Home Study Program Module 6
Purchasing Property

Wealth Creation Dynamics

Learn how to **drastically** advance **your** financial future.

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Welcome

Module 6
Purchasing Property

Welcome to module 6 of the Wealth Creation Home Dynamics Study Course - Purchasing Property.

This module is number 6 of 24.

Each module is presented in the same layout and contains exercises that you can do in your own time.

The benefits of participating in this Home Study Course are:-

- You progress at your own pace.
- You can study in the privacy of your own home.
- You can ask questions regarding the course at questions@apin.com.au

We hope you enjoy the Wealth Creation Home Study Course.

Best regards,
The team at APIN

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Module 6 - Purchasing Property

Buying a property

There are generally two ways to purchase property – buying by private treaty or buying at auction. Let's look at some key points you can use when purchasing, including how to work out the value of a property.

Buying by private treaty

- Build a relationship with local agents.
- Organise an inspection when the vendor is home.
- Ignore all the agent's excuses.
- The agent always acts in the interest of the seller!

Buying at auction

- Do your own homework and arrive early. Set your upper limit and don't tell a soul.
- Be the final bidder if the reserve is not reached.
- Avoid bidding until the property is 'on the market'.
- Go for a 'Knock-out' early on or take control at the end.

What is the fair market value?

The highest price a buyer, willing but not compelled to buy, would pay and the lowest price a seller, willing but not compelled to sell, would accept.

Determining the value of the property

When a valuer is hired to determine the value of property, the value will not be appraised as at a certain date. The price at which the valuer arrives is not cast in stone; it's merely the valuer's personal judgment of the value of that property.

Despite the fact that properties always have a 'market value' range, usually plus or minus 2 ¼%, a valuer will often determine one single estimate of value.

Because so many variables are involved, valuers generally try to determine the value using several different ways. While you will not use a professional valuer in the purchase of every single property, you need to become familiar with the three methods most commonly used. You can actually learn to use these three methods yourself without any formal training.

Market sales analysis

- Look at what similar properties have sold for in the same area
- Compare size, age, construction, number of bedrooms, bathrooms and features.

One way to determine the value of property is to look at the price which similar properties in the same or similar neighbourhoods recently have sold for.

The asking price or listing price (if the property is being offered by an agent) of properties currently for sale is of little use in determining value. This is only someone's estimate of value or, for that matter, a 'lets offer it at this price and see what happens' approach.

While valuers are quite scientific in the way they compare properties that have recently sold, you can do a reasonably accurate job yourself. Find one in the same neighbourhood that is similar to the one you are considering so you can compare 'apples to apples'.

You should know the approximate land size and building size of each property, the age, construction (cement block, brick or wood frame, etc.), number of bedrooms, bathrooms and any extra amenities the property has, such as a two car garage, veranda and central air-conditioning.

In the case of larger properties such as apartment buildings and office buildings that produce rental income, you should:

a. Compare the selling price per apartment unit by dividing the selling price by the number of apartments.

b. Compare the selling price per total square metre by dividing the selling price by the square metres.

c. Compare the Gross Income Multiplier, which is the selling price of the property divided by the income it generates each year. (If a property generates $80,000 per year in rental income and sells for $650,000, the G.I.M. is approximately 8 ... $650,000 divided by $80,000 equals 8.125)

Most of this information can be obtained from real estate agents. To research it yourself, public records located in the Land Titles Office, also have information about the selling price, square meters, and layout of the house (number of bedrooms, baths, etc.)

Cost analysis

- Estimate the cost of building the same or similar structure.
- Add the cost of land.
- Subtract any wear and tear (real depreciation).

The cost analysis looks at the current cost of building the same or very similar structure. The cost of land is added into the figure. Then, any wear and tear the property may show is subtracted to arrive at the value. The last element of this process is very subjective and could distort the true value of the property.

