

Property Investment - Purchase Costs

The purchase costs of an investment property are often understated. In part it has to do with the marketing messages by services feeding off the industry wanting to play down your costs of being involved. But there is also an all too regular occurrence of the real estate buyer not digging deep enough when investigating all the costs that actually come into play by the time ownership is in place.

It is not possible to accurately budget for what you can afford to buy without knowing all the costs of the purchase. So this chapter will set about to identify the broad range of costs that come into play when purchasing an investment property and enabling ownership. The costs have been grouped into three categories, the obvious costs, less obvious and the obscure.

There is a template checklist of costs in the resource tools section of this book, which you could use to complete the variables as they apply to you and determine the total spend to complete your real estate purchase. You will also see a completed example of a purchase costs budget with the figures used to identify the total costs of an example purchase.

The Obvious Costs

These costs are commonly discussed by most real estate professionals, although it's interesting as to what detail you will get, depending on which industry professional you are speaking to. For example it's rare for the pushy real estate selling agent to emphasize the cost of building and pest inspections. The inspection is something they would rather buyers neglect, it can slow the purchase process and may reveal issues that affect their ability to earn a commission. The important point here is that you recognise that there are a range of particulars that add to the "true" total costs of a real estate purchase. Investigate how they apply to you and at exactly how much expense.

The Purchase Price

This is the price of the real estate stated as the "Purchase Price" in the contract of sale. It will be determined by the property characteristics, location and market environment that you are buying in. This is the most easily identified cost but is all too often confused in conversation as the total of your purchase costs. The purchase price is merely the starting point to which many additional costs are added before you complete a purchase and arrive at ownership.

Stamp Duty on Land Transfer

The amount of stamp duty is calculated on the value of the land and improvements, most commonly identified as the "Purchase Price". However the stamp duty payable on the transfer of land varies from state to state and in the case where the purchase price reflects a figure for land and improvements yet to be completed, the stamp duty may not apply to the full purchase price. It is critically important that you seek a solicitor's advice on the stamp duty payable and applicable to your purchase.

Each state has its own scale of stamp duty payable and invariably they all increase with value of the land and improvements. You will also find that the stamp duty payable will apply to the "Market Value" of the land and improvements where the "Purchase Price" is determined to be less than the "Market Value". There are also situations where the buyer may qualify for stamp duty concessions and discounts. For reference and further identification of your stamp duty payable you can visit the web site or call the state revenue office in the state you are buying.

Many a real estate buyer is sold a property, yet to be completed, on the basis of significant stamp duty savings. Tread very cautiously as the stamp duty is calculated on the improvements at the time of signing the purchase contract. If the building was near completion at the time of signing a purchase contract the savings would not be as significant as if signing at the time when the property was just a vacant building site. Once again this emphasises the importance of seeking legal advice to determine the exact stamp duty payable on your purchase.

Transfer Fees and Mortgage Registration Fee

These are government fees but much less than the stamp duty payable on the transfer of land. They do vary from state to state and once again the state revenue office can advise but your final enquiry should be to your solicitor and specifically as to how it applies in your case. The Transfer fee is usually a fixed figure and the Mortgage Registration fee usually varies with the size of the mortgage. If you visit nationwide real estate portals like realestate.com.au you will see they have some handy stamp duty calculators that can determine hypothetical stamp duty and government charges for variable purchase prices and mortgage amounts, as they would apply state by state.

Loan Fees

The Loan Fees are a combination of application fees, valuation fees and documentation fees. Each lender will have a different policy on their loan fees. Depending on the perceived degree of difficulty for preparation and providing of your mortgage to purchase, you may encounter variations to the standard loan fee set out in the lenders marketing material. Be prepared lenders always have disclaimers and people are often charged more for their loans than they initially were made aware of.

Buyers Agent Fees

The selling agent is paid a commission by the seller. Under no circumstances should a buyer be paying a fee to the selling agent, regardless of legislation this is obviously a gross conflict of interest. There is however a growing pattern by real estate buyers to engage the services of a buyers agent (also referred to as a buyer's advocate) who acts exclusively for the benefit and advantage of the buyer. No buyer's agent should receive a fee from the seller or seller's representative, regardless of legislation it is a gross conflict of interest and act of professional misconduct.

