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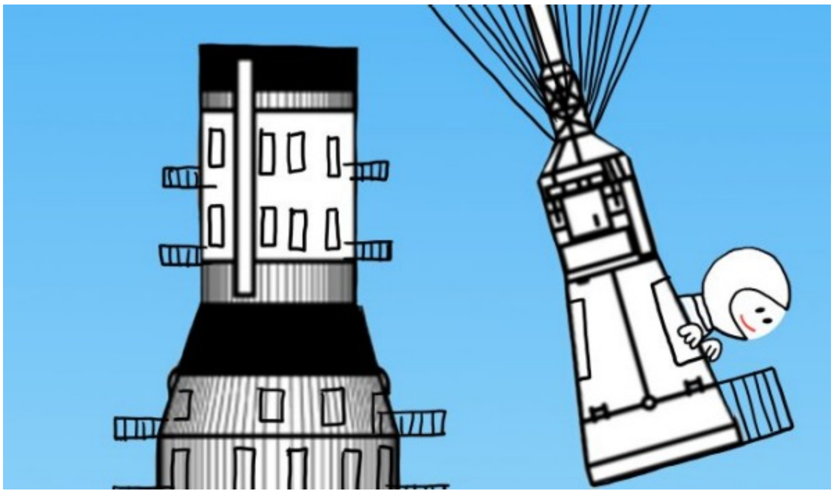
Strategies for after the property boom



by **Duncan Hughes**

A knock-out financial punch has helped the Fincher family protect their biggest property investment and help them stay in the suburb they love.

Jason Fincher used his brains – and got a developer to exercise some brawn – by knocking down the wall between adjoining apartments to create a three-bedroom home at a 25 per cent discount to the cost of buying a similar-sized apartment in the same area.

It's a case study for the sort of unconventional thinking that many investors and home buyers will need to employ if any of the numerous predictions about a property downturn turn out to be correct.

"It was an unconventional call," says Fincher about trading up from a small, single-fronted house with a backyard to a large second-floor apartment with a large balcony in Elwood, about 10kms south-east of Melbourne's central business district.

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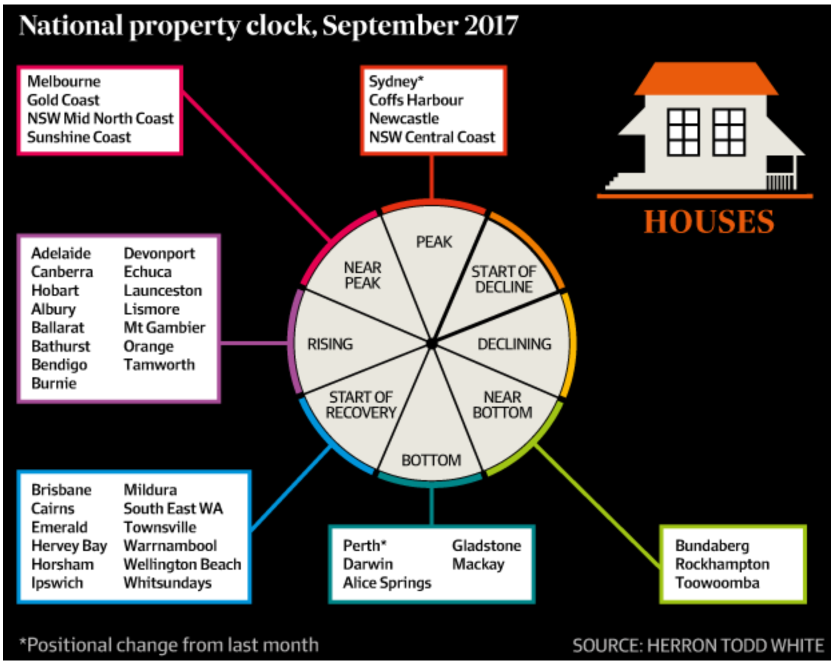

National property clock

"But we are feeling pretty comfortable about it," says Fincher, a builder who checked out the reputation of award-winning design and construction outfit Piccolo Developments before committing.

Fincher, his wife Deborah (a vet whose surgery is also in Elwood), their three sons (Jake, 12, Kye, 10 and Raph, 8) and dog Indi are also comfortable about trading a backyard for a large balcony. They have a farm where they spend the weekends.

A five-year property boom has pushed up prices in bayside suburbs like Elwood nearly 60 per cent and close to 75 per cent in comparable harbourside postcodes around Sydney, according to CoreLogic, which monitors prices.

But a deflationary mix of tough speed limits on the volume of loans that lenders can offer, new taxes on overseas buyers and prices outpacing buyers' capacity to pay are slowing demand in property hotspots like Melbourne and Sydney.

Falling auction clearance rates and shrinking rental yields – plus the prospect of rising interest rates – are a clarion call for smart investors to consider what happens after the boom.

Savvy move that suits the family: Jason Fincher with sons (from left) Jake, Kye and Raph with dog Indi. **Pat Scala**

Think cash flow

Michael Hutton, head of wealth management for HLB Mann Judd, warns unprepared property investors could face a cash flow crisis in the next 12 months if the market begins to cool thanks to rising costs and falling returns.

"Investors who have made their investment decisions on conditions that prevailed in recent years could well find they are financially over-stretched if conditions deteriorate," Hutton warns. "This is not the time for investors to be over-stretching."

Geared investors should have a cash flow that covers likely events and worst-case scenarios, such as rate increases or a change in government that could lead to an overhaul of negative gearing benefits.

