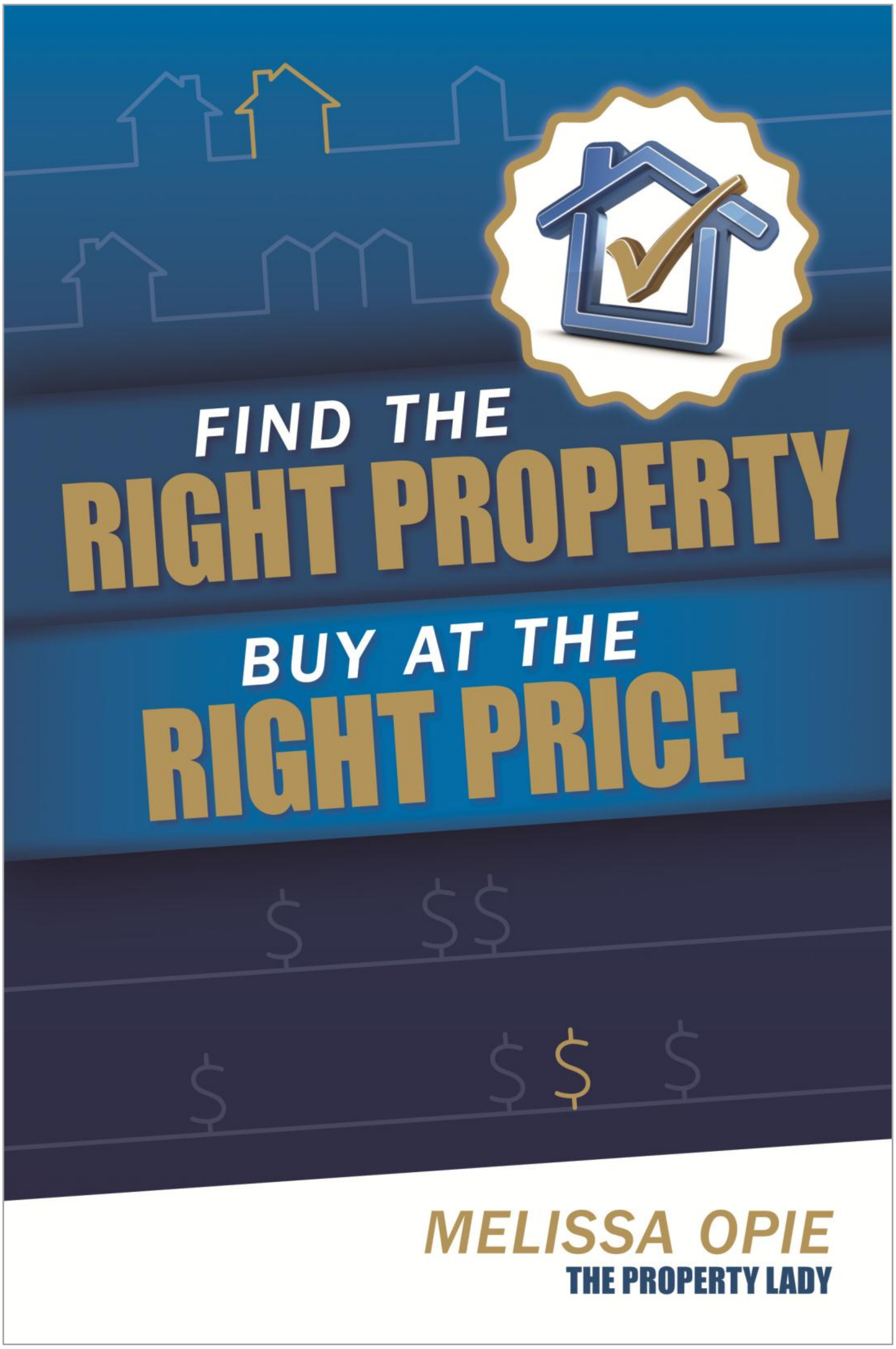

Sample chapter

Foreword

Property investment, regardless of your level of experience, requires a commitment and skill that can only be acquired through thorough research, experience, astute judgement and a willing financial institution. Get any one of those factors slightly wrong and the chances of obtaining the sought-after returns can be compromised.

A review of the broader Melbourne market over the past decade will show very simply that property has generally appreciated in value; in fact, the median price of a house or apartment has more than doubled in most capital cities in Australia. However, if you made the wrong decision in relation to location, timing and property type, it would have been possible not to record a positive result. Conversely, there are astute investors who make a valuable return acting in a counter-cyclical manner to the overall market.

