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Pros and cons of letting your property

What is it?

When you buy a residential property as an investment, you do so with a view to letting the property to earn a monthly income and in the hope of making capital gains when you sell it.

Property is generally expensive and few people can afford to pay for it out of their own pockets, so you would probably approach a bank for a loan.

Bear in mind that because of the high interest rates at the moment it is unlikely that the rentals you receive will cover your monthly loan repayments, especially if you have taken out a loan to the value of more than about 50 percent of the property.

Of course, this depends on the size of your loan and the demand for rental accommodation such as your property offers.

How do you make money

You can make money in two ways. You can earn rent from your tenants and you can make a profit when you sell the property by selling it for more than you bought it for.

But remember, there is no guarantee that you will not make a loss. If you are forced to sell the property when demand for property generally is low, you could lose money.

In the 18th article in our Scrapbook series Charlene Clayton provides the pros and cons on opting to buy a house for investment purposes.

Don't forget to include all the costs that you have incurred in buying, managing and renting the property, in calculating whether you have made money on it.

To evaluate whether your investment is a good one, you should calculate your total return. This is the income yield (rentals which you collect less expenses – see diagram) plus your profit or loss.

Ideally, you should monitor the value of the property regularly, say once a year. You could call in a professional valuer to assess what the property is worth, or you can get a rough idea of the value by comparing it with sales of similar properties in the area.

To work out your actual return, you

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must take inflation into account. So, if you made a 10 percent return on the property you bought five years ago, you should deduct inflation of 8,7 percent, which is the average inflation rate for the past five years, to work out your real return. As a rule of thumb, higher priced properties produce lower income yields, but have greater potential for capital appreciation.

Who should invest?

Anybody who is prepared to play landlord and bear the responsibilities attached to that and who can afford to take the risk of making a loss.

How to choose an investment

The bottom line is that you should buy a property you believe will turn out to be a good investment. This means that you should get it for a good price, be able to sell it for a good price and be able to attract tenants easily while you hold the property.

You cannot predict these things accurately, so you may still lose money on your investment. Some of the factors you need to take into consideration when buying are:

◆ Price: Compare the prices of similar properties for sale in the same area to see if you are getting a good deal;

◆ Area: Buying a property in a reputable area will ensure that the value of your property continues to rise along with market levels. Consider all factors that could affect the value of the property, such as a block of flats to be built next door, or a highway that will be built past the front door. Check these details with the local authority;

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◆ State of the property: Satisfy yourself that future maintenance costs will not be excessive.

◆ Features: These will add to the value of the property and will attract tenants; and

◆ Security: Check the crime rate in the area with the police and your

property, you will generally have to pay a deposit of 10 percent or more of the value of the property.

Transfer duty and conveyancing costs

Transferring a property into your name involves a com-

LETTING YOUR HOUSE

How to calculate investment return

What you pay		What you earn	
Loan repayment	R	*Rental or lease agreement*	R
Sectional Title -Levy	R	*Less agents collection fee (if applicable)*	R
Freehold Property Rates	R	*Net rental*	R
Insurance premium (if not included in loan instalment)	R	*Total income*	R
Allowance for repairs and maintenance (say 10% of rent a month)	R	*Less expenses*	R
		Return	R
Total	R	*Your total return = Income Yield + Change in capital value*	

suburb and the city in which you buy.

You can expect to pay about R260 000 for a house in a middle class suburb in Johannesburg. A similar house in Cape Town will set you back by about R360 000. In Durban you can expect to pay about R225 000 and in Pretoria the house will cost about R240 000.

If you take out a loan to pay for the

percent on the amount between R60 000 and R250 000 and eight percent on the balance over that.

Conveyancing fees are payable to the conveyancers for their work and are calculated on a sliding scale based on the value of the property.

For example, transfer duty, a conveyancer's fees and VAT total R1 982 for a

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R50 000 property and R21 474 for a R350 000 property.

It is important to remember that when you buy a property directly from a builder or developer, you do not pay transfer duty, but you are liable for VAT. This is usually included in the advertised purchase price, but it is important to find out before signing the offer to purchase.

Bond costs

If you are taking out a loan, the registration of the mortgage bond over your property is done by attorneys appointed by the bank which grants you a loan. Costs involved include a legal fee charged by the attorneys, stamp duty, and bond registration costs based on the amount of the bond.

For instance, stamp duty, conveyancing fees and VAT will be about R1 200 on a R50 000 bond and about R3 120 on a R350 000 bond.

Assessment fees

The bank charges a fee for assessing the value of the property before granting you a loan. You can expect to pay about R100 for a property up to R50 000. On a property of between R50 000 and R499 999, a valuation fee of 0,2 percent up to a maximum of about R850 is charged.

Initiation fee

Most banks charge a bond initiation fee of about R175 for setting up a bond.

Costs of finding a tenant

Once you have bought the property you have to find a tenant.

You can do this yourself or ask an estate agent, who will charge you about five percent, to find a tenant for you. The fee is payable upfront and is based on the rental period.

To manage the property on a monthly basis, agents charge about 10 percent of the monthly rentals which are collected.

Repairs

From time to time you may have to have repairs done. The details of who is responsible for what must be dealt with in the lease agreement.

Rates

You have to pay annual rates to the local authority where the property is located.

Insurance

If you have a loan, banks insist that the property is insured for its full replacement value, which includes improvements such as swimming pools. The bank will arrange insurance cover and will add the monthly premium to your loan instalment.

You can expect to pay about 0,255 percent for houseowners insurance to which must be added 0,004 percent for political unrest cover provided by the government insurance organisation SASRIA.

Note that this insurance does not cover the contents of the property – that is the responsibility of the tenant.

In the case of a sectional title unit, the insurance is arranged by the body corporate and the premium cost is included in your monthly levy.

Levies

If you have bought a sectional title property, you will have to pay the monthly levies, which cover the rates, water and insurance costs (that covers the structure, not the contents).

You could include this in the rental you charge your tenant, but you should not pitch the rental so high that you chase potential tenants away.

Investment period

The is no fixed period when investing in residential property, but it should be seen as a long term investment.