STORY BEN KINGSLEY & BRYCE HOLDAWAY

In this edited extract we look at six of 18 strategies outlined in the *The Armchair Guide to Property Investing*

# PATHWAYS TO PROFIT

**W**E'VE CREATED specific strategies that we believe cover off all the mainstream reasons why you're looking to invest in property. Our strategies fit into one of these four categories: area (or location) strategies for capital growth; property selection strategies for capital growth; area strategies for yield and income; and property strategies for yield and income.

Each of these can be read as a powerful standalone strategy but they can also be interlinked and intertwined, depending on which pathway you choose. Remember what's right for one person might not be the best fit for someone else. With all of that in mind, let's get into the strategies!

## LOCATIONS FOR CAPITAL GROWTH

### 1 CHANGING PLACES, CHANGING FACES

This strategy relates to old working-class areas as close to CBDs as possible. They are the areas that have been (or are about to be) transformed into hip and happening urban renewal locations. The term is "gentrified" and, because they are more affordable for younger people, they are becoming popular. Areas such as Collingwood or Richmond in Melbourne and Alexandria or Macdonaldtown in Sydney are good examples of fully gentrified suburbs. This strategy still requires you to put your hand in your pocket, as you will pay more for property here than you would for a bigger house out in the burbs, but the future prospects for good growth will justify the spend.

- **Difficulty level.** This strategy requires lots of research and an "investor grade eye". If you're not willing to build your knowledge about this one, you should look to outsource the research. Most of these properties require some updating, so if you can handle that you'll be winning.
- **Risk and time allocation level.** Low to moderate risk. The challenge for these areas is that for every five you get right there is potentially one area that could take longer to gentrify. The short-term risk of losing capital value is very low if you've researched the area adequately but again the upside is well worth the effort.
- **Price point.** From as low as $350,000 around Australia. (Again properties can exist in our largest, older regional towns but forget units there and just focus on houses from $350,000, close to the really wealthy suburbs.)
- **Tax implications and when to buy.** These properties are negatively geared to start with but, if strong growth is experienced, this could result in the strategy delivering a potential neutral and positive position quicker than might be expected. If the area is selected correctly and the purchase is timed well, there's potential in the short term for the investment to outperform in the form of strong capital growth. Add this to the attractive price point and you can see why we love this strategy, even with its degree of difficulty.

### 2 THE WAVE RIDER

This is about identifying areas benefiting from the success of neighbouring locations and suburbs. The strategy is based on the fact that demand for certain accommodation – usually houses – is exceeding what's available in an area. Buyers will soon turn to the next neighbourhood to still enjoy the best of the amenities the area has to offer. Therefore, these are second-tier locations and, when the wave effect of capital growth occurs, one day they too will become blue-chip locations. Initial yields are usually better in these locations because the capital growth isn't as consistent but there will potentially be better gains in the future as more people become interested in the location due to affordability pressures. As such, the impact on the household cash flow is not as great compared with buying in premium locations. So from a borrowing-power perspective it's more achievable for most investor households.

- **Difficulty level.** It takes some skill to figure out which locations are likely to become wave riders. Focus on watching the demand drivers and supply, distance to amenities and commute time to employment centres. A novice can easily have a crack at this one but there are risks, so you'll need to be careful. One tip is not to stray too far from train transport in our major cities. And look for the potential for improved local amenities in the immediate area, even when what attracted the current owner-occupier were the great amenities reasonably close by.
- **Risk and time allocation level.** Moderate risk if you do your homework; high risk if you cut corners, because it relies on choosing an area riding on the success of another. The area research is going to be time-consuming because there are more areas that offer "fool's gold" instead of potential real gold.
- **Price point.** Units start from $300,000 and for houses you're looking at $500,000 – higher in Sydney and Melbourne. This strategy also works in our regional markets but focus on regional cities with populations over 50,000, with the price point for houses starting around $200,000. Generally, we don't use this strategy for units.
- **Tax implications and when to buy.** These properties offer a higher initial yield than their blue-chip neighbours but they can be still slightly negatively geared, depending on the interest rate of the day. They are likely to become positively geared in five to seven years if you time the market right. Most households can usually afford this strategy and are able to borrow to make it happen.