Costs of construction are estimated on a per-square meter basis. Usually no attempt is made to estimate the actual cost of the construction materials. Several technical sources are generally accurate in estimating the per-square metre cost of a building.

As a new investor, you would be best advised to contact several builders in your area and just ask the question, “What are the building costs for a 170 square meter, three bedroom, two bathroom home exclusive of land, driveway and landscaping?”

The value of the land would be determined by doing a market sales analysis and learning the price for which other comparable lots are selling. Driveway and landscaping costs could then be determined by contacting firms that specialise in these areas.

After doing this for several properties, you will soon have a very good perspective on building costs in your area. You can then make some comparisons with the information you collect using the market sales analysis approach.

This is the least reliable way of determining value, especially for older properties, however is practical when assessing a brand new property.

Nett income approach

- Property value is a function of the nett operating income.
- Calculate the gross rental and subtract all associated costs (agents fees).
- Divide by your 'reasonable rate of return'.

The third method for determining value, called the nett income approach, is primarily used for evaluating larger (three units and up) income properties. It does not work as well with houses and smaller apartment units because too many emotional factors affecting price are present in the market place.

In simple terms, this approach says that the value of a property is a function of the nett operating income (or nett income) it produces. The nett operating income is the money that you would be able to spend if you owned the property free and clear of any mortgage debt. If rent increases or expenses decrease, the nett income goes up and so does the value of the property. If it does not generate enough nett income to pay the mortgage payments and generate some extra spendable cash, you will not buy it.

This approach for finding a property's value can have powerful implications, especially if you are able to purchase it based on Market Sales Analysis value (the amount for which comparable properties have sold) and sell it for if the nett income value (the property's value in relationship to the amount of nett income it generates before any mortgage payments.)

Once you've worked out the nett rental, that is the gross rental less the agent's fees if you have one, then divide that number by your reasonable rate of return. We often use, in today's market, 6%.

For example, a particular property may have a nett rental income of $9,000. Dividing this amount by 0.06 you determine that its value is $150,000. The seller does not know anything about the nett income approach to value but he or she sure does know that the property is worth $175,000.

If then nett rental income was to increase to $12,000.00 per annum and you applied the same formula i.e.: divide $12,000.00 by 0.06 = $200,000.00 you could argue that a realistic selling price based on 6% return was now $200,000.00, an increase of $50,000.00.

In an example like this, you would probably be best advised not to tell a seller how you arrived at the price you're offering. Just say, "I've done some figures and this appears to be the best offer I can make at the moment." By wording your response in this open-ended way, you are leaving room for a larger counter-offer at a later date if you choose to make one.

As you can see, there is no way to make an exact valuation. The only thing you can be assured of is that if you buy in an area with solid growth potential, there will continue to be increases in property value. Your negotiating techniques will assist you and ensure that you achieve the best price possible.

For smaller properties, such as a single-family home, the market sales approach to determining value is considered the most reliable method available.

If we have a good property in a growth area that we are willing to buy, our aim should very simply be to try to get that property at the best price possible. The worst mistake an astute real estate investor can make is to leave more money on the table ... remember you make your money in real estate when you buy.

Now you have worked out what ‘value’ the property is, it’s time to submit an offer to the Agent.

- Submit offers in writing accompanied with a cheque. This shows you are serious and also makes the Agent and Vendor act quickly. Below is an example of a letter of offer.
- Always wait for a counter offer.

(Your Name}
c/{Your Company)
(Your Address)
(Phone)
(Date)

(Real Estate Agent)
(Address)

Dear (Agent),

(PROPERTY ADDRESS)

Thank you for taking the time to show me the above property.

As I mentioned to you, I’m always interested in purchasing properties that will offer me a reasonable return on my Investment and the property you showed me seems to meet many of my investment requirements. As such, I hereby submit my offer to purchase the above property, along with reasonable consideration of $750 made payable to (Real Estate Agent).

