3 Tips To Protect Your Property Investments In Less Than Certain Times

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TRILOGY news
"the property investor's mortgage broker"

With ongoing speculation about an investor fuelled housing bubble and the potential fallout should China's economic ascension come to a screeching halt, it's interesting that so many Aussies are still keen to dabble in the property markets.

And as property prices start to cool off in some of the more overheated markets and interest rates are tipped to remain on hold, it's possible that those who've been contemplating another housing asset acquisition for some time, could take the leap sooner rather than later.

Irrespective of whatever's occurring around you, as an investor it's important to cover your bases and ensure your portfolio is stable enough to withstand any sudden changes in the markets.

There's always an element of risk involved when it comes to investing; what if your situation changes and you lose your job or can't find a suitable tenant? What if your income or ability to meet your mortgage repayments becomes an issue?

But as with any type of investment risk, you can plan to mitigate the potential hazards around our changing property markets.

So here are my top 3 tips for investors to ensure they have the capacity to secure, and more importantly retain, top-performing assets in a less than certain economic climate.

1. Be Prepared

Establishing a financial buffer to ensure you can maintain your mortgage repayments should your situation change, and you find yourself experiencing a run of rainy days, is a necessity for successful property investors.

A line of credit or offset account linked to your loan is one of the best ways to maintain a cash buffer, as it has the added benefit of helping to reduce the amount of interest applied to your loan.

This reserve can be used to cover shortfalls between rental income and monthly repayments on negatively geared property and hedge against interest rate rises. Not that they're likely to occur anytime soon…but it's always best to be safe, right?

Plus, if there is a maintenance emergency with your rental property that requires a quick fix, such as a broken down hot water service, you'll have the necessary funds at hand to attend to these issues in a timely manner, keeping your tenants on side and happy.

And of course happy tenants often mean long-term tenants. However, should you find yourself with an empty investment property for a few months, your buffer can be another way to make up that lost rental income and keep on top of your repayments.

2. Cover your bases

While handing over a large sum of money to an insurance company probably doesn't make you jump for joy, having adequate cover to protect you in the case of an unfortunate event will certainly soften the blow. Plus, as an investor, your policy cost is a tax deduction.

Make sure you read your policy carefully and ensure you are sufficiently covered for things like public liability – in case your tenant injures themselves on the premises and decides to sue you. As well as Landlord insurance – to cover payment defaults or damage by tenants.

It also pays to cover yourself. It's incredible how many people are compelled to insure their car and personal belongings, but don't consider insuring the most important thing of all – the life they've worked so hard to build.

Income protection, in case you are unable to work for some reason (particularly for those who are self employed) is a must, as is life insurance to protect your financial wellbeing should anything happen to you.

3. Buy right

Given that property values are often subject to external forces and can therefore fluctuate up, down or sideways, it's critical to ensure you approach your investment endeavours strategically.

Wherever possible, purchase your property assets below intrinsic value. This is about buying the right type property at the right price. Over capitalising means it's likely to take longer for you to start accruing that all-important capital growth.

You also want to ensure that any investment you consider has a history of solid capital growth, in an area that has performed fairly consistently over a long stretch of time.

Ideally, look for housing that outperforms the averages, as the extra growth you gain in the good times will help tide you over during any downturns, providing more consistency over the long term.

Look for an investment that's aesthetically pleasing and has some element of scarcity, such as unique architectural features. And make sure it has enduring appeal with both tenants and owner-occupiers alike. These make for far more stable investments than things like generic, high-rise apartment towers.

And wherever possible, seek out property that has value add potential, as manufacturing capital growth is the perfect way to make up for slower growth periods in the markets.

5 Top Tips To Negotiate A Pre-Auction Purchase

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More properties are being transacted under the fall of the hammer than ever before in Australia, a nation that's historically transacted the bulk of its real estate through private treaty.

Logically, auction activity has increased most in those areas where demand is consistently outstripping supply, leading to continued upward pressure on property prices. Think inner city Melbourne and Sydney obviously.

