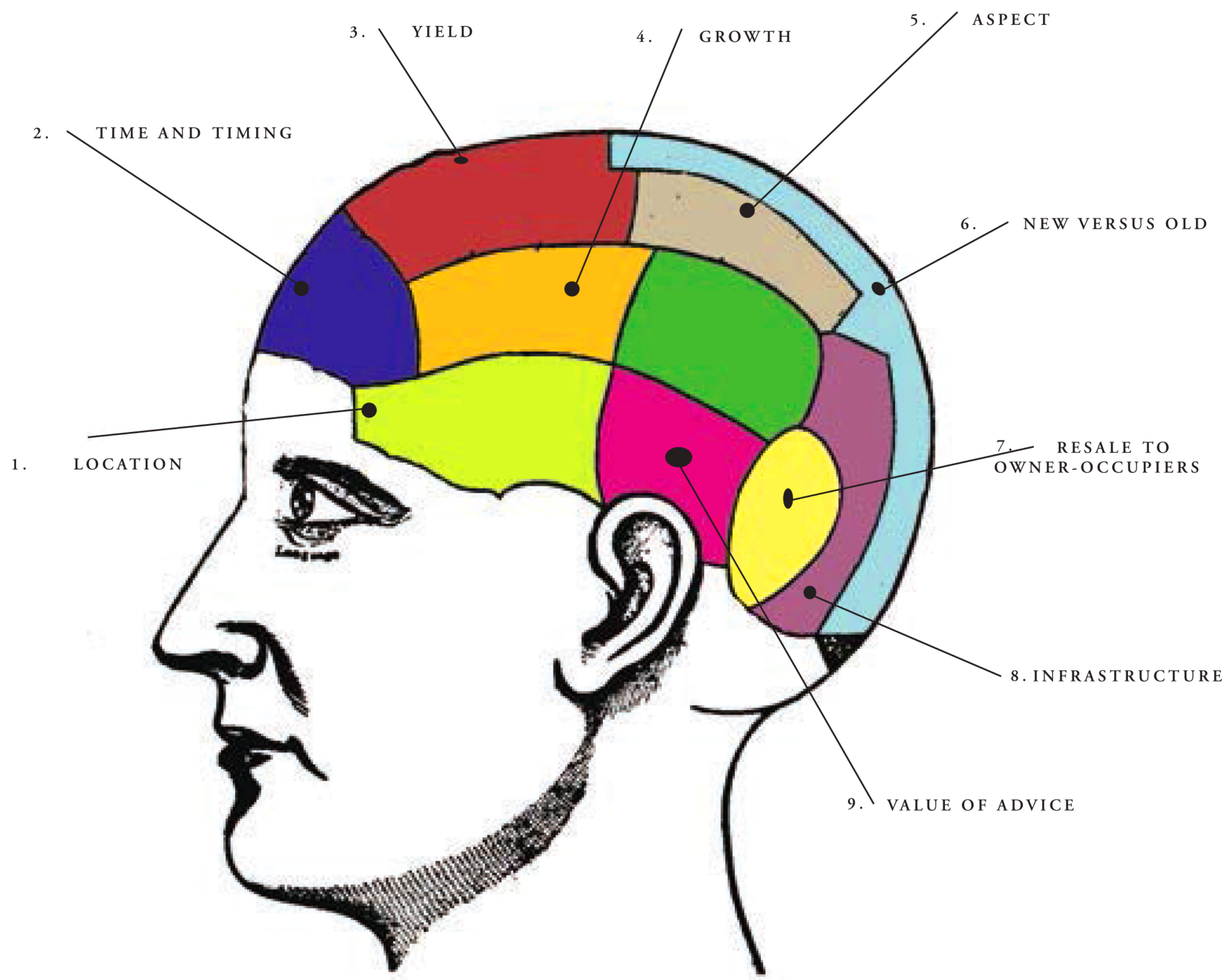
9 THINGS TO CONSIDER BEFORE BUYING AN INVESTMENT PROPERTY



Financial education for smart Australian Investors

WEALTH ADVISER FINANCIAL EDUCATION

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Letter from Wealth Adviser

Dear *Reader*

The goal of Wealth Adviser is to ensure that concise, informative financial education is available to everyone at no cost. Our books and seminars seek to inform people of not only the benefits but also the potential risks and pitfalls of various strategies and investments. With this aim in mind, we are delighted to provide you with a free copy of this eBook.

