5 Fatal First Time Investor Mistakes And How To Avoid Them

This Issue:
March 21, 2017

TRILOGY news
"the property investor's mortgage broker"

When you set out to create a retirement fund with residential real estate as your chosen investment vehicle, depending on the road you take the journey can be one of smooth sailing, sunshine and lollipops, or downright rocky and hazardous.

The beginning will have a significant bearing on where you end up with your property portfolio and in what state you arrive; hopefully unscathed rather than battered and bruised.

So to help you get to where you intend to be financially in ten, twenty and thirty years time, here are the five things you DON'T want to do when starting out as a property investor…

1. Jumping in without the right knowledge

It's incredible how many would-be investors get bitten by the property bug and all of a sudden want everyone's opinion on the housing market and the best possible location in which to make your millions…fast!

And there's no shortage of willing opinion-givers either. Everyone has a story about 'this guy' they know who bought an apartment for $X, did a few cheap renos and then turned it 'round for a massive profit. Or the 'newest investment hotspot you just have to get in on!'

Investing in property isn't a cheap proposition, nor does it come without any associated risk. On the contrary, it takes a lot of money and as with any asset, things can go awry.

As such, you should rely on your own research and if in doubt, consult an industry professional who understands the market and how to invest in it successfully for long term gains. Not your Uncle Bob!

2. Trusting an 'expert' without doing your homework

So you've realised Uncle Bob's investment advice is next to useless – given he's perpetually broke and asking to borrow money off you – and decided to consult an actual 'expert'.

Where do you start? The cyclical nature of real estate makes it a very fickle beast. It's feast or famine and when things are going well, everyone wants to hang a shingle and profess to a resounding knowledge of all things bricks and mortar.

But the problem is…whom do you trust? It's the perpetual home-buyer and property investor conundrum, because this is an industry renowned for some 'bad apples'.

You can generally pick the good advice from the self-serving by whether it seems to align with your own personal property investment strategy and objectives.

If a 'financial adviser' is trying to tell you that a lifestyle property on the far north coast would be 'perfect' for your portfolio, whilst flashing glitzy marketing material around, but every other asset you own is within 10 kilometres of a major city, well…you can join the dots.

Qualify anyone you speak with to get a better idea as to what experience and understanding they have of property investment and finance specifically, and whether they receive any commissions for referrals and from whom. You need to work out where you stand.

3. Incorrect structuring

Successful investors are the ones who focus on things like ownership structures to optimise their net wealth position, without diving headlong into a property investment.

Then there are the other 90 odd percent who try hard, but just don't ever seem to get the numbers right in order to create a self sustaining, long-term portfolio.

Generally they either 'fall' into investment by accident – think meeting the love of your life when both of you already own a home – or just jump in without any understanding of how, why, where and when to buy.

It's called a strategy and every investor needs one to succeed! Based on your strategy, you'll work out things like what type of properties you should acquire, where they should be located and how you'll finance them.

I say 'properties', plural, because your strategy needs to include significant forward planning. And of course that includes what type of ownership structures you'll purchase each property in to optimise things like negative gearing and cashflow benefits.

4. Incorrect financing

Walking blindly into different loan structures means you're likely to get tangled in a mess of different lenders and loan products that will hinder the timely growth of your portfolio.

A good mortgage broker who is well versed in the intricacies of forming and nurturing an optimal debt portfolio that helps to grow your asset base instead of obstructing it, will ask you a lot of questions. Not just about the property you intend to finance today, but the many more you hope to buy tomorrow.

They'll take the time to get to know what your journey looks like now and how you want it to be in the future and help you avoid things like cross securitization.

Finance can be a property investor's victory or your undoing, so if ever in doubt, seek guidance when it comes to the best possible lenders and loan products for your needs.

5. Doing nothing

Some wannabe property investors tick all the right boxes with regard to research, homework and preparation.

They seek out multiple experts on all things residential real estate, devour investment books and publications and almost become experts in their own right by the end of all that education.

But they never quite make it up the property ladder.

That's because they've educated themselves into a state of fear. There seems to be a tipping point with human beings where we suddenly know too much about something and then decide we don't want to think about it ever again.

For whatever reason, it becomes too confronting. Perhaps you feel like you waited too long, you'll never have the necessary time to build a sustainable investment portfolio with property, or maybe you got caught up in media headlines about 'bubbles' (intended reference).

