



The Shocking Truth

The 7 Deadly Sins of Property Investing

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Introduction

The majority of new first time property investors commit most of these 7 deadly sins. It is painful to watch people make these basic and fundamental mistakes, but for whatever reason pursue an agenda of someone else, rather than their own.

Property Investing is at its heart a very simple process. Follow the rules, and you will not have any major problems. So here are the 7 deadly sins:

1. Thinking like a consumer;
2. Being swept into the agenda of a so called “guru” investor;
3. Buying on emotion;
4. Inadequate taxation advice and preparation;
5. Not having an “exit” strategy;
6. Not researching BEFORE a purchase;
7. Not having a “head for the numbers”.

Deadly Sin #1 – Thinking Like a Consumer

Consumers are impulse buyers. If the cash is there or worse still, the Credit Card has available funds; any whim will be satisfied by an impulse purchase.

Consumers have little concept of the “no gain without pain” maxim. They are conditioned to instant gratification, and therefore the planning required for a long-term investment strategy is never contemplated.

Consumers believe most of what the media tell them. So if the media is running stories about how property prices are booming, consumers run out and buy an investment property, generally close to home so they can keep an eye on it. But they tend to wait a few years to make sure the media is telling the truth, positioning their investment at the end of the current growth cycle. If the media are running stories about property prices depressing, consumers sell their investment properties and buy shares, top up their Superannuation, or worse, they put the money in the Bank. But they do this as soon as the first stories about the pending crash hit the press.

Consumers are scared of debt (unless it is their own home Mortgage, Credit Card debt or a Lease for their new toy). The concept of productive debt leveraging a growing asset class is completely foreign to them.

Consumers believe that Taxation benefits will make them rich, and make investment decisions based primarily on Taxation benefits.

Consumers believe the fastest way to wealth and happiness is to pay off their Mortgage as fast as possible, because that is what the media tells them is the best way to beat the “warlord” Banks.

Consumers believe that owning their own home is the way to maximise their wealth in life, because that is what conventional wisdom teaches them. So much so that when the Government changes the First Home Owners Grant from \$7,000 to \$14,000 as they did in 2001, a boom in real estate sales is fuelled that marches prices in the worst suburbs forward like never before, creating their own

nightmare when the Gravy Train leaves the station and the bubble bursts.

Consumers believe that borrowing 100% of the value of their new home (because they have no savings) is the only way they can become rich in the long run, completely ignoring the fact that the unproductive mortgage interest from this high gearing will cripple their cash flow.

Consumers believe that people that invest aggressively are rich and that rich people earn so much money that they have no idea how the average working class lives from day to day.

Consumers believe their 9% company Superannuation contributions (and possibly a little more every now and then) will more than adequately provide them with enough income to maintain their current lifestyle when they retire. After all, this is what the Government and the Media tell them is the right way. If it looks like their Super may not cover their requirements on retirement, they blame the Government and start agitating on the “talk back” radio programs, Letters to the Editor, and their local Member.

What is the remedy?

Metanoia!

This is a Greek word that means “Change the Way You Think”.

Meta means “the highest level”, and Noia means “thinking”. In other words, go to the highest level of thinking.

If you do what everyone else does, you will get the results everyone else gets. If nothing changes, nothing changes. Go to a higher level of thinking and do what everyone else does **NOT** do. Plan and strategise, based on your own needs. Use the most amazing organ in our body called the brain (the only differentiating feature between us and the animals of the world), and challenge everything that the “common” wisdom leads you into.

Accept nothing on face value. Research everything, and know the indisputable facts that give you the base line knowledge on any subject that is of interest to you.

We are in the Age of Information. Never before in the history of mankind have we had available such volumes of the written and spoken word for free and at the touch of a mouse button, just waiting for the intrigued consumer ready to make the decision of his/her life to become an **INFORMED** consumer, and then the natural progression to **INVESTOR**.

The mind of a professional investor requires discipline and self-control. Professional investors use all available information and modern technological tools to maximise their returns and minimise their downside risk.

