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A joint publication of Lambros Realty & Ryder Property Research

Getting Started

First Steps to Becoming a Property Investor

2017 Edition

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Executive Summary

Part one: Strategy

Know what you want to achieve

It's difficult to create a property portfolio if you don't know your objectives. Unless you have a clear goal and a strategy to achieve it, you won't know what to buy and where to buy it.

You must ... Have a goal; Have a plan for reaching that goal; Understand your risk profile; Know your borrowing capacity; Be willing to do some work; Know where to access good information; Know who to believe and who not to believe; Have a strong constitution and the resolve to persist.

Know your financial capacity

You can't start a search for properties to buy until you know your financial capacity. How much can you borrow and how much can you afford to pay for property? There's little point in scouting around for properties in areas where typical houses cost $650,000 if your financial situation allows you to buy properties worth only half as much.

There are plenty of options available on the Internet to help you to settle this question before you waste too much time in the market. There are many websites with useful information and online tools for people who haven't applied for a loan before and are thinking of using a mortgage broker.

They can help with issues such as: How much can I borrow? Can I use equity in my home for investment? What areas will banks lend or not lend in? What is the process involved in applying for a loan? What information will I be required to give to the lender? Why do they require the information they ask for? Why should I use a mortgage broker? How do I protect myself from fraud or scams? What is a credit reference report? What is Mortgage Insurance and why do I have to pay?

Understanding your risk profile

What you choose to buy and where you choose to buy it depends on your risk profile.

A person's Risk Profile depends on a number of factors, including ... **Age** (a young adult might be willing to take more risks than someone nearing retirement); **Family situation** (single people may be less concerned about risk than people with kids); **Investment experience** (those with more knowledge/experience can handle higher risk); **Investment goals** (e.g. capital growth or income returns); **Time frame** for achieving investment goals (not necessarily dictated by age).

This report provides a Risk Rating System for various types of locations. For example, location types considered to entail the lowest level of risk for property investors include (a) Outer suburbs of capital cities with identifiable growth factors and a good track record; (b) Middle-ring suburbs of capital cities with identifiable growth factors and a good track record; (c) Major regional centres with diverse economies, identifiable growth factors and a good track record.

Investing is a long-term business

Property is a long-term business and should be approached with a long-term perspective.

US billionaire Warren Buffet said: "I buy on the assumption that they could close the market the next day and not reopen it for five years." This means he would not be able to sell. People should approach real estate the same way. If you're planning a quick re-sale you've missed the point.

George Soros, global financier and philanthropist, reckons that if you find investing entertaining, you're probably not making any money. "Good investing is boring," he says. Good property investing is about buying in locations with growth prospects and putting them away in your portfolio.

Most successful property investors are accumulators. They seldom sell. They just keep buying, whether the market appears good or bad. They don't care about GFC's or RBA meetings or the next ABS release of unemployment data – the stuff that excites economists and fills newspapers, but ultimately changes nothing.

Make decisions and take action

Investors allow events such as elections to affect the decisions they make and the actions they take. The reality is that nothing happening in federal politics changes the fundamentals of real estate investment.

Consumers like to delay decisions. An impending interest rates decision, an upcoming State Election, nervous signals from major overseas economies, the outcome of the AFL grand final - anything will do, really. They can blame uncertainty and that lets them off the hook.

Genuine property investors don't react that way. If they're serious about investing, they know it's a long-term strategy and short-term events in the economy or in politics don't matter. They have a plan and they implement it, undistracted by the background static of politics, economics and media.

Extract emotion - this is for financial security, not ego

Some investors allow ego to intrude on the property buying process. This leads to them to make bad decisions. Some investors chase glamorous properties rather than properties that provide solid criteria for capital growth and good returns.

Some investors like to speak about how many properties they own. More relevant, however, are questions such as: Is the value of your portfolio growing? Does it provide income or does it cost you money? Is your property portfolio helping you to achieve your goals?

More important than the number of properties investors own is the nature of them and how they are performing in helping them to achieve their objectives. It's better to own five cashflow-positive properties than ten negatively-geared ones.

