Why Property Investment is "Safe as Houses" Part 2

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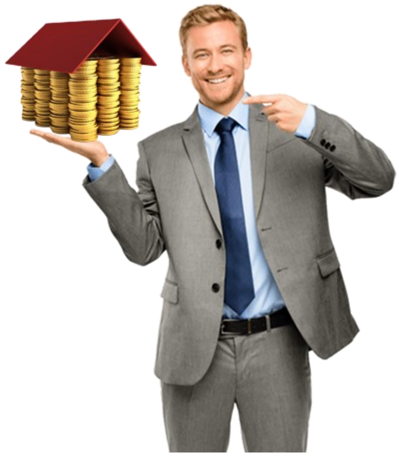
STRATEGIC INVESTORS
Creating Smarter Investors

The best investments offer financial freedom and security for the short term, long term or both. But the key is to make sure the investment is a safe option for your circumstances before you move forward with it.

As the first eBook in this series explains, there are seven core principles to making a safe investment:



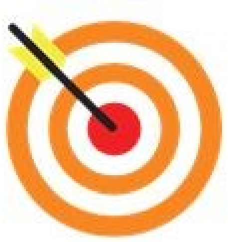
1. Be specific about the purpose of the investment,
2. Be really clear about whether you want growth, income or both,
3. Look for a track record of performance,
4. Get third-party validation of the asset's value,
5. Keep your other assets safe,
6. Work out a contingency plan for things that could go wrong; and
7. Have an exit strategy.

What these seven safe investing rules really highlight is that information and knowledge remove risk. This is something we already know and apply to many other areas of our lives, but somehow with investing, it can get lost along the way.

For example, if you needed to have surgery, you would probably consult with medical professionals and find an expert in that field - someone with years of knowledge, training and experience - rather than approaching a stranger at random. There's much more risk with the stranger, so we know it's not worth it! The same should be said about investments.

So how does this relate to property specifically? Compared to other kinds of investments, there is a wealth of information about the property that's freely and/or easily available to you. It's also easier to work out the purpose and goals of investment property, as this is one kind of investment that you can actually see with your own eyes.

To put all of this into perspective, let's take a closer look at how investment property matches up to the seven golden rules of safe investing.



1. Be Specific about the purpose of the investment

- Do you need it for cash flow (e.g. to pay your mortgage off)?
- Can it save you money in tax?
- Is it going to provide you with income in retirement?
- Could you sell and live off growth?

Property could tick all of these boxes. When you invest in property, you become a part of the business of providing quality housing to people. That's also partly the purpose of investment-whether the plan is to rent or to sell at a higher price.

Unlike investing in shares or stocks, which could just sit there at the mercy of the market, housing gives you an active investment. It's practical by design, which means that your investment will add value to other people's lives. In turn, that guarantees the investment's return.

This is a powerful rule for the property because it can help you look for the right kinds of investments based on your goals. So let's break down each of the different options.

2. Be Really clear about you want growth, income or both

In general, growth is based on speculation (regardless of the type of investment). Historically, there haven't been many people who can accurately predict growth at a valuable level. That means there is always a risk when you choose an investment for growth. Investing in the property (or anything) specifically for growth is like putting all your eggs in one basket.

But if this is a path an investor wants to take, at least with property, there are all kinds of suburbs and market reports that can be used to analyse property sales, population growth, design trends, and so forth, which could help at least make the risk a calculated one.

On the other hand, investing for income offers a much clearer approach. If the goal is income, the focus becomes the difference between how much the property costs to hold onto and how much money it makes through rent. The number you get from that calculation is your investment property income, and it's real. It starts straight away and can grow over time as the debt on the property reduces.

