WHY AREN'T WE ALL PROPERTY MOGULS?

Statistics show that most landlords stop at just one investment property. So why do so many investors never get past their very first property? API discovers 10 reasons why there aren't more property moguls. **CAROLINE JAMES**

Of all the Australians who own rental property today, a whopping 73 per cent own one property.

And less than one in five landlords – 18 per cent – own a residential rental-base of two properties, according to Australian Bureau of Statistics (ABS) figures, which leaves only nine per cent of us with portfolios of three properties or more.

As has been widely reported, interest rates are at historically low levels. Our population continues to grow, and increasing numbers of people will rent for life. So what *exactly* is stopping the vast majority of Aussie landlords from accumulating more properties and, in doing so, building far greater personal wealth?

Experts identify 10 key reasons most want-to-be-property tycoons stall after buying their first or possibly second investment home.

1 FEAR OF RISK

Everybody has a personal risk tolerance profile; some of us are quite comfortable with perceived risk while others are highly risk-adverse.

There are six main fears when buying a property, Cate Bakos of Cate Bakos Property says.

- **Overcapitalisation.** That is, paying too much. "In Aussie words, being ripped off… there are so many stigmas associated with real estate agents and concerns around agents ripping off undiscerning buyers."
- **Buying a lemon.** "Everyone fears their property underperforming in terms of capital growth when benchmarked against others in a similar area."
- **Troublesome tenants** who either trash the property or don't pay their rent.
- **Vacancy problems.** "A common fear is having a property that's hard to let with low or no tenant demand."
- **Lifestyle sacrifices** if the property ends up costing more than initially expected resulting in extreme negative cash flow.
- **Market crash.** "They fear a 'bubble' or downturn will strike as soon as they've purchased, creating a negative equity position."

All are legitimate fears but there are actions that can address every single one, Bakos says.

How to overcome this obstacle

"Firstly, an agent can't rip-off a buyer if the buyer is educated. Buyers should make it their business to have a firm strategy, know what type of property represents their desired strategy and, in particular, cash flow requirements, and should avoid problem areas and property types," she says.

"Such properties include those that aren't residentially zoned, those under 45 square metres and those with undesirable attributes such as overlooking a main road, train line, bordering industry, etc.

"Buyers need to be aware of property values in the area they're looking and if they are in doubt, either hire a professional or source a valuation report."

2 LOW INCOME EARNER

A major blocker to growing a portfolio beyond one or two rental homes is "the perception that you need to be rich to invest", Bakos reveals.

And while it's true that regular income is imperative to securing lender funds if borrowing to buy, and also to paying ongoing out-of-pocket holding expenses, a disciplined investor on a low income isn't necessarily excluded from purchasing rental homes just because they have a relatively small amount of funds left at month's end after subtracting living expenses.

"I have helped income earners on less than $40,000 per annum purchase investments," Bakos says. "The key is having a deposit or equity and *understanding* your maximum 'out-of-pocket per month' budget.

"In the past four years I've helped investors secure properties that have been yielding six per cent gross rental yield and in this low interest rate environment, that means that their out-of-pocket expenses per month in many cases have been zero or very close to zero."

How to overcome this obstacle

Mitigating this problem demands investors being organised with their pre-approval, spend limits and out-of-pocket cash flow limits, and sticking to their budget.

3 LACK OF CASH FLOW

Chris Gray from Your Empire Buyers Agents says a big stopper to us all becoming moguls is the misconception we must pay our investments' losses from our net income.

"They try and cash flow the negative gearing from their wages and, if the difference between the rent and the mortgage on an investment property is minus $10,000 a year and you earn say $70,000, then there will be a limit to how many properties you can afford after paying for your living expenses," Gray says.

How to overcome this obstacle

Use portfolio equity to cover any gaps between rental income and ownership expenses. Lines of credit can serve this purpose.

"I believe the answer is to use your equity to cash flow your properties so you don't have to sacrifice your limited wages," Gray says.