Extract emotion - you're not going to live there

Buying a home can be an emotional business. Buying for investment is a different process. Logic replaces emotion as the key driver.

Or it should. This is the mistake some investors make: they bring the same emotions and process to an investment as they do to buying their home. They buy things they shouldn't and overlook the best options because they're in downmarket areas or are dwellings they wouldn't choose to live in themselves.

Some investors treat properties as trophies to be paraded before friends and colleagues. They'll enjoy a brief ego massage but will never achieve wealth through property investment.

Extract emotion - peripheral issues don't matter

History shows that lifting interest rates does little to quell a rising market. There's no evidence that lifting interest rates correlates to a fall in dwelling prices. Investors need to avoid becoming emotionally impacted by peripheral issues like interest rates and media speculation about them.

It's easy for property investors to be distracted and discouraged by negativity generated in the media by organisations pursuing political objectives. It's important not to let these peripheral issues scuttle an investment plan.

Examples of negativity generated by organisations for specific reasons include claims of a "chronic housing shortage crisis", claims of an "affordability crisis" and comments about "bubbles" with an imminent threat of prices collapsing – all of them furphies.

Extract emotion - don't insist on buying locally

One of the biggest mistakes new investors make is clinging to the notion that they should buy in their own backyard. Many potential investors work on the assumption that it's smart to buy in the area in which they live. It usually isn't.

Some buyers seek to invest locally because they want to be able to drive past and keep on eye on it. Others think it makes sense because they understand their own market. Still others reason that if you buy close to home they can self-manage it and save some money. And there are many who believe that you must personally inspect any property you buy and therefore you should buy locally for the sake of convenience. None of these arguments stands up to scrutiny.

The key point is this: when you buy an investment property you want to make the best purchase you can get your hands on. It's highly unlikely that the best buy in Australia will be found in your local area. Your best chance of buying well in an area that delivers the rental returns and/or capital growth that you're seeking is to consider the whole nation as your market.

Part two: Research

Be willing to work - and persist

No one has ever become a successful property investor without putting in some hard yards. Investors need to research the target areas to be sure they will show growth and to conduct due diligence on the property they plan to buy.

Investors need to show resilience and persistence. It can take time to identify the right property to buy and to successfully negotiate a contract and settle a sale. Often the first attempt to buy a suitable property in a chosen location is unsuccessful. Even more often, the financial institution providing the loan will create problems and introduce delays.

Gathering information - know where to find reliable market information

People can't invest sensibly without good information. Investors need to become readers and surfers. They need to read good information sources and tap into the vast resources offered by the Internet.

This chapter of the report details a number of the Internet sources that provide information about the market, specific locations and influential events.

Gathering information - learn to recognize which information is unreliable

The key to successful investing is good information. Only if you know what's percolating in and around the property industry can you see where the growth spots will be. Therein lies the problem. There are few industries where it's harder to get quality information than real estate.

The biggest handicap is the property industry lobby. Many industry lobby groups believe the best way to advance a sacred cause is to generate press releases based on "research". It's easy to run a survey with a pre-determined result and present it to media as research-based information that supports the industry's viewpoint – e.g. approvals take too long, taxes are too high, land supply is too restricted, stamp duty should be abolished and green measures will cost jobs.

A popular alternative is exploiting the reality that you can twist any set of numbers to support your opinion. Leading practitioners of this shallow art are the Housing Industry Association (HIA), the Property Council of Australia (PCA) and Urban Development Institute of Australia (UDIA).

Property investors need to wary of media (mis) information sourced from these organizations. Be particularly wary of claims of housing shortages and record low affordability.

Gathering information - be aware how misleading medians can be

Median prices are very much abused and mis-used by journalists, who present changes in median prices as evidence of equivalent changes in property values. An example was the Melbourne newspaper which claimed the typical house in the city had increased in value by $98,000 in the past 12 months because the city's median house price had increased by that amount. This showed an alarming lack of understanding of how medians work.

Median prices more often than not tell us what type of property is selling rather than movements in property values. A large rise in a city's median price may simply mean that the market is being dominated by sales in the upper end. A fall in the median price may mean that the bottom end of the market is dominant.