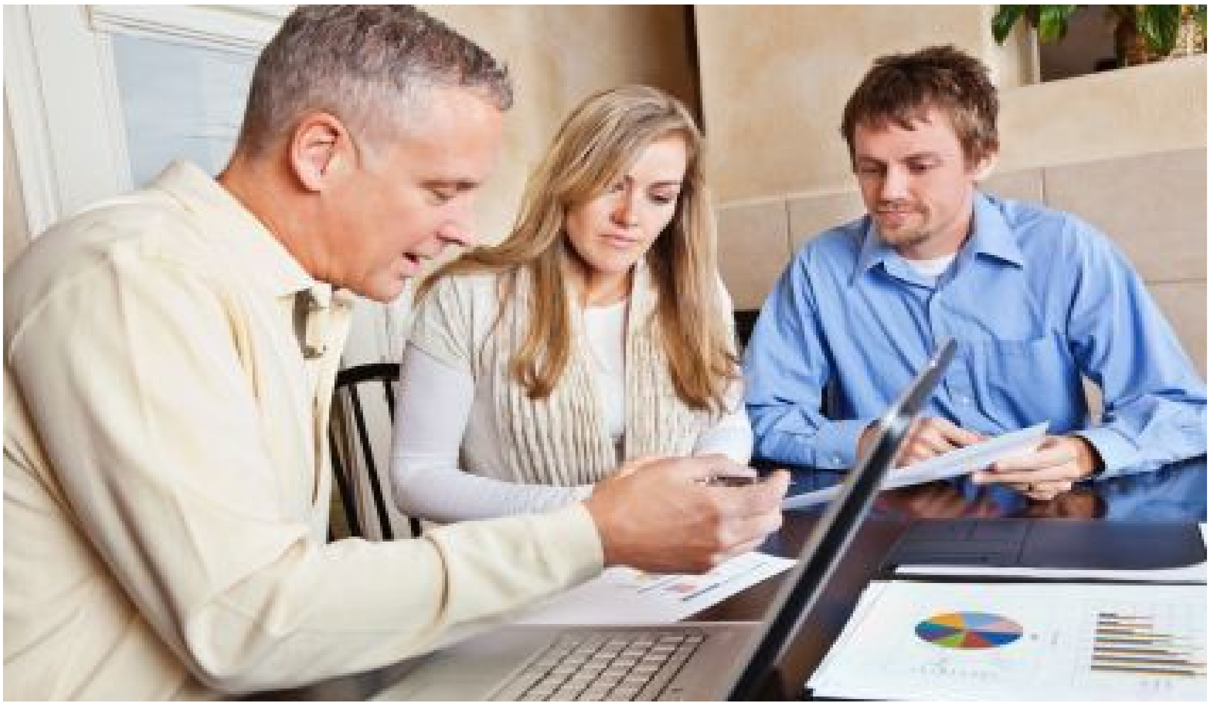
This is a hands-on approach to investing that most astute investors use when making decisions. Instead of speculating on a profit through sale, they aim to make their money when they buy.

3. Look for a track record of performance

The great thing about property is that it always has information about its the track record of performance. Whether it's a house, apartment or even a block of land, you will be able to look at previous years of growth for that specific property or those around it.

A good idea is to look at the last 5-10 years of growth for the property, suburb and/or region to get a clear idea of its record of performance and any other relevant trends (population growth, property prices, roads and infrastructure etc.).

All of these details are available online and at local real estate institutes. Because there is so much information (compared to other kinds of investments), it's easier to predict the performance of the investment.



4. Get third party validation of the asset's value

The primary role of these people is to go out and assess the value of a property and write up qualified reports based on their assessments. This is one way to get third-party validation of a property's value (probably the most common).

Experienced investors also have another strategy that could help you make sure you are paying the right price for an investment property without spending money on a report - and it all comes down to how they finance the purchase.

Instead of approaching their existing bank or lender and requesting a loan for another property, these investors will approach a new bank for their investment financing. Not only does it keep the debts separate (another safe investing rule we'll look at later on), but it also reduces the risk of overpaying on an investment property because the new lender has no other assets or debts to factor into the equation. On the other hand, an existing lender will factor in existing debts (such as your home), which could mean you end up paying more than the investment property is worth without even realising it.

For example, let's say you have a home worth $500,000 and $200,000 left on your mortgage. You now want to buy an investment property for $500,000.

Your current will factor in your existing home, valued at $500,000 and say: "You're presenting me with $1 million, which means I can lend you 80% of that, or $800,000."

