Australia's Leading Property Educator & Amazon Best Selling Author

How to start creating Real Wealth *through* Real Estate

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Introduction – Helen's story

If you want to make money, create wealth and be financial free *right now*, then don't read this book!

I'm not about get-rich-quick schemes. Rather, my goal is to show you how you can build a quality property portfolio and build your wealth position, without living off baked beans, as that's no fun at all.

If you're seeking quick moneymaking solutions then I want to apologise upfront, because I'll be offering nothing of the sort. I'm here to show you how to grow your asset base and improve your wealth for the long-term. I'm giving you a methodical, logical process to help you secure your financial future in a systemised way, so that you can avoid making huge financial mistakes.

Throughout this book, you will learn the secret to achieving real wealth. I will show you how a personalised investment strategy – with an exit plan to cover you for life's little hurdles – is the key to financial abundance.

I can say this with confidence because I have applied what I am about to teach you in this book myself, and I'm now at the stage where I am financially independent to do what I want, when I want, and how I want.

My favorite phrase at the moment is, "I want what I want and I want it when I want it, and it's because I can."

Before I get into the nitty-gritty of how you can create financial freedom through property, let me start at the beginning by sharing with you how wonderful I am... Ahh, I mean, my story!

Once upon a time... just kidding!

Seriously, over the last few years, my husband Ed and I have built up a real estate portfolio worth millions. We have purchased properties all over Australia, from large capital cities to small regional towns, and we have purchased a variety of properties including houses, townhouses, units and apartments.

What do all these properties have in common?

Our property acquisitions haven't simply helped us to get ahead – they've completely transformed our lives.

Let me start at the beginning...

When I first met Ed – the love of my life – around a decade ago, he had more hair and I was a couple of kilo's lighter. He worked as a corporate executive and I was employed in a high profile corporate job, working outrageous hours and getting paid quite handsomely for doing so.

Although we earned good incomes, we lived the way that most couples do, and spent all that we earned. I had a truckload of bad debt as well as sizeable car repayments, and although I worked hard and earnt good money, I felt like I deserved to "reward" myself – so I did. I treated myself to new clothes, shoes and handbags every other week, and we ate out frequently, had an active social life, and generally enjoyed our lifestyle.

The only problem we had was that we couldn't really afford the lifestyle we were keeping. We were both earning decent incomes, but neither of us had drawn up a budget or kept track of what we were earning and spending. We didn't own our own home, or in fact own any assets of any major value, other than a second-hand car. I used credit cards like they were going out of fashion, and I'd racked up thousands of dollars worth of "bad debts" as a result. And to top things off, Ed was going through an expensive divorce.

We realised that things had to change.

One weekend we decided we wanted to get out of the city and take a break, so we loaded our dogs, Molly and Jasmine, into the car and set off for a camping getaway. At that time camping was about the extent of our holidays, as we couldn't really afford much more.

That Saturday evening we sat around the campfire, sipping on a glass of red wine (or maybe two – it was cold), and we talked about our future. We discussed our plans, which included starting a family, and we talked about our eventual retirement.

We knew the type of lifestyle we wanted to live in retirement, however, when we calculated where our superannuation was headed, it worked out that we would be living off around $28,000 per year as a couple.

It was clear from these numbers that we would not retire comfortably, nor even really survive.

To add salt into the wound, having a family meant a loss of one income. We were working in the corporate world where most people spent more time and money 'looking good' by acquiring all of the status symbols possible, which demanded two full-time incomes. I watched so many colleagues come back to work so soon after having their babies, and it was heartbreaking, especially when you could see that they would clearly rather be at home.

Ed and I realised that in order to financially survive, I too would have to rejoin the workforce and become one of the many hardworking 'corporate mums' who have a baby, and then have to return to work within six months. It's something that we were both committed to avoiding, but we weren't sure how.

And so that night, we made a decision.

Right then and there, we devised a plan to invest in property for the next five years, beginning with the purchase of own home.

We raced back to our rented home the following day and sat down to do a proper audit of our finances. The reality wasn't pretty. We had a small amount of savings, which was a start, but we also had several high-interest personal debts and credit card accounts that were chewing through our disposable income. We quickly worked out that the first order of the day was clearing those debts.

I created a budget and worked out a series of payment plans to pay off our credit cards and personal loans as quickly as possible. It took quite a bit of discipline to stick to it – there was no more browsing department store racks on my lunch break – but we were committed to getting ourselves out of the precarious financial situation we were in, so it wasn't too difficult to make the necessary changes.

While we were paying off these bad debts, we were also looking to buy our first home together. We eventually found a modest and comfortable three-bedroom home in Melbourne that fitted within our price range, and we were thrilled when the bank approved our loan.

We signed the contract and handed over our deposit, and things were humming along nicely – until a letter from our solicitor gave us (me especially) the shock of our life.

The letter outlined the fees and charges that would be payable upon settlement. There were several closing costs that we hadn't anticipated, including bank fees and charges, and one massive expense I hadn't even considered stamp duty.

It was my first property purchase, and I didn't even know what stamp duty was. The result was that we were $12,500 short of being able to settle on the purchase of our new home.

I literally felt like a deflated balloon. "What are we going to do?!" I wailed to Ed. "How are we going to find another $12,500 this late in the game?"

