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Successful property investment
IT'S EASY WHEN YOU KNOW HOW

Many dentists invest in direct residential property with varying degrees of success. Making money from property is easy if, like with many things, you know what you are doing. There are only three things you need to focus on and it's not rocket science. In this article, I will show you just how easy it is to make a lot of money from property investing.

THE QUALITY OF YOUR ASSETS WILL DETERMINE YOUR SUCCESS

The simplest rule to investing is that the quality of your assets will determine your returns (income and capital growth). Quality assets will, over the long term, deliver quality returns and the reverse is true. If all you do is invest in the highest quality assets you can afford, you'll be a very successful investor. "You need to do few things right as long as you don't do anything wrong" suggests Warren Buffett. This advice cannot be truer when it comes to investing. The smartest, fanciest, most complex structures/product cannot magically generate quality returns from poor quality assets. So when it comes to investing in property, only buy an investment-grade property.

WHAT IS INVESTMENT-GRADE?

Investment grade properties double in value every 7 to 10 years on a perpetual basis (which equates to a 7% to 10% per annum compounding growth rate). There are a few important points to make in relation to this definition:

• Of all the properties existing in Australia, probably less than 5% would be regarded as investment-grade – so I'm not talking about just any old property.

• When I say "perpetual growth" I'm not necessarily suggesting its forever, only our lifetime. Mathematically, property can't double in value forever as eventually no one will be able to afford it. However, there are plenty of investment-grade properties that will double in value every 7 to 10 years over the next say 30 years – and probably even longer. The discussion about property eventually levelling out is a valid one but not relevant to this discussion.

There are thousands of examples of individual properties that have appreciated in value at average rates of 7% to 12% pa (compounding) over the past 30 years. Many two-bedroom, single-fronted houses in Prahran, South Yarra and Hawthorn in Victoria (for example) sold in the early to mid-1980s for $75k to $80k. The same properties would be worth over $900k today – that's close to 8.5% pa.

Focus 1: Scarcity

Essentially, scarcity means demand will always be greater than supply (as the supply of scarce properties is typically fixed or in decline). Compare two examples: firstly an apartment in a block of 200 versus a Victorian, single-fronted, two-bedroom cottage. There's no scarcity with the apartment because there is literally hundreds just like it. There is scarcity with the Victorian cottage because no one is building period style cottages anymore and many are located on very (scarce) valuable land. Arguably, supply of these types of assets is in decline whilst at the same time they are in high demand. Similarly, investing in a new property in a new residential estate doesn't make a good investment because land supply isn't scarce. Just like with diamonds, scarcity pushes prices up.

Focus 2: Land Value

Every established property's value is made up of two components; land value and building value. It is commonly understood buildings depreciate over time and land appreciates. Typically, tenants will be attracted to properties with more building value (accommodation) whereas investors should be attracted to properties with more land value. That's why newer properties tend to achieve a higher amount of rental income (and the reverse is true too).

Consider the example of a new apartment worth $550k located in a high-rise building. In this situation it would not be uncommon for the building value to be $500k and the attributable land value to be $50k. For this property to double in value over the next 10 years (value of $1.1m), what needs to happen? Well the building component will depreciate to say $400k at the very least (probably lower). Therefore, the land value needs to be $700k (being $1.1m less $400k) – it needs to increase from $50k today to $700k in 10 years or 30% pa compounding over 10 years. I'm sure you agree this almost certainly won't happen.

Alternatively, consider a two-bedroom 1930s apartment worth say $600k. In this situation, the land value is likely to be $450k and the building value is therefore $150k. In the next 10 years the building won't depreciate that much – maybe another $30k. Therefore, for the total property's value to double, the land needs to increase from $450k to $1.08m or 9% pa compounding.

Of these two example properties, which one do you think has the most chance of being double its value in 10 years? That is why land value is very important and one of the reasons buying property off-the-plan doesn't work.

Focus 3: Proven Performance

It is important to check the past sales history of potential property investments to assess their past performance.* The reason for this is that the fundamentals that drive property values tend to be objective (not subjective) and static – or if they do change they take many decades to change. Things like proximity to shopping strips, hospitals, the CBD, arterial roads, architectural style and so forth rarely change. Therefore, if these things have driven the value of a property up by an average of (for example) 8% p.a. for the past 30 years, then it's likely that the same growth rate will occur for the next 30 years assuming these fundamental factors don't change. It's about investing in a sure thing because you do not need to take the risk in investing in a property that hasn't proven it can deliver investment-grade returns. There are a few fundamental things that drive a property's value including:

- Scarcity and land value component, as discussed above
- Proximity to amenities such as shopping, medical services, parks, schools, public transport, arterial roads and so forth
- Good natural light especially in living rooms, privacy (visual and noise), security, logical floor plan, attractive architectural style (inside and out), car park on title if it's an apartment, structurally sound building and so forth.

Therefore, before you invest, make sure that property has demonstrated strong performance in the past.

I DON'T DO MY OWN DENTISTRY!

The quality of your investments will determine how successful/wealthy you will be. Therefore, if nothing else, your attention should be laser-focused on investing in only the highest quality assets you can find. To find these assets seek advice – or at the very minimum a second opinion. I don't do my own dentistry – I go to my dentist; I didn't write my will – my estate lawyer did; and I don't select the properties I invest in (even despite my knowledge and experience) – my trusted buyers' agents do this for me.

The financial consequences of making even the slightest of mistakes, e.g., 7% growth pa versus 9% when investing in property are just far too valuable in dollar terms, to not do everything possible to avoid investing in anything less than an awesome quality property. We work closely with clients to make the most of their financial opportunities including providing access to our team of trusted advisors.

Dentist HOME LOANS

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