

To have and to hold?



Commonly regarded as the sensible option for investors, is buy and hold ever *not* a sound strategy?

For many investors, buy and hold is the most appealing investment strategy available.

David Stafford, general manager – sales and marketing, Indigo Group, points out that property in Australia tends to double in value every 7–10 years, which means that the average person “should look to property investment as a 3–7 year strategy to realise good growth”.

Angelo Piazzetta, CEO and founder of The Property School, adds that buy and hold “is the best way to build long-term wealth”. But he warns that due to the negative cash flow in most situations it may restrict the number of properties you can buy.

“With buy and hold you are looking for long-term capital growth, so the focus is on properties that deliver that objective,” Piazzetta says. “Positive cash flow properties do not always fit into this strategy.”

hold for as long as possible,” he says. “Time is your best friend.”

Opting to hold won’t guarantee you property riches, however, as Stafford explains. “Nothing is fail-safe and people do lose money in property,” he says. “But usually this occurs because they have over-extended their debt to an unmanageable level or tried to move in or out of property at the wrong time of the cycle without good advice.”

Timing matters

Timing is key, says Piazzetta, particularly for investors who have a short or medium-term strategy. “If the strategy is long term then the timing is not as important but the objective should always be to make as much money as you can when you buy, that is, buy the best value property you can.”

Stafford agrees that market timing is important, saying it plays a big part in turning a good property deal into an

sell when they feel comfortable with the market value of a particular property. “With this in mind you don’t need to time your entry into the market,” she says. “Ideally you would not want to purchase at the top of the cycle as you will pay top price for a property.” Investors who do purchase at the top of the cycle need to ensure that they sell when the next cycle peaks to reap the benefit of maximum growth, she says.

One way of avoiding purchasing at the top of a cycle is to study the market Australia-wide and purchase in another state or area that is not currently at the top or nearing the top of the cycle. “There will always be an area that will provide you with a good buy if your research is substantial,” says Cronin.

Weighing up the costs

In terms of the comparison of cost involved in buying and selling versus buying and holding using equity there are many additional variables that need to be studied, says Cronin.

Depending on the price of the bought and sold property, there are buying and selling costs that need to be taken into consideration. These include stamp duty, mortgage fees, building and pest inspections, agent’s commissions, conveyancing fees and the cost of any cosmetic renovations.

If you can afford to hold, then it would be “far more advantageous” to do so, says Cronin, particularly if you’re able to use the equity to purchase again. “Equity is a powerful tool,” she adds.

Ultimately, the decision on whether or not a property should be held onto is a personal one, but the fact of the 7–10 year cycle is unavoidable. “It is a fail-safe strategy unless the purchase was made in an area that does not provide the growth indicators, for example, population growth, infrastructure development and economic growth,” she says.

absolute winner. However, he believes that there is “never a bad time to buy property. How many people wish they bought into markets like Noosa Heads or Byron Bay 15 years ago and would have said then it’s too expensive or the returns aren’t high enough?”

Julie-Ann Cronin, director, The Home Straight, agrees. “There is nothing worse than looking back in years to come to see that a property you sold earlier would sell for \$X now or be worth \$X if it had been kept,” she says.

Cronin adds that buy and hold enables investors to ride the cycle and

A different perspective

“For many investors, ‘buy and hold’ means buying a good asset such as shares or property and holding it for the long term and hopefully never selling, because in general good assets always go up in value over the long term,” says Bill Zheng, CEO of Investors Direct.

Most property investors have interpreted buy and hold as ‘buy and hold properties’. Zheng says this is not quite correct and he explains why.

“Over the last 20 years, if you did not borrow money to invest, statistics show that residential properties and shares performed pretty much the same. So it wouldn’t matter whether you bought and held shares or properties – you would have achieved similar results.

However, if you did borrow money to invest, the result could be quite different. Let’s examine how a property investor makes money over time.

Did you know that an average Australian home worth \$400,000 today was valued at around \$10,000 about 40 years ago? \$10,000 in cash back then was a lot of money. But if you only needed to pay that \$10,000 back today, it would have been a lot cheaper, because money loses its value through inflation. The amount of money that could have bought a house 40 years ago could only buy a double garage today.

Imagine someone had lent you the \$10,000 to purchase a house 40 years ago, and all you had to do was to look after the interest repayment. Let’s assume the interest rate was 8% a year for the 40 year term.

