks look favourably upon lending for property investment.

From the first of January 2019, the Reserve Bank of NZ's restriction on banks will be that they will require a 30% deposit from the purchaser if they are purchasing an existing property as an investment.

New builds are excluded, which means that you can purchase a new property as an investment, or build a new rental property, and borrow up to 80%.

They are "temporary restrictions" that have been in place in one form or another since 2013. It is hoped that at some stage the restrictions will be eased further for both investors and homebuyers.

These Reserve Bank restrictions only affect the main banks - non bank lenders don't have to abide by the same rules. If you fall outside of the main banks' lending criteria, the mortgage broker may put you in touch with a non bank lender that might be better suited to your situation.

In order to work out how much you can borrow from the bank (based on your available equity, and assuming that you meet the bank's lending criteria for provable income), you can use the following calculation:

Divide your savings or available equity by the percentage deposit you are working with i.e. 30% for an existing property (or 20% if it's a new build). In some situations, depending on the type of property, you might need even more than 30% as a deposit as banks often have different rules for different types of properties. This is another good reason to use an independent mortgage advisor! They understand all of the different lending rules that each bank has!

So, for example: if you had $100,000 of available cash and/or equity and you were applying for 70% lending (30% deposit), you would divide $100,000 by 30% (or 0.30) to give you the maximum purchase capacity of $333,333. Again, this is assuming that you have sufficient provable income to meet the bank's lending criteria for "that" side of the equation.

$$\text{Purchase Price} = \frac{\text{Available Savings/Equity}}{\text{\% Deposit}}$$

Some of you might be thinking "you can't buy anything for $333,333!" but in some parts of New Zealand, you can actually buy a small block of flats for that amount of money.

As stated earlier, if you're looking at purchasing or building a new rental property then that's exempt from the Reserve Bank restriction. You can still get 80% lending in that situation. You just divide your savings or available equity by 20%. In other words, your $100,000 in savings or equity would allow you for project build cost of up to $500,000.

3. Cash flow

Property generates income if you buy positive cash flow properties where the rental income pays all of the outgoings. Admittedly this has become harder in many places across New Zealand due to the fact that house prices over the past few years have increased a lot faster than rents have, but it is still possible in many areas of the country. And as the property market continues to slow down, we are starting to see positive (or at least neutral) cashflow deals starting to return in many areas.

The sooner you buy the better, in our opinion (as long as you are making your purchasing decisions based on the fundamentals of property investing, rather than on emotion).

If the area that you live in does not have the cashflow return that you need or want, then there are plenty of other great investment opportunities across New Zealand.

Paul and I have bought (and sold) property as far south as Invercargill, and although investing outside of the area in which you live can pose a few extra challenges, they are not insurmountable, especially with the amazing technology that is now readily available.

4. Tax benefits

Property investment offers several tax benefits also (as does any other business), including being able to claim depreciation on chattels, and the interest portion of your mortgage payments on a rental property is also tax deductible. You can also claim some other expenses in the business of property investing if you have an accountant who knows what they are doing.

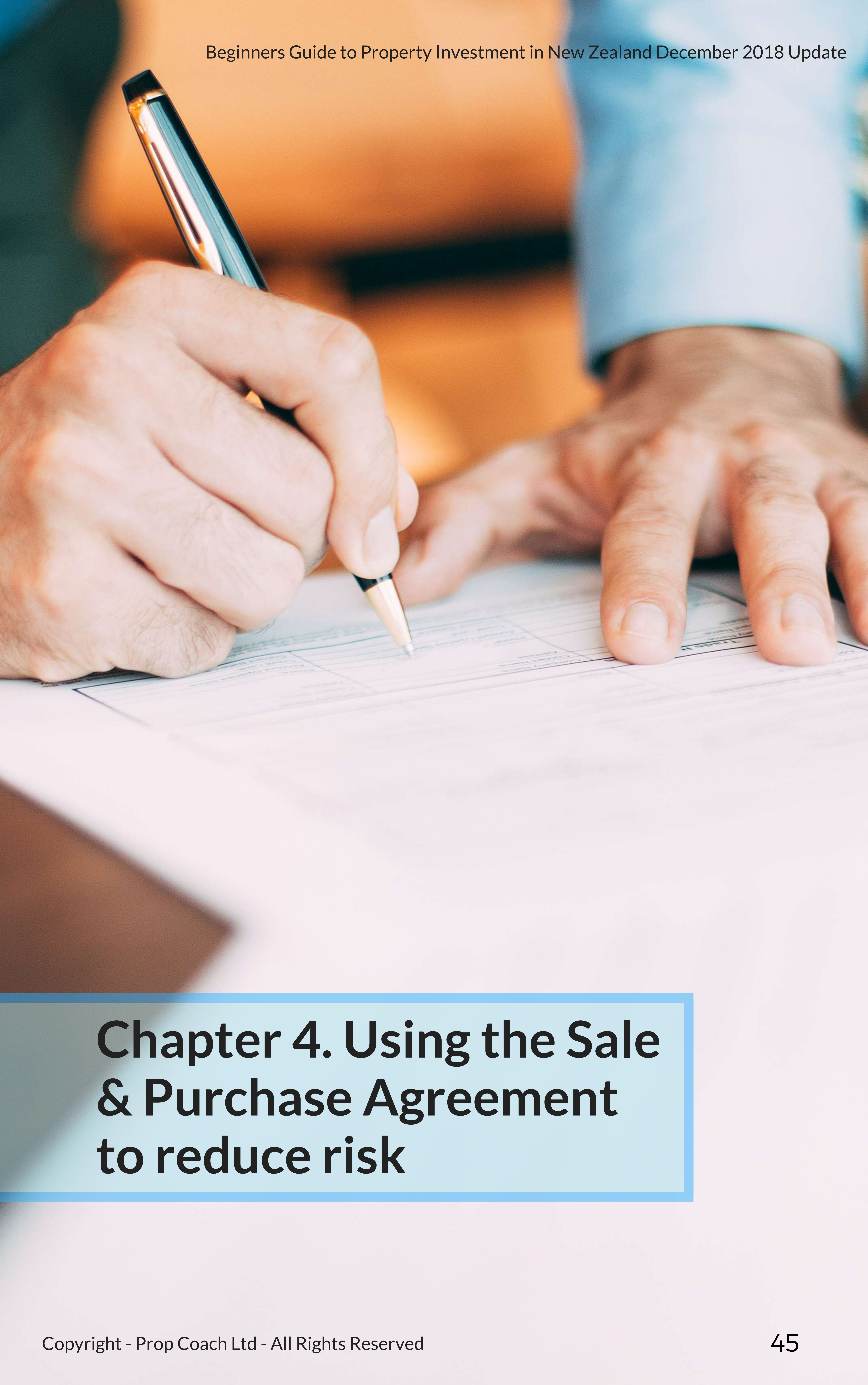
Make sure that you seek professional advice from an accountant who specialises in property investing, and you may find that you could claim on items such as petrol, home office expenses, property investment magazine subscriptions, books about property investment, and coaching/mentoring programs too!

However, having said that, as I mentioned earlier, I see any tax benefits as being a "bonus" rather than as the "reason" for investing in residential property. The main point here is that property investing should be treated like a business not a hobby, or you may well get the financial returns of a hobby, which is usually less than impressive.

There is much discussion at the moment about the Government's proposal to ring-fence tax losses for property investment. This does not mean that property investors will lose the tax benefits of investing. It simply means that they will not be able to offset those tax losses against their personal income (thereby reducing their personal tax rate). Instead, any tax losses will be carried forward as a tax credit in the entity that owns the property investment. Again, make sure that you seek professional advice from an accountant who specialises in property investment.

So, in our opinion, property investment has some advantages over the other pathways to create wealth (leverage being one of our favourites!), and the risks involved can be effectively managed if you know what you are doing.

Now let's take a closer look at how we go about purchasing an investment property.



Chapter 4. Using the Sale & Purchase Agreement to reduce risk

Chapter 4. Using the Sale & Purchase Agreement to reduce risk

In order to purchase property in New Zealand you use an **"Agreement for Sale and Purchase of Real Estate"** that has been prepared and approved by the Real Estate Institute of NZ Incorporated, and by the Auckland District Law Society Incorporated. This is a very powerful document, one that it's important to understand. If you sign it, you may well find that you are legally committed to buying a house even if you find something wrong with it later, so you need to be very careful when you complete this document.

Most purchasers get their advice regarding completing the sale and purchase agreement from the real estate agent who is selling them the property.

You need to remember that the real estate agent is working for the vendor.

Although they also have a duty of care for the purchaser, it is their job to get the best deal possible for their client (the vendor - the person who owns the house).

So, to keep you safe as a purchaser there are four things we recommend:

1. Familiarise yourself with the standard sale and purchase agreement
2. Use the and/or nominee option (ensure this does not get crossed out)
3. Pay the deposit once you have gone unconditional
4. Use a due diligence clause

Let's look at each of these in more detail.

1. Understanding the sale and purchase agreement

The standard sale and purchase agreement is full of fine print, including how the contract works, your responsibilities and the vendor's responsibilities.

There is a lot of legal speak involved, but nevertheless, it's important you understand what it all means, because by signing the agreement you are saying you agree with all these clauses.

So, read through them all and make sure you are clear about what they mean. At the very least, this exercise can be a great cure for insomnia! If you are not sure about anything, ask someone who knows, such as your lawyer, to explain it to you.

2. The and/or nominee option

On the first page of the sale and purchase agreement is space for the purchaser's name, followed by the words "and/or nominee". These three words can make the negotiating process much easier, for reasons explained below. The "and/or nominee" option allows you to put your own name in there, but you have the option of changing it to another entity before settlement. This is very useful, because many investors will buy property via an entity such as a company or trust.