In some locations where accommodation supply is incredibly prohibitive, houses going under the fall of the hammer have been achieving ridiculously lofty results, way above the quoted guide price.

If you happen across a property as an investor, which is due to go to market via auction, you can certainly ask the vendor's agent whether they'd be willing to table a pre-auction offer. Of course as with most things in life, just because you can, doesn't mean you should.

In some instances, where you can see there'll be less buyer demand – perhaps due to the property requiring extensive cosmetic rehabilitation to bring it up to most people's standards – you're potentially better off waiting to see what the market tells the owners it's actually worth.

Particularly if it looks as thought a property will be passed in at auction, it's good to hang tight and wait for the dust to settle before swooping in with an offer that will solve the vendor's dilemmas, and see you walk away with a little extra value equity at point of purchase.

In some instances however, particularly hotter markets where the auction process might see you in a competitive bidding war, it can be in your best interests to open the channels for parlay prior to 'the big day'. And then there's the instance where someone else forces your hand…

What if you're an interested party, who's made enquiries on a property that's headed for auction, and the selling agent calls to inform you that the vendor has taken

Here are 5 ways to increase your chance for success with a pre-auction negotiation…

1. Do your research

You might be 'flying blind' when it comes to making a competitive offer against another potential purchaser when trying to secure a property prior to auction, but you should still have clarity around the top price you're prepared to pay.

The best weapon when it comes to negotiation is knowledge. Know the market, know the value of the property in question and armed with that power, approach the parlay with all guns blazing.

If it means putting in an offer above the quoted price range, go for it! There's no point risking losing the home of your dreams or ideal investment just because you wanted 'a steal'. But you should also be prepared to walk away if the price is too high.

2. Be prepared to walk away

While no one likes to consider him or herself a 'loser', it's far better to walk away and live to fight another day than over-commit financially. This comes back to tip number one – if you know the true value of a property and set a limit on what you're prepared to pay accordingly, make sure you stick to your plan. After all, there are plenty more "fish in the sea" and by losing gracefully in one instance, you just might find you're a bigger winner the next time around.

3. Don't be forced into a "Dutch Auction"

When two or more potential purchasers end up making "blind bids" prior to the property going to auction, you have what's referred to as a 'Dutch auction' on your hands. With no idea how much the other party is offering, the selling agent will tell you that they've submitted a higher amount and ask whether you'll increase your offer in response.

This can go back and forth numerous times, depending on how far each party is prepared to take it. Apart from being a dodgy practice, Dutch auctions often push the price of a property beyond reason as emotions get the better of the unwitting participants. Again, the key is to walk away when you reach the limit you set yourself.

4. Use time to your advantage

Never be too hasty or impatient, as this will work against you and could be the reason you lose out to another purchaser. During any negotiations, waiting is often the best weapon in your arsenal. It will make the other party sweat a little and give you the upper hand.

5. Don't be too revealing

Real estate agents are skilled at obtaining information from potential purchasers, including the price they're prepared to pay for a property. It's their job after all! Sometimes you might end up revealing things you never intended to them, which can be detrimental to your negotiation power. Keep your cards close to your chest when it comes to your bottom line to ensure the agent doesn't use your information to sway another potential buyer to outbid you.

Ultimately, while real estate negotiation is a game of tactics, the most desirable outcome is that all parties walk away feeling satisfied that they've achieved what they hoped for. If you're always looking for the solutions in a negotiation, you'll come out on top.

The Housing Bubble Name, Shame and Blame Game

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Over the past few years, as house prices in our major capital cities have continued to climb due to increased demand, mum and dad investors have been consistently demonised for their role in creating a so-called housing bubble.

Even in the current climate, where most analysts are saying the overheated housing sector has died down to more of a slow, controlled burn than the raging inferno it was, the average Aussie looking to shore up their retirement fund with real estate is in the firing line once again.