Purchase Price:	$255,750
Deposit:	$750 enclosed
Balance of Deposit:	$24,825 within 7 days from exchange of contract.
Balance:	$230,175 upon settlement at a time suitable to the vendor
Leasing:	(Real Estate Agent) to be managing agents

I have submitted offers on two other properties in the area and will be making a decision to purchase one within the next 24 hours. As such, this offer is valid for the next 24 hours only.

I look forward to your favourable response so that the Contract of Sale may be signed and exchanged as soon as possible and settlement arranged at a mutually agreeable time.

Yours faithfully,

(Your Name)
(Your Company)

Exercise

Find a property for sale by AUCTION on the internet in your suburb. Using one of the value methods, use this page to determine what you think the value should be and what would be your maximum bid at auction?

What are some key points you would use when submitting an offer on a property?

Checklist (for investment)

Use the following checklists to help you in purchasing a property.

The checklist (for investment)

- Select the right property for the right area, house, unit etc.
- Select properties which offer high depreciation and tax benefits.
- Engage a Quantity Surveyor to provide full depreciation schedule.
- Minimise the cost of the investment and build equity by adding value.
- Select properties which are in small style developments (less than 30 units). Apartments in large high-rise developments can perform poorly unless they are unique: top floor, pent house style etc...
- There are always exceptions to the rule.
- Re-value the property after you have improved it.

Checklists (when purchasing)

- The Contract of Sale must be checked by a solicitor on conveyancer.

a.	Caveats	(report from land titles office)
b.	Easements	(report from local council)

- Development restrictions
- Body corporate issues, strata management report.
- What easements are running along the edge of the property. If it runs in the middle of property, then there may be problems doing renovations and therefore restricting future potential for development
- “Envelope” restrictions, i.e. second story etc…
- All extras add to body corporate fees, i.e. gym, pool, etc… So ensure a thorough search is done including a fire department report.
- Minimise the cost of the investment and build equity.
- Insert Clause in “Contract of Sale” that the offer made is subject to solicitors approval within 72 hours and valuation approval.
- Get an R.P data report of all properties sold in the last 12 months in the area and street you are buying in.
- Negotiate with your cheque book in hand.
- Do not haggle – explain your offer is based on market research.
- Be prepared to walk away.
- Come back in two days and tell the agent to present the offer to the vendor again.
- You can negotiate on second meeting – first time give your price and walk away if they don’t want your price.
- Obtain a certificate of land size, from the lands title office: do not rely on survey in contract, get an independent report; do not trust the sales agent or your solicitor.
- Obtain records from local council on the property you are purchasing.
- Go to council yourself and look at the file relating to the property and see if there are restrictions on the site.
- Banks will only lend against contract price if settlement is more than 6 months.
- Re-value the property- after you have improved it.
- Advise the bank of the new valuation price.
- Constantly be in touch with the valuer – build a good relationship with them.

Only purchase property at wholesale prices

- Wholesale means property purchased below market-price and must be at least 5% below.
- Obtain a Residential Report.
- Negotiate with the agent/developer/builder as a Professional Property investor.
- Discuss the state of the market — display your expertise, show proof.
- Show the agent a bank valuation.
- Obtain proof of other sales within the area.
- If you want to buy well then you must look the part. Look as if you can afford to buy (wear good suit and tie).
- You need a business card with mobile on it — and phone and fax.
- "I am a professional property investor and I'm looking to buy 3 to 4 properties in the area in the next 6 months — I have been looking at properties for a while now. This is the property I want".
- "I am here to buy, and I want to negotiate the best price".
- Only approach properties which have been on the market for at least two months or more if you want to get a good deal.