However, if you put the name of your company or trust in that space at the outset, all directors or trustees have to sign the document. Usually during the negotiation process, various things are changed in the agreement (countersigned), and every time there is a change, all directors or trustees need to sign/initial these changes. As you can imagine, this could become a logistical nightmare. And if your lawyer is one of your trustees, it could also become very expensive (as most lawyers charge an hourly rate).

Instead, use your own name as purchaser, so each time you make a change to the agreement only you have to sign/initial it.

When you get to unconditional or settlement date (check with your accountant and/or lawyer to see which is best for your situation), you nominate your company or trust and settle the property in the name of that entity. This can save you a lot of time and money.

3.The deposit

Typically, real estate agents will ask for 10% deposit upon signing the sale and purchase agreement. You don't have to do this. Usually we try and reduce that amount a little, say to 4% or 5%, (enough to cover the real estate agent's commission) and depending on the circumstances, we can often use it as a bargaining tool.

Secondly, because our offers are conditional, we make the deposit "payable when this agreement becomes unconditional".

In other words, only once our conditions are satisfied and we've declared the property unconditional do we pay the deposit.

By doing these two things, we have to fork out less money upfront, and only have to provide it once we are sure the deal is going ahead (i.e. when you declare the contract to be unconditional).

It's far better sitting in our bank account than the real estate agent's trust account, in our opinion.

It also means we can have multiple conditional offers out at once, without having to find deposits for all of them before we have even decided which one(s) if any, we are going to buy.

4. Due diligence clause

In the section of the sale and purchase agreement titled "Further terms of sale" we always recommend you insert a due diligence clause. Due diligence is basically the homework that you need to do on a property before you should declare the Sale and Purchase agreement to be unconditional.

In a nutshell, this clause means that you can look at anything to do with the property, and it's entirely your decision as to whether or not it meets your criteria and whether or not you'll go ahead with the purchase.

The point of this clause is to keep you safe. If you find something untoward, you can go back to the vendor and explain you've found a problem. You then have three options:

- Decide not to buy the house
- Ask the vendor to fix the problem
- Renegotiate (e.g. to lower the purchase price)

When we say this clause allows you to look at anything, we really mean anything, and we'll go over the types of things you should investigate in the next chapter.

It's important that the due diligence clause is worded correctly. To that end, we've included the one we use here.

Due Diligence

This agreement is entirely conditional upon the purchaser approving in the purchaser's sole and unfettered discretion all matters that the purchaser considers may touch, concern or affect the property or the commercial viability of the transaction within ____ complete working days after the date of this Agreement by both parties.

If notice is not received in writing by the vendor's solicitor or agent by 5pm on the ___th complete working day after the date of this agreement of the purchaser's approval of the property then this contract is at an end. This condition is inserted for the sole benefit of the purchaser.

This clause is worded in such a way that it gives you a very safe exit position, which is very important. It means that if the seller doesn't hear from you, the agreement automatically falls over.

So if you do nothing, or if something comes up so you are unable to deal with it (e.g. a relative overseas is dying and you are on the plane before you remember about the agreement) you will not end up "accidentally" buying a property that you didn't intend to buy.

You will need to nominate a timeframe in the agreement within which you have to complete your due diligence. While 10 complete working days is fairly standard, it does depend to a certain extent on the market. In a hot market you'd be lucky to get the seller to agree to 10 working days, so you may have to be prepared to agree to a shorter time frame.

We've found it's possible to compete due diligence in as little as three working days, but you will need to be very organized, move extremely quickly, and have a bit of luck on your side also. In a slow market, however, you could put as many as 20, 30 or even 40 days. If a vendor has had their property on the market for 600 days, they may not be too worried about another 20 – they might just be happy to have finally received an offer!

You are not obliged to give a specific reason if you decide not to go ahead with the purchase - you can just say "due diligence has not been satisfied".

Chapter 5. The importance of due diligence

Chapter 5. The importance of due diligence

Sometimes you can face a bit of resistance about a due diligence clause from agents (especially during a booming property market), their theory sometimes being that you are just going to try and get out of the deal. Explain that you are not in the habit of wasting your time or anyone else's, and that you only put offers in on properties that you are interested in purchasing, but it has to work for you as an investor so there are some things you need to check before you can go unconditional.

Due diligence is important in keeping you safe and making sure a purchase will work for you.

It's about doing your homework to find out if a property is a worthwhile investment or not, it is not about finding ways to waste people's time.

So what sorts of things should you include as part of your due diligence investigation?

- **Builder's report:** You need to know that the house is structurally sound, that it doesn't leak etc.
- **Finance:** You must to confirm with your lender that you can get the finance required to buy the property.

- **Legal aspects:** You want to make sure there are no legal issues with the property. Look at the title and the flats plan (if applicable) to make sure nothing is amiss, check the body corporate (if applicable), and run everything past your solicitor.
- **LIM report and council file:** While we will often get a LIM report (Land Information Memorandum) from council, we always at the very least, get a copy of the property file from council. We've seen properties for sale where according to the LIM report everything was fine, but when we looked at the property file we identified all sorts of problems. In one instance the house had a downstairs apartment that was not on the plans i.e. renovations had been done that the council knew nothing about and therefore didn't have council approval. Often it's the things that AREN'T on the LIM or in the council file that are of particular interest. As well as being more comprehensive, a copy of the property file is generally a lot faster and cheaper to get.
- **Zoning information:** It's important to know what is happening in the area, what you can do with your property, and what the neighbours are entitled to do with theirs. It's best to talk to council, or you can use the local Council's GIS viewer (or similar).

- **Market value:** You need to know what a property is worth, so that you don't pay too much for it. This may be determined by comparing the target property with other similar properties that have sold in the vicinity recently. Alternatively, you may decide (or be required by the bank) to get a Market Valuation. This is where you pay a Registered Valuer to write a written report which gives an estimate as to what the market value of the property is.
- **The numbers:** The property has to work for you financially. What is the market rent for the property (get a written rental appraisal from a Property Manager)? What are the expenses (rates, insurance, property management fees, vacancy, bodycorp etc.) associated with the property, so you can determine the pre-tax cashflow position.
- **Drug testing:** We recommend that you get a drug test done at the point of purchase to ensure that you are not unknowingly renting out a property that is above the current Ministry of Health Guidelines and/or the levels that are acceptable to the Tenancy Tribunal. This is especially important if you suspect that the property has been used to manufacture methamphetamine, as the readings can be quite high in that situation, and the cost of decontamination can be very expensive.

All of your due diligence must be complete before going unconditional.

This can become problematic if you are bidding at an auction because there are costs, time and effort involved with due diligence, without any guarantee that you will be the successful purchaser. From an investor's point of view, buying via negotiation is sometimes preferable, because you only incur the costs of due diligence once you have a firm (conditional) contract.

What happens if you don't do due diligence?
It can cost you a couple of thousand of dollars to
check everything about a property before you buy it!

Due diligence should be considered to be a cost of business - certainly an essential part of the purchase process in order to reduce the potential risk.
Imagine buying a rental property without getting a building inspection done, only to find out after you were unconditional that the roof urgently needs replacing.
This could cost you around $12,000 or more.
Unexpected repairs such as this will certainly cost more than what you spend on due diligence. If you identify an issue during your due diligence period but you still want to proceed with the purchase, you may be able to renegotiate the purchase price with the owner to take the issue into account! This can save you THOUSANDS of dollars.

Chapter 6. How to find hot deals and invest like a professional

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If you don't know what an opportunity looks like, you simply won't see it. There's a well-known awareness test video that illustrates this perfectly. Viewers are asked to watch a basketball clip, and to count the number of passes one of the teams makes. Try it for yourself – go to **https://www.youtube.com/watch?v=Ahg6qcgoay4**

Opportunities are everywhere when you know what to look for. Here is a common example of a missed opportunity in property investment:

"When I first starting investing in property, I spent a lot of time driving down around looking for an awesome deal and I was having a hard time finding one. Every day I'd drive past this horrible house that was all rickety, the windows were boarded up, it desperately needed a paint job, there were car bodies out front, and the lawn was hip-height. I kept driving past, looking let's face it, for something much better than that!

After a while, I realised that if I bought that property I could tidy it up in a heartbeat, fix the windows, get rid of the cars and add a whole heap of value - and I could buy it a huge discount. I had been driving past a great opportunity every day. But by the time I realised this, I was too late - it had a sold sticker on it. Now I drive around looking for properties just like that."

So, there are opportunities out there, and just because you miss out on one, it doesn't mean they are all gone. But you do have to get off your butt to find them. This is about opening your eyes, getting some education, understanding the fundamentals of what you are looking for and how to find it. Property investment takes persistence and consistency. You will get a lot more "No" responses than "Yes" responses to your offers on the S&P Agreements.

The key is to research the areas that you are planning to invest in, build relationships with the real estate agents that work in those areas, and make offers. Then keep trying until you find the deal that meets your buying rules.

The problem that most new investors have, is understanding what type of property deal is the "right" one for them in order to achieve their goals.

Waiting on the "Right" Time

It's often in a market boom that people become interested in property investments. Values often increase really strongly at this point and the media constantly talks about things such as "is your house earning more than you are?"

However, it is often during the boom that new investors purchase entirely the wrong type of property for their financial situation! Or they pay far more than they should for a property, because they worry that if they don't buy "something" they will miss the boat. This can actually prevent them from achieving their investment goals.

