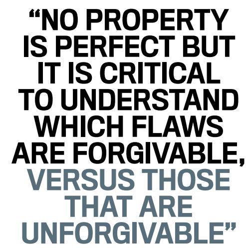
EMOTIONAL PROBLEMS

Property investors who allow emotions to enter into the transaction make three key errors which can lead to long-term problems that could easily be avoided

By Cate Bakos



One of the biggest challenges I face as a buyer's advocate is 'de-programming' my investor clients when they apply emotional rationale to business decisions. Investors can have many different reasons and justifications for making the decision to embark on their investment property journey, and these can include:

- Planning to build a wealthier future for their retirement
- Planning an early retirement
- Enabling their children to get into property easily via a gifted property or gifted equity
- Asset diversification (for those who may have invested in other asset classes such as shares or bonds)
- Tax benefits via depreciation or negative gearing (in my opinion, this is not a justifiable reason to invest in property, but many would disagree)
- Housing a parent, sibling or child
- Buying a holiday house
- Demonstrating to their friends and family they have an investment property
- Creating a 'forced savings' model for themselves
- Giving themselves a project
- Creating a passive income stream for themselves via strong positive cash-flow properties

Evidently, there are many reasons people choose to invest – but they are not all sound reasons.

The first task for every new investor is to establish why they are choosing to invest. If the motivation is based on an emotional need, they need to weigh-up the risk and the lost opportunity cost.

Mistake #1: Holiday dreaming

Four years ago, when my own parents were facing their retirement, my dad asked me about my thoughts on them putting their savings into a holiday unit in far north Queensland's Townsville. They had enjoyed regular holidays up there and felt it would be sensible to secure their own little dream unit on The Strand for their bi-annual trips.

It's important to note my parents have never been landlords, nor do

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they aspire to be. They maintain a negative association with the idea of tenants and were aghast when I sought to clarify their idea by asking whether they'd lease their property. I had to break it to them that I believed their idea was terrible. I asked my dad (who is a qualified accountant) to run the cash-flow numbers himself based on two scenarios:

1. Purchasing the unit for $400,000, paying out rates, insurances and maintenance costs, and saving $2,600 per year in accommodation costs while enjoying a median annualised capital growth of six per cent per annum

2. Purchasing a unit in an inner-ring Melbourne suburb for $400,000, paying out rates, insurances and maintenance costs, plus the cost of their Townsville accommodation, whilst enjoying a net rental return of $16,000 per annum and a median annualised capital growth of seven per cent per annum

Many folks talk to me about the idea of buying a holiday house as an investment and the basis of their logic is that they'll enjoy a dual benefit with a rental return and a desirable holiday home for their own personal use in the summer months and holiday periods.

What they often overlook is that the rental returns are only lucrative at the same times they want to inhabit the property themselves, and finding an off-season tenant is a real challenge.

Not only do they miss this fact, they also underestimate the cost and effort required to manage a short-term holiday let. Property management for short-term rental properties is no longer the standard 7.7 per cent management fee - it can reach up to 20 per cent and other services including laundry, cleaning and hamper provision can push the management costs up even further. Notwithstanding the larger vacancy rates as well, a holiday let for an inexperienced holiday let investor can spell trouble.

You have to select an area with proven growth drivers. Just because a holiday hotspot is nice in summer doesn't mean it will offer strong growth. Typically these holiday locations don't offer 'outperformance' growth for two reasons:

- Firstly, they are a long distance from white-collar, strong employment centres. Only retirees, self-employed people and other holiday home owners are driving the market
- Secondly, when times take a turn for the worse, these discretionary items are the first to be offloaded in a hurry. A desperate fire sale can only spell one thing: a disastrous sale price. When the economy is in trouble, it is little surprise that holiday hotspots have so many 'for sale' signs up. The growth prospects of an area will always be a concern if the area is vulnerable to strong downturn and desperate fire sales

Mistake #2: Personal preference

When I take holiday houses out from the web of emotional rationale, the next common delusion I uncover becomes that of 'personal preference'.

It's surprising just how many investors select properties based on what they'd love to live in. As I say to all of my clients who make this mistake, "Unless you are representative of your target tenant, it doesn't matter if you don't like the property. What is vital is that the target tenant will like the property".

For example, in some of the tightly held, groovy, inner-ring suburbs, the emerging cashed-up demographic are professional Gen Ys. They typically value being within walking proximity of local cafés, shops and stations. They enjoy catching up with their friends when they go out, and they value their own time. They refuse to spend time stuck in traffic and they respect public open spaces, availability of public transport and the sense of community that these inner-ring, vibrant, village locations offer. They don't care much for separate dining rooms, impressive gardens or vast entertaining spaces.

So it came as a bit of a shock when one of my clients lamented that the properties I had shortlisted in

Melbourne's inner-beachside pocket of Elwood didn't feature separate dining areas. I had to point out the target tenant would conduct almost all of their socialising and dining in the nearby café strip.

In regional towns, blue-collar worker families and longer-term tenants value different attributes. Some landlords will aspire to upgrade their properties with smart internal renovations (perhaps modern, stone bench-top kitchens), but the tenants would value upgraded heating or solar panels, or shedding and gated yards much more than they'd value a kitchen upgrade. Investors who don't tap into what the target tenant values overcapitalise on the property and/or improve it without reaping the rental benefits of their efforts.

Mistake #3: Expecting perfection

One of the most common 'emotional' decisions investors let cloud their judgement is buying where they are familiar, or worse still, buying near to where they live. When I ask why, I am almost always answered with "so I can keep an eye on it". "That is what a good property manager is for," I retort.

Aside from potentially selecting an area that may have investment property flaws, (such as high vacancy rates, low rental returns, limited capital growth prospects or infrastructure changes that limit the suitability of the area for target tenants), the investor is also limiting their own property portfolio diversification.

Arguably, the worst emotional overlay when it comes to investment property selection is that of expecting the right property to score 100 per cent. In all of my years of experience, I've never found a property that scores 100 per cent.

No property is perfect but it is critical to understand which flaws are forgivable, versus those that are unforgivable. Generally speaking, elements that can be altered with time and/or money can be forgivable, such as a kitchen upgrade, wall colour, or garden tidy-up.

Elements that can never be changed need to be carefully considered and scrutinised. Aspects like main roads, pending developments nearby, the absence of car spaces on the title, and high outgoings need to be understood in terms of their adverse effects on growth prospects and cash flow.

The really difficult decision comes when the negatives, which may be changeable, come with potentially high expense or without guarantees, such as challenging zoning, strata titles/company share properties, structural concerns, and non-titled courtyards which have leasehold potential.

For a buyer's advocate, most of these 'maybe' items ring alarm bells and we are highly trained to select non-problematic properties. But accepting that no property scores 100 per cent is the first important step, and being able to score properties in a carefully considered manner is paramount to managing your success. ■

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