Research technique points

- Choose 4 suburbs you feel comfortable with.
- Look at suburbs next to well performing suburbs.
- Become an expert in that area or areas you choose.
- Research R.P data www.rpdata.com.au
- Obtain government reports from your local council.
- Visit every agent in your chosen area.
- Establish a 'Close" relationship with the agents you like best.
- Tell the agent what outcomes you want from the relationship eg: I'm looking to purchase 6 properties in the area in the next ....
- Ask for the names of the 'four' best streets in each suburb.

purchasing checklists

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- Visit every property for sale in your chosen area.
- Visit every established property sold in your chosen area.
- Visit a minimum of 10 auctions and record the results.
- Find out everything you can about the area, schools, buses, council approvals etc...
- Read all newspapers and publications relating to the area
- Inner City Areas (Within 10 KMS of CBD) perform the best.
- Target areas and suburbs with the fastest capital growth over the last 4 years, then look at the properties next door to them.
- Each area should have a 'lifestyle centre' with cafes, bars, restaurants, sports centres, private schools, universities and parkland and public transport.
- The best areas are the ones which have council heritage and height control restrictions thus creating an artificial 'land and property' shortage.
- Choose streets and suburbs close to established 'Blue Chip' suburbs. These areas have dramatic rise in capital growth when their blue- chip neighbour becomes unaffordable in terms of equity, debt capacity and rental capacity.
- Obtain a certificate of land size, from the lands title office: do not rely on survey in contract, get an independent report, do not trust the sales agent.
- Solicitor to check contract sale

  Caveats, report from the land titles office
  Easements, report from local council
  Development restrictions
  Body corporate issues etc...
- What easements are running along the edge of the property. If it runs in middle of the property, then there may be problems doing renovations and therefore restricting future potential for development
- "Envelope" restrictions, i.e. second story etc...

R.O.I.

- You must achieve the highest possible returns on the money you invest
- The key is to leverage your money.
- Look to invest in a variety of areas.
- Leverage and buy $1 million of property – even if the property increases by 5% then you have $50k potential income or equity.
- You need to measure the return on your money, not on your asset.
- Using leverage provides greater returns on the money you invest ... so the return on your money (equity) on the asset is the crucial calculation when assessing investment performance.
- Remember your long term goal (65 years of age) is to remove the pressure from the government to support you in retirement.
- We must become self sufficient if we are to achieve financial freedom.

Exercise

When purchasing a property, what are some of the points you and your solicitor should investigate in regards to the property?

What are some of the things you could do to ensure you purchase at a ‘wholesale’ price?

Properties 15km - 20 km outside the CBD

Certain locations have different points to consider. Here we look at properties that are 15-20km outside of the CBD.

Advantage of outer area properties.

Easier availability of lower priced properties and more to choose from.

It is much easier to obtain a smaller dollar amount deposit bond or bank guarantee.

It should be much easier to negotiate discounts with outer area builder and developers. They are usually prepared to work for less margin per property.

Properties outside 15km turnover faster.

You have a larger purchasing audience.

It is much easier to obtain the required funds if any is required.

You have the opportunity to make more profits by bulk buying house/land packages.

When purchasing outer area properties from builder-developers, you may be able to obtain a further 6 to 12 months 'extra' settlement time, after the property has already been built.

Some builders assist purchasers by providing vendor finance for up to 12 months, as long as you can pay them RENT for the property in the meantime.

What is vendor finance and how does it help you?

Longer settlement terms from the vendor may assist you in obtaining 100% finance for the property.

Only purchase properties in outer areas with an established infrastructure.

Areas where people under 40 years of age want to live are preferable, with established infrastructure such as cafes, bars, restaurants, sports centres, kindergartens, schools, universities, and parkland.

Close proximity to major shopping centres is a must as well as public transport.

Always buy in the top four best streets of a suburb.

Proximity to lakes, rivers, ocean and golf courses is an advantage.

property location

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Choose suburbs which contain brand new subdivisions and examples of opulent brand new housing of $500,000+

Purchase properties in beautiful looking subdivisions, preferable less than 5 years old.

Target suburbs where brand new properties show a minimum of 6% rental return.

Ensure that the suburb you choose has shown a minimum compound rental growth of 5% over the past 3 years.

Ensure the suburb or area has a rental vacancy rate under 3%.