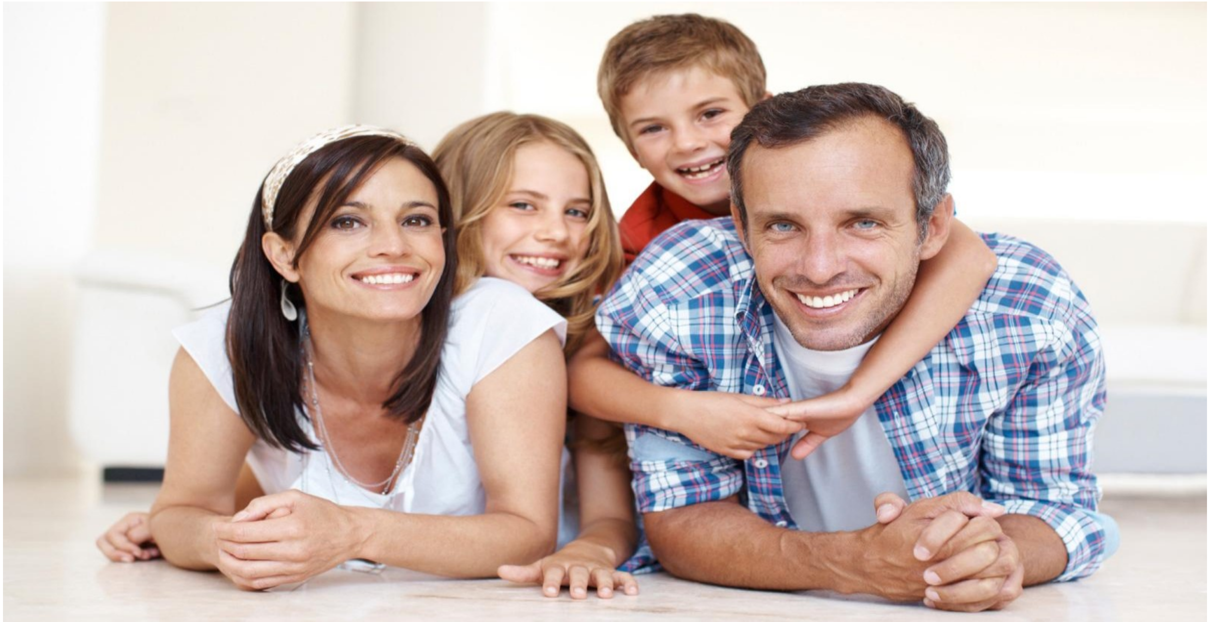
At this stage, you only need $700,000 (the existing $200,000 loan and an investment property loan of $500,000). Now your lender hires a valuer to assess the property you want to buy. The valuation comes back and says that the property is only worth $400,000.

Your lender then works out that this means you would be borrowing money against $900,000 worth of assets (your home and the investment property). They calculate 80% of that as $720,000, and you only need a total of $700,000 to buy the new property at its $500,000 price, so they agree to lend you the money without ever telling you that it's not worth $500,000.

However, when you go to a separate lender, you are only borrowing the $500,000 needed to call the investment property. Even though they will go through the same validation steps as to a current lender, if the property is not worth $500,000, they won't approve the loan, and you'll know that the property is not worth its cell price.

This strategy is a huge benefit to investors. Still, it often takes them years to figure out because most banks would never tell you to go to another bank, and most mortgage brokers won't tell you because they don't make more money suggesting other banks and would have to do more work.

The example we've looked at above also relates to keeping your other assets safe when borrowing money for an investment property. Safety is being able to separate other lenders so that none of your assets can be linked together(which would be a massive risk of something going wrong).



5. Keep Your Other Assets Safe

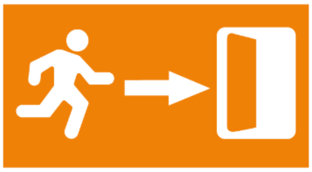
When you have a rental property, there are usually very predictable issues that you can prepare against. This includes a bad tenant, dealing with property damage from tenants, visitors, or natural disasters (depending on where you buy), expenses from repairs, rates or loans and so forth.

Because all of these issues are common in the real estate world, there are also a lot of existing contingency plans. There's landlord insurance, for example, that can help you deal with any tenant issues. Similarly, you can often request an overdraft on your loan as a buffer for maintenance costs and set aside savings or other finances to not affect your cash flow.

There are also a lot of resources out there for new property investors and rental property owners that can help you become aware of the common issues and solutions so that you are prepared for them if they ever do arise.

6. Work out a contingency plan for things that could go wrong

When you have a rental property, there are usually very predictable issues that you can prepare against, such as getting a bad tenant, dealing with property damage from tenants, visitors, or natural disasters (depending on where you buy), expenses from repairs, rates or



7. Have an exit strategy

In comparison to other kinds of investments, these resources and the predictability of property makes it a lot easier to have contingencies and security around the investment you've made.

The exit strategy for property is usually pretty simple: you can put it back up for sale if it doesn't work out. There will always be a market for the property at the right price, and the key is finding the market and meeting it at the time you want to sell.

With so much information available on the property, it's often possible to find out how much demand there is for a property before you buy it so that if you need to exit, you know you will probably get a buyer relatively quickly. This research could also come into the contingency plans you have in place and probably even into the purpose of the investment. If you have planned for growth, then there's a good chance your exit strategy will make you money - especially if you sell at the right time.

But even if you haven't factored in growth, it's usually possible to sell and break even on an investment property. Especially if you have separated your assets and have a loan with a different lender, they wouldn't have lent you money if they thought it was a significant risk.

These factors make it a lot easier to walk away from an investment property when compared to other kinds of investments, where timing is often key, and speculation is usually still a big part of the process.

So remember, it's ideal to have as much information and knowledge around them as you can before you make a commitment when it comes to investments.

With so much accessible, comprehensive and reliable information available for investment properties, there's really no reason for you ever to make an uninformed decision. So that's why property investment really is as safe as houses.

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