NEXUS

PRIVATE WEALTH MANAGEMENT

The Ultimate Guide To **Property Investing**

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Introduction:

Property investors should understand that the Australian Securities and Investment Commission (ASIC) does not consider property to be a financial product. Consequently, there is no such thing as financial advice for property investment in the eyes of the regulators. This is remarkable given that the many Australians view property as their primary investment vehicle. As a result, consumers do not enjoy the same protections or recourse from real estate transactions that they do for shares or bonds, and property sales people are not required to perform or verify any product due-diligence.

The lack of regulation and education required to sell property for **investment purposes** has made it difficult for would-be investors to obtain high quality, objective information about their property investments. This has provided a platform for large marketing companies to fill the void of 'Property Guru' espousing many myths and over-simplifications in order to sell their own products, en masse, with a one-size-fits-all solution. By the end of this guide, you will understand why investing in property is not a one-size-fits-all proposition, and why what works for one investor may not be appropriate for another.

At Nexus, we believe in educating consumers and assisting with implementation as and when required. We help our clients with a coordinated approach to property acquisition, accounting, financial planning, mortgage broking and estate planning services. We do not sell our own property or have any interest in any property development.

The reason we are sharing so much intellectual property is that over the years, we've found that the more educated people are, the more they will engage in professional services.

'The Ultimate Guide to Property Investing' will provide you with the framework for building a successful property investment portfolio and step you through the many considerations you'll be faced with on your journey.

No matter what your level of understanding of property investment, I'm sure there will be something new for you within this guide.

Stephen Vick
Managing Director

About the author

Stephen Vick is the Managing Director and founder of Nexus Private Wealth Management. Stephen holds a Bachelor of Business majoring in Banking/Finance & Accounting, a Diploma of Financial Planning, and a Diploma of Finance & Mortgage Broking Management. He also holds Specialist SMSF accreditation, a Real Estate Agency License, is an Authorised Credit Representative, and is a member of the Real Estate Institute of Queensland (REIQ).

Stephen has spent over 25 years in the finance industry and has held senior positions with Australian Finance Group, Australian Unity and MLC.

General Advice Warning

Nexus Private Wealth Management, their officers, employees, and agents make no representations or warranties with regards to the information contained in this presentation as it is general information only and neither represents nor is intended to be personal advice on any particular matter.

We have not taken into consideration any individual circumstances. We strongly suggest that no person should act specifically based on the information contained herein but should obtain appropriate professional advice based upon their own personal circumstances. The information contained within is current as at the date of writing.

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Chapter 1. Investment Strategy

Most people think property investing is relatively simple and that it's all about finding the best-looking property they can find within their budget, because if they love it, then others will love it too.

However, accurate analysis of property investments is an incredibly complex process. And like all investments should be purely about the financial outcomes and not about the emotion or personal benefits you may receive from owning property.

There are many property wealth creation strategies that you will read about or view on social media. However, they all broadly fit into just four categories, being:

01 THE **FLIPPER**

02 THE **DEVELOPER**

03 THE **YIELD CHASER**

04 THE **GROWTH SEEKER**

We summarise each of these below:

The Flipper

The Flipper, generally, has a short-term investment view and is trying to acquire property that's undervalued or distressed, often looking to add some value by renovating or decorating, then reselling to realise a quick profit.

This is probably the most personally gratifying strategy, particularly if you're renovation enthusiast. There are many people who have done well from this strategy, and some who even make a living out of it. But there are several hurdles the Flipper needs to overcome to profit from their investment.

Firstly, the cost of buying and selling an average residential property in our capital cities is roughly $50,000 to $60,000 once you've paid the stamp duty, bank fees, legal costs, and real estate commission. You then need to recover your project costs which can include materials, labour, council approvals, your own time spent, loss of rent for the duration of the project, and other standard holding costs such as insurance, rates etc. Finally, you need to account for the opportunity cost of having your equity tied up for the duration of the project (when it could be used to earn a return elsewhere). Anything you make above these costs is real profit.

Should you achieve a profit within 12 months, you'll be expected to pay capital gains tax at your marginal tax rate on that profit. If you sell the property after 12 months you will be entitled to the 50% capital gains tax exemption, unless you're deemed to be running a renovation business by the ATO.

Making a profit by flipping is by no means impossible, but the upside needs to reflect the risks taken on for such a project. The risks involved with flipping property include:

- Underestimating material and labour costs
- Being unable to obtain council approvals
- Time frame blow-outs and increasing holding costs
- Short-term negativity in property markets at completion of project

When it comes to flipping properties, many of the success stories happen in a rising property market, where the Flipper would have made a good profit from a buy and hold strategy anyway, and not due to the investor's design skills.

Unless you're in the building industry whereby you don't have to pay full retail price for materials and labour, it's usually not until you gain experience and become very good at renovations, are you likely to add genuine extractable value to the process.

Some Flippers have no intention of renovating, but seek undervalued or distressed properties to purchase at a discounted rate, in the hope of achieving instant equity. It is rare to meet people who have accomplished this. The Australian property market is incredibly efficient (meaning the market knows what something is actually worth), and with roughly 120,000 people working in the real estate industry, it's unusual to find a property that's genuinely $30,000 or more under market value. If a real estate agency obtained a listing that represented such a bargain, it's unlikely the opportunity would find its way out of the office into the open marketplace. Even if you could buy under market value, a bank appointed Valuer is unlikely to value it much more than what you paid for it within the initial years following your acquisition. This makes it difficult to create instant equity and immediately leverage into the next acquisition. This strategy is often touted on social media as a way to acquire 10 properties within 10 years. I have never met anybody who has achieved even close to this goal.

As you will see in chapter three, you'll likely make more money by paying fair price for superior properties than you will by receiving a discounted rate on distressed properties. Flipping, as a strategy, should be reserved for the passionate and determined home designers/project managers.

The Developer

The Developer is a bit like the Flipper as they are also trying to add value to an existing property opportunity.

For example, a small development may involve the splitting of 800sqm of land (possibly even with an existing house on it) into two blocks where Council regulations allow it. To achieve this, architectural plans must first be drafted and then it is a matter of getting the Development Application (DA) and Building Application (BA) approved through Council. We've all heard stories of development applications being held up by Council for one reason or another. This is where holdings costs can become an issue when borrowing to fund projects.

After negotiating their way through Council, the Developer then has to demolish whatever is on the block which can involve asbestos removal, termite assessment, soil testing, etc. and then commence the building project. A great deal of skill is required to manage a building project and coordinate multiple trades, each with their own idea of how things should be done, to a designated timeline. If the Developer lacks those skills, then the appointment of a Supervisor for the project is another cost factor to allow for.

Larger projects sometimes involve the purchase of cheap land on the city fringes – where a Developer has purchased with the intention of 'land-banking' until the relevant Council re-rates the land as being suitable for residential construction. This strategy can be a massive gamble as the time frames can run to decades and there's no guarantee that the Council will ever 'come to the party'. When the projects do get off the ground, there'll be a requirement to provide roads, utilities and sewage infrastructure which can easily run into hundreds of thousands, if not millions. Over the last few years the growing focus on environmental impacts has put a more complex spin on even the simplest infrastructure projects.

Apartment complexes come with their own set of challenges and most larger projects will require a number of pre-sales before the Lender will agree to release funding for the construction. Banks have also been known to 'move the goal posts' midway through the development process, bringing progress to a halt. This can see the demise of a Developer who does not have deep pockets.

Another strategy that some developers pursue is using Property Options or Put & Call Options to secure potential re-development opportunities using very little capital. The idea here is to offer home owners a price for their home that is well above market value but has a very long settlement time, often years. This is done in the hope that Developer can obtain rezoning or development approval from Council, therefore, increasing the value of the property in excess of the agreed contract price. If the Developer cannot achieve this, they will forfeit their deposit (or Option price).

Often those marketing this type of strategy are experienced developers trying to enlist an army of inexperienced 'Finders' to knock on doors to see if they can convince someone to take their home off the market for years before settling on a sale.

When a genuine opportunity does present itself, which is rare, the experienced Developer will provide the option holder with the funds to complete the project. They, of course, will also share in the profits for their involvement, without the risk of losing any of their own capital on deposits (Option Costs).

For every property development success story there's also a horror story. Profits can be considerable, but developers need to deal with so many unexpected factors. Weather, labour costs, material costs, approval delays, disputes, hostile neighbours, changes in legislation, the solvency of builders and tradies, red tape, and even the interpretation of contract law can all test the patience of even the most seasoned Developer.

Suffice to say that some of the biggest and most successful property Developers in Australia have gone bankrupt at least once, so it's certainly not for the faint-hearted. First time Developers would be well advised to ensure ready access to large amounts of capital and an experienced mentor, as property development can be very complex and capital intensive.