The buyer agent fees payable will vary depending on the level of service the buyer has requested, the service can start in the form of valuations, negotiation and auction bidding up to full blown property investment strategy planning, search and acquisition. Each state has its own professional real estate institute which provides service agreements so that the services provided by buyer agents and the fees payable can be clearly identified.

Building and Pest Reports

In some cases the buyer may choose to have only one or the other, in any case it is not yet a mandatory requirement that a building and pest inspection be completed prior to completing a contract of sale. However the growing consumer awareness and desire for peace of mind has seen significant growth in the industry of pre-purchase building inspections and pest inspections. The costs of inspections vary with the size of the building and degree of difficulty.

Some service providers will give a small discount when booking for both a building and pest inspection. The predominant pest causing damage is the termite and so in some parts of Australia (where termites do not exist) pest inspections are not as commonly advised as a building inspection. You can investigate the costs of building and pest inspections particular to your purchase location and property type at inspectionangel.com.au and similar service directories.

Solicitor Fees

Provided there are no problems the only Solicitor costs you will endure are for those of the conveyancing. In simple terms conveyancing is the service of completing the legal paperwork and administrative tasks required to go from signing a contract of sale to completing settlement, at which point your name is transferred to title as the owner.

Keep in mind that there are conveyancing services which are not Solicitors. These can usually be a little cheaper to employ. Also keep in mind that during the process of conveyancing there are times when expert legal advice provided by a Solicitor is required. At this point the costs of legal advice can escalate if you didn't engage a Solicitor in the first place.

Building Insurance – Fire and Malicious Damage etc. etc.

As soon as you have signed a contract of sale for a real estate purchase you have created an insurable interest in the property. Imagine the mess you would be in, if the building and any improvements were burnt to the ground or damaged by a storm just after signing a contract of sale. In this case it's reasonable to expect a legal minefield and a huge amount of hassles unfold, the only thing which may offer peace of mind would be knowing that you already had the building insured for its complete repair and return to as good as new.

Contact your favourite insurance company and seek full insurance cover for your purchase, explain the purchase position you are in and buy the insurance cover for the complete new for old replacement of the buildings and any improvements. Do not skimp on the cover make sure it allows for any demolition and removal work that may be required before repairs can begin. Seek professional insurance advice and make sure you add the costs of building insurance to the total of your purchase costs budget.

Less Obvious Costs

Often mortgage brokers won't discuss the costs of lenders mortgage insurance until deep into a service discussion, there are some valid reasons for this, as it doesn't apply to all buyers. But the fact that not all buyers encounter the following costs makes them no less important to be aware of. It can be these less obvious costs that come as a surprise expense and ultimately place unnecessary pressure on a buyer's desired mindset as a happy and prosperous landlord.

Lenders Mortgage Insurance (LMI)

There are regular circumstances where a bank will impose a fee of lenders mortgage insurance, a policy which covers the banks risk of loss by providing the mortgage. LMI is usually applied when the buyer is borrowing more than 80% of the purchase price, although sometimes it may be imposed due to a perceived risk associated with the size of the property or its location.

The actual cost of the LMI is not a fixed figure but depends on the size of the loan. Some people choose to add the cost of LMI to the balance of their loan, if the lender will allow it, which means you end up paying interest on the costs of LMI for the term of the loan. When discussing mortgage products with your lender or mortgage broker make sure they clearly identify the conditions when LMI will be imposed and the costs associated, it is usually a multiple of thousands of dollars.

Adjustment of Rates and Outgoings

If the council rates and other outgoings like owners corporation fees have been paid in advance by the seller, then there will be an adjustment at settlement that comes out of the buyers pocket, this can often be over a thousand dollars. The owners corporations can specify that a new owner is responsible for already scheduled works without say. This work and costs should be detailed in the minutes of an owner's corporation meeting but is sometimes missed. Make your own full investigations with the owners corporation managers of the building or instruct your solicitor to investigate any liability you may be buying into.

Sworn Valuation

In the case that a bank specifies a special purpose valuation, you may be charged extra on top of standard application fees. There are also circumstances where the lender may require a valuation of the rental income.