Well, as the saying goes, where there's a will, there's a way, and so we managed to cobble together the extra money we needed by borrowing it from family. Fortunately, we were in a position where we could afford to service a little extra debt, so it wasn't too much of a burden, but it sure was a humbling experience.

It demonstrated to us very clearly that we still had a lot to learn.

When settlement day finally rolled around, we were ecstatic and celebrated with a bottle of champagne. We broke the budget a tiny bit, but we had our house. It had been just a few months since our chat around the campfire, and it really did feel like we were taking the first steps towards our financial future – and it felt wonderful.

One thing we had discovered when we purchased our home was that property is addictive. Now that we had successfully bought our first home, we wanted more!

But we also knew that if we wished to continue along this path, we needed to seek some guidance. Our first purchase had proven to us that it was all too easy to make mistakes when buying property – and when you're playing with hundreds of thousands of dollars, you really don't want to be gambling.

Some people naturally understand the difference between "good" debt and "bad" debt, and they understand the benefits and pitfalls of different investment strategies. For us, it was a long learning process.

I'd bought a handful of real estate investment books and we had attended a few seminars, but we decided it was time to take it up a level and begin seriously investing in our own financial and property education.

We started working with respected property mentors and coaches who were experienced property investors themselves, and it was with our newly-acquired knowledge and guidance that we set about purchasing our second property, which was our first investment property. This transaction ran much more smoothly, even though it settled while we were on our honeymoon, which presented its own challenges!

From there, we invested in another property and then another, and before we knew it, our portfolio had grown to include six properties worth around $2 million.

I have to admit – we were pretty chuffed with ourselves. In just a few short years, we'd gone from being broke and in debt to owning half a dozen properties, including our own home.

And yet, we had so much more to learn.

Even with all that we had achieved, we still hadn't discovered so many of the rules and strategies that successful real estate investors live and breathe by.

We didn't understand the concept of "cash flow" properties, and in fact didn't know it was possible to own positively cash flowed property – where the rent exceeds the mortgage and other property expenses.

We'd never entertained the idea of partnering with other investors in a joint venture.

We didn't know about depreciation, which as we found out was a tax gold mine that we had been missing out on.

And although we'd set some specific goals for our investing, we didn't know quite how we were going to achieve them.

Throughout this period, we continued to attend seminars and workshops and surround ourselves with positive, knowledgeable investors, so we could absorb as much as we could about investing in real estate.

In total, I estimate that Ed and I spent around $100,000 educating ourselves in different investment strategies, and the right and wrong ways to invest in property.

Most of our family and friends thought we were crazy, especially when in our early days of investing, we forked over around $20,000 for one of our more expensive mentorships – money that we had to borrow – but we still feel it was absolutely the best money we've ever spent.

Our outlay has been returned to us many times over, because without this education, we would have made even more mistakes than we did. We were fortunate that we had been able to recover from our stamp duty mishap – but what if we'd bought a more expensive property, and miscalculated by $30,000? Or $100,000? We would have been broke before we had even started.

For us, investing in our own education has been, without question, the key to our success.

During the accumulation stage of our investing we had continued to keep things simple and live life relatively cheaply, in order to service our growing property portfolio. On weekends, we would still grab the camping gear and head out bush for a few days.

And then after six properties our property investing momentum came to a sudden grinding halt. Out of nowhere the banks just stopped lending money to us. We had hit the proverbial "financial brick wall", because in the eyes of our lenders we had too many loans and as such posed too high a risk for them. Even though we could afford to make the repayments on more loans, they simply weren't willing to extend any further funds our way.

Not to be deterred, we started to learn more about risk and how the banks really operate. The result was that we fine-tuned our approach.

We began researching joint ventures and positive cash flow properties, and before too long, we'd added six more positively cash flowed properties to our portfolio in the space of six weeks. This pacified lenders who became suddenly happier to sign off on the loans and continue doing business with us.

Fast forward a few more years and we now have a diverse, balanced portfolio of capital growth properties and positive cash flow properties, including a mix of apartments, townhouses and houses located all over Australia. Our focus is very much on spreading our risk.

We've learnt over the years through trial and error, and today, we enjoy the lifestyle that comes with owning a multimillion-dollar property portfolio. We live in our dream home in a suburb of Melbourne (which we paid for in cash). We haven't been camping in quite some time…they've been replaced with overseas trips to Europe, Asia, the United States, and my favorite, the South Pacific – who doesn't love the tropical islands, with their crystal blue waters, sandy beaches and delicious cocktails!

I still love to shop for shoes, handbags and these days, diamonds, but I don't have to go into debt to have them. Our newfound wealth has to a large extent given us the freedom and flexibility to enjoy life on our own terms.

In 2009, we were over the moon to welcome a new addition to our family – our beautiful baby girl, Alexandria! And the absolute best part is, neither of us had to go back to work. Both of us now have the time to spend at home watching her grow and blossom, without worrying about money or fretting about going back to a job we don't like.

Having a balanced portfolio has allowed us to replace our job incomes, so that we don't need to work another day job in our lives. How cool is that!

When you no longer need to work a day job any more, the question is what do you do with your time? You can play golf or tennis but after a while, you feel the need to do something more meaningful. We chose to launch Real Wealth Australia because, as a result of our success, friends and family members started asking us for advice on how we did it.

We get a huge amount of joy out of seeing other people succeed, so we began with the intention of educating and guiding other investors through the property investing journey.