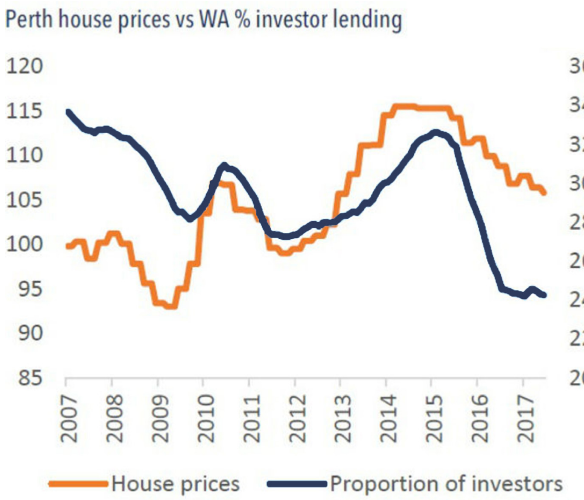
Same, but different?

This time around, experts are comparing the local property market to conditions that brought some of its comparable, overseas counterparts to the brink of serious collapse.

The source of this current housing crash speculation, and subsequent vilification of mum and dad investors, just happens to be a large hedge funds manager. Not sure if that's coincidental...

Watermark Funds Management recently warned that we are experiencing similar patterns in house prices as countries where significant market crashes occurred post GFC, including the US, the UK, Spain and the Netherlands.

The investment firm is pointing the finger at Perth and Darwin as evidence of the issue around mum and dad investors particularly, with property values in both cities declining alongside the number of investors who've jumped ship from these ailing markets.



Source: ABS

One of the big concerns raised by Watermark is the proportion of new mortgages acquired by "amateur" property investors, which stands at 35 per cent here in Australia; around three times higher than the US, UK and Canada.

In Sydney, 42 per cent of activity in the local market is attributed to non-professional property punters, down from half of all new mortgages in 2015/16.

Source: Citi Research

Do they know what they're doing?

It's not necessarily the fact that these average Australians preparing for their impending retirement with residential housing assets are evildoers.

Moreover, it's the basis on which many are selecting and purchasing properties that has market watchers worried.

A survey conducted by ME Bank in November revealed that over half of all investors active in the markets are using past performance alone, as a guide for future success.

When asked the primary reason for their love affair with bricks and mortar, 56 per cent said, "Australian house prices have always gone up in the past."

More concerning however, was the 11 per cent of respondents who stated, "so many other people are buying investment properties it must be safe," while only 34 per cent were confident in their buying decision due to "advice or analysis".

Certainly, it's impossible to deny that house prices have always risen in Australia. Officially calling an end to the house price boom early last month, UBS analysts noted a staggering 6556 per cent growth in this asset class over the past 55 years.

But ME Bank head of home loans Patrick Nolan, cautions that investors shouldn't take past performance alone as the sole barometer for future success, "particularly with property prices so high."

"Analysis and advice is the best basis for making any investment decisions, particularly if you're tempted to rely on past performance, or indeed if you are basing your decision on what other investors are doing."

Nolan rightly points out that our markets are rather diverse, meaning not all properties will perform equally at any given time.

"While Perth is currently recovering from a downturn, Melbourne and Sydney are growing albeit not as fast, while growth in Hobart has improved.

"Apartment development in Brisbane, Sydney and Melbourne are also at record high levels, with some commentators speculating supply may outstrip demand in the short-term," said Nolan.

Breaking point

So what is likely to tip the scales on mum and dad investors to potentially bring this house of cards crashing down around novice landlords?

Aside from the obvious crackdown on investor lending by banking regulators, Watermark says if a Labor government came into power nationally, it may curb tax breaks like negative gearing, causing more mum and dad investors to jump ship, due to decreased cashflow and increased holding costs.

"This is a concern to the extent that recent macro-prudential measures and possible future tax changes are being specifically designed to reduce investor activity in the Australian housing market," the Watermark report states.

According to the investment firm, excessive property investor activity was one of the catalysts for house price volatility in the US, just prior to and immediately post-GFC.

Over there, so-called "investor" cities had over 50 per cent appreciation during the housing boom and then a 50 per cent larger correction in the wake of the subsequent market decline.

"The US experience in the '00s suggests that housing markets with high participation of leveraged speculators tend to exhibit increased volatility in both booms and busts," the report said.