It was Albert Einstein that said:

“The definition of insanity is doing what you have always done and expecting a different result”

Remember the movie The Matrix?

Will you take the Red Pill or the Blue Pill?

Deadly Sin #2 – Swept up by the “Guru” Investor

With the progression of the Internet, many so-called “guru” investors with marketing expertise have risen to prominence with a grab-bag of differing strategies. Do the names Michael Yardney, Steve McNight, Margaret Lomas, Jan Somers and Hans Jakobi ring a bell?

Now I am not saying that these people and many others have not been successful, nor am I saying they are not making a positive contribution to the profession of property investing. What I am saying is that all these people have their **own** way of investing in real estate that has suited their style and personality. Their styles and personality are **not** yours, and **your** style and personality should determine the direction of your investment strategy.

I would like to try to simplify the primary choice that leads to **ALL** other choices you have as a potential property investor.

Active vs Passive Investing

The most important choice you must make is this first choice. This choice depends completely on your current lifestyle, professional and risk profile choices.

An active investor is one that proposes to utilise their own time to source, negotiate and manage their real estate assets. Providing the financial resources are available, active investors can progress quickly to devoting full time work to their real estate investing activities. Active investors are much more likely to pursue speculation opportunities, where developing a cash flow and full time income from your **real estate business** is the primary goal. Active investors tend to be a little more impatient with results, and are much more likely to look for subdivision, renovation and/or positive cash flow investing opportunities.

A passive investor on the other hand has a priority on their current lifestyle, family and professional employment, and invests for their long term benefit. Passive investors are much more inclined to buy and hold for the long term in high growth suburbs where low maintenance and high yields and high capital gain are likely without any physical intervention. Passive investors are more patient, and have an eye on retirement from an early age.

Passive investing does not mean you commit Deadly Sin #6 though. It is still your responsibility at the end of the day to make sure the property you buy is at the current market value.

Many first and second time investors progress to becoming active investors as their experience and knowledge grows, and it is a high risk strategy to embark on active investing without some prior experience and property investment platform.

Many “guru” investors offer training and development products to help novices understand their particular specialisation, and encourage novices to become involved with their particular specialty. Whilst the success from these education and training activities can be measured, the majority of students in these programs do very little with the training after the completion of their course/s.

By following the recommendations from this report, any potential property investor can equip themselves to make excellent investment decisions based on an unemotional assessment of the numbers and markets, thereby minimising their downside risk.

By activating “metanoia”, you will never need the services of any “gurus” unless

you decide to become an active investor and seek the help from those with the expertise in your area of specialisation. There are many ways to make money from real estate, but it is up to you to decide which strategy will suit your own personality and risk profile.

I highly recommend you read a book by Dale Beaumont called “Secrets of Property Millionaires Exposed”. You can purchase this book from the website at:

<http://www.secretsexposed.com.au>

Read between the lines as I did, and you will see that all these “gurus” have their own strategies that suited them, and they kept at it until they were successful at it.

For those of you like the millions of Australians that do not want the headache of developing a real estate business from their investing activities but want to invest successfully, your choice is to become a passive investor initially, where you leverage the expertise of professionals. Your choice here is to possibly employ a Buyers Agent to source property for you, or to use a company like [Ozinvest Pty Ltd](#) to source and manage your properties.

Deadly Sin #3 – Buying on Emotion

I alluded to this issue in the previous section.

Bottom line is that no matter how much you love or hate a property, the investment dynamics of that property will not change.

Residential real estate is a commodity. Everyone has to live somewhere.

So the prices of residential real estate (both rental and sales) are based on the supply and demand dynamics within the market. If the demand for property exceeds supply, prices will be rising. If supply exceeds the demand for property, prices will be steady or falling.

This is subject to one major factor in residential real estate, and that is affordability.

When demand is exceeding supply to a large extent, it is likely that you are experiencing a boom in real estate sales prices. The only factor that holds this dynamic back is **affordability**. We all remember the last boom in Sydney prices that stopped in November 2003. Why did the market suddenly stop?