Now, with this book, I hope to continue the process. I want to provide you with all of the information and guidance you need to move forward on your path towards real wealth. Whether you're just starting out and you're looking to buy your first investment property, or you're an experienced investor keen to brush up on your knowledge, you're sure to learn strategies and ideas in these pages that you can apply to your own situation.

I've created this handbook as a complete guide to property investing, in much the same way that our mentoring programs are structured, so you can dip in and dip out and read at your own pace.

I want to make it as easy as possible for you to learn everything you can about property investing, so that you not only understand what to do and how do it, but also how to put all your learnings into a **positive action plan**.

Let's get started!

[breakout box]
Are you a hedgehog or a fox?

In his famous 1953 essay, "The Hedgehog and the Fox", philosopher Isaiah Berlin divided the world into two distinct categories: hedgehogs and foxes.

His essay was based upon the ancient Greek parable, "The fox knows many things, but the hedgehog knows one big thing."

The fox is a cunning creature that is able to devise many complex strategies to sneak up on the hedgehog. Foxes build their knowledge and skills by drawing on a wide range of experiences, and they tend to know a little about a lot.

Hedgehogs, on the other hand, view the world through the lens of a single defining idea. Rather than knowing a little about many things, they know a lot about one thing.

In Jims Colllins' book 'Good to Great', he references the story of the hedgehog and the fox when discussing great leaders.

"Day in and day out, the fox circles around the hedgehog's den, waiting for the perfect moment to pounce," Collins writes.

“Fast, sleek, beautiful, fleet of foot and crafty – the fox looks like the sure winner. The hedgehog, on the other hand, is a dowdier creature, looking like a genetic mix-up between a porcupine and a small armadillo. He waddles along, going about his simple day, searching for lunch and taking care of his home.

“The fox waits in cunning silence at the juncture in the trail. The hedgehog, minding his own business, wanders right into the path of the fox.

“’Aha! I’ve got you now!’ thinks the fox. He leaps out, bounding across the ground, lightening fast. The little hedgehog, sensing danger, looks up and thinks, ‘Here we go again; will he ever learn?’

“Rolling up into a perfect little ball, the hedgehog becomes a sphere of sharp spokes, pointing outward in all directions. The fox, bounding towards his prey, sees the hedgehog defence and calls off the attack. Retreating back to the forest, the fox begins to calculate a new line of attack.

“Each day, some version of this battle between the hedgehog and the fox takes place, and despite the greater cunning of the fox, the hedgehog always wins.”

Essentially, this story illustrates the different ways in which we view and interact with our world. Foxes have a scattered, continually evolving their approach, and they become a jack-of-all-trades, but a master of none. Hedgehogs are able to simplify their complex world into a single, organising idea – in Collins’ words, they can “see what is essential, and ignore the rest”. They can learn how to do one thing, and do it very well.

So which one are you: a hedgehog or a fox? And which mindset do you believe will lead to a more financially successful future?

For the record, I’m a proud hedgehog.

Chapter 1 – Your credit profile

I’m about to let you in on a little secret about investing in real estate that most people don’t know.

A lot of people, including seasoned investors, think that property is all about bricks and mortar, but that’s really an illusion.

Property investing is actually about finance, because your ability – or lack thereof – to secure finance is what ultimately allows you to buy real estate.

I talk with so many investors on a weekly basis that are full of questions and concerns about where they should invest in real estate, where the hotspots are, and what types of properties they should buy, but they’re jumping a little ahead of themselves. They’re asking these questions before they’ve worked out how much they can borrow, or whether the banks will even provide them with finance

The truth is, without access to funding from banks and/or other lenders, your property investing journey is dead in the water before it’s even begun, so it’s vital that you understand finance. It really does hold the key to your success as you work to build your property portfolio.

To truly understand how banks operate and how they make decisions about furnishing you with funds, you need to start at the very beginning… with your own credit profile.

Your credit profile or credit report is the document that banks and financiers refer to, to check whether you represent a “good” or “bad” risk to them… financially speaking. That is whether you are likely or not meet your repayment commitments if they lend you money.

Each and every time you apply for finance, whether it is for a credit card, mobile phone plan or home loan, an entry is made on your report.

The keyword here is “apply”. An entry is made on your credit profile every time you *apply* for finance – not those times that you are approved or rejected, but when you submit your application for finance.

As well as credit applications, information about how you mismanage your accounts with various providers is also included on your credit report. The failure to repay bills such as utilities, phone bills, loans, credit cards and mortgages is all logged.

Do you consistently pay your bills on time, or are you more of an “I’ll wait for the second notice to roll around” kind of person? How promptly you pay your $120 mobile phone bill might not seem like a big deal at the end of each month, but this could actually be the difference between you being approved or rejected for a home loan!

Remember when you graduated from high school or university, and you received a transcript of grades for all subjects taken. Think of your credit profile as a report card for your finances… it’s basically a transcript of your personal financial history.

As a guide, note that your credit file can contain the following information:

- Personal details such as name, residential address, date of birth, driver's licence number
- Credit applications and enquiries you have made during the past five years (the file records *applications* for credit, not actual *approvals* of credit)
- Notation that a credit provider with whom you have a credit account is a "current credit provider"
- Overdue accounts (defaults) which may have been listed against your name
- Public record information such as:
  - directorships and proprietorships
  - bankruptcy information
  - judgments and court writs

All lenders, and in fact any companies that provide you with credit, will evaluate you in terms of the risk of you not paying them back. This is as true of your bank as it is of your mobile phone provider or electricity supply company. To help them make this decision, they will look at your credit file for evidence that you have a good credit history.