One of the reasons that we do free training events for property investors is to teach them that they should not be making investment purchases based on emotions. That is what homebuyers do. Investors need to do things differently, and buy based on the numbers instead.

What I mean by this is, when it comes to buying your own home, most people will go to the bank that they have always banked with, ask them how much money they can borrow, based on the amount of deposit and how much provable income they've got. And that becomes the top dollar purchase price (assuming that they actually meet that particular bank's lending criteria for provable income).

And then they go shopping to find something within that price point. When it comes to buying an investment property, it's a totally different situation.

We want to remove as much of the emotion out of the process as possible. We buy based on the numbers and when I say "the numbers" I'm talking about gross yield, net yield, discount, return on deposit etc. - all of those things, just to make sure that it's actually a good investment deal. If you're not crunching the numbers on an investment deal, then all you're doing is speculating.

If you are speculating, you are hoping that the property is going to increase in value. Remember that capital growth is the only part of property investing that we've got no control over! So why would you do that?!

This is just a reminder that property investors should not be competing with home buyers. Homebuyers will outbid astute property investors every day of the week because there's a massive difference between buying a home (emotional purchase) and buying an investment property.

So when is really the best time to invest in property? It's a bit like planting a tree. The best time is always going to be 20 years ago, but the next best time is always today.

Prices will generally increase over the long term (unless you are investing in small towns with shrinking populations), so today's prices will look ridiculously cheap in 10 years from now. As investors, we always look for Windows of Opportunity, and these appear right throughout all of the stages of the property cycle. Be prepared to take action when you see a deal that meets your purchase guidelines.

Some would argue that if they waited a bit longer for the market to slow down even further, then they could purchase at the bottom of the market. But the truth is, that you only know you are at the bottom of the market when it has started to pick back up again. If you are trying to time the market like that, there's a good chance you will get it wrong, and you will miss that window of opportunity to purchase a property when there are less buyers competing against you.

Capital growth is currently still quite strong in some areas of New Zealand. If you're living in one of those areas, the decrease in market activity may not be very obvious yet. However, in other places like in Auckland or Hamilton, you will really be feeling it. Less market activity creates the opportunity for people to get out there and negotiate a great deal. By that, I'm talking about buying property below its actual market value.

Property Valuation

In a nutshell, real estate agents provide free information on the recent sales in an area, and what you have to do is compare those properties with the ones you are looking at. For example, if you are looking at one property in a certain area, it's best to get as many comparable recent sales in that area as you can. This will give you a range of sale prices, and then you will be able to compare the property you are looking at, to others that have recently sold to get an idea of what the market value of your target property is.

This knowledge can give you leverage when you are negotiating.
There are different opportunities at every stage of the property cycle regardless of whether it is a boom or a slump. Likewise, the different stages of the property cycle also require different investment strategies and negotiation techniques.

Window of Opportunity: Winter

Luckily this Window of Opportunity happens every year. People don't like to go house hunting in winter because it's cold outside and it's dark early. So over the winter months, it's often a really good time to get out there and negotiate hard on properties. And if it's been raining, then you get to see the property in its worst possible light. In this situation, you can see whether there's any flooding issues on that property, whether there's a leak in the ceiling and it's dripping through into the lounge or any other problem. Its pretty hard to disguise that it if pouring outside.

Window of Opportunity: Christmas and Summer Holidays

This window comes every year as well! Over the Christmas and New Year period, the property market often slows down. But there are always people that are interested in selling or motivated to sell leading up to Christmas, and early in the New Year. If you find the right deal with a motivated vendor, you can get yourself a really good deal.

The Possibilities are Endless

Making a mistake in property investment can be very costly and can take you a decade or more to recover from financially. The good news is that there are ways to avoid making many of the mistakes that new investors make. "If you think education is expensive, you should try ignorance".

While the risks can be high to the untrained investor, even the slowest stage in the market can become the perfect opportunity for the informed buyer.

After every boom there's always a correction, and after every correction there's always another boom. So it is important that you learn how to invest successfully throughout the entire property cycle.

The key is to know and understand what type of investment property is the right one for you, and where you are most likely to find that sort of investment!

At an Auction

Properties not sold at auctions either have an asking price, or they are advertised as price by negotiation. This gives you the ability to negotiate the price and settlement date before you spend any money checking out whether the property is okay or not. However, a property that is advertised as sale by auction, does not give you this option. If you're putting your hand up in the auction, you need to be prepared to be the buyer at the end of the auction, which means that you need to have done all of your due diligence before the date of the auction, or you are taking a huge risk that there could be something "wrong" with the property. This can prove to be an expensive mistake.

However, if you have done all of your homework (due diligence) and you are prepared your hand up in the auction room, you might actually be able to get yourself a really good deal because the auction process in New Zealand is really transparent. The vendor, the owner of the house, has a "reserve price". The reserve price is the lowest price that the vendors are prepared to accept on the day as a cash unconditional offer. Sometimes they will even reduce their reserve price, depending on how the auction is going. If you are the only person bidding on a property in the auction room, then you have the best chance of being able to buy the property for the lowest price that the vendor will accept.

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But if you don't put your hand up, you lose that opportunity. And if there's no one else in the room that's prepared to bid and you wait until after the auction so that you can put in an offer with a due diligence tools in it, you might find that you end up in a multi-offer situation. In that situation, you've got to put your best foot forward because you may not be given the opportunity to negotiate further.

Chapter 7. How to put your cash or equity to work

Chapter 7. How to put your cash or equity to work

So now we want to put your cash or equity to work for you, rather than you having to work for your cash or equity.

For those of you that already own a home, this is how you work out how much "available equity" you've got in that home so that you can use that to fund the deposit on a rental property.

At the time that you purchase a home, the bank will lend you (as a general rule) 80% of the purchase price or 80% of registered valuation, whichever figure is the lowest, and this is assuming that you have sufficient provable income to support that amount of mortgage.
Six months after you have bought a house, the bank doesn't care how much you paid for it anymore. They want to know what it's worth NOW. If you've owned your home for long enough and you get a new registered valuation (market value) on that property, the bank would lend you 80% of the registered valuation (as long as your provable income is still sufficient). You can arrange all of this through your independent mortgage broker, and they will crunch these numbers for you.

Registered Valuation multiplied by 80% then deduct your current mortgage balance to get the amount of available equity.

E.g If your home has a registered valuation of $700,000 you would multiply $700,000 by 80% (0.8) which equals $560,000. This means that as long as your provable income was sufficient, you could borrow up to $560,000 secured against that property.

If your existing mortgage is $360,000 then this is money you have already borrowed out of the possible $560,000 that the bank is prepared to lend to you for that property. So, you take $560,000 and subtract the $360,000 that you have already borrowed, and you are left with an additional $200,000 that you could borrow against that property. That means you have $200,000 of "available equity".

Available Equity thru a Home Property:

Available Equity = (Reg.Valuation x 0.8) - Current Lending

= ($700,000 x 0.8)- $360,000

= ($560,000)- $360,000

Available Equity = $200,000

What we would generally recommend that you do, if possible, is to set up a revolving credit facility for that available equity. A revolving credit facility works a bit like an overdraft, it is essentially a pre-approved line of credit. You don't pay interest on it until you take money out of it, and you can withdraw funds and deposit funds several times without getting the banks approval each time.

You do not use a revolving credit facility to buy cars or boats or go on holidays or anything like that! It is purely to be used for deposits on rental properties and, or the renovation that you might need to do on those properties.

Again, an independent mortgage broker who specialises in investment properties can help to ensure that you get your loan set up in the correct way to make it as easy as possible for you to move forward with your investing.

We recommend our sister company www.miteam.co.nz as they are the mortgage brokers that we have personally used for over a decade now.

If you own a rental property, this is how you can unlock equity in that property. Under the RBNZ restrictions (effective from the 1st January 2019), you might only be able to borrow up to 70% of the registered valuation of that property. Again, in this situation, this would be assuming that you'd already owned that property for at least six months (or three months after purchase if you had completed significant renovations), and that your provable income was sufficient to support that amount of debt.

When it comes to the provable income for a rental property, the bank will look at your personal provable income, and they will also take 75% of the rental appraisal or the actual rent that you're getting on that property, and add that to your provable income.
So buying rental properties with high rental return, can actually strengthen your lending position if you're limited by your provable income for example.

So for a rental property, you would take the registered valuation multiplied by 65% (0.65), then deduct your current mortgage to work out what your available equity is. E.g. if your registered valuation is $700,000, 65% of that is $455,000. So if you current mortgage is, $255,000, then you'd still have $200,000 available equity.

Available Equity thru a Rental Property:

Available Equity = (Registered Value x 0.65)- Current Lending
= ($700,000 x 0.65)- $255,000
= ($455,000)- $255,000

Available Equity = $200,000

So now that you've got this revolving credit facility, you could use that to fund the deposits (and renovations) on rental properties. The reason that we like the revolving credit facility is because it will enable you set up a revolving account in one bank secured against your home or your rental, and then you can use that to fund the deposit on a new purchase, and then borrow the majority of that purchase price from a different bank.

This reduces your risk when it comes to lending. You're spreading your lending with more than one bank.

Now the question is, if you put 30% deposit into a property, you want to be able to pull it back out again as quickly as you can, so that you don't have to save up another deposit to buy the next deal.

Buying your first property is always the hardest because you've got to get that initial deposit from somewhere. Once you've got your foot on the property ladder, things start to get a whole lot easier moving forward.

Recycling your Deposit

Putting cash or equity into a deal and quickly taking it out is called recycling your deposit. It doesn't require any savings because you can use the same cash or equity in another deal.

