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PropertyInvesting.com 'Insider'

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

Issue 11, Volume 2 - November 2003

By Steve McKnight

30th November 2003

Hi and welcome to your November 2003 edition of Insider – the e-zine outlining how to successfully invest in real estate delivering a positive cashflow outcome.

If this is the first time you're receiving this newsletter then I warmly welcome you to the PropertyInvesting.com community. Don't forget to regularly log on to our forum at <http://www.PropertyInvesting.com/forum> and leverage off all the great tips and advice on offer.

As usual, there's a lot to discuss this month so let's get right into it… here's what's on offer:

Our New Format

One of the problems we regularly encounter when sending out this newsletter is the many requests for help from members who are having trouble reading it – either because they can't open it or else it's treated as SPAM and deleted from overzealous software.

After a recent brainstorming session, the PropertyInvesting.com team came up with the solution of distributing this newsletter in plain-text format while also providing the pre-formatted easy-to-read version on our website too.

We expect this change will increase the readability of this newsletter and as such more members will benefit from the information on offer.

If you have any questions or comments about these changes then we'd love to read them. Send an e-mail to newsletter@propertyinvesting.com.

Has the Property House Price Worm Finally Turned?

On the off chance that you've been oblivious to all the recent press, the Reserve Bank of Australia (RBA) decided at its meeting on the 4th November 2004 to raise the target cash rate by 0.25% (a quarter of one percent).

As expected, lenders passed on this increase in the form of a rise in home loan interest rates and in doing so poured a big bucket of freezing cold water on the seemingly endlessly hot property market.

Only the truly ignorant, and perhaps the current government with an election on the horizon, could have hoped that interest rates would remain unchanged into the foreseeable future.

For some time now the RBA has been making noises about an inevitable rate rise and how it would spell trouble for highly leveraged (read: over committed) property investors.

So, has the recent interest rate hike had any impact?

Indeed it has. Auction clearance figures (of all properties available for auction, the number of properties that actually sold) in Melbourne and Sydney have dipped and now real estate agents are starting to say there's the beginnings of an oversupply of properties comparable to demand… all during the traditional busy late-Spring sales season.

But let's take a pause and bring all the economic chit-chat back to some investing basics and analyse what it all means.

The rate rise has meant that there has been a significant change in the investing landscape and it's prudent for all property investors to make a decision about how to react.

The first option might be to just roll with the punches and absorb the extra interest cost, which on a $200,000 mortgage equates to an extra $363.75 per annum (on the basis of a 25 year loan, monthly payments and a rise from 6.0% to 6.25% interest).

However, adopting this passive approach will decrease the profitability of your investment (by reducing the positive cashflow) or, where your property is negatively geared, add to your existing loss.

If you're not happy wearing the extra interest, a second option would be to try to pass on the additional burden through a rent increase. While sounding great in theory, this isn't an option for investors with tenants on fixed-term leases that have a set agreed rent.

Furthermore, for those with floating (month to month) tenants, or no tenants at all, you may find fierce competition for the rental dollar means you may need to discount your rental to keep or attract clientele, meaning you'll be left having to absorb the additional interest.

Finally, a third and usually less considered but very effective option is to decide to repay a portion of your mortgage and therefore reduce your principal owing to a level where your interest charge remains unchanged.

For example, using the above $200,000 mortgage example above, you would have to repay $4,619.08 in order to keep the repayment at $1,282.19, allowing for interest rates to increase 0.25% from 6.0% to 6.25% per annum.

In fact, in the absence of being able to increase the rent and assuming that you had cash sitting in a low interest earning account, I regard this final option to be the most practical and sensible of all three.

One of the biggest mistakes I see investors making is getting into debt without any plan for how to get out of debt. This is especially true for those adopting interest-only loans, or else continually refinancing equity to fund the deposits on further property acquisitions.

In a situation when interest rates are rising, being in a position where you have significant debt without a plan for how to repay it places you in a very high risk category.

Now, don't get me wrong, there's nothing fundamentally wrong with refinancing or using interest-only loans. However, what I'm saying is it's critical that your investing plan needs to identify how you plan to repay debt, especially in an environment when property prices become flat or start to fall.

Aside from the investor needing to act (or at least acknowledging that choosing to do nothing will mean a fall in profits), rising interest rates also puts pressure on general market sentiment too.

The latest craze at the moment is for the press to write gloomy headlines, which causes people to start to fear that downturn and doom is now the order of the day; optimism will soon turn to pessimism.

When this occurs, demand will tapper off while supply will hold steady or increase; the result is an eminent fall in property prices.

