

# Property Primetime

The newsletter for informed property investors

October 2008

## October Feature Article

What is a Hybrid Investor?

**Scott Caddaye**

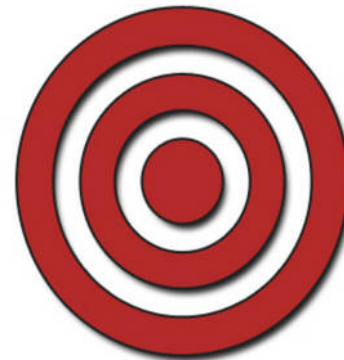
Everyone has heard of negatively geared or growth investors, and most people have heard of cashflow and positively geared investors. In this article I explore the marriage of these two opposite investor types into a new type of investor known as a HYBRID investor.

Whereas a cashflow investor accepts low capital growth in return for positive income, and a growth investor accepts high out of pocket costs in return for high capital growth, a hybrid investor is someone who is looking for the surety of a low out of pocket or holding costs, combined with an expectation of better than average capital growth. They are a classic case of wanting to have their cake and eat it too ...

*continued on page 2*

## Special Announcement

Investment Property Hotspot Suburb Predictions



I have just completed an exhaustive analysis of Melbourne and Victorian suburbs. This analysis considers median prices, rental yields, vacancy rates, 10 year historical growth, 12 month historical growth, property age (and eligibility for depreciation), Domain and Residex growth predictions, and average days on market statistics.

Surprisingly – only 5 suburbs feature with strong growth and yield predictions in each of the following brackets:

- Houses between \$250k and \$350k
- Units between \$250k and \$350k
- Houses between \$350k and \$450k
- Units between \$350k and \$450k

The output of this analysis is available free to all of my clients.

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## What is a Hybrid Investor?

I have always been a hybrid investor and have selected each of my properties first and foremost on their ability to minimise my out of pocket costs. Don't get me wrong – none of these are your typical cashflow properties (eg. student accommodation or old houses in country towns) – they are a range of units and houses in suburban Melbourne which cost me (on average) between \$1,000 and \$2,000 out of pocket each per annum. The other important benefit that each of these properties promises, is the expectation of better than average capital growth (and indeed one has already grown by just on 50% in only a two year period).

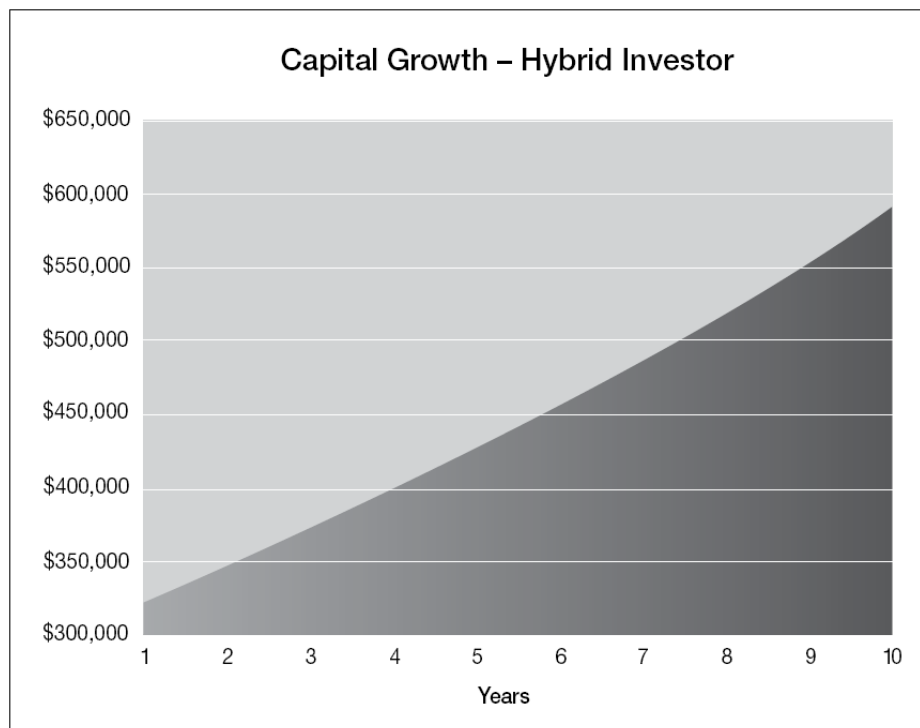
The following excerpt from my book – “The First Timer’s Guide to Australian Property Investment” – explores a typical example of how hybrid investing can work:

The example below shows a 30-year-old house (not eligible for depreciation claims) purchased for \$300 000, with a loan for 80 per cent of the purchase price (\$240 000) at 8 per cent p.a.

