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PropertyInvesting.com 'Insider'

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

Issue 5, Volume 2- May 2003

By Steve McKnight

27 May 2003

Hi and welcome to the May 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.

This month's topics are:

1. [Thanks for your support / Site Upgrade Alert](#)
2. [Inflation And Property](#)
3. [Topical Forum Post Of The Month](#)

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Thank-You!

I'd like to start by offering a big thank you to everyone who referred a friend to the website over the last month. As I type this newsletter our membership stands at 7,778 which means that we will soon exceed the 8,000 mark and maybe even the 10,000 mark by the end of June!

Do you know someone that could benefit from this free newsletter? If so then help us turn our membership goal into a reality by telling them about us. It's easy to do... just use our [online referral facility](#).

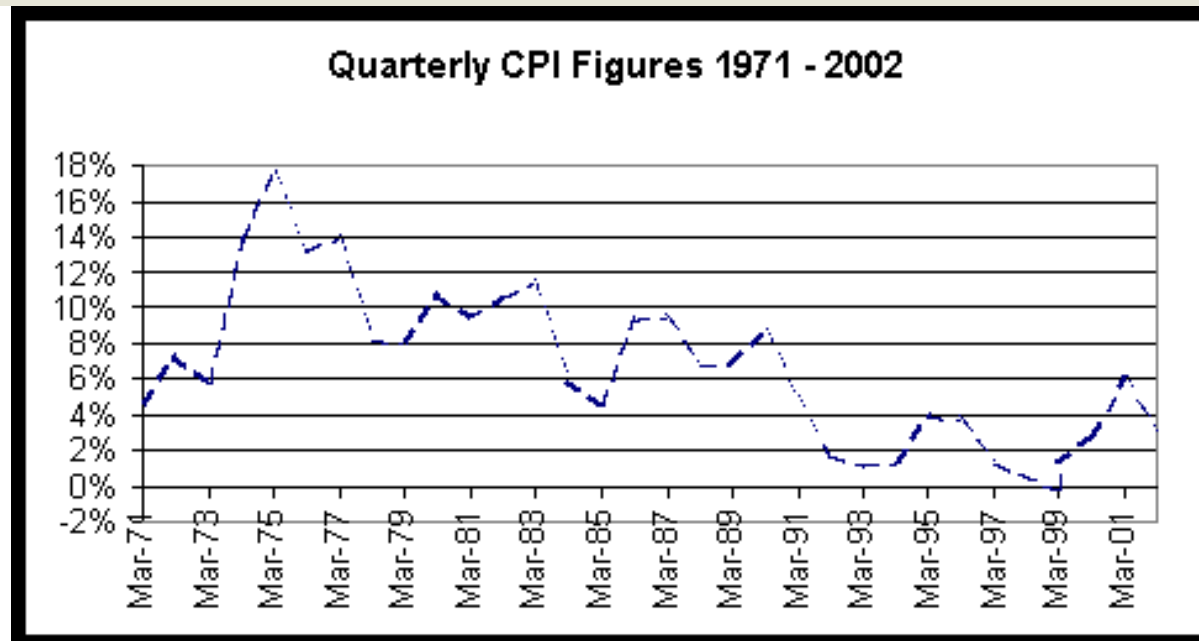
The massive growth in our database has meant that we need to upgrade the 'behind the scenes' side of PropertyInvesting.com. This will all hopefully be completed by the end of June and, when we switch over, two of the most obvious benefits will be the increased speed and also the new forum with stacks more functionality to make life easier for us all.

Inflation

Over the last few months now we have been examining the issue of property investing from a capital gains perspective. This month I'd like to continue the discussion by talking about the impact of inflation on real estate profits.

Inflation is an economic term for the rate at which general prices of goods and services increase.

In Australia, inflation is generally measured by changes in the consumer price index (CPI). The graph below (Source: Reserve Bank of Australia) shows the movement in inflation in Australia since 1971.



Using data from the Reserve Bank, I've calculated that the average annual inflation rate between March 1971 and March 2002 is 6.8%. This may not mean much as a figure, but what it tells us is that a \$1.00 in 1971 would buy the equivalent of \$7.69 at today's prices.

The impact of inflation means that a dollar today will buy more than a dollar in a year's time.

