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When less is more

Would you invest in one \$1m property, or three \$330,000 properties? *Chris Gray*, property investor and property expert on MyHome TV, sheds new light on the concept of investment diversification



In my previous article for *Your Investment Property*, I wrote about the pros and cons of investing in a bargain property or a property with all the ticks, including location, size and positioning.

This month, let's take the idea further: if you were approved for a large loan, would you invest in one large asset or a few smaller ones? For instance, would you buy one \$1m property or three \$330,000 properties? This question also applies to those buying for themselves: would you invest in three \$330,000 units and use those rents to rent a \$1m property for yourself? Or simply buy a \$1m house for yourself?

Some people will immediately sway one way and others the other way, but it's important to realise that in property investing, there's no right and wrong; there are a number of strategies that work. However, it is important to understand the pros and cons of each decision – and, above all, the performance of your strategy when put into action.

Choosing a \$1m property

Advantages

Putting a million dollars into one large asset does come with a number of advantages. If you're time-poor, you'll appreciate the fact that one property is easier to manage – you have one agent to deal with and one mortgage to look after.

With \$1m, you can also get into almost any suburb you want. And if you're investing for capital growth, that's good, because those suburbs often have a higher entry point. If you're buying to live in it yourself, the property is also capital gains tax-free.

Even better, with that kind of money, you can probably afford a house.

Houses bring two strong advantages: they typically achieve more capital growth than units as there's more land content, and they give you the freedom to renovate or extend without getting approval from body corporates or strata managers.

The list of benefits goes on. With \$1m, you can invest in a luxury property. Luxury properties often appreciate in value even quicker, especially if they have great views. They will also probably not be subject to the normal economic fluctuations



that affect 95% of the regular market, as the owners are often wealthier and can cope better with interest rate changes. In turn, there are fewer buyers that can afford these properties, so you might be able to buy well below market value if times do get really tough.

But \$1m can not only buy you a house, it could also buy you a large block with redevelopment potential. You might be able to replace the house

It's usually safer to diversify your assets – if you're risk averse

with a block of units, or add a house at the back and then subdivide. The potential profits from this kind of move can be huge, especially if you are one of the first to do it in an area where the development rules have recently changed. You can find out about development rules at the local council.

You might not even have to do the development yourself. You could simply get some plans approved through council and then on-sell it to a buyer who would do the building work. This is a way to add value to your property without getting involved with builders.

Disadvantages

The downside is that by putting all your eggs in one basket, your financial welfare is at greater risk. It's like putting all of your savings into a seemingly

stable company and the unthinkable happens – the company collapses. You could lose the lot.

If something happens in your suburb or street that results in a slump in prices, it could cause havoc for you. If there's a flood or your roof comes off, you'll have no rent coming in, but you'll still have to pay your mortgage. Ideally, you will have insured your home, but not all things are covered in insurance policies, and do you want to rely on an insurance claim being paid out?

Also, while more expensive properties often achieve higher capital growth (great if it's your home), they often bring in lower rental returns – about 2% lower than units (not so great for investors). You could furnish it and let it as an executive rental – which may achieve more rental income – but often this kind of income is more lumpy and subject to market volatility.

On the subject of volatility, while luxury properties might grow quicker, if this top end of the market falls out, it might remain in a slump for a long time, as only a small percentage of the population can afford them.

Opting for three \$330,000 properties

Advantages

It's usually safer to diversify your assets – if you're risk averse, this would be the more attractive option for you. By buying three small properties in three different suburbs, you can bet on at least two of those suburbs doing well. If one suburb crashes or is affected by a natural disaster, it only affects 30%



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of your portfolio. The same applies to properties spread across states. Perth has been doing extremely well in the last few years, while Sydney and Melbourne have slowed considerably. Recently Perth started slowing down and Sydney and Melbourne started to make their recovery.

Lower-priced properties generally bring in proportionally higher rental returns. A \$330,000 property offers more reasonable rent than a luxury property, attracting up to 80% of potential tenants in the area, bringing greater competition for that property and, in turn, perhaps achieving a 4–6% return for the investor. A luxury property, in comparison, might only bring a 3–4% return, simply because many people that can afford the rent can also afford to buy.

Disadvantages

Buying a set of cheaper properties comes with disadvantages. The investor has more to manage, for one. Expect to deal with three different agents, strata managers and tenants, and to pay off three separate mortgages. When you're looking to buy three units, you'll need to do three times the research. This involves not only looking at figures in your area and speaking with agents and valuers, but scouting out 50–100 properties in each of your three areas before you make your decision.

If your tenants are from lower socioeconomic groups, they may bring more problems than tenants who can afford the top end of the market. They may cause more damage to the property, may be unable to keep up with rental increases and may not pay the rent on time. Higher-income tenants often value their credit ratings more and can't afford to have their professional reputations tarnished.

If you've bought three lower-priced units rather than a house, you may also be limited by how much you can renovate and update them – and extending is often impossible because you are limited by the strata corporation. Renovating is one of the quickest and easiest ways of adding extra value to a property. If the building's facade or entry is tacky, you might not be able to do anything about it if the body corporate is happy with it as it is.

Finding the middle ground

If I were approved for a \$1m loan, my own strategy would be to invest in lower-value properties. Depending on the areas I choose to invest in, rather than three \$330,000 properties, I would probably choose to invest in two \$500,000 properties, particularly if they were in Sydney or Melbourne. This would enable me to get into a good suburb close to the CBD without

buying well above the median unit or house price.

My personal strategy is to buy around the median price as it means the majority of the local population can afford to either buy or rent those properties, and so those properties are less likely to be vacant.

It's important to keep in mind, however, that strategies change. If your portfolio were around \$1m, it would be risky to have all of it tied up in one property. But if you had a \$4–5m portfolio, one expensive property and the remaining funds in median-priced properties would be a good balance. The luxury property would represent just 20% of the total portfolio.

Occasionally, investors need to dip a toe in a different type of property market to see if it suits them. If you try this using just a small part of your portfolio and the move doesn't work, then it's not going to send you under. If the move works, the risk was worth it.

A number of years ago, I bought a house-and-land package in Algester, south of Brisbane, for just under \$300,000. At the time, this represented about 10% of my property portfolio. In the first year, the property went up around \$50,000 in value, but then it flattened for many years. Either way, the risk for me was minimal.

More recently, I purchased a block of units in Sydney's eastern suburbs for refurbishment for just under \$2m. It was a lot more money, and to everyone else the purchase looked extremely risky. But again, it was about 20% of my current portfolio, and so again the risk was diversified.

Whichever decision you make, my tip is to keep the bigger picture in mind. Make your decision based on the size and diversification of your investment portfolio and the median price in the area you're buying, rather than focusing on the pros and cons of a single transaction on its own. ■

Chris Gray is the Property Expert on Channel 9's MyHome TV, and the author of Go For Your Life: How to Turn Your Weekdays into Weekends Through Property Investing. Chris builds property portfolios for investors – finding, negotiating and renovating properties on their behalf. For more information and to read chapters 1–3 of his book for free, visit www.goforyourlife.com.au