Median prices can be useful for investors as long as they understand their limitations. When there is a large sample of sales over a long time frame – e.g. five or ten years – they may show something worthy of credence.

Gathering information - question everything, believe no one

Real estate is a breeding ground for scams. Most states and territories have enacted legislation in the past decade to stamp out the worst property practices. Common tactics - such as under-quoting in auction ads and dummy bidding - still abound, despite those laws. Recently we've seen a new kind of real estate scam: misinformation.

An important rule for property investors is: ***Question everything, believe no one.*** Even ethical people speaking from the heart need to be questioned, because their position represents the views of one person – and others may disagree.

This chapter of the report presents brief profiles of real estate analysts who deserve credibility - and some of those who do not.

Part three: Buying

Units or houses – which best suits your strategies

The dominant paradigm of Australian real estate has been that houses show better capital growth rates than apartments. The standard argument has been that houses have greater land content than apartments and that while land parcels appreciate, dwelling structures depreciate.

Gradually that is changing. For many years households have been getting smaller while houses have been getting larger and more expensive. Increasingly buyers are opting for apartments for affordability and lifestyle reasons.

Apartments, increasingly, are challenging that old paradigm about houses delivering superior capital growth. More people choose to live alone or as couples without kids. Many baby-boomers want to downsize. Young adults are happy to live in a small home as long as it's wired. More are opting for units because they're cheaper and less time-demanding.

Deciding where to buy - more important than what you buy or when

A critical feature of successful property investment is deciding **where** to buy. In many ways it's more important than **what** you buy – or **when.**

Investors fail to see the best opportunities to buy real estate because they look too "micro". The bigger picture is more important. But they can't see the suburb for the houses (the real estate version of "can't see the forest for the trees").

Many investors put their energies into scrutinising the individual property to buy. That's important – but where they buy is more important. Most crucial of all is the rationale supporting the where.

Deciding where to buy - there's life beyond the big cities

So much of our population and headline action is in the big cities, we tend to forget there's a life beyond them. For some reason, property investors cling to the coast like a security blanket.

The last place they'll consider is a regional centre. Most favour the inner suburbs of capital cities (all, except Canberra, coastal), in the mistaken belief this is where the best growth resides. Sea Change locations also figure highly, although few deliver good long-term growth.

Regional centres and country towns barely rate a mention. It's only in the context of mining towns that investors will look inland and that's seldom a smart move. This means many are missing the best opportunities to invest well.

Deciding where to buy - outer suburbs often provide the best growth

The most temperamental markets in Australian real estate are the premium suburbs in Sydney and Melbourne. Long-term, they have capital growth records that are poor by national standards, particularly those in Sydney.

The prestige markets run amok every three or four years. Usually, this price surge is followed by a sharp decline in values. The price graph for most of the millionaire suburbs resembles a mountain range. A peak is followed by a trough, usually quite a deep one.

The middle-ring and outer suburbs don't behave like that. Their price graphs tend to be smooth and the long-term growth averages are higher. It's the property market's version of the hare and the tortoise.

This provides a win-win-win situation for property investors. In the cheaper suburbs they have a lower entry price, higher rental yields and usually superior capital growth.

It's important to remember that not all outer suburbs will provide superior growth. Investors need to target areas with identifiable growth drivers.

Deciding where to buy - Hill Change offers better value than Sea Change

An online poll asked people where they thought it was best to buy for long-term capital growth. The two most popular choices were Sea Change locations and inner-city suburbs. Bottom of the list were regional towns and outer suburbs.

The reality is that the opposite is true. The best performers on capital growth consistently have been the cheaper areas of our capital cities, much better in fact than the inner-city suburbs. Equally, regional towns and Hill Change locations regularly out-grow the seaside icons.

There are few more iconic sea change destinations than the Gold Coast, which has earned a reputation as the king of population growth in Australia. But it's a long way short of being the king of capital growth. REIQ data shows that the worst performers on capital growth in Queensland over the past five years include the Gold Coast. The median price for apartments in Surfers Paradise was lower in mid-2015 than it was 10 years earlier.

Iconic Byron Bay has a poor long-term growth average, while Noosa Heads is one of the worst capital growth performers in Australia.

