PropertyInvesting.com 'Insider'

Discover proven tips, strategies and techniques to dramatically increase your property investing profits

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Hi and welcome to your August 2003 edition of *'Insider'* - the PropertyInvesting.com e-bulletin for positive cashflow investors seeking a lifetime of passive income through real estate.

Are you receiving this newsletter for the first time? If so then I'd like to extend you a warm welcome on behalf of the entire Property Investing.com community.

The topics for this month's newsletter are:

1. It's a bestseller... but what did you think?
2. Fixed or variable interest? What are your options and which one should you choose?
3. Site upgrades are just around the corner...
4. Know someone who would profit from this newsletter? Spread the good news and receive your special report "Doom, Gloom or Boom".

Let's get started...

It's a bestseller… but what did you think?

On the 4th August my first book titled *"From 0 to 130 Properties in 3.5 Years"* was released. Now, just a few weeks later and thanks to some serious publicity, the book has not only become a best-seller, it's actually the #1 business book in the country.

In case you haven't heard the news, *"From 0 to 130 Properties in 3.5 Years"* tells the true story about how Dave and I started in real estate and goes on to detail the methodology behind our investing success.

I have deliberately written the book in a friendly and easy to read format that also delves into a lot of detail about the "how to's" of profitable investing.

It's been very encouraging to read letters and e-mails supplied by people who've read the book. For example, here's what Paul had to say:

> *"I received your book 130 properties last week and found it to be the best and most informative book on property investing I have ever read. I am very skeptical on matters of this kind and don't often respond to email feedback but had to send you this email Steve. Best wishes in the future, you and your partners deserve it - Paul"*

Have your read the book? If so then I'd love to know what you thought! If you have a few spare minutes then please send me an e-mail

If you haven't managed to secure your edition then don't sit around and wait for the movie! You can always try at your local bookstore, but given the huge demand they may be out of stock. Luckily, you can also order online from PropertyInvesting.com. Because we have sufficient stock we can usually ship via Australia Post on the next business day.

If you are unaware of the book and would like to know more then check out http://www.propertyinvesting.com/resources/13

Fixed or variable interest? What are your options and which one should you choose?

Over the past few months we’ve been looking at the issue of finance as it pertains to property investing. To date we’ve:

1. *Reviewed principal and interest/interest-only loan terms and*
2. *Looked at LVR and LMI*

This month let’s move our discussion to the topic of interest rates, and, in particular, which is best… fixed or variable?

About interest rates

At the risk of saying the obvious, interest is the fee payable when your borrow other people's money.

When it comes to home loan interest rates, these are usually set by the lender's based on the following three factors:

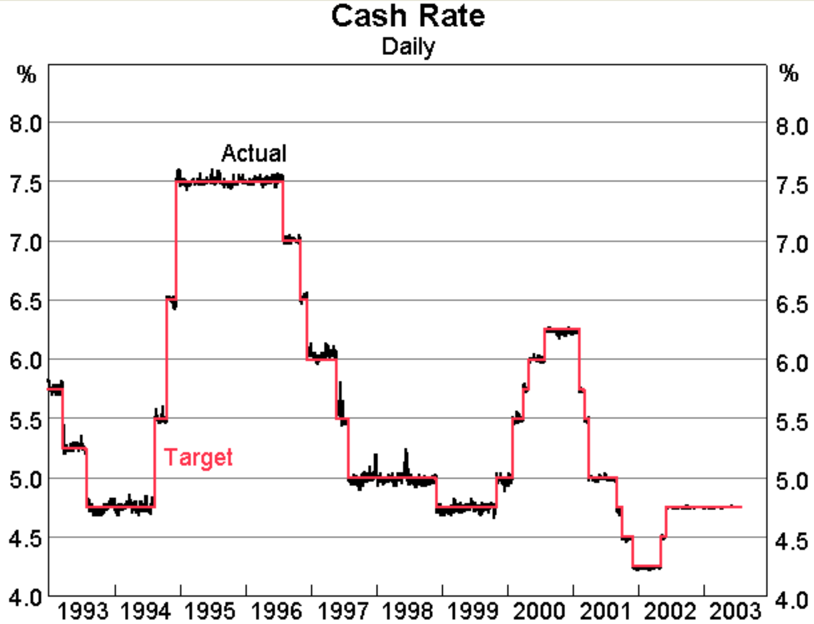
Factor #1: The basic cash rate as set by the Reserve Bank of Australia (RBA)

It is the RBA's job to enforce monetary policy, which is the way that the government influences the economy via interest rates. Note: There's an excellent discussion on how the RBA sets monetarey policy at: http://www.rba.gov.au/MonetaryPolicy/about_monetary_policy.html

The RBA meets once a quarter to set and discuss the status of the 'cash rate target' - which is the interest rate applicable to the overnight money market.

