Fact Sheet - Direct Property

This document provides some additional information to help you understand financial planning concepts in relation to **direct property**.

For more information, please contact the DPM Private Wealth team on (03) 9621 7000 or email info@dpmfs.com.au.

Costs & Risks of Direct Property

Any decision to purchase, retain, or sell a direct property asset should be carefully considered as there are specific costs and risks associated with this type of asset. We have listed below some of the main costs and risks relating to direct property assets.

Purchasing the Property

Purchase costs include:

- Time and cost of searching for a suitable property
- Inspection reports (e.g. structural and/or pest inspections)
- Legal and conveyancing fees
- Loan establishment costs
- Stamp duty

Location: The character and location of a property can have a big influence (positive or negative) on the current and future desirability of the property to purchasers and/or tenants. It is important to know the area in which a property is located, and to determine what future developments may be planned nearby which could impact on its suitability as an investment (such as a new highway, rubbish tip, high-rise development).

Timeframe: Direct property should be viewed as a long-term investment. This is due to the potential short-term volatility that the direct property market (and/or specific locations) may experience. There are also significant purchases, ongoing and sale costs associated with investing in property which may take time to recoup.

Opportunity cost: When investing into direct property, you forego the opportunity to use that money to invest into other assets which may be more appropriate to helping you achieve your goals and objectives. That is, after taking into account the estimated costs, risks and returns that apply to each of the major asset types, is direct property more likely to provide the best net return?

Owning the Property

Risk vs return: The return on direct property is impacted by various risks: The rental income you receive will be influenced by the demand for property in the area in which it is located and the condition of the property. Any increase or decrease in capital value is also influenced by the demand for property in the area. Current interest rates may also impact the demand for the property.

Lack of diversification: No one type of security, assets class, or investment strategy provides the best performance over all time periods. Having all or a high percentage of your investable funds in any one particular asset class may not give you the best return for your money.

Lack of liquidity: Unlike many other investment types, it is generally not possible to sell off a portion of property. As a result, direct property is an inflexible asset. If you were to decide to sell a property, there is usually a lengthy time-delay between making the decision to sell and actually receiving the sale proceeds.

Problems with tenants: There are likely to be periods where a rental property is untenanted, meaning that no rental income is received for that period. Tenants may also damage the property, and may pay the rent late or not at all.

Ongoing costs: There are many ongoing costs associated with direct property.

These may include:

- Maintenance and repair of existing structures and fittings, both internal and external
- Body corporate fees, and the time required to attend body corporate meetings (if applicable)
- Agent fees (where an agent is used to secure a tenant and/or manage the property)
- Time devoted to managing the property. Even when paying an agent to take on some of the day-to-day responsibilities, the owner still needs to be involved in many aspects of managing the property
- Council rates, land tax, other taxes (where applicable)
- Loan interest, repayments and fees
- Insurance

Improvements: Often capital improvements to a property are necessary (such as the replacement of an oven or air conditioner). Such capital outlays can be costly and unplanned. Other costs may include building or renovation work, or subdivision costs.

Legislative risk: The taxation rules relating to investment properties currently allow the claiming of certain deductions and depreciation which may make property investment more attractive to some investors. There is no certainty that these potential tax benefits will continue into the future, as the relevant legislation may change over time.

International property: Where international property is being held or considered, it is important to be aware of any applicable international tax laws, residency issues and currency risks before you proceed with this advice.

Selling the Property

Sale costs: There are many sale costs associated with direct property.

These may include:

- Time needed to select an agent to manage the sale
- Advertising the sale
- Time spent preparing and vacating the property for inspections
- Legal and conveyancing fees
- Agent fees

Capital gains tax (CGT): Unless the property is your home, you may have to pay CGT on some or all of any gain in the value of the property (i.e. the difference between the price you bought and sold it for). This could significantly reduce the net sale proceeds available to you once the property is sold.

Sale date uncertainty: Unlike some other asset types, it may take months or even years to sell a direct property. This could be due to the property's location and desirability (or lack of), the asking price, and/or the length of the settlement period. Generally it takes at least 2 months from the time you decide to sell to when you receive the sale proceeds.

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