

Building property riches

FROM SCRATCH

Starting an investment portfolio is something practically anyone can do, but it takes solid strategy and research – as well as confidence – to be able to jump in and go for it. *Kit Kadlec* reports on the important first steps in part 1 of a two-part series

Surely if you wait a little longer, the property market will be better and your job more secure. The timing is just too uncertain right now.

This attitude is one many Australians share, but it's usually not the right strategy, says Jan Somers of Somersoft Financial Services, and author of numerous property investment books.

She likens the mentality of starting an investment portfolio to that of buying the latest electronic device.

"It's like waiting for a digital camera to come down in price," she says. "It's going to get cheaper every year – and you'll end up with no camera if you keep to that strategy."

Housing prices in Australia won't go down forever, but there are always going to be reasons why the next time might be a better one to jump in.

"Property is one of those things you can't wait for," she says. "You can't say you'll wait for a better time because you don't know what that better time is."

Yes, one could look back a year earlier and think it would have been better if they'd waited. But that's hindsight, and nobody can ever predict exactly when the best time to buy property is. Few could have pinpointed the timing of the current global economic situation, for example.

"My recommendation is to get into the property market, bite off more than you can chew – and just chew very hard!" says Somers. "You've got to get your feet wet. It's no good sitting back and saying: 'We've got to wait for better interest rates or a better-paying job'."

There's no time like the present, agrees Paul Do, author of *I Buy Houses: The Property Investor's Handbook*. Property prices are down and so is confidence in the market, but that's even more reason to consider buying now, he says.

Investors are actually better off buying when others aren't, he adds. Lower prices mean there are opportunities to make larger gains when they rise again.

"Unfortunately, in these down periods, most people shy away from the market," he says. "The novices tend to get interested in the market only when it's booming."

First step – getting financed

Although almost anyone can get into property investing, it does require that you at least have some money or assets to get you enough credit with a lender.

For some people, like middle-aged or elderly couples, this can be easier as they probably own their own home. That equity can be used towards borrowing for a purchase, as can any savings they've accumulated.

For buyers starting out and without any property already in their name, it's a little trickier, but far from impossible.

"They're clearly going to need a deposit – there's no way you can get around that," says Somers. "You simply must have one."



Some banks were previously offering 100% loans, but that's rarely seen any more. At best, some allow for a minimum of a 5% deposit, although many others might demand 10% or even as high as 30%.

"It depends on the bank, on timing, and who you talk to," says Somers. "They really do have upper, middle and lower 'drawers' depending on how you present your case."

for properties you can't afford, he says. While pre-approval offers no guarantee you'll get the loan, it can give you confidence and a general idea of what you can borrow. This is especially important when considering buying at auction.

The financing aspect can also cost more than you've originally budgeted for. Make sure you include those added extras when buying a

» "From the day most people decide they want to buy a property, they can almost afford it. It's more just convincing themselves that they can"

Do says that even if you're able to get 100% finance from a bank, it's usually not something you'd want to do.

"It's very risky, so there's low security in doing that," he says. "Some novices look for short cuts and it ends up costing them more – experienced investors never go for the short cut."

Do advises not even bothering to make a serious search for a property until you know what your borrowing capabilities are. Get pre-approval from your bank. There are also tools online – such as the online calculators provided at the *Your Mortgage* magazine website www.yourmortgage.com.au – that you can use to calculate how much you're able to borrow.

Not doing this could lead you to completely wasting your time searching

property – like legal fees, research, mortgage insurance, stamp duty and more. They can amount to 11% of the property purchase price.

Also find out about council fees, strata fees, body corporate expenses and property management fees. An accountant can help you figure out negative gearing and capital gains tax. And never leave your budget too tight. Save some cash on the side for any future maintenance or repairs.

From there, you should consider how you want to structure your mortgage. If you're looking to invest, it can be beneficial to take on an interest-only loan and maximise your cash flow.

It may all seem a bit daunting, but a good way to get help is to seek

Young investor mistakes

Jan Somers – of somersoft.com.au and author of several books on property investment – says there are numerous pitfalls for those new to investing. Here are some of her tips:

X Avoid your credit line for unnecessary personal expenses – Once you've secured a loan and built up a credit line, it's often tempting to tap into it for vacations, cars etc.

"I've seen people use credit lines and get themselves in quite a mess," she states. "You're supposed to draw back only the absolute minimum you need for whatever expense crops up, but that often doesn't happen."

X Don't think you can renovate yourself if you don't have the skills – Investors often look for cheap properties they can fix up. But don't count on major renovations being done cheaply if you don't have the know-how and experience. "It's a very good strategy for some people, but it doesn't work for everyone," she warns.

X Don't believe interest rates will stay this low forever – Somers says that in the past 30 years in Australia's property market, she's seen plenty of movement – up and down – with interest rates, so don't get complacent.

"Every time you buy something, you've got to knuckle down and secure what you have," she says.

X If you buy something speculative, use only a small portion of your asset base –

Somers admits something on the speculative end, like a holiday rental property or a place in a mining town, can pay off – but you should never wager too much on it.