When it comes to recycling your deposit, you need to get a new registered valuation on the property you've owned for more than six months (or three months if you've renovated). You multiply the registered valuation figure by 70% (if it is a rental) then deduct your current lending and that tells you how much the bank will allow you to top up your mortgage, enabling you to "recycle" that money back into your revolving credit facility.

At the end of the day, you don't have to understand how this works. If you've got the right mortgage broker, they just "make it happen".

In order to recycle your deposit, you need to create the same amount of available equity. E.g. if you are recycling 20% deposit, you need 20% available equity in the deal.

There are actually three different ways that you can create equity when it comes to property.

- Negotiate a discount when you purchase
- Add value to the property e.g. renovation etc.
- Capital Growth over a period of time

The amount of equity that you can create across those three points will depend on what's happening in the property market.

For example, in a booming market, you'll be able to get positive capital growth, versus in a downturn where you might get little to no (or even negative) capital growth.

When it comes to adding value, you should always take into account the amount of money that it costs to increase the value of that property. You should be able to expect to increase the value of the property by somewhere between 5%-15%.

In a booming market, you might only be able to negotiate a 5% discount on the registered valuation.

In a slow market there's much less competition. The media talks about how it's a bad time to buy property, so all your competition disappears. That gives you much better capacity to be able to buy property below its value, because you might be the only person that offers on a particular property. You might deal with a vendor who's got plenty of equity in the deal which could allow them to accept your offer. So even though it might be a low offer, it could be the best offer that they get, and if they are motivated to sell (for whatever reason), you could get a great price! That's what we call a win-win situation.

Then, if you can add value to the property, this will also increase the amount of equity you have in that deal.

You might not get any capital growth if it is a slow market, but because you are able to negotiate a bigger discount due to the fact that there are less buyers in the market (less competition), you might not even need any capital growth! You might be able to generate enough equity to enable you to recycle your deposit purely by negotiating a discount, and adding value to the property!

On the other hand, in a booming market, you might not be able to negotiate much of a discount. Let's say you only get 5% discount from market value. But you can add 15% value through renovations. Now you're at 20% equity, which means that if the Reserve Bank lifts the restrictions on lending and it goes back to 20% for investment properties, you could recycle your deposit without any capital growth. However, at the moment with the restrictions effective from 1st January 2019, you need 30% equity, so if you were only at 20% through the combination of discount and adding value, you would need to wait until you had an additional 10% capital growth on that property before you could recycle your full deposit (or hope for the Reserve Bank to lift the restrictions!).

In a booming market, we generally have to rely on a bit of capital growth for us to make the deal work enough for us to be able to pull the full deposit out so that we don't have to save the next deposit, because it is harder to negotiate large discounts on purchase when there are lots of "emotional" buyers in the market.

So you can see that by using a combination of those three things (discount, adding value, and capital growth) you'll be able to create enough equity to allow you to recycle your deposit within a certain timeframe, regardless of what the property market is doing.
You should also be able to see that the bigger the discount on purchase, the faster you will be able to recycle your deposit, and the less reliant you will be on capital growth. This is why investors can generally recycle their deposits faster in a slow market than in a boom, therefore creating more wealth in a shorter timeframe!

Now, some of you might be thinking that a 20% discount is unrealistic. Let me tell you that's absolutely possible.

In a really slow market like the previous property slump (which also coincided with the Global Financial Crisis), what we actually saw was negative capital growth in a lot of places. But people were able to buy property 20% to 30% below value.

During this period, one of our clients got the largest discount that we have ever seen. They bought a property 58% below registered valuation!

The vendor was well aware of the fact that they bought the property for less than half of its value. However, for the six months that our clients were trying to purchase this deal, the vendor had been saying no to them in the hope that they would get a better offer.
For six months they waited, and during that entire period, the ONLY offer they received was the one from our clients.
Unfortunately for the vendor, due to their financial situation at the time, they simply couldn't wait any longer.
They decided to accept the offer from our client, because although it was less than half of what their property was worth, it was the best offer they could get at the time, it still worked for them, and it was in fact a whole lot better than their only other alternative (mortgagee auction).

Chapter 8. One example of what can be achieved within 10 years

Chapter 8. One example of what can be achieved within 10 years

This is where we introduce you to our 10 Year Plan or the “get rich slow plan”. This is just one idea that could enable you to get in to the top 6% of the population who are financially secure in retirement, but please understand that this is not the “secret to success” in property investment. Property investment is not a “one size fits all”, and while this might be a great plan for some people to follow, it might not be the best plan for you.

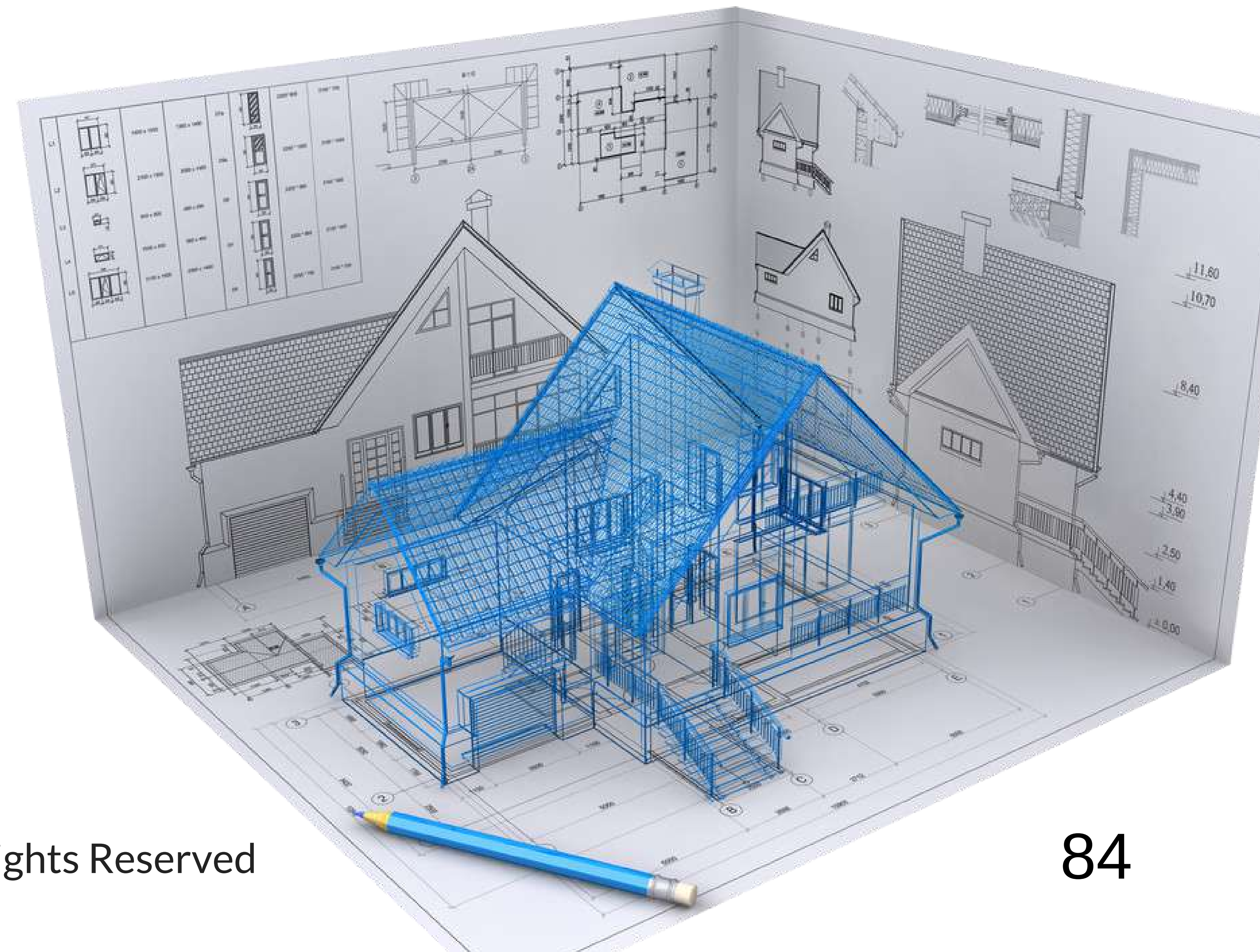
The main purpose of showing you this 10 year plan, is to teach you some more of the fundamentals of property investing. There are literally hundreds of different ways in which you can build wealth through property investing, this is simply one idea. In order to keep it as simple as possible though, so you don’t miss the key principles (such as how to recycle your deposit) we have had to make some assumptions.

Basic assumptions for the 10 Year Plan

- **All houses are purchased 20% below valuation.** Why is this important? Because it creates the equity you need to be able to be able to recycle your deposit in order to purchase your next investment property. You may be thinking that's all well and good in theory, but is it actually possible to buy houses 20% below valuation? It depends on the market. In 2008 you could find deals up to 40% under market value in Auckland, but as I write, although the property market in Auckland has slowed somewhat, even 20% is unlikely. But that doesn't mean you should ignore this rule. You just have to create that difference yourself. How? By a combination of the following three things:
    - Get as much discount on purchase price as possible (let's say for example in a booming market that might be 5% below market value) by hunting and digging for the right property and then negotiating well. This is perfectly do-able, but will involve a little tenacity.
    - Add some value by renovating. By spending a little money, in the right way, you can often add 5-15% (sometimes more) to the value of the property.
    - Be patient. The property will experience some capital growth over time. 5% per year on average over the long term wouldn't be unrealistic.

So, by combining the three strategies above, after 12 months you could have created a difference of 20% (or more) between what the property is worth and what it owes you.