RENTAL INCOME	\$17 160
– Loan repayments	–\$19 200
– Ongoing costs*	–\$3 820
= NET CASH LOSS	–\$5 860
+ Tax return (at 31.5% inc. Medicare)	\$1 846
= NET CASH FLOW p.a.	–\$4 014

Although this investor is losing money every year, the amount is not significant (less than \$80 per week) so they are less dependent on long-term capital growth. Given their focus on buying a property in an area with reasonable growth potential, they will most likely experience an average capital gain to offset the losses they are making.

For example, a property purchased for \$300 000 and growing at 7 per cent p.a. over 10 years will have appreciated by \$290 145 to a new value of \$590 145.



Along the way it will have cost an additional \$40 140 (\$4014 x 10 years) to hold. Total gain (before capital gains tax and selling costs): \$290 145 – \$40 140 = \$250 005.

The reduced ongoing holding costs (out of pocket costs) diminish the risk you might be forced to sell early or in a flat market. If you decide to hold the property for the long term—it is still bringing in a good income and will eventually turn cash flow positive as the loan is paid down and rents rise. If you decide to sell, you will get the benefit of an average to good capital gain. As you can see, the hybrid investor has more flexibility and lower risk than either the cash flow or growth investor.

# A Close Encounter of the Share Market Kind

**Scott Caddaye**

Despite my passion for property investment – there was a time (exactly 12 months ago) where I seriously considered a complementary investment in shares. However, after detailed analysis and consideration of all options available to me, I decided that shares were not right for me.

## **WHY DIDN'T I INVEST IN SHARES?**

1. My number one fear was that of encountering a crash, or it's more commonly encountered friend - the "negative year" that fund managers and brokers talk of in the share markets. I heard stories of it being reasonable to expect a negative year (or two) once every 5 or 6 years ... and as at Oct 2007 we had enjoyed approximately 5 positive years. I couldn't see why a person would choose such a bad time to get into shares (to me it was like investing in property after a boom that had been going for a record breaking length of time).
2. Number two was my inability to deal with the fluidity of shares. Property price growth can sometimes slow – or even stall – but it rarely goes backwards for long or by any significant margin. Share prices on the other hand looked like a yoyo by comparison – with significant increases and decreases just part of the "game".

Before I made my decision NOT to invest in the stock market, I consulted with a broad range of people including those with considerable investments in shares. No matter how many happy share investors that I spoke to though, I just couldn't bring myself to take that step into the share market. Instead – I decided to simulate a \$100k share investment and sit back and see what would have happened if I had been brave enough to take the plunge.

## **WHAT WAS IN MY SIMULATED SHARE PORTFOLIO?**

I wanted to explore several different scenarios – so I prepared the following investment groups:

- A. The blue chips – comprised mostly of top 50 and top 200 Australian companies
- B. A combination of blue chips with hand picked "larger" companies that promised high yields and better than average growth
- C. A simple purchase of an index fund (such as ASX/S&P 50 – SFY and the ASX/S&P 200 – STW)
- D. A more speculative purchase of the top 15 commonly tipped growth stocks for the coming year

## **SO HOW MUCH WOULD MY \$100k HAVE BEEN WORTH 12 MONTHS DOWN THE TRACK?**

It will come as no surprise to learn that my \$100k would have taken a considerable hit in the 12 months from October 15 2007 – October 15 2008. Here are the results:

- A. The blue chips eroded my \$100k down to just over \$50k – losing me half of my money
- B. The blue chips and hand picked combination saw me slightly worse off with just under \$48k left remaining
- C. The better of the two index funds (ASX/S&P 50) left me with nearly \$60k (still a 40% loss)
- D. The "Hot Tip" stocks lost me over \$70k – leaving me with a miserable \$30k remaining (interestingly – two of these hot tips went into liquidation some time ago and are now worthless)

## **PROPERTY VERSUS SHARES:**

If I had invested in shares – my best case scenario would have seen me lose 40% of my money in 12 months. Now I am the first to admit that this is a spectacularly bad 12 months to use for the basis of comparison – but it is a true and fair indication of what can (and periodically DOES) happen with shares.