"Because it's speculative, there are huge gains to be made, but also huge losses," she adds.

X Don't be stingy – Maintain your property well.

"You can't expect tenants to live with torn curtains, hotplates that don't work or a dirty carpet," Somers declares.

To make a bigger profit, you must be willing to spend some money when you can, she adds.



out another investor as a mentor. As the case study here demonstrates, surrounding yourself with like-minded people gives you important support.

Starting early

For young investors without much savings, sometimes it's up to parents to help out. This might entail lending a deposit, or using the equity in their home to secure a loan. But that option isn't for everyone.

"That's a family issue to be sorted out," says Somers.

Parents or other relatives could also help you start out by offering free accommodation or reduced rent at their place as a temporary place of residence.

"Buying your first property as an investment is a great idea," says Somers, "but only given that you have cheap rent somewhere else." It might mean boarding at home with parents, or sharing another rental property with others.

Such tactics aren't usually necessary for those potential investors with more savings, however. Most people with a stable job and some savings are surprised at how easy property investing is for them. It's often daunting to consider such a huge purchase, but once past that stumbling block, the rest is usually smooth, Somers says.

She recommends investors use something like property investment analysis software to gain confidence. You can ask it questions like 'what if I need to paint the property and recarpet it in five years?' or 'what if it's vacant for four weeks of the year?'

All kinds of other calculations can be thrown in too.

"There are umpteen variables you can calculate," says Somers.

The program usually ends up providing them with the confidence they need to go forward.

"From the day most people decide they want to buy a property, they can almost afford it," says Somers. "It's more just convincing themselves in their mind that they can – and most people are surprised that they actually can do it."

Different mentality

Younger buyers may just need the confidence that they can, in fact, finance a jump into the investment property world. For older Australians, it's all in their head, says Somers.

"For an older couple or someone who already has their own home, the biggest stumbling block is mental," she says. "They've probably grown up with the idea of superannuation and other funds."

But Somers points out that as the share market and superannuation have fallen dramatically in the past year, she wouldn't be surprised if some older couples were now considering property investing for the first time.

"They've already got an investment base," she exclaims. "They can simply walk out the door and borrow with that equity."

But these potential investors have already grown accustomed to a comfortable lifestyle, and property investing might not be the easiest thing to convince themselves to do.



Securing his financial freedom

Peter—Casual teacher/DHA property investor

When Peter moved from England to Western Australia in 1997, he never thought he would become a property investor.

In 2001, Peter came into \$30,000 inheritance which he used to buy his first Defence Housing Australia (DHA) property—today he owns six.

"Living in a remote area, I wanted a property investment strategy that didn't require hands on management. I looked at other property investment options but decided DHA was by far the safest option for me, says Peter.

"DHA property investments work because they are hassle-free, the rent is assured and the lease is secure.

"The long term lease gives me the confidence I need to hold the property and achieve as much capital growth as I can."

"I get great satisfaction from my portfolio; my aim is to build a significant property portfolio, sell some off when the lease expires, and live off the income."

This strategy has been so successful that Peter has been able to give up his permanent day job to pursue full time property investing.

"DHA investments are something I believe in, I have no hesitation in recommending them to others."

If you want an investment strategy you can believe in, contact DHA today.

**Call 133 DHA
Visit www.invest.dha.gov.au**



Case Study

Wealth creator



“They have a huge financial advantage,” says Somers, “but perhaps a considerable psychological disadvantage.”

Getting over that hurdle, however, often comes down to just gaining the confidence in property investing by educating yourself in seminars, books and talking to experts – or even other investors. As Somers herself experienced, confidence can be gained by doing the research, adding up the numbers and weighing it against other options.

Tax and capital growth

Paul Do says tax should be investors’ last consideration, but it’s an important one nonetheless. Capital gains, land tax and possibly GST are all factors that need to be understood.

An important point to remember is that you’re only taxed on capital gains if you sell your property.

“Investors like Warren Buffett have achieved huge returns over the long term because they bought capital growth assets,” says Do. “You should be buying high capital growth properties – and never selling.”

If you buy high rental yield properties, though, you’ll be taxed on the rent.

The luxury of that option, however, might depend on what your financial situation is. Somers says if you have a low wage and savings, you really need to sacrifice growth and go for yield, but the opposite is true for those with a well-paying job. With that in mind, she adds, you should select properties accordingly.

For more information on other tax matters, check out the tax section in this magazine. It usually comes down to personal circumstances, so seek out a property accountant for help.

Before any property purchase, it’s crucial to understand the tax issues first, otherwise it could end up costing you later.

Following this general introduction, in the next issue we’ll be exploring some of the next steps required to start your property portfolio, by going into greater detail on the strategies and decisions of how, when and where to make your first purchase – or purchases. ■

John Webb started out with a high-income job in IT. He worked hard and it paid well, but he told himself it wasn’t something he would be able to do his whole life. The question was – how could he find a different way to make money outside a salaried position.

“In my 20s, I was happy to push my career hard,” he says, “but I knew that my priorities would change as I got older.”

