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REPORT

Property Health Check

Diagnosing property for investment success

By Neil Smoli of the Aviate Group

Property Health Check: Diagnosing property for investment success

By Aviate Group Managing Director Neil Smoli

In any field, be it medicine, business, education or otherwise, research is more than important. It informs an entire approach, mitigates risk and is the basis for the delivery of the optimum outcome. Such it is with investing in residential property too.

Every investor, post purchase, will tell you they did their research, their due diligence. Yet most property investors fail. Despite the reputation of residential property as being a low risk investment class capable of delivering strong, reliable returns, the majority of investors get it wrong.

They aren't lying. Most investors do research a property prior to purchase. The question is whether the research they are doing is the right research.

It's about knowing what to look for, understanding the factors that influence a property's chance of success and how these factors will influence an investment property over the long term. After all, ideally, property is a long term investment.

This research takes time. Time poor professionals may find it impossible. This is not a sleight, it's a fact. Let's take a look at some of the factors property investors should be researching to get an idea of just how substantial the due diligence process should be.

The right research

There is a broad range of factors that can shape the success – or otherwise – of any given investment property. These range from the macro level, encompassing the broader economic situation, down to the property market level and further to the micro level, such as those factors that are specific to the property itself.

All these factors must be considered if an investor is to be able to truly claim they have done the right research. But it goes further still. Considering these influences is one thing, but how do you evaluate them? How do you ascertain the likely impact of, say, negative white collar

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employment growth in a particular suburb when the level of infrastructure spend in that same suburb seems positive?

Acknowledging what they don't know is something most investors fail to heed, and this is the main reason so many don't realise their goals. Engaging an investment property expert, one that doesn't charge the investor but instead prioritises their safety and security, is best risk mitigation strategy.

We will discuss different fee structures later, but suffice to say that groups intent on charging the investor a fee from the outset are not operating in the investor's best interests.

So how does the macro picture determine investment property success? What types of factors do investors need to weigh up?

Residential property as an asset class benefits, broadly speaking, from its relative security compared to other asset classes like shares, new business ventures and other investment schemes.

The ability to recognise and understand the property market cycle is of course critical. This cycle is inevitably influenced by the state of the broader macroeconomic environment, both at an international and national level.

At Aviate, we consider factors such as interest rate trends, employment market statistics, demographic shifts, existing and proposed legislation, changes to taxation and global economic scenarios with the capacity to influence the domestic market, among many others. There are many elements to consider when it comes to painting an accurate picture of the macroeconomic landscape and its impact on investment.

A micro analysis is equally important as the situation closer to home, related to the state in which the property is located, can inform an investment's future success.

Factors like housing grants, building bonuses and other incentive programs are generally administered at a state government level. These programs change regularly and can have significant ramifications for property investors and the various markets operating within the state.

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State budgets, infrastructure spending and other social expenditure can all affect the capacity for an investment property to attract quality tenants now and in the future, while growing in value over the long term.

Even if the investor has cast a net globally, considered the national perspective and focused on the state based impacts on investment property, for a proper, comprehensive analysis, the task is not yet complete.

The fundamentals of the market related to the specific city in which the investment property opportunity is located must also be considered. Every capital city around the country has its own drivers, nuances, strengths and weaknesses.

In Sydney, the main motorways serve some areas better than others. In Perth, some markets are populated predominantly by people employed in the resources sector. New projects in and around Brisbane CBD have the potential to alter the prevailing tenant demographic. Some areas in Melbourne are moving to oversupply, but standout pockets still exist.

Then there is the apartment site itself. Which apartments in a development are best positioned, in terms of aspect or penetration of natural light? Are apartments on the top floor a better investment than those directly above a garage entry point? Why?

It's one thing to ask these questions –and there are many, many more that investors need to consider - but it's another to understand exactly what impacts the answers might have on an investment property's success. Understanding and evaluating these factors and then identifying and securing an investment property that satisfies the various criteria is not a simple task, especially for the time poor professional whose expertise lies in another field entirely.

This is why it's so crucial for investors to engage a company which specialises in investment property and has the track record to demonstrate the success and security of its approach.

Diagnosing Henry

A term to describe a particular type of professional and increasingly referenced in investment circles is Henry – "High Earners Not Rich Yet". It's a term that aptly describes many professionals in the medical field as well as other high earners in the various professional industries.