Buying and selling for capital gain is also different from the process engaged in by owner-occupiers. There are different rules and requirements: capital gains tax, land tax and working with property managers to ensure a regular income are some of the different factors. Each of these factors needs to be fully accounted for before you start; failing to do so may turn your profit into a loss and for this reason you should always carefully consider an investment choice not solely based on tax breaks.

If you have not been an investor it can be very simple to make any one of these mistakes and waste a lot of time, effort and, more importantly, your hard-earned money.

This book provides aspiring investors with essential information on how to become a successful property investor and how to avoid the common pitfalls.

Enzo Raimondo
CEO, Real Estate Institute of Victoria
Melbourne, January 2012

Introduction

Buying a property is a huge decision. It's not like buying a pair of shoes, or even a new lounge suite. Getting it wrong could cost you tens of thousands of dollars in the purchase, not to mention hundreds of thousands in compounding capital growth over time. But you knew that, right? Otherwise, why would you have bought this book?

You bought this book because you want answers. You know you want to invest in property — you're already convinced it will be the ticket to your financial freedom and the retirement lifestyle everybody hopes for. But there are a few stumbling blocks. You're not confident about distinguishing between the great properties for long-term growth and the ones that might bring in good rental return now but won't perform as well over time. You know which suburbs are 'hot' at the moment because you read it in the newspaper or saw it on TV. But have you missed the boat on that suburb? Is it now out of reach price-wise, or has the bubble burst?

And, even more troubling, what is the property *really* worth? You know the asking price, you know what other properties have sold for in the same suburb, but what is the value of *that* house or *that* unit? No-one wants to get ripped off, and paying too much will mean it takes longer to reap the true rewards of your investment. Also, when couples buy property together, you don't want a bad purchase to create tension in the relationship. Decisions should be made together, and both people need to be convinced that the decisions are the right ones — the only way to do this is to get educated so that your decision-making is balanced and informed.

In my business as a buyer's advocate, these are the things about property investing that I find terrify people. For most people, property acquisitions are the biggest purchase decisions they will make in their lifetime. It's understandable why the process strikes fear into most. And, while most people *want* to invest, anxiety reigns and often prohibits potential investors from taking that all-important leap to securing their financial future.

That's where this book comes in. There are hundreds, if not thousands, of property books out there. There are many that deal with cash-flow negative and cash-flow positive properties, negative gearing, renovating, managing a rental property, structuring your loan (I've even written one about that!) and minimising tax. This book has elements of all those things, but its focus is on two fundamentals: how to find the right property and how to know you're paying the right price.

This book is not just for seasoned investors, or those who already own property—it's also for the first home buyer or those who intend to be owner-occupiers. We will talk a lot in this book about 'investors', and by that we mean 'everyone intending to buy property, for whatever purpose'. The fact is that every property purchase should be viewed as an investment, even if the buyer does not intend to rent it out or to buy other properties and use equity. Even if your intent is to only purchase one property in your lifetime, chances are that at some stage that property will be sold (even if it is after your death!), so making that purchase with an investment frame of mind is important. The financial choices you make today will have a significant impact on your lifestyle in the future, and the lifestyles of your children and your children's children.

I am based in Melbourne but have clients all over the world. I won't suggest for a minute that the property market is exactly the same all over Australia when, in fact, it can vary from street to street! But there are certainly buying principles that do apply all over the country. Those principles that apply to smart investing for the long term are the ones I'll take you through in this book. I'll give you rules you can apply no matter where you live, and no matter which state or territory you want to invest in.

I'll give it to you straight and I'll make it simple. My main interest in writing this book is to educate. I want Australians to overcome the fear of debt that still seems to hold many of us back and look to a future of financial security. Funding my own, *very* comfortable retirement is important to me and I hope I can pass that aspiration on to you, too.

As I mentioned earlier, in this book I'm not going to concentrate too much on the nitty-gritty of the finance side of building your portfolio; that is, the ins and outs of what loan to get and why. I'll stick to the fundamentals of finding the right property and paying the right price. Once you've got those two elements down pat, you'll be on your way to the future you've always wanted for yourself and your family.

Chapter 1
A fast-moving train: the property market

Part of the problem for would-be property investors is that the market can move very fast at times, and 'current' information dates quickly. Every quarter, newspapers all over Australia print median house prices, indicating which areas have gone up and by how much. (Median house prices will be explained in chapter 8.) But there's so much more information that a buyer needs before they can feel confident enough to dip their toes into the property game, and several more factors need to be addressed. Factors such as: How do they know the 'boom' areas are genuine and it's not too late to invest in them? Which properties should they target in these boom areas? When should they avoid these areas and concentrate on 'sleeper' suburbs? How do they know they're paying the right price? These are the issues that keep potential property buyers awake at night and often scare them off making their first property purchase. As a result, they sit on the fence and do nothing.

