

PROPERTY

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COORDINATOR'S MESSAGE

By Adrian Vorbach

The lead article "Why proactivity provides profits," by Silverhall Director Mike Anderson, makes interesting reading. Property markets are cyclical in nature and to maximise capital growth they should only be held during periods whilst they are growing in value (uptrending). Fortunately, different areas in Australia have different growth rates and the aim should be to switch when a property starts consolidating into another area that is clearly growing – a bit like share trading really!

Author of "I buy houses: The Property Investors Handbook" Paul Do challenges the concept of why buying the worst house on the best street might not be the best idea. Cheap houses attract the most buyers and unless you can buy well and superficially renovate cheaply, you may well do better paying more for a better home that may have been over capitalised.

This issue also features two book reviews by AIA members. The first is a review of Paul Do's book. Brian Cordiner advises that this book provides a step by step guide to Paul Do's buying process stressing his "value" approach to real estate investing.

Jennifer Williams provides a review of "Property is a Girl's Best Friend" by Propertywomen.com. Jennifer feels that this book is probably of most value to new property investors.

Adrian Vorbach is a Councillor of the AIA.

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WHY PROACTIVITY PROVIDES PROFITS

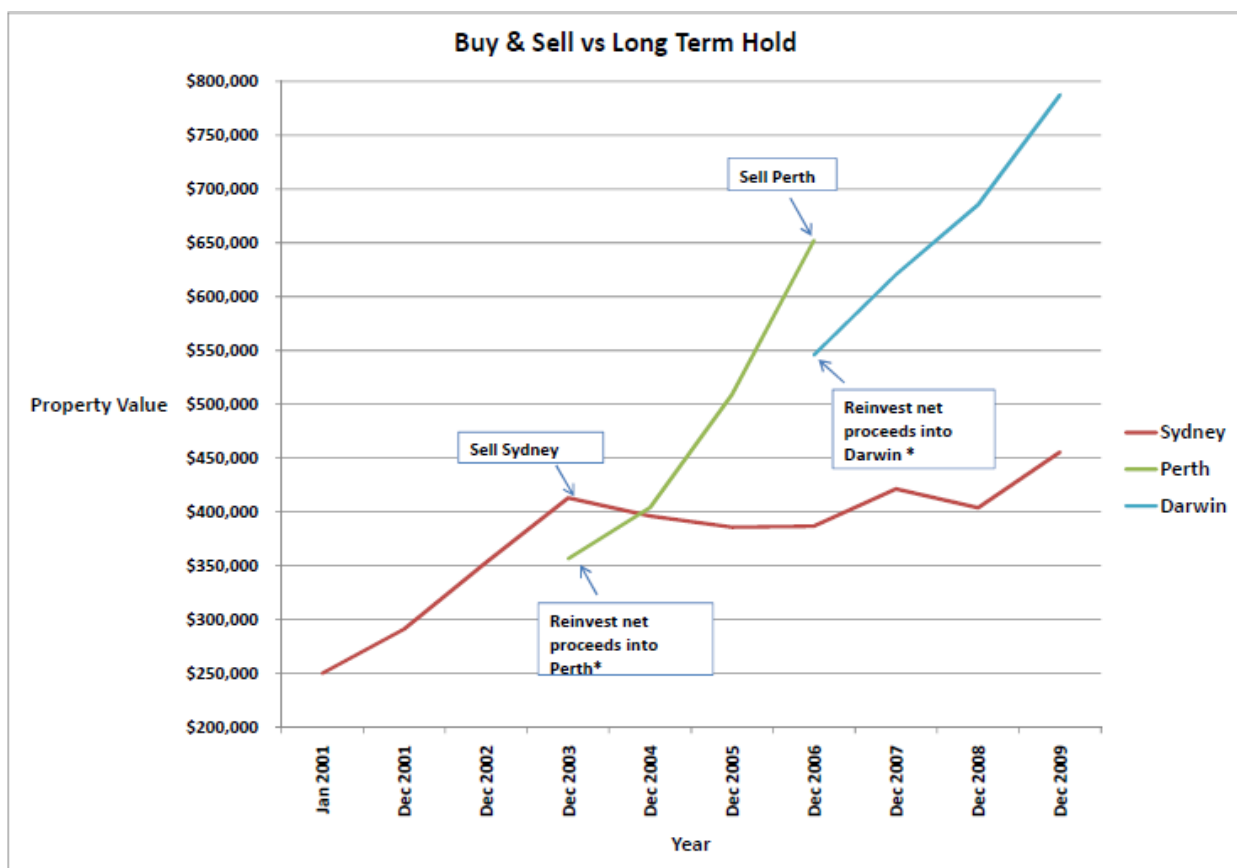
By Mike Anderson

Through fifteen years in the property and financial services industries Silverhall Director, Mike Anderson, has learned that a proactively managed portfolio can deliver far superior results to the age old 'buy and hold'. Whilst many people are fervent believers that property is only a long term investment, Silverhalls strategy strives for shorter term success based upon active research and monitoring.