Deciding where to buy - regional centres are safer than mining towns

There's a fine line between a Boom Town and a No Go Zone. One of the stark lessons as the global economic fallout contaminated economies and markets across Australia late in 2008 and into 2009 was the speed with which thriving mining towns turned into ghost towns. We saw more examples of Boom Towns becoming No Go Zones with the recent decline in the resources investment boom and global commodity prices.

Australia is littered with former boom towns. Investors wishing to benefit from a resources boom are better advised to buy in the nearest regional centre rather than in pure mining towns.

Deciding <u>when</u> to buy

"Is this a good time to buy?" is the dumbest question a property investor can ask. If you're currently asking that question, you have misunderstood a lot about property markets. A more pertinent query is: ***Where*** is it a good time to buy? In simple terms, it's always a good time to buy – somewhere.

Australia is a big country and the mistake many commentators make is to discuss real estate as if Australia was one large market. That clearly is not the case. Australia is myriad sub-markets and they are not all at the same stage in the property cycle, nor influenced by the same issues.

Choose any moment in the last 20 years and you will find locations in Australia that were rising, some that were falling, others that were stagnating, some booming thanks to local catalysts and some going through tough times for reasons exclusive to that location.

Negotiation

One of truisms of real estate is that you make your money when you buy, not when you sell. This means you set yourself up for solid capital gains by buying at the right price.

Buyers need not fear negotiation. Yet it's the thing people dislike most about buying and selling real estate. There's an almost universal aversion to looking another person in the eye and talking money. It's almost as if we think there's something unclean about bargaining over price.

While real estate agents often espouse their talents in this area, few agents know how to negotiate. Agents often don't even try to negotiate on behalf of their clients (the sellers). Plenty of agents are happy to talk down their seller's price in the interests of making an easy sale. This puts buyers in a good negotiating position.

Many people think they know little about negotiation because they fail to realise how often they negotiate. Every time we buy something we negotiate. Everyday interactions with family and friends involve negotiation. Taking a phone call from someone selling a service teaches plenty about negotiation, because we're dealing with people trained to turn objections into selling points.

This chapter of the report provides a series of tips on how to negotiate effectively to secure property at the right price, including good preparation and understanding where "the power" lies.

Part 1: Strategy

Know what you want to achieve

It's difficult to create a property portfolio if you don't know your objectives.

Unless you have a clear goal and a strategy to achieve it, you won't know what to buy and where to buy it.

Some investors are clear on their goals in property investment: they want to create a portfolio of positive-cash-flow investments which will fund their future years and help the kids as they grow towards adulthood.

They want properties where the income is sufficient to cover the costs of ownership.

And they want them to be in locations that have identifiable drivers of capital growth.

Both are achievable if you know what to look for.

But many people approach property investment without first sorting out this most fundamental issue: **what am I trying to achieve?**

If you don't know the answer to this question, it's difficult to know what you want to buy and where you want to buy it.

You must ...

1. Have a goal.
2. Have a plan for reaching that goal. Understand your risk profile.
3. Know your borrowing capacity.
4. Be willing to do some work.
5. Know where to access good information.
6. Know who to believe and who not to believe.
7. Have a strong constitution and the resolve to persist.

Equally as important as having a clear goal and strategy is having a goal and strategy based on quality information.

Here are a series of scenarios based on real people. They describe a variety of situations with prospective investors.

Scenario #1:

Carol and Kevin are 40-ish and own their home with a mortgage. They're concerned about their retirement and have absorbed media messages about our aging population and the idea that in future the nation won't be able to fund a rising number of retirees with pensions.

They know nothing about shares but think they understand real estate quite well. What they don't know is how to achieve their goal of a secure retirement. They don't know their borrowing capacity or their risk profile. They don't know how much income they will need to generate from investments to live comfortably in retirement. Therefore they don't know how many properties they will need or what kind of properties to buy.

They have not put anything down on paper or spent any time with a calculator. Until they start to sort out their priorities, they will struggle to develop a coherent investment strategy.

