Investors' survival guide

Owning rental property is not always a bed of roses

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LANDLORDS are expected to flood back to the market this year, lured by the prospect of rapidly increasing rents and widespread predictions of rising house prices.

A report by property analyst Australian Property Monitors, released this week, forecast house rents would rise by about 5.6 per cent to an average $380 in Melbourne this year.

Unit rents will rise by 7.5 per cent, an average rental of $360.

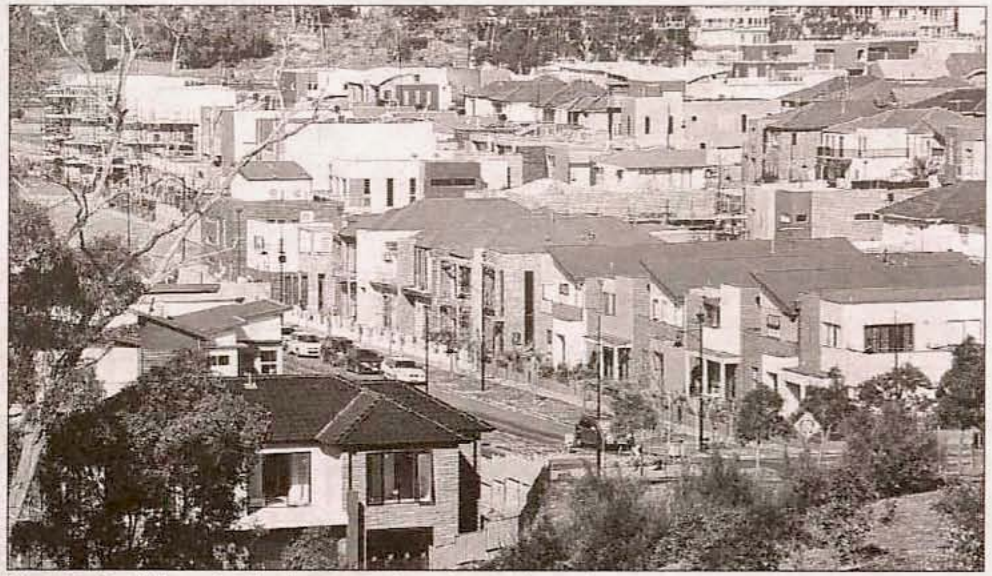
Pundits expect the figures to be followed by even higher growth in 2011.

According to APM, population growth, climbing interest rates and taxes and low supply would push up rents as more people are priced out of the owner-occupier market.

If this sounds enticing, be warned that being a landlord is not just a matter of sitting back while the money rolls in.

There can be sizeable problems for unwary investors — and no one should think that being a landlord means money for nothing.

Here, we run through some of the most common problems for landlords . . . and how to solve them.



Home help: Being a landlord can sometimes be a rocky road.

REPAIRS/MAINTENANCE

Landlords can be hit with big bills at any time and these can reduce returns.

If your rental property is a stand-alone house, the bills are your problem, though they are tax deductible against your rental income.

Unit owners in strata premises benefit from a centralised, pooled ownership structure, which means expenses are shared between owners.

But there are many cases in which major repairs have been needed to a strata premises and there has not been enough money in the sinking fund, requiring big extra contributions from all the owners.

"If you are buying a strata property you need to check the repairs history for the building and look at how much money is in the sinking fund," James Garnsey, of financial services firm Yellow Brick Road, said.

Mr Garnsey also warns about the potential for defects in modern apartment blocks and resulting problems in chasing developers or insurers for financial redress.

"In a building I lived in, the body corporate had to wear the expenses of chasing the builder, who had gone bust," Mr Garnsey said.

"The block was only built in 2001 but had serious problems and we had to pursue a damages claim for $1.2 million.

"It took us nine years to get the money and cost us about $400,000 in legal fees."

LAND TAX

Generally, if your land holdings in Victoria have a total taxable value of $250,000 or more (excluding exempt land), you must pay land tax. Your principal place of residence or land used for primary production is usually exempt.

For example, if you bought investment properties in with a land value component of $1 million, you would be liable for a tax bill of $2975 each year.

TENANT DISPUTES

If you are faced with a tenant more than 14 days in arrears, you are entitled to give them notice of vacate, but to do so for such a short lapse would be inadvisable.

Try to come to an agreement with the tenant, but if you do want them to leave there are strict rules governing the eviction process and if you breach any of them, the law could land on the tenant's side.

To win evictions — or for most serious tenant disputes — you must apply to the Victorian Civil and Administrative Tribunal for a hearing.

But they can be time-consuming and stressful, so it highlights the importance of getting the right tenant from day one.

That means stringent reference checking and regular property inspections.

THE VOID

Though Victoria, and Melbourne in particular, has a very tight rental market, properties can be empty for months.

Unreasonable rents, a glut of properties at the same time in a particular area or even just a period of fussy tenants can mean that your property can remain empty and eat into your returns. Just three months without a tenant will reduce your yield by 25 per cent.

RISING INTEREST RATES

After a period of record lows, rates are rising and each 25 basis point rise will add about $75 a month in payments on a $350,000 mortgage.

Some forecasts have interest rates as high as 7.8 per cent this year.

The financial markets are forecasting the cash rate to rise by 0.75 per cent this year to 4.5 per cent, although many economists think it could be higher at 4.75-5 per cent. That means mortgage rates up at 7.6-7.8 per cent.

Be warned.

NEGATIVE GEARING

This isn't a pitfall unless you suffer from the widespread misconception that negative gearing allows you to reclaim the entire shortfall between rent and mortgage interest from your tax bill.

The reality is that only a proportion of losses can be claimed, in line with your marginal tax rate.

So if you pay tax at 30 per cent, you can claim 30 per cent of the shortfall.

If you pay tax at 46.5 per cent, you can reclaim 46.5 per cent of the shortfall.

That is why negative gearing is so much more effective for higher-rate taxpayers.

If you're doing your sums based on being able to reclaim back all of your shortfall, it's time to think again.