The key outcome for most investors when buying property is capital growth. However, as the property market is cyclical in nature, a long term approach will dictate that we will be holding assets that are not growing for years at a time. The Sydney market, as an example, had strong growth from 2001 to 2003 yet the market did little for the subsequent six years. Six years of negative gearing with rising interest rates and no growth- if not negative growth! During this same period we saw other markets performing in a very different manner. Perth witnessed stunning growth from 2004 to 2006 and Darwin performed solidly from 2005 to 2009.

What is very evident when examining the history of property cycles is that any boom period is followed by a period of stagnation, and then another period of growth. The key therefore is to be in the markets during the upside and then trade out and into a countercyclical market that is about to grow. In theory it is easy but in practice it takes a great amount of research to identify the stage a market is going through and then overlay that with the other principle variables that impact the market such as demographics, government policy, and infrastructural change.

The following Chart illustrates the results of a proactively managed portfolio. It assumes a house is purchased in Sydney for \$250,000 in 2001 before being sold in 2003. After accounting for agency



* Net proceeds take account for CGT, agency selling fees, legals, and stamp duty on new purchase.

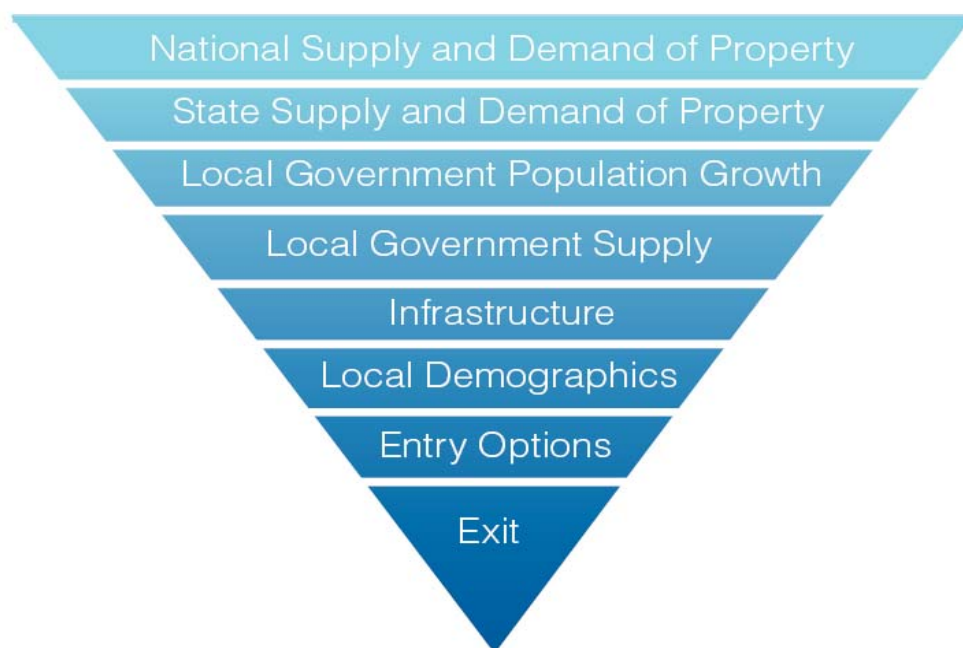
Source: Silverhall, Residex House Price Trading Indices

selling fees, legals and capital gains tax the residual is then invested in the Perth market (less stamp duty). This investment is held until sale in 2007 where the residual balance is invested into the Darwin market. When compared to holding the one property in Sydney over this same period the difference is well in excess of \$300,000.

Whilst some people may have enough income and equity to buy and hold all three properties, they are the minority. For those that have the capacity to hold only one investment property the opportunity cost can be tremendous. Keep in mind that this example spans the best part of a decade. That is a decade of growth you cannot get back if you were stuck holding a poor performing asset.

Silverhall uses a research strategy overlaying population growth and movement, government planning, infrastructural change but most importantly a focus on exit point. Having clients understand who is going to pay more for their investment in 3-5 years, and why, leads to better investment decisions being made.