The Yield Chaser

Firstly, it's important to distinguish Gross yield from Net yield. The gross yield of a property is simply the rental return only measured as a percentage of the value of the property. For example, if a $500,000 property pays $25,000 rent per annum (or $480 per week), then it's gross yield is calculated at $25,000 divided by $500,000 which equals 5%. The Net yield is the rental return less all ongoing expenses. However, most investors are more interested in the total after tax holding costs. This can differ from investor to investor depending on their tax position but we will cover this in more detail in chapter 2 of this guide.

Examples of high yielding properties are commercial, industrial and retail purpose buildings, serviced apartments, hostels, and student accommodation. Despite potentially long periods of tenant vacancy and high maintenance costs, these types of properties can still generate good long-term net yields.

The types of investors we usually see seeking high yielding properties are either retirees or high net worth individuals. Retirees often have little or no debt attached to their investments and are merely seeking replacement income with the assets they have accumulated.

They won't be as concerned with growth if they have no intention to sell, and rather choose to pass their assets to the next generation. We also see sophisticated investors with large existing property portfolios choosing high yielding properties to diversify and improve their cash-flow or borrowing capacity.

A good yield is essential for those relying on rent to replace employment income, or to help meet the holding costs of the property, particularly when there's borrowing involved. However, so long as you have enough cash-flow to retain your investments, **growth will be the primary source of wealth creation** over the long-term. The growth component is simply the amount the property increases in value over time.

To illustrate this, the following table shows two investment properties both costing $500,000 to purchase and both returning a total of 15% per annum.

Value of a $500,000 property over 20 years (Table)

Returns	Investment A		Investment B	
	10% Yield	5% Growth	5% Yield	10% Growth
Year 1	$50,000	$25,000	$25,000	$50,000
Year 5	$276,282	$138,141	$152,628	$305,255
Year 10	$628,895	$314,447	$398,436	$796,871
Year 15	$1,078,928	$539,464	$794,312	$1,588,624
Year 20	$1,653,298	$826,649	$1,431,875	$2,863,750
Total		$2,479,947		$4,295,625

Investment A returns 10% yield and 5% growth and investment B returns 5% yield and 10% growth. You can see that in year one both investments return the same amount, being $75,000. However, because the yield is calculated on an and exponentially increasing growth figure, you can see that over time, investment B's yield is catching up with the 10% yield of investment A. In addition, you can see the compounding growth of investment B has risen to more than $2,800,000 after twenty years, compared to $826,000 for investment A. Cumulatively, investment B has outperformed investment A by more than **$1,800,000**. An extreme example, but you can see that if you had a choice, higher growth investments will provide better mathematical outcomes than higher yield investments.

The trick for most wealth accumulators is to generate just enough yield to be able to hold onto, not only one property but several properties, while still focusing on long-term growth. This requires accurate cash-flow modelling and running several 'what if' projections to mitigate risk.

The Growth Seeker

Every property exists somewhere on the spectrum of high growth and low yield, or low growth and high yield. It's generally a trade-off. For example, as mentioned previously, commercial and industrial property historically produce high yield, but their growth is usually quite low. This is because their growth is often a reflection of business productivity and more closely follows the consumer price index (CPI) and not residential property markets. On the flip side, luxury residential property, for example expensive residences overlooking the water, tend to have much higher growth rates with much lower yields. Your standard residential property sits somewhere in the middle and has an advantage over many other asset classes because of the enormous pool of potential renters and buyers.

Growth Seekers are usually balancing the limited resources of their equity and cash-flow to accumulate and hold as many assets as possible. This requires a non-emotional, long-term, 'rack 'em' and 'stack 'em' approach. In Australia, growth seekers are rewarded the most by the tax office with income tax off-sets that subsidise lower yields and capital gains tax concessions that reward long-term profit makers.

Yield and Growth are characteristics that are trade-offs, and sometimes a mix of both types of investments is appropriate. However, most Australians that are still trying to grow their wealth and reduce their tax from negative gearing strategies, tend to be growth seekers.

Summary

If you love the idea of replacing your current career with that of being a professional Renovator or Flipper, then go for it. I would never discourage anyone from following their dreams. I will say though, do not go in with rose coloured glasses. The reality TV shows are not reality. The amateurs featured on these programs are supported by a large cast of experienced professionals. From talking with many investors over the last 25 years, I can say that most Flippers find it very difficult to make any real gains from the first few projects they take on.

Developing, is often the most profitable of all strategies in the short-term if you get it right. And if you're lucky enough to have friends or family that can mentor you or assist with capital funding, then you'll have a head-start. However, this investment strategy also carries the most amount of risk. Like anything, professional developers learn their craft over many years. It is very hard for someone with no experience to compete in this field. If it was easy, everyone would be doing it. Property development is not easy, and as in life, the high rewards require high amounts of stress and dedication.

Most 'Mum and Dad' property investors take a long-term approach and generally fit into either the Yield Chaser or Growth Seeker category. There can be many reasons for choosing one over the other or possibly even having a mix of both. As investing is the focus of this guide, we will delve deeper into these two strategies from here on.

Chapter 2. Holding Costs

To explain how to calculate the actual holding costs of a property, we're going to look at two examples. The first being a new apartment and the second an older established house – both are similarly priced and in the same suburb. These are real examples of real properties for sale at the time of writing. The address details have been withheld for the privacy of the owners.

The following table shows the cash-flow from a brand new three-bedroom, two-bathroom, two-car garage, off-the-plan apartment in Newmarket – a good inner-suburb of Brisbane. This is a ground floor apartment with 104 sqm internal living area, 41 sqm external patio, and is on the market for $650,000.

INCOME & EXPENSES	AMOUNT (pa)	NOTES
Rental Income	$32,240	$620 pw x 52 weeks
Vacancy	-$1,240	$620 pw x 2 weeks
Total Income	**$31,000**	
Loan Interest	-$32,500	5% pa (assumes 100% of property funded)
General Expenses	-$4,919	Rates, insurance, body corporate fees etc.
Property Maintenance	-$500	Annualised average over 10 years
Property Management Fee	-$2,728	8.8% (inc GST)
Total Actual Expenses	**-$40,647**	
Depreciation	-$21,064*	Paper loss only
Claimable Expenses	**-$61,711**	
Tax loss (including depreciation)	-$30,711	Total income minus claimable expenses
Tax Refund	**$14,434**	47% of tax loss (assumes highest MTR)
REAL CASH-FLOW	**+ $4,787 or $92 per week**	Total Income, minus Total Actual Expenses, plus Tax Refund

*Depreciation is quite high in the first year and diminishes over time. This often helps with cash-flow in the first few years when the rent is generally at its lowest. After 10 years, the claimable depreciation may reduce to less than 50% of the first-year figure for some properties.

To calculate our total income, we simply annualise our gross weekly rental income and deduct an amount for expected vacancies. It's essential to get a couple of rental appraisals from different real estate agents, preferably not the same agent you're buying the property from, and use the lowest one quoted for your gross rental income figure. The current vacancy rate for new apartments in Newmarket is 2.2% or approximately one week per annum. I usually double the vacancy rate to be conservative, which means allowing for two weeks.

We then calculate our total actual expenses. To do so, we first estimate our interest expense. Again, it's prudent to err on the higher side when using loan interest rates. You then deduct the general expenses. Be sure to include things such as council rates and services, landlord insurance, body corporate fees, letting fees, accounting fees, etc.

I've listed property maintenance on a separate line because I wanted to make the point that this should be averaged over a 10-year period. In this example, because it's a brand-new apartment, there shouldn't be any serious maintenance or structural issues as new buildings have a 6.5 year statutory builder's warranty (for Queensland properties). Therefore, I have just assumed $500 per annum for maintenance costs.

We then deduct our property management fee, which is usually 8.8% (inc GST) of the rental amount. I would never encourage any investor to take on this role themselves, or be a part of the body-corporate committee, or get involved emotionally at all with their investment properties. If you're trying to build a portfolio, getting too involved can become very stressful and may artificially limit your investment potential. This fee is tax-deductible, and outsourcing to professionals will save you much angst.

So those are the total actual expenses that you will incur, however, from a tax perspective, the ATO allows you to claim depreciation on the fixtures and fittings (if you're the first purchaser of those things) at a diminishing rate over the first few years of a property's life. You're also able to claim depreciation on the building over 40 years. If a property is over 40 years old, no depreciation can be claimed. Although these deductions apply to your income tax payable for the year, the related expenses are not something that you would usually incur as an out-of-pocket expense on new properties. Consequently, the allowance has a positive effect on the actual holding costs of this apartment. The builder's estimate for the full amount of depreciation on this property in the first year is $21,064. This number can be confirmed by obtaining a Quantity Surveyor's report.

