Your Guide to Becoming a NZ Property Investor

Learn the basics of buying your first investment property

By Thrive Investment Partners

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Getting Started

Congratulations on taking what is probably your first step towards becoming a property investor. This guide is intended to introduce the key points to consider when becoming an investor:

- Funding – you need to understand how money is raised for an investment property and how much of it you can raise.
- Portfolio Basics – how to build a resilient portfolio you can live with for 10+ years (property is a long-term investment).
- The Numbers – yield, capital gain and return on investment.
- Asset Selection – apartments, townhouses and houses and the merits of each.
- Finally – finding a deal!

Funding

The best investment property is the one you can get funding for, so it's essential to understand how much you can borrow. This can be broken down into two sections:

A. Equity

Equity is the difference between the value of your property and the outstanding mortgage (the bit you own). Investors mostly use the equity in their owner-occupied house as a deposit for their first investment property, so they need to know how much equity they have available to them. Equity is calculated by:

Property Value - Outstanding Mortgage = Equity

Equity Example:
Property value: $1,000,000
Outstanding mortgage: $650,000

$1,000,000
- $650,000

Equity = $350,000

However, you can't use the full amount of equity for a deposit because the banks will only allow you to lend up to 80% of the value of your house. This is what we call 'useable equity' and it's what makes up the deposit you have available to you (assuming you aren't contributing any cash).

Consider this example below:

Useable Equity Example:
Property value: $1,000,000
Outstanding mortgage: $650,000

($1,000,000 x 80%)
- $650,000

Useable Equity = $150,000

Investors need a 20% deposit for new build investments and a 40% deposit for investments in existing properties. This means that your useable equity needs to be more than 20% of the purchase price for your first new build investment property. For example, if you had useable equity of $150,000 then you would have a big enough deposit for a $750,000 new build property, but can only purchase an existing property up to $375,000.

New Build (20% Deposit): $750,000 x 20% = $150,000

B. Serviceability

Serviceability is the ability for you to pay your mortgage. The banks have a number of checks and balances in place to judge investors on their ability to service the debt. Although not formally in place, it is convenient to consider the debt-to-income ratio (DTI).

A debt-to-income ratio means people can only get lending from the bank up to a certain multiple of their income. For instance, if a bank imposed a DTI of 7, this means someone can only get lending of up to 7 times their gross annual household income plus the rental on the new build investment property at 80% (20% vacancy allowance). Although on existing properties banks will only consider 70% of the rental income (30% vacancy allowance). This takes into account existing lending on your own home, so to calculate your serviceability based on the DTI rules, it might look like this:

- Gross Annual Income: $160,000
- New Income From First Rental Property ($600/week x 80% x 52 weeks): $24,960
- DTI: 7
- Outstanding Mortgage On Own Home: $450,000

Borrowing Power
(($160,000 + $24,960) x 7) - $450,000
= $844,720

We then need to combine your equity and serviceability to see if you're able to purchase your first investment property. In the example above, the person has $150,000 available to them as a deposit and can service additional debt of $844,720.

As a result, this person could purchase a new build property worth $750,000 or less because they can service that debt and have the deposit available to them.

Speak With A Broker

A mortgage broker will be able to give you further advice on lending capability and specific advice around banks' lending policy, interest rates and so on.

It can be tricky for investors to get lending, so here are a few tips on how to improve your chances of getting an approval. Banks consider three things when assessing your loan: character, security and serviceability (more on this under Investment Concepts).

Here are some tips to boost each:

- Tidy up your accounts. Pay all your bills on time, don't let your account go into overdraft, reduce unnecessary spending.
- Reduce or cancel any short-term debt.
- Credit cards, hire purchase etc. Obtain a copy of your credit report.
- Keep a copy of your financial records if you're self-employed. Have up to date financials available for the bank.
- Show a consistent savings record.
- Take in a border or two.
- Ask for a raise at work.
- Convert 'at risk pay' from commission or bonus to regular payments.
- Reduce subscriptions and memberships.
- Reduce discretionary spending like eating and drinking out.
- Consider switching to low-maintenance, fuel-efficient vehicles if commute costs are significant.
- Revalue your property either by registered valuation or e-value.
- Accelerate payments on your mortgage to reduce debt faster.