Inflation And Property

One of the biggest mistakes property investors make is to overstate the capital gains they earn by not allowing for the impact of inflation.

Let's look at an example.

John buys a property in Sydney in December 1992 for \$185,000 (the median house price). He holds it for ten years and then sells it for \$450,000 in December 2002.

At first glance, John seems to have made a profit of \$265,000 (\$450,000 - \$185,000), which would be an annual return on his investment of 5.89% ($\$26,500 / \$450,000$).

Yet this is not the case. First of all, we need to add on John's purchase costs - let's allow for 5% which means that his total price was \$194,250.

Next we need to deduct John's sale costs of 3%, so his nett sales proceeds is \$436,500.

We also need to deduct Capital Gains Tax. John bought the property in his own name and qualifies for a 50% CGT discount, so (assuming he is on the top marginal rate) he would pay tax of \$58,746 $((\$436,500 - \$194,250) * 0.50) * 0.485$. Now his capital gain is \$183,504.

Finally we need to adjust for inflation as a dollar in 2002 buys a lot less than a dollar in 1992. When we discount our gain back using the average inflation over that ten-year period, John's gain is further reduced to \$143,353.

Now John's nett return on investment is 3.19% ($\$14,335 / \$450,000$).

What Does All This Mean?

OK - so far there has been a lot of numbers and you might have become a little lost so here's a mini summary.

Inflation is the term given to the rise of prices over time (however caused). The impact of inflation is that a dollar will buy more goods and services today than it will tomorrow.

When it comes to property, if you invest for the medium to long-term then your capital gains return can be easily overstated because you're not comparing like figures. In John's example he invested in 1992 yet made his profit in 2002 - tens years later when inflation had eroded part of his profits.

The Impact

For investors who recycle their property within one or two years, the impact of inflation will be negligible. However, for those that look to the long-term and hope that their capital gains will fund their retirement, the impact of tax and inflation can dramatically whittle away their wealth.

It's important to watch out for the impact of inflation on your profits. Don't be fooled into thinking that you have made loads of money if all it means is that you have been treading water by keeping pace with inflation.

Forum Post Of The Month

This month's [feature forum post](#) is from BlueBear. He writes:

I continue to hear that the property boom is about to bust... I'm looking at buying an IP (cost 120k, rent about 220 per week) but in the back of my mind, I keep hearing "STOP! the bubble is about to BUST!"

(read the post and replies

at:http://www.propertyinvesting.com/forum/topic.asp?TOPIC_ID=1397)

Well, recently we have had both the Governor of the Reserve Bank, and also the Federal Treasurer, warning about the dangers of property investors borrowing too much money.

These warnings are only issued because they perceive that there is some threat to investors, with commonsense being left behind in favour of trying to make money.

And to this extent I agree - the average property investor needs to be very careful about what s/he chooses to buy as, sooner or later, the property boom will end (probably when interest rates rise) and prices will need to stabilise.

However the alerts do not mean that the opportunity to make money in property is now over. All it means is that you have to be more astute in your investments in order to mitigate the risk of losing money.

One thing is for certain - you can make money in any market at any time if you are properly equipped to take action on opportunity.

For example, when Dave and I started investing in Ballarat we were told that we were mad because we would never achieve capital gains in the country.

Yet we didn't listen to this nonsense because we saw an opportunity (wraps) that others did not, and were able to make money irrespective of what happened to the value of property.

The same opportunity exists for you too, regardless of whether or not property prices fall off the planet. The only danger is for those investors who threw caution to the wind and bought based on greed, without much idea of what they were really investing in.

When the market turns it will be those that relied on good luck rather than science that stand

to lose the most. My advice is that it's now more important than ever to get educated.

If you would like to make a comment about the future of real estate then please post it at:
http://www.propertyinvesting.com/forum/topic.asp?TOPIC_ID=139

Summary

This month we've continued our review of capital gains returns and found that inflation has seriously eroded your long-term profits.

The key to being a sophisticated investor is to always know how much profit you have in your investment and to ensure that it at least keeps pace with movements in inflation.

We also considered BlueBear's post. The lesson there is to not let fear prevent you from making a decision if your due diligence says the investment stacks up, and you have strategies in place to mitigate the risk of something going wrong.

Well, that's probably enough for this month. Best of luck with your property investing and remember that 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>