

PROPERTY

Table of Contents

| | | |
|----|--|--------|
| 1. | Coordinator's Message by Adrian Vorbach, AIA Councillor | Page 1 |
| 2. | How to judge the passing of a real estate cycle low by Phil Anderson, Economic Indicator Services | Page 2 |
| 3. | Pitfalls for first time real estate investors by Anthony Keane, <i>Adelaide Advertiser</i> | Page 4 |
| 4. | Top tips for successful property management by Geoff Doidge | Page 7 |

* * * * *

INTRODUCTION

By Adrian Vorbach

The first article by Phil Anderson, Director of Economic Indicator Services and real estate author, shows a fairly consistent 18 year real estate cycle.

The second article by Anthony Keane, financial journalist of the *Adelaide Advertiser*, highlights pitfalls for real estate investors.

The third article by Geoff Doidge of Reno Kings, well known real estate operator and author, provides us with his top tips for successful property management.

Adrian Vorbach is an AIA Councillor and Coordinator of the AIA SA Committee.

* * * * *

HOW TO JUDGE THE PASSING OF A REAL ESTATE CYCLE LOW

By Phil Anderson

"The further backward you look, the further forward you see."

Winston Churchill.

A study of US history reveals a very clear (average) eighteen-year cycle in US real estate prices, measured from trough to trough or peak to peak. The actual cycle has never been shorter than 17 years, never longer than 21. Not only has the real estate cycle been historically consistent at about 18-years in duration, each cycle has unfolded in a highly regular and consistent manner. I have highlighted this in past AIA journals so we won't go into that again here, except to say that past US (and Australian) real estate lows occurred in 1991/2 and 1974.

Which leads us into the all important question; *how can we know when this current cycle will have passed?* The 18-year cycle has been a bit harder to see, this time, in Australia, so we will deal with the US situation first, then talk about Australia.

So, how can we judge the passing of a real estate cycle low? The answer to this question can be found in the stock market. We start with a look at the cycle low of 1991, Figure 1.

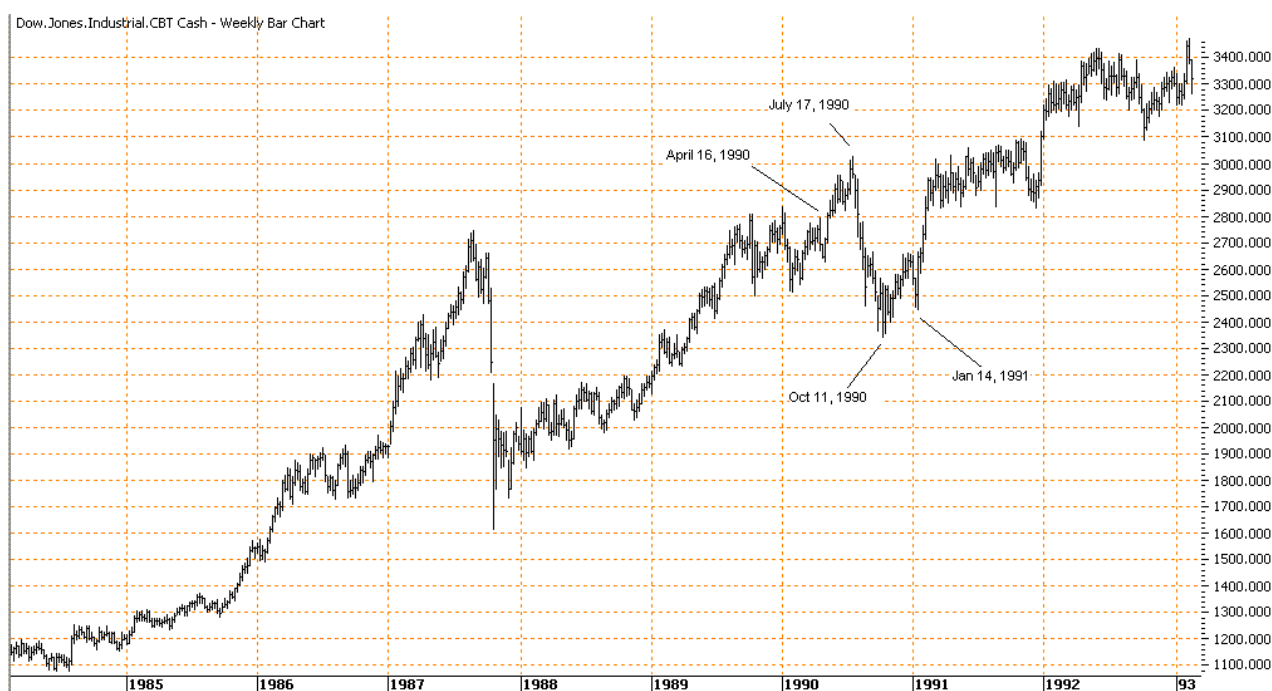


Figure 1: Dow 90-91 lows

We can see that the US markets, as measured by the Dow, made a low in 1990, October 11th, as the state of the deteriorating real estate market became obvious to all. Significantly though, this low ended up higher than the 1987 crash low, which was not the case in some other nations. More significantly, as the US real estate market grew worse in the later stages of 1990 and 1991, US

