

Money

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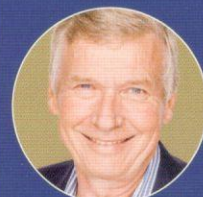
INSIDE
69 pages for
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YOUR 2017 REAL ESTATE GUIDE

STRATEGIES ON BUILDING WEALTH ONE HOME AT A TIME

**HOTSPOTTING STATE OF THE MARKET WRAP-UP
RETIREMENT PLAN BUILDING A PASSIVE INCOME
DEPRECIATION PRE & POST BUDGET DIFFERENCE**

OUR EXPERT PANEL



PAUL CLITHEROE
Why prices will
keep rising



MARGARET LOMAS
Positive cash flow -
losses into gains



JANE SLACK-SMITH
Property for
\$124 a week



BEN KINGSLEY
\$129,000 ahead by
rentvesting



PROPERTY FOR \$124 A WEEK

There's good value in areas that feed off the growth of the overheated capital cities



STORY JANE SLACK-SMITH

The property market couldn't be more different from what it was two years ago when lending was easy and deposits could be as little as 5%. Since late 2015 there have been considerable changes in the lending environment, which has resulted in a lot of confusion. However, I believe astute investors can take this opportunity to grow their wealth while others are still trying to predict what is going to happen and will miss out.

I have been investing for over 17 years. I buy when I can afford it, in the best location I can afford. I have bought at the top of the Sydney and Melbourne market and at the lows. The cycles have never affected my decision, because I buy for the long term. As a low-risk investor who has been able to build a multi-million dollar portfolio (that virtually looks after itself) I leave timing the cycle to very experienced investors.

I invest based on my Trid3nt Strategy. This allows me to make money in three ways in any cycle:

1. Buy below the market to get instant equity. Yes, this is harder in a fast-moving market but in times of upheaval and confusion this is an opportunity to capitalise on.

2. Manufacture equity. I do this with a strategic renovation, the location of the property as

the key to achieving this before the strategic renovation even starts.

3. Buy in an area set for good, steady capital growth. This is the key to long-term wealth building.

In this example I target an area that has high predicted capital growth. It is one thing for a property to "only" cost you \$124 or \$245 a week but if that is all it is doing then after eight years it is still valued at its original cost. This is not getting ahead; this is going backwards.

As an engineer, when I started out I wanted to make my \$45,000 nest egg work for me and not lose time or money getting it wrong. So I read over 200 property books and went to seminars and decided I should reverse-engineer the characteristics that outperforming suburbs had in common. I came up with 30 filters but the macro criteria came down to the suburb having population, income and job growth. This works in any market conditions.

I decided to stay clear of the capital cities but be under the direct influence of the drivers that radiate out from the ones that experience the growth. Hence, I wanted to consider the feeder cities for Sydney and Melbourne. Although these two cities have gone gangbusters in the past five years alone, there is a period ahead when this type of growth will slow (not go backwards substantially due to the drivers). This is primarily based on these cities becoming affordable.

However, I believe the satellite cities of

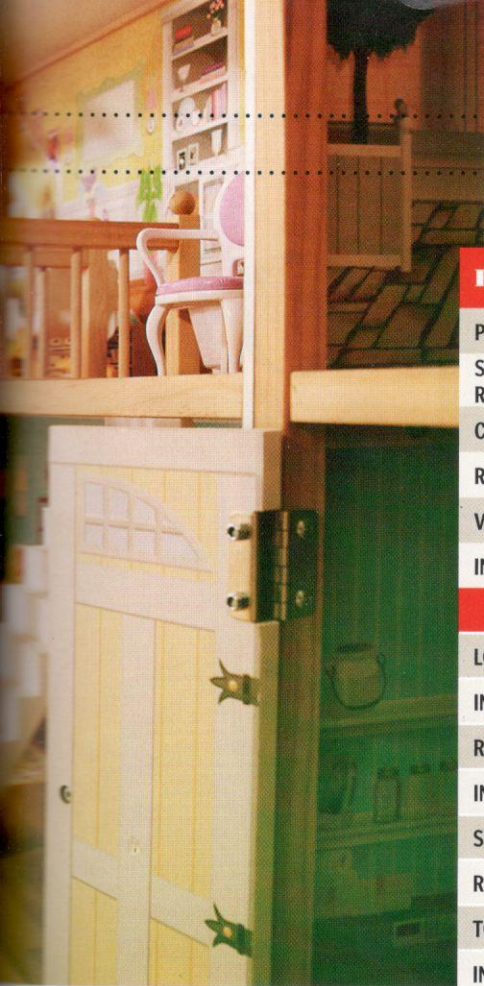
Wollongong, Newcastle, Geelong, Ballarat and Bendigo will continue to grow steadily. With this in mind I looked at the Predictions Report supplied by Residex for Victoria and Tasmania. I scanned the top 100 suburbs and applied a few of my 30 filters. I wanted good predicted growth, a rental yield higher than the capital city average, over 10 sales a month and over 30% renters in the suburb.

One of the suburbs that stood out was Newtown in Geelong (postcode 3220). It has a median price of \$720,000 and a 3.3%pa rental yield with 32% renters and 192 sales last year. More importantly, in the next five and eight years Residex predicts a 5%pa growth.

One of my other criteria to minimise risk is to buy only the typical property. In Newtown, 72% of people live in houses and 42% in three-bedroom properties; hence I would further refine my research to these properties. According to CoreLogic, there are 5501 properties in this postcode and 1602 three-bedroom houses.