- **20% deposit.** From the 1st January 2019 the Reserve Bank of NZ restrictions on the main banks mean that you will need a 30% deposit - unless you are purchasing a new build, or getting finance via a non-bank lender. However, your deposit doesn't have to be cold hard cash! You could leverage equity you have in a property you already own, or you could perhaps borrow money from family. As long as you meet bank lending criteria for sufficient provable income as well as equity, then banks will lend you up to 80% of the purchase price or the registered valuation (whichever is lowest) at the point of purchase for a new build, or up to 70% for an existing property. If the RBNZ restrictions are lifted, we may well see lending on investment properties return to the "usual" 20% deposit requirements with main banks. This is the reason that we have assumed a 20% deposit for this example.



On the subject of provable income, it is also useful to remember that banks will take approximately 75% of the rental income of a property and add that towards your provable income. So, if you are low income earners (like Paul and I were), then rental properties with high rental return (Gross Yield) can actually strengthen your borrowing ability! More on this later.

- **5% capital growth.** We use this figure because as I've stated earlier, we believe that over the long term it's pretty conservative. We know that house prices don't increase by 5% each year every year, but we do know that over a long period of time (such as 10 years) we can expect house prices to have increased. In many places in New Zealand, houses double in value approximately every 10 years, which equates to an annual capital growth rate of roughly 7.2%. By assuming 5% we err on the side of caution, which helps to reduce our level of risk.

- **Loans are on interest-only terms.** The repayments on an interest-only loan are smaller than for those on a principal and interest (P&I) loan of the same amount, and so they help to maximise your cash flow. Most investors, if they were to have all their loans on P&I, would find their cash flow drying up fairly quickly. If you want to pay off mortgages (which is a good idea), then pay off your home loan first as there are no tax benefits to having a personal mortgage.
- Only the interest portion of mortgages on rental properties is tax deductible. Just don't make the mistake of paying off your home mortgage before you start buying investment properties by leveraging your equity. Remember, life is not long enough to create wealth by doing this! You want to get your money (or equity) working for you as soon as possible, so that you can stop working for your money.
- Banks are usually happy to give interest-only loans if your equity is enough to meet their current lending criteria, though the term will be shorter than for a Principal and Interest loan (e.g. five years). However, it is usually just a formality to roll it over for another term on interest-only when the term is up, as long as you still have sufficient equity in the property. Speak to a good mortgage advisor about this, as banks will often change their lending rules.

- **Properties are pre-tax cash flow positive or neutral.** This means the costs involved with running the property e.g. rates, insurance, property manager, repairs and maintenance, body corp fees and loan repayments etc. are all covered by the rent you collect. No extra money has to come out of your own back pocket. It is possible to buy properties like this right now in New Zealand (even in Auckland), but they don't appear every day. By no means is every single house on Trademe is cash flow positive, but they are absolutely there if you know what to look for and how to negotiate a good deal.

Okay, so now we have covered the assumptions that we have used for the sake of simplicity, let's have a look at how this plan might actually work.

The get rich slow plan in action

The best way to explain how the 10-year plan works, is through an example.

Year One: Buy your first rental property
(following the assumptions discussed previously)

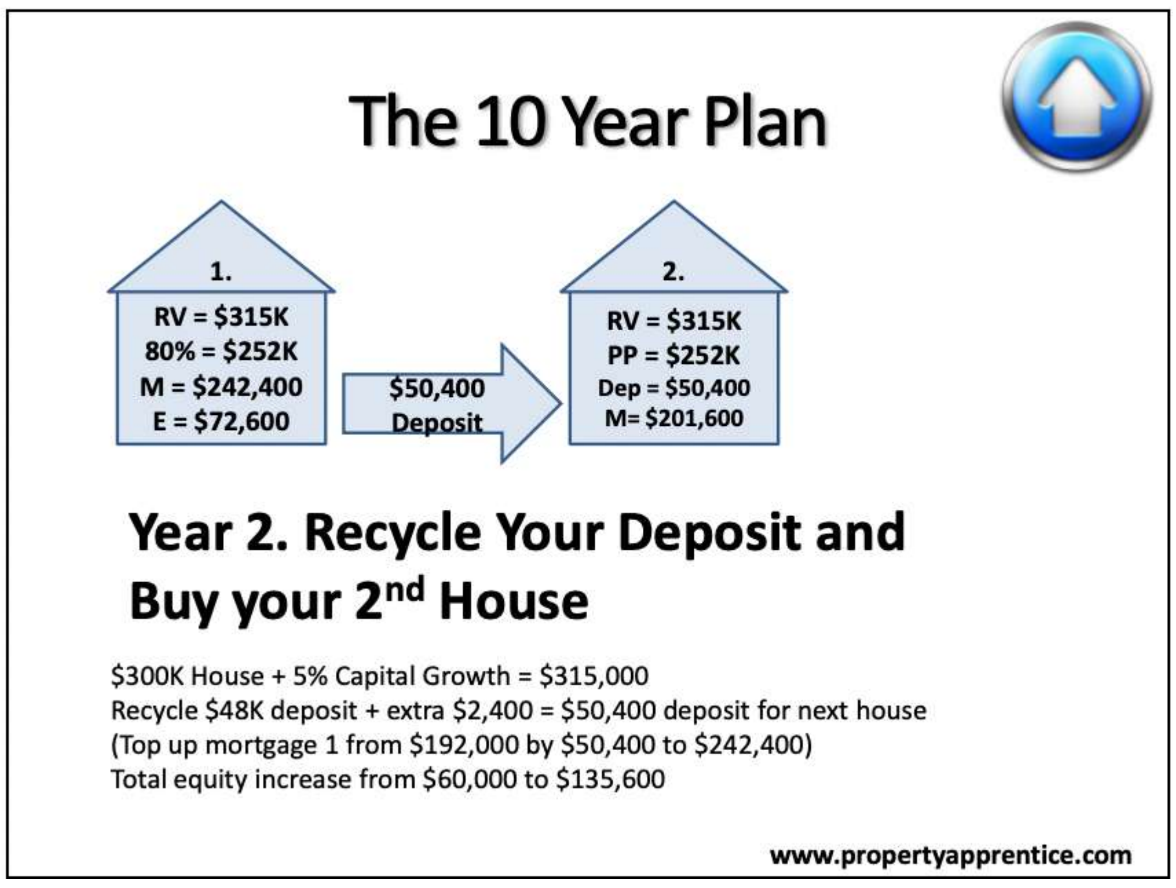
- You find a property with a registered valuation (RV) of $300,000. We deliberately chose a low value property here to show you how this plan looks even with "cheaper" properties.
- You negotiate to buy 20% below value i.e. Purchase Price (PP) of $240,000.
- The bank lends you 80% of the purchase price (assuming that you meet their lending criteria), which is a mortgage (M) of $192,000. You provide the other 20%, or $48,000, as a deposit (D) either in cash from savings, or from equity that you have in another property. You have created equity (E) of $60,000 (on paper) because of the difference between your purchase price and market value. In other words, you have instantly increased your net worth by $60,000 so you are immediately better off.

**From 1st January 2019, you will only be able to borrow 70% of the purchase price from the bank (due to the RBNZ restrictions), so if you need to borrow 80% you will need to use a non-bank lender who is not bound by the RBNZ restrictions.*

This is a nice start, but it gets better! Because this property is cash flow neutral or positive, in the first year of ownership it is going to cost you nothing. Not a cent. On top of that, it will experience 5% capital growth (based on the assumptions previously explained). So, after 12 months of ownership, it is worth $315,000.

Now let's say you are interested in buying the house next door (again, just to keep the plan simple so you don't miss the key points here). Being similar to the property you already own, this house is also worth $315,000. To buy it, you again need a 20% deposit. But where do you get another $50,000? By saving another deposit? No, that takes far too long.

A much better way to get the second deposit is by recycling the first deposit from the bank, and this is how you do it.