While I'm not suggesting you don't do any research at all, it's important to not weigh yourself down with too much information that stops you from taking that first step.

After all, it's the first step that sets out the journey before you.

Signs Of Stress Starting To Appear In The Lucrative Home Loan Market

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What happens when you put all of your eggs in one basket…or an overly large portion of eggs in one basket anyway? According to a colleague who has chickens and hence, eggs, it's likely you'll end up with a big, gooey mess in said basket.

The question then becomes, how many eggs are too many?

Right now, the metaphorical eggs and basket represent the amount of mortgages (eggs) that can be attributed to Australia's banking sector (the basket).

More specifically, what proportion of all loans written by deposit taking institutions constitutes a mortgage of some kind? And what happens if (and when) interest rates start to rise, creating visible signs of mortgage stress across the board?

These are serious questions Australian banks are obviously not olking about (see what I did there?), if the recent pull back on lending to 'riskier' borrowers is any indicator.

Up, up and awayyy….

In the last Trilogy Report, I mentioned that the slight dent regulators had made in market activity with the introduction of macroprudential measures in 2015, was having little to no effect when it came to curbing investor based borrowing.

Indeed, reports have recently emerged that depict yet another investor led resurgence in the housing market at the beginning of this year.

Investor lending may have suffered a notable decline immediately after APRA put its proverbial foot down in 2015, falling swiftly from a record high ratio of 53 per cent to 44 per cent at its lowest point.

However this was a momentary breather, as the proportion of investor lending has steadily climbed back up in the last 14 months.

In December last year it was at 48.88 per cent, before reaching a new post-cutback high (pre-macroprudential policy) of 50.28 per cent in January.

Figures show lending to investors has risen by 27 per cent over the past year, up from an annual growth rate of 10 per cent just a few months ago.

Further rubbing salt into the wounds of regulators desperately trying to keep a lid on what they perceive as "riskier" lending, the data also indicates this growth is centered on the much-maligned Sydney and Melbourne property markets.

So what happens next?

Well, it's kind of like a déjà vu scenario, with a few twists thrown in for good measure…because of course, everything is same old, same old, but ever changeable all at once. Don't ask me how it works. It just seems that's life these days!

First up, regulators are getting grumpy and starting to target policies and practices within the finance sector that they find concerning.

But what happens when you're not just working against banks chasing lucrative profits, you're also working against government policy obviously intended to keep breathing life into the housing sector, such as recently announced CGT and stamp duty concessions for Victorian homebuyers?

Now it's getting really interesting…and we haven't even discussed foreign investment yet!

Of course the bureaucrats also don't want to look like they're ignorant to the hardships faced by would-be first homebuyers, caught in a rental market at risk of being overrun with tenants who can no longer buy into a property of their own.

Now we're looking at rental prices rising in our inner cities and lo and behold, you've got a rental market crisis on your hands as well as an affordability issue!

Demonstrating how…err…seriously the government's taking the subject of housing accessibility, Treasurer Scott Morrison announced a couple of weeks ago the proposed creation of an Affordable Housing Finance Corporation (AHFC).

Using a "bond aggregator" model, the AHFC would provide longer-term, lower rate loans for community rental housing, backed by the Commonwealth balance sheet and at no expense to taxpayers. This, they believe, will stimulate tens of millions of dollars of new private sector investment in community housing.

While the opposition thought it noble that Morrison's considering the growing number of people on low incomes now facing rental stress, Labor leader Bill Shorten wanted to address the "elephant in the room, and that is the unsustainable tax concessions of negative gearing and capital gains discounts."

Banks take care of their own business

Let's get back to that banking basket shall we? When you have $1.5 trillion tied up in a mortgage market that's being described as "fraying at the edges", chances are you're not going to wait around for regulators to ride on in and save the day.

Particularly when you start to hear whispers of an impending rate rise on the cards…and perhaps even a concerted global push to raise interest rates…

It seems the Reserve Bank is getting an itchy trigger finger, putting all cards on the table in its most direct warning yet, implying that it may step in with tighter macro-prudential policies to control "risk".

Specifically of course, the RBA speaks of the risk associated with the latest resurgence in borrowing by property investors, who are often the first ones to pull out of the market when things get financially tougher.

