

Top 3 mistakes nearly all property investors make

Having helped hundreds of property investors finance their acquisitions, I have been able to gain a great perspective as an "outsider" with regard to how property investors go about making their investments. There are some common things that the vast majority of investors do not do, which I think negatively impacts on their chances of success.

Doing these things will not necessarily cost you a lot of money, take a lot of time, or maybe even change the way you invest. However, taking these three simple but critical steps will greatly increase the likelihood of you building a significant amount of wealth.

Mistake #1: Think about the end first

Building wealth is one of the most rewarding things we can do for ourselves and our family. Of course, wealth doesn't necessarily bring happiness or magically make life great. However, wealth does create opportunities and making the most of those opportunities can change your life!

Building wealth often involves making significant personal commitments – such as committing a certain amount of income, using equity, taking on risk and the like. Building wealth takes up your time – mostly after hours, which you could be spending with family or friends. Why is it then that probably 99% of property investors do not have a financial goal and timeline in sight? Many investors I talk to don't know what they are aiming for – they say that they are investing to "build wealth" and that's as far as they get. Rarely will someone say (for example) that they are investing to reach their goal of having \$100,000 of net investment income in 15 years time. To maximise your chances of being successful, you must have a firm and exact target. The target could be in the form of net wealth (i.e. assets less liabilities) or net passive income.

Why set a goal? First and foremost, setting a goal will allow you to develop an investment strategy. An investment strategy will address things like how many properties you need to buy, what value, where, when, who will own the investments and other matters relating to the acquisition stage of the plan. The plan will also need to identify an exit strategy – i.e. is there something you need to do at the end to meet your goal. If you don't develop an investment strategy, how do you know if your current investment activities are enough, too much, just right? For example, someone might have a goal of buying two properties in the next 7 years to fund retirement. If they plan to retire in say 10 years, they might actually find that the portfolio may not produce enough income in 10 year's time. In this situation, maybe they need to bring forward the property acquisitions. In addition, having an investment strategy allows you to plan for life changes. A good example is starting a family. Many couples will rely on one person's income for a period of time when the baby is born. Therefore, planning for this in advance will ensure that you maximise your opportunities.

Secondly, the other major benefit of developing an investment plan is the psychological and emotional leverage it creates. If people can see that investing in property today in a certain way (which might mean making some personal short-term

sacrifices) should allow them to meet their goals in the future, it puts any personal sacrifices in perspective. It shows how rewarding making those sacrifices can be. Also, having a plan increases the chances of you sticking to the investment strategy rather than chopping and changing based on emotions or BBQ chit chat. Changing investment strategies regularly is probably the biggest thing people do that destroys wealth. It's a bit like financial planners moving client monies from one fund manager to the next – it's totally unnecessary and costs clients money. Get the strategy and investments right from the start and you'll find you will have to make very few costly changes.

Developing an investment strategy has to be the first, and probably the most important thing you do. Develop a smart investment strategy, write it down, look at it regularly and I will almost guarantee you that you will meet your goals – it's that simple.

Mistake #2: Not knowing how to review performance

Most people spend in the range of \$350,000 to \$500,000 on each property investment which is a considerable amount of money. However, I can count on my hand the people who review the performance of their property and can tell me what capital growth rate their property has achieved. In fact, investors often pay more attention to the rental income (which is the smallest proportion of the overall return on property) than they do the capital growth rate. That is just crazy. It doesn't make sense to spend so much money on an investment and not diligently review its performance on a regular basis.

How do you review the performance? We believe that the best way to review a property's performance is to calculate the implied capital growth rate and compare it to the average capital growth rate in the State that the subject property is located. For example, one of our clients purchased an investment property for \$723,000 in Prahran (one of Melbourne's blue chip inner-city suburbs) on 2 December 2006. The property's value in June this year was estimated to be \$900,000 to \$950,000. The implied compound annual average growth rate for this property is therefore in the range of 15% to 19% per annum (compounding) which is very strong growth. Melbourne's median price in December 2006 (when the property was purchased) was \$391,000. The latest median price for June 2008 was \$451,000. Therefore, the median price grew by 10% per annum over this period. This tells us that the subject property has outperformed the market by 5% to 9%, which is excellent. It's our belief that all investors should be aiming for a growth rate of 2% per annum above the average growth rate. Now, of course, you might be thinking that you may not get growth of 15% to 19% every year. However, good quality properties should perform well above the average over the long term (for example, the same property in Prahran has grown by 16% per annum since September 1996 when it was sold for \$160,500 12 years ago. By comparison, the average property growth rate over the same period in Melbourne was just under 10%).