Year two: Recycle your deposit and buy your second rental property

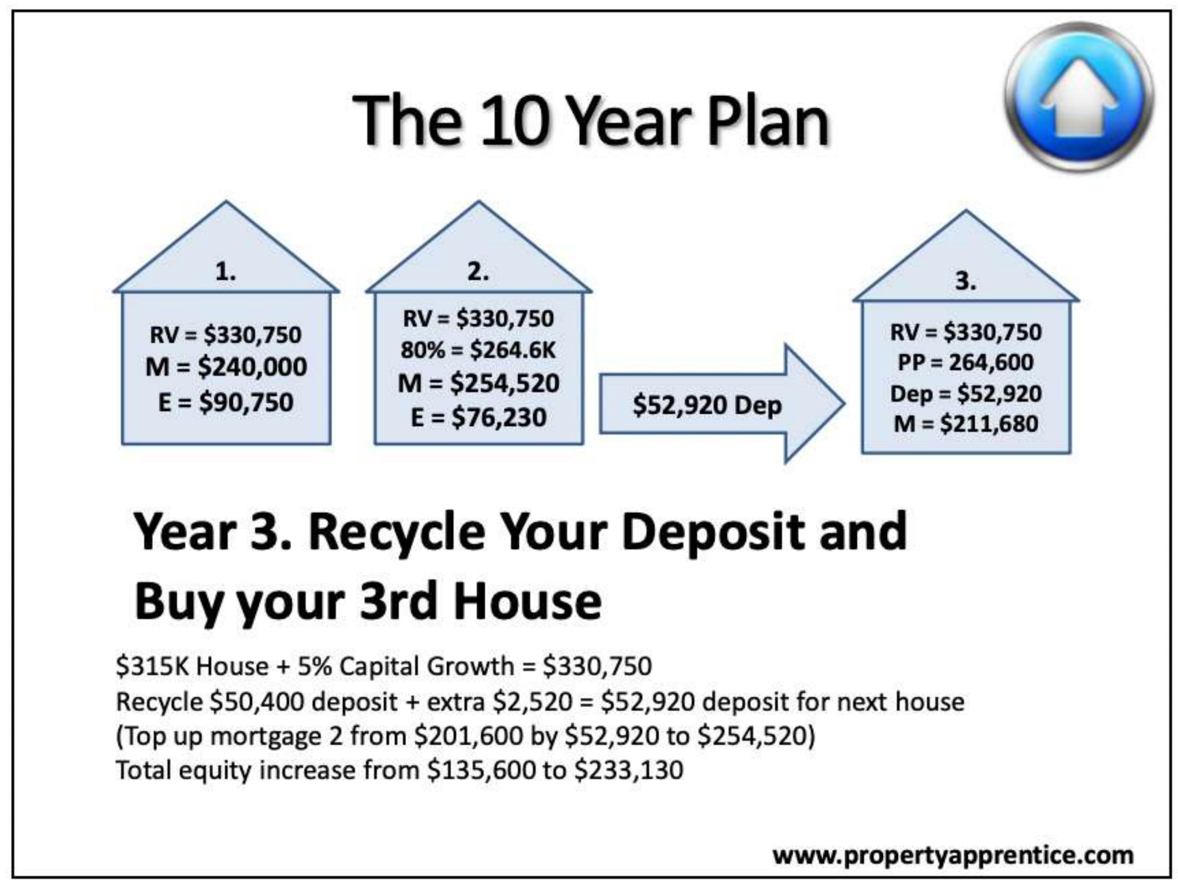
Remember how I said that at the point of purchase the bank will lend you up to 80% of the RV or the PP – whichever figure is lower? ***Well, 6 months after purchase the bank is no longer interested in how much you paid for the house.*** Now what they will want to know what that house is worth today. For this, you will need to get a new registered valuation. House number one has now increased in value by 5% to $315,000, so you would get a new registered valuation of $315,000 and take this to the bank. Assuming that you still meet bank lending criteria, you would be able to top up the mortgage to 80% of the registered valuation, which would be $252,000. However you wouldn't need to top the mortgage up to that amount! All you would need to do in order to buy the second rental property which also (for the sake of simplicity) is worth the same amount as house number one, is to top up your mortgage on house number one, to $242,400.

This is an increase of $50,400 which can then be used as a deposit for house number two. You have now effectively recycled your original deposit of $48,000 and pulled a little bit more out so that you can fund a 20% deposit on the “house next door”.

Now you repeat the process with House #2. You buy it for 20% below valuation, using the deposit provided by House #1. You now have total equity over both houses of $135,600. How much did you have to save for a deposit since you bought your first rental property? Zero – because you simply recycled your original deposit.

How much have you had to pay per week to own these properties? Zero – because they are both cashflow neutral or positive pre-tax (the rent covers the cost of all of the expenses associated with owning the properties).

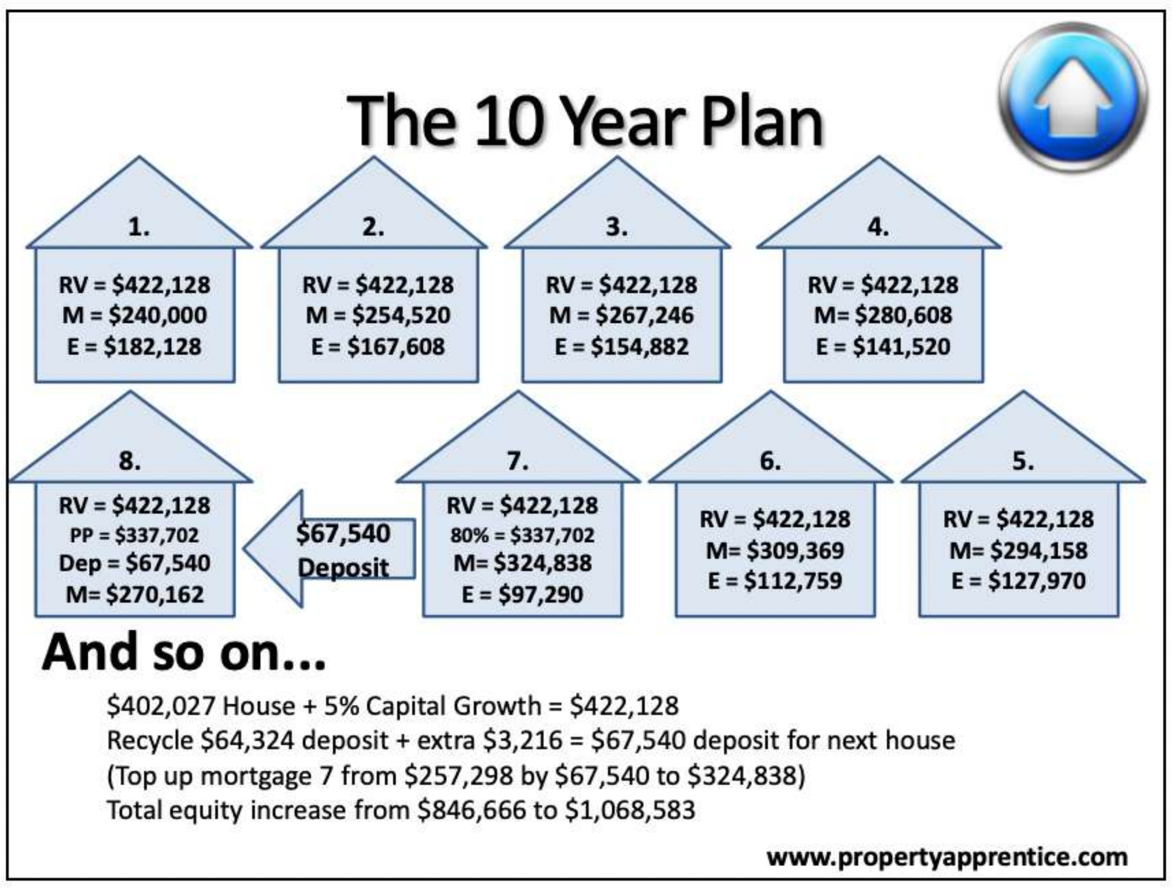
Could you have saved $135,600 within 12 months? ***Possibly not.***



Year three: Repeat!

After 12 months, you can repeat the process again by recycling the deposit from house number 2 in order to purchase house number 3. All houses have increased in value by another 5%. You don't need to touch the mortgage on House #1 again - it will stay the same for the rest of the 10-year plan. This time you top up the mortgage on House #2 in order to buy House #3. Again you don't need to top up to the full 80% of the new value; you just need enough to pay 20% of the purchase price of House #3. Your equity has now increased to $233,130.

Now let's just repeat this process, buying one rental property each year by recycling the deposit from the previous rental property that we purchased. Again, this is just ONE example of what you can do with property investment. But seriously, do you think that if you knew what sort of investment you were looking for, and if you knew the property market in the area that you were looking in, and you were actively looking for properties to purchase… do you think that you could find ONE deal every 12 months? ***I would suggest that if you couldn't, then you would be doing something seriously wrong.***



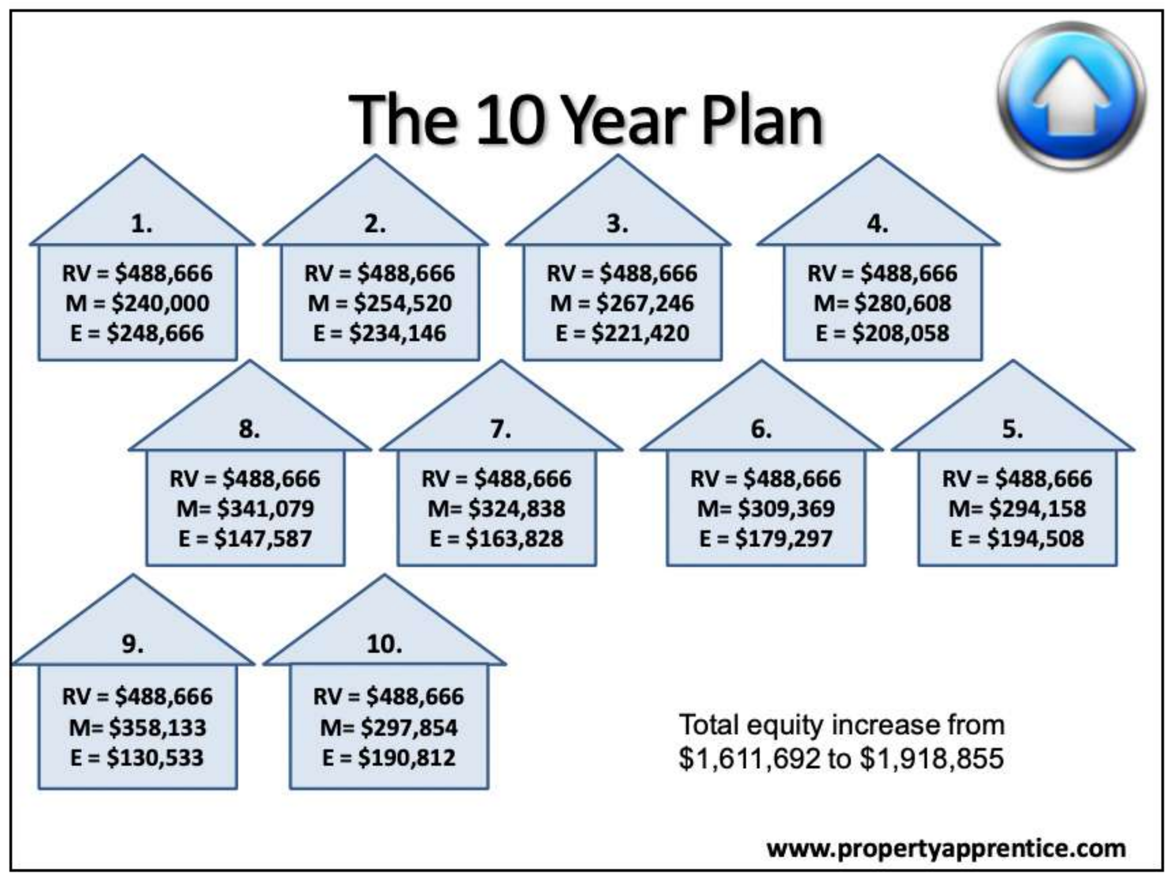
Fast forward to year 8:

By simply recycling the deposit from the previous purchase and using this to purchase one new rental property each year, you would now have eight properties and your equity would be over $1 million (using the example shown above, and following the assumptions given for the 10 year plan).

