q property: PROPERTY FIT

When it comes to building a property portfolio the right techniques and industry knowledge can save you a lot of pain. So, here's a quick guide to the most popular strategies to help you find a method to fit you and your circumstances.

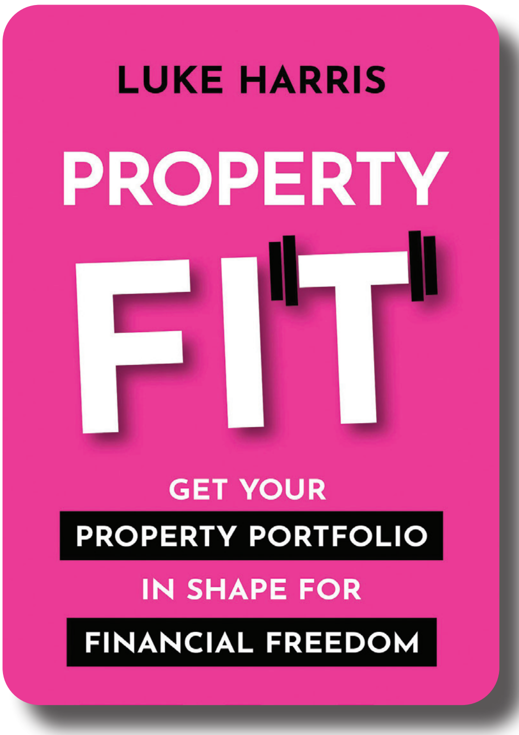
THE EASY FIT

These strategies are excellent performers if you're just starting out. Executed correctly they'll do the heavy lifting for you; but they're not sexy, they're workhorses! It's all about numbers, profit and growth; not high ceilings, ocean views and swimming pools.

Positive and negative gearing

Positive gearing provides income over and above all expenses, providing investors with a financial buffer and assists with borrowing for more property, as lenders can see the positive cashflow position. However, investors often choose a property based on its cashflow outcome rather than its investment fundamentals, and may not end up with the best long-term investment. Also, a positively geared property may not remain that way as interest rates and other expenses impact the cashflow position over time.

Negative gearing provides significant tax advantages, allowing you to save on tax yet still hold an asset. Lenders can often 'add back' some of these on-paper losses to their loan-servicing calculators so you can continue to borrow and build your portfolio. Short-term negative gearing can be offset by capital growth if the asset is held long enough. However, cashflow drain can kill a healthy portfolio, and investors with negatively geared property are more sensitive to interest-rate rises and changes to tax laws.



Established residential property
An obvious positive is that you can see the property before purchasing and you know what you're buying. Established housing can be improved to add value through renovation, subdivision or development; it can also be quickly bought, settled and tenanted. However, purchasing a second-, third- (or more) hand property means you could be buying hidden faults, and repairs and maintenance can affect cashflow and slow down portfolio growth. Tax depreciation benefits are also reduced and, combined with repairs, can cause a hit to your financials.

New or off-the-plan residential property

This is a solid strategy, allowing you to fast-track your property portfolio without fuss. New property can rent for a higher price, is lower maintenance, comes with a warranty and provides tax depreciation benefits - allowing you to direct funds towards building your portfolio instead of maintaining an older property. However, off-the-plan properties can be delayed and valuations can come in below purchase price, meaning that before settlement you may need to chip in additional funds. This is common in areas that are oversupplied or in high-rise buildings.

Commercial property

Commercial property offers stability, with rents typically paid on time and other expenses generally covered by the tenant. Rents are often higher than residential, and tenants generally sign longer leases with built in increases and options to extend. However commercial property is linked to external economic factors and businesses can fail, meaning lost rent.

THE HIGHER RISK FIT

These next strategies are about lifting the lid on what's possible at the riskier end of the investment ladder. Having said that, they offer fantastic opportunities to build your portfolio, as long as they fit your long-term objectives and risk profile.

Renovating

Executed correctly, renovations can provide an uplift in property value without needing to spend a fortune. However time delays can chew up huge chunks of potential profit, and when working on an older property you never know what problems might arise. Inexperienced renovators often run out of time or money; so don't spend more money than you need to, and never get emotionally attached to the property. Treat it like a business from start to finish!

Flipping property

Flipping property can be a fast way to increase cashflow. You can renovate, add rooms, secure planning approval for further development or change the approved zoning of land (for example, from rural to residential). Knowing which locations to research and how to narrow down which property to purchase is critical. If you time the market accurately, you can ride the wave of price increases - provided you add value appropriately. However, entry and exit costs are high, with stamp duty, holding costs and selling costs payable over and above any other costs. Taxes on profits can also be huge, so remember to make sound commercial decisions.

Property development

Property development involves buying land, knowing how to obtain funding and present your application, what terms to sign up for, how to avoid being ripped off, obtaining planning approval, building, selling and orchestrating everything in between! The unwritten rule is you need a 20 per cent margin, which is your profit, and this must be balanced against your risk tolerance. External factors can impact your project and if you fail it can send you broke. You need substantial financial buffers and a good asset base … you also need to be prepared to lose some – or all – of your capital.

Short-stay accommodation

This can be an amazing strategy to increase yields, with many investors building a great cashflow portfolio this way. One of the biggest risks is cashflow fluctuation; you need a financial buffer to get you through low booking periods. Aim to double your baseline rent when setting price. If you can achieve $400 per week on the long-term rental market, you should aim to average $800 on the short-stay market. Guests can cause damage to your property, insurance can be expensive, and you need to consider the time involved in managing the property yourself versus engaging professionals to manage the process for you.

These strategies are about helping you determine the best pathway to success without wasting time on activities that may not produce an ideal result. Likewise, different strategies come saddled with different risk levels, but this can be mitigated with the right education, the right team of people around you and an informed plan of attack. You can always make money, but you can't get time back, so don't waste this precious resource by pursuing the wrong strategy.

Luke Harris is the author of Property Fit (Major Street Publishing $29.95), and is the CEO of The Property Mentors, a Melbourne-based business that educates, motivates and facilitates clients from all around Australia to achieve financial freedom through property.
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