prosolution Newsletter

Finance for Professionals, by Professionals

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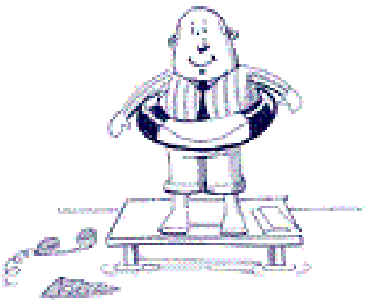
In this issue:

Buying Property No Mistakes!

Generally, property purchases are by far the biggest transactions that we undertake in our lifetime. In fact, the second largest purchase (probably a car) is often 10 to 20 times less money than we spend on property. However, we will often spend a lot more time researching the purchase of smaller items, like a computer, than we do on the purchase of a home. Where's the sense in that? Spend $2,000 on a computer and spend hours trying to find the best deal. Spend half a million dollars on a home and buy on emotion (and then spend the rest of your life paying for it)!



But no one seems to make a bad purchase. When was the last time someone told you that they "paid $50,000 too much for our house. It was a really bad purchase". You will rarely hear someone say this. People will justify the purchase to themselves. They probably won't even admit to themselves that they stuffed up – certainly not when so much money is involved.

What about regularity? How often do we purchase property in our lifetime? My guess is the average Australian might purchase three to four homes in their lifetime. However, how often does the property market change? It's probably fair to say that the market changes every 12 months. Therefore, every time we buy property, we are buying in a different market and therefore can't benefit too much from our previous experiences.

What about other purchases? Chances are, if you are going to invest $5,000 in direct shares you will probably seek the opinion of a stockbroker or financial planner. Why? Because we admit we lack market knowledge and experience in that field.

It always amazes me that people will spend $500,000 on a home and not seek any advice or do much research. I think there are two reasons for this fact. Firstly, people use debt to pay for property so they don't actually have to hand the cash across the table. It's easy to lose appreciation for how much money you are spending – it's just a number on a page. Secondly, people are influenced by emotion. These two influences can be a recipe for disaster. Consider an unexperienced and emotional purchaser. A vendor's dream!

Do not despair. There is a little known solution. Buyers' Advocates ("Advocates") and Property Investment Advisors ("Advisors"). Advocates are people who can assist with all aspects of a property purchase, including finding the right property, advising, bidding at auction, negotiating the purchase price and terms, etc. Advocates are perfect for owner occupier purchases. Advisors are more geared to investors and provide the same services as Advocates but they also offer investment advice. This investment advice might include (but is not limited to) what types of properties provide better investment returns, future growth suburbs, asset selection, accumulation and disposal, selecting rental managers, portfolio review, etc. Most Advocates and Advisors are flexible in the services that they provide. They can do as much or as little as you want.

Advocates and Advisors will charge you a fee for their service. Often the fee will be based on a percentage of the purchase price of the property. Some Advocates and Advisors will agree on a fixed fee (especially of you are only using part of their service). The fee for their full service (which usually includes sourcing and purchasing the property) usually ranges from two to three percent of the property's purchase price.

Are they better at buying property than you? No one can really say for sure. It is hard to compare what a property would have been purchased for with or without an Advocate or Advisor. However, there are a few points to note.

1. It is reasonable to assume that if you purchase properties every day of the week, then you are probably going to be better at it compared to someone who purchases property every 10 years. Notwithstanding that, Advocates and Advisors would know the area (suburbs) better and more importantly, the real estate agents that operate in that area better than you.

2. Advocates and Advisors are not emotionally involved. This can be a great advantage because they will not get "caught up" in any real estate agents games (i.e. things they may do to create urgency or fear that you may lose the property of you don't raise your offer price).

3. There is the undisputable fact that advocates and advisors can save you many, many hours of time, especially during the search phase of the buying

process. Sometimes this factor alone can be worth the fee.

4. Advisors can also be particularly valuable for investors. Advisors can advise on what types of properties will provide better capital growth, higher rental yields and lower vacancy rates, etc. You can also request an Advisor to construct an investment property portfolio plan which many include the acquisition of multiple properties over a certain timeline. One Melbourne based independent Advisor, Wakelin Property Advisory, told me about a client that they have been working with for the last 20 years. The client has accumulated $1.6 million of equity in residential property over that period on a fairly modest current income of $45,000 per year. This client has benefited from careful planning and judicious asset selection, which goes to show how valuable independent and professional property investment advice can be.

People might think why should I pay someone for doing something that I can do myself. The question that they should probably ask themselves is how much time and money is it going to cost you if you don't use the services of an Advocate or professional Advisor?

I have no vested interest in recommending Advocate or Advisory services. They only reason I am writing this article is to raise the awareness. I truly believe they offer a very valuable service. I would not personally purchase a property without one. Visit some websites, speak with friends or even speak with an Advocate or Advisor. All I suggest is just consider it.

Do you have a question? Feel free to email us at info@prosolution.com.au.

Turn of the tide: do holiday homes make wise investments?

The arrival of summer prompts many of us to grasp the opportunity to get away to our favourite beach or country location, even if it's only for a few days. Once we're under the calming influence of sun, surf or bush, we may muse on the possibility of combining our investment objectives with the laid-back way of life that generally comes with owning a getaway property.

Whilst turning your day-dream into reality by purchasing a holiday home can be a worthwhile goal, it is rarely advisable to combine investment and lifestyle goals in one property. This is chiefly because the emotions that determine our lifestyle objectives are frequently at odds with the rationality that governs a successful investment strategy. If you want the property to serve two specific and disparate purposes, you should be aware of the drawbacks.