This gives us our total tax loss which we multiply by our marginal tax rate to calculate our tax refund. To calculate our actual holding costs, we simply take our **total income** less our **total actual expenses** and add back our **tax refund**. In this case, we have a positive cash-flow of $4,787 per annum or $92 per week. This is a classic case of how you can be negatively-geared but still have a positive cash-flow.

It is prudent to run several scenarios that allow for increases in interest rates and other costs as well as factoring in future rental increases or higher vacancy rates. This will show what effect these changes will have on your total cash-flow and asset position. Your personal circumstances and tolerance to risk should be taken into consideration when running 'what if' scenarios.

Now let's look at the established house:

The following table is the cash-flow for this three-bedroom, two-bathroom, two-car garage, established house on 577sqm of land, also in Newmarket with an asking price of $689,000.

INCOME & EXPENSES	AMOUNT (pa)	NOTES
Rental Income	$28,600	$550 pw x 52 weeks
Vacancy	-$2,200	$550 pw x 4 weeks
Total Income	**$26,400**	
Loan Interest	-$34,450	5% pa (assumes 100% of property funded)
General Expenses	-$4,900	Rates, insurance, letting etc.
Property Maintenance	-$8,000	Annualised average over 10 years
Property Management Fee	-$2,323	8.8% (inc GST)
Total Actual Expenses	**-$49,673**	
Depreciation	$0	No depreciation claimable
Claimable Expenses	**-$49,673**	
Tax loss	-$23,273	Total income minus claimable expenses
Tax Refund	**$10,938**	47% of tax loss (assumes highest MTR)
REAL CASH-FLOW	**-$12,335 or -$237 per week**	Total Income, minus Total Actual Expenses, plus Tax Refund

Gross yields on houses are typically 1% - 2% lower than apartments, mainly due to the higher ratio of living area to land cost in favour of the apartment. The rental appraisal on this house is $550 per week, and the current vacancy rate for houses in Newmarket is 4.2% or approximately two weeks. So, we will allow for four weeks' vacancy per annum.

Loan interest is slightly higher because the house is more expensive and the annual expenses will be lower, because, although the house has higher rates and insurance costs, there are no body corporate fees.

When it comes to the ongoing maintenance of houses, there are usually more things to consider when compared to the up-keep of apartments. Maintenance items on older houses can include things like gardening, painting of fences and walls, upgrading roofing and gutters, asbestos removal, replacing rotted timber work, retaining walls, pest and termite control, plumbing and electrical, general attrition of appliances, and possibly even the updating of kitchens or bathrooms. I would suggest getting a building and pest inspection done before purchase to ensure there are also no costly structural issues you may be unaware of. It's these things that can often force the investor to have to sell before they've had time to realise a capital gain if not allowed for in the cash-flow modelling. Speaking with many home owners over the years, I would suggest it would be prudent to assume a cost of approx. $80,000 maintenance over ten years, for a fourty year-old plus property, giving me an average of $8,000 per annum.

The Property Management fees will be a bit less for the house as the rent is less. However, another significant difference between the old house and the new apartment is the claimable depreciation. Because this house is over 40 years of age there will be no depreciation to claim back.

Once I subtract my **total expenses** from my **total income** and add back my **tax refund**, you can see that the actual holding costs of this house are $12,335 per annum or $237 per week.

REAL CASH-FLOW	PER ANNUM	PER WEEK	CASH-FLOW TO INVESTOR
Apartment	+ $4,787	+ $92	Total Income, minus Total Actual Expenses, plus Tax Refund
House	- $12,335	- $237	
Difference	+ $17,108	+ $329	

In using the two different property types above as examples, you can see that the holding costs differ by $329 per week or $17,108 per annum. Obviously, this is a significant difference which is why it is essential to do these calculations on any prospective acquisition. Getting the numbers wrong may be detrimental to your standard of living or impact your ability to borrow for another property. Worse still, it could result in you having to sell the property prematurely, suffering a significant investment loss.

The difference in actual yearly cash-flow may even be greater than shown in my example because when I used an annual maintenance expense of $8,000, I assumed that all of those expenses were fully deductible. However, money spent on an investment property falls into one of three categories. The first category is repairs, which can be claimed against income in full each year. The second category is expenses deemed to be capital in nature, such as structural additions and improvements. You won't be able to claim these in your tax return as they form part of the cost base of the asset and will only be credited when you eventually sell the property. The third category is the more expensive fixtures and fittings, such as carpets, which can't be claimed in full when the expense is incurred but can be depreciated over the life of the asset.

The purpose of this example is not to advocate one property type over another, they all have their place, it's merely to highlight how important it is not simply to rely on a 'back of the envelope – rent covers mortgage' calculation.

Another factor that may affect your cash-flow is the borrowing structure. Incorrect debt structuring may impact the tax deductions if, for example, part of the purchase is funded with savings and not debt. Using the equity in another property to fund the deposit and stamp duty is a better option if you still carry personal debt. Ownership structuring will also affect the tax deductibility of the property. Most banks now allow property title ownership in one person's name (often that of the highest income earner), while still having the loan in joint names (for serviceability). Using discretionary trusts or Self-Managed Super Funds to purchase investment property will also change the tax outcomes and therefore the cash-flow. It is important to seek professional tax advice for clarity on these issues and how they relate to your circumstances.

In the next segment, we'll look at how growth affects total investment returns and what drives capital growth.

Chapter 3. Growth Drivers

Before we get into what drives growth in property markets, it's essential to see what effect capital growth has on overall investment returns. The following table shows the effect of a range of compound growth rates on a $500,000 investment over 10, 20 and 30 years.

Growth in value of a $500,000 property

GROWTH RATE	10 YEARS	20 YEARS	30 YEARS
1%	$552,311	$610,095	$673,924
2%	$609,497	$742,973	$905,680
3%	$671,958	$903,055	$1,213,631
4%	$740,122	$1,095,561	$1,621,698
5%	$814,447	$1,326,648	$2,160,971
6%	$895,423	$1,603,567	$2,871,745
7%	$983,575	$1,934,842	$3,806,127
8%	$1,079,462	$2,330,478	$5,031,328
9%	$1,183,681	$2,802,205	$6,633,839
10%	$1,296,871	$3,363,750	$8,724,701

For the sake of this exercise, I will focus on the twenty-year column. Depending on your age and personal circumstances, of course, I would consider twenty years or longer as a good buy and hold time frame for which to aim. If over twenty years, your investment achieves only 1% growth, then ignoring the buy and sell costs and the net holding costs, you would have made a profit of $110,095.

If you were lucky enough to make 10% then you would have made a profit of $2,863,750. These are extreme examples of course, but there are many examples of suburbs around Australia that have achieved growth rates of over 10% in the last twenty years. According to the Australian Bureau of Statistics (ABS), the Residential Property Price Index (Weighted average of eight capital cities) has risen an average of 5.2% between 2003 and 2018. I will use 5% as an estimated average property growth rate for my next example:

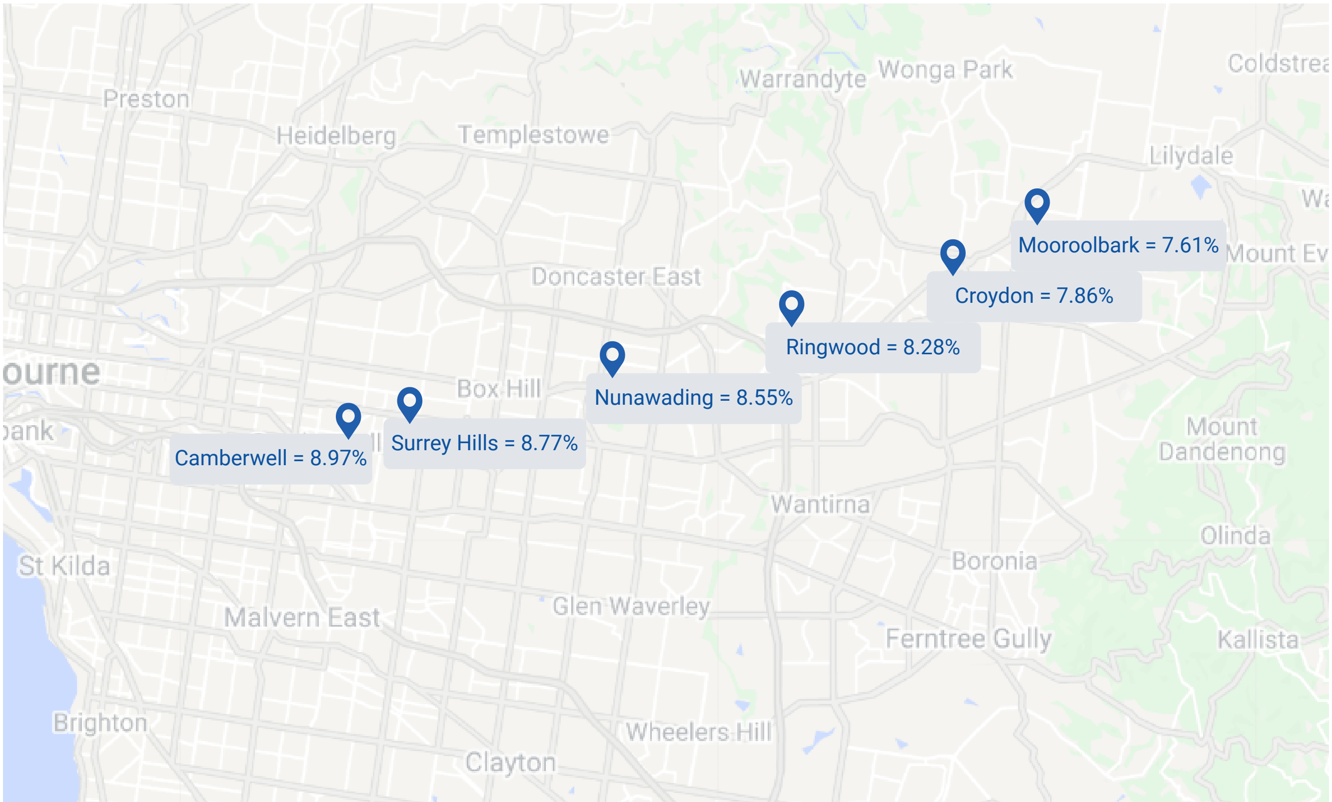
As you can see in the table, if Investor X achieves just 1% under the average growth rate and Investor Y achieves only 1% above the average, then Investor Y would earn over half a million dollars more than Investor X. A net profit amount of $508,006 is the difference between just 4% and 6% annualised growth on a $500,000 property over twenty years. Clearly, even small differences in growth rates translate into large differences in profit when measured over the long-term.

Now that we know what sort of impact capital growth can have on our investments let's look at what drives' capital growth.

Firstly, let's make something very clear… the only thing that alters the price of an investment property (or anything for that matter) is Supply and Demand. This is a basic economic principle. All assets need an increase in demand and a constraint of supply, in order for their capital value to increase.

The following diagrams show growth rates in a number of suburbs in Melbourne, Sydney, and Brisbane over the last 10 years.

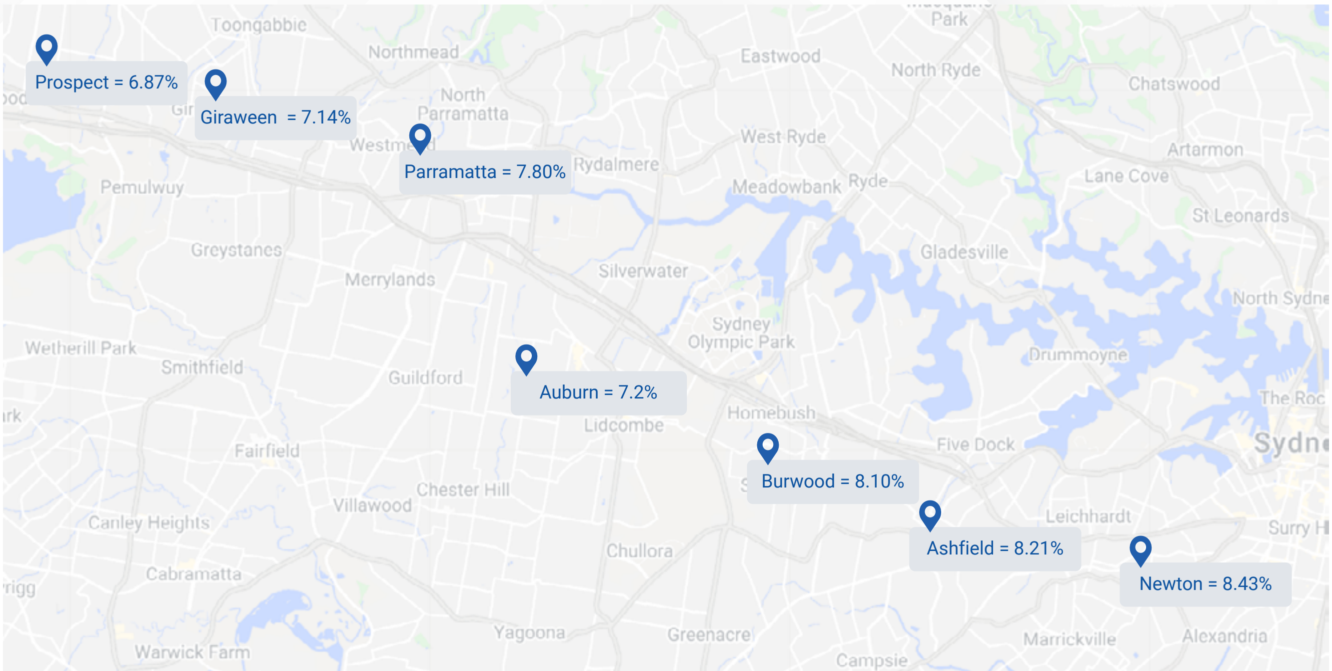
Melbourne



Average Growth – 1993 to 2018

(Source: Price Finder House Prices, average annualised growth rates over last 25 years)

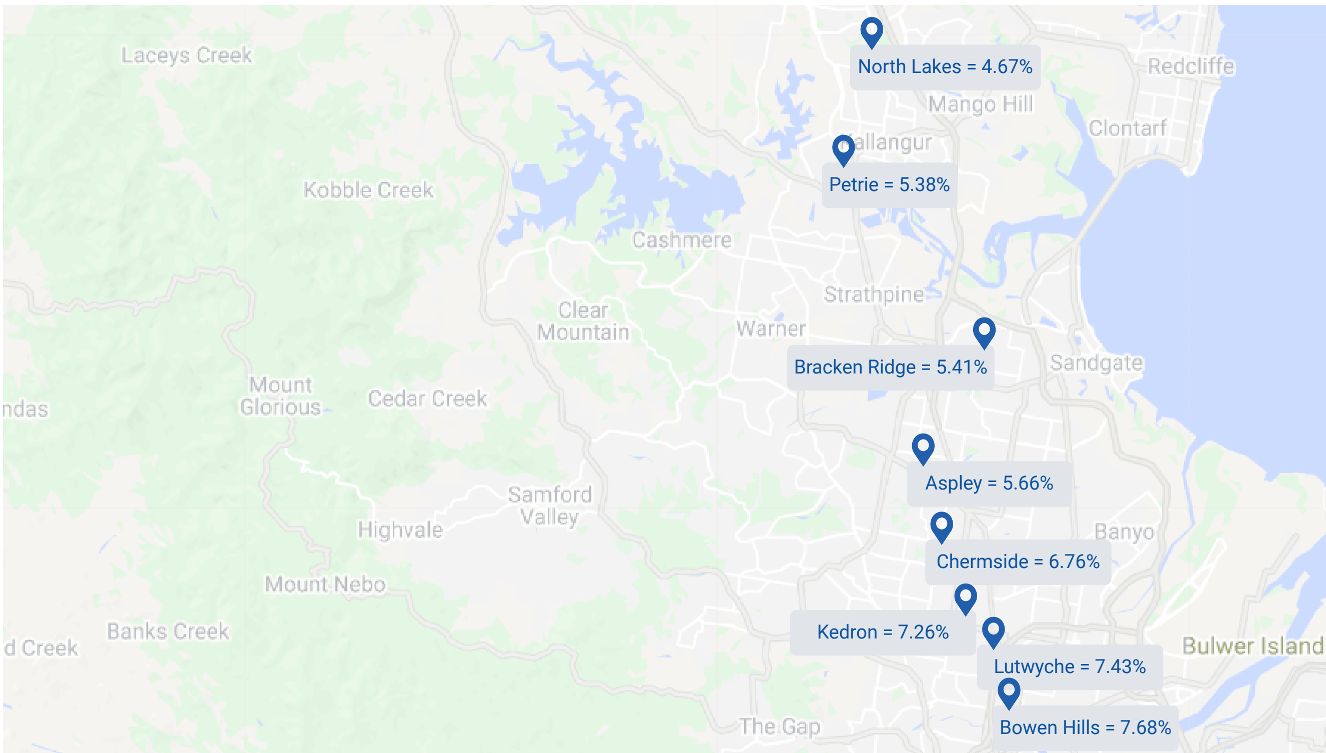
Sydney



Average Growth – 1993 to 2018

(Source: Price Finder House Prices, average annualised growth rates over last 25 years)

Brisbane



Average Growth – 1993 to 2018

(Source: Price Finder House Prices, average annualised growth rates over last 25 years)

As with all data analysis, there will always be outliers. However, generally, you can see a high correlation between suburbs being closer into the CBD and having higher growth rates – there is a pattern here. And this makes sense as for every one-kilometre ring you travel out of the city there is an exponential amount of supply opportunities available.