In that same 12 month period – each of my investment properties increased in value by between 10 and 20%.

I realise that in the long run shares will provide similar returns to property – but it is the crazy rollercoaster ride they take on their way that makes them just too scary for me to ever seriously invest in.

## NEWS HEADLINES

13/10/08

### **Westpac 3 year fixed rate - an amazing 6.99%**

Not content with their already market-leading fixed rates - Westpac has this morning slashed up to another 1.1% off their fixed rate home loans.

The new rate for a 3 year home loan is now just 6.99% - representing the lowest 3 year rate in over two years. The 1, 2, 4 & 5 year rates have all dropped as well - to a very tempting 7.19%.

These dramatic drops will almost certainly end the record low uptake of fixed loans that we have been seeing over the last 3-6 months. Fixed rate loans fell out of favour when the variable seemed destined to keep on rising - but the sudden reversal of the variable now sees the fixed rate racing downward at an accelerated rate.

These dramatic rate drops, coupled with record population growth, record low vacancy rates and large increases in rent returns, clearly demonstrate that the bottom of the property market is now behind us and we have entered a new period of upturn and growth.

07/10/08

### **Reserves Slashes 1.0% from Official Interest Rate**

In a move more drastic than any we have seen in over 16 years - today the Reserve Bank slashed 1.0% from the official interest rate. Whilst experts and analysts debated the likelihood of a 0.5% cut (against the less likely 0.25% reduction) - NO ONE (with the possible of the Reserve themselves) saw anything like a 1.0% cut coming. Although, there was one bank that just might have anticipated a cut this big - and that is Westpac. Just 3 weeks ago, Westpac slashed their fixed rate loans to levels not seen for around 12 months (a sure sign of their belief that the variable was going to drop ... and drop fast).

The last time rates moved down at such an accelerated rate was August 1994 (when the official rate dropped from 7.0% to 5.5%).

This is "champagne cork-popping" news for struggling home owners, and should provide a significant impetus to any intending property investors.

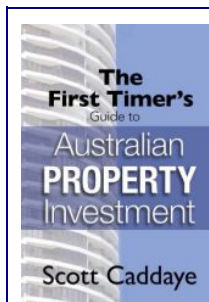
30/09/08

### **Buyers Advocates and Buyers Agents – the new spokespeople of the real estate industry?**

Buyers advocates have long been seen in print in investor magazines such as Your Investment Property and Australian Property Investor – generally offering balanced and unbiased advice on topics ranging from where to buy and what to buy, to how much to pay and how to negotiate the best deal. However, in recent weeks they have started to pop up in more mainstream media as virtual spokespeople for the real estate industry.

It has now become the norm for the Melbourne Sunday Age to interview multiple Buyers Agents on the results of the auctions of the previous day. Buyers' Advocates are also being interviewed on prime time television (David Morrell was on Melbourne's Today Tonight just last night).

With over 60% of home purchases in the United States being managed by a Buyers Advocate, it now seems that the Australian real estate industry is starting to embrace these relative newcomers onto the Australian scene too.



After a series of radio interviews and associated promotions, I am pleased to say that "The First Timer's Guide to Australian Property Investment" has been launched and is now widely available from both online and shop-based book retailers Australia-wide.

This month's feature online retailer is TheBusinessMall – who are selling my book for \$22.95 (inclusive of postage Australia-wide).