We live in interesting (and somewhat difficult) times where making good, informed, long term investment decisions is harder than it has been for quite a while.

People are simply looking for someone they can trust who can help and guide them with their financial and investment decision making. Finding that person is not easy in Australia.

We hope that some part of what you read in this educational eBook is beneficial and of service to you. From there, once you have a general understanding of options available to you, we believe that it is important for you to seek personal advice that is appropriate to your situation. You should find a trusted adviser and work with them.

Hopefully we get a chance to meet with you at some point, to introduce ourselves and what we do.

Best regards

Wealth Adviser

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Introduction

Congratulations, you're on the right track towards successful property investment, as anyone in the business will tell you that research is a huge part of the process. If you're interested in finding out more about how to invest in property this book will serve as a primer on what you need to start thinking about.

One point we would like to clarify before we go any further is that we are investors rather than entrepreneurs, and this book has been written with this in mind. When we talk about property investment we are referring to buying and holding for the long term, as in 10 years or more, rather than entrepreneurial activity where one buys with a view to renovate and sell.

As property investment advisers with decades of experience choosing the right investment property for clients, we are giving you the inside scoop on how we go about selecting property, and we hope you find this information useful.

1. Location

Think of location and property, and comments such as 'it's a block from the beach', 'there's a school within walking distance', or 'the train station is two blocks away' probably come to mind. That's because a person looking for a place to live typically has these considerations at the front of their mind.

As a property investor you also need to consider location in these terms, because your prospective tenants and most of your future potential buyers – owner-occupiers – will care about these things too.

Essentially though, an investor needs to consider location on a higher, more strategic level. In residential property investment, location matters in terms of what it means to the market a prospective property is in.

What do we mean by this? If you're thinking about buying an investment property, you ought to consider the location because real estate markets are defined geographically.

Let's say your recently purchased investment property is a duck, floating on a pond, and that pond is the suburb you've bought in. As it rains and more water enters the pond, the water line rises, and so does the duck. Just as house prices overall in your suburb rise, so does the value of your house. Gains in real estate investment are about the water line rising in your pond, in other words, what the specific market you're in is doing.

It's imperative to realise that the so-called 'Australian property market' is actually made up of hundreds of sub-markets. It's much easier for the media to refer to 'the Australian property market' as though it is one entity, but as investors this has no relevance. The notion that there's one big Australian property market that follows a certain path is a fallacy.

There is also no New South Wales property market, or Victorian market or Western Australian market. Because within each of these areas there are a multitude of markets which all behave very differently. Looking at recent trends, you could argue that there is no Sydney market either. Rather, there's an Eastern suburbs market and there's a Parramatta market, and even within each of these suburbs there are huge discrepancies. For example, within the eastern suburbs, the way Bellevue Hill and Vaucluse behave is very different to the way Randwick behaves or Maroubra behaves. Even *within* Bellevue Hill you can dive down to street level and find that some streets can perform very differently.

The important thing to consider as an investor is to make sure the market you're in is a good healthy vibrant market because if it rises – even if you've got some other decisions wrong – you're still going to be dragged along with the overall market.

You can buy junk in a rising market, and everything just goes up. Ten years ago if you'd bought 'junk' in the Eastern Suburbs, you'd be sitting on some very expensive 'junk' today. (We're not advocating buying junky property; we're only suggesting that the first consideration is the specific market your property is located in).