stock markets actually began making *higher* lows, beginning in January of 1991. Here then, is the clue to understanding where the real estate market is, at lows. By early 1992, US stock markets had even begun moving into all time new highs, *despite the fact that its real estate markets still had much unsold inventory* slowly being offloaded by the banks left holding the assets of former high-flying entrepreneurs, now broke or out of business.

This is why EIS encourages real estate operators to understand the stock market (and vice versa; stock market traders to understand the property cycle). At real estate recessionary lows, it is the stock market that will bottom first, before the real estate market. Most professional stock market traders realise that stock markets lead the economy by around 6 to 9 months.

The same process was at work after the 1974 real estate recessionary lows. See Figure 2 below.

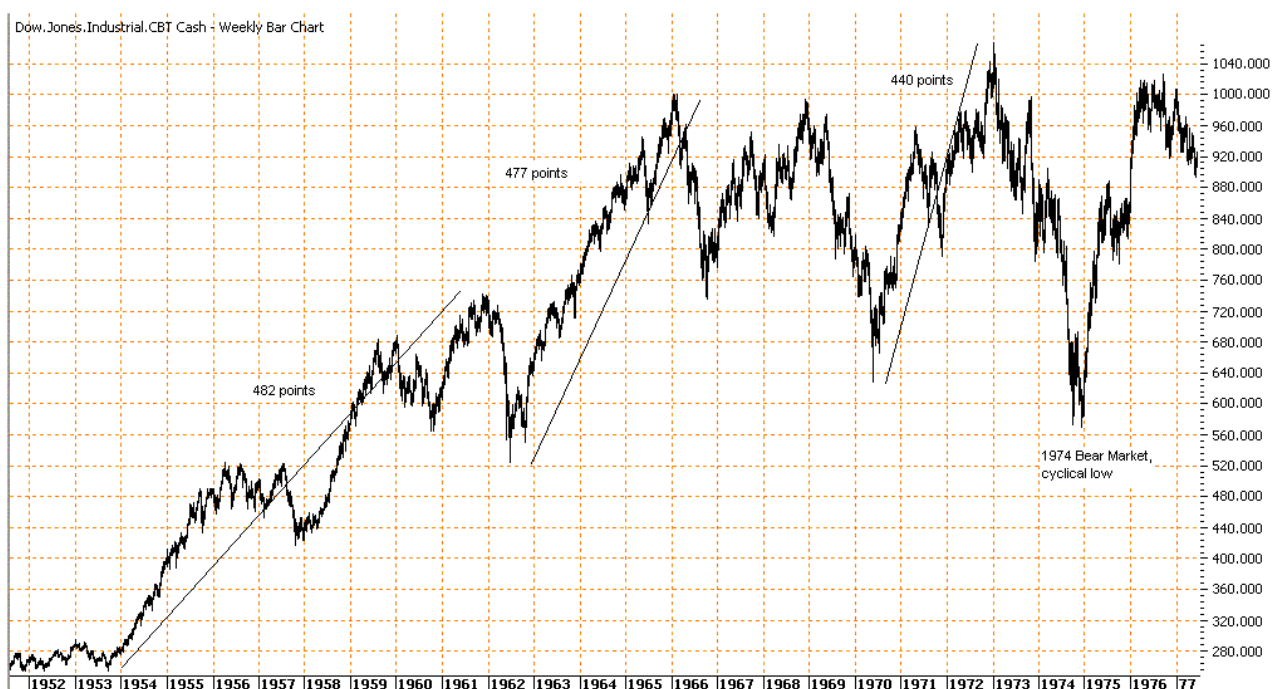


Figure2: Dow '52-75

After 1974, we can again see higher stock market lows in 1975, and again through and into 1977. Another real estate cycle had well and truly begun by this stage, despite the fact that a lot of real estate inventory still remained unsold in all those years.

This is the process we must now watch for in current markets, 2010 and going forward. The US has, historically, always led the world into these cycles, and always out again. With a little help from China, the same is going to happen again. This, at least, is once again what the current US stock market is indicating, with its higher lows for this year, 2010, than in 2009.

