STORY BRYCE HOLDAWAY

Income for life

Putting together a great property portfolio is as easy as A, B, C and D

I'VE BEEN INVOLVED WITH property investment for more than 15 years. It started back in 1999 when I bought my first investment property and it's fair to say I've been passionate about residential property investment ever since.

After that initial purchase, I've not only continued to build my own portfolio but also carved out a professional career helping hundreds of property investors build their own portfolio to generate a passive income for life.

So it proved thought provoking when I stumbled on a quote last year that made me reflect on how well I actually understand the very topic I am so passionate about: Albert Einstein said, "If you can't explain it simply, you don't understand it well enough."

These 12 words of wisdom ignited the challenge to understand my topic so well that I could explain it simply enough so that anyone could get it, whether a first-time investor or an experienced portfolio builder.

It was from this that I began my mission to develop a "formula" that I could use to simply explain how to build a passive income for life with residential real estate.

So here's the result:

Property investment equals
A **asset selection**
plus B **borrowing power**
plus C **cash-flow management**
plus D **defence**

Importantly, mastering each of the four disciplines gives me a solid framework for building a residential property portfolio. And it takes away the guesswork and confusion that often results from conflicting opinions about the subject while easing the anxiety and mystery that can come from doing something that is statistically and experientially not that common – that is, setting ourselves up for life financially.

Here's a brief look at each of the four elements of the formula:

A Asset selection

Just because we live in a property doesn't mean we automatically qualify for mastery in this area. In fact, at any time there are more properties on the market that are not suitable as an investment than there are ones that do make the grade. So how do you decide which of the 9.4 million-plus dwellings in 15,000-plus suburbs you should consider as an investment property?

Here are three criteria that I apply as starting point:

Owner-occupier appeal is very important. Owner-occupiers represent roughly 70% of the market and they tend to buy property emotionally, which means that someone is more likely to throw logic out the window if they fall in love with your property because they have given their heart to it.

On the other hand, if you plan to hold rather than sell, a valuer is more likely to use favourable other properties for comparison when determining how much your property is worth if it has this type of appeal.

The alternative is properties with investor appeal– for example, student accommodation – where there is zero owner-occupier appeal. The problem here is investors don't buy with their hearts but rather with their calculators, so price growth can be limited.

Scarcity If I'm looking to buy an apartment, I go for a maximum of 20 in the block, with a strong preference for established properties that have no pool, gym, caretaker or lift, which increase body corporate outlays.

If I'm looking for a house, I avoid new subdivisions as there is no scarcity of land. I go for built-up inner-urban areas with established infrastructure, great lifestyle drivers and, ideally, something with period-style architecture.

Investment grade There's no point buying a mansion in an A+ suburb that you know will grow in value year after year but will put you under enormous cash-flow pressure because of the typically low rental yield you should expect (1%-2%).

A property that has fantastic income potential but little or no capital growth prospects is also unlikely to serve you. The aim should be to buy at a price between $350,000 and $850,000, as most people can afford this bracket and the feasible rental yield (3%-5%) provides an "investment grade" blend to suit your overall requirements.

A buyer's agent can help you master this discipline if you don't have the time to track down the right property. An experienced and competent agent will be great at asset selection, communication and negotiation.

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B Borrowing power

The first step is to get on your team an investment-savvy finance broker who you easily relate to and trust. Any investor looking to build a portfolio will need multiple loans, probably with more than one bank.

As a great chess player thinks two or three moves in advance, so too should your mortgage broker think two or three loans in advance, not simply facilitate a transaction in isolation. They will need to consider all the players: the banks and the product most suited to you; the valuer and the critical role they play; and the mortgage insurers, including when you should avoid them and when you should embrace them.

And all the while they must ensure you have an adequate loan structure in place and can meet your existing lending obligations. I cannot emphasise enough how critical it is to unlock your borrowing power optimally and that a good mortgage broker will be the key.

C Cash-flow management

This is the arguably the hardest of the four disciplines to master but it can be the most revealing and rewarding. It requires a thorough understanding of your household finances, the effects of compounding interest on your mortgage and the tax implications of investing in property, to name a few issues. But by getting this precise, you can focus on how many properties you actually need, rather than on how many you think you should have.

I generally find that most property investors I speak to don't actually know how many properties they will need to be able to retire. So, without this critical piece of the puzzle, they focus single-mindedly on the mantra of "keep on buying as many as you can". But this can lead to runaway debt, poor loan structuring and a short-term focus on acquisition at the expense of awareness of the medium- and long-term impacts on your cash flow so that you keep the properties while juggling real life – taking maternity leave, going on a holiday or renovating the kitchen.

With the correct understanding of household cash-flow management, the focus can quickly move beyond simple accumulation to include debt retirement and the positive result this can ultimately bring – retiring with a passive income for life. To master this you will need to simulate all the relevant inputs in a spreadsheet that factors in both the present and future value of money.

D Defence

Cash-flow management is the hardest of the four disciplines and defence is the one that is most easily forgotten or missed. It really is the act of guarding the fort. If you go to the effort of building a portfolio, the last thing you want to do is leave yourself exposed to circumstances outside your control.

In effect, defence is all about insurance – insuring your income, your assets and your lifestyle. By covering these three elements of your life, you can be comfortable knowing that if you're unable to earn an income or are incapacitated, you and your loved ones will be protected. The good news is that this is probably the easiest discipline to master as it's the exclusive domain of a qualified (and competent) financial planner

Finally, it really is true that the whole is greater than the sum of the parts. The key parts of the property investment formula are much like the members of your favourite band – they perform different roles and it's not until they work in unison that the music is made. At the very least, following this formula will help you avoid fulfilling one of Einstein's other great quotes: "Insanity: doing the same thing over and over again and expecting different results." ***M***

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SHOW TIME IN MELBOURNE

You can hear more from Bryce Holdaway at the Melbourne Home Buyer & Property Investor Show from August 29-31 at the Melbourne Convention & Exhibition Centre. You can also catch presentations and seminars by experts including *Money* editor Effie Zahos, Chris Gray and Margaret Lomas. *Money* readers can get free entry – a saving of up to $20. To get your free ticket visit homebuyershow.com.au for the Melbourne Show, select "Purchase tickets" and, when asked to enter the promotional code, type in MONEY. The website also has details about the exhibitors, new products and exclusive specials.