You must visit every single real estate agent in the area to establish the TRUE vacancy rate.

Avoid apartments in outer areas.

Demand for apartments located more than 15kms from the CBD, is less.

You should only purchase separate title houses on land size blocks of not less than 450sq metres.

Select properties designed by “brand name” architects and builders.

People prefer to live in good-looking, exquisite buildings.

Owner-occupiers may be attracted by the “name” of the builder. They believe the product is trendy.

The project is more likely to attract a “better class” of customer because of the appeal associated with the brand name.

Select architects and builders who have won awards.

Select properties which meet the tenant’s requirements

Large bedrooms

Security features – intercom, alarm, security gates are in advantage.

High quality internal finishes – granite, polished floorboards, designer bathrooms, double shower, spa bath.

Architectural and beautiful design with good a colour scheme and street appeal.

Select properties in streets and suburbs where there is less risk of large future development impact.

Perform due diligence in regards to current and future town planning applications surrounding the proposed property. The wrong development in close proximity to your property, can adversely affect your rental and capital gain potential.

Select properties which offer high depreciation and taxation benefits.

Ask the developer for the depreciation schedule.

Engage a quantity surveyor to perform a MAXIMISED depreciation analysis on the property.

Higher depreciation usually improves cash flow position.

Avoid projects where the rental income is based on short-term or holiday rentals.

Avoid off-the-plan projects, which may not satisfy pre-sale requirements.

The risk of non-completion or changes to the property can be high.

Obtain a Guarantee from the developer in writing and subject to, in the contract of sale.

Add in clauses to the conditions of the contract to protect yourself.

Settlement to occur after satisfaction by the purchaser as set out in the contract.

Builder can take 6 months to fix defects.

Avoid projects, which have sold 30%, or more, of their units, within the first 3 weeks of marketing. Professional investors do not make instant, emotional decisions.

Select property which has been on the market for at least 2 months.

The vendor and the real estate agent, are usually more motivated, if the property hasn't sold after 2 months of marketing.

Never offer to purchase a property prior to auction. Buy only after the auction has FAILED and the property has been passed-in, unless you really want it and feel the market is about to change.

The agent is more motivated and therefore more important to you than the vendor.

The agent wants to move onto their next property and save face.

The agent does not get paid more for the extra time they could spend selling other properties.

The agent may do better if they sell the property for 5% or 10% less than the vendors asking price and move on.

The vendor could become a more desperate (motivated) seller, if the property has not sold for 3 months or more.

Marketing costs are rising.

Interest costs are accumulating.

Construction costs are rising.

Other costs are being incurred—such as rates, property taxes and solicitors fees. (plus other reasons)

The longer it takes to sell the property, the greater the risk of it not selling.

There is also a risk of "losing' the marketing agent… agent stops being MOTIVATED.

Once you have chosen the specific properties which fit your investment criteria, establish a preference list of your top 5, with your favourite as number 1.

Your properties should be in different suburbs and can be a combination of properties brand new and established.

Obtain a bank valuation and opinions from local agents.

Provides a second opinion and a market appraisal tool for your negotiations.

Ring you current financier to find out their list of residential valuers.

Ring all the valuers on the list and ask them to provide you with a list of financiers who use them.

Use valuers who work for multiple financiers and bankers.

Use valuers who work in multiple areas, otherwise you will need to use different valuers.

Exercise

Why would you consider buying a property that is 15km to 20km outside of the CBD?

Most commonly asked questions for Investment Properties

What is a residential investment?

A residential property is a house, townhouse, terrace or unit, which the owner does not use as a personal residence, but rents out. This allows the investor to benefit from both tax advantages and rental income from the property.

What is a negatively geared property?

The term "negatively geared simply refers to a situation where your cash outflow to maintain an investment exceeds you cash income from the investment itself.

For example, with residential property, if the mortgage payment on your property exceeds the rental income from the property, it is considered to be negatively geared. In other words, the investment income is negative, which allows you to claim the interest costs on your mortgage or loan as a complex tax deduction.

