

Building property riches from scratch *Part 2.*

Starting an investment portfolio is something practically anyone can do. But it takes some solid strategy and research – as well as a bit of confidence – before you can jump in and go for it. In the second part of the series, *Kit Kadlec* reports on the next steps you need to take when building up your portfolio

In the first section of this two-part series, we detailed the strategies and preliminary approaches you need to take when starting an investment portfolio.

Property investing is really something anyone can do, even with little or no savings, if you take the right steps and approach it soundly and smartly.

This section looks at what to do to put it all into practice after the financing

is secured and buy that first property – and turn it into a larger portfolio in the longer term.

Starting line

With financing in hand, the next step is to decide when to buy and where.

“There’s a time when some markets are strong and others are weak,” says Paul Do, author of the recently published *I Buy Houses*. “Before you buy

anything, you’ve got to make sure that the market is in the buying zone.”

Put simply, that means buy near the bottom of the cycle, when one can gain up to 20% in capital value over the long run compared to other times, he says. If you buy at the same time as everyone else and values are peaking, you can actually cost yourself about 20% of capital growth in the longer term, he adds.

Timing is a very important factor, as he highlights in his book. Don’t feel that you have to buy every year – there can also be periods of rest.

“During those times, you look at other states, or invest in the stock market and other assets,” he suggests.

Timing really can differ location by location. Sydney’s market is tipped by most analysts to be stronger than Perth right now.

But in the end, it comes down to your own situation and what you can afford. And first-time investors shouldn’t just limit themselves to areas near their current home because they know it best.

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“That could be a risk in itself,” Do says. “Say you live in a regional area, when it loses a key employer, you’ve got property prices falling from hundreds of thousands of dollars to tens of thousands.”

Diversity is more important, he says, but in smart areas – and mix it up a bit as well.

“If you put all your eggs in one basket, you’re setting yourself up for a huge risk,” Do adds.

The differences can vary vastly from state to state. Those markets that tapped into the mining boom of years past are now already declining or predicted to fall further by economists. Others less reliant, such as Sydney, could reap the benefits in the next coming years.

If the property is far away, should you go and see it? Some experts say you don’t need to, but you should always do enough homework to understand an area.

Do says you can hire others to do the building checks and inspections.

“It’s more important to know that you’re not overpaying,” he states.

Jan Somers, of Somersoft Financial Solutions and author of numerous property investment books, says she has bought many properties over the phone – and her children have too.

“In the early days, I would have leaned towards buying a property that was close by,” she says. “You don’t need to do that.”

The key is that you still have to do a lot of research if you buy in a distant location.

“Not that you go and buy anything anywhere, but when a good one comes along, that’s what you want to act on,” Somers says.

Apart from location, investors should also seek out a specific type of property. Somers says lately, she’s leaning towards something a bit bigger, like a four-bedroom with two bathrooms and a double lock-up garage.

“I think tenants’ expectations have risen, so they’re more inclined to say: ‘Well, if we’re going to rent, we might as well rent something that’s comfortable,’” she says.

Peaking too soon

That strategy might also have an impact on your choice of location.



“Clearly, with inner-city property, you’re looking for growth rather than yield,” Somers says. “For outer-suburban property, you’re looking for yield rather than growth. Property in country towns, other than mining towns, tends to have lower growth and higher yield, unlike the inner-city, which has higher growth.”

A strong yield can lead to enough profit to make your property positively

any more,” says Jo Chivers, director of Property Bloom in the Hunter, north of Sydney. “If you’re in a high tax bracket, it can be good to have a few of them, but as you move forward, it can be hard to keep buying them and you need to look for properties that are cash-flow neutral or positive.”

Running out of financing can be vexing to an investor who wants to keep buying – especially when the timing

» It’s really frustrating when your hands are tied because you’ve reached the peak of your purchasing power’

geared – essentially earning more than your mortgage costs, taxes, property management fees and other expenses.

A negatively geared property has more tax benefits, because you’re not actually earning income. Your net loss can then be used to reduce the tax payable on your other income.

Keeping some property negatively geared to offset your taxes can be a key benefit to consider. They might also be more likely to have strong capital gains, unlike the lower valued areas with higher overall yields.

But investors need to be wary of racking up too many that are negatively geared early on, as it can hamper further financing.