Broker JP Morgan has predicted that investor lending could rise by up to three percentage points in coming years, as the banks differentiate pricing and offset regulatory headwinds.

Former RBA board member, Professor Warwick McKibbin, warned that anyone who is currently highly leveraged and "working off capital gains rather than fundamental rental returns," will face "a bit of a squeeze."

"Ideally you wouldn't be in this situation…but now that you're here, it's really going to have to be done very carefully," he said. "It's pretty clear interest rates are rising (globally)."

Under pressure

The banks have bigger reasons to tighten lending practices and consider independent rate rises as part of their overall lending strategy too. Namely, protecting their ass…ets.

According to research group Digital Finance Analytics, 22 per cent of households in this country are in "some degree" of mortgage stress.

The pain is worst in regional and outer suburban areas of course. However it's NSW, where borrowers are most exposed to rising interest rates due to soaring house prices pushing up borrowing commitments, that's of most concern.

In the last week, both Westpac and the NAB have increased home loan interest rates.

The NAB announced that it's upping the rate on variable, owner-occupier loans from 5.25 per cent to 5.32 per cent, and on investment home loans from 5.55 per cent to 5.80 per cent.

This coincides with warnings from McKibbin, who suggests an "adjustment" was looming and property prices could dive if highly leveraged borrowers came undone in the wake of rising borrowing costs, and suddenly jump ship.

McKibbin said the government's distinct lack of action when it comes to structural reform around the finance sector in the last decade, and its reliance on the RBA to stimulate a sluggish post-GFC economy by systematically cutting interest rates, had placed the property market in a precarious position.

"It may be a smooth adjustment or it may be a panic: it depends very much on how the political process handles it," he observed.

"But it does seem given on any realistic interest rates above where they are now…that the prices of houses in the Australian economy are excessive relative to the rates of return and risk that's in the system."

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When justifying the bank's position on its latest, independent interest rate rise, NAB chief operating officer Antony Cahill said, "Clearly the investor market is seeing strong levels of demand across Australia, particularly in Sydney and Melbourne."

On the flipside, the National Australia Bank has cut its fixed rate offering for first homebuyers from 3.98 per cent to a record low 3.69 per cent for a two-year term.

Meanwhile, ING Direct, Australia's largest lender outside of the Big 4 has reported that its home loan lending was growing faster than the market at 10 per cent each year, but was bucking the trend with 77 per cent of all loans written to owner-occupiers.

Many banks are also looking at ways to reduce their exposure to specific sectors of the market, considered to be less secure.

The Commonwealth Bank has revealed that it increased provisions in Western Australia last month, to buffer against losses as the proportion of borrowers falling behind on repayments rose to double the rate of the remainder of its $460 billion mortgage book.

Lenders are also visibly backing away from the booming inner city, east coast apartment sector due to worries about over-saturation of stock and ailing values.

And the beat goes on…

TSee what I mean by déjà vu? Is it all sounding familiar yet?

Investors climb back on board the property wagon because it's the vehicle and direction that makes the most sense on an otherwise uncertain economic horizon…

Regulators get nervous about a resultant surge in borrowing, potentially exposing the banking sector to excessive risk in a context of rising interest rates and highly leveraged property owners…

The banks play along, acting to increase interest rates and once again shift the borrowing goalposts for investors particularly, justifying their actions as a response to regulatory rumbling about macroprudential policy (whilst rubbing their hands in delight at the increased profits to come)…

In the meantime, the government sits back, watching from the sidelines and occasionally sending some type of enticement into the arena to keep buyers buying, renters renting and property chugging along to maintain the economic status quo.

Once again the message for investors is loud and clear. If you have a strategy, objectives and timeframes to which you're working, alongside contingencies to allow for all these variables that keep replaying, you'll survive the roller coaster ride.

Pay attention to the changes banks are making and the noise from regulators in particular. Moreso however, have your little ducks in a neat row. Have a watertight financial structure and don't ever over leverage yourself into a repayment predicament.

This is a conversation we always have with clients. You need to be far more conservative in your number crunching and forecasting than current rates require, if you want to outlast what lies ahead. The potential risks are always real.

Macquarie analyst Victor German says, "While banks' move to increase investor mortgage profitability is positive for earnings in the short term…it puts additional pressure on an already highly leveraged household sector. This, coupled with a rising global rates outlook, suggests the risk around investor portfolios appears to be increasing."