There is also the regular case where a buyer that hasn't engaged a buyer's agent may require an independent sworn valuation in preparation of presenting an offer to purchase.

Land Surveying

If there is a common occurrence of irregular and damaged fences in the area or simply unclear boundaries for a particular property you want to buy? The cost of a land surveyor should be included to ensure that you have clarity of the exact dimensions and area of real estate on title that you are buying and that they match the physical boundaries as inspected on site.

Accountant Fees

Tax advice, ownership structures, self-employed income verification and any number of applicable financial tasks may be required of your accountant so be prepared for an increase to your accountants bill. It is better to set aside at least \$500 for accountants advice as required rather than avoid it and make mistakes that might cost you more down the track.

Land Tax

This is applied state and your accountant will be able to advise you of your liability, it will vary with the value of the land and most revenue offices of each state provide online calculators or assistance by phone call. In 2011 Victorian land tax on an investment property with unimproved land value of \$350,000 was \$475 for an individual. In Queensland the same example would cost zero, so make sure you investigate with your accountant as to exactly what your costs will be.

Quantity Surveyor

When buying an investment property that earns income, the benefit of reducing your annual income tax can be enjoyed by applying depreciation expenses. This first requires the preparation of a depreciation schedule by a quantity surveyor. The cost of the quantity surveyor and depreciation schedule will vary with the size of the property and degree of difficulty, a standard Australian home will probably cost between \$700 and \$1000.

Locksmith

It is a surprising but regular occurrence that selling agents and many owners seem to neglect the importance of handing a full and complete set of working keys over at settlement, this includes garage keys and duplicate remotes, window keys, controls and security system instructions. Often overlooked but important for the security and benefit of future tenants is an effective set of door locks, ideally keyed alike.

When inspecting a property to be purchased take a note of the number of door locks and security measures in place and allow for a locksmith to changeover, update and provide new security locks that are conveniently keyed alike.

Cleaning and Minor Maintenance

To avoid disappointment at settlement and also make a great start for your new tenant, you should allow for a professional cleaning and minor maintenance program of the property. Items such as dirty ovens and cook tops, grimy showers and bath tubs, dirty carpets and walls are common place in the world of post-sale real estate. Broken smoke detectors, light bulbs, shower screens and faulty tap washers are also common place and often neglected of maintenance once a property is sold. Setting aside \$1,000 will go a long way towards getting the property presentation and basic function to a good standard for presentation to prospective tenants.

Heavy Duty Rubbish Removalists

There are real estate sales where the previous occupant of a property you may have purchased leaves behind a mess of unwanted possessions. The cost and hassle of removal can be battled out in the courts but there are often warning signs that can be used in preparation of this occurring. The warning signs can be picked up in the presentation of the property, watch out for sellers in the midst of massive dispute and homes occupied by disgruntled tenants, they're all prime candidates for those that will come with unwanted possessions. When in fear of this occurring start allowing a cost for the professional removal of bulk items and hoarded junk. In light of the warning signs it would be hoped that you have also negotiated a sizeable discount to the purchase price while other would be buyers have simply steered clear.

It's important to note that just because a licensed selling agent was involved in the sale does not mean that the selling agent will ensure that the house is handed over in a clean, tidy and completely vacant of personal possessions. This happens at the vendor's discretion and unfortunately the standards of duty and care to provide vacant possession can differ.

Appliance Servicing

Heating units, hot water services, air-conditioning, ovens, hot plates, dishwashers and garage remotes may require servicing, repair or replacement. Most pre-purchase building inspections don't include testing appliance operation and performance, sometimes gas and power services are not connected so testing is impossible anyway. The landlord that is preparing to become happy and prosperous will set aside funds for the replacement and repair of major appliances and services. If the property was considered in really bad condition and in need of replacing many appliance and service items, then you would have to work out an extensive quote for replacement and repair. If the building services appear in good condition and previously maintained, then setting aside 0.5% to 1% of the purchase price should be a safe starting guide to cover the cost of any appliance in need of major service or replacement within the first year.

When you are buying to live in yourself you might put up with cold showers for a week while you find funds for a new hot water service. In the case of a tenant paying you money for well serviced accommodation the repair will be expected to be more immediate.