The benefit of comparing performance against the "average" is that it compares like with like. That is, over some periods, property growth can be quite subdued and in others very strong. Therefore, you must compare your property's growth in light of the general market conditions. Also, the aim is to always invest in an above average property, so you should demand above average returns.

There are some situations where investors have admitted that

their property hasn't performed very well (say where there has been no growth), but are often very reluctant to do something about it. They make comments like "hopefully it will pick up soon". I understand that it's costly to dispose of a property, but it is even more costly to hold onto an underperforming asset (for more, refer to our February 2007 newsletter).

What if it looks like my property has under-performed? Whilst there is a logical and detailed assessment process you need to go through, the likely outcome is that you will probably be best served by disposing of this property and quickly!

Mistake #3: Not sensibly mitigating risks

All investments carry some level of risk. With property investment, people often employ a gearing strategy (i.e. borrowing to invest), which means they might carry higher levels of debt. This creates additional investment risks that must be managed.

When it comes to dealing with risks, we have three options. We can accept the risk and do nothing. We cannot accept the risk and not invest. Lastly, we can transfer some or all of the risk to another party. Examples of transferring risk include arranging income protection insurance or fixing your mortgages interest rate.

Some common investment risks for property investors might include higher mortgage interest rates, property under-performance, vacancy or tenancy problems, affordability issues, property damage and the like.

Every investor's risk profile and tolerance levels are different. Therefore, when developing a risk management strategy, you need to obtain professional advice so that all your investment risks are identified and each risk is assessed. A decision needs to be made to accept, transfer/mitigate or reject the risks. A pragmatic and methodical approach will ensure no risks slip between the gaps.

Sadly, we often see property investors (for example) without any income protection insurance, getting asset selection wrong, without any regard to interest rate exposures, without considering asset protection measures and the like. There are some simple things people can do to manage these risks much better.

Why do people overlook these things?

I think many people overlook these very important 3 issues because the vast majority of property investors do not receive any professional financial planning advice. I can understand why. The vast majority of people I have spoken to over the years are simply unimpressed with the financial planners they have met in the past. In addition, most financial planners know very little about direct property and have been conditioned to believing it's a poor investment class. People feel "put off" by the whole financial planning industry and go it alone without any professional advice, which is good and bad.

Of course, we at ProSolution Wealth Advisory are completely different to nearly every financial planning practice in Australia. For a start, we specialise in property investment strategies and therefore have firsthand knowledge of what most investors are doing wrong. That's just the tip of the iceberg (see right hand column for more).

What to do

You have two options. You can skill yourself up on all these financial planning issues. There are plenty of courses to attend and books you can read. Also, the internet is a wonderful resource. If you are passionate about property and have plenty of spare time, you will probably enjoy the education process. The other option is to seek professional advice. Of course, as someone who runs a financial services business, you would expect me to say that. However, I honestly believe that most people need to obtain professional advice when investing large amounts of money. Why take the risk of potentially getting it wrong? Therefore, get some advice. It doesn't have to be from us. Any trusted, knowledgeable, property-friendly, independent adviser will do a good job (refer to our August newsletter for how to choose an adviser). Good luck with developing your investment strategy. You won't regret it!

We have launched ProSolution Wealth Advisory

We are very proud to announce that we have launched ProSolution Wealth Advisory, a fee-for-service financial planning practice. Earlier this year, we completed a client survey (which you may recall). The response was overwhelming and confirmed our belief about what people were looking for. The general response was that people had lost confidence in financial planners and that they wanted broader financial advice (i.e. consideration of all sorts of investments including direct property). We have designed our service taking into account this feedback and have received fantastic feedback from our initial clients. Whilst we have more information on our website, the main strengths of this new service include:

- No commissions. Instead, we charge you a fee ensuring we have no conflicts of interest
- We consider all asset classes and specialise in property investment strategies
- We have very sound long-term investment methodologies backed by proven fundamentals - we don't speculate!

For more information about the way we think, download our special report titled "**What most financial planners don't know will cost you dearly!**" - [Click here](#).

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