The first year:

- property value = \$10,000
- interest repayment = \$800
- if inflation was 3%, the \$10,000 you borrowed is now worth \$300 less because of inflation. By not contributing \$10,000 of your own (and maybe better using it elsewhere)

Real life Investing in their retirement

Wayne Fry, 55, and his wife Vicki McLean, 49, are strong believers in buy and hold. Looking at the ever-increasing value of their portfolio it’s easy to see why.

They decided to get into property in 2003, when faced with the prospect of a financially insecure retirement, and since then they’ve purchased five properties in SA and completed a Property School course at the Adelaide TAFE.

From the very start, their goal was to buy and hold and generate passive income by letting the market work for them. “When the properties are set up correctly and the maintenance program is under control, apart from day to day management, there is not a lot to do,” says Wayne. “The major work is setting up your business plan and locating what you want to purchase. It’s like two streams of passive income, one from the tenant and the other from capital gains. No matter where we are or what we are doing the money keeps coming in.” Buy and hold had another appeal: “I did not want to work long stressful days buying and selling houses,” says Wayne.

The couple predict their portfolio will increase in value by about \$200,000 by February 2009, based on the expectation that property prices double every 7–10 years. “This is a no-brainer – it is a statistical fact,” says Wayne.

As far as Wayne is concerned, the facts speak for themselves. A property the couple purchased in 2003 for \$245,000 is already worth \$360,000. “I allow a margin of 50% of the gain to be absorbed in capital gains tax and expenses such as negative gearing, but that still leaves an in-pocket gain of \$57,000, which is a very conservative estimate,” he says.

“The four other properties display similar trends. There is no way we could have saved that amount of money in three years. With the depreciation and negative gearing taken into account the next property has been taken care of by our tax refund. We are now looking at a block of units.”

And while the couple has been tempted to sell when things have been quiet in the capital gains area, they’ve managed to stick to their long-term strategy.

“No pain, no gain,” says Wayne. “We stuck it out in line with our business plan and have no regrets. It is a pleasure to crunch the numbers and see how all the properties have improved in value. Booms are cyclical and houses keep ascending in value, say no more.”



Pros and cons of buy and hold

Pros

- lower buy and sell costs if held for longer, rather than buy and sell, buy and sell
- don't have to deal with capital gains costs until the decision to sell, well down the track. A staggered selling of properties will make the most of your personal tax situation (obtain advice from accountant when considering selling)
- unless you get the timing right, you could sell before the greatest capital growth has been achieved
- the value of a property compounds the longer you own it

Cons

- if the property is negatively geared it may be difficult to maintain personal cash flow because of commitments

Source: Julie-Ann Cronin, director, The Home Straight

you have saved this loss of \$300. This is a difficult concept to grasp, but basically your lender has just lost \$300 and you have saved \$300 by not using your own funds

- so your interest payment is really \$500 (\$800 less \$300 'profit')
- rental income at 4% is \$400
- so technically it has only cost you \$100 to hold on to your property (\$500 less \$400). If your property increased in value by 10% in the first year, you would have an additional \$1,000 in equity

The second year:

- property value = \$11,000
- interest repayment = \$800
- if inflation was 3% it would have cost the lender a further \$300 – you saved this loss on your money
- you're still paying \$500 in interest (\$800 less \$300 'profit')
- rental income = \$440 (4% of the increased property value of \$11,000)

- so technically it would only cost you \$60 (\$500 less \$440) to hold on to the property in the second year. If your property's value went up by another 10%, you would have an additional \$1,100 in equity.

We can continue the example for 38 more years, but you should get the picture: each year, mortgage interest repayments look cheaper and the principal outstanding becomes less valuable, thanks to inflation.

Let's take an example based on real data (national standard variable interest rate and the median rental yield and median price for Melbourne, over the last 30 years) from Residex and the RBA.

Assume that:

- you were renting a median price house 30 years ago and then secured a 100% mortgage on the property;
- instead of paying off all the interest and principal, you only pay the amount you were paying as rent to the lender (so your mortgage is not an additional financial burden); and
- the lender does not require you to pay any more off the mortgage and the additional money owed is accumulated into the existing loan.

The graph shows that the inflationary pressures on rent and house prices over the last 30 years mean that even if you only used your rental payments to service your mortgage, you would still have paid off your mortgage within 30 years ... and generated almost \$430,000 in equity.

The important point to understand is that money loses its value through inflation – this includes the money others have lent you.