A good example is a property that I have been following in my local newspaper (http://www.realestate.com.au/)

From memory, it was originally for sale at $425,000. Then, in last week's paper, the price had fallen to $395,000. Finally, in yesterday's paper I noticed it had dropped further to $365,000.

Given the lack of buyers, you'd probably expect to pick up the property for around $350,000, which is a long, long way off the original asking price and a huge drop in profits for the vendor.

Some years ago I was listening to an audio tape of an interview with Raymond Aaron – a Canadian property expert. He said that in his experience changes in property sentiment were like the Titanic trying to turn – it happens, but it takes a lot of time. He then contrasted this with changes in the stockmarket, which can happen overnight.

I agree with his comments, and believe that the property market will not crash overnight or as a result of any one factor. However, a number of accumulated factors can combine to cause the market to come off the boil, but these factors will need time to properly sink in.

Some recent developments I've noted include:

1. Repeated warnings from the Reserve Bank, culminating in a submission stating that yields on property prices are too low for professional property investors.
2. Interest rate increases causing property profits to drop.
3. Auction clearances falling indicating demand is drying up

compared to the heady days of emotion charged bidding.

4. Companies run by much criticised property developer and seminar spruiker Henry Kaye going bust (more to do with the negative publicity associated with the aftermath).

In short, these issues combined with other known and unknown factors have and will continue to contribute to the combined market sentiment of the day. Already some of the wind seems to have come out of the real estate market and it's compelling viewing to see what'll happen next.

One thing is for sure though, bad news spreads a lot quicker than good news!

Have the repeated warnings and negative publicity been enough to rein in the hype and control the mania, or will speculators come back when prices fall slightly and perceive opportunities to snap up bargains?

Once again talk of what the property market will do is nothing more than a collection of opinions. We'd be far better off acting on facts, but opinions only turn to facts with the passage of time and as investors we need to try to stay informed about changes to market sentiment, and in doing so, retain control of our investments.

Recently I started a post on the forum called 'Rabbit Season... No, Duck Season", I invite you to read my comments (http://www.propertyinvesting.com/forum/topic.asp?TOPIC_ID=5780) and post your opinion about what you think is likely to happen and also what you are doing to give substance to your investing position.

Details of Your Christmas Bonus

A question that I'm regularly asked is: "What kind of accounting structure do you use to protect your assets and minimise your tax?"

The short answer is a company and trust set up, but the reasons behind this are far more critical to understand than the words company or trust. In fact, your best structure needs to blend together asset protection, tax minimisation and cost effectiveness.

Because everyone's situation is different, it's critical that you assess your available options and make an informed decision. Being educated by an accountant who bills by the hour will be an expensive exercise, which is why I created a resource called 'WealthGuardian'.

'WealthGuardian' was created by myself in conjunction with respected Chartered Accountant and tax expert Paul Harper. Together we outline the the advantages and disadvantages of buying property as an individual, partnership, company, trust and superannuation fund. All in all, it's a very comprehensive audio and workbook resource that allows you to work through some difficult issues (albeit explained in easy to understand language) at your own pace.

Now, with Christmas coming and my sincere desire to see you properly educated and correctly structured, I'm offering an enticing

Xmas bonus. Buy WealthGuardian prior to 12 January 2004 and we'll include a 'Tales from the Trenches' (value $95) absolutely FREE.

'Tales from the Trenches' is a four pack audio cassette containing insightful interviews I've conducted with other professional investors to draw out the secrets to their success. Both products come very highly recommended from previous purchasers, and, as always, you're covered by our 14 day money back guarantee which means you can trial the products and if you're in any way dissatisfied, return them in the specified time frame and receive a full refund.

You can find out more information and/or order online at: http://www.propertyinvesting.com/resources/11

Summary

We're entering very interesting times for property investors. Every boom must bust, and every bust must boom. The question before us is simply an issue of timing - does the market have the required oomph for prices to keep rising, are we at the doorstep of a correction, or will prices trend sideways while we all wait to see what happens next?

Whatever you decide, it's time to form an opinion. It's wise to remember that in order to maintain control over your investments you must (1) assess the current market environment and (2) take action accordingly. To do otherwise is to risk being subjected to swinging market sentiment that's largely out of your control.

Well, that's it for this month! As always, I wish you the very best with all your investing activities. Until next time, remember that success comes from doing things differently.

Warm regards,

Steve McKnight

P.S. Don't forget about the special offer available on WealthGuardian. Find out more at: http://www.propertyinvesting.com/resources/11