"It's the same as using working capital when buying a business that doesn't make a profit for the first few years.

"Using equity isn't standard thinking and will be subject to lenders' serviceability rules but that's how many experienced investors do it."

4 LACK OF CAPITAL GROWTH

One of the main blocks stopping landlords expanding their portfolios is lack of capital growth, Warwick Brookes, director of Domain Property Advocates, says.

This plants the brakes on how quickly they can refinance existing loans to release that equity gain, which will pay for a deposit on the next investment.

"Ninety per cent of investment properties in the marketplace have average capital and rental growth and the only way for a PAYG salaried person to grow their portfolio properly is with good capital growth, because without that level of growth they can't keep their LVR (loan-to-value lending ratio) at the right level," he says.

How to overcome this obstacle

One way is seeking advice from an independent and expert local source, such as a buyers' agent, who can advise on where the strongest prospects lie for future capital growth in your target city or state.

"Don't forget that all the agents selling properties are working for other people. Not you. Everything they sell is good because they're being paid to tell people that."

"Just like you need a set of plans to build a house, you need a documented plan to build a high-performing property portfolio."

MIRIAM SANDKUHLER

5 NO LONG-TERM INTEREST

Angie Zigomanis, senior manager residential at BIS Shrapnel, believes most of us don't become property moguls simply because it was never our intention.

"My guess is it's not what they're intending in the first place.

"I suspect most purchasers are buying to negative gear for a tax refund, although still have the hope or expectation of capital growth for their investment, evident by the level of tax losses being claimed for properties in the ATO (Australian Tax Office) data," Zigomanis says.

He says BIS Shrapnel research shows younger singles and couples who invest in property often sell down once they start a family, so investing can be viewed as a means of building short-term wealth to pay for a future family home, while also gaining the tax benefits of negative gearing. These buyers view their rental homes as stepping stones to owner-occupied homes and will have to re-enter the market at a later date and begin again, Zigomanis says.

"Our survey also suggests some people are uncomfortable with the potential debt associated with purchasing multiple properties.

"More than half of investor households earned less than $125,000 per annum and arguably for many of the households below this income threshold, particularly families with children, they would be concerned about taking on more debt/risk in purchasing an investment property beyond a single dwelling.

"If the investment goes sour, they're probably prepared to carry the losses on one property, but don't want to leave themselves exposed to losses on multiple properties."

How to overcome this obstacle

Zigomanis is unconvinced this mindset really can be changed.

"Some people are more likely to take more risk in building a portfolio, while others aren't.

"Being armed with more information could help with having the confidence to take on that risk but chances are you probably can't change people's nature too much."

TOP 10 REASONS

Why investors stop at one property

1. Fear of risk.
2. Low income earner.
3. Lack of cash flow.
4. Lack of capital growth.
5. No long-term interest.
6. Unrealistic timeframe.
7. Lack of knowledge.
8. Lack of planning.
9. Procrastination.
10. Poor investment choices.

6 UNREALISTIC TIMEFRAME

It's very common for investors to lose heart and not reinvest when their wealth-creation expectations are out of step with reality, Brookes says.

"When their expectations on how quickly they can grow it aren't met, they give up," he says.

Brookes says most of his advocacy clients have two or three rental properties, which usually take 15 years to amass. It's unrealistic to expect to build a high-quality portfolio overnight.

"Most people who come through our door can get two good investments over an eight-year period and three over 15," he says. "Now it may not sound sexy but it works and at the end of the day these people have good equity. It's not how many properties you have but your net equity that's important."

How to overcome this obstacle

Get real, get educated, set clear long-term goals, understand your personal investment strategy and be patient. It's more important to buy well and hold than to rush purchasing underperforming assets.

7 LACK OF KNOWLEDGE

"The old school thinking is that if you want to retire you need to pay off your home and then buy an investment, paying that off too, to retire on the rents," Gray says.

But, of course, the key to serious wealth creation is capital growth and compounding over time, the longer the better.