“Depending on your income, you can generally buy only a certain number of negatively geared properties before the lenders say they can’t service your loans

is hot. That’s why building up enough equity to keep moving forward is extremely important when building an investment portfolio.

“It’s really frustrating when your hands are tied because you’ve reached the peak of your purchasing power,” Chivers says.

So, in making that first purchase, you need to decide whether or not you want to live in it. One of the key reasons for moving in early on is that you’d qualify for government incentives as a first homebuyer – but to get them, you need to live in the property for at least six months.

But there are other factors to consider, especially if you’re not a first homebuyer. Your principal place of residence does not generate any income, so the expenses incurred are not tax deductible, Do says.

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On the other hand, investment properties do generate rental income, which is taxable, and therefore any costs incurred are tax deductible.

Using equity to buy and multiply

By definition an investment portfolio should be a collection of properties. So after the first one, you should be looking for ways to get the next – and then another.

But before you get too far ahead of yourself, plan it out. As discussed earlier, you need to get your financing in hand. Then, in the case of subsequent investments purchases, if you exhausted your savings on the first one, it will depend largely on the equity available.

Building equity can be done quickly, especially if you bought a property below market value – and that might be easier now than ever.

“It’s a buyer’s market, so if you can get a below-market discount on a property and prove it to the bank, that’s another way to create equity,” Chivers says, “and it’s a prime time to negotiate below the market value.”

This happens when you can offer a price lower than the property is actually worth – and come out a winner if the seller is desperate and looking for a quick sale. Show the bank that a similar home nearby sold for \$20,000 more over the same time, and you can tap that into your equity if it’s convincing.

The equity you build can then be drawn out and used as a deposit towards your next purchase.

Such instant gains might not happen though and you can also build equity with a property gaining value over time.

To find out when you’ve made gains in your property’s value, you need to keep up with what’s happening in the local and regional market. Check with your real estate agent or follow the numbers in publications like this magazine.

If you think you can take out another loan for a second property, you need to get refinanced. Chivers believes the key is to be prepared.

“Get a couple of local real estate agents to come to appraise it,” she says.

Compile as much information as you can about the value, such as the recent sale prices of homes nearby and a list of the features your property has. You can also list new industries in the area or infrastructure that could add to its value.

“Put all that information in so you’re maximising its value of your property, and therefore you can create more equity for yourself,” says Chivers.

Refinance when it counts

In a fast moving market, you could be refinancing every six months, she says. But don’t do it too much unless it will be of benefit to you, as the process comes at a cost.

“It depends where you are in a cycle,” Chivers says. “If you’re in a flat market, there’s no point in having it revalued.”

The key is to know when to do it, and that is when the market value is likely to have increased. How do you know? Look at the properties around yours.

“It’s best to keep refinancing as the market goes up and maximise

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the equity you’ve got in your property,” Chivers says.

Do suggests less frequent valuations, not even every year is necessary, he says. “You want to minimise your costs,” he says.

Overall, he suggests you need equity of about 20% of the property value to move forward with another purchase.

Other than gaining equity, you also want to make sure you’re paying the best interest rate and saving cost that way as well. That’s something that should be checked between six to 12 months, Do says.

Investors can also develop their existing property to gain equity. For example, if you bought a house with some extra land, you could add more value simply by subdividing, she says.

You could then add another dwelling. Or perhaps just add on to your existing structure.

Sometimes, just getting the council approval for a subdivision is enough. You can hold on to that sometimes for up to five or more years, adding value along the way, especially if the council limits

further subdivisions in the area after you’ve been approved, making your property more valuable, Chivers says. “Council regulations could change,

As your properties pick up and grow, the more important it will be to seek help managing them. Securing regular tenants is just part of the work involved

so that approval itself could add value,” she continues.

A final way to gain equity to borrow for a subsequent investment purchase is to seek the help of friends or family, just like one would do if starting out with no savings for a first purchase. Be sure to have solicitor read over and explain the details of any joint venture first, however, so you know what you’re getting into.

“It’s more of a risk, but it does let you move forward and let you keep buying property,” Chivers says.

Managing the property

As your properties pick up and grow, the more important it will be to seek help managing them. Securing regular

tenants is just part of the work involved if you try to do it yourself. According to the Office of Fair Trading, you must also:

- provide your tenant with a written residential tenancy agreement (lease) – you can purchase a lease pack from most stationery suppliers
- Provide your tenant with a list of all entry costs
- Ensure the residential premises are reasonably clean and fit to live in
- Ensure the required smoke alarms are installed

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Case Study

Building a portfolio through confidence



Some people new to investing often find it hard to take the plunge and put their savings into the property market. There's always risk involved, but the lost opportunity can sometimes be costly, as well.