Silverhall's Property Selection Process



Silverhall does not pretend to have a crystal ball on EXIT, however, through sound due diligence and constant review they advise clients when the market is showing signs of peaking. It is much easier to get out of a market that is still moving up than one that has commenced a decline.

Mike Anderson is a major shareholder of Silverhall and will be presenting at the AIA National Investors Conference from 25-28 July at the Surfers Paradise Marriott Resort. He and his partner will also be presenting at the Gold Coast group on 17 February and to the Sydney North Group on 17 March. Refer to the EVENTS section of the AIA website for more details.

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WHY BUYING THE WORST HOUSE ON THE BEST STREET MIGHT NOT BE THE BEST IDEA

By Paul Do

One of the most well known sayings in real estate is: “buy the worst house on the best street.” What it really means is that a property’s location is more important than the physical characteristics of the property because you can’t change it. This is generally true, except for the owner-occupiers who might prefer to live in a mansion in the outer suburbs than in a shack near the CBD.

But what if we fix the location? Is buying the worst house on a street the best idea? In my experience, no. When it comes to the worst properties, investors see an opportunity to pick up a property for less than its true value, arguing that most buyers will avoid these properties because they require too much work to fix up. They also think that the worst properties provide the best opportunities to add value, further increasing their returns. Owner-occupiers see a blank canvas to put their own stamp on the property.

As a result, buyers tend to behave irrationally towards the worst properties. Instead of walking away when the price reaches fair value, they are prepared to pay more, thinking that they can more than recoup the additional outlay from the repairs and renovation. This irrational behaviour drives up the price of the worst properties, so that many are overpriced to start with, and you would make a loss on the buying stage with these properties.

To compound matters, it is very difficult to buy a run-down property and renovate it for a profit, despite the myth created by the renovation shows on TV. If it were easy, you would see many more tradespeople getting into the game either by themselves or in partnership with equity investors. When you take the opportunity and holding costs into account, and exclude the natural capital growth of the property, few people can confidently say they made money on the renovation stage.

Another reason is that the worst house on the street is also the cheapest, and has the most possible buyers. In contrast, the best house on the street, is the most expensive, and has the fewest possible buyers. The level of competition from other buyers is very important because my first buying criterion is to avoid competition. You can only bag a bargain by avoiding competition from other buyers. As a matter of fact, when I encounter too much buying competition, I usually increase my budget to move to a higher price point where there is much less competition.

Finally, the worst houses are never overcapitalised – where the owners have spent too much on the renovation/addition and are unable to recoup all of their outlay. On the other hand, it is much easier to find overcapitalised houses among the better ones, especially when markets are weak. Sometimes these start off being the worst house on the street that fell into the hands of a novice investor or owner occupier with grand renovation plans. It is much easier to wait for the novices to do all the work and then buy the overcapitalised properties.

If you insist on targeting the worst house on the street, then make sure you only need to make cosmetic, not structural changes, to the property. Structural renovations require major changes to the “bones” of the property, and are expensive and time consuming. They also require specialist knowledge and skills, and anything that can possibly go wrong with structural renovations, will go wrong. Cosmetic renovations, in contrast, only require giving the property a facelift or some added functionality to increase the rent.

Also, before you embark on any renovation project, get feedback from real estate agents and valuers on the needs of the market and the value you can add to the property, to avoid overcapitalising. This helps you work backwards to calculate your walk-away purchase price as the expected value of the house after renovation less all costs (including opportunity and holding costs) and profit margin.

In conclusion, buying the worst house on the street might not be the best idea because you could end up with an overpriced property to start with. Moreover, it is difficult to make a profit just on the

renovation stage, let alone to make up for the possible loss in the buying stage. My preference is to buy the better properties. There is less competition, and sometimes the properties are overcapitalised, which means that I get more property for my money.

Paul Do is the author of *I Buy Houses: The Property Investor's Handbook*. For more information go to www.ibhb.com.au.

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BOOK REVIEW

Title: ***I buy houses: The Property Investor's Handbook***

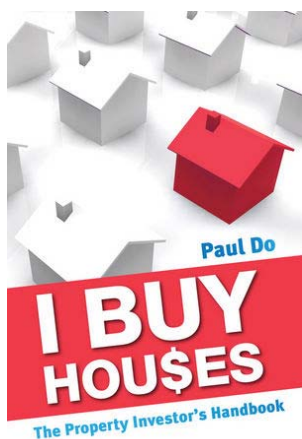
Author: Paul Do

ISBN: 9781 7421 68494

Publisher: Wright books, Brisbane, 2009

Reviewer: Brian Cordiner

RRP: \$34.95



Paul Do is a successful Australian investor in both the stock market and in real estate. This is his first book, developed over 10 years, and it reflects his practical experience in investing in real estate over different real estate cycles and in various Australian states. He has “been there - done that” with purchasing and selling established properties as well as acting as the developer when the situation warrants.