Considering how important your credit report is, I'm always shocked to learn just how few investors have a copy of their own Credit Report, or know where to get a copy of it – or even know that such a report exists! I'd estimate that of all of the property investors that I've dealt with over the years, around 95% of them have never seen their own credit report, let alone understood it.

The fact is, a bad credit rating can have long-lasting impacts on your ability to invest in property. Not only can it adversely impact on your borrowing capacity, it can also mean the difference between being eligible for loans with reasonable interest rates and charges verses loans with hefty interest rates, fees and charges.

HEDGEHOG FAST FACT: Overdue accounts are listed on your credit report as a payment default, and even when they're fully repaid, they remain on your file for five years from the date of listing. A payment default is an account of $100 or more that is 60 days or more overdue. For example, if you have a telephone bill of over $100, and it was due more than 60 days ago, it could be listed on your credit file as a payment default.

When credit report's attack

Your credit report can make or break your property investing career, as it can significantly influence how much finance you have access to.

It reminds me of a young woman I met at a property expo. Jessica was in her 20s, working in a great marketing job, and she was very passionate about real estate. She was keen as mustard to invest in her first property. Unfortunately, though, her story was a prime example of how decisions made early on can linger for years to come.

"I'd love to begin investing in real estate, but my biggest challenge at the moment is my bad credit rating," Jessica told me. "I honestly don't know where to start to try and rebuild it, and I feel like I'm never going to get ahead with this burden on my shoulders."

In her own words, Jessica had been "incredibly naïve" with her spending habits in her younger years. At the age of 21, she decided to buy her first car – she promptly fell in love with a shiny, brand new hatchback at her local car dealership, and had to have it!

The salesman assured Jessica she'd be a shoe-in for finance on the car. Of course, the finance company he recommended was in cahoots with the car yard, and would give the salesmen a decent commission for every new finance customer he signed up – but Jessica wasn't to know any of this.

Besides, the repayments of $450 per month seemed affordable. It was a little over $100 per week and Jessica was living at home paying $50 per week rent, so she felt it was a manageable expense. At the time she was earning $27,000 per year in a graduate-entry marketing assistant job, and taking home around $1,800 per month, but that was set to increase each year as she was promoted up the ranks in her company.

The car she was buying was worth $17,000 – which became $18,500, including on-road costs and registration – but with finance, Jessica would pay $27,000 for the car over the next five years, including interest. That was equivalent to her entire year's salary, before tax!

Jessica signed on the dotted line and was soon cruising home in her brand new car.

And then, the proverbial hit the fan.

"Shortly after buying the car," Jessica recalls, "I was made redundant – and it sent me into a total tailspin!"

She had no savings, and couldn't borrow money from anywhere. Her parents weren't in a position to help out, and she struggled to find another job in her industry.

Jessica ended up taking a casual waitressing job to help pay the bills, but she couldn't keep up with her car repayments. "About a year after I bought the car, it was repossessed," she says.

It's only now, several years later, that Jessica fully understands the impact of that situation.

Today, she has a relatively secure corporate job and she's earning six figures. She has no personal debts and has $60,000 in the bank, so she's ready to buy her first property – but with her tattered credit rating, the banks didn't want to know her.

One week after meeting we sat down at my office and discussed her position. I discovered that she'd never actually seen her credit file, so we ordered a copy of her credit report online straight away – we needed to know what we were dealing with.

Within 24 hours, we had her full credit report in our hands, and we were able to go through it line by line to unearth her true credit profile.

We discovered that, yes, as expected, Jessica had a big, fat blemish on her credit rating as a result of her car finance nightmare. But we also saw that her ugly credit smudge was due to drop off of her credit profile in around 12 months time, as only the last five years' worth of transactions were kept on the file.

Since the car incident Jessica had been able to demonstrate that she had developed more positive financial habits and had in fact been able to save a substantial deposit on an investment property. This and her good income from a stable employer were important factors that were very important for lenders when considering her for a loan.

In her current situation, she was still what banks would consider to be a riskier candidate than, say a borrower who had applied for a loan with a completely clear credit record – but in 12 months time, Jessica would be in a better position as she would be able to apply for a loan with a completely clean credit file.

Over the next year I coached Jessica through the process of educating herself about real estate and sourcing properties that suited her investment strategy. At the end of 12 months, she'd saved an additional $12,000 and went on to purchase two investment properties!

If Jessica and I hadn't met at the home expo, and she'd never checked her credit report as a result, who knows how long she would have waited around before buying her first property?

Pre-approvals and your credit profile

So exactly how is the information in your credit report developed?

Your credit file is initiated the very first time that you apply for credit, whether you're signing up for a mobile phone contract or applying for a car loan.

It is gathered by credit reporting agencies, and contains information that is available in the public domain and which is obtained from public authorities. If you defaulted on any loans or failed to pay any bills – regardless of how big or how small the amount is – then an entry can be made in your report.

As a guide, your credit profile can include information such as:

- Credit applications and *credit enquiries* you have made during the past five years
- Records of current credit accounts

- Overdue Accounts, known as ‘Defaults’, that are listed against your name
- Bankruptcy information
- Court judgments
- Public record information such as Directorships and Proprietorships

You can see here how the story of the hedgehog and the fox comes into play again. Hedgehogs tend to play it simple, they opt for fewer personal loans and credit cards, because they like a simple, easy-to-manage roster of debts.