Anne Karran, an investor from Victoria, bought her first properties with her husband, John, in 2002. They purchased a townhouse in Indooroopilly for \$305,000, and a unit in Woolloowin for \$230,000, both suburbs in Brisbane.

Yet, after that early splurge, Anne says she waited five years before she decided to buy again.

"The properties didn't really grow in value for a few years, and I convinced John that we couldn't afford to buy another," she says. "I'd lost a bit of confidence doing it."

In hindsight, she now admits she passed up good buying opportunities, including around Perth where values have skyrocketed. But she had no way of knowing that at the time, of course.

Drawn back in

The boost that got the couple back in the market came in 2007, when they were considering selling their home in Hampton East, a Melbourne suburb, for another one. But rather than sell it, Anne says, she and John held on to it while still going ahead and buying the new one.

"I guess I was attached to it," she explains, and added that they'd done some significant renovations.

The Hampton East property was negatively geared and, sure enough, it increased in value 20% in just one year, she says.

"It gave me more confidence and got me excited about investing again," Anne declares.

She started looking around again for more purchases and although the pair didn't quite have the savings, when she looked again at the Brisbane properties, she found both had built up plenty of equity.

That paved the way for another purchase – this time a house in Dysart, a mining area of Queensland.

"I'd read that the mining towns can give you a potential good rental yield, and this area had grown substantially," Anne states.

Positively geared, that property, too, has gone up 30% in the year since she and John bought it.

On the tail of that success in 2008, the couple decided they might want to buy another. But the difference this time was they decided to put a lot more research into the purchase. Their previous buys were based on a few things they'd read in magazines, but little other study to back it.

Taking the next step

"I didn't want to keep on 'stabbing in the dark' without doing my due diligence," Anne says.

For her 47th birthday, John got her a book on property investing and she started to understand the additional things she should have done when making their property purchases, such as ring council members in areas she was considering buying and asking about upcoming infrastructure plans, for example.

She then enrolled in a property class run by the author of the book, Helen Collier-Kogtevs. Working full-time with three children, Anne says she didn't always have the time to do much property research or worry about management, but she soon learned about the savings it could produce – such as by depreciation.

After the course finished last November, they bought a property in Moranbah the following month. This time, Anne went to see it first with a group of other potential investors.

"It was really helpful to see that it wasn't just a tiny little town in the middle of nowhere," says Anne. "It was actually a thriving centre, which gave us a lot of confidence that it was a growing area – and to find that they welcomed investors."

She says she wished she'd known in 2002 what she knows now, as it would probably have led to an even larger portfolio.

"I thought then that I couldn't afford it, but I may have found a way to make it happen," she says, adding that at the time, she was considering buying in Perth – before the prices rose so dramatically.

One of the best things Anne has picked on up lately is the networking connections with other investors. "I didn't know a lot of investors when I started out and that kept me in the dark a little," she says. "But building up that network helps you have confidence in what you're doing, and keeps you going."

- Lodge any rental bond money with the Office of Fair Trading within seven days
- Complete three copies of a condition report at the start of each tenancy and give two copies of the completed report to the tenant, at or before the beginning of the tenancy

Just for one property alone, that's enough for many investors to pass the work on to a property manager. But in doing so, it's still good to have some understand of the tenancy laws, Do says.

"Once you understand the complexity, I'd recommend that most people use a property manager," he says.

For your part, an important part of property management is to keep good records, says Do. That means for your expenses, for tax returns, but also for warranties.

Hard work pays off

Summed up, running an investment portfolio can seem like a lot of work – managing your assets, keeping track of future buying opportunities and checking for refinancing options.

But in the end, the time you put in pays off. And it's actually not as hard as you might think.

"Once you've got everything set up, it pretty much runs itself," Do says.

He says he even sometimes has to remember the exact address of his properties, as he rarely has to think about such details anymore.

"It takes very little effort," Do adds.

The hardest part might be the early steps, especially if you have little savings. But working hard early on can get you the early pieces to make your investing later on easier. Going from one property to 100 is not something that relies solely on luck. 🏠



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