## PROPERTIES FOR CAPITAL GROWTH

### 3 THE UGLY DUCKLING

You find a property with "good bones" and in due course renovate or restore it (but it can be livable in the meantime). At some point you will bring it to market to realise even further wealth gains. The trick is in the buying so you can derive further profit out of your efforts. You'll need to factor in any cash flow and borrowing buffers you believe might be required, plus more to cover the shortfall in rental income during the renovation period. It's usually a short-term, quick equity gain harvest that makes this strategy so rewarding, because the gain can be turned into a further equity release to potentially buy another property, giving you a multiplier-of-wealth effect. When you're doing your calculations about how much to borrow, it's best to be conservative. Before making cosmetic renovations, you will get a lower rent due to the tiredness of the property but post reno you should get a good rental boost. A minimum rule of thumb is for every $1 you spend on your cosmetic reno you need to get $2 back in the final valuation post renovation.

- **Difficulty level.** Knowledge is an important ingredient in this play. You need to focus on what the end sales value should be and make sure that you're within a budget and it's delivering adequate returns. If you want to save money, it comes down to labour, so if you're good with your hands or have a trade all the better. Time and project management skills are a must, otherwise your effort to achieve a quick gain will be lost.
- **Risk and time allocation level.** Moderate and the bigger the project the higher the risk. This one's for those with high energy and a strong work ethic. It will be very time-consuming, so you'll want to be sure you're happy that this will become a second job for a period of time. Factor into your costings some blowouts. This will ensure your project will have the right margin to be worthwhile.
- **Price point.** As this strategy is based on buying a tired property and bringing it up to current market appeal, it can work in any price range. It's about buying under market value when you compare the property with similar stock on offer and then realising its potential to add value.
- **Tax implications and when to buy.** There are great potential tax benefits because you're renovating. Some will be immediate and others depreciable over time. It doesn't really matter when you buy because it can work in any market cycle. If you do the project well,

it will stack up. And remember, you can also buy the ugly duckling, rent it out for a few years and then turn it into the black swan you know it can be.

### 4 THE PIGGY BACKER

This strategy is where you buy an older house that will piggyback off the new stock in that area that sells for significantly higher prices. It has an extra benefit: the rental yield as a percentage of the property's value will be better than that of its newer counterparts. What we mean by this is that even though the rent you get each week will be lower than for brand new properties, the overall yield percentage is better because your property is lower in value. It's still a capital growth strategy but higher yields are also in the mix.

- **Difficulty level.** You need an in-depth understanding of the thousands of areas where this strategy could apply. It all sounds relatively simple but the level of knowledge needed is significant to ensure you are aware of these types of capital gains. It's usually a long-term strategy but, if timed well, it could offer the option to capitalise on any equity gains in the short term (three to 10 years). Remember we want to locate old properties – postwar or 1960s to '70s houses – where there is a lot of new stock being built close by at significantly higher prices.
- **Risk and time allocation level.** Low to medium risk if well executed; high if not. This strategy will yield a great return if the future plans for the area materialise, so your timing needs to be right. If you're thinking of going it alone, the strategy could take a lot of time and energy to research the thousands of potential locations.
- **Price point.** This is "affordable country" property – houses from $350,000 in the capital cities and from $200,000 (yes, as low as this) in some regional locations.
- **Tax implications and when to buy.** Properties are negatively geared initially, or neutral if there are low interest rates for city locations. In regional locations, with low interest rates they may even be positively geared. Overall your investment will move to being neutral or positively geared in less than five years, usually as the lower values of the property are offset against good rental income amounts. Timing is critical for this strategy because all of the upside comes down to when the new stock comes onto the market.

## LOCATIONS FOR YIELD AND INCOME

### 5 NO VACANCIES

This is all about finding areas where rental demand is high, which means vacancy rates are low. These locations can offer higher rental yields due to the underlying demand, as well as some level of growth in values while the demand exists, because many investors just chase yield or positive cash flow returns and they compete with other buyers. Cities with gross rental yields of 5.5%-plus, combined with vacancy rates of less than 1% to 2%, are prime opportunities. Yet at the time of writing, because of the low interest rates, yields are lower as property values across the board have been growing. For regional areas, look for yields higher than 6% and vacancy rates of around 1%. This is about controlling an asset for as little money out of the household budget as possible. However, we still recommend holding six months' worth of property expenses as a cash buffer, just in case.