Why property?

The great thing about property is that it is tangible. You can see and touch it. Plus, property investing is something you can manage yourself. Of course, you will need help with the legal and financial aspects, but it's a form of investing that many people feel comfortable with because property is familiar.

Easy finance and relatively cheap loans have made property investing available to everyone. People are now better placed to buy their first home as well as build up a multiple-property portfolio. Up until the 1990s, it simply wasn't possible for most people to be able to obtain finance to a buy a second or third property for the sole reason of making money. People had holiday houses, but most people wouldn't have considered setting themselves up in this way. It just wasn't done.

Today, people *want* to invest. We all know about investing but, up until recent times, most people tended to leave all their investment decisions to their financial planner because they knew very little about managing superannuation or other funds-management strategies. Many people see shares as a risky way to invest because they don't understand the markets and are scared off by news about dramatic market drops that get beaten up in the media.

So that leaves property.

There is a certain amount of intuition that we all have about buying property, which may come simply from living in houses, renting, hearing stories or reading newspapers; or it may come from previous experience in buying homes. It is obvious to most of us that a beachfront mansion is going to cost a lot more than a small outer-suburban unit, and we know that a well-presented property in a good location is going to attract more rent than a dump in the boondocks. But there is so much more to it than this—of course there is, otherwise everyone would be a property mogul! There's market knowledge, there's drive and there's a certain amount of guts. Because, let's face it, the decision to make a half-a-million-dollar purchase is not one that most of us would make every day. It's the fear of taking on significant debt that scares most people away from buying property.

Shares or property?

This is the question that incites the most debate between investors, and one that ultimately comes down to a case of personal preference. I prefer property because you can see and touch it. I like knowing that I can add value to my investment by managing it in the right way. With shares, there is really nothing you can do to influence whether their value will go up or down.

A 2011 study by Dr Ashton de Silva and Professor Gavin Wood, published by RMIT University in Melbourne, measured the typical rates of capital appreciation accruing to homeowners and rental investors across 108 segments of the Melbourne housing market. These rates of capital growth were compared with that gained from a balanced portfolio of Australian shares, as measured by movements in the Australian All Ordinaries index.

The housing capital growth estimates used in the study came from a sample of more than 500 000 repeat sales of houses between 1990 and 2010, a 20-year period that included the 1991 recession, the Asian financial crisis, the 2001 recession and the recent global financial crisis.

The study showed that the quarter-on-quarter percentage increase for property was 1.6 per cent compared with a 1.3 per cent increase for shares.

While this is just one study, it does provide some weight to the argument of investing in property over shares. Not only were the returns for property in the study greater, but they were also subject to less volatility.

Fear cripples would-be investors

In my experience, fear stems from a number of things:

- the idea that all debt is 'bad' (an idea often handed down from our parents)
- not being confident about being able to spot the properties that will make the best investments

- not feeling comfortable that the price is right
- concern about making a mistake that could cost tens of thousands of dollars.

Negativity feeds on negativity. If you start with a negative outlook, sometimes it's difficult to get past it. Successful people do things that unsuccessful people are not prepared to do.

The mind is a powerful thing. If you think you'll never make a lot of money in your lifetime, you probably won't. If you think you will make a lot of money, and you set about achieving it, chances are that you will achieve it.

Property investing is not for everyone, but anyone can do it. It doesn't take a six-figure income and it doesn't take the unlocking of some mystical vault that holds all the secrets to success. It just takes a willingness to learn and the nerve to take on some *good* debt.

Good debt is the kind that will allow you to make more money. Bad debt is the kind that you can't derive any monetary benefit from, such as the purchase of a car. Cars, unless they are bona fide classics, will always depreciate. You're not likely to buy a new lounge suite and sell it in 10 years' time for a profit, either. Well-chosen property, on the other hand, will always appreciate. It always has and it always will. As they say, you can't make more land. Land close to a CBD or water is precious because there will never be any more of it.

Strategic investing

There are lots of different strategies for investing in property. I've found that most people tend to stick to the strategy they feel most comfortable with or the one that has given them the most success. But of all the different strategies available, there are basically two in terms of financial set-up: cash-flow positive properties, where the income from the property (rent and tax benefits) outstrips the cost of owning the property (mortgage repayments and holding costs such as property management fees and maintenance); and capital-growth properties, which are properties that will increase in value the fastest. The argument against capital-growth properties is that there are costs associated with maintaining them—that keeping them has a detrimental impact on your hip pocket, which many people can't afford.