Lenders then use the cash rate target as a benchmark rate and add a profit margin to set their base variable home loan interest rate.

The graph below shows the movement in the cash target rate since 1980 (Source: RBA):



Factor #2: The perceived risk in the investment

The margin a lender adds will depend on the perceived risk associated with the loan.

Home loans are usually seen as one of the safest classes of finance because the security that underpins the property (ie first mortgage over the title of the real estate) is so strong.

At the other end of the spectrum are the interest-free terms offered on retail purchases that quickly depreciate, for example - three years 'interest-free' on TVs and fridges sold from places like Harvey Norman and Myer/Grace Brothers. When the interest-free period is over then interest is levied at 21%+ per annum.

Banks try to mitigate potential risk by completing credit checks and by only lending a portion of the purchase price rather than the entire amount (see discussion on loan to valuation ratio).

Factor 3: Competition

Despite trying to eliminate as much risk as possible, lenders must also compete to attract new and repeat business. Honeymoon interest rates, packages for professionals, flexible loans and more recently reward point schemes are also enticements to select one lender or another.

At the end of the day though, the interest rate remains the biggest carrot or hurdle for most investors. Flexibility is a very close second though. With increased competition has come a myriad of options between variable, fixed or even split loan terms.

Interest rate terms

When it comes to financing your property investment, your lender will usually offer a choice from many variable and fixed interest rate options.

Variable Interest Rates

A variable interest rate simply means that your rate is subject to a change (both upwards and downwards) with the minimum of notice.

A lender can adjust their rate at any time, but major movements are usually only made in response to the RBA adjusting the cash target benchmark rate.

The benefit of having a variable interest rate is that you can usually make extra or lump sum repayments without any penalty. It's also generally true that the variable rate is lower than the fixed rate, although this is not necessarily the case at the moment, which is a little unusual.

The disadvantage of having a loan with a variable interest rate is that your repayment is subject to change and if the movement is up, then the higher interest cost can dramatically impact both the affordability and profitability of your property investing activities.

Fixed Interest Rates

As the name suggests, a fixed interest rate is where you lock in your interest cost for the duration of the term of the fixed period.

In Australia there are now choices of 1,2,3,4,5 and 10 year fixed loan periods. In the United Stated you can a fixed loan for up to 30 years!

While the biggest advantage of fixing your interest period is the security of knowing your repayment will not change, you need to weigh this benefit against the problem that if you do repay or refinance early, then you'll be slugged with penalties.

This is so because your bank will have attempted to lock in or match your loan against a fixed term deposit - when you pay out the bank then has an exposure on the other side. The penalty for early repayment varies, but it is usually a factor of the shortfall between the variable and fixed interest rates and the time remaining on your fixed term loan.

A question that you might be asking is "when should you take a hit and cop the penalty by repaying a fixed interest loan early?"

I'd say that you need to weigh it up on a case by case basis, but I'd only look to pay out early where I could increase the profitability of my portfolio and the penalty is incidental to my continues success.

For example, Dave and I have just sold a block of units that we had under a fixed loan where there was still about eighteen months left to run. Because we're paying out early we'll be slugged a $4,000 penalty on a $160,000 loan. This is quite a lot of money, however the profit that we stand to make will allow us to go and purchase more houses on better yields.

Split Loans

These days, some investors offer an alternative to structure your loan as a 'split loan'. This hybrid loan allows you to lock in a portion of your loan on fixed interest and keep the remainder on variable terms.

If you're seeking flexibility within the one loan product then this might be ideal. The only problem is that you might be restricted in your choice of lender as not all financiers offer this type of loan product and be careful with keeping an eye on the fees and interest rates charged as your flexibility may come at a significant cost.

Making your decision…

You need to let the circumstance of the deal dictate what loan terms fit best.

For example, if your goal is to repay debt as quickly as possible then selecting a pure fixed interest loan does not make much sense given you'll be hit with penalties.

Steve's Investing Tip:
Let the circumstances of your deal scope the loan terms that you accept.

