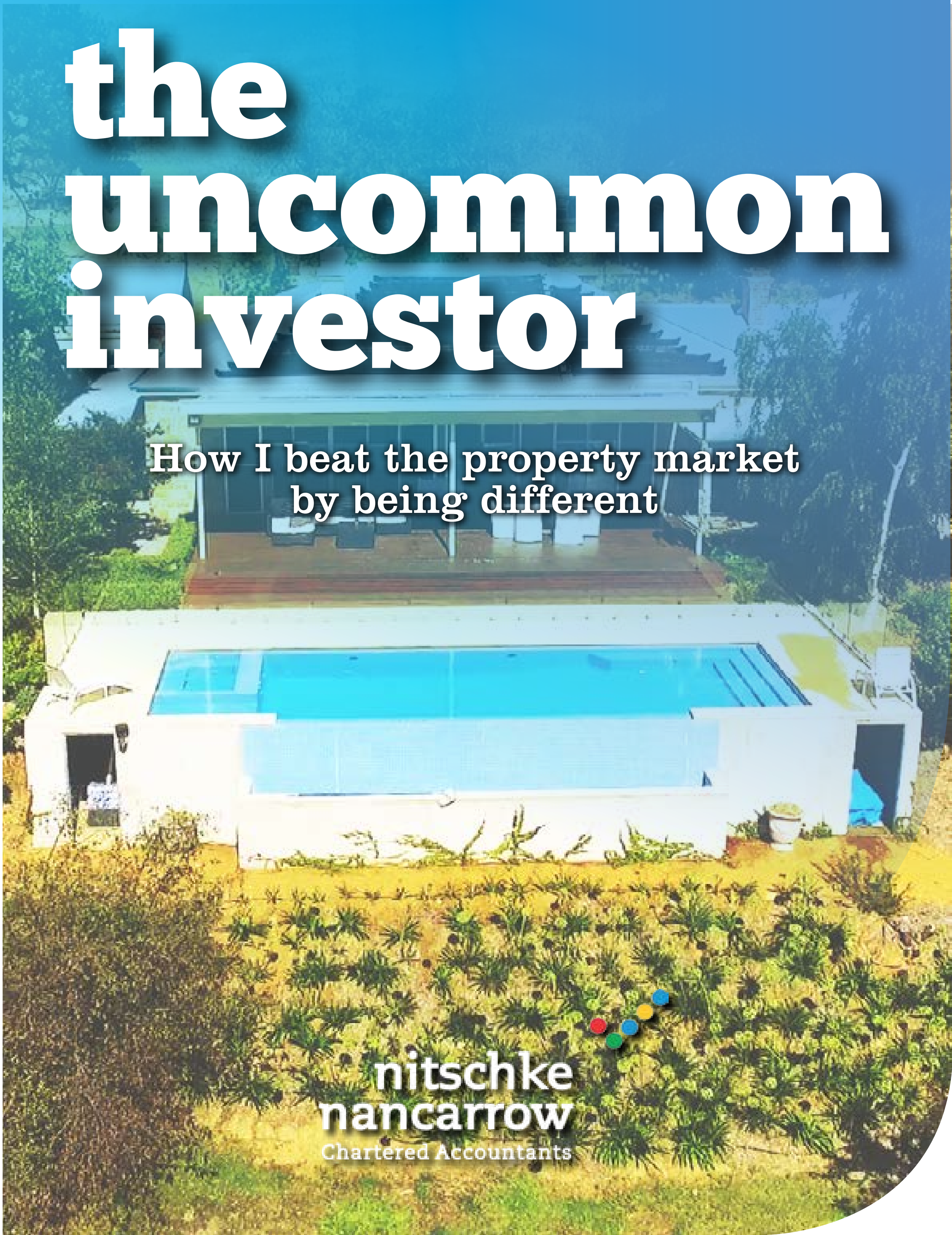
KYM NITSCHKE

the uncommon investor

How I beat the property market by being different



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Why You Should Invest in Real Estate

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Why Buy a Property

Buying a property is one of the only ways you can legally make a very expensive investment using money that you do not have.