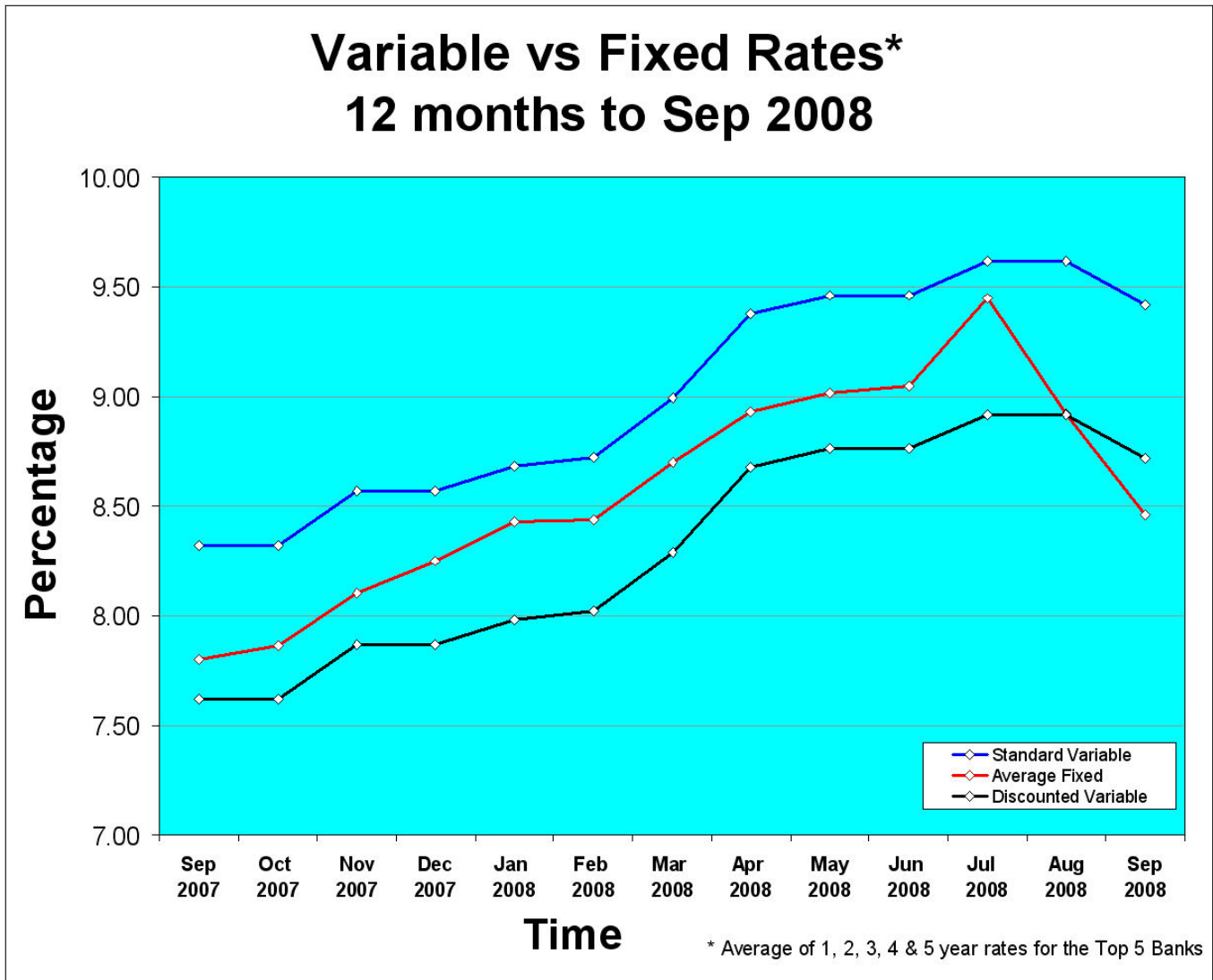
<http://www.businessmall.com.au/store/viewItem.shop?idProduct=378>

30/09/08

**Fixed rates sprint past the variable in a downhill race to the bottom**

In the July – Sep 2008 quarter, the variable rate has dropped a meagre 0.25%. In that same span of time though, fixed rates have dropped by up to 1.5% - more than 6 times the reduction that we have seen in the variable.

The average discounted variable rate as at Sep 30 2008 is 8.72%, but the average fixed rate is just 8.46% (and in some places as low as 7.99%). This is the first time in well over 12 months that the average fixed rate has been lower than the average discounted variable – a sure sign of where the banks believe the variable is soon to go (down ... way down).



