EXPERT OPINION

The 'future-proof' property test

You may be able to afford your investment loan today, but will your portfolio still be affordable in five years' time? The answer is to conduct a 'future-proof' test that ensures you're never caught short financially

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Philippe is an experienced property investment specialist, mortgage broker and author of *Creating Property Wealth in any Market.*

A NEW client recently contacted me to talk about getting a new investment property. She earns a solid income and works in a stable industry, and she lives to a strict budget, which puts her in a great position to invest.

"The investment property I already own in Sydney has a very low yield and costs me about $250 a week after all costs and taxation, but I can comfortably afford it," she shared. "I'm looking to invest in something that costs about the same."

We sat down for a strategy planning session, as I always do with new clients, and she was shocked when we got to the end. Why? Because I showed her that she was actually in quite a vulnerable position, and adding a second low-yield investment property to her portfolio only stood to make matters worse. Although Sydney is great for capital growth, an investor has to be able to afford to hold properties in such a low-yield environment.

The bigger picture

When you're buying an investment property, it's crucial that the mortgage repayments are affordable – both right now and in the future. Many investors are quite good at working out what they can afford right now. It's the 'projecting for the future' part where they can come unstuck.

In this instance, the client said she could afford her property shortfall of $250 per week. While this was true, she was failing to consider a number of factors.

- What if interest rates went up? An increase of 1% on her $650,000 loan would see her weekly shortfall increase to about $325. An increase of 2% would mean her shortfall would be over $400 – or more than $20,000 per year! Add a second such property and she would be in trouble!
- What happens when the loan transitions to principal and interest (P&I)? Currently, she is paying interest only (IO) as the loan is only two years old. However, in three years' time the loan will convert to P&I, and her weekly repayments will increase as a result. Although this loan can be refinanced to another IO loan, costs will be much higher as banks have recently been instructed by APRA to reduce the number of new IO loans by 25%!

Considering her situation, I was not confident about recommending that my client add another low-yield property to her portfolio. Instead, I suggested she look for a property that had a better yield, to minimise her financial risks.

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How can you future-proof your investments?

I suggest you start thinking ahead in order to future-proof your investments.

Start by contemplating your lifestyle in five years' time. What major cost centres are coming up, such as kids starting private school or university? Do you have any major overseas holidays planned?

Consider your investments. Assume that in five years interest rates will be much higher than they are today, say 7%. If you own any property already, are the loans interest only? When do they convert to P&I, and are you financially prepared to manage these increased payments?

By projecting how much your lifestyle and your properties are likely to cost you in five years' time, you can make sure you can truly afford it without running into financial difficulties down the road.

NEED HELP WITH YOUR PORTFOLIO?

Contact Philippe at Multifocus Properties & Finance to get a jump-start on your portfolio with expert advice.

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