Let's break the transaction down into it's simplest form: you buy an asset (the property) and typically put down 10-20% of the purchase price as a downpayment (deposit). If you're purchasing a million dollar property, this means $800,000-$900,000 of the initial money could be financed by a lender. Where else can you invest in such a highly-leveraged asset?

The banking system worldwide finds the model perfectly acceptable, and there are other benefits to you beyond the property itself, including taxation benefits.

If you lose money on an investment property, you can reduce the taxes that you pay to the government each year. The opposite scenario is also helpful to you: even if the value of the property climbs yearly, you don't have to pay tax on it until you actually sell it. The beauty of this model is that you can borrow money against the increase in value (such as through a home equity line of credit) without paying any additional taxes.

Unlike a lot of business ventures which require huge risks, buying property is a tried and true method. If you spend more and more time perfecting your skill at buying and developing properties, you'll only get better at it over time.

When you first start in the property game, you'll likely have little idea what you're doing. But after you've bought three or four properties, learning along the way, you will become very good at the craft of real estate investment. The money you make as you spend more time in the game will likely grow with experience.

Real estate investment, in my experience, is the only business where you can make millions of dollars in a socially acceptable way -- unlike many shady business ventures that promise a quick profit at someone else's expense, improving and developing properties is generally good, noteworthy, and encouraged.

Once a property is rented out, it can generate passive income for you, which means revenue will accrue without any work on your part, whereas most profitable business models require a lot of time and effort.

In other words, investment properties can make money while you're sleeping, if you get the property model right.

Saving Up A Deposit

A 20% deposit is usually required, plus 5% of the purchase price for stamp duty and legal fees, in order to obtain financing for your real estate purchase. If you're buying a million-dollar house, you need to have $250,000 saved. How in the world are you going to save that much money?

This is probably the biggest issue that prevents people from buying their first property. I see it time and time again when young couples come and see me and say they want to buy their first house. The first question I ask is, how much money do you have saved?

The trouble is that it takes time to save a deposit. Even if you're saving money slowly overtime, home values are generally rising too -- so you need to come up with a clever strategy.

Most people in life sell time; they work at a day job with set hours, giving up their leisure time in exchange for a paycheck. When you are young and/or working at a lower-paying job, it is very difficult to pay your daily expenses and simultaneously save for a big deposit.

My strategy was a little bit different. Rather than having a part time job when I was young, I bought day old calves from the local dairy farmers where I lived. Then, I would foster them and raise them, and mother them and feed them warm milk every morning and night for a period of about 12 weeks.

Then I would put them out in my paddock on my family property and watch them grow. After a period of 1 or 2 years, they would grow from a $100 calf to a $700-800 cow -- a 700-800% return on my initial investment!

The reason that worked for me is because my dad let me use his farm for free. He was losing money on the transaction while I was making money, and he said it wasn't a sustainable business model. And while that may have been true, it was a really good way of teaching me the power of investment returns and the power of patience -- I could sell the cows after 1-2 years for $700-800, or I could keep them and mate the females so that they would produce another calf after a further year of time.

At the peak, I had 40 or 50 breeding cattle and was producing 40 or 50 calves a year. It didn't take long for me to save up enough for a deposit on my first home, a $232,000 property.

While I was breeding cattle, my wife worked part-time in a local cake shop, living at home with her parents and saving almost all of her earnings through diligent financial planning.

Selling your labor by the hour is how most of us make a living, and it's low risk. But if that doesn't allow you to raise a deposit quick enough, you can look to other more creative methods.

The beauty of the internet these days makes it possible to do many part-time jobs from home as well. If you are very serious about saving up for a deposit, you can work into the wee hours of the night. It may take years out of your life, but the money is worth it.

Many people use the internet to flip things as well. Rather than working for an hourly rate, these individuals buy items and resell them for a profit using Amazon, Ebay, or another site.

This is a risky plan, and I've seen a number of situations where people have lost money. But with the risk comes the ability to learn the craft of identifying bargains. If you become good enough, you can make more per hour than if you sold your labor at an hourly rate.