A high-quality mortgage broker can coach you on this. Thrive Investment Partners has an associated company which can assist with this.

Portfolio Basics - Key Investment Concepts

The following investment concepts should be at the forefront of mind when researching how to grow your property portfolio:

Scale

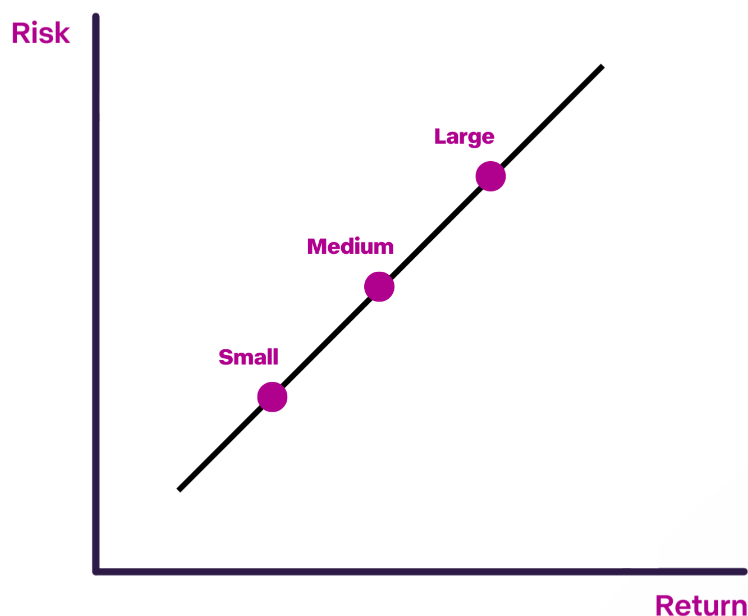
Scale refers to the number of properties and value of the assets under investment. Closely related to leverage. This is the idea that you need a big enough position in a market for the increase in value to be meaningful in terms of your goal. Retirement is a big undertaking and to do it well takes a lot of capital. Property investors largely seek capital gains to a greater or lesser extent to accumulate this nest egg.

For Example:

Small Scale – purchase a single investment property and commit to repaying the lending. Let it appreciate and either sell or rent it to fund retirement. There is no speculative element as there is no dependency on appreciation in value. Although, this is harder to achieve as there are no other properties being sold to help pay off the first property.

Medium Scale – several properties are purchased (say four). These are held long-term, and the mortgage is paid down as much as possible. Eventually the investor sells one or two to pay off the balance of the debt. The retained properties are rented to fund retirement.

Large Scale – the investor purchases as many properties as lending criteria allows. All lending stays interest only. When the time comes the investor sells as many properties as necessary to freehold the balance.



Typology

An investor can increase scale by varying the typology (type of property).

Invest For Growth

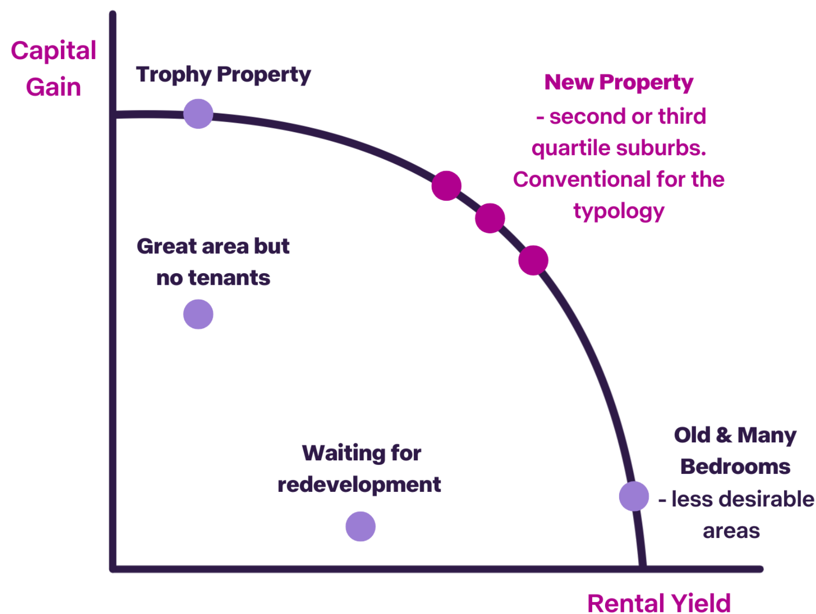
Some property grows in value fast but doesn't produce a lot of yield (rent). Those properties make you wealthy but sap cash flow meaning borrowing capacity is exhausted sooner.