So it's deciding if it's Sydney or Brisbane, that's only the start of the decision-making. As an investor, when you buy in a specific location you are essentially buying into a specific market. Pay attention to how close a prospective investment is to basic amenities, but more importantly, focus on which market the property is located it in, and what that market is doing in terms of its potential for growth, which brings us to the next consideration: timing.

2. Time and timing

They say timing is everything, and in real estate this certainly can hold true, but it all depends on what your objective is. Timing is often the primary focus of real estate 'entrepreneurs', who make a very big deal about when to buy, and when to sell. And indeed timing *is* very important if you are going to be in the market for only a couple of years – if you overpay just slightly for a property, and the market doesn't behave itself, you're in trouble.

As investors though, the focus needs to be on paying fair value for a property and buying in the right market (which refers to our first consideration, location). Buying at the right time is a secondary consideration. If you pay a fair price for a good property in a market with the potential for growth and you are holding it for the long term, timing becomes much less of an issue.

And let's face it, no one has the ability to see into the future, and to pick the bottom or top of the market. A strategy which involves time in terms of duration, and which focuses on buying a fair value property is much more integral to the success of a property investment than just trying to get the timing right.

Once you've decided to invest long term, and pay a fair price for a quality property in an area where you have decided there is growth potential, timing becomes a secondary consideration. That's because there's an inverse correlation between the term of the investment and the need to get timing right. If you hold a property for 10 or 20 years, timing becomes less and less important.

The classic example of this is your typical mum and dad, who bought a property 30 years ago for $30,000. Even if they'd overpaid by 10 per cent, and it was really worth $27,000, today that property is worth $800,000 – so the fact that they'd overpaid becomes irrelevant. *Time* has reduced the importance of timing.

Timing does matter, but what you really need to consider is how long you're going to be holding onto a property. If you're an investor, don't fret about timing. If you're an entrepreneur, fret about it because it can really hurt you.

As long as you're paying fair value then time takes care of the rest. If you're overpaying then it's obviously going to take much longer to make up for that mistake. So the focus should be on fair value, not on getting the timing right.

One of the negatives of excessively worrying about getting the timing right is the bargain-hunting mentality, because it often leads to inaction, and an unnecessary delay of a purchase.

The bargain-hunting buyer expends huge amounts of time and energy looking for the cheapest deal, and two to three years later no property has been purchased yet, because they are still trying to squeeze out a bargain every time a property comes up. Meantime, the market's gone up 10 % and the bargain hunter has missed out on growth in the market.

Now we're not going to tell you to ignore everything we've said about holding for the long term, but it should be said that no amount of time can save you if you've entered into a market you haven't properly researched. Buying fair value and holding for the long term is the essence of no-frills real estate investment, but first and foremost, be aware of the market you are entering into.

You must be armed with as much knowledge as possible in order to make a good decision. If you don't have the time to do the necessary research, find someone who can advise you. Holding for the long term is an excellent strategy for an investment as illiquid as real estate; however, it's not always going to save you if you've chosen the wrong market to buy in.

When it comes to timing, the message to investors is clear: don't focus all your valuable time and energy trying to forecast the troughs or peaks of the real estate waves. A long-term investor understands that real estate on average increases at or faster than the rate of inflation, and that paying fair value for a property in a carefully selected market is what matters.

3. Yield

The higher the yield the better, right?

Certainly this is the traditional take on yield, or 'return' as it's called in the share market, where the concept has come from and where it's more readily discussed.

To calculate yield, total up the income you will receive from a property in a given year and then divide this by the sale price. You will receive the yield in a form of a percentage. This basic analysis does not take all of the many factors which must be taken into account: the price of your mortgage, property taxes, and other expenses including depreciation. So while it's a rough estimate, this calculation does serve as a tool for estimating how much your investment will return each year as a percentage of what it's worth. In residential property yields are typically between 2.5% and 5%.

Just as a high returning share may come with increased volatility, in real estate, it pays to be aware of the dynamics behind high yield, because the higher the yield the better is not necessarily true in all cases.