On the demand side of the equation, it turns out that employment is one of the primary drivers as most of us don't like to spend hours every day getting to work, and a good proportion of our jobs are located in the CBD. Other demand-side growth drivers include access to transport nodes, hospitals, schools, universities, restaurants, lifestyle amenities and the growing migration and immigration rates.

Another contributor to demand is a shift in demographic trends. The Australian Bureau of Statistics (ABS) has stated that the fastest growing household type is the loan person household. Likely contributing factors include young people staying single for longer, higher divorce rates, and the widow effect caused by the baby boomers approaching life expectancy.

Baby boomers need access to essential services such as hospitals, aged care and lifestyle amenities. As part of the July 2017 budget reforms, retirees are now receiving tax incentives to downsize.

Many young people are now buying an investment property as their first property purchase and continuing to rent near the CBD, as they can't yet afford to buy a home that meets their needs in the locations they want to live.

These demographic trends support the notion of an expanding gap between the price of inner and outer suburb prices in Australia over the next 20 to 30 years.

Many regional cities across Australia appear to have similar growth drivers to the capitals, yet historically have not performed as well over the long-term. This is because they're reliant on one or several specific industries to drive demand, such as mining, tourism, education, defence etc. Consequently, they tend to exhibit boom and bust type characteristics. They may perform well over short periods but do not have all the growth drivers to achieve good consistent long-term returns like our capital cities.

A growth factor that is not merely a consequence of location is a property's point of difference or buyer appeal. When attempting to sell the property and realise a profit we want to be sure to appeal to the owner-occupier because they make up about 70% of all buyers in the market. So standard of finishes, views or aspect, floor plans, amenities, and other design features all contribute to the owner-occupier paying more for your property than the one down the road. To appeal to Investors, being the other 30% of the market, the certainty of the asset's ability to generate consistent income into the future is what they are interested in. So yes, the yield is an integral part of a property's growth prospects. And this makes sense as every investment's capital value is intrinsically linked to its ability to earn future income. The more certain the income, the higher the capital that will be risked to attain it. Appealing to 100% of potential buyers will provide a higher probability of selling your property within a reasonable time frame and at a comparatively good price. However, this factor is quite small when compared to the other factors related to location.

In chapter four, we look at other influences that can affect a property's growth prospects, such as infrastructure plans or re-zoning.

Summary

If it's growth you're seeking, there may be some pockets that defy historical trends and have a short-term spurt of high growth. However, the main things that influence supply and demand is the desire to be close to work and amenities, and the diminishing number of dwellings closer to the major employment precincts. So, if you're an investor with a long-term view and want to play it safe, you may consider staying close into the CBDs of the major capital cities, in what are sometimes referred to as the blue-chip suburbs, especially if your trying to build a portfolio of multiple properties. Trying to pick the next hot spot is almost impossible, and even if you get it right, the suburb may not perform up to par over the long-term. One bad decision here can significantly restrain your total investment portfolio growth.

Chapter 4: Assessing Risk

There are lots of risks involved with buying property, and some of them are very obvious. But we are going to start this segment with one that is not so obvious, that being **timing risk**. If you have a substantial amount of savings and you don't need to borrow to invest, then when property and shares are performing poorly, you may be able to get a better return on cash-based investments like bonds, debentures, and term deposits. However, property and share markets often turn quickly and trying to chase the various asset classes, year on year, can be like chasing your tail. It's often important for investors to get the right balance of asset allocation across multiple asset classes, be fully invested, be patient, and don't try to time markets.

If you **are** borrowing the majority of funds to invest, then the risk of being in the market (in the short-term) is going to be limited to the amount of negative cash-flow your strategy demands. For example, if a $500,000 investment is only going to cost you $2,000 per annum to hold onto, then I would suggest that the risk of getting the timing wrong, and missing the upswing, would certainly out-weigh the cost of participation (i.e. $2,000 pa). It's also worth noting that many historical spikes in property prices are preceded by very poor market sentiment. Therefore, as a long-term investor borrowing to invest, the answer to the question of when to invest should always be **"as soon as you can safely afford to"**. Those who try to time markets are taking a large and unnecessary risk.

When we look at project-specific risk, your checklist of items to research should include the following:

1. **Buying Off-The-Plan (or prior to completion) –** There are pros and cons to purchasing property off-the-plan (or before completion). In understanding the risks, you must first understand the various critical stages of development before deciding if buying off-the-plan is right for you. The critical stages of development in chronological order, are:
    - **Development (DA) and building (BA) approvals –** This is the stage whereby the Developer has secured rights to the land, completed their feasibility assessment, have completed the draft development and/or architectural plans, and have obtained the council approvals for the project.
    - **Pre-sales target –** If the Developer is borrowing some of the funds required to complete the project, commercial lending arrangements will generally require the Developer to achieve a number of sales, with no contract conditions, before releasing these funds. This requirement is known as Pre-sales and can represent as little as 10% or as much as 100%

of the total number of lots in the project. Lenders will generally require fewer pre-sales in good property markets and more sales in uncertain markets. It is not unusual for the banks to change these percentage requirements mid-way through the project if market sentiment turns.

- **Building Commencement** – This usually happens once bank funding has been secured. However, if the Developer is of strong financial standing, they may not require Pre-Sales before commencing construction. Once construction has begun, it is easier to make predictions around completion dates.
- **Title Registration** – This is when the main building works have been completed, all regulatory requirements have been met, and individual lots have been issued titled by the State Titles Office. There may still be minor defects to attend to at this stage.
- **Settlement** – By this stage the purchaser's lender has completed valuations and unconditionally approved the loan. The property is ready for the transfer of title from Developer to Purchaser, and Purchasers are usually offered a 'pre-settlement inspection' to have any concerns attended to before settlement.

The main benefits of buying property prior to completion are:

- You usually get the best pick of properties in a new development (as the best ones go first). This could include acquiring the lots with the best views or aspect, and/or the lots that are likely to be rented first;
- Purchasers are sometimes offered discounted pricing in the pre-sale phase as Developers are often desperate to reach their pre-sale funding target. Significant financial investment by the Developer can be lost if the project cannot proceed past this stage.
- Having ownership of an investment that has the

potential to grow in value while the holding costs are $0.

- You will sometimes be able to customise the design and inclusions of your property to give it a point of difference.
- If buying land and contracting a builder to construct the dwelling, you will only pay stamp-duty on the land and not the total house/land package.

The main risks or negatives associated with buying off-the-plan are as follows:

- Securing property off-the-plan will usually require the purchaser to sign an unconditional contract and pay a deposit of 10% of the contract price. The longer the time-frame the greater the opportunity cost of having your money invested elsewhere. As mentioned above, this could be a positive or a negative depending on investment markets during your contract period.
- If you enter into a contract prior to the issue of council development or building approvals, your contract will usually contain a clause that allows the Developer to make immaterial modifications to building plans, floor plans or even the contract price. This will be contingent on Councils requiring changes to the draft plans due to environmental, engineering, or town planning reasons. It is important to understand the difference between material and immaterial changes before signing the contract. Purchasers are usually disappointed when changes are made that can affect the rentability or saleability of the property but are deemed immaterial under the contract terms. In this event, the purchaser has little recourse, and they will be unable to terminate the contract, even if it materially affects the expected yield.

- If you enter into a contract on a lot within a development before the pre-sales target is achieved, keep in mind that the Developer may never obtain the financing required to start the project. However, you will usually find within the terms of the contract that the Developer has the right to hold you to your contractual obligations and deny access to your deposit for a specified period of time. This is referred to as the Sunset period or the Sunset clause. Time frames for Sunset clauses will vary from project to project but, 3 to 5 years is common. If the Developer cannot complete the project within the Sunset period, you may find that your contractual obligations prevent you from investing your money elsewhere over this period.
- Once construction has commenced, the risk of non-completion significantly diminishes. However, the weather, industrial relations, and bureaucratic red tape can still see lengthy delays to expected settlement dates.
- Most sales prior to Title Registration will usually require the purchaser to sign an unconditional contract – without a finance clause. This means that if you are unable to secure funding and settle on the property, the Developer will have the right to keep your deposit and pursue you for any other costs incurred in rescinding your contract and acquiring another purchaser. Most banks will provide pre-approvals so that you can have more certainty around access to funds. However, pre-approvals are generally issued with 3 to 6-month expiration terms, depending on the lender. After this term has expired, the banks will re-assess the application based on their usual criteria. If you have lost your job within this time and cannot service the loan, you again risk losing your deposit and more. It is also possible for your bank to simply

change their borrowing criteria at any time prior to Title Registration, rendering you unable to source funds to complete.