Foxes, on the other hand, are always looking for the “bigger better deal”: the low-interest credit card, or the balance transfer deal that helps to consolidate debts. They’re constantly trying this and that to find the solution to their problems, rather than sticking with one proven (albeit boring) method of attack. The result can be a chaotic credit profile peppered with entries.

As mentioned earlier, a note is made on your credit file every time you enquire about making an application for credit. If you apply for a credit card, for instance, that will be entered into your credit report. This is where people can get into trouble.

If you’ve ever applied for a home loan before, you’ll be familiar with what banks call “pre-approval”. This is when you compile all of your information, put an application in with your bank, and they input your data into their system.

They then advise you that in principle your loan has been pre-approved, provided that is that all of your records and references check out, that the value of the house you’re buying stacks up, and that your financial situation doesn’t change between application and settlement (for instance, you don’t lose your job).

Pre-approval gives you the ability to set a realistic price range, and provides you with the reassurance that you may need to confidently shop for property in the knowledge that your finance is essentially sorted.

Here's my problem with it.

Let's say that you fill out your application and send it off to your bank for pre-approval. The bank processes the application, and is pleased to offer you approval for a loan up to $250,000.

The only problem is, you've found a property that you want to buy but you need to borrow $300,000. When speaking with your bank previously they had advised you that this amount was pre-approved, so you call them to find out why the approved amount was only $250,000.

Your bank advises that the problem is the level of personal debt between you and your partner and that this stems from the fact that you have five joint credit cards and personal loans with credit limits totalling $45,000.

The month before applying for a mortgage, you had tried to shape up your finances by transferring two credit cards onto one new credit card account, which offered a low balance transfer for twelve months. Before that, you had six personal debts totalling $52,000 – you had tried to get your accounts in order, but clearly it wasn't enough!

So, you re-evaluate. Of your five remaining personal loans and credit cards, two are credit card accounts that you'd like to keep open for "emergencies". On one of these cards you owe practically nothing, and on the other the debt is around $500, so you reduce both of the limits to $1,000 each.

Now, you still have five credit cards and personal loans, but the total credit limit has been reduced to $38,000. You re-submit your application to the bank and they revise their pre-approval – up to $280,000.

Close, but no cigar! You're still $20,000 shy of your desired loan amount.

A friend recommends that you speak with their mortgage broker, as he helped them get their finance over the line a few months earlier. You meet with him and he tells you that your bank is notoriously conservative with mortgage LVRs (loan to value ratios). Even though you have a 20% deposit, your personal debt is making them uncomfortable. So, your new broker recommends that you apply with a different lender that has more relaxed lending rules.

Let’s recap. In the last six weeks, your credit profile has recorded the following – you have:

- Applied for a new credit card
- Been approved for a new credit card
- Transferred the debt from two existing credit cards to your new credit card account
- Closed two credit cards
- Been pre-approved for a home loan of $250,000 with Bank A
- Reduced the limit on two credit cards
- Been pre-approved for a home loan of $280,000 with Bank A

And after all of this activity, you are about to apply for pre-approval a third time with a new lender, Bank B. You have a solid deposit and, now, a consolidated level of personal debts, but the high level of “pings” on your credit report could make Bank B nervous. If they offer you pre-approval for $300,000, you’re in business – but what if they turn your application down? You then have another credit enquiry entered onto your credit report, and a credit rejection. How do you think the next lender you approach is going to treat your application?!

According to Australia’s largest credit reporting agency, Veda Advantage, credit providers each have their own lending criteria. Hence, they will each attach different degrees of importance to the information in your credit file and in your application, depending on the level of risk they wish to take when deciding whether or not to approve your credit.

To your initial bank, keeping your personal debts and credit cards to a minimum was important, but that may not be the case with your new lender.

They might be more interested in stability and security – in which case, an erratic recent financial history may serve against you.

This is why I firmly believe that you need to get all of your ducks in a row before you even consider making a single loan application.

Even if you plan to apply with your own bank, I recommend that you engage a qualified and experienced mortgage broker. I guarantee, they will be your biggest assets when it comes to investing in property!

Your mortgage broker should be able to help you to shore up your finance application so that you have the best possible chance of it being approved first time up. They're the ultimate hedgehogs. They spend each and every day building their lending expertise with various banks and lenders. They understand the lending rules, procedures and policies that each lender operate under better than most.

They do all of the loan shopping for you, and they find the best deals on the market for you and your situation – without needing to put your credit profile at risk every time they find a better loan opportunity.

Once your application is perfectly polished, your broker will guide you towards the best lender for your situation.

Rather than submitting applications and enquires here, there and everywhere, you apply for pre-approval with one just lender, one time only – so just this one entry will appear on your credit file report.

HEDGEHOG FAST FACT: Credit applications and enquiries, overdue accounts, payment defaults and court judgments are held on your file for five years. Bankruptcy Act Information is held on your file for seven years.

Dealing with errors and fraud

Every few months or so, a story pops up on a nightly current affairs program that shows a customer fighting with their bank or a telephone company over an overdue account.

Usually, the bill amount is ridiculously low, and at the centre of the dispute is the fact that the giant multinational company is taking the customer to court over the amount.

We've all seen the stories, right?