Then in 2000, aged 32 and renting a flat in Bondi, he got an idea from a book that would ultimately steer his life in a new direction. The book was Robert Kiyosaki’s *Rich Dad Poor Dad*.

“The book introduced me to concepts of wealth I’d never known,” he says. “I come from a poor background so neither my parents, family or friends had any idea about wealth creation.”

One particular idea the book left him with was that wealth held income-producing assets. With that thought, Webb decided the most appealing asset class to him was property.

“It felt tangible to me, easier to understand – and safer,” he says. “Suddenly, I had a goal, a strategy. I would continue with my career, but with the aim of building a property portfolio that would eventually replace my day job.”

Starting slow

Rather than jump right in, Webb took a couple more years before he made his first purchase – two house and land packages on the Gold Coast.

In the time in between, he did research and gained some confidence.

“After reading Kiyosaki, I had the ‘what’ to aim for, but not the ‘how,’” Webb says. “So I spent the next two years buying as many property books as possible and learning how to do it.”

He found that while the approach was always different, they all had a common theme – it is possible to achieve wealth and financial freedom through property.

“That time was well spent. I needed to convince myself that building wealth with property was possible,” says Webb.

He used a nest egg saved from working overseas to buy the first two properties; one was for \$234,000 and the other, \$297,000.

“I liked the idea of buying houses as opposed to flats, and two brand new houses in Queensland easily trumped one flat in Bondi,” Webb laughs.

He borrowed 80% of the purchase price for both properties and paid the balance in cash. Even though it was a major purchase, Webb says he didn’t feel too overwhelmed by the process at the time, because he was well prepared – and confident.

“By then, I knew buying property was the right choice,” he says of his calm demeanour at the time. “Perhaps it helped that it all seemed so surreal. I was signing my name against purchases of half a million dollars in one go – it just seemed so absurd,” he recalls.

“I’d never have dreamed of such a thing happening. I’d wanted a new direction – and got it in spades.”

From that point on, Webb says, he was able to look at his property purchases in more abstract terms.

“I went about my day hardly thinking about it,” he says. “I just put my trust in the process. Nowadays, I’m quite comfortable dealing with such large amounts.”

Some parts of the buying process are still a bit challenging, and frustrating too, he finds.

“It was a whirlwind of legalese and paperwork,” says Webb, “and with each new purchase, that frustration doesn’t seem to abate.”

Success breeds success

As it turned out, Webb bought at an opportune time and in a good location. But he admits it might not have worked out so well without a bit of luck, too.

“Looking back with the benefit of what I know now, I’m amazed that things did come out the way that they did,” he says. “Basically, my first efforts were ‘dumb luck.’”

After the first ones, he went on to build a portfolio now valued at \$2.25m, including a couple of mining properties in Western Australia and Queensland, and his own residence, which is a fixer-upper on a large block of land 10km from the Sydney CBD.

While property investing takes some effort, Webb says it has definitely been worth it for him. And, when asked for tips to new or potential investors still on the fence, he simply says: “Start now!”

“Get educated, go to seminars, read books, and seek out other property investors who can point you in the right direction,” he says. “Learn as much as you can about property investing. Then back yourself and have a go of it yourself – do it first-hand.”

“Property investing is a process. The destination should be financial freedom, and a property portfolio simply the vehicle to get you there”

He also suggests looking at property investing as a process, rather than a destination. Instead, the destination should be financial freedom, and a property portfolio simply the vehicle to get you there. Webb says it’s that philosophy that has made it easier for him to deal with such large dollar amounts, and to broaden the range of properties he might not otherwise have looked at.

Investors should also beware of getting too emotionally involved with their purchases.

“Learn to turn off [your emotions] and focus on the task at hand,” Webb advises. “They can affect your ability to take action, and it’s the first action – the first step into anything new – that’s the hardest.”

■ JOHN’S PORTFOLIO	
Property	Current value
PPOR	\$520,000
Gold Coast	\$420,000
Gold Coast	\$470,000
WA	\$570,000
Qld	\$270,000
Total	\$2.25m

With practice, however, that process gets easier.

Finally, Webb says that surrounding yourself with like-minded people is crucial.

“To me, this is paramount,” he says. “Because I have no one in my family or social circle who knows about property investing – or is even interested in it – I find it’s easy to take my eye off the ball. But being among a group of fellow investors keeps me attentive and focused on my goals.”

Planning ahead

Of the immediate future, Webb says, he’s looking to settle on a block of land

with a view in Western Australia, and putting a house on it. He could then sell it, eventually, to finance rebuilding his own home. He’s also looking at buying in Queensland to develop units.

An overall goal of his is to have 10 mortgage-free properties, but he’s already been warned by other investors that once he gets there, he may not want to stop. Nevertheless, Webb says he’s happy with where he’s at – although, looking back, he wishes he had started earlier.

“If I’d started in my early 20s, I’d be at my endgame by now,” he grins.

Webb also regrets passing up some earlier deals he wasn’t sure about at the time. Rather than timing, he says, the key is to find good properties where the numbers stack up. ■