On the other hand, if you want to lock in your profit and secure a long-term cashflow, perhaps a fixed interest loan would be the most appropriate option as you are not subject to adverse market interest rate fluctuations.

The problem is many investors buy first and then worry about securing finance after they have signed a contract. This is to say they think about finance only once it is needed, rather than shopping around and looking for the best deal.

Saying this another way, there's a temptation as a property investor to treat the processes of (1) buying a house and (2) finding a house as mutually exclusive rather than complementary events.

The time to be thinking about the way you plan to finance is prior to buying your investment while you still have time on your side.

Matching the right property with the right loan can only be done once you have outlined your plan for how you'll profit from your real estate (ie. matching the right property with the right person with the right strategy).

All too often, investors (if they have a plan at all) only structure up until they have signed a contract at which point they let their solicitors, accountants and rental managers take over while the investor adopts a passive approach.

This relaxed attitude accounts for why so many investors achieve such poor results.

Some thoughts on pre-approval

While I'm saying that thinking over your finance options before there is an urgent need would be a very wise thing to do, I'm certainly not advocating that you should only start investing once you have secured a written pre-approval.

Pre-approval is confirmation of the maximum amount you can borrow together with the basic terms of your finance, but it does not amount to an ironclad guarantee your lender will either provide any money or money on the terms specified.

In my experience, pre-approval is of little benefit since your lender can (and probably will) change the terms prior to actually lending the money. For example, Dave and I had recently received signed, sealed and delivered pre-approval at 70%LVR only to be told at the 11th hour (and after we'd agreed to buy over $1m worth of property) that in fact the maximum LVR was 60%.

The lesson here is that it's always a good idea to include a finance clause even if you already have been granted pre-approval. You can never be too careful and you certainly don't want to be caught short.

Final Thoughts on Interest Rates

Dave and I use a mixture of variable and fixed term loans. We look to fix our rates on larger value properties of where a rise in interest rates may cause our cashflow to suffer dramatically.

Ultimately you'll need to decide what is best for you in your circumstance. What I would say is that the time to be thinking out which option is appropriate is well before you buy and not as settlement looms and you need to make a decision quickly.

Finally, while interest rates may go lower, we are now at a historical 30-year low. If you had to lock in your rate, now wouldn't be the worst time in the cycle to be doing it.

Site Upgrade Just Around The Corner

www.PropertyInvesting.com is scheduled for closure on Sunday 7th September 2003 from 9am until 9pm to allow for an upgrade to be completed.

While you won't necessarily see a lot of change to the presentation of the website, there'll be plenty of changes behind the scenes as we aim to make the site more enjoyable and easier for you to use.

I ask that you be patient over the coming weeks. If you find any bugs or glitches please let us know about them by sending an e-mail outlining the problem to admin@propertyinvesting.com.

Spread the good news

Our aim at www.PropertyInvesting.com is to become and maintain the title of being the biggest web-site of its kind in the Southern Hemisphere. We pride ourselves on being focused on delivering helpful information that is practical and relevant for all investors.

You can help us achieve this goal be referring just one person who you think might be interested in this newsletter.

If you'd like to help us out then fill in the form at:
http://www.propertyinvesting.com/files/pop_welcome.htm

As a thank-you we'll send you a free copy of the special 10 page investors report called "Doom, Gloom or Boom" (value $19.95).

Summary

So far this month there's been sales of over 20,000 copies of *'From 0 to 130 Properties in 3.5 Years'*! This has not only made it a bestseller... it's become the #1 business book in the country.

If you've already bought a copy then thanks for helping make it a huge success. If you haven't and you want to buy one then I recommend you order online now while stocks last.

This month we've focused our attention on variable, fixed and split rate interest loans.

We have briefly looked at the advantages and disadvantages before coming to the conclusion that the most sensible thing to do is not just accept any type of finance, but rather to let your investing outcome and circumstances dictate your choice.

It's certainly true that the more you leave to chance the more risk there is that something will go horribly wrong.

Well, that's enough for now. As always, I wish you good fortune with your property investing and remember... success comes from doing things differently.

Regards,

Steve McKnight

P.S. Don't forget to tell your friends about the site and this newsletter. The easiest way to do this is by using our simple “refer a friend” facility at:
http://www.propertyinvesting.com/files/pop_welcome.htm

P.P.S. To read the back issues of this newsletter visit:
http://www.PropertyInvesting.com/backissues