Scenario #2:

Ken is a 23-year-old professional in IT, earning $80,000. He has purchased a one-bedroom unit in near-city Melbourne as his principle place of residence. His plan is to retire young and he has determined that property investment is his ticket. He wants to build a portfolio steadily by buying on average one property a year and by the age of 35 own 12 investment properties.

He does not want to be negatively geared because owning multiple properties that each cost him money will drain his income and also hamper his ability to get loans. He is willing to take on some risk but wants a balance of medium-risk properties and low-risk – and he wants them all be positive cashflow or at least cashflow neutral.

Ken has a clear picture of his goals and his strategy, which is to buy and hold, using growing equity to fund future purchases. He will be seeking to buy affordable properties in regional centres or outlying city suburbs, with some properties that are higher risk, such as locations which partly or largely reliant on the resources sector.

Scenario #3:

Elizabeth is clear that she wants growth. Capital gains are her priority and she doesn't care too much about rental returns. She has the (mistaken) belief that she can't have both at the same time. She is quite firm about wanting to buy "quality", which she defines as good houses in "prime" inner suburbs of capital cities.

This means that Elizabeth has a clear goal and a clear strategy – but one that is based on a series of misconceptions. This can be as dangerous as having no goals or strategies. She has developed her attitude to real estate from media messages and has done little quality research, nor has she consulted qualified people with real estate expertise.

How will you decide?

SEA CHANGE TOWN?

CITY SUBURB?

HOUSE?

APARTMENT?

Know your financial capacity

You can't start a search for properties to buy until you know your financial capacity.

How much can you borrow and how much can you afford to pay for property?

There's little point in scouting around for properties in areas where typical houses cost $600,000 if your financial situation allows you to buy properties worth only half as much.

Fortunately there are plenty of options available on the Internet to help you to settle this question before you waste too much time in the market.

These include the **Mortgage & Finance Association of Australia.**

This is the body that regulates mortgage brokers in Australia. Its website (www.mfaa.com.au) is full of useful information and online tools for people who haven't applied for a loan before and are thinking of using a mortgage broker.

Even if you're applying directly to a bank or other lender this website can provide the right questions you need to be asking when you have your interview with the lender.

It can help with issues such as:-

- How much can I borrow?
- Can I use equity in my home for investment?
- What areas will banks lend or not lend in?
- What is the process involved in applying for a loan?
- What information will I be required to give to the lender?
- Why do they require the information they ask for?
- Why should I use a mortgage broker?
- How do I protect myself from fraud or scams?
- What is a credit reference report?
- What is Mortgage Insurance and why do I have to pay the premium?

How much can I borrow?

It's not difficult to find on-line mortgage calculators that can give you an estimate of how much you can borrow to buy residential property. These calculators will ask you to input basic information about your financial position, such as income and living expenses, to provide an idea of how much you can borrow.

The Aussie Home Loans website, www.aussie.com.au is one of many with mortgage calculators. Another can be found on the Mortgage Choice website, www.mortgagechoice.com.au

Every lender will have its own methods of assessing borrowing capacity so please use these online tools as a guide only. A lender will examine your monthly expenses as well as your income when it assesses your borrowing capacity.

What is Mortgage Insurance and why do I have to pay for it?

Lenders Mortgage Insurance is required mainly when you borrow more than 80% of the value of the property. In some cases it is required for the whole loan, depending on which financial institution you are using.

There are two main mortgage insurance companies in Australia (although some banks have their own internal insurance).

QBE LMI AUSTRALIA
www.qbelmi.com/pg-Online-Business-Tools.seo

Location Wizard will tell you whether or not the insurer will cover a property or not, and if so what the maximum Loan to Value Ratio (LVR) will be.
www.qbelmi.com/pg-Location-Wizard.seo

Servicing Capacity Calculator will give you an idea of the amount the insurer is willing to lend you based on your income and expenses. It does not take into account your assets or equity in your assets; it simply determines your borrowing capacity based on income.
www.qbelmi.com/pg-Nsr-Calculator.seo

GENWORTH FINANCIAL
www.genworth.com.au

Location Guide
www.genworth.com.au/lender-centre/tools-and-resources/location-guide-australia/

Servicing Calculator
www.genworth.com.au/lender