Service Connections

Sometimes it may be necessary to allow for the connection or reconnection of services such as electricity, gas, water or sewer. The upfront cost must be calculated and added to the purchase costs budget. Make sure you have addressed the services that are available and connected prior to your commitment to purchase. In particular service connection fees will be incurred where there is a need for repairs and renovation.

Property Management Fees

The actual property management fee of an investment property will be deducted from the monthly rent that is collected. However you will still need to allow for the upfront costs of marketing and advertising the property for rent – often to the value of two weeks rent. Plus there is usually a letting fee of one or two weeks rent once a tenant is signed up and that comes out of their first rent payment. In effect this will add to your purchase costs by the equivalent of at least 4 weeks rent.

Cost of Initial Vacancy

It is not likely that even under perfect circumstances that you will find a tenant to move in after the day of your settlement and possession. The lucky landlord allows for this by setting aside 3 months of mortgage payments to cover a period of vacancy – this may vary depending on the state of the rental market. If it only takes two weeks before you are collecting rent then that becomes bonus cash which you can put aside for potential periods of vacancy that may come at future changes of tenant.

Landlords Insurance

Once you have settled and have become a landlord it is advised that you obtain landlords insurance, this will typically cover situations such as theft or malicious damage by the tenant, rent defaults by the tenant, legal fees incurred to recoup rent defaults and liability cover. Please note that there are variations, excess charges and capped payout limits, so read the fine print and use a reputable insurance company. The ballpark range for the cost of landlord insurance at the time of writing this book appeared to be around the equivalent of one and half times the value of one week's rent.

Obscure Costs

These are the costs that real estate buyers simply seem to forget about, they're not easy to quantify and may not seem as important as those already mentioned. However if you want to attain the happy and prosperous mindset of the landlord that truly feels lucky, it would be advised to provide some thought for each of these and add them to your total purchase costs budget.

Real Estate Subscriptions, Books and Education

Maintaining an up to date understanding of the real estate market and broader financial markets allows you to adequately converse with agents and associated real estate services. Broadening your real estate education can contribute to a better understanding of the market place. Reading investment books and magazines should be added to your list of things to do as part of the purchase process and role as a landlord.

Transport Fuel, Wear and Tear

Don't underestimate the additional fuel costs and wear and tear on your car or if you using public transport it will still cost and affect your current household budget.

Communication Costs – Phone & Web

Mobile phone usage and costs is going to go up as you deal with more agents. As you surf the internet for real estate for sale and educational videos, your internet service provider may also hit you with excess usage unless you upgrade your plan.

Lost Leisure Time – Cost of Fighting Fatigue

What cost can you put on your leisure time and how will you make up for its loss. Some people will indulge in a midweek massage to make up for lost quiet time on the weekend. Once you start the purchase process your usually available leisure time will be reduced and you may have to pay for it in other ways to make sure you can effectively continue to complete your work and personal commitments.

Lost Income

This is particularly relevant if you work on weekends as significant time inspecting real estate occurs on the weekend. There will also be days during the week and evenings where your priority will need to be viewing a house for sale, you may have to arrange some flexi hours reschedule clients or reduce some overtime shifts. Whatever it is your earning income is worth it is likely to take a hit during the purchase process.

Unpleasant Surprise Costs

If you have taken all costs already mentioned into consideration, the likelihood of an unexpected cost appearing as a surprise is extremely low. However there is still a need to set aside some funding for an emergency cost at settlement.

Personal Reward

Dinner and Drinks, book a holiday or buying yourself a personal gift. These are just a few of the things you could do for yourself as reward for getting through the end of the process. Becoming a happy and prosperous landlord will be reward in itself but to mark the occasion and create a genuine sense of making the finish line. Plan and budget for a reward after receiving your first rental payment. It may be as small as setting aside a \$100 for a lovely dinner or a \$1000 long weekend getaway, in either case the habit of celebrating such a milestone achievement is important and should not be neglected as part of the process.

Feedback

We welcome any comments you have regarding the contents of this document. If you feel we should be including an expense that isn't here please get in touch. We would love to hear your suggestions for improvement and contributions that could benefit the next reader.

Thank You.

Yours Sincerely,

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