For high income-earners such as doctors, dentists, and medical practitioners, you can also take out a personal loan and use that money as a deposit on a home. These individuals make a full disclosure when they are applying for their loan, but because of the way that serviceability is calculated on home loans, often these high income earners will find that this financial trick enables them to qualify for a home loan, sooner than they thought. It's an artificial way of getting a deposit, but it works. Not a lot of people are aware of it, but when you actually get your mortgage broker to crunch the numbers, you will find that in a lot of situations that personal loan will be the fastest way that you can get together a deposit.

Getting a deposit together is really hard work, but there are creative ideas that can assist you along the way.

Many high-income professionals will be able to borrow up to 97% of the purchase price of their home, and with the purchase of lenders mortgage insurance, mere financial mortals may be able to borrow up to 95% of the purchase price of the home, depending on the lender.

A 3% down-payment may sound great, but it doesn't come cheap: in order to get the deal, you will have to pay a lending mortgage insurance organization a fee, which can sometimes be between $3,000 and $15,000. If the property is sold at a later date at a lower price than the mortgage price, the bank can effectively cash in this lenders mortgage insurance and get reimbursed for their losses.

It's a perfectly legal and legitimate financial device, but it comes at a high price. You have to be entirely sure that the profit that you are making on this house purchase decision is going to more than cover the cost of the lenders mortgage insurance.

Another alternative for the ambitious future-homeowner who is cash-strapped is to get a parental guarantor. If you have very kind parents who own a property that is at least 20% paid off, you can ask their bank to lend you an amount of money against their home equity in the form of a personal loan. Parental guarantees are becoming more accepted for first-time buyers as property prices steadily increase.

In a nutshell, it's really hard to save up a deposit, but if you are very determined it is definitely possible.

Organise Your Financing

Start planning your finance as early as you possibly can -- before you even start looking for a house. It's really important to work out how much you can afford to borrow and how much the bank will be prepared to lend you.

You will need to gather all of your identification documents such as passports, birth certificates, your credit card and bank statements, recent payslips, and income tax returns.

There will be a few other documents you will need in addition to that. Once you've submitted the proper documentation, the bank will then calculate your lending capacity.

If you start this process early on, it makes it easier to look for a property. It helps you set parameters so that you stay within budget. Often, real estate agents will try to lead you astray (both in underpricing listings and by showing you out-of-budget houses), but stand strong.

A major advantage of getting a pre-conditional approval from a bank before you start looking at properties is that as soon as you find the right property, you will be able to act quickly. Sellers love simple offers -- if you make it simple by removing any conditional elements from the terms of sale, you will be much easier to deal with. This will assist in making your offer look even more attractive to the vendor.

I would suggest that you use a broker to organise finance for you. It's free, often they get you a better deal than you would find by yourself, and they usually have a bank of about 30 lenders to choose from. They have deals straight from the banks from time to time that won't be advertised on websites and are often confidential. If you have a close relationship with a broker, they will be able to call you when those offers are available. If you just walk into a bank branch, you may think that you are cutting out the middleman, but that's not usually the case. Banks generally pay mortgage brokers a fee, but that fee is already factored into their advertised interest rate.

Banks appreciate that half of their deals now come from mortgage brokers because they see brokers as a cost-effective way of gaining business. Nowadays, it doesn't cost more money to find financing through a broker, and you'll very likely end up getting a cheaper rate than you would by walking straight into the bank.

The other advantage of finding a good broker is that they can mentor you, giving feedback on properties and locations. If you are finding it difficult to borrow money, they can help you figure out what steps you need to take overtime to get into a more favourable financial position.

Once you decide to use a broker, you should ask for recommendations from friends who have recently made profitable real estate investments. There are unfortunately many brokers who are not as skilled as others -- and that's not the sort of person you want to trust with finding you the best deals.

Don't do what I did, which was use an old school friend to organize my first home loan. I did that only to find out that the interest rate they were charging me was much higher than the rate I could have gotten straight from a bank branch. Friendships are one thing, but business is another; you don't want to get locked into an uncompetitive interest rate purely because you are supporting your mortgage-broker friend. You want to choose a mortgage broker because they are the best at the game and at the cutting edge of giving you a deal now and for years to come. If and when you decide to purchase additional properties, you will want to work with someone who gives you customised, quality service in line with the needs of you and your growing property portfolio.