They're so absurd that they're almost laughable, but the reality is that it only takes one entry against your name in a Credit Report to cause long-lasting damage to your credit rating. It doesn't matter whether the default relates to an amount of $150 or $200,000, it's the fact that a default is listed at all that will work against you. As a reminder, you only need one account of $100 or more to be 60 days overdue for a payment default to be recorded on your credit file.

I've spoken to many people over the years that have applied for finance and were declined, and they never knew why. Their credit report could be the culprit, particularly as errors can slip through on your report that you're never aware of.

If you don't know what your credit profile looks like, you can't take action to have an error rectified – and while it remains on your report, it can impact your ability to borrow. This happened to me.

In my younger years, I was a little irresponsible with credit cards and personal loans, and I was tardy in paying these debts on time. At one point, I even had a debt collector knock on my door wanting to repossess my car if I didn't pay up. Until that point I didn't fully understand the impact of my flippant behaviour, so it was the wake up call I really needed.

I finally got my act together and began behaving more responsibly with my money. In my eyes, though, the damage was done: I thought that my credit rating was shot and I'd never get a loan. I didn't even try to buy my own home for years because I was too scared to apply for finance, as I thought I would be declined. I never knew I could obtain a copy of my credit report to see for myself what was actually on it – and I hadn't realised that it only contains the last five years' worth of information.

HEDGEHOG ACTION ITEM: It's vital to keep an eye on your credit report, as even the slightest negative entry can impact your borrowing power for years to come.

You can obtain a copy of your credit profile completely free of charge from the credit-reporting agency Veda Advantage Information Services and Solutions, which is the same company that banks and lenders turn to when they need to confirm the financial behaviours of loan applicants.

To request your credit file, you will need to visit www.mycreditfile.com.au and provide the following information:

- Full name
- Date of birth
- Driver's licence number
- Two forms of identification, including:
    - A copy of your driver's licence, passport or birth certificate
    - A document issued by an official body that clearly shows your name and address, such as a rates notice, utility bill or bank statement
- Current residential address and previous residential addresses
- Details of your current or previous employer
- The name of the organisation with which you most recently applied for credit
- A daytime telephone number
- Your signature

After you have compiled all of the above information and sent in your request, a copy of your credit file will be dispatched to you within 10 working days. It is possible to fast track your request by paying a small fee, but it's important to note that you can only request a copy of your own credit file.

Another issue is fraud. Identity Fraud costs the Australian community billions of dollars each year, as technology is making it increasingly easier for someone to steal your personal details and use that information to gain credit, cash, goods or services.

Keeping an eye on your credit report is one way that you can monitor your financial records and ensure that no one else is taking advantage of your good name.

HEDGEHOG FAST FACT: Identity Fraud costs the Australian community around $2.2 billion a year. To learn more about identity fraud, credit card fraud, or rectifying errors on your credit report, visit www.mycreditfile.com.au

[Case study] Dealing with unexpected errors

Jenny Nottingham was conscientious with her finances and did everything by the book – so she was shocked when she discovered that her credit profile showed a relationship with a bank she'd never even banked with!

"I'm diligent at paying off my debts, including my credit card on a monthly basis, so the last thing I expected was a credit problem," Jenny explains.

"But there it was, in black and white – I reportedly had an ongoing credit relationship with a bank that I didn't even recall having an account with!

"Oh my word, what had happened? Had I forgotten some account? Had I been reckless with my account details? Was I the victim of some fraud? The entry was made 15 years ago – anything could have happened!

"Well, denial did not move me any closer to an answer, so I swallowed my pride and called to find out what was going on. Now, I'll admit, having a sensible conversation with call centre operators about an unknown account with a bank that had been taken over twice in 15 years was a bit tricky...

“In the first conversation, the officer indicated that just because I had a credit entry did not mean it would impact on my borrowing capacity. Whilst this might have provided an ‘easy out’ for me, I dreaded not being able to answer a question from a future credit provider on (a) how much this credit was and (b) what it was for! So I tried again.

“My second attempt established that there was no active account (good news), but also, no definite pathway to clear the entry from my report. I was advised to write a letter, which I did, but of course I suspect that letter is still sitting in someone’s ‘too hard’ basket.

“In my third attempt, I finally got through to a diligent call centre operator who agreed she would stick with me – and my problem – until it was sorted. After several iterations she finally told me she was putting me through to the debt collection department. Oh my God, my worst fears realised! I had an unpaid debt of an indeterminate amount outstanding... the next step would be someone knocking on my door presenting me with a huge bill... can you imagine it?

“Well imagine no more! It turns out the debt collection department have access to all past and present systems. The very nice man confirmed I do not have any active accounts OR outstanding debts – yippee!

“Even better, he had a very nice relationship with the company who manages the credit reports and voila’ – with one simple call made on my behalf, the entry was deleted, and it will remain forever absent from any future reports.

“Perseverance, tenacity and just a little courage turned my rogue credit entry into history – and I can now confidently have discussions with any lending agencies about my all my credit activities!”

Chapter 2 – Setting goals

If someone asked you, "Where do you see yourself in ten years time?" would you have an answer? I'm not just talking about your property investing, but in all facets of your life: work, family, social life, health, career, wealth… what are your goals for your future?

Many of us have a vague idea of our plans for the future. We might know that we want to have a family, and we know that we want to be financially comfortable. Some of us even have big dreams, and see wealth and abundance on the road ahead.