An example of a situation where high yield alone may not be enough for a sound property investment is in recent trends in some mining towns around Australia. When BHP, for example, sets up a local division of its operations in a small town, it brings a raft of new workers with it. These new temporary residents need somewhere to live, so the company leases 200 houses in the one town. BHP pays $400 per week to rent houses that are worth around $200,000, for example. This works out to around 10% yield, fairly high for residential property. Does high yield alone make this property a smart buy? Not necessarily. As the yield goes up dramatically, house prices start to follow, as other investors, spurred by the high yield, come into the picture and buy houses in town. This unnaturally inflates the market.

The problem arises when BHP decides to wind down or pack up its operations, say five years down the track. Rents return to normal in the area and house prices follow again, this time going down.

If you'd been 'unlucky' enough to buy a property in this town at the peak of the price rise, and then wanted to sell after BHP had left town, the prospects of either high yield over the long term, or high capital growth would both be very unlikely.

High yield has to be treated with caution, and it can come at a big price to growth. As an astute investor you must have an understanding of what the dynamics are behind abnormally high yield. To do this, again you'll need to do some research, have local knowledge and understand what trends are active in the relevant market.

For example, in Sydney yield has been rising. Rent has tightened and the market has softened, and yields are now close to 5%. This is driven by a number of factors, including an influx of new immigrants, most of whom will likely remain, and which should bode well for long term capital growth.

Finding equilibrium between yield and capital growth is the aim, essentially. And realising, again that markets are determined geographically, with yield changing from area to area.

Generalisations such as 'high yields are always good' and 'low yield generally means overpriced real estate' are dangerous. You really need an experienced, educated mind to see through it.

For example, waterfront real estate has a long history of low yield, but that does not preclude it from being a good investment, because the potential for capital growth of a waterfront property is so significant in could outweigh the deficit in yield. So the goal is to find a balance.

4. Growth

Capital growth refers to the increase in the value of your property over time – you buy something for half a million dollars and then 10 years later, it's worth a million dollars. In residential real estate, it's where the money is made. As discussed earlier, yield is part of the property investment equation but particularly in residential real estate, capital growth is just as (if not more) important.

When considering the growth prospects of a property, it helps to begin by identifying what drives property growth in general.

First and foremost are the forces of demand and supply, in other words people wanting houses and the availability of houses. Demand includes the existing population and the new population arriving or departing. Supply covers both existing houses and new houses being built. Naturally, demographics play a big part in the supply and demand equation, and capital growth potential.

In Tasmania, for example, the lack of any population growth negatively impacted property prices. Across the decade June 1992-September 2002, Tasmania's population experienced consistent quarterly net migration losses. In four of these years (1997-2000) the losses translated into absolute decline, as the net outflow of migrants exceeded even the gain coming from natural increase.

Property prices, unlike other capital cities in Australia, experienced minimal growth. If you'd bought a house in Hobart in 1986 and held onto it for the next 15 years, your property would have been worth about the same in 2001 – far from a worthwhile investment.

The demand for housing is strong, but as intelligent investors, we wouldn't stop our analysis of the region here, because supply needs to be considered as well. The Gold Coast area is rife with developers, and it all depends on how the scales are tipped.

If you were considering an investment in the Gold Coast area you'd want to find how both demand and supply are affecting prices, and are likely to affect them in future. Whenever the balance goes out of sync either way you will have either a positive or negative change in prices.

Inflation in the building industry is another factor which can put upward pressure on house prices and result in capital growth. Demand and supply can be static, but if the cost of building a house goes up then so do house prices overall. As builders' salaries and materials become more expensive, the price of building one house goes up, and it makes that house more expensive. This price rise spreads to every other house around, even if they were built for less.

Another factor which impacts property prices, and therefore capital growth, is money supply. Interest rates affect money supply – the more they drop, the more money banks will lend based on the way their formulas work internally. The invention and engineering of financial products also affects money supply. Not long ago, nobody would have dreamt of lending you more than 80% to help you buy a property, but times have changed, and on the whole it has become much easier to borrow.