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For the time poor professional, their salary is typically not a source of concern. But a salary, however substantial, is not the same as wealth creation. To equate earning bank interest to investing is as futile as walking to the corner store to train for a marathon.

So it's worth asking whether you fit this mould. Have you invested before? Why or why not? Do you have investments that are putting money into your bank account without you having to work at them?

At this point is worth considering what is meant by financial freedom. It's not a pie in the sky term; there is a mathematical basis to it. Put simply, financial freedom is a state most investors seek - yet only few reach – whereby the investments they have made have the capacity to provide the income they require without the investor having to work at them any longer.

Obviously it's a long term process, indeed the timeline investors typically place on achieving financial freedom is for their retirement. For an investment portfolio to be able to deliver and sustain this level of return, the investments therein must be carefully researched to perform well into the future. An emphasis on security is essential, and there must be a willingness on the part of the investor to maintain a long term vision, even at the expense of some short term budget limitations.

It's important to note that financial freedom is not solely the domain of the wealthy; those on high incomes. It is perhaps even more important for those on average salaries to work towards this goal.

So how does one get started? How do Henrys become successful investors who one day reach the ultimate goal of financial freedom?

The simple answer is to start investing. More difficult is to do it right the first time.

In the same way you might refer a patient to a practitioner specialising in another field, the best investors know where their strengths and weaknesses lie and in the case of the latter, they engage expert help.

No two investors are the same so a one-size-fits-all approach is useless. In the case of property, it's important to understand the investor's motivation, their current situation, their capacity to meet repayments, their end goals and their objectives along the way.

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Once this profiling is complete, a strategy based on the secure, perhaps staggered acquisition of the right type of investment properties can be developed. There are techniques including maximising the use of existing equity, unlocking depreciation and taxation benefits, negative gearing, undertaking regular valuations and other financial instruments that can support investors as they pursue their financial goals.

If you recognise the Henry traits in yourself and wish to leave the tag behind, and you presumably don't have the time or specialist expertise in the investment property field, how do you select a property investment company to partner with? After all, there are plenty of spruikers out there. Choosing the best property partner is an essential part of an investor's research.

Partnering properly in property

We should declare a vested interest here. For more than 12 years Aviate has worked with investors, from mum and dads on average salaries, young people just starting out, to long term career professionals looking to sure up their pending retirement.

In this time we've seen different groups come and go, different models built and unravelled, and there are some consistent themes that can be drawn.

First and foremost, people invest in property because it is deemed low risk. It therefore makes sense to partner with a company which prioritises the investor's security above all else. There is of course a place for high risk-high return investments but, generally speaking, this is not property's place in a portfolio.

Security when it comes to investing in property covers many different areas. For instance, investors should partner with companies that insist upon obtaining a property valuation from a major bank panel valuer. An investor should never rely on the word of a developer or agent when it comes to how much a property is worth. By extension, any investment property company that doesn't insist on obtaining a valuation prior to purchase should raise the eyebrows of investors.

A valuation from a recognised valuer ensures the investor pays a fair market price for the property, not a price subject to additional margins for the developer, the agent or even the property investment company itself.

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Understanding how a property investment company is remunerated is a question all investors should ask. If a company doesn't disclose its model up front, alarm bells should be sounding.

An investment property company is typically remunerated by the developer, with the fee generally expressed as a percentage of the purchase price of the property. Traditional real estate agents would generally receive 2% to 3% commission, whereas for property investment groups the commission rates might vary from 5% to 8%.

These higher fees reflect the costs associated with servicing their investors, ongoing research expenses and longer lead times, as settlements can take up to 24 months. There are groups that charge as much as 12% to 15% however anything above 6% can be considered excessive and moves away from benefiting the investor.

Ideally, investors should choose companies that charge a capped rate. This way, the company is not swayed or manipulated to present a property or a development to an investor because it is offered at a higher commission rate. Instead, when a higher commission rate is offered, the additional amount above the stated rate should be rebated back to the investor at settlement.

This is the most transparent way for the company to secure a property for an investor.

Remember, the fee to an investment property company should be payable by the developer or vendor, not the investor. The investor should pay simply the price of the property, the same price stipulated or less than the valuation.

Again it comes down to security, and the need to prioritise the security of the investor above all else.

Aviate's secure investment property service is specifically geared towards time poor professionals. Our approach is diagnostic as we undertake extensive investor profiling to understand why certain Henrys are not in the financial position they would like to be in. Then we set about creating a strategy using secure investment property to help them get there.

Call it holistic financial health.

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