When you sit down with the broker, find out the maximum amount you can borrow. When you make your first purchase, it probably won't be for that maximum amount, but it's worthwhile knowing. Remember, as your portfolio builds, generally so will your ability to borrow money -- and the more you can borrow, the more expensive properties you can buy.

A first time buyer looking to make a $300,000-500,000 purchase will face a lot of market competition. But as the price ceiling on properties you're able to afford increases, you often end up getting a better value for your money.

And don't worry too much about being able to service the amount that you borrow if interest rates increase; banks have already done that worrying for you. In a lot of situations, people will be successful at a property auction yet they'll tell me they are worried about being able to meet their repayments. Since the global financial crisis, banks have really tightened up on their lending policies. And who can blame them? They had to write off a lot of loans as a result of poor lending prior to the GFC.

While more organisations are looking over their shoulders, interest rates are also at record lows. When you apply for loans, banks will often add 3% to the current interest rate in order to figure out whether or not you can afford the rate if interest rates increase, meaning there is already a built-in buffer in their serviceability calculations.

In the past, it was unheard of for people to borrow more than 80% for the purchase of property. But now, as property prices are increasing, you might want to consider taking out mortgage protection insurance on your loan.

The cost of organising lenders mortgage insurance from 80-87% is relatively cheap and you're considered a low risk lendee. Once you go above 87%, your risk of defaulting increases substantially, as does the cost of lenders mortgage insurance.

Organizing the finance of a property purchase gets easier with experience. In subsequent purchases, you'll be more in tune with banking requirements and you can place yourself better for your next property purchase by reflecting on what you've learned.

It's tough organizing financing because banks have tightened up their rules. But as your portfolio grows, you'll get better at figuring out the game of buying property, and your ability to organize financing should improve as well.

Finding The Right Property

When you are looking to invest in real estate, you need to take the time to do it right.

Knee-jerk investments don't end up being clever business moves in the long-term. Clever people are patient and shop around -- and do their research. They wait for a good deal to arise before they invest.

So how do you find the right property?

Once you have your finances organised and have set your price range, start by shopping around from the comfort of your couch. Go online -- in Australia, one favorite website is realestate.com.au, and look at properties in your capital city and price range. The domain website is also good, and I actually prefer using it because it has better filter sorting settings.

It's also helpful to research the highest capital growth rates per suburb before honing in your search. Then, decide what your ideal property looks like: old or new? Plain or with character? How many bedrooms and bathrooms? What features and rooms are essential?

Too many times, people don't take the time to consider their needs and wants thoroughly. When my family was outgrowing our house in the city, I took stock of my needs: my young family needed space and we didn't want to have a long commute to work each day. Then, I visualized my ideal property: a stone cottage on 20 acres of land within 20 minutes of the CBD in Adelaide. Armed with this vision, I began searching for this property.

It soon became clear that only two suburbs in Adelaide were going to work for my criteria: Crafer's West and Piccadilly Valley. Narrowing this down made it so much easier for me to locate my next property purchase. I searched those regions using available software, narrowing it down by block size and then by individually looking at properties. Remember at this point none of the properties which I like were on the market. Most people would think that my rather bizarre approach was a waste of time. One of the 20 properties I looked at on the software just happened to have a tiny little for sale sign on the fence; I was able to buy it directly from the realtor because I knew exactly what I wanted. I had my finances organised, so I was a prime candidate for a popular property.

There were 30 people ahead of me waiting for an opening inspection on the property, so having my finances in order made all the difference. I was able to jump the queue because I had done my homework.

I bought that property at full price, unconditional and not subject to finance. The vendor couldn't believe their luck at having a crazy guy like me going in at full price before even setting foot inside the property, but because I had experience, I believed this was a risk-free deal.

Once you have the ideal property in mind, it's very important to be able to sit down and read, research, and build up your knowledge base. Invest time in understanding the suburbs you like. Read The Seven Steps to Wealth, which was a game-changer for me -- the fundamental rules inside are what I always look for when buying properties.

I lost $50,000 doing my first property investment because I didn't do thorough research. I rushed in, bought something that was offering a big rental return, and got the fundamentals of the deal all wrong.