All capital growth can be explained by supply and demand, inflation, and/or the supply of money. So if you're looking at a property that has doubled in value, it's doubled for one, two or all three of these reasons.

5. Aspect

Aspect refers to which way a property faces, and the accepted truth in Australia is that north-facing is good. A north-facing aspect usually means more direct sunlight, for more of the day. When considering any property then, is it a matter of north or nothing?

In a recent development of 20 units in Maroubra, in Sydney's east, quite a few of the units faced south but they looked over the water. If north-facing only was our stipulation, we would have missed out on the properties in the development which looked over the water, and which may well have had more potential for higher yield, higher capital growth or both.

Every property needs to be taken on its merits so there is no absolute truth when it comes to aspect What's really at stake is how aspect affects a particular property and what that means in terms of brightness and sunlight.

A north-facing property that receives direct sunlight all day can sometimes receive too much sunshine, and a lot of people don't want to have to keep the blinds drawn and the air conditioning on all day. What really matters, is how the design of a property is affected by the direction it faces.

When considering aspect it's not just a matter of north, south, east or west, but what this means for a property given its design, and how this play s out it terms of light. Checking out a property at different times of the day is a good tactic, as is looking out for things such as mould and dampness problems in places where no light reaches.

The moral of the aspect story is that every property needs to be taken on its merits. Shying away from anything other than north-facing also means you could potentially miss out. You might find that is a development of 30 units, price-wise and yield wise, units on the southern side are better than some on the northern side – and if you've done proper research you'll be assured you're making the best buying decision possible.

6. New versus Old

You and I buy a renovator's delight, pay for land value, demolish, build a brand new house on it, and make lots of money. That's being entrepreneurial, and it makes for great dinner party conversation.

Buying a new property, holding it with minimal capital expenditure and forgetting about it for 10 years may not make such great conversation, but it can be a much better way for someone with a day job to invest intelligently.

Not everyone has the time or desire to spend endless weekends renovating a property. If you've got the time, knowledge and dedication, then you're probably wise to stay away from new, but many people either can't or don't want to spend their weekends renovating. If you're one of those people, it's worth considering why considering a new property can be a much smarter, cheaper and more carefree way of investing in real estate.

Let's begin by understanding what goes into the value of a property. When you pay half a million dollars for a property you are buying two things: land, or space, and bricks and mortar i.e. physical structure. The land itself is an appreciating component, assuming demand is fuelled by immigration and other factors. It only becomes more valuable with time. The physical structure, on the other hand, only becomes less valuable with time. It's depreciating. So property has two components: land value and physical structure, one goes up in price and one goes down.

The extreme version is buying something and not spending a cent on it for 25 years. You can imagine how deteriorated it would be. When you sell the property at the end all you are getting back is the land value. But this is not typically what happens.

In reality what happens is the structure deteriorates, and then gets upgraded with a new bathroom, a new kitchen, new floors, and so on. One thing that does not get measured in real estate is the spending involved in keeping a place up to scratch, known as capital expenditure. This is a key concept, because it's a significant amount of money and it's not mentioned or measured in any real estate data.

When that half million dollar property becomes a million dollars, what isn't mentioned is the amount of capital expenditure that went in during the time someone owned it. When a half-million dollar share portfolio goes to a million 10 years later, there is no capital expenditure.

In property though, billions of dollars and countless hours are spent, every year, on improving the structure of investment properties, and it is a number that isn't measured or factored in when looking at growth. When median house prices are measured, and their growth is documented, capital expenditure is not mentioned, but it should be.

The costs of owning an old property are big, yet an estimated 90% of people who go out buy an investment property without getting any assistance will buy an old property. Why is this the case? One can only assume that when it comes to choosing old versus new, people associate new with costing more, but not everything is as it seems.