Apart from the basic rule of supply and demand, you can probably see your profits being made in two ways:

1. over time property prices and rental values gain monetary value due to inflation. This means that they become worth more (or more expensive); and
2. over time your mortgage and repayments lose monetary value due to inflation. This means that they get cheaper.

So property investors relying on supply and demand as their only strategy would have probably missed the main reason why property investors make more money than most other types of investors – because they can leverage inflation through the effective use of mortgages.

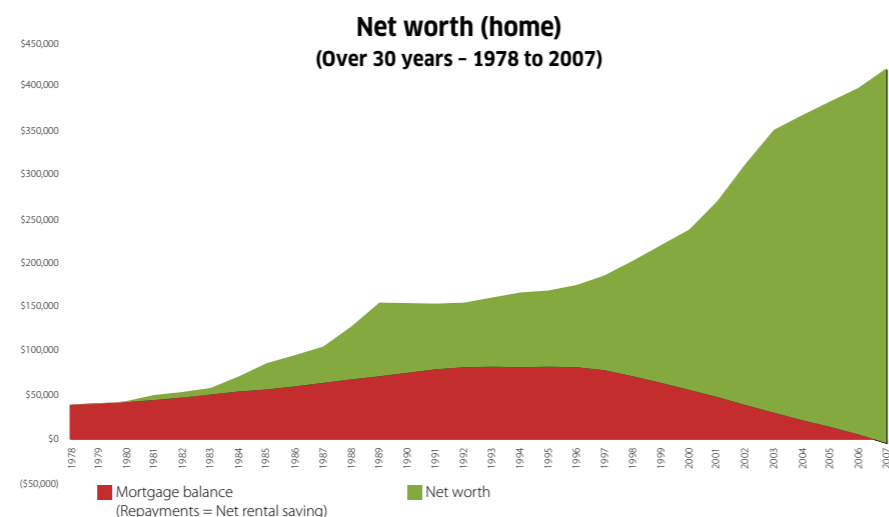
If you can find a way to effectively delay interest and principal repayments of a mortgage, you will make more money due to inflation alone.

A simple way to delay repayment of the principal is to pay interest only forever and never pay back your mortgage or sell your properties.

An effective way to delay interest repayments is to use a 'cash flow mortgage' where you can delay a portion of your interest repayment.

Property investors will make returns similar to those of other types of investors if they only buy and hold properties, but they will make a lot more money if they buy and hold mortgages (which include interest repayments).

So for property investors, buy and hold properties is not an effective strategy, but buy and hold mortgages is."



Source: Residex and the Reserve Bank of Australia

Real life

Taking the long-term view



When Damien Meyer, 30, started investing in property, he was always in it for the long term.

He's been investing in the more affordable Blacktown City Council area in Sydney's west for 18 months, and he's very keen to hang on to his properties until they make him rich.

"The way Sydney's expanding out towards those areas, it's changing dramatically," he says. "I'm buying houses on very big plots of land because I see value in them

and potential for them to go up dramatically.

"The main goal is to eventually subdivide each block of land. I'm looking at a 5–10 year period and I would like to start subdividing in the next 4–5 years as the area develops."

All of Damien's four properties were bought for under \$250,000 – the latter three within the space of 15 months. And he's since renovated each property and secured good tenants and a healthy rental return.

"I'm buying houses on big plots of land because I see ... potential for them to go up dramatically"

Buying and selling to make a quick buck is certainly not his style. "If I was planning on doing it like that I could buy a house that's really rundown, renovate it, sell it on and take the money and run. That's certainly a way of doing it. When I got the properties revalued after I'd renovated them they had all gone up in value substantially."

Damien has invested with the aid of Property Secrets, and he plans to continue working with the company going forward.

As for the future, buy and hold could well be his best option. "If the rental income from each property is still good after I've gone through the subdivision and maybe put duplexes on each one I may even hold them permanently." ■

Buying Property is a Team Effort

Maree's Team includes:

- Buyers Agent/Licensed Real Estate Agent
- Depreciation Schedule Specialist
- Financial Planner
- Finance Broker
- Conveyancer
- Builder
- Tax Agent/Accountant
- Property Management
- Tradesmen

Maree Leach has put together a one-stop shop to assist her clients with their needs. From existing property to house and land packages, Maree can help you whatever your budget!

Buying property is rewarding and can put you in charge of your destiny—just as I am.

Remember: "Hard yards reap rewards."

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