- If you have signed an off-the-plan contract and paid your deposit, you need to make allowance for the bank valuation to come in lower than what you have paid for the property. Low valuations are quite common, particularly in uncertain markets. If you do not have enough funds to make up the shortfall, again, you may find yourself in a position of not being able to settle. Allowing for equity and serviceability buffers when obtaining borrowing capacity or pre-approvals is crucial when purchasing any property.
- Sometimes you do not get what you expected when buying off-the-plan. The images in the glossy brochure may not look anything like the finished product. This risk can be reduced by researching the Developer's and the Builder's reputation, visiting completed developments by the same Developer, and getting professional industry feedback. Someone experienced in this area can often reconcile the inclusions with the images or may be familiar with other work by the same Builder or Developer.
- There are additional risks if you purchase the land first and contract a builder to complete the house/dwelling. These include; being unable to negotiate a fixed price on the construction; delayed time frames; providing a larger deposit; having to make mortgage payments on the land and construction but having no income until the construction is completed and tenanted; and having the stress of making decisions about design, inclusions, landscaping etc.

Nexus has assisted many clients with off-the-plan property transactions over the years without a hitch; however it is essential to be aware of the risks. As you can see the risk reduces as each of the above critical stages are reached, and the risk/reward trade-off will be different for every investor's circumstances.

2. **Flooding or overland flow -** Is the property affected by flooding or water run-off? Check the area flood plan provided by Council. Some City Councils provide interactive 'Flood Awareness Maps' on their website.
3. **Neighbouring developments -** What is the zoning in the area and are there any large-scale residential projects planned to be developed near the property? This competition could have an affect on your expected rental return. A future neighbouring development may also obstruct your property's view or aspect.
4. **Infrastructure projects -** Are there any proximate infrastructure projects that may affect the liveability of the property? Any longer-than-usual vacancy periods need to be allowed for in the cash-flows.
5. **Development Application approvals -** If it's a new build, does the Vendor have development approval? Often, we see property developers selling projects before they have approval and frequently end up having to change the price or the floor plan after you have gone to contract because Council impose an unforeseen requirement. Many off-the-plan sales contracts allow for these changes to occur without an opt-out for the purchaser.
6. **Building inspections -** If the property is new, it's likely that significant structural defects are covered by a legislated warranty scheme and non-structural defects will be covered for a period of up to 12 months. These time frames differ from state to state. However, regardless of the age of the property, I would still recommend having a building inspection completed before taking ownership.

7. **Subsequent ownership -** Has the property been previously purchased? From July 1, 2017 depreciation on fixtures and fittings cannot be claimed as a tax offset if the property has been owned by anyone other than the builder/developer. It is important to know if the Developer has transferred the property into a family members name or into another entity such as a company or family trust before selling it to you.
8. **Existing leases -** If the project's completion date was greater than six months prior to your purchase, and the property is tenanted in the meantime, depreciation on the fixtures and fittings will not be claimable against your income tax.
9. **Tenancy risk -** In addition to insuring against fire, flood, natural disaster etc, you should also ensure that you obtain landlords insurance to protect against tenancy issues.
10. **Inflation -** Another not so obvious risk is inflation or opportunity risk… the risk of not being invested for one reason or another. Some people wait years even decades to pay down their mortgage before getting serious about investing and sacrifice many years of growth because they thought they weren't in a position to get into the market, when professional advice may have suggested otherwise. If you're not sure if you're in a position to invest, talk to a Mortgage Broker or Private Wealth Manager and don't just rely on what your bank manager says. If you're not invested, then it's likely that inflation is eating away at the value of your savings.

Chapter 5. Common Mistakes

According to RP Data, 73% of all property investors in Australia have only one investment property in their portfolio. That's quite surprising, isn't it? And 91% of property investors have two or less properties in their portfolio. This suggests that less than 10% of Australians are experienced property investors, which is why I am passionate about education and regulation in this area.

Often people fail because they've made one of the following mistakes. These are the most common and significant mistakes made by property investors:

1. **Not running cash-flow models.** As mentioned in chapter two, the actual holding cost of a property is not that easy to calculate, and many people underestimate the ongoing costs of holding property. It's also essential to model cash-flow projections that include movements in interest rates, vacancy rates, and changes to employment or lifestyle expenditure. I also recommend obtaining a quantity surveyor's report and PAYG tax variation (to smooth out the lumpiness in cash-flow that can be experienced when owning an investment property) if appropriate. Finally, it's crucial to allow for financial buffers. These omissions are very common for inexperienced investors and can have devasting consequences to the would-be investor.
2. **Mistaking growth for capital growth.** Often clients ask me about booming city fringe areas. These areas often exhibit a lot of the growth attributes that I mentioned in chapter three. There's usually enormous population growth in these areas, as well as significant infrastructure spending, essential services, and even lifestyle amenities. These are all important demand-side growth attributes. However, there's often enough land in these areas to supply subdivision for the next 50 years or so. Remember, you need both **high demand** and **restraint of supply** for anything to go up in value.
3. **Buying in an area you know.** Often people confine their property research to the few suburbs around where they live or perhaps their favourite suburbs. As demonstrated in chapter three, if they sacrifice just 2% of growth because they've ignored superior suburbs, then on a $500,000 property over twenty years, they may be sacrificing over half a million dollars of profit.

There's an entire nation of opportunity out there, don't limit your investment options.

4. **Believing profits are made in the acquisition phase.** You can spend your weekends going to every auction and every open house, reading every real estate magazine, trawling through the internet, and negotiating your hardest, and if you're successful, you may be lucky enough to buy something tens of thousands of dollars under genuine market value. But again, if you've sacrificed just 1% growth to achieve this, then you may be denying yourself of hundreds of thousands of dollars of profit over the long-term. If you're following a buy-and-hold strategy, you're better off paying fair value for investments with great growth attributes than you are paying a discounted rate for an inferior asset.
5. **Buying property for the fringe benefits.** If you've ever had thoughts of buying an investment property near the beach because you'd like to stay there a couple of times a year and perhaps even retire there one day, you're not alone. Many people try to combine lifestyle choices with investment choices. But frequently, the times you would like to stay at the beach are also the peak earning times for your investment property. Holiday rentals also have high maintenance costs due to the large number of tenants and will often require a revamp every few years. It's likely that staying in luxury hotel or an Airbnb will be a lot less costly in the long-run. And when you eventually retire, you'll probably want something bigger, better or less lived in anyway. Another example of buying for fringe benefits is acquiring expensive real estate for status or boasting rights. If you simply view your investment properties as boring money-making boxes and do not base your decisions on personal reasons, then over time, you may accumulate enough wealth to retire to any beach-house or penthouse you desire.

If there's a fringe benefit associated with any investment, be assured it is dragging down the overall performance. It's best to keep lifestyle decisions and investment decisions separate.

6. **Getting emotionally involved.** A property may sell for more than you think it's worth and it may rent for more than you would pay. And that's because there's obviously a market for it, and given the money involved, property markets are quite sophisticated and efficient (price accurate). It may not be the type of property you would want to live in, but you don't have to live in it. On the flip-side, don't think you see some charm or potential that the market doesn't see. This charm is already priced in. Investment decisions should be based purely on the numbers and not on your personal biases towards property. My experience is that it's very difficult for first-time investors to walk away from an investment property that they've fallen in love with, even if the numbers don't stack up.
7. **Misinterpreting statistics.** Statistics are often misused and it's important to look behind the numbers to see who's quoting them. Often, long-term increases in property prices can seem impressive in isolation but pale in comparison when held up to just average compounding investment returns.

   When it comes to metrics used in measuring property performance, you'll often see **'median growth rates'** used as a measure of price increases. There's a couple of things the investor needs to be aware of when assessing this metric. Firstly, the word median refers to the middle not the average. For example, if only five properties were sold over a specified time period in a specified location, then their median value would be the price of the third (middle) property and not the average price. This can distort real returns where there's only a small amount of data available.

But that's not the main problem with using median growth rates. The big issue with how this value is calculated is that it's measured on the **value** of properties **sold** within a particular **timeframe**, usually annually. Let me give you a couple of examples of how this may give a false impression of genuine growth.

