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5 Things to Avoid in 2010

Investors,
This is an article by Margaret Lomas, who runs Destiny Group and can be seen on Sky News. Her views are more about cash flow balance than going for capital growth properties that may be highly negatively geared. Her views are worth considering.

5 things to avoid in 2010 **5/03/2010**

The opportunity to make big profits still exists, but you have to be very selective and smarter with your investments. Margaret Lomas explains.

You've got to love the great Aussie spirit. While the rest of the world was in meltdown, we were prepared to declare that we were in recession - for one day! We stopped spending for a week or so, just to see what would happen, and then started again when we didn't see any immediate negative impact on our own economy. Economists predicted a crash in property markets which simply didn't come - in fact almost as if to take up the challenge and prove them all wrong, we saw growth across the board for most of 2009!

Having said all that, scratching at the edges of our consciousness remains a niggling doubt about whether all of this positive thinking can really protect us as much as we would like. However, we look at the domestic situation, economies the world over continue to freefall and technology almost guarantees some sort of impact back here on home shores. While we were able to put it all out of our minds for a few weeks as we geared up for the Christmas festivities, with the new year upon us, many of us will need to once again address our personal financial futures.

Where property is concerned, there are challenges which property investors will face. Being forewarned is always, I think, also being forearmed. Here are some things to be careful of in the coming 12 months:

1. Niche market property
I have never been a fan of any unusual kind of property, if for no other reason than that it carries a greater risk than standard residential property. Student accommodation, serviced apartments and seniors' lots have a volatile history and present a greater opportunity for it all to go horribly wrong.

Student accommodation may seem like a great idea due to its higher than normal rental return, but yield is not always king, and resale can be difficult. Issues range from the fact that long hiatus periods at local universities can lead to extensive periods of vacancy, to the fact that repairs and maintenance costs can soar, making these an unattractive buy for a future investor. Growth in this market has been sluggish at best and oversupply is a major concern around many universities.

Seniors lots still have an unproven track record for both growth and yield, and banks simply don't like them much, making borrowing to buy them fraught with problems. While they are marketed on the back of a prediction that many older Australians are set to retire still renting, many of these developments are built in undesirable suburbs with little appeal to the retirement market.

Serviced apartments and hotel rooms are usually purchased within known tourist hotspots, and one thing we do know is that Australians are planning to spend less on holidays for the coming few years. This will mean that the quoted occupancy levels on such property, based on historical data taken from more prosperous times, will unlikely be achieved. This is especially troublesome for new investors who are relying on strong yields to support loans and help them obtain the equity they need to leverage into more property.

2. Sea change/Tree change/ Inner city

Ask anyone what the key factor is in the success of any property investment, and I guarantee they will respond with 'location, location, location'. The advertising company who invented that slogan displayed a stroke of genius when they coined perhaps the single most influential phrase in property investing history. In my opinion, it's also been the biggest con, and today the phrase has fallen into the power of those who use it for evil rather than good - developers and marketers who sell overpriced property to unsuspecting investors on the back of its physical appeal.

In Terry Ryder's 'Iconomics' report, he basically found that in the past 10 - 15 years, property situated in iconic locations, such as near the sea, in beautiful rural surroundings or within 10 km of a CBD has shown lacklustre growth, often struggling to show double digit growth figures. Conversely, bread and butter property in lower price ranges and situated in outer metropolitan areas or larger regional centres has boomed along nicely.

The reason is very clear - more demand, more pressure, better growth. There are, quite simply, more people who can afford lower priced property situated in areas with great infrastructure planning than there are those who can afford those in higher price ranges. In addition, lower priced property tends to be a little recession proof, as the cost to buy remains affordable far longer when times are tough.

During 2010 such lower priced property will come into its own and continue to defy economic pressure to show great growth in both value and rental yield. On the other hand, property in iconic locations will continue to limp along and suffer the greatest impact.

3. Off-the-plan

I have never been a fan of off-the-plan purchases, and now more than ever I issue the warning to stay away. The fact is that we simply do not know exactly how our property markets will weather this current storm, and so any kind of speculative investing should be avoided at all costs.

When you buy off- the- plan you are speculating that the price you are paying once completed will match, or exceed, actual market price. If it doesn't, you suffer an instant loss, since you are unable to pull out of the contract.

In addition to this, if you borrow for such a purchase, the bank will carry out their valuation just before you settle. If the valuation at that time is less than you are paying, you will only be allowed to borrow the maximum allowable loan against the value, not the actual price. Where you are gearing highly, this could leave you with insufficient funds to complete, and if you withdraw you will lose your deposit, which is most likely to have been around 10%.

Lastly, with build periods of up to three years, your commitment to that project may preclude you from further borrowing to take advantage of other good buys which are bound to become available in the coming few years. If your commitment to buy an off-the-plan property works out less well than you have anticipated, you have also lost the opportunity which investing elsewhere may have brought to you.

4. Buying for growth

The age old debate about buying for growth or for cash flow must now be tempered with a new approach. The facts now prove what I have been saying all along. If you make sure your cash flow is good enough to help you hang on to the property, and you ensure that any property you buy has the 20 characteristics which are the important growth drivers, that property will, at some time within a 10 year period, have a growth spurt and add to your net worth. Cash flow keeps you in the market, growth gets you out at the end.

If you buy with the misplaced notion that growth and cash flow cannot occur in the same property together, you are likely to end up with a property which costs you too much to support and your chances of holding it long enough to get that growth will ultimately diminish.

If you take care to ensure that you buy property with a cash flow you can afford and the criteria which is proven to result in growth over time, then you will get both.

Most importantly, though, is to know that growth does not occur because a property is attractive, expensive or, as mentioned previously, situated in an iconic location. It occurs because demand exceeds supply, and so it is more likely to be situated in areas where the greatest concentration of people exist - that is, those in median wage brackets who tend to buy in lower price ranges.

5. Over-committing

Low interest rates always make us feel positive about the future, and can lead to careless borrowing. Property investors should be sure that, when they borrow to invest, they build in a margin to the interest rate of at least 2.5% and only borrow what they can afford at that higher rate. Considering that fact that interest is a tax deduction, this will allow a rise of close to 4% without causing too much stress.

In addition to this, buying in areas with a downward trend on vacancy often means that rents are on the rise. As properties become more scarce, landlords are able to raise rents and this improves cash flow. During 2010 it is crucial that you are able to find properties which are coming under greater demand by tenants, and this will also mean you have a greater capacity to increase rents in response to interest rate rises.

Investing in 2010

While the big falls predicted by many economists failed to materialise, it's premature to believe we are out of the woods just yet. Both the US and the UK are still in the grips of a major crisis, and though Asian markets look much brighter, their confidence is not necessarily supported by surplus budgets. We should continue to take care with our property investing and walk softly, even while we carry big sticks. The challenge is to seek out and buy property which has the best cash flows and the greatest chance of growth given the current economic circumstances. Now, more than ever, your emotions must stay out of the mix and your head must rule!

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