Should you pay a large deposit on an investment property?

Making the decision to buy an additional property for investment purposes is a major step and can yield long term returns, however there are many choices you need to make first, such as whether or not it is wise to pay a large deposit.

There are pros and cons associated with paying a large deposit when buying an investment property.

A major advantage is reducing the mortgage bond required, which would mean lower monthly repayments. In this way, it may be possible for the rental income to cover the monthly bond costs plus some of the other costs like maintenance, municipal rates and taxes, insurance etc.

Also, paying a large deposit could potentially mean a lower interest rate on the mortgage bond itself since the bank will have greater security, and, over time, a reduced total interest bill. Usually the interest rate you save with the deposit will be greater than the interest you will receive if you invest the deposit elsewhere.

Another advantage is being able to even qualify for a bond in the first place. If you are an investor without a track record or significant assets then a bank may insist on a large deposit as a condition to granting you a loan.

However, there are also disadvantages to putting down a big deposit. The greater the deposit, the less cash you could have available to purchase other properties and thus you would reduce your ability to diversify your property portfolio risks.

Once your cash has been utilised as a deposit, it cannot be accessed easily. If you invested your extra money elsewhere e.g. in an interest-bearing account or in shares or unit trusts, then it is generally more readily available.

But remember, before deciding on your deposit amount you have to look at all your cash flows on an after tax basis.

For an investment property, provided you hold if for a sufficiently long period for it to qualify as an investment rather than as trading stock, you can reduce your rental income by the interest you pay and the other property-related expenses you incur. But you will still have to pay capital gains tax on the sale.

You need to consider your various options based on your own cash flow and tax circumstances.

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