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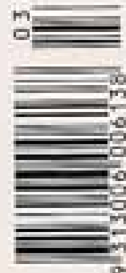

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TOP TIPS: ANNE LAMPE, ALAN KOHLER & ROSS GREENWOOD

STORY PAM WALKLEY

Bricks & mortar

One good reason for choosing property investment over shares is that you're in the driver's seat

WHEN SHE BOUGHT her first home in 2001, Jane Slack-Smith had already decided it would be her stepping stone to financial independence. And indeed that $425,000 Carlton home was the springboard to a portfolio of eight investment properties for Slack-Smith, who is now a director of Investors Choice Mortgages.

She spent $50,000 renovating the property and six months later it was revalued at $700,000. She used this equity to buy the next property and has kept on repeating this process.

She secured each property separately, as you will read in Effie Zahos's article on page 50. Indeed, she warns against using your home as joint security for investment property purchases, even if this is the bank's preference.

"I am a low-risk investor and so have many buffers and exit strategies in place to make sure that if circumstances do change, I can respond on my terms, not those dictated to me by the banks or the markets."

The first Carlton purchase, on which she has just undertaken another $45,000 renovation, is now valued at $1.2 million. "Big numbers from the beginning eight years ago, but achievable if properties are bought well and then renovated with a plan," Slack-Smith says.

To her "buying well" means researching the market so thoroughly she can spot an opportunity to buy below market and also to add value quickly through renovation. She buys only in capital cities where there is good demand and she does not buy specialised property, such as student accommodation or holiday houses, because the resale market is limited. And she does not renovate to her own taste.

Given how much Australians love property, it's not surprising that many choose to build wealth through real estate. For many it's also much more familiar than getting into the sharemarket – after all, they have had experience buying, and perhaps improving, the family home.

Of course real estate is no more a sure thing when it comes to making money than shares, but it does have certain characteristics that make it attractive to more cautious investors and those who like to have more control over their investments. If you own an investment property, you are in the driver's seat. You can add value you to your asset in many different ways, from a general tidy-up and repaint to a complete renovation.

But if you own shares in a company, you have no control over its operations, so you cannot do anything to improve its share price.

Also, as we have seen in the global financial crisis, share prices can be very volatile. In the course of just over two years the ASX All Ordinaries Index topped at nearly 7000 in October, 2007, before plummeting below 3100 in March, 2008 and climbing again to over 4900 at the end of 2009. More recently in 2010 it lost about 8% of its value in just over a month.

Sure, property prices do sometimes fall, but in Australia they do not experience anywhere near the same extreme price fluctuations as shares.

Real estate investors also have quite a lot of choice about where to put their money, as there are myriad sub-markets. Residential is the most popular but should you buy a unit or a house? Capital city or country town? And which state? Some of the things you need to consider to help make these choices are:

- Do I want to start small?

If so a unit may be the way to go as it will have lower entry cost.

- Do I want a property that puts money in my pocket from day one?

If so, you need to find a positive cash-flow property, one where the rental income and depreciation allowances add up to more than the ongoing costs of buying it, including interest on borrowings and other expenses.

You are more likely to find these in country areas, where capital growth can be constrained, than capital cities. Cash-flow positive properties are particularly attractive for retirees or those on lower incomes as they do not generate significant tax breaks.

- Do I want a property that will grow in value and provide me with tax breaks?

NEED TO KNOW

Taking out a reverse mortgage

Asset-rich but cash-poor retirees can benefit from unlocking the equity in their home by taking out a reverse mortgage, sometimes referred to as an equity release plan. Generally only available if you are 60 or over, it's basically a loan you don't have to pay until you sell the home or die. You don't even need to earn an income to qualify. You can take out the loan as a lump sum, in a regular income stream, as a line of credit or as a combination of these options.

According to the Australian Securities and Investments Commission (ASIC) the amount you can borrow is linked to your age – the older you are the more you can borrow. "The money you owe increases over time," explains ASIC. "Fees and interest are added to the loan balance as you go, and the interest compounds. This means you pay interest on the interest, plus interest on any fees or charges added to the loan balance."

When comparing loans, look for one with a "no negative equity guarantee". This means if your property's value falls below what you owe, you will not have to pay back any more than your property's value. MARIA BEKIARIS

CASE STUDY

Joint family effort pays off

Eight years ago Eleni Rossides pooled resources with her mother Lulu and sister Andry to buy a home in south-western Sydney. "We found a beautiful big home with a pool and garage for only $265,000," says Eleni.

Before taking the plunge into home ownership, the family rented a small flat above the hairdressing salon Eleni's mum had been running for over 20 years.

Two years after buying their home, the commercial property next to the salon was up for sale. They saw this is a great opportunity but were unsure whether they could afford it.

"We thought that with the mortgage on the house it would be impossible to get another investment," says Eleni. Nonetheless they made some inquiries with a broker who showed them how they could use the equity in their home to buy the commercial property.

They were surprised to learn the home they bought for $265,000 was worth $400,000. They borrowed $70,000 from the home equity as a deposit and for renovations and took out a 15-year commercial loan for the remainder. "The 'rent' the hair salon pays to the loan, along with income for when we've rented the upstairs, covers a majority of the mortgage, and then we benefit at tax time from the difference," says Eleni.

"The beauty is that it's a happy ending – mum and my sister get to work in a salon that is owned by our family rather than a landlord and the asset is building," she says. The investment property was recently valued at $550,000 – pretty good considering they bought it for just $250,000! MARIA BEKIARIS

Inner-city suburbs within a 12km ring of your chosen capital are most likely to fit the bill. These will cost relatively more and the rental income will not pay all the costs, so the property will be "negatively geared".

Of course you will be able to claim the shortfall plus non-cash tax breaks against your regular income. This type of investing particularly suits high-income earners.

• Do I want a property in my home state or elsewhere?

Buying close to home means you will be more familiar with the market, but choosing to invest interstate will give you more diversity, as markets generally behave a little differently to each other.

Investing interstate is particularly good for those who have built up a considerable portfolio as it will reduce the total bill for land tax (this is a state-based tax).

Then of course you may decide to invest in commercial property, as our case study did. The Rossides family bought a hair salon which some of the family lease back, but of course there are many more types of commercial property. A lot of investors start with a retail shop, a strata commercial or factory unit, as these require a relatively small outlay, often no more than a residential unit.

As with residential, it's important to research so you choose a type of property in an area where there is tenant demand. Commercial tenants are also looking to lease in areas that are easily accessible for their employees and also for product distribution, so transport links are even more important.

The advantage of commercial property is that usually leases are longer than residential, often three years as opposed to six months, and generally there are fewer tenant hassles.

But getting a good tenant can be a problem, particularly since many are small business operators who may go broke in their first few years of operation. It's wise to try to secure a tenant who is prepared to give a bank guarantee to cover the rental. Returns from commercial property are likely to be higher than from residential because of the higher risks. Commercial leases also usually call for pre-set rent rises or reviews, where the rent cannot fall, and often the tenant pays many of the outgoings, including rates and repairs.

If you are interested in commercial property there are specialist real estate agencies (a Google or Bing search will bring up a list). A good website to get a feel for what is available is www.realcommercial.com.au.

For example, I did a search for leased office property in the Melbourne CBD and found a 65sqm office suite for $349,000. It is leased for four years at a return of close to 7%, with the tenant paying all outgoings. The lease calls for annual 5% rent increases.

Sounds terrific! But of course the website cannot tell me how financially secure that tenant is. That is something I need to check.