Because of the extra tax benefits you can claim, generally for the same out of pocket costs it's about three times the cost to own an old property as it would be for a new property of the same value. If you're looking for an investment property around the $500,000 mark, it might cost you $15,000 per year to run if it's old, and $5,000 per year to run if it's new.

If you were an entrepreneur you would never consider new because you'd be looking for the opportunity to add value. But as a real estate investor who wants an 'invest and forget' strategy, new makes sense. Old properties cost more to own, and often require more time and effort to own.

Buying new gives you a property with no capital expenditure for as long as possible. It might be five or six years, sometimes even 10 years if you're lucky, before you really start having to shell out $20,000 for a new kitchen or bathroom.

A new property also requires minimal or no investment of time, and no calls from real estate agents about the boiler or the pluming. If you select well, and you're able to buy a new, rentable property with good yield from day one, and it costs you next to nothing to hold you can forget you even have it, and that's the value you need to consider in buying new.

7. Resale to owner-occupiers

Understanding what characteristics of a property make it easier to exit from ownership is probably the single most important yet unconsidered point when entering property. You don't consider exit strategy when buying shares because it costs $30 to sell your shares, but it sure doesn't cost you that to sell your property.

It costs time, money, energy, real estate commissions, negotiations, heartache and stress – let's face it, it's a pain to sell a property. So anything that can reduce that stress and increase the final price in your hands is good. The best way to deal with exit strategy problems is to buy something that an owner-occupier would be happy to buy later.

At any given time, about 80% or more of buyers in the market are owner occupiers, and the remainder are investors. So if you're trying to find an investor to buy your property, in some cases you may be looking for a needle in a haystack.

A serviced apartment, for example, is an investment that on entering would seem to be a decent option. A holiday rental, for example, in a newly-discovered resort town, which yields high rent during weekends and holidays.

Down the track when you try and sell it, however, you've only got a small number of potential buyers. Compare that to a unit in a small block, on a quiet street in a leafy area of Sydney, with transport to the CBD nearby. You're appealing to a much larger pool or buyers, and it will make selling your investment property a lot easier, and with a better end result.

8. Infrastructure

Picture a house in the desert, with nothing around it. This property, just standing on its own, has a certain value. Someone comes along and builds a big, blue lake next to it. The value of that property is no longer the same – it has (presumably) increased in value because of something that's happened next to it. Someone else comes along and builds a shop nearby and not long after someone else comes along and builds a school and a road. All of these things affect the value of that property.

In the same way the house in the desert gains huge value from a lake, school and road appearing nearby, a suburban Brisbane unit, for example, can grow substantially because of what's going to be around it. It pays to consider what existing infrastructure is nearby a prospective investment, and what future infrastructure is in the works.

For example, in the area you are looking, there could be plans for an industrial site to change zoning and then turn into a supermarket. This one change could affect the whole face of the area, and increase the value of your investment.

Infrastructure also plays out on a much larger scale. For example, the state government decides to build a $2 billion port in an area which was once purely industrial. What that normally means, besides the obvious existence of a port where there wasn't there before, is a marked change in the whole area and surrounds, a sharp increase in employment and in dollars coming into that area, for example. More jobs and more salaries means more people looking to live nearby, which puts upward pressure on housing. So big infrastructure projects are a reasonable leading indicator for what will happen for the future of house prices in the area in two or three years down the line, so it's helpful to know where and what infrastructure is being built.

It's also helpful to know what infrastructure's being built that could negatively impact the value of a house. For example, the Lane Cove tunnel in Sydney's north could negatively impact the value of a property if it were close by.

Infrastructure can and does have a far-reaching impact on property values. You need to have the knowledge to be able to make a good property decision, which means either undertaking research or employing someone to do it for you.

9. Value of advice

As you've gathered by now, there are a lot of considerations which go into making a real estate investment decision. The more knowledge you have the better decision you're going to make. You can go out and collect the information and knowledge that you need or you can get people to help you with the decision-making process.