I bought a unit in the outer suburb of Adelaide, where in the neighboring suburb they were releasing lots and lots of blocks of land. In the end, the oversupply of new houses in the neighboring suburb drove the rent that I was able to get for my old rundown unit into the ground.
I sold the property five years after buying them for $50,000 less than what I paid for them. It was a disaster, but what I learned from the experience was invaluable.

When you're buying a property, go for a big block. The bigger the block, the better. Block size and location is far more important than the building(s) on the property. While land goes up in value historically, buildings go down in value. You don't want to build a massive gorgeous house on a tiny plot of land, because it's not going to generate a good return.

You want to buy a property as close as possible to the city for a number of reasons. Commute times will be lower, as will the petrol costs of that commute. Rental demand is generally stronger closer to the city. The quality of schools and shops will be better as well. There will be more demand when you go to sell the property as well.

What you really want to aim for is the worst house on the best street. Houses can be renovated and aesthetically improved. When you buy a house, you want to do an aesthetic facelift on the property rather than a massive expansion -- you'll get bogged down by the astronomical cost as well as council and architect meetings, building issues that will take a lot of time. In my experience, renovations take twice as long and cost twice as much as your initial estimate.

Ideally, as with any investment, you want to purchase a property that is undervalued for shallow, aesthetic reasons. It could be something like a massive gutter-clogging, foundation-cracking tree, or car bodies festering in the backyard and a distinct lack of maintenance from street view -- you don't want a property with true problems like a termite infestation. Low street appeal means lower purchase price relative to its true market value with the impediment removed.

Try to choose an up-and-coming suburb close to the CBD of a capital city -- something that is on its way to gentrification. If you get in early enough, you will reap financial rewards.

Try to avoid buying at auctions. They are difficult, emotional, and hard to gauge. There is nothing worse than overpaying because you're in a stressed mental state.

With investments, you must always keep cool, calm and collected. Take your time. Get an app on your phone from either Domain or realestate.com.au and refresh it every night to see which new properties have been posted. Search in weird places like Craigslist, EBay, Gumtree, and your local paper. Contact local agents and ring them weekly to develop a relationship -- they can be invaluable in helping you find hidden gems. Find someone with more than three investment properties to serve as your mentor -- they are in the top 5% of property buyers and know what they are doing.

The property market is cyclical. The longer you ride out that cycle, the more you will understand and the better positioned you will be. If you find the right properties, it will propel you forward, while the wrong choice can set you back a lot. So do your homework and put yourself in the best possible position to buy a property with great financial value and potential.

Which Is Better: High Rent Or High Capital Growth?

What is more important, high rental returns or high capital appreciation?

Land goes up in value while buildings go down in value. You ideally want to purchase the biggest block of land in an ideal location so that in 10-15 years, a developer will want to purchase the property. At this point, you'll generally be paid based on the size of the land, not the building, because they'll likely replace the structures with something bigger and better.

A lot of people make the mistake of chasing rent; I did this with my 2nd and 3rd properties. The numbers looked great in a spreadsheet, but my rental tenants soon found more attractive options and I was left with two empty apartments. I had to plead with them to move back in at a lower rent. If you buy based on rental or yields, you will end up with a volatile income stream.

I've learned my lesson and I never buy units, townhouses, or strata titled properties; I buy standalone properties or time style properties. When you're part of a group, you only ever own a unit in a group.

People in group situations always underestimate the strata fees that they pay to the strata corporation. Overtime, this adds up to lots of money, and often the strata corporations are inefficient managers.

I always chase capital appreciation and not rental return. Even if rent is down a little bit, it ends up being down for less than your interest repayment and other expenses and you can still carry the loss if your asset is increasing in value.

When I understood the importance of capital growth, my assets started growing like crazy without me having to do anything at all. I like to think of it as if my properties are increasing with value while I'm sleeping. Now they are not only going up during the night but they're going up while I'm going about my everyday job. When I sit down every January and reflect on the year behind, I tend to get excited that I have another year under my belt in my property modelling. If I've chosen well, all of my properties are only increasing in value each year after year after year.

Disclaimer: Please note this is only a general overview of my experience and this should not be taken as advice and you should consult a professional.