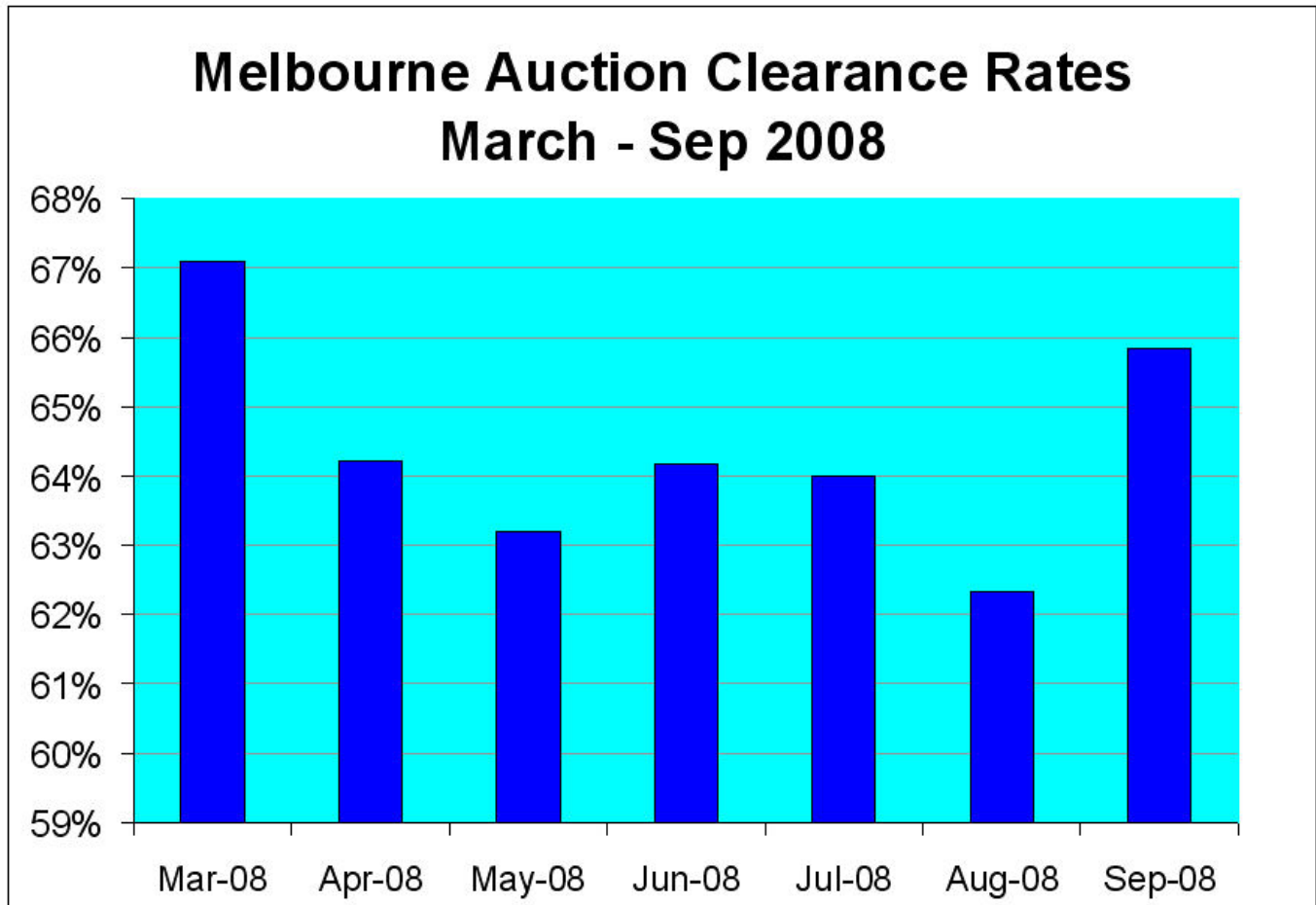
As a Buyers Advocate – I see the impact of this on the ground when searching out deals. Where two or three months ago I could buy the optimum property in a suburb with little or no competition, I am now having to out-bid (or act extremely quickly) to steal a march on the growing number of buyers and investors that are starting to return to the market.

30/09/08

**August record low in Auction clearance rates replaced by September record high!**

What a difference a month can make. In August we experienced a 6 month low in Melbourne auction clearance rates – with the average clearance rate for the month dropping to just 62%. Now, as we move into a traditionally stronger Spring selling period (fuelled by interest rate cuts and the promise of more to come) – we see the September Melbourne auction clearance rate climb to a 6 month high of 66%.

Whilst still not at the levels we saw at the start of 2008, it is a positive sign for those holding property or selling property. For those looking to get into the Melbourne property market – the sooner you talk to your Buyers Advocate the better.