All you can really do is prepare yourself and your portfolio to be as resistant to any impending property storm as possible…

What Does Your Investment Look Like?

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One of the most critical things to get your head around as an active property investor is, well, your head.

You may not think so, but how you think can greatly influence the outcomes of your daily reality. Frequently we do things on automatic pilot, making conscious decisions as we go about our business, rooted in all sorts of associated emotions at a subconscious level.

Some will be favourable and pleasant…others not so much, depending on the associated memories of the particular experience.

The interesting thing about how we think, Is that the more aware you are of your own instinct and intuition…the more self aware you are…the more likely you are to make effective decisions based on logical, solution seeking processes.

This is the difference between an investor who remains calm and focused in the current frenzy of negative press surrounding property and finance, and capable of making investment choices in line with their strategy and objectives…or the one who panics and reacts to all the noise.

When you feel entirely uncertain about what you're doing and importantly, what it means to you at a deeper level, you're far more easily led by the headlines and scared off by negative connotations about the direction certain markets are seemingly taking.

The first question to ask yourself to get a better understanding of how your mind works is…

What drives you?

What is your agenda? And please be entirely honest with yourself, even if it proves difficult.

Many people don't want to suggest money is their end goal, because it's associated with greed or self-interest. But guess what… everyone is secretly driven by some form of personal compensation, and hence, some degree of self-interest. It's just how we humans are programmed.

Some people focus on self-interest that's perhaps broader serving… think those always volunteering their time to 'the greater good' without
expecting compensation. They do it because it makes them feel good.

For some, making money has the same effect on us at a physiological and psychological level. It makes us feel a sense of personal achievement and hence, we feel good about ourselves. Remembering these are all proven chemical responses that actually do, make us feel good!

Naturally, the better we feel about our decisions, the more confident we grow in our own intuition and the more positive our inner dialogue becomes.

With this mindset, we are less likely to panic amidst the mayhem. We can maintain focus and find solutions to problems that might arise on our investment journey, because we're not in a constant state of fear, and attempting to work in a logic inhibiting, flight or fight response.

Feel the fear

Fear repressed is almost twice as unhealthy as fear acknowledged and worked through. Because when you refuse to acknowledge fear as an investor, you risk losing that connection to why you're doing what you're doing.

Do not underestimate the damage that occurs to your decision-making capacity, when you operate in a perpetual state of fear…

Will the markets crash? Can I keep making my repayments? Will interest rates go up? What if I can't find a tenant?

Studies have demonstrated that people suffer almost twice as much pain losing $1, as they feel pleasure in gaining that same dollar (Kahneman and Tversky, 1991).

Often, this fear to let go is what inhibits important investment decisions, such as whether to retain or offload a less than startling asset in your portfolio. Invariably and without even realising it, this combination of subconscious reactionary decision-making that's grounded in fear, can lead to self-sabotage on a grand scale.

Don't get too attached

Investment decisions must always be based in logic and rational thinking, and not made on the emotional response you feel at any given time.

Emotional attachment is crippling to many a portfolio. It's far better to become attached to your sound investment strategy, than it is to form some type of bond with your rental property. And finally…

Remember who you are

It's easy to be guided by a self-proclaimed property guru into some type of investment strategy that promises profits beyond your wildest dreams. But rarely will such schemes deliver.

Don't be tempted to follow trends at the risk of losing sight of what it is you're doing and why. If it feels wrong, it most likely is. And if it's all too hard, there's a good reason for that. Go with what works for you.

What Might Happen If More First Time Buyers Are Lured Into Housing?

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Does anyone else find the government's continual scapegoating of ageing, equity laden investors who are allegedly keeping their kids locked out of the housing market, even as that same government ncourages further buying activity, somewhat ironic?

What about Treasurer Scott Morrison's recent suggestion that elderly homeowners should selflessly downsize their digs, freeing up an estimated 50,000 more properties to maintain a semblance of sanity around house prices? I'm not sure how that figure is arrived at, but we'll go with it for now…

Budget bluster

The elderly property downsize push was just one of the actions Morrison hinted at within the upcoming federal budget, with incentives planned to encourage retirees out of housing too big or impractical for their needs.