To qualify as a top-quality investment, a property must deliver two key outcomes – consistent, long-term capital growth of at least 5–6% above inflation, and regular rental income in line with market rates. Capital growth and rental return are primarily determined by supply and demand, so if more people want to purchase or rent than there are properties available, a rise in the capital value of the property and commensurate rental demand will follow. For example, in most major cities across Australia, a carefully-selected property purchased for around $500,000 in a prime inner suburban area will provide investors with steady long-term capital growth and a consistent, gross annual rental income in the region of 3-5% of the property's value.

Contrast this with a similarly-priced holiday home. Holiday destinations tend to be highly seasonal, and rental demand for holiday accommodation is likely to fluctuate over a 12-month period. During the peak season for example, your holiday retreat may return a rent of around 7% of its value, but this may be followed by months of reduced or nil rental income in the off-season when it sits vacant or is rented for short periods only.

What's more, high vacancy rates pose an increased security risk and it's fairly easy to spot an unoccupied property. Your insurance broker can advise you on suitable cover and the cost of premiums, which may vary considerably depending on the property's location and projected occupancy.

Many people consider holiday homes as a luxury purchase, and it is this characteristic that makes them particularly sensitive to market downturns. When the economy falters, investor confidence can take a tumble, and holiday homes are usually high on the list of expendable items, especially if their owners are in financial difficulty. Ultimately, prices fall and capital growth suffers! Even though there are exceptions to this rule, such as properties that command exceptional views or have water frontages, the ongoing costs of servicing the debt and maintaining such properties may well be too high, given the importance of diversification in your investment strategy.

Significant maintenance costs can be a high price to pay for getting away from it all – even for quite modest getaway properties, especially in coastal and alpine regions where climatic conditions can take their toll on structural integrity, paintwork, roofing and guttering. Multiple tenancies also cause wear and tear, and careful tenants may be hard to find.

Unlike other residential property investments, holiday tenants expect furnished accommodation complete with most household amenities including bed linen, kitchenware and appliances. The ongoing cost of replacing and maintaining these items to an acceptable stan-

dard may further erode your rental income.
Furthermore, if you intend to occupy your holiday home yourself at peak letting periods whilst claiming it as a genuine income-producing investment asset for the purposes of negative gearing, you may have difficulty convincing the tax department that your property is a genuine income producer!

You will also need to allocate a sizeable chunk of your rental income to property management fees. Whilst professional managing agents generally charge a modest fee for managing standard residential tenancies, the extra workload associated with the frequent tenancy turnover of holiday homes during peak periods – finding tenants, drafting leases, arranging cleaning, repairs and maintenance, inspecting the property between tenancies, and preparing condition reports – means management fees can be substantially higher. Unless you're prepared to travel to your holiday home for each tenant changeover and do the work yourself, this will be an expense that's hard to avoid.

As you contemplate the view, the case for purchasing a holiday home may seem overwhelming. But as the old saying goes, 'act in haste, repent at leisure'. If you have the capital and cash flow to support a holiday home without requiring solid investment performance, then buy and enjoy! Just keep your lifestyle requirements separate from the rational decision-making that is essential when it comes to investing in long-term growth assets.

Monique Wakelin is a founder of Melbourne-based Wakelin Property Advisory (www.wakelin.com.au) and co-author of the best-seller, *Streets Ahead: How to Make Money from Residential Property*.

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Quick Tips on Avoiding The Cost of Mortgage Insurance

Purchasing property in capital cities is becoming more difficult after the growth in property prices over the past few years. As such, more people are finding that they need to borrow a greater proportion of a property's value. If you borrow more than 80% of a property's value borrowers must pay for lenders mortgage insurance. This can cost many thousands of dollars. Here are a couple of quick tips in order to avoid or minimise this cost.

- Mortgage insurance premiums can vary greatly between lenders. Don't forget to ask your lender or mortgage broker for an estimate of the cost. It is just as important to compare the interest rate as it is the cost of mortgage insurance.
- Consider supplementing your deposit with money from a personal loan and only borrowing 80%. Often it is cheaper to get a personal loan (and repay it over 5 years) and avoid mortgage insurance (even taking into account the higher personal loan interest rate).
- Some lenders will waive mortgage insurance if you commit to repaying the loan down to 80% within 2 years. You can return to normal repayments if your loan to value ratio falls below 80% before the two years are up (i.e. if the property's value increases).

Mortgage insurance is not all bad, especially for investors. It allows you to get greater leverage into the market and it is tax deductible (over the first 5 years of the loan).

Westpac increases discount

Westpac recently announced that it will increase the top tier interest rate discount within its professional package (called Premier Advantage). Clients that borrow over $500,000 from Westpac will be entitled to an interest rate discount of 0.70% off the standard variable rate for the life of the loan (up from 0.60%). This results in a current variable interest rate of 6.37% to 6.47% p.a. (depending on the product). This new discount applies after 31 January 2005 to new clients only (or existing clients that increase their lending).

There are other lenders that will offer similar discounts (e.g. St George) so it might be worth understanding what the rest of the market will offer if you are considering lending money. Furthermore, Westpac's investment interest rates are 0.10% higher than their residential rates. Most other banks interest rates are the same for investment and residential. Westpac may not be as good as other banks for investment loans.

Drop us a quick email if you would like to know what your bank should be offering you.

Complimentary seminar — details soon

ProSolution is pleased to announce that it will be offering a complimentary seminar in Melbourne titled: Returning to fundamentals. Finance and property investment will be the main two topics covered at this seminar. The seminar will be held on Wednesday 16 March 2004. ProSolution is lucky enough to have a high profile guest presenter.

We only have 100 tickets and they are expected to be taken up fast so you will need to act fast when we release full details in about a week.

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