In eight years, based on 5% growth, this property would be worth \$1.063 million – a \$340,000 equity gain, or \$43,000 a year. Compare this with the prediction of 2%pa capital growth for the greater Melbourne area. It just shows that there are markets within markets and underscores the importance of understanding where to buy.

I would also actively manufacture growth and spend up to 10% of the value of the prop-



HOW IT WORKS: \$720,000

PURCHASE PRICE	\$720,000	
STAMP DUTY AND LAND REGISTRATION ETC	\$40,000	
CONVEYANCING	\$2000	
RENTAL YIELD	3.3%	
VACANCY RATE	2%	
INTEREST RATE	5%	
	SCENARIO 1	SCENARIO 2
LOAN AMOUNT	\$762,000	\$576,000
INTEREST	\$38,100	\$28,800
RATES	\$1500	\$1500
INSURANCE	\$1000	\$1000
STRATA AT 6%	\$1400	\$1400
REPAIRS/MAINTENANCE	\$800	\$800
TOTAL COSTS	\$42,800	\$33,500
INCOME	\$23,760	\$23,760
NET INCOME AFTER VACANCY	\$23,285	\$23,285
PURCHASER'S PAYG INCOME	\$78,000	\$78,000
TAX RATE	32.5%	32.5%
NORMAL TAX	\$16,900	\$16,900
NEW TAX	\$10,600	\$13,600
TAX BENEFIT	\$6300	\$3300
TOTAL COST PA	\$12,740	\$6440
TOTAL COST PW	\$245	\$124

erty on a cosmetic renovation, adding a minimum of \$2 for every \$1 I spend. In this case, applying the 5%pa growth over eight years to this new \$140,000 in value would add another \$207,000 or \$26,000pa to the growth – that is \$69,000pa in growth!

So how much would you be willing to pay to make \$43,000pa, or even \$69,000a? Anything less than \$43,000 would make it worthwhile but the less it costs the better. What if it could cost you less than \$13,000 a year, or even \$7000 a year? This is the

key to manufacturing equity: the location of the property, with the predicted growth to make you money while you get on with life.

Since the watchdog APRA put restrictions on lenders, we need to consider changes to the way we borrow money and fund our purchase. So I want to share two examples of the potential out-of-pocket costs of this property.

In the first I assume that the buyer has equity in another property and that they will use that equity to cover a 20% deposit, the \$40,000 stamp duty and land transfer etc and \$2000 for conveyancing. This means the total loan is \$762,000. The \$42,000 and the 20% deposit (a total of \$186,000) is secured by one property and the remaining 80% loan (\$576,000) is secured by the Newtown property. These properties should not be cross-collateralised and the loans can even be with separate lenders.

The key is that these loans are interest

only and, under the APRA changes and bank policy requirements, the maximum against the investment property has to be at an 80% loan-to-value ratio. The benefit of an interest-only loan is substantial: any unused cash should be directed towards your home loan or other non-deductible debt such as credit cards.

One further consideration. I recently spoke to an investor who had a property portfolio where their rent paid all costs, so the portfolio was neutrally or positively geared. They planned to sell their portfolio down after retiring at 65 in what they believed would be a more beneficial tax environment for them. However, their five-year interest-only loans recently reverted to a principal and interest loan, resulting in an additional \$3000 a month in costs. This has resulted in a portfolio sell-down ahead of time. So one consideration we discuss with clients is potentially securing as

long an interest-only period as possible, even if it costs a bit more.

Some lenders have 25-year interest-only line-of-credit loans. Yes, they still expect you to pay off the principal at the end of the loan. However, it is worth consideration despite the higher interest rate – about 0.15%pa more on average. You do need to be diligent with this type of loan, so speak to your broker, especially as some lenders' line-of-credit loans are for only 10 years. For this example, I am using an interest rate of 5%pa for a line of credit.

The other assumptions are that there is a 2% vacancy rate so the property rental income is only 98% of the maximum; there are costs associated with holding the property; and I have not allowed for any depreciation based on the May budget proposals. In addition, I have assumed a \$78,000pa income for the purchaser and a 32.5% tax rate. Note the tax benefit is based on negative gearing, and although there is discussion about removing this benefit if you buy before any changes it should be grandfathered. This is another reason not to try to time the market but to buy now while you can lock in current lending policies, capital gains tax and negative gearing benefits.

The second costing uses the same assumptions. However, I assume the purchaser has cash to contribute. This could be from savings or, as we see often, from the Bank of Mum and Dad. Hence the interest calculation is only on the 80% of the property value (\$576,000).

As you can see in scenario 1, with the tax benefits the cost of the property is \$245pw or \$13,200pa and in scenario

2 it is \$124pw or \$6900pa. Remember this property has the capacity to add \$43,000pa, or \$69,000pa with a strategic renovation, to your wealth in the next eight years. I think that makes it a truly remarkable investment.

The Trid3nt Strategy allows you make money in at least two ways – capital growth and renovation. And if you are clever with your negotiation techniques or have an eye for opportunity, especially during times of market confusion, three ways, for \$245pw or less.

Jane Slack-Smith recently was awarded Australian mortgage broker of the year. She is the director of Australia-wide Investors Choice Mortgages and founder of Your Property Success online education, author of Your Property Success with Renovation: 2 properties, 1 renovation, \$1million in the Bank and co-host of the Your Property Success podcast.