"What happens to your ability to service debt if interest rates increase?" he asks. "Or if the property remains untenanted for an extended period? How will changes to depreciation rules affect cash flow?"

Hutton says evidence from local and overseas property crashes shows it is the inability to service debt rather than a precipitate crash in property values that causes investors to lose their portfolios or homes.

"For many residential property investors, understanding cash flow and making sure that debt can be serviced throughout a property downturn and interest rate increases is likely to be the difference between financial success and failure."

Have a buffer

For home owners that might mean postponing major renovations, such as a new bathroom or kitchen, to avoid putting too much strain on a stretched family budget.

Property advisers recommend having the equivalent of three months' rent – or mortgage payments – as a buffer.

Major lenders, such as Westpac and Bendigo and Adelaide Bank, are more closely monitoring their borrowers by requesting detailed information about total household spending, other debts (including credit cards) and all sources of income (including bonuses).

According to Martin North, principal of Digital Finance Analytics, an independent market analyst, more than one in four households – or about 860,000 – are estimated to be in mortgage stress. About 50,000 households are at risk of default over the next 12 months.

Flat incomes, underemployment and rising expenses such as spiralling council rates and energy costs are a toxic combination for many family budgets.

Buy in cheaper area

North says an increasing number of households are solving their financial problems by moving their home address – or investment portfolio – to a cheaper postcode, which is typically inter-state.

Research by Herron Todd White, a national network of valuers, shows that top performers like Melbourne, Sydney, the Gold Coast and the Sunshine Coast are at (or approaching) the peak of the market for houses, which means the next move is usually down.

Adelaide, Hobart, Brisbane and Cairns are either rising markets or at the beginning of a recovery, according to its analysis.

Some property owners are selling their median priced house or investment property in Sydney for $1 million and buying two in city fringe suburbs of Adelaide, says North.

It's not a risk-free decision because there is no guarantee prices will continue to rise or that a comparable job with similar pay (or tenants) can be found in the new address.

Remember tax breaks

Property investors should be looking at ways to reduce tax and boost cash flow, says BMT Tax Depreciation chief executive Brad Beer.

The federal government has cracked down on some deductions but a first-year investor can typically claim between $5000 and $10,000, which includes the cost of having a depreciation schedule professionally compiled, says Beer.

Investors can also claim capital works, which involves the building's structure and fixtures, for up to 40 years.

Structural renovations completed by the previous owner are also deductible.

Think outside the square

Daren McDonald, head of property for consultancy ShineWing Australia, suggests considering an alternative use for a property, such as dual occupancy, or building a granny flat in the backyard.

McDonald recommends those considering the strategy to start by obtaining details of any planning overlays applicable to the property and approaching local council about planning and building permits.

A town planner can tell you what you can and cannot do, which might save months before planning tribunals.

Estate agents should be able to provide an estimate of what the completed construction might be worth, whether there is a market for what you plan to build and indicative local rental demand.

For example, a renovated house in Winmalee Drive, Glen Waverley, 21kms south-east of Melbourne, recently sold for less than a neighbouring unrenovated property because the best use was redevelopment.

Refinance

Lenders are offering lucrative refinancing deals to investors and owner-occupiers with good credit records, 20 per cent deposits, low outgoings and steady, dependable income.

Comparison sites include finder.com, Canstar and RateCity.

Other mortgage broker, loan agency and loan auction sites include flongle, Tomorrow Finance, LoanDolphin and Lendi. Each has competitive rates and solves different problems, such as linking a borrower to a broker, lender, or both. Ask about commission payments.

Offer tenant incentives

Paul Nugent, a director of Wakelin Property Advisory, says landlords should offer incentives to good tenants, such as using some of a rent increase to replace blinds or install air conditioning.

It typically costs the equivalent of two months' rental income to find another tenant.

Be apartment savvy

A loud alarm should be ringing for apartment owner-occupiers, investors or off-the-plan buyers who have put down a deposit and are awaiting completion to ask the owners' corporation to check on any fire risk from external cladding.

Recent high-rise fires in Melbourne and London where combustible cladding acted as an accelerant to engulf the buildings have prompted government inquiries about the number of buildings involved, potential risk and who is liable for reparations.

Lenders are attempting to limit their exposure to buildings that do not comply and insurers may refuse to cover the cost of cladding removal or price premiums too high for strata corporations to afford.

"Do your homework," says Phil Dwyer, national president of the Builders Collective, which is committed to improving industry standards. "Ask the sales person who the builder and developer are. What buildings have they previously built, where are they now? Ask for references from previous buyers. If they can't, then it might be a red flag!"

Sahil Bhasin, national general manager of Roscon Group, which advises on strata properties, says the biggest problems are with buildings in the outer metropolitan suburbs that are under 25-metres, or seven storeys, that do not have sprinklers installed.

Checklist

- Review your funding arrangements and ensure you know how the agreement works. For example, what rate does to the loan revert to at the end of the fixed term?
- Would a new valuation lead to a better deal and lower interest? Will it result in higher council rates?
- Review the quality of your tenant. Is there adequate security if the tenant defaults? Is there a bank guarantee or tenancy deposit?
- Are you maximising the value of your property? Are rents at the current market rate? Is the whole of the property leased, or deriving income?
- Does landlord insurance cover loss of rent and damage?
- Review property strategy and other investments to ensure they match your overall goals.

Source: ShineWing

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