A dream, however, is just that… it's a concept. A dream is a goal without a plan. How do you expect to reach your goals in life if you don't plan to achieve them?

Some people have a slightly firmer vision for their future, and they've started making some plans. The hedgehogs amongst us might know that we want to own five properties by the time we reach our 40th birthday, for example, or we might be working towards a place where you can retire on your property portfolio in several years time.

To be a successful property investor, you need to have more than broad goals and ideas. Yes, it's important that you dream big – I always say you should reach for the stars, so that if you don't reach your goal you can still land on the moon. But as well as these "big picture" goals, you need to know the actual steps you can take to turn your dreams into a reality.

As an investor, you need to work out what you want to achieve with property, and then sub-divide these achievements into short-term, medium-term and long-term goals.

Most of us know someone, or know of someone, that has had a terrible experience with property. Timing and attitude have a lot to do with it, but at the end of the day, it really boils down to planning.

I remember attending a real estate seminar many years ago, and the property coach delivering the presentation at the front of the room was talking about a man he had recently met.

He'd struck up a conversation with a businessman at an airport lounge, and they asked the usual "So what do you do?" questions. When he said that he worked in property, his new friend sneered and replied, "Real estate's a mugs game..."

Well, as it turns out, this guy had been burnt. He was a successful lawyer and in the late 1980s, he and his heavily pregnant wife had bought a beautiful house in the Melbourne suburb of Toorak. It was a gorgeous family home that they could see themselves raising a family in, and because he was earning good money, the $950,000 asking price didn't scare them off.

A couple of years later he had two kids, a hefty mortgage, and interest rates were inching towards the high teens. His wife was a full-time stay-at-home mum and his six-figure income, although substantial, wasn't enough to cope with raising a family and monthly mortgage repayments of more than $10,000.

Eventually, they were forced to sell up – at a loss. They sold their beautiful dream home for $820,000 18 months after moving in, and lugged their worldly goods into a rented premises.

Of course, this was in the early 90s during the "recession we had to have", so he wasn't alone in his journey, but he felt like a complete failure. He and his wife eventually bought another (much more modest) home years later, but he's never since invested in property outside of their family home, and to this day he believes that real estate is the root of all evil.

Our property coach listened to this man's story, and he didn't say much to try and convince him of the benefits of investing in property. The man was passionately convinced that property was a rotten investment. He had personally had a bad experience, and nothing our property expert said was going to change his mind.

There is a flip side to the coin, though. Somewhere, there is an investor or homeowner who tells a vastly different story about the very same property.

"Did I ever tell you how much I paid for our place in Toorak? A little over $800k. We paid 15% less than the vendor paid the year before, when he bought it for $950,000. It was worth over $1 million within a couple of years..."

It's not that the eventual buyer of the home was necessarily smarter or wealthier than the first buyer – but he had much better timing, and he was clearly much more prepared. He had a plan, and he'd done his research, so he was able to buy and finance this property purchase, despite high interest rates and the tight lending conditions that prevailed at the time.

This man from the airport lounge is not all that unique, as the double digit interest rates of the early 1990s forced many, many people out of their homes. But it does demonstrate that your journey towards real wealth and financial prosperity through property can be littered with challenges.

In this case, because he was overextended and highly leveraged, he simply wasn't able to manage the financial burden of his growing mortgage. It's a situation that many investors and homeowners faced more recently during the Global Financial Crisis (GFC).

Others can be caught out because they don't count on finance markets drying up. Until 2007, for example, we were largely accustomed to gaining quick access to lending and refinancing, so it was a huge slap in the face when banks all of sudden became more selective with their loan approvals.

Then there are those who lose their jobs or other income sources, and find that they can no longer afford to keep topping up their investments when they have no money coming in. And there are people who are impacted by situations that catch them off guard, like divorce or family illness.

These kinds of situations can occur at any time, and some of them are completely out of our control. But if history has taught us anything, it's that the biggest mistake we can make is to fail to plan. I know it's a cliché, but failing to plan really is planning to fail, especially when you're dealing with hundreds of thousands of dollars.

With the right preparation and risk mitigation strategies, you can protect your investments and ensure that you keep moving forward, regardless of how the market – or your personal life – is travelling. You need to prepare for the worst, while hoping for the best, and to do this, you need a plan.

Setting SMART goals

When you invest in property, you're making decisions based around large assets and huge amounts of money – so it's a good idea to have an "investing road map" to help guide your decisions.

Ideally, you want to set goals that fit into three categories: short-term goals, medium-term goals and long-term goals:

- Short-term goals are those things that you wish to achieve in the next 1-3 years.

- Medium-term goals are things that you'd like to happen in the next 5-7 years.

- Long-term goals are your “bigger picture” goals that you’d like to manifest over the next 10 years or more.

When you begin setting goals for your property investing, the best place to start is with your long-term goals, because once you know your end goal, you can then begin breaking it down into smaller goals.

You also need to think about all of the other aspects of your life that could impact your investments. I have a goal “checklist” that I go through with my clients to help them think ahead about what changes and situations could come about now or in the future.

Goal setting checklist:

- ✔ Finances. This includes external influences – such as interest rate movements – and internal factors, such as your income and your ability to gain funding approval. Is your job and your industry stable? Do you have wide-ranging skills that will help you find employment if you’re laid off – or do you have a back-up plan to generate income if you’re not working? If you’re self-employed, will this impact your ability to source finance to fund your property purchases?