- **Difficulty level.** You need to know what makes for an investment-grade property – it's all about the current and future demand for property in that area as well as the stock coming onto the market. Develop your "eye" and do your research for what the market is looking for, and work out how you're going to beat others to it. Consider diversified employment, population growth, lifestyle qualities, income, the history of the town and future stock.
- **Risk and time allocation level.** Moderate to low risk, due to the rental demand, lower out-of-pocket cash flow risk and the affordability of the housing stock in question. This game can be time-consuming because very few of the areas you will consider will be investment grade, and we see this as a medium- to long-term strategy, one for more than 15 years.
- **Price point.** Low end of the market. In regional areas you're looking in the $100,000 to $300,000 range (we prefer houses over units). In the city, we're mainly talking about prices below $750,000 for houses and below $500,000 for units, because the really low vacancies only occur in great lifestyle areas where people stay for the long term. You can get really low vacancy rates in other areas, such as mining towns, but due to their boom-and-bust nature vacancy rates aren't always low. In fact, they can get shockingly high at the end of a mining boom.
- **Tax implications and when to buy.** In a low interest rate environment these properties will be more neutrally or positively geared in regional areas and maybe slightly negatively geared in the capital cities. In a regional sense, it's important to get the timing right because these areas traditionally grow in spurts. In the big cities, unless a huge supply of new stock arrives in the area, usually the rental demand is high and vacancy rates are low in the great lifestyle areas.

## PROPERTIES FOR YIELD AND INCOME

### 6 THE DOUBLE-UP

The aim is to produce additional income streams from the one property, so think of the classic model of a granny flat or bungalow and you get the drift as to how this one works. It could also be transforming a double-storey dwelling into two homes. Let's say you find a property with a large basement or rumpus room downstairs and turn it into a small studio with kitchenette and ensuite which you can lease out separately from the upstairs. This strategy is not about large-scale construction or a dual-occupancy set-up, which requires a long and detailed council planning approval. Rather it's all about restructuring the home where possible (within planning guidelines) or adding accommodation that doesn't require arduous town planning work.

Identify areas that this type of accommodation is best suited for, such as where there are many international or local students. Close to a university is a great start. Also remember that these properties already exist. The current owners might have set their property up for either their ageing parents or for the older child who wanted their own space. Google search for key words such as "dual income", "granny flat" and "bungalow", etc, to find these types of properties, as they can sometimes be tricky to seek out. Make sure you investigate to see if the property has a permit for the two living spaces and also talk to local property managers and the university to see if there is strong demand for this type of accommodation in the area.

- **Difficulty level.** Understanding tenancy regulations is a great start here in relation to fire regulations, insurance and permits. You may need to invest time and effort to build up your local knowledge by talking to the local council to find out what is required to be fully compliant with rules and regulations. Some building companies specialise in this type of work and they should have a "rules and regulations list" for the local council where you are potentially looking to do this.
- **Risk and time allocation level.** Medium risk, as you have the comfort that at least there is one dwelling on the land earning you some income. There is regulatory risk, as highlighted above, plus in some cases property managers might not be willing to manage this second accommodation, so you'll have to self-manage the tenants and their issues. Naturally, it will take up a lot of time to find an acceptable property and then to do all the extra bits needed to double-up the income. There's a great cash flow outcome, though, if you get it right.
- **Price point.** Upwards of $400,000 in the city fringe and higher near universities and closer to the CBD.
- **Tax implications and when to buy.** The best properties will be positively geared, or neutral at worst. If a property is negatively geared, that will be the result of putting a new granny flat or bungalow on the site. Yet the positives of this will be the depreciation you can claim. You won't need to time the market for this strategy; you just need to find the right property. Furthermore, it's less aggressive than some of the other income strategies, such as renting a property bedroom by bedroom. **M**

**WIN A COPY**

This is an edited extract from *The Armchair Guide to Property Investing* by Ben Kingsley and Bryce Holdaway, published by Major Street Publishing. (RRP $29.95). To win one of five copies tell us in 25 words or less your property investing strategy. Send your entries to money@bauer-media.com.au or *Money* magazine, GPO Box 4088, Sydney, NSW 2001. Entries close July 6, 2016.