Two reasons:

1. The Federal Government withdrew the additional \$7,000 first home owners grant; and
2. Average home owners could no longer afford the prices of Sydney real estate.

An emotional investor will **not** consider the current economic conditions in a given market. They tend to buy because the proposed investment is located close to their home, and they think it is a bargain. Whilst over time these investments may provide solid gains, the investor is often bound by poor capital gains in the initial years, thereby reducing their ability to leverage into other investment properties in the future.

Unemotional investors buy in whatever market is in a growth cycle. If Perth is

growing, that is where their focus of attention will be. If Darwin is running, unemotional investors will be closely scrutinising the market. When Brisbane starts moving, unemotional investors buy there.

This means that at any given time, unemotional investors have property in a growth market, thereby maximising short to medium term growth and minimising downside risk. **This is the holy grail of property investing.**

The other major emotional problem to overcome is the fear of debt.

There is a **HUGE** difference between productive and unproductive debt.

Unproductive debt is any debt that services non-income producing assets, and is therefore not tax deductible. Your home loan, credit card debts, personal loans for consumer activities etc are all examples of non-productive debt.

Productive debt on the other hand services assets acquired for income production, and are generally appreciating assets.

You need to minimise unproductive debt, and maximise productive debt.

Let's assume you purchase 3 Investment Properties in the next year worth \$1mil, for which you borrow the whole purchase price. Now the thought of \$1mil in debt to most Australians is enough to send the shivers down your spine. Now zoom forward 10 years, and the three properties are now worth \$2mil. **You have just made the easiest \$1mil you will EVER make!** Would that \$1mil of debt seem like a big problem now? I think not!

The basic principle of property investing is the leverage you gain by having an income producing asset in your name with money provided by someone else.

So forget about the worries of debt! Replace that worry by the worry of not doing anything when you can easily afford it! Start thinking like an investor!

Deadly Sin #4 – Inadequate Taxation Advice

One of the primary reasons real estate investing is so prominent in the minds of potential investors is that the Federal Government has structured the Taxation Legislation to encourage property investing by allowing negative gearing of real estate investments. This strategy ensures there will always be a reasonable supply of property to those that cannot afford or choose not to buy their own home. It is a way of the Government subsidising the housing market to ensure the supply part of the equation, particularly for the less wealthy in the community.

Negative gearing means that any excess of expenses over the income of a property investment (including some very generous depreciation allowances) may be claimed against any personal income derived from other sources. This encourages property investors to maximise their borrowings (generally 100% of the property value PLUS purchasing costs) with the resultant shortfall from rental income becoming fully tax deductible from their primary income.

With this background, why is it that the great majority of Australians that invest in real estate never take professional advice from property taxation specialists **BEFORE** making their initial purchase?

It is beyond my understanding, but this is generally the case. For the sake of the cost of around \$400-\$600, the majority of property investors take no advice and

potentially forgo thousands of dollars in future taxable income from Capital Gains by not seeking the correct advice as to the appropriate ownership structure.

Bottom line is, never take the advice from the salesperson as to what name you should buy the property when you are paying your deposit. All the salesperson wants is the deposit and the subsequent sale.

Always consult your professional property taxation specialist **before** you engage any sales opportunity to ensure you have the correct financial structures in place based on your own current circumstances to maximise your asset protection and legally minimise taxation today and in the future.

Deadly Sin #5 – No Exit Strategy

There are 3 certain things in life:

1. Death;
2. Taxes;
3. Change.

Nothing ever stays the same. So whatever you do now, make sure you can always change tack in the future with minimum downside risk.

I am not a great believer in staying with an investment property that is underperforming in its market. Rarely can these situations be turned around without significant investment of time and money. The opportunities for improving investment outcomes are constantly abundant, so from an “opportunity cost” perspective, sitting with a “dud” does not make good business sense (the way that unemotional investors think).

By always purchasing in a market in a growth cycle, you can confidently minimise any downside risk if you are forced into a position where you must liquidate an investment property.