I prefer capital-growth properties, and tables 1.1 and 1.2 (overleaf) show why.

Table 1.1 shows that a property that increases in rent by 10 per cent a year, with 5 per cent capital growth per year, will be worth about $1.3 million after 20 years.

Table 1.1: 5 per cent capital growth versus 10 per cent rental growth per annum

	5% capital growth p.a.	Property value	10% rental growth p.a.
Year 0		$500 000	
Year 1	$25 000	$525 000	$50 000
Year 5	$30 388	$638 141	$60 775
Year 10	$38 783	$814 447	$77 566
Year 15	$49 498	$1 039 649	$98 997
Year 20	$63 174	$1 326 649	$126 348
20-year total growth	**$826 649**		**$1 653 298**

Let's look at what would happen if we flipped the scenario around—if you achieved 10 per cent capital growth and a 5 per cent yearly increase on rental income over 20 years (see table 1.2, overleaf).

After 20 years, our $500 000 property is worth more than $3 million and our rental income is around $150 000. What does that tell you about the first scenario? No-one would argue the fact that the result achieved in the second scenario is obviously better in the long run—but is it realistic? It is. And it all comes down to compounding capital growth.

Table 1.2: 10 per cent capital growth versus 5 per cent rental growth per annum

	10% capital growth p.a.	Property value	5% rental growth p.a.
Year 0		$500 000	
Year 1	$50 000	$550 000	$25 000
Year 5	$73 205	$805 255	$36 603
Year 10	$117 897	$1 296 871	$58 949
Year 15	$189 875	$2 088 624	$94 937
Year 20	$305 795	$3 363 750	$152 898
20-year total growth	**$2 863 750**		**$1 431 875**

But what if I can't afford the repayments? I hear you ask. The answer is: you can! Without going into too much detail about loan set-up, in my first book, *Property Rich*, my co-author and I detailed the mechanics of the 'kitty loan', the principle of which comes down to borrowing the shortfall between what you achieve in rental income and what you pay out in loan repayments. You can set up an extra loan with your lender that you can draw on to a maximum amount to cover the shortfall. Check out *Property Rich* (Wrightbooks 2011) for a full explanation.

But let's get back to the capital-growth strategy.

The strategy I'm proposing works like this: investing in capital-growth properties means the value of your property portfolio will increase in value more quickly. You can then leverage off this equity, borrow more money from the bank, and accumulate more astutely selected properties.

Some say this strategy is suited only to investors who have time up their sleeves to wait for the properties to increase and build their portfolios, and who have income to cover the shortfall. *I* think it's a strategy that is suited to *all* investors.

Real wealth from property is not created through rental income along the way; it comes about by building your portfolio through leveraging off the increasing equity you amass in each property as your portfolio grows. The 'wealth' is realised when you can live an enviable lifestyle in retirement through selling the properties for more that you bought them when the time comes.

Capital growth compounds, which means that growth is not calculated solely on the original purchase price but on the cumulative growth that occurs every year. So, for a well-selected $600 000 investment property that grows in value by 10 per cent every year, it will be worth $660 000 in year 2, $726 000 in year 3, $798 600 in year 4 and so on. Pretty soon you will have doubled the value of your investment *and* created more equity on which to borrow more and buy more.

Buy and hold properties

This book is targeted primarily at property investors (whether they are seasoned investors or first home buyers), not traders. To me, property traders are people who buy properties, do a quick renovation, and then 'flip' them to make a fast buck. There's nothing wrong with that—plenty of people make a good living out of it—but this book is targeted at the long-term investor and the properties I will steer you towards are suited mainly to long-term gains, often referred to as 'buy and hold' properties.

As I've said, property always increases in value over the long term. There may be recessions, dips in the market and global financial crises, but property always goes up. How much it rises depends on how smartly you buy. The increase in value of capital-growth properties works on the same principle as compound interest.

Compound interest is interest calculated on the principal amount you originally invest, which is added to the principal amount, and compounded again. So, in the first year of your investment you earn interest on what you invested. The next year you earn interest on both your original capital *and* the interest from the first year. Then, in the third year, you earn interest on your capital and the first two years' interest. It works like a snowball rolling down a hill. As your investment dollars roll down the hill they get bigger and bigger. And the beauty is, even if the snowball starts off small, it will still grow over time.

This is true of the property market. Each year, your property will increase in value between 7 and 10 per cent (depending on where you are at in the property cycle and how well you have chosen the property). That increase will not only be on the original purchase price; it will compound based on adding the 7 to 10 per cent to the value every year. In table 1.3 we'll do the maths on a $500 000 property that increases by a modest 8 per cent every year.