Recent studies demonstrate that negatively geared rental property remains the most tax-efficient investment vehicle in the 1990's.

What if I didn't feel comfortable about going into debt?

While the concept of debt may seem disturbing, the reality is we live with debt of one from or another, and few people attain true financial independence without some form of leveraging. In fact, most Australians are actually more comfortable with debt than they realize, through the mortgage on their home, or perhaps the loan on their motor vehicle or their furniture. Many of us are in "debt" to the taxman by virtue of the fact that we earn an income.

There are two key principles that will ensure security when it comes to borrowing:

Only borrow to purchase appreciating assets

Make sure your debt is manageable

What happens if my income stops and I can't service my debt?

The answer to this question can best be demonstrated by looking at the financial circumstances of the average Australian family. With interest rates the lowest they've been in years, many families are focused on paying off their own home as quickly as possible.

For example, a couple may be trying to reduce the term of their loan by paying an extra sixty dollars each week. If one partner gets sick, or loses their job, they may be placed in the position where there is no redeemable asset base to turn to but their own home.

If the same sixty dollars a week were invested in a second house, the risk may actually be diminished. The advantage of investing in a redeemable asset base is that, if something happens, the family house is not put on the line – there is something else to turn to.

Life or trauma insurance and income protection policy will replace 75% of a person's regular income while that person is unable to work.

What if I need money in a hurry?

Residential property offers a lot of flexibility. Today, if you need cash in a hurry you can actually draw the equity off your own home simply by refinancing.

If, in the worst case scenario, an income stream is cut off for an extended period of time and there is no other redeemable asset base to turn to, the investment property can be sold to pay back the loan.

What happens if the interest rates rise?

If this is a concern, take out the long term or fixed interest loan. That gives the investor two advantages.

The repayment amount is known in advance, it is therefore easier to plan financially.

The amount of interest paid will remain constant for the duration of the fixed term, despite a rise in interest rates.

Remember, whenever interest rates rise, property prices also rise, providing the capital growth in stream for investors. We only have to look back to 1988 too see an example of the parallel between a rise in interest rates and a peak in property prices.

What happens if I can't find a tenant for my new property?

It has been our experience that, provided a building is in reasonable state of repair and you are not a greedy landlord, you can find a tenant for it.

This is particularly true of the lower end of the rental market. If there is a protracted vacancy rate (for example, anything more than two weeks) it may be a matter of adjusting the rent slightly.

With the right property management in place, however, vacancy should not be a problem. A good manager – in the form of either on-site management, or local real estate agent – should have no difficulty finding suitable tenants, with whom they can foster a long-term relationship.

What happens if a property is damaged or if I have a bad tenant?

Comprehensive insurance will protect your property against most forms of damage. The cost of insurance is minimal and is tax deductible.

If you are correctly insured, an instance such as natural disaster can actually work in your favour, by creating a significant tax advantage.

With effective property management, tenant difficulties should be non — existent or reduced to a minimum.

What if I don't have time to manage my own investments?

Maintaining control of your investment does not mean active involvement. Once a property has been purchased, an investor's involvement can be reduced to a minimum through the use of an effective property manager.

As mentioned in a previous question, the right kind of property management will save the investor time, money and tenancy headaches.

Managers can assist in some or all of the following areas: maintenance, improvements, tenant screening, rent collection, lease preparation, advertising and inspections, tenant relationships.

When selecting a professional manager, it is important to look for someone who is not only a good people manager, but someone who runs the rental roll like he runs his own business.