"It's much better to put extra repayments into buying an extra property as that's likely to rise by more money than you can save in interest by paying loans off."

How to overcome this obstacle

Buy as much as you can afford to hold for the long-term and then when you've hit your asset value goal, wait.

"Every 10 per cent increase in the market will reduce your gearing by 10 per cent and before you know it you're 50 per cent geared and achieving neutral cash flow," Gray says.

8 LACK OF PLANNING

Many property investors buy a property as a means of "jumping on the bandwagon of wealth creation", Miriam Sandkuhler of Property Mavens says.

"Their friends or family have bought a property and they have been led to believe it's the way to get rich and retire. They may also have read a few books, been to a seminar or two and more than likely have bought their own home, so of course they think it's easy."

But while becoming wealthy is possible with property investing, most start the process by looking at listings, inspecting a few and then buy, often without any real planning or strategy.

How to overcome this obstacle

Make a detailed plan so that you understand your ultimate goals and can work backwards from it.

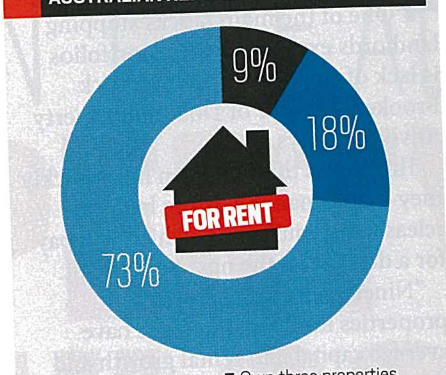
"For example, in how many years do they want to retire and on how much money? Once they have the answers they can assess how much their assets are worth now, how much they need in the future, what the shortfall is between the two, and how many properties they'll need to buy and over what period to achieve their goals."

Sandkuhler says that it's this strategic/planning process that will make it clear to many that one property "simply won't be enough".

"This process also allows investors to carefully consider if these should be capital growth or income-generating or a combination of both and, from there, the purchase price, location and type of property can be determined in that order," she says.

"In short, just like you need a set of plans to build a house, you need a documented plan to build a high-performing property portfolio."

AUSTRALIAN RENTAL PROPERTY OWNERS



Source: Australian Bureau Statistics (ABS)

9 PROCRASTINATION

Investors plagued by analysis paralysis or those who've had a bad experience in the past are highly likely to stop at one or two properties.

"People who lack confidence in the property investment space will often procrastinate," Janet Spencer of Buyer Solutions says.

"People who are 'too busy' in their businesses, careers and focusing on the family on the weekends to action their property investment plans are unlikely to invest beyond one or two properties."

How to overcome this obstacle

Review your lifestyle priorities. What do you want and how will you get it?

Accept past mistakes as stellar opportunities to learn and use that knowledge to build long-term wealth.

Yes, buying an additional rental home or two will take up some of your time in the early stages. But if you make the commitment sooner rather than later, those hours of research and searching have the power to create financial freedom to do more of whatever you want for the rest of your life. Surely that's a great incentive to take the plunge?

10 POOR INVESTMENT CHOICES

This is frequently why investors can't keep growing their portfolio, all experts claim.

"While there's an abundance of highly biased free advice on offer in the marketplace… it frequently results in poor-performing property being sold to investors who don't understand the advice they received is biased and only find out the hard way after they have bought the property and are struggling to lease it or can't easily sell when they want or need to," Sandkuhler warns.

Poor investment choices can result in rental properties that don't grow in value or, even worse, go backwards in value, which means there's no equity growth to leverage against in order to buy more property.

This can be devastating for investors and quickly derail their future portfolio-growth ambitions.

"Also, if the investor is unable to secure a stable tenant, they're left with a property that isn't receiving an income," Sandkuhler adds.

How to overcome this obstacle

Investors should do their own research to ensure their purchase choices are based on solid evidence of rental demand and capital growth.

Don't take on everything your friendly developer tells you as gospel. Seek independent advice. API