So what are some of the sources for advice? Your local real estate agent, a get-rich-quick seminar or books are the mainstay. Reputable, knowledgeable property advice is not easy to find, and it continues to be an unregulated space.

In Australia the property advice sector, relative to other financial advice, is largely unregulated. Federal legislation and the Australian Securities and Investments Commission (ASIC), which enforces company and financial services laws to protect consumers, investors and creditors, do not recognise property as a financial product. Both are silent on how it should be treated and how it should be advised on. State-based legislation, which is for real estate agents, covers the mechanics of a property transaction, but nothing is mentioned about how to advise on it.

Because of this legislative vacuum, it is very difficult to find a reputable adviser specialising in investment property. Unfortunately in the past, this area has been tainted by many unwieldy, unregulated operators who have profited on the desire of everyday Australians to get advice on how to enter the investment property market.

A new breed of advisers is emerging and proactively filling that void, bringing a planning and research-based ethic that is enshrined in federal law. We are proud to say we are part of this new generation, and we believe we are on the cutting edge of delivering this new type of service. We voluntarily bringing the same ethos we apply to financial advice to investment property, treating it as though it were any other financial product. This means we research it, provide strategy around it, bring expertise to the selection of it, and help with its implementation.

Do you like what you see? We aim to provide a no-nonsense property advice service based on research and disclosure. What we do is simple but not easy, as locating a good property requires extensive and exhaustive searches, combined with expertise and local knowledge. Our objective for all our clients is essentially to locate a good property, in their price range, with minimal stress and cost, and maximum profitability.

Readers Notes

Wealth Adviser Financial Education

Financial Independence is a point in life when you are no longer dependent on work, government or family for your income. It is a point where you are generally debt free and have sufficient investments and income to look after yourself.

A Financial Adviser is a professional who brings together a wide array of skills, experience and disciplines to develop and execute a financial strategy to help clients achieve their goals and objectives on their journey towards financial independence.

A Financial Plan is a written document that outlines a steady path towards your financial independence.

A survey was carried out on Harvard MBA students. The question they were asked was:

"Have you set clear, written goals for your future and made plans to accomplish them?"

- *3% had goals and they were written down*
- *13% had goals but they were NOT written down*
- *84% had no specific goals*

10 years later those same students were followed up. The 3% who had goals written down were earning 10 times as much as the other 97% combined.

Our observation from this is that written goals keep you focused and give you purpose.

At Spring Financial Group our mission is to bring *a fresh approach* to financial services in Australia.

Please contact Spring Financial Group to organise an initial obligation-free meeting to see how you can take a positive step towards a written financial plan for your future.

The steps are:

1. An initial obligation-free meeting
2. A thorough investigation of your personal circumstances, goals and objectives
3. A review of strategy and options by our Advisory Panel, including:
   - Finance
   - Tax & Accounting
   - Superannuation
   - Equities & Securities
   - Property
   - Estate Panning
   - Risk Management
4. Preparation and presentation of a financial plan to suit your individual circumstances
5. Implementation of your Financial Plan
6. Review of your Financial Plan.

Who we are & what makes us different

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Our advisers are educated and experienced in Financial Planning, specialising in advanced investment strategies for wealth accumulators and retirees. We are unique in that we provide deep expertise in sourcing and investing in direct residential investment property - so you will not be offered managed funds as the only investment solution

We provide a balanced approach to investing between property and shares; plus considerable expertise in Self-Managed Superannuation Funds and wealth creation.

We are a fully integrated firm; consisting of:

- Spring Financial Group - Financial Planning
- Spring FG Accounting - Accounting and tax
- Spring FG Finance - Mortgage broking and structuring advice
- Spring FG Realty - Investment Property advice
- Spring FG Equities - Shares and trading advice
- Wealth Adviser - free financial educational eBooks.

We operate a primarily fee-for-service based advice model.

Let us help you to meet your financial goals and objectives by contacting one of our experienced Advisers or send an email to info@springfg.com.

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