I ran through this process in my book *Secret Life of Real Estate and Banking*. This consistent process was examined from the 1792 downturn, and then for each real estate led recessionary low after that right up until 2006, with a prescient forecast for the next US real estate low in 2010. In the book, roughly at the end and at the beginning of each *historical* chapter, I discussed how the economic news turned from greed to fear, then back again, and I put in US stock market charts to help readers relate the economic and financial news to those charts. An exact repeat is once

again taking place, and the US stock market is indicating the cycle from 1992 to 2010 is fast becoming history.

For Australia, we have had our cycle, and are well into the next one. The only caveat I would place on that is whether Australia might be lining itself up / synchronizing itself with the cyclical forces coming out of Asia (China), rather than the once dominant US. If that were the case, Australian real estate investors should watch around 2015 rather carefully. Perhaps this could be the subject of another AIA article at a future date.

Phillip Anderson is the Director of Economic Indicator Services and author of 'The Secret Life of Real Estate and Banking.' For those interested, further information on this topic can be seen on his YouTube channel:
<http://www.youtube.com/user/BusinessCycles>.

* * * * *

PITFALLS FOR FIRST-TIME REAL ESTATE INVESTORS

By Anthony Keane

GETTING started in property investment can be a scary proposition. It's not every day you sign up for hundreds of thousands of dollars of debt for something you don't live in.

History has shown that, for long-term investors, the rewards are usually worth the risks, but there are plenty of traps the first-timers need to avoid.

Tax, interest rates, tenants, property agents, renovations and insurance are among the areas where mistakes can cost investors big money, or at least deny them some of the profits they seek.

Today, *Your Money* examines some of the traps for first-time property investors.

SEMINARS THAT BITE

University lecturer, author and investor Peter Koulizos warns about so-called "property education" seminars that are really just sales seminars designed to flog overpriced property to pumped up investors.

"But I would encourage people to try to see lots of seminars – just leave your cheque book at home," he says. "You get different perspectives and can get good information, but just go with your eyes wide open."

WHERE'S THE RESEARCH?

"Some people spend more time researching the plasma TV they are going to buy rather than the property they are going to buy," says Koulizos, who wrote *The Property Professor's Top Australian Suburbs*.

These days we are spoilt for choice, with a wealth of information about property prices, trends, hot and cold suburbs, tips, traps and warnings in the media.

BUYING FOR TAX PURPOSES

Koulizos says many people look at property investing as a way to get a bigger tax refund. "But you are only getting a refund because you made a loss," he says.

This practice is known as negative gearing, but seasoned investors know that a positively-geared investment - where the property pays you a profit - is the ultimate aim. First-time investors are usually negatively geared, so why not get your tax refund back sooner?

Louise Carr, a property strategist with investment group Ironfish, says completing an income tax variation form can help you smooth out your cashflow rather than get a lump sum refund at tax time.

"You can organise to get your tax back on a weekly or fortnightly basis with your pay," she says.

DEPRECIATION DEBACLES

One of the best tax benefits from property investment is being able to claim a deduction for depreciation of items within the property and the building cost of the property.

You don't physically pay these costs, so effectively it's free money through your tax return. However, many investors don't understand depreciation, Carr says.

"Deductions for new homes can be up to \$15,000 a year. We often find that some accountants don't make people aware of it. We recommend going to an accountant who owns property themselves, so they know the advantages and are aware of tax legislation."

A depreciation schedule will list all your depreciation deductions. They typically cost \$500-\$600, are tax deductible themselves, and are available through a quantity surveyor.

BAD ADVICE

Everyone has an opinion about property and these days opinions are divided about real estate investing.

There are also different views about what to buy, where to buy and tax strategies, and investors should not rely on advice of friends and family, who may have completely different financial situations.

Carr says getting good professional advice is crucial. "People who get advice from friends and relatives find that their investments are generally not set up properly," she says.

PAYING TOO MUCH

Ian Lloyd, an advisory board member of property and finance group Investa Solutions, says some investors pay more than they should.

"There are developers out there who, I believe, are offering properties that are overpriced," he says. Some government schemes and incentives are prompting people to create properties and developments that are "a little manufactured" and slug hefty management fees, Lloyd says.

Property management is another area where people can pay too much.

"Don't pay letting fees or reletting fees to property managers," he says. "For every week of rent you give up, for example for a letting fee, that equals 2 per cent of your rent. So if you pay an 8 per cent management fee but there's two weeks' rent for letting, it's 12 per cent.