Invest For Yield

Some properties generate a lot of rent relative to purchase price, high yield. Often these properties have limited capital growth.

Investors can use this to their advantage by holding both types of property. The high-yield properties help pay for the high-growth properties. This allows further leverage/scale and larger profits over the long-term.

Property is scored on a curve. The best property in the best area with the best prospects for growth should have the lowest yield. The worst property in the worst area with terrible prospects for growth should have the strongest rent yield. If this doesn't hold the property is considered "suboptimal" and should be ignored.



Duration (Time)

There is a correlation between age and the appropriate amount of risk/scale/leverage. Time informs as to the scale and level of speculation that is appropriate for the portfolio.

A 60-year-old who wants to retire in five years wouldn't spread their surplus income across four properties. They would be likely to buy one, put cash into it and aggressively attack the mortgage with principal and interest repayment (amortisation). Potentially, also using some of their KiwiSaver pay out to finish the loan repayment to produce an inflation resistant, income stream in retirement.

A high income 30-year-old could justify focusing solely on their own mortgage and using the equity in the property to propagate a multi-property portfolio, leveraged to 100 percent. Those loans would be "interest only". With a 35-year investment horizon there will be multiple cyclic "booms". Usually, these investors seek a cash flow neutral portfolio and that is what justifies their choice of typology.

Diversification

This is a simple but extremely important concept. It works on the premise that picking winners are fickle. By spreading your investment across the country and across a range of typologies you will get more consistent and greater capital appreciation, and rental return.

Our philosophy on this is to try and choose properties that are not correlated i.e. not part of the same market, nor influenced by the same factors.

Leverage

Leverage is using borrowed money to make more money, with the requirement your return is greater than it costs to use the borrowed money. The return from the investment should be greater than the interest rate otherwise it's not viable. There is more to it though. The ability to access borrowed money depends on three things: character, security and serviceability.

Character means you pay your bills and do what you say you will do, almost all our clients have no problem meeting this threshold.

Security for residential investment means having headroom between the value of your property and the maximum lending to value ratio. For your own home, you can borrow up to 80 percent of its value. For any existing properties, you can borrow up to 60 percent of the value.

But it gets even more complex when you spread your borrowing across different lenders and if this is done right it allows you to access more capital without increasing the interest rate or risk. Likewise, getting the typology and the split between yield and growth right allows you access the optimal amount of leverage.

Serviceability is the main hurdle for most investors. Again, this is heavily influenced by the split between growth and yield properties. Choosing properties with strong cash flow even though the capital gain prospects are lower than other options can make sense because it enables you to increase scale. This trade-off is central to building a property portfolio.

Cashflows and Capital Gains Projections

Working out cash flow is important so investors can understand the cost of ownership.