There's also been talk about resurrecting the 'early release of superannuation' scheme, which would allow young, would be first homebuyers to unlock a potential deposit on their own home from their super fund.

If you recall, this similar conversation occurred fairly immediately after the GFC when the government was trying to come up with ways to stimulate residential real estate activity.

So what about the elephant in the room then? The old negative gearing nugget that most housing, finance and social commentators will concur has a lot to do with the influx of highly leveraged investors we're currently seeing in our housing markets.

Well, Morrison's comment on talkback radio summed up the government's stance on amending negative gearing legislation…

"I mean Labor is just saying get rid of negative gearing and all your problems are solved. That's just ridiculous.

"Last time Paul Keating did that, rents in Sydney went through the roof. Now I don't see how increasing your rent helps housing affordability, particularly if you're renting."

Not to mention all those votes you'd lose. And no doubt votes are what the Liberal party hopes to collect with plans to address our young people's property woes.

But what about the government's proposals? Won't inviting more participants onto the playing field, in the form of first time buyers wielding deposits fluffed up by their super funds, simply create even more activity and demand in a market obviously suffering an accommodation shortage in key localities?

Making waves

The bottom line for any government in power right now…and the same bottom line they've been facing since that fateful financial crisis in 2008, is that without property performing well, we face a plethora of financial falters and fumbles moving forward.

First and foremost is the fate of all those fortunes tied up in property portfolios and of course, a banking sector that's fairly exposed to changing tides. Hence, anything that threatens the current level of activity isn't really ideal.

And the thing is, do we need to be talking about increasing activity right now, or do we need serious measures in place to look at the housing shortage issues we're facing?

Estimates suggest that some 20,000 homes are sitting uninhabited in Melbourne alone due to foreign buyers looking for a place to park their cash, but not really wanting the headaches of a long distance rental relationship.

Earlier this month the Victorian government moved to reduce those numbers, introducing a 1 per cent tax applied to foreign owners who "land bank" local properties.

Many have accused the federal government of not only ignoring the surge in foreign investment of late, but also actively provoking it, even though Morrison has boasted that his party has "forced the divestment of more than $100 million in residential property sales that were illegally acquired by foreign investors."

Meanwhile, Assistant Minister for Cities, Angus Taylor has said that Sydney is building half as many new houses as required to keep up with current levels of demand.

"If Sydney had been growing its housing stock as fast as it should have, to keep up with population growth in Australia, we should have built about 35,000 homes a year for the last 15 years. We have actually built 17,000."

New South Wales Planning Minister Anthony Roberts says the state government has a strategy in place to address this imbalance, with 'inclusionary zoning ' measures that would see a certain amount of new home construction set aside at affordable prices for people on low to moderate incomes. The scheme has already been widely adopted across the US and in London.

Are these the more pertinent conversations for our politicians to have, as opposed to ideas like unlocking super funds and injecting further money into an already overheated sector?

Fule to the fire

Many financial commentators seem to think early withdrawal of superannuation to unlock the property door to first time buyers is not the best idea right now. Some suggest it's downright silly to even contemplate such policy reform for numerous reasons.

Firstly, young people would essentially lose out on a large chunk of their future wealth, as less money in their super fund means less of that compounding magic to build their nest egg for retirement. This could, in turn, see even greater investment activity in property as yet another generation becomes disillusioned with structured super funds.

And as we saw when incentives were thrown around like lollipops to get young people into property immediately after the GFC, it's likely house prices will continue to increase. Because you haven't addressed that fly in the ointment – the shortage issue.

Encouraging people to leap into the property markets at what's arguably the very extended peak of an ongoing boom in key areas isn't really the greatest move to grow wealth.

And finally, the biggest mammoth in the building when it comes to the super proposal put forward by the government, would have to be that most young people simply wouldn't have sufficient funds to make for a decent deposit anyway.

Research released by super industry group AFSA showed that the average super fund balance for an Australian aged 20 to 24 years was $5,118 in late 2015. Those aged 25 to 29 were in a slightly more lucrative, yet just as useless super fund situation, with $16,441 to their name.

Not really going to cover that 10 to 20 per cent deposit on a property in Sydney is it?

No doubt the government needs to be seen as doing something to address housing affordability, even if it cannot really empathise with the plight of the common people, facing the current conundrum…

Here's hoping they go about it with a plausible solution in mind. One can dream…