When new satellite suburbs pop up on the city fringes, first home buyers may start buying/building small, low-set, low-cost dwellings. And as time passes and more homes are built, shops, amenities and other infrastructure is invested in taking advantage of the growing population. Consumers and speculative builders become progressively more confident in the suburb and begin spending more on **new** homes. Before long you'll see two-storey houses and the occasional mansion pop up. Because people are now spending more on new homes in the area, and the fact that median values are measured on **sales at a point in time**, means that the medians are much higher in the later years of the suburb's development. This translates into large upward trends in median growth rates for these suburbs. However, it doesn't mean that those who bought cheaper homes in years before are now getting much more for their homes when they sell. It just means that the market is now spending more on larger new homes in the area.

Let's look at another example. A luxury apartment project is constructed in an expensive suburb, consisting of large penthouses and million-dollar views. In the years following, only smaller projects consisting of one and two-bedroom apartments, with inferior aspects are constructed in the same suburb. This of course will translate to a large drop in apartment median growth rates for that suburb in the years following the prestige development. Given the small number of apartments and townhouses sold in any one suburb each year, median growth rates are poor indicators of real price growth for these dwellings. Median values are only one tool used in assessing property performance and shouldn't be used in isolation.

8. **Not comparing apples with apples.** Just to take our example of median growth rates a bit further, it's important to make sure you're comparing apples with apples. You'll often see median growth rates quoted for apartments and townhouses one or two percentage points lower than that of houses in the same suburb, when assessed over long periods of time. But quite often the average house price in any given suburb will be twice the price of an apartment in the same suburb. If we were to spend the same amount on an apartment, as we were a house in the same suburb, we would no doubt be able to purchase a luxury apartment. Of course, luxury property usually achieves the highest growth rates of all residential properties. Conversely, if we were to only spend on a house what the average apartment cost in that suburb, well it would probably be falling down, or at least require significant spending. So, clearly comparing apartment growth and house growth in the same suburb is not comparing apples with apples, particularly in inner suburbs where average house prices are very high. For any set price, you will generally have to compare an inner-city apartment to a mid-ring townhouse to an outer-suburb house. Consequently, the mix of capital, cash-flow, property type, and investment strategy is quite unique to each investor.

9. **Listening to media commentary.** I think it's fairly well accepted now that there's very little real news. Most media today is judged on the amount of views or clicks it receives. It's also well researched that fear and bad news attract far more attention than good news. As an investor, if you reacted to all market commentary, you would be buying and selling every day and destroying your wealth, or you would never invest at all. A long term 'buy and hold' strategy usually provides the best results, but it does take a lot of nerve to stay calm when it seems everyone is telling you you're doing the wrong thing.
10. **Following someone else's strategy.** We discussed strategy in the first module, and I hope what you got out of it was that everyone is different. We all have different incomes, liquidity requirements, risk profiles, goals, time frames etc. So, it's impossible for someone to know you what's right for you unless they have conducted a thorough analysis of your circumstances and are experienced in these matters. Friends and family may be well-meaning, but it's unfair for them to overlay their experiences, good or bad, onto you. A lot of times they will be telling you what they think is good for them – not for you. But remember it's never a good idea to take someone else's medicine.

11. **Believing the value is in the land content.** One of the most common beliefs held by first-time property investors is that "the only component of a property to rise in value is the land content", sighting that "the building itself depreciates in value". This is a complete myth. The logic appears sound but is an over-simplification often used by those selling house and land packages on the outskirts of the city. The truth is that it's not the land or the building – it's simply the location or opportunity to live or invest somewhere (supply and demand), that causes price rises. If it were only the size of the land that dictated prices, then tiny one-bedroom apartments in the middle of London and New York wouldn't be selling for over $5,000,000, and all the land in the middle of Australia would be worth a fortune.

12. **Getting the ownership structure wrong.** If you were going to purchase only one investment property in your whole life, based on the tax treatment alone, it's likely that it should be purchased within your superannuation. This depends on many things, of course, but I'm simply making the point that the tax treatment on investment properties will have a considerable impact on the long-term financial outcomes. Using self-managed super funds, or discretionary trusts, or even holding title in the name of highest income earner within the family, can make a big difference to the mathematical outcomes.

13. **Structuring debt incorrectly.** Debt funding and structuring would be the most common area where mistakes are made. It is certainly a topic that is worthy of more than one paragraph. So, we have created an entire guide for investors. You can download our e-book 'Advanced Debt Management Strategies' by clicking on the link below for more information on this topic.

14. **Turning the old home into an investment property.** Many families that are in a position to upgrade their family home elect to turn their old home into an investment property. They reason that one transaction achieves two of their goals (upgrading and investing). Sometimes the emotional connection with the original home factors into their decision, yet this can be a costly mistake. By the time most people come to do this, the old home often has a low amount of debt attached to it and the new dream home would usually require a much larger new loan. In this case the total debt becomes mostly non tax-deductible, or bad debt, that being against their new principle place of residence (PPR) and the good debt, the now tax-deductible debt on their old home, is comparatively low.

This is the opposite of what it should be. Investors should be trying to structure their affairs as to have as little non-tax deductible (bad) debt as possible. In addition, the old home will usually have very little if any depreciation to claim and being an older home will more than likely have high maintenance costs. It's also likely that their first home was purchased in a more affordable suburb in the outer suburbs and will not experience superior growth rates in the coming years. In this scenario, it is often better to sell the old home, pay down the loan on the new home using the proceeds, then re-draw equity to buy a new investment property, with high levels of debt, high depreciation, low maintenance costs, and in a high growth area. The emotional connection you have with your first home may cost you hundreds of thousands of dollars.

15. **Not having a risk management plan.** A structured risk management plan may utilise tools such as cash buffers, insurances, discretionary trusts, SMSFs, Wills and even testamentary trusts. All these things have inherent costs of course, but a well-structured risk management plan is essential and should simply be viewed as the cost of doing business when you're a professional investor. We all experience challenges in our lives, and without a contingency plan, your investment portfolio can crumble like a house of cards.

So, there are my **15 most common mistakes** made by investors when building a property portfolio. These are the things that contribute to the majority of Australians not having the financial capacity, and/or the appetite, to grow their portfolio beyond owning just one or two properties.

Chapter 6. Property Selection

If you're investing in property with a long-term view, then there are many things to consider, as discussed in previous modules. But before you start your search, it helps to narrow down the field and be sure of the type of property that is going to best suit your strategy. Of course, there is no such thing as a perfect property, and invariably, there is a trade-off of attributes that we all must consider when selecting what's right for us.

The four areas of compromise are:

Budget | **Location** | **Affordability** | **Type**

For most people the budget is fixed and is often dictated by how much the banks will lend them, what their asset allocation or diversification plan is, and what their financial goals are. Although, budget may be less of a consideration for the cash rich yield seeker.

It's well accepted in the property industry that location accounts for approximately 80% of the total returns of an individual property. Therefore, location may not be something you want to compromise on very much if you're a growth seeker.

The next area is the affordability. Whether you're a yield chaser or growth seeker, you need to ensure you calculate your holding costs correctly after allowing for all expenses. Of course, yield chasers will be looking for the highest yields they can find and need to have a long-term plan for their ongoing capital requirements. Some growth seekers will not want the prospect of owning an investment property to impact on their lifestyle, while others can afford to be deeply negatively geared. Remember, yield and growth are often trade-offs in themselves.

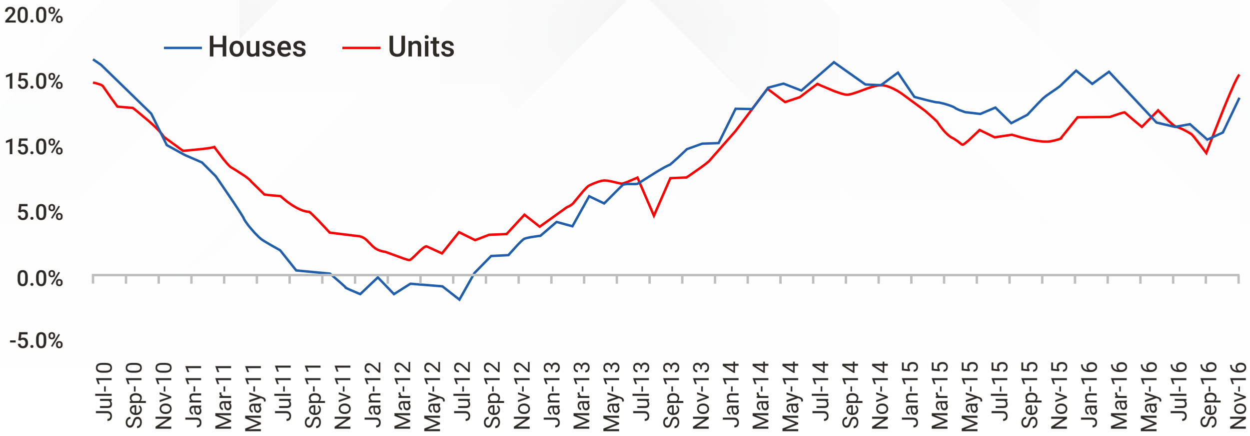
Which brings us to property type. Traditionally, commercial properties pay very high yields but their growth more closely follows the consumer price index, which is quite low compared to residential property. Commercial, Industrial, and Retail investors also need to allow for the possibility of expensive fit-out costs and long vacancy periods. These properties can be quite capital intensive and are often more suited to yield chasers who have plenty of capital and liquidity, merely looking for income replacement with no intention to sell (with assets passing to their estate beneficiaries). Serviced apartments, student accommodation and holiday homes also have high gross yields and lower growth rates, but the maintenance costs are the things to watch out for here. Over the long-term these properties will also usually require significant capital expenditure.