As a Buyers Advocate myself, I am having to work twice as fast now to unearth the optimal properties for my clients quickly – before the competition arrives and turns a great buy into an average one (forcing me to move on and unearth the next gem before anyone else gets to that one).

## NEWS HEADLINES (CONTINUED)

**28/09/08**

**Attention all intending property investors – the bottom of the Melbourne property market has happened? If you blinked, you may have missed it.**

For anyone still waiting on the sidelines contemplating when might be the right time to enter the Melbourne property market – I have good news and bad news. The bad news is that the right time was probably a couple of months back. The good news is that most people haven't realised this yet, so there are still plenty of opportunities to bag a property bargain before the masses return to the market.

We have just come through a period of records including record low vacancy rates, record low auction clearance rates, a record run of 12 consecutive interest rate increases and record population growth. We are now entering a new period where house prices that have been flat are starting to grow again, where fixed interest rates are returning to levels not seen in over 12 months, where auction clearance rates are back on the rise – and where demand for rental accommodation remains at previously unseen levels (driving rents ever higher).

As a Buyers Agent – I see the impact of all of these positive indicators on the ground when searching out deals. Where two or three months ago I could buy the optimum property in a suburb with little or no competition, I am now having to out-bid (or act extremely quickly) to steal a march on the growing number of buyers and investors that are starting to return to the market.

With share prices all over the place right now - there has never been a better time to lock in some consistency and stability by turning to bricks and mortar.

**16/09/08**

**Westpac SLASHES Fixed Rates – knocks even the online lenders off their perches**

In the same time that they have delicately trimmed their variable rate by a barely noticeable 0.25%, Westpac has taken an axe to their full suite of fixed rate loans with massive cuts across the board.

Online lender One Direct has been the leader in low fixed rates for over 12 months – but Westpac has now knocked them off their throne in the two, three, four and five year loans (with Westpac rates up to 0.4% below the online lender's best effort).

Westpac's fixed rates have dropped back to levels not see for almost 12 months, with their three, four and five year rates now at a bargain basement 7.99% (for borrowings over \$150,000).

***“Picking the bottom of the property cycle is a difficult task, but in all likelihood the residential property market has now passed through the lowest stage of the cycle.”***

***“The peak buying conditions that have been evident for most of 2008 may soon be over; the window of opportunity is starting to close. More buyers means more competition which means less time to consider a purchase and less leverage when negotiating. In all likelihood, the latest interest rate cut has highlighted that residential property is more than likely through the eye of the storm.”***

RPData – October 10, 2008

## TOP 5 REASONS WHY PROPERTY IS BETTER THAN SHARES

1. YOU CAN BORROW MORE AGAINST PROPERTY THAN SHARES (SHOWS THAT THE BANKS THINK IT IS A SAFER BET)
2. GROWTH IS GRADUAL - NOT AN UP AND DOWN (PROFIT & LOSS) ROLLER COASTER
3. YOU CAN NEGOTIATE THE PURCHASE PRICE
4. YOU CAN INSURE IT AGAINST LOSS
5. IT IS TANGIBLE AND EASY TO UNDERSTAND (WE ALL LIVE IN PROPERTY)

## BONUS TOP 5 QUOTES FROM MARCUS PADLEY (STOCKBROKER & AUTHOR)

1. "VOLATILITY HAS REDUCED THE MARKET TO A CASINO"
2. "IT IS ALL ABOUT AVOIDING LOSSES, NOT MAKING PROFITS, AND I'M AFRAID THAT MEANS AVOIDING THE MARKET"
3. "OPTIMISM IS JUST OPTIMISM ... IT IS NOT JUDGEMENT, AND IT IS AS MISPLACED IN A DANGEROUS MARKET LIKE THIS AS BRAVERY"
4. "CASH IS A WONDERFUL THING. IT IS POWERFUL TO HAVE CASH. "
5. "IF I WAS STILL HOLDING STOCKS – YES I'D STILL SELL THEM"



### CONTACT US

At **SNAP**, we pride ourselves on always being accessible and responsive to our clients.

Please feel free to email or call and we will respond quickly and courteously.

Don't forget to take advantage of our FREE initial consultation and needs assessment - just call or email to set up a time and place that suits your needs.

### SNAP Property Buying Support

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