Table 1.3: compounding interest principle applied to a $500 000 property over 30 years

	Property value	8% annual increase	End-of-year value
Year 1	$500 000	$40 000	$540 000
Year 2	$540 000	$43 200	$583 200
Year 3	$583 200	$46 656	$629 856
Year 4	$629 856	$50 388	$680 244
Year 5	$680 244	$54 420	$734 664
Year 6	$734 664	$58 773	$793 437
Year 7	$793 437	$63 475	$856 912
Year 8	$856 912	$68 553	$925 465
Year 9	$925 465	$74 037	$999 502

Year 10	$999 502	$79 960	$1 079 462
Year 11	$1 079 462	$86 357	$1 165 819
Year 12	$1 165 819	$93 266	$1 259 085
Year 13	$1 259 085	$100 727	$1 359 812
Year 14	$1 359 812	$108 785	$1 468 597
Year 15	$1 468 597	$117 488	$1 586 085
Year 16	$1 586 085	$126 887	$1 712 971
Year 17	$1 712 971	$137 038	$1 850 009
Year 18	$1 850 009	$148 001	$1 998 010
Year 19	$1 998 010	$159 841	$2 157 851
Year 20	$2 157 851	$172 628	$2 330 479
Year 21	$2 330 479	$186 438	$2 516 917
Year 22	$2 516 917	$201 353	$2 718 270
Year 23	$2 718 270	$217 462	$2 935 732
Year 24	$2 935 732	$234 859	$3 170 590
Year 25	$3 170 590	$253 647	$3 424 238
Year 26	$3 424 238	$273 939	$3 698 177
Year 27	$3 698 177	$295 854	$3 994 031
Year 28	$3 994 031	$319 522	$4 313 553
Year 29	$4 313 553	$345 084	$4 658 637
Year 30	$4 658 637	$372 691	$5 031 328

As you can see in table 1.3, a $500 000 property can become a $5 million property over 30 years.

The other important factor that table 1.3 highlights is that the more you spend on the property to begin with (assuming you only spend what the property is worth!), the more your investment will grow in dollar terms. So, using the numbers in table 1.3, if you bought a property for about $800 000 (shown at around year 7), it would only take you about 23 years to reach that $5 million mark. And, when you multiply that across a few properties, the numbers, obviously, only get bigger. And you become wealthy faster!

> ***My tip***
>
> Perform regular 'health checks' on your properties to ensure that they are well maintained and attracting the maximum rental income.

Buying property under this strategy, you will most likely be paying more in mortgage repayments that you will be receiving in rental income (although this is alleviated through the kitty loan system, outlined in *Property Rich*). However, the property will eventually become cash-flow positive, meaning that even if you borrowed more than 100 per cent of the purchase price and only paid the interest on your loan, the rent will go up and up over time, and eventually take over your repayments. As you build up a portfolio of properties, the value of these properties combined will allow you to borrow more money to fund the next one.

Don't be fooled—it's hard work!

Buying and holding property, in essence, means you buy well and then sit on it. But that doesn't mean there's nothing left to do. It's important that you stay on top of your property manager, ensuring you always attract good-quality tenants and that you achieve the maximum rent possible. It also means maintaining your asset so it can continue to attract those quality tenants and that maximum rental income for the life of the investment. Maintaining the property well will also ensure that its value continues to soar — which is very important not just for your long-term gains but also so the bank will value it highly when you are looking to borrow more money to buy the next property.

I usually advise clients to avoid buying and selling to try to make more money in the short term — what you will gain you will lose again in transaction costs, time and energy. Let the properties work for you over time. Then, when you're ready to retire, reassess your portfolio to ensure you have enough money to live the retirement you planned for.

Although I say that anyone can invest in property, don't be under any misconceptions that it is easy. Being a successful property investor takes time and commitment to learning.

Successful investors devote a lot of time in the beginning to get to know their target market. They research carefully. After a while it becomes easier. Things take less time, and you can add or drop properties from your research list quickly so you don't waste time looking at properties that don't match your criteria.

Many investors buy, hold and hope. The techniques you'll learn in this book for buying the right property at the right price will take the 'hope factor' out of the equation. Chosen well, property is always going to appreciate (have I mentioned that already?); by how much it appreciates depends on the choices you make along the way. Those choices are sound investment decisions based on research and good negotiation skills.

Of all the buying strategies, buying and holding long-term growth properties is the most passive and the least time- and energy-consuming. And it will make you the most money. This book will teach you how to do it. And still sleep at night.

Key points from chapter 1

- Well-chosen properties will always appreciate over time.
- Capital-growth properties are a solid type of investment.
- Not all debt is bad—don't be crippled by fear.