"Then, if it's re-let and there's another fee, you are in effect paying 14 per cent.

"If you can negotiate something a flat fee – something like 10 per cent – you don't lose rent up-front through letting fees."

NO SAFETY NET

Investors can lose everything if something goes wrong and they don't have the financial firepower to cover costs and loan repayments.

"Have a strategy where you have set up a reserve," Lloyd says. "A good finance broker or adviser can help you set up a buffer that would mean if you lost your job you could still keep the property."

Carr says it doesn't have to be cash - an available line of credit could be enough protection.

"Have a kitty of \$20,000, so if you run into trouble or tenants don't pay on time, you can still sleep at night."

INTEREST RATE PANIC

Fixed rate loans have been losing popularity, but fresh talk about rising rates can prompt beginners to fix.

Koulizos says some people can get trapped in a long-term fixed rate loan - say five years - because they panic when rates are relatively high.

“Then in three, six or 12 months the rates start to come down again but you have locked yourself in for years paying a higher rate,” he says. “Generally people fix at the wrong time, but fixing can be good – especially if you are risk-averse.”

EASILY SCARED OFF

Some investors decide to sell up after one bad tenant, Koulizos says.

“You can get rid of a tenant who’s doing the wrong thing, but as soon as you sell your asset will not be going up in value,” he says.

The vast majority of tenants are not evil, and if you treat them well most of them will respond in kind.

USE YOUR HEAD

Koulizos says many people renovate an investment property with their heart, not their head.

“They renovate a property like they want to live in it, and can overcapitalise,” he says. Save crazy colours for your own home. Rental properties with neutral colours attract a broader range of tenants.

IGNORING INSURANCE

Landlord insurance is vital for investors. It’s tax-deductible and not as expensive as you might think.

For example, Carr says a policy that covers things such as malicious damage, accidental damage, rental default and legal liability would cost you \$255 a year through major landlord insurer Terri Cheer.

“Some investors think ‘I have a property manager – I don’t need landlord insurance’, but they do.”

LACK OF PATIENCE

“Property is get rich slow,” Carr says. “Some people don’t believe that property prices will double again, but historically they have doubled every seven-to-ten years.

“The more time you go through the cycles, the more money you are going to make.”

Anthony Keane is a journalist with the Adelaide Advertiser. This article first appeared in the Your Money Section on 11 October 2010.

* * * * *

TOP TIPS FOR SUCCESSFUL PROPERTY MANAGEMENT

By Geoff Doidge

Tip 1: Buy the right property for rental

There are two main criteria for buying the right rental property: (a) the right location and (b) the right property type.

- (a) **The right location.** Research is essential. What is the vacancy factor? What are the capital growth prospects? How close is it to transport, shops etc.? Walking distance to transport is a major advantage for tenants, as they highly value the savings in petrol and parking costs. Who are your tenants likely to be? If they're likely to be students, for example, you would focus on property with easy access to universities and colleges.
- (b) **The right type.** The choice varies from units to houses to blocks of flats. You might use the 'cookie cutter' approach, finding out what works for you (e.g. detached houses) and keep doing it well. Alternatively diversify across a range of types. Both strategies have advantages and disadvantages. For example, when the Commonwealth Government restricted overseas immigration and student visas, some colleges folded, student rental vacancies increased and rents fell as landlords fought for the remaining tenants.

Tip 2: Get the right training

The average home owner has no idea of tenancy laws, and it's no wonder some newbies get into serious trouble. You wouldn't drive a car without a licence, so get some property management training if you intend to be a landlord. The POA (Property Owners Association) is a great place to start; and REI (Real Estate Institute) courses another.

Tip 3: Do it yourself or use a property manager

There are big savings to be made as a DIY (e.g. 10% commission is \$10,000 on a \$100,000 rent), but you must know the rules. For 'time poor' people, a property manager is the way to go. Find the best one in your suburb — POA referrals could help. There are a number of tips on how to find the Property Manager of the Year in our book, *Managing your investment property*.

Tip 4: Advertising

I had five agents advertising a rental house, but they all advertised on the same websites without success. I advertised on a student website and rented privately in just one week. Access to the web is critical, but don't overlook the newspapers for newly arrived people without web access. Make sure you have a 'For Rent' sign outside (just one), as your prospective tenant may be across the street.

Tip 5: The right tenant

This is the most important tip of all. Good tenants are greatly to be valued. They pay the rent on time, are quiet, and keep the place tidy. I had a bad tenant who came with a house I bought, and realised too late that I should have requested vacant possession. I have 58 tenants, and this one tenant took more energy and effort than all the other 57. A comprehensive application form (there's one in the book) and rigorous checking of tenancy history are essential. And don't just check with the tenant's current manager. That manager may say anything to get rid of a 'tenant from hell'.