If you purchase in a market in a down cycle, no matter what price you pay for the property, liquidating it may be problematic if you are forced to sell.

So always buy in a market in a growth cycle, so you can always find a buyer that will generate a profit for you if you are forced to sell.

The other key factor to consider is always purchase properties in the middle of the affordability scale from a rental perspective. At the time of writing, the amount of rent an average wage earner can afford in Sydney is between \$350-\$400 per week. These properties will sell for around the \$500,000 mark, so that should be your target price range for Sydney. In the inner suburbs, these prices are a little higher.

By ensuring your target price is within the average affordability ranges means that your possibility of poor tenants that do not pay their rent is minimised. Also, higher priced properties are much more difficult to sell or rent in times of economic decline, so by staying in the middle ground prices, you will minimise your downside risk by having the largest number of potential purchasers if you have to liquidate.

Deadly Sin #6 - Poor or No Research

There is simply no excuse any longer for not knowing the current information about recent sales in an area. There are many services on the Internet that provide detailed reports of properties that have sold in the past three months.

<http://www.homepriceguide.com.au>

<http://www.rpdatareports.com.au>

<http://www.residex.com.au>

Any of these reports will provide you with exactly the same information Registered Valuers use on behalf of your lender to assess the valuation of the property you intend to purchase.

Information is king in negotiations. The more you know the more power you have to make the right offers and appropriate terms and conditions.

Most local councils also now have large volumes of information available on their websites relating to development applications and future potential property zoning changes. This information is also vital for property investors.

Current properties for sale in an area are all listed on prominent websites like:

<http://www.realestate.com.au>

<http://www.domain.com.au>

So there is really no excuse except laziness that property investors can use to justify an inappropriate investment decision. Even rental prices can easily be assessed by calling local property managers to assess the current market rental by inspecting current available properties.

Deadly Sin #7 – Poor Head for Numbers

Most potential investors do not have a benchmark in their minds to test the viability of an investment quickly. This leads to potential problems with overpaying for an investment, or undercharging rental. At best, it leads to a lot of wasted time on non-productive due diligence research when the time can be better spent.

Here is a quick “rule of thumb” to help you quickly assess viability.

The 5% rule is really useful in assessing a property quickly. You know that a \$500,000 property rented at \$500 per week represents a gross rental yield of 5%. So \$300,000 at \$300pw also represents 5% rental yield. Equally simple to work out are fractions of the base 5%.

So if a \$400,000 property is bringing \$200pw, you know the gross yield is 2.5%. If it is bringing \$600pw in rent, it has a rental yield of 7.5%. Likewise if a property is renting for \$350pw, and the rental yields in the area are around 4%, the property will be worth around \$400-\$420,000 to you as an investor.

Using the base 5% Rule, you can quickly calculate any property viability on your feet with no calculator or sophisticated software.

Likewise, you need to have an appreciation for annual running expenses other than loan interest. When you take into consideration all fixed annual costs, a house and

land will consume around 30% of your rental income, providing you are utilising a professional property manager. If you buy a property in a Body Corporate, your expenses may rise to up to 55% depending on the BC Fees. So if you want to buy a lower priced Strata Titled property, you will have a very large negative gearing component that will probably never correct itself. Urgh!! You would want to be very sure you are experiencing exceptional capital growth to wear that constant reminder of a mistake is assessment.

Develop these skills and you will save an awful lot of time and effort, and save you from making some mistakes.

What Do I Do Now?

You may wish to attend one of our FREE Property Investment Workshops, where all your questions about real estate investing will be answered by our panel of expert professional practitioners.

You can book the next Workshop near you by visiting:

<http://www.propertyinvestmentworkshop.com.au>

If you are interested in finding out details of how OzInvest can help you towards financial independence by investing in real estate, call our office on 1800 800 775 to arrange a confidential and obligation free meeting with one of our trained Investment Property Consultants.

Check out our website at:

<http://www.ozinvest.com.au>

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