Residential property on the other hand usually has a more balanced yield and growth trade-off with less of a need for large capital expenditure. The choices in the residential market are generally luxury homes, houses, townhouses or apartments. Choosing between these property types is often an area of confusion for Growth Seekers.

For instance, luxury homes tend to have the highest growth rates out of all of these, however, their yield is usually quite low. So, unless you have a large budget to start with and are happy to fund the negative cash-flow, they may be unaffordable.

For as long as I can remember there has been a belief that houses provide better returns than units. However, data provided by Core Logic on total returns of houses vs units from July 2010 shows that while they may perform differently at different times, the long-term trends are very similar. There is very little evidence to show any difference in total returns between houses, townhouses, and units when measured at specific price points. As a general rule, apartments tend to achieve higher rental yields than houses, which achieve higher growth rates. However, the overall returns are similar over the long-term.

Combined capital city annual changes in total returns for houses and units (Graph)



Source: CoreLogic RP Data

For many investors, their budget and cash-flow requirements are relatively fixed, which means the compromise will be between location and property type. We all would love to achieve the high long-term growth rates that some of Australia's best blue-chip suburbs have achieved – think Vaucluse, Toorak or New Farm. But the truth is – as investors most of us just don't have the financial resources to buy and hold onto a big house in one of those locations. The next best thing might be to achieve slightly lower growth (but achieve a better yield) by investing in an apartment or townhouse in a great suburb – rather than a big house in a suburb that has historically achieved sub-standard growth rates. This decision is uniquely personal as you may have to endure many years of second guessing your decision before realising a profit.

It is important to be clear of your strategy, be unemotional about your choices, resilient in times of economic uncertainty, and stick to your strategy. This discipline will help you build a substantial property portfolio over time.

Chapter 7. Bringing It All Together

In chapter one, we talked about the various property investment strategies categorising them into four groups being the Flipper, the Developer, the Yield Chaser, and the Growth Seeker. In a nutshell, the strategy that's right for you will depend on your age, your financial position, your appetite for risk, and the personal time you're prepared to devote. This further divides the strategies into being relevant for either speculators or investors. With investing being our focus, we switched our attention to the things that are important to both Yield Chasers and Growth Seekers.

In chapter two, we showed how to calculate holding costs and highlighted some of the longer-term capital expenses to allow for when calculating total return on investment. We also drew a comparison between the yield strategy and the growth strategy, with the observation being that if you can hold onto your investments for at least one market cycle, then focusing on properties with high growth prospects will usually provide a better total return on investment than focusing on high yielding properties.

In chapter three we acknowledged that location is responsible for the majority of the growth in property and we discussed some of the important facets of location being employment, transport, schools, hospitals, and lifestyle amenity. We also looked at other growth drivers, such as point of difference, and certainty of future income. We attested that forgoing even small percentage points in growth to achieve other goals, such as staying in areas you're familiar with or buying distressed property, can have a significant adverse effect on your long-term returns. Growth is essential when borrowing is involved and is the primary objective of most wealth accumulators.

In chapter four, we explained how to assess the risks. Of course, not all risks should be avoided altogether. But it's prudent to understand the risks before taking them on. A good risk management plan should assess all risks associated with your property purchases and decide what risks to accept, what risks to avoid, what risks to outsource to a third party, and what risks to insure against. In addition to building and landlord insurance, it's imperative that every investor perform an assessment of their personal insurances, including life, TPD, income protection, and trauma insurance. Appropriate levels of cover will see your investments achieve the desired outcomes no matter what life throws at you.

In chapter five, we explored some of the myths surrounding property investment and common mistakes made, noting the lack of good information and advice in this area. It's not surprising to see why most Australians go it alone when trying to build property portfolios. With 91% of all Australians owning only one or two investment properties, I think it's fair to say that there is an enormous need for more education around property investment. Improvements here will help the entire economy.

And in chapter six, we looked at the property decision matrix and the compromises that all investors must make. Every property exists somewhere on the spectrum between high growth and low yield, and low growth and high yield. Meeting the net yield requirement for your first and subsequent properties must be the priority before chasing growth. But when it comes to growth, it may be more sensible to sacrifice on property type than to sacrifice on location.

There are several other things to consider when looking at your property investment as a portfolio and not just a single acquisition.

Firstly, diversification is important when building a property portfolio and it's best to simply diversify by location rather than changing property type and therefore, your overall strategy. I would generally not recommend buying more than one property in any particular suburb and while it may be practical to have your first few properties in your home city, I'd be looking at alternative cities as your portfolio grows.

Many property investors are staunchly property only, however, building a share portfolio with surplus income as you build your property portfolio allows you to participate in the growth of other markets as you're waiting for property equity to build. If you are bullish about property, this can help you acquire your next property sooner. The ability to sell down shares quickly means that they can also act as buffer in case you run into cash-flow problems.

Having access to an alternative asset class will smooth out the volatility associated with being invested in a single market. We know that residential property markets can often go sideways for long periods of time, so having exposure to other markets can help with your overall growth and income strategies. I would highly recommend getting professional advice from a qualified financial planner when it comes to putting together a share portfolio, or even if shares are appropriate for your circumstances.

Having a well-conceived funding plan is very important if you want to get serious about building a property portfolio. Some of the biggest mistakes I see in this area come from not structuring the debt correctly. If you're still paying off your own home, it's important to ensure that as much of your debt sits against your investments and not against your home. This is because the debt on your investments is usually 100% tax-deductible whereas personal debt is not. Mistakes in this area can result in paying tens of thousands of dollars in unnecessary tax. It's also important to understand how the various banks assess your borrowing capacity. There can be enormous differences from bank to bank in what they're prepared to lend and what security they're prepared to accept. As your portfolio grows, the income or yield from your investment properties will also play a role in calculating your serviceability. You may be in a position to be deeply negatively geared when buying your first property, but this could limit your ability to acquire multiple properties. A good mortgage broker, who has access to the majority of lenders, is essential when building a property portfolio.

Tax planning is also an important part of building a successful property portfolio. Again, this may not be difficult when purchasing just one property, but it gets more complicated when acquiring multiple properties. A financial planner or accountant will be able to ascertain whether you should purchase your properties in your name or your partner's name or in joint names or whether the use of a discretionary trust or custodial trust is more appropriate. The ownership structure can have a significant effect on the tax payable and therefore, total returns.

Finally, running cash-flow projections will ensure you can afford to hold onto your properties and not be forced to sell before they've made a profit. The key things to remember here are to:

1. Calculate the net holding cost correctly and utilise a PAYG tax variation if appropriate.
2. Allow for changes in interest rates - modelling a 2% increase in rates should be enough but possibly more if this makes you feel comfortable.
3. Allow for changes in future income if you're intending on having a family, moving to part time work, having a career change, or starting a business.
4. Allow for future personal capital expenditure requirements like renovations or upgrading the family home, buying new cars, holidays, children's education etc.
5. Allow for insurance premiums to protect your family and your investment plans.

A good long-term financial plan will help with these things and keep you on track. Property investing, when done well, is not a simple process and is very specific to the individual investor, which I'm sure you can appreciate by now.

Final Note:

According to RP Data, only about 10% of all Australians even own investment property and only 2.5% of the population own two or more properties. So, I would encourage you not to take advice from friends, family or the armchair experts. Do your own research and get help from a professional.

Nexus Private Wealth Management can help you with as much or as little of the process as you require. This could include creating strategy, running cash-flows, setting up trusts, investment research and due diligence, finding and acquiring properties, implementing insurances, providing tax and SMSF advice, mortgage broking, and estate planning.

Having all of your financial services under the one roof saves you time, money, and paperwork.

From all of us at Nexus Private Wealth Management, thank you so much for reading. Please consider sharing this guide with your friends, family, or colleagues. Best of luck with your property journey.

Additional Resources:

Please click on the images below to download Ebooks from the same author:

Investment Fundamentals

Investing in Property Using Superannuation

Advanced Debt Management Strategies

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