The book is suitable for first home buyers and also experienced real estate investors. There are five parts to the book covering: the real estate basics; his SYSTEM T decision making process; detailed information on the buying process; managing your properties and finally - the part of most interest to people with reasonable knowledge of real estate - making money in real estate.

The author provides a step-by-step guide to the buying process that he advocates and includes a live example of the decision making process applied to the purchase of a Sydney property in 2007, including how he selected the property to bid on, from the 10 potential candidates he identified in his research.

The buying process that Paul utilises involves a “value” approach to real estate investing with substantial desk research rather than numerous property inspections. He researches the real estate cycle using a top-down approach starting nationally, then by state, by city within the state and even down to the suburbs within the cities to find buying “windows” (or selling opportunities). He strongly recommends the accumulate strategy and only contemplates selling if it is absolutely necessary or to take profits to fund a new acquisition. If property prices are outside his “buying zone” he recommends waiting on the sidelines or investing in other assets until the cycle swings your way again.

Utilising graphical trends and applying his technical analysis to the real estate cycle, and having determined the intrinsic value of the property (from net present value of future cash flows), he finds the “buying zone” which may be a few months or years in duration. Features of the book include a comprehensive glossary, index and reference list as well as a listing of resources to assist the reader. He references his own website www.ibhb.com.au which is a useful resource for potential investors.

In summary, the author shares with us his substantial experience in selecting, purchasing and managing real estate investments and is a value read for any serious real estate investor.

Brian Cordiner is a member of the AIA.

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BOOK REVIEW

Title: ***Property is a Girl's Best Friend***
Publisher: Wright books, Brisbane, 2009
RRP: \$32.95

Author: Propertywomen.com
ISBN: 9781 7421 69347
Reviewer: Jennifer Williams



Real estate is a very important form of investment for Australians. This book comprises a series of essays by Australian women (and one man) who have different areas of expertise in real estate matters. Each area is essential to be a successful property investor. The author, propertywomen.com, is a membership website which provides information and events relevant to property investment.

The book attempts to provide a one-stop-shop for all the issues encountered in real estate investment. I think it would be a good handbook for anyone starting out as a property investor. It perhaps lacks the in-depth detail to be of great use to established property investors.

However, some chapters would be of interest to those with more experience, for instance the chapters on setting up joint ventures and on ownership (title) structures.

Areas covered by the book include:

- Budgeting and tracking cash flow
- Networking – identifying suitable real estate agents, accountants and insurance brokers.
- Strategies for making money through property investments, eg. renovating to increase rental income.
- Cash flow and gearing – benefits of being positively or negatively geared
- Renovation – can you profit by buying, renovating and selling in a short time period?
- Subdivision and development – steps involved in subdividing land and building multiple dwellings
- Setting up joint ventures
- The Title – legal and tax implications of ownership structures
- Options – for example giving a tenant the option to buy the property they are renting
- Property management – using professionals or doing it yourself.

What I found particularly useful were the lists and worked examples found in many of the chapters. For example, Robyn Masters' chapter on analysing a deal explained how to calculate rental yields and listed these basic guidelines on acceptable rental yields:

- **“Low yield: 1 to 4 percent.** This property must have huge capital gain potential, but will be cash-flow negative, so make sure you have the cash to hold this property for the long term. For me this would have to be an amazing property – perhaps something on the beach!
- **Average rental: 5 to 7 percent.** This is what most investors expect, but you can do better. I would only buy a property in this range if it had good potential for capital gain or was new with low maintenance requirements.
- **Target yield: 7 percent and upwards.** Now you're talking. These properties have reasonable cash flow and the rent might even pay for all the expenses before the tax refunds. Just make sure there is still some capital gain potential: investors normally create huge wealth through capital gain, not net surpluses, so make sure the property still has potential for growth.”

In summary, *Property is a Girl's Best Friend* would be very useful for beginners (women or men) in property investment. Those who already have a toe in the water will find some of the information adds to your knowledge.

Jennifer Williams is a member of the AIA.

This bulletin is produced by the:

Australian Investors' Association
PO Box 2477
Fortitude Valley BC Qld 4006
Tel: 1300 555 061 Fax: 07 3257 3932
Email: aia@investors.asn.au
Web: www.investors.asn.au

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