Congratulations! You are now a property millionaire!

Since your first deposit for House #1 you haven't had to save anything. You still don't have to pay anything to own these eight houses either. How much is this portfolio paying you to own it? You might be getting $10 per week from one property, $20 from another, and another may be costing you $20 per week.

Overall you may be cash flow neutral or slightly positive, but realistically it is hardly going to be enough to live on yet, is it?!

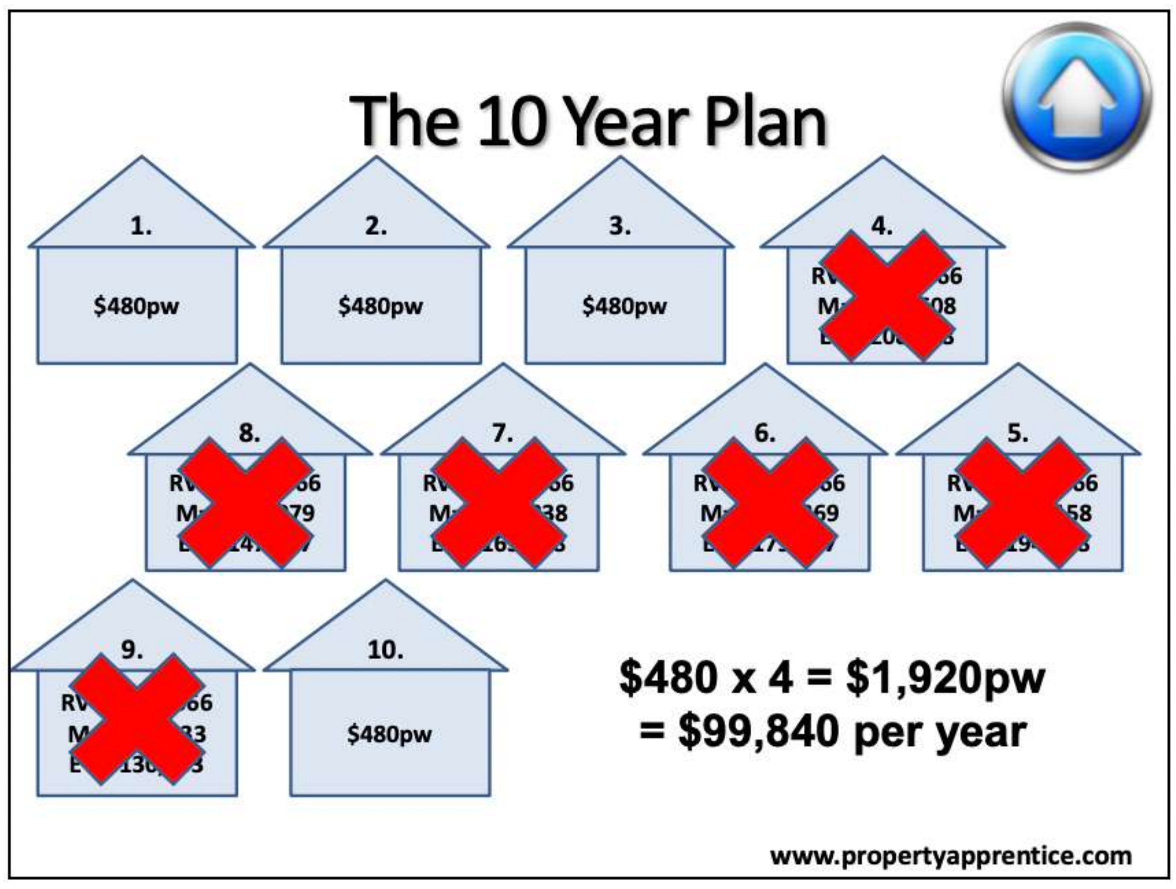


Fast forward to the end of year 10:

By the end of year 10, you have owned House #10 for a year. Your total equity is now just under $2 million. How did that happen when after year 8 it was only $1 million? This is due to something called “compounding”. Because you gain 5% per year on each house, it means House #1 has been doing this for 10 years, House #2 for nine years etc. In other words, the larger the value of your property portfolio, the faster your equity grows during periods of capital growth.

Right, so you’ve got $2 million in equity, but you are still in your day job, because your property portfolio is only netting something like $50 a week. What could you do if you now decide that the time is right for you to exit the workforce?

You could sell some of your properties.



Let's say you sell six houses, and use the proceeds of those sales (less any tax to pay) to pay off the mortgage on the remaining four houses.

If House #1 had a gross yield of 10% at the point of purchase, it would be generating $480 per week. Even if you had no rent increases for 10 years, with four mortgage free rental properties producing $480 per week, you'd have an annual pre-tax income of just under $100,000. This is what we call passive income. It is money that comes in to your bank account every week, regardless of whether you get out of bed in the morning or not.

For some people that will be enough for them to give up their day job.

But what if it's not enough for you? In the 10-year plan above, we recycled our deposit once every year. Do you remember how quickly I said that the banks would let you recycle your deposit? Six months after purchase. So, you could have double the number of properties in the same time by recycling your deposit every six months in order to buy another rental property. This way, you'd end up with 20 houses, sell 12 and have eight mortgage-free. This would effectively double the final result of the 10 year plan, generating just under $200,000 per year in pre-tax income.

Structuring your borrowing

In order to reduce the risk involved with building a property portfolio and recycling your deposits, we suggest two things:

1. Use a mortgage broker who specializes in investment lending. We recommend our sister company **www.miteam.co.nz**
2. Use a good Accountant and Lawyer who also specialize in property investments

Different banks have different criteria in determining a person's provable income. I've seen people apply for loans in the past with banks they have good relationships only to be been turned down because they do not fit in with the criteria. Independent mortgage brokers work with both bank and non-bank lenders and can give you advice which ones would most likely approve your loan.

In other scenarios, independent mortgage brokers are in direct communication with banks that can lend you more than 80% of the property's amount. They would be more than happy to refer you to these opportunities.

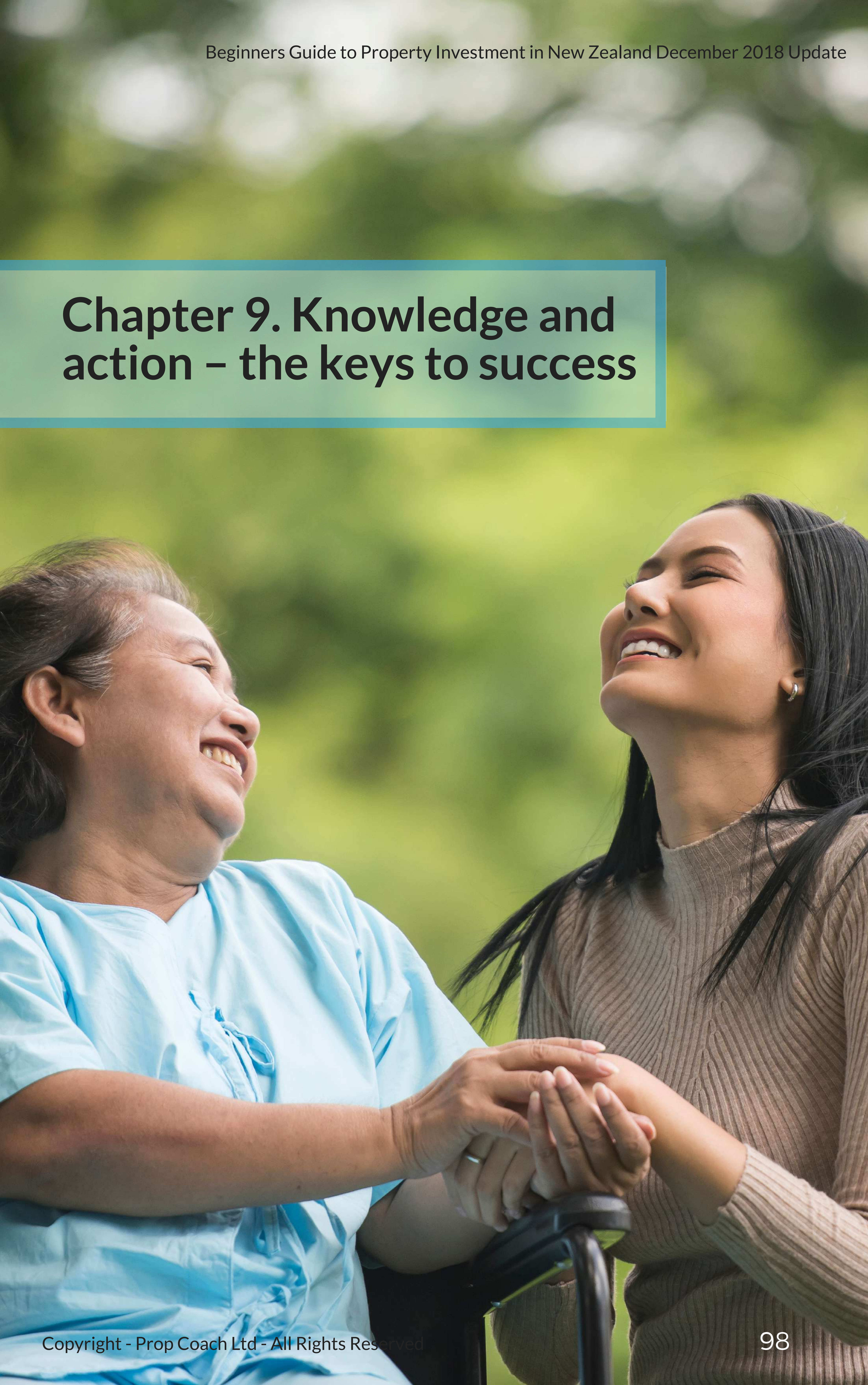
If possible, keep your home with a completely separate bank than your rental properties.