Let's run a basic cashflow:

Property Investment Analysis Summary	123 Gaverick Road Christchurch
Purchase Price	$750,000
Set Up Costs (lawyer, valuation, etc.)	$3,500
Cash Deposit (if any)	$0
Loan Amount	$753,500
Loan Type	Interest Only
Loan Term	30 Years
Interest Rate	4.50%
Rental Income	$600 p/w
Vacancy	2 weeks p/a
Annual Rent	$30,000
Yield	4.16%
Annual Costs	
Mortgage Payments	$33,908
Property Management	7.95% + GST
Letting Fee (1 week rent + GST)	$690
Rates	$3,500
Resident Association	$1,800
Insurance	$0
Body Corporate	$0
Maintenance	$750
Accounting	$250
Other Costs	$0
Your Weekly Cost (Year 1)	**$262**

We can also forecast capital gains by compounding a growth rate, say 5%, for the number of years the property is owned.

Capital Gains Projections	
Projection Term	10 Years
Capital Growth Rate p/a	5.00%
Projected Property Value	$1,221,671
Projected Mortage Balance	$753,500
Project Equity	**$468,171**

Asset Selection

So, what do I buy? In the residential property space, there are apartments, townhouses, and houses. So, what are they and what's best? The simple answer is there is no silver bullet. Let's consider the differences:

Apartments

Apartments grow in value slower than townhouses or houses, but are generally higher in yield. When considering cash flow, investors look at yield. Gross yield is:

$$\text{Gross Yield} = \frac{\text{Annual Rent}}{\text{Purchase Price}} \times 100$$

Because apartments have a lower purchase price and a similar rent to the other options, their yields are typically higher meaning investors seeking cash flow prefer apartments.

Strong yield (rental income) makes it easier to get funding for your next property. However, the trade-off for high yield is lower capital growth so it's important to consider this when weighing up your investment options. Ideally one offsets the other because capital growth is where the majority of wealth is made during a property investment lifecycle.

Townhouses

Townhouses are usually cheaper than houses because there is less of a land component and often fewer external walls. Townhouses represent a middle-ground for investors where they can purchase at a reasonable price, have good yield and good capital gain.

Townhouses are a very popular investment choice and especially good for first time investors who might not have enough equity or serviceability to pay for a more expensive standalone house.

Houses

The most expensive of the options. An off-the-plan house & land package has the highest land component and is standalone – meaning it doesn't have any shared walls. A lot of New Zealanders grow up with this sort of living situation, so the lure of familiarity is large. However, this doesn't mean it's the best investment option for first time investors because yield is often low (weak cash flow).

This makes cost of ownership high and rules out a lot of first-time investors because they don't have the surplus money to fund the investment.

Finding A Deal

What does a good deal look like? Here are some focus points:

- Is the price reasonable or under market value?
- Can I negotiate a discount on the purchase price?
- Does the cash flow stack up?
- Is the developer reputable?
- Is it in a good location?

Common Risks

There are also some inherent risks with buying property, so here are some key things to look out for:

- Developers with poor track records. Has the developer delivered products as promised in the past?

- Contracts with hostile clauses. Once you have a conditional contract in place, make sure to seek legal advice on the clauses within the contract. Sunset clauses, vendor conditions, and price escalation clauses should all be noted.

- How your deposit is treated. The majority of deposits are kept in a solicitor's trust account and can't be accessed by the developer. This means you will get it back if the development is discontinued but this should still be checked with your lawyer.

So which property should you buy?

As always, it depends on your individual circumstances. Your personal financial situation dictates what investment type is best. It's hard to do any of this on your own and it is important to seek advice from experts that can help you. Building a team of experts around you is a critical first step to unlocking a successful property portfolio and setting yourself up for a bright future.

How Thrive Investment Partners Can Help

Thrive Investment Partners is an expert financial advice company that is property centric. We help Kiwis build wealth through property investment.

We understand that everyone's knowledge, experience and investing risk appetites are different – we partner with you to develop a financial plan and execution strategy that supports your wealth goals. Each investment we recommend is backed by research. Our advisers like nothing more than a client who asks 'why'. We 'deep-dive' opportunities to manage risk but also to fully understand the 'upside' for you.

If this sounds like you, book a time to speak to our team using the link below and take the first steps.

Talk to our team

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