Author of the report Hamish Chalmers, said if Aussie mum and dad investors suddenly make a mad, collective dash for the exits, we face the same possibility of a sharp decline in house prices.

"Our research highlighted that the Australian economy is exhibiting many similar symptoms that those other economies did before they had their housing-led busts, so things are definitely slowing," said Chalmers.

"What happens next is dependent, and how bad things will be depends on the reaction from the Government and regulators.

"It depends on the actions of the banks themselves and I think crucially, and where Australia is different, is that there is a huge army of amateur investors."

Of course our situation is arguably different in many other ways if you want to compare apples and oranges.

For one, our banking sector is much more heavily regulated than the pre-GFC financial services sector in America. And we traditionally have a higher rate of home ownership, providing underlying stability for the housing markets, even though this has decreased slightly in recent times.

Furthermore, overseas participation in our property markets is continuing at a substantial rate, as Chinese buyers help to underpin the new apartment sector and absorb the vast amount of stock quickly coming on line, which many were concerned would cause a supply over-saturation.

At the end of the day…

Property is one of those sectors that always causes a good deal of conjecture around future economic stability, as it is such a steadfast fixture of our nation's 'wealth ideal'. Where the current climate will lead us however, is really anyone's guess.

The take home message for investors is do your homework. Purchasing property investments based on what everyone else is doing, or the simple fact that prices have always gone up in the past isn't really cutting it. If you want to stay in the game and ride out the ups and downs that are par for the course with residential property, seek professional advice and do some serious number crunching.

No one can predict the future, but you can be better prepared with the right foundations for your investment portfolio.

Will Interest Rates Be Going Anywhere, Anytime Soon?

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Spoiler alert…after declaring last month that interest rates will remain on hold for the brief remainder of 2017, speculation now turns to what the coming year has in store for mortgage holders.

Many economic boffins predicted a rise in the official cash rate at some stage throughout 2018, however now there's less certainty, with some suggesting we'll be waiting until the latter half of 2019 for any movement from the RBA.

This prediction comes off the back of a continuing cool down in house prices, with falling clearance rates indicating that the real value of residential property could be lower than the official figures we'll see emerging at the end of the year.

Of course house prices and interest rates are inextricably linked. Should the markets fall precipitously, the RBA will no doubt sit on its hands a little longer, lest rising rates scare too many out of the game at once, thereby causing a greater fall in values than would be palatable.

Around 70 per cent of analysts are now forecasting a rate rise no sooner than the middle of next year.

However, a growing number of experts have pushed this prediction out to 2019, after last month's comments from Reserve Bank governor Phillip Lowe, reaffirming that current economic conditions were not ripe for rate rises. Stubbornly low wage growth and inflation are two key reasons Lowe is reluctant to see rates rise anytime soon.

On the other hand though, the central bank is understandably reticent to drop rates down any further, given that when they did so last time, thinking much of the wind had left the sails of the housing boom, property transactions took off again in a big way.

But what if property prices fall more substantially over coming months? What if wage growth and inflation continues to flatline, or worse, decline rather than actually grow?

Will the RBA be backed into a corner, forced into yet another rate reduction to prevent a jarring crash in the sector? And if so, will APRA step into the fray once more with all regulatory guns blazing?

Lenders have already tightened up their policies and practices around handing out housing finance, particularly to investors, on the back of historically heavy-handed intervention from the regulator.

In fact the Commonwealth Bank recently informed mortgage brokers that it's about to launch a major overhaul of its lending policies in a bid to "ensure the long-term sustainability of the property market."

This further crackdown will include further fine-tuning of existing lending policies, such as increasing required deposit amounts, and the introduction of new measures to make acquiring a loan in higher-risk suburbs far more difficult.

This announcement coincided with a startling new report from UBS that suggests $500 billion worth of loans in the Australian banking system are based on factually incorrect borrower information.

In light of all this upheaval in the banking and property sectors, it will be interesting to see how 2018 plays out for interest rates, and whether the Reserve Bank will be forced to once again sit impotently by and watch it all unfold for a further 12 months.