Tip 6: Getting tenants started

A standard checklist to get tenants started, like the one in the book, is essential. List items such as sufficient keys (one per tenant), condition report and bond form. I take the bond and two weeks' rent in cash, because internet transfers can take 48 hours and cheques can bounce. After that, they pay the rent by direct debit. Negotiate that they start within one week if accepted. They have

to give 14 days' notice of leaving, so they give me 7 days and I give them 7 days. Have your leases finish in a peak period — say mid-January, not December.

Tip 7: Oh no! Bad tenant

Nothing gets your focus like a 'bad' tenant. The main problems are rent arrears, noise and damage or, if you are really unlucky, all three! On the few occasions that a 'black sheep' has slipped through my guard, I have found it is best to swallow my pride and put it in the hands of an agency property manager. This has two advantages. First, it strips the emotion between you and the tenant. Second, the agent will comply with the thousands of tenancy laws.

Tip 8: The nuts and bolts

If you DIY, make sure you have tenant payment records. My version is in *Managing your investment property*. Get a quantity surveyor to do your depreciation schedule for tax purposes. Keep your rent at or just below market. Maintain the property regularly or you will be left with a major renovation and long vacancy when the tenant leaves. The irritation of a constantly dripping tap which you never fixed may be the final straw that makes the tenants leave. Concentrate on street appeal, as many tenants do a drive-by before going inside.

Tip 9: Multiunit dwellings

These could be a duplex, triplex or block of flats. If you own the block, you have control. You can renovate without asking the body corporate. For example, you can allocate areas for tenants' private use and fence them off to create a courtyard. This means higher rent, equity gain and more tax write-off.

Tip 10: Building a rental property portfolio

The key is to buy well and add value by renovation, subdivision or redevelopment. Rent fast for good cash flow and low vacancy. Use the equity gained to refinance and buy again. It works. This is what we have done to build a \$27 million portfolio returning about \$1 million rent per year.

Summary: These tips should help you get the right tenant at the right rent for long-term cash flow and capital gain.

*Geoff Doidge of Reno Kings is co-author of Managing your investment property. A review is available on the AIA website <http://www.investors.asn.au/reviews/books/?bid=287>. If you order your copy of the book from www.essentialguide.com.au you receive **\$300 worth of bonus material!***

* * * * *

This bulletin is produced by the:

Australian Investors Association
PO Box 7439, Gold Coast MC Qld 9726
Tel: 1300 555 061 Fax: 07 5538 8376
Email: aia@investors.asn.au Web: www.investors.asn.au

Disclaimer

This Disclaimer is made for the purposes of the Corporations Act 2001 as amended by the Financial Services Reform Act 2001 ("the Acts").

The Australian Investors Association

The Australian Investors Association ABN 75 052 411 999 ("AIA") is a non-profit association that aims to assist investors become more knowledgeable and independent. In furthering its aims the AIA offers general information through its *publications*. The AIA has no Australian Financial Services Licence ("AFSL") under Part 7 of the Corporations Act 2001 as amended.

Does not contravene the Acts

The AIA, its officers, agents, representatives, and employees do not hold an AFSL and does not purport to give advice or operate in any way in contravention of the Acts. The AIA, its officers, agents, representatives, and employees exclude all liability whatsoever, in negligence or otherwise, for any loss or damage relating to this publication to the full extent permitted by law. The AIA has a policy that does not permit the endorsement or recommendation of any product or service regulated by the Acts.

Provides Information only

This *publication* has been prepared as an information *publication* without consideration of any *reader's* specific investment objectives, personal financial situations or needs. Because of this, no reader should rely upon the information and/or recommendations contained in this *publication*. Readers should, before acting on any information contained herein, consider the appropriateness of the information, having regard to their objectives, financial situation and needs.

The AIA believes that the material contained in this *publication* is based on the information from sources that are considered reliable and is accurate when issued. However, the AIA does not warrant its accuracy or reliability. All views and information expressed by the AIA, its officers, agents, representatives, and employees are for the purposes of discussion only.

If this *publication*, or any information, relates to the acquisition, or possible acquisition, of a particular financial product, the reader should obtain a product disclosure statement relating to the product and consider that statement, and should consult a licensed person before making any decision about whether to acquire the product. The opinions expressed in this *publication* are those of the authors and do not necessarily reflect the views of the AIA.

Copyright: All rights reserved. No re-publication or copying in any way, including electronic means, may be made without the prior written consent of the AIA.