Also, spread the love around several banks for your rental portfolio so that you don't have all of your eggs in one basket so to speak. A good independent mortgage broker can sort all this out for you.

You need to structure the lending correctly in order to ensure that your properties are not secured against each other, which is why you need a good mortgage broker.

For example, some people might need to use the tougher banks first and save the easier ones for when their situation gets more complicated. Whatever you do, get expert advice - and because mortgage brokers are free of charge to you (they get paid by the banks), years and years of this expert advice won't cost you a cent.

Chapter 9. Knowledge and action – the keys to success



Chapter 9. Knowledge and action – the keys to success

As property investors, it is also important to know and understand which deals work best for your individual situation and goals. Banks may lend you 95% of your property's value if you decide to build a new home. At this rate, if you had $100k in savings, and if your provable income was high enough, you could potentially build a property valued at $2 million...

But is this really a good idea? Even if the bank is willing to lend you large sums, this doesn't mean that you should do that. You need to work out whether or not the mortgage you will be taking out is affordable not just at today's interest rates but also when the rate increases in the coming years.

At the moment, we've got really low interest rates. The long term average interest rate in this country is approximately 7% percent. So, if you can only just afford to make the mortgage payments when interest rates are 4%, if interest rates climb to 7% (or more), you could find yourself in some real financial difficulty. Always make sure that your budget fits with a higher interest rate.

And if you think it's going to be tight, you need to make sure you've got a plan B in place. So either you might pay down as much of your mortgages as you can now until your fixed term expires. Or you might consider taking on flatmates, for example, to help with the mortgage payments.

Nearly every Kiwi thinks they know a lot about property. It's a topic of conversation at practically every barbeque (especially in a booming property market), and most people like to believe they are experts (even if they've never actually bought a property themselves). We were no different when we first started out. However, we had an idea that perhaps we didn't know everything, so we attended seminars and got some education - and we were amazed at what we learnt. Or to put it another way, we were amazed at how much we didn't know!

So, we can't stress enough how important education is. But it doesn't end there. For education to be of any use whatsoever, it needs to be combined with action. You have to know what to do - and then go out and do it.

If you are going to move forward, you need both knowledge and action. Think of them as being two legs.

If you only take steps with the knowledge leg, you'll spend hours and hours attending seminars and reading book after book, but never visit properties or put in offers. How well will your investing go?

To put it bluntly, it won't go at all. In ten years from now you will own the same number of properties that you own now, as you will just have been moving around in circles.

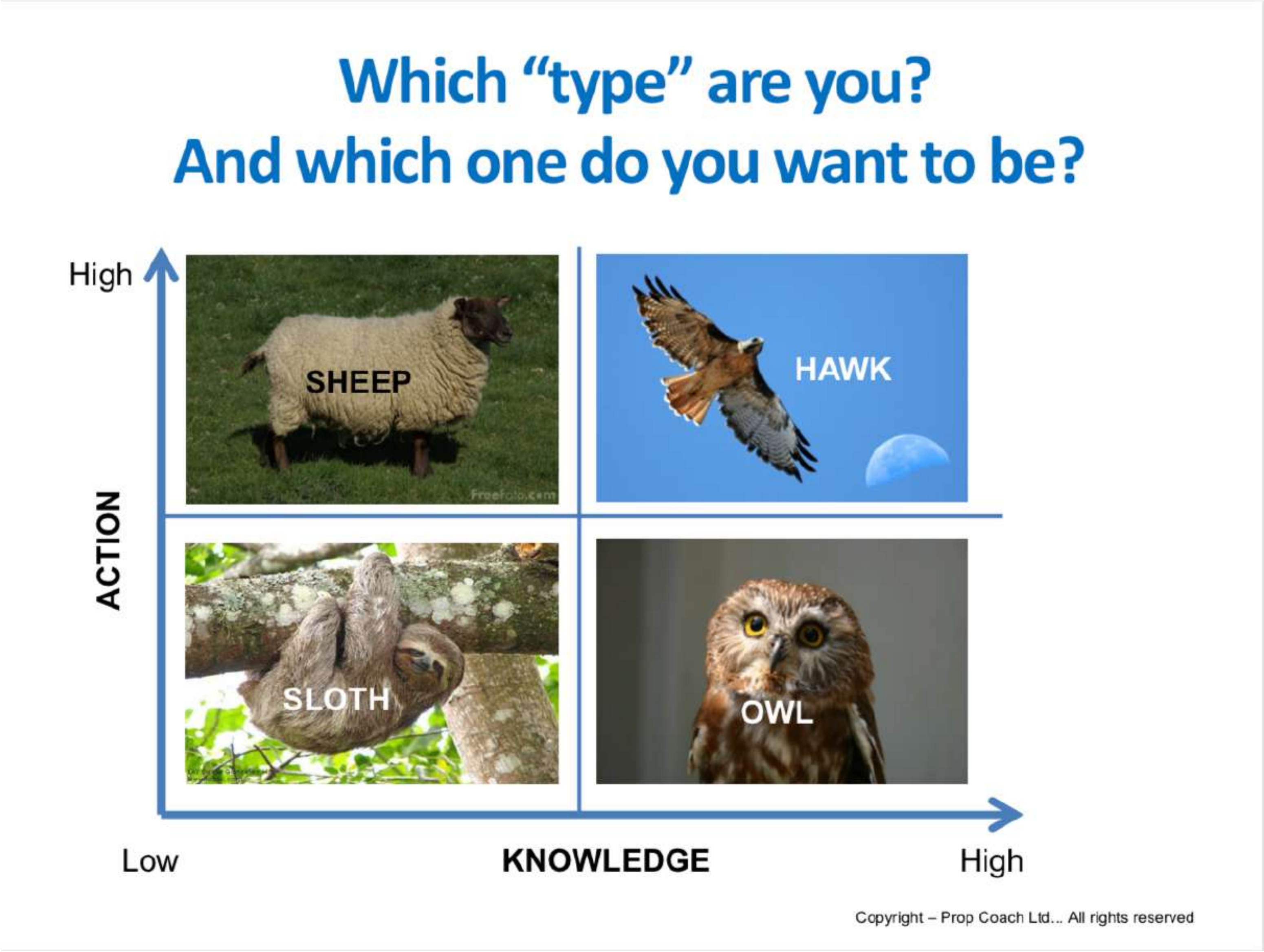
On the other hand, if you only take steps with the action leg, you are likely to make expensive mistakes that you might not even be aware of until well after the fact. At the end of the day you don't know what it is that you don't know. If you learned something from this book, trust me when I tell you that there is a whole bunch of other things that you need to know and understand when it comes to property investing in order to avoid making costly mistakes that could either financially cripple you, or take a decade to recover from financially. This is why we created our Property Apprentice Lifetime Coaching Program.

Intellectual knowledge without action is useless. Action without knowledge is directionless.

At Property Apprentice we can give you the knowledge that you need in order to build a solid rental portfolio based on the fundamentals rather than based on luck.

We are committed to helping our clients and can give you the knowledge, systems, ongoing support, contacts, and the benefit of our guidance and experience - for as long as it takes. After all, we've just shown you a 10-year plan! Your plan might be shorter or longer than that. Chances are ***(and history with our clients has also shown)*** that regardless of your starting position, we can help you to achieve your desired result in a shorter timeframe than you might be able to do on your own. Also, by providing you with back up and support as and when you need it, we can assist you throughout this process and thereby help you reduce the risk and the stress involved!

My husband Paul & I have been teaching people how to invest in NZ real estate since 2007, and over that time we have discovered that people fall into one of the following four quadrants. Which quadrant do you think you are in at the moment?



Now that you know which quadrant you currently fit into, have a think about which quadrant you would prefer to be in. We specialise in helping people to achieve the results that they desire, regardless of their starting position. We can certainly help with the knowledge side of the equation (Sloths & Sheep) – and although we can help to motivate you if that if what you need (Sloths & Owls), the action part is up to you.

Perhaps your first step will be to join our coaching program. We have a great team of coaches who would **love** to help you.

Call us on **(09) 575 7736** or email us at **info@propertyapprentice.com** for more information or to arrange a no obligation consultation with a member of our team to see how our coaching program can guide you.

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