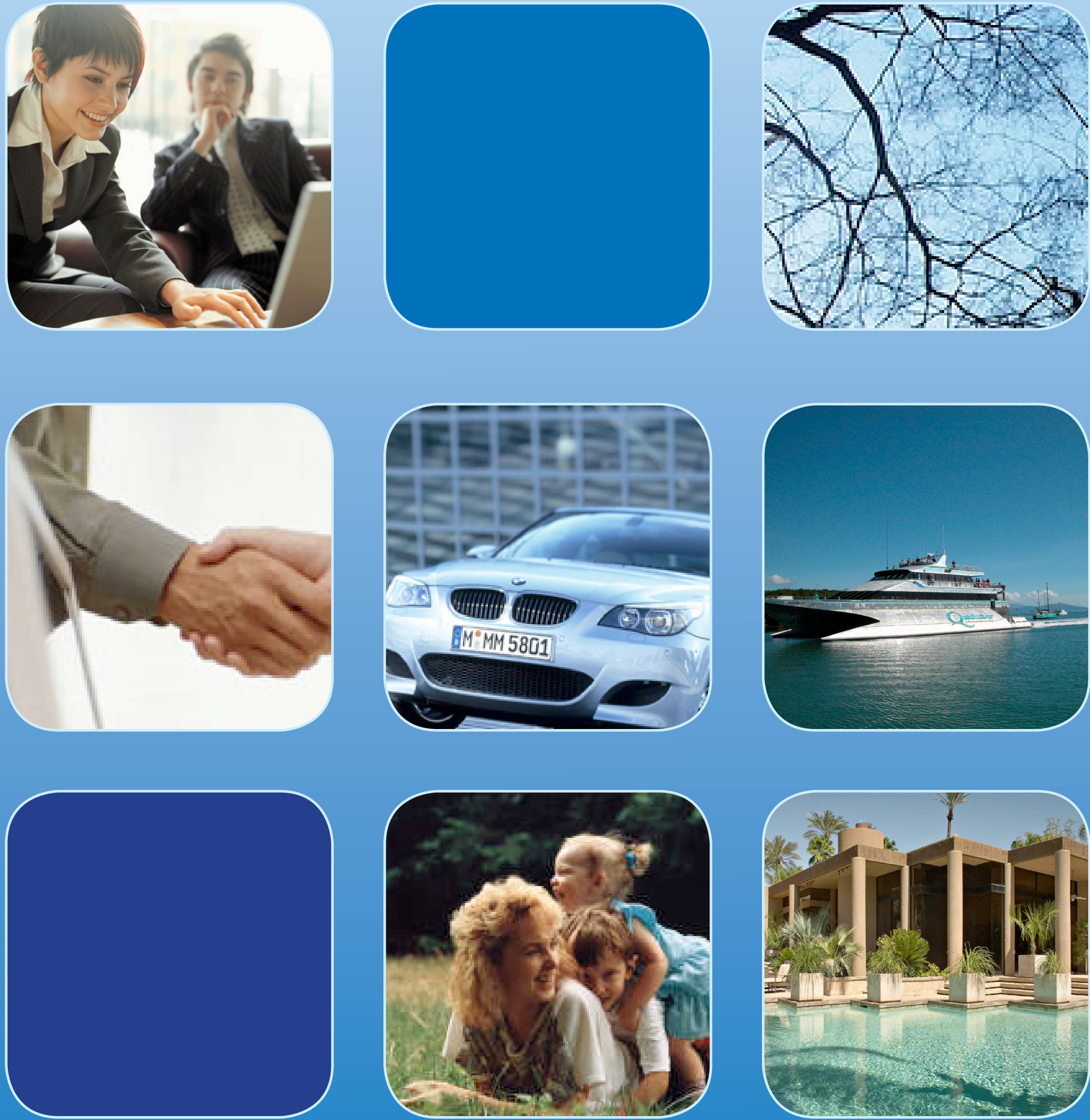
What if I don't have enough money for a deposit?

Cash is not necessary as a deposit when there are sufficient assets to borrow against. For example, the equity in an existing home can be used to finance the purchase of an investment property and its associated costs.

final reflections

What key points have you learnt from this module?

Write out your own quick checklist you could use when viewing potential investment properties.



You are ready for the next module.