- ✔ Family. Are you planning to have a baby or expand your family? Will your household drop from a two-income household to a one-income household, and if so, how will you cope financially? How are you preparing for the extra expenses that parenthood entails?

- ✔ Lifestyle. Do you have one car or two cars? Will you need to buy/upgrade your vehicles in the next 5-10 years, and if so, how will you fund it? Do you plan to send your children to private school, and how have you planned for these types of expenses?

- ✔ Travel. Do you plan to travel, and how often? How much will it cost, and how will you pay for it?

- Emergencies. Do you have an emergency buffer account to deal with any sudden or unexpected changes – such as job loss, medical costs or car repairs? If not, how will you pay when unexpected expenses such as these crop up? Do you have asset protection and exit strategies in place to deal with unexpected challenges?

Asking questions relating to property investing and your own personal situation will get you thinking about your future and the types of circumstances you need to prepare for.

It is now time to start setting your goals – and they need to be SMART goals. That is: Specific, Measurable, Attainable, Relevant, Timely.

SPECIFIC

Specific goals should be specific and detailed because you're much more likely to achieve a specific goal than a generalised vague goal. Creating specific goals is tantamount to having a detailed road map to guide you and your progress.

FOX WARNING: If your goals are general, you'll approach them wearing your "fox hat": in a scattered manner. You'll always be working, looking, searching, hoping for the right solution, and you'll never feel truly comfortable on your journey because you're always on edge, waiting for the "bigger better deal".

If you get into the hedgehog mindset, your goals become fine-tuned. It's almost like having focused tunnel vision, because you will have a definitive plan to guide you towards success. Once you've set specific goals and you begin working towards them, you'll often become more relaxed about the process, because you'll feel like you're making real progress.

To set a specific goal, you need to think like a journalist and ask yourself the answer to the six "W" questions:

- Who – Who is involved – you? Your partner? Joint-venture partners?
- What – What do you want to accomplish?
- Where – Where do you want to buy your investment properties?
- When – When do you want to purchase your investment properties?
- Which – Which properties do you want to buy? Here, you can identify any requirements and constraints that will impact your decisions.
- Why – What is the purpose or benefit of accomplishing this goal?

General goal: I want to invest in property.
Specific goal: I want to own three investment properties by my 40th birthday.

MEASURABLE

This is where you establish concrete criteria for measuring progress towards attaining your goals. Have you ever been on a diet? If so, you'll appreciate how this works: jumping on the scales once a week shows you how much progress you've made, and keeps you motivated to stay away from those Tim Tams the following week. Measuring your progress is vital, as it helps you to stay on track and maintain enthusiasm for what you're doing.

To make your goals measurable, split your larger goals up into smaller targets. Ask yourself questions such as, "How much will I need for my deposit?" and "How much money will I need to save, in order to buy a property next year?"

General goal: I want to own three properties
Measurable goal: I want to buy one investment property every two years, so that by the time I turn 40 I'll own three investment properties.

ATTAINABLE

When you become passionate and focused about property investing, you'll notice that your attitude changes. You develop the skills, abilities and financial capacity to reach your goals, because you begin actively seeking out and seeing previously overlooked opportunities. Goals that once seemed far away and out of reach eventually move closer and become attainable, because you grow and expand to match them.

Unattainable goal: I want to become a billionaire next year.
Attainable goal: I want to own eight properties by the time I turn 50, with each property generating 10% rental yields that I can live off.

REALISTIC

Yes, you should be reaching for the stars – but you also need to make sure that your goals are realistic. If you have no money in the bank and your goal is to buy ten properties in the next two years, you're not going to get very far! And when you feel like you're not achieving your goals, you'll quickly lose motivation.

To be realistic, your goal should represent an objective that you're willing and able to work towards, and you should truly and honestly believe that you can accomplish it. I am living proof that if you can conceive it, you can achieve it, so don't feel pressured into limiting yourself; just don't make your goals so extravagant that you're setting yourself up for disappointment.

Unrealistic goal: I want to buy ten investment properties so I can retire off my property portfolio in three years time.
Realistic goal: I want to buy ten investment properties in the next ten years, so I can work towards retiring off my investment portfolio in ten years time.

TIMELY

Your goals need to be grounded within a time frame, as deadlines provide a much-needed sense of urgency. If you want to buy an investment property "one day", what incentive do you have to stop eating out twice a week so you can put that $100 per week towards your deposit?

If you anchor your goals to a deadline – such as, "I want to buy my first investment property by June 30 next year" – then you will consciously and unconsciously work towards achieving that goal.

General goal: I want to buy an investment property next year.
Timely goal: I want to save $20,000 by June 30 next year, so I can buy my first investment property by September 30 next year.

HEDGEHOG ACTION ITEM:
Consider investing in the Real Wealth Australia CD ROM, "Getting Started in Property Investment – The Right Way". It includes a PDF goal-setting worksheet, "Instructions for setting your investment goals", which will help you to generate ideas and begin creating your goalposts using three easy steps.

Knowing your intentions

As property investors, we learn to make decisions based on the facts: it only takes one or two missteps to realise that decisions made based on emotions and reactions will lead you down the wrong path!

However, even when investors make decisions based on black-and-white, well-argued facts, they can fail to take into account their own personal situation – which is why it's so important to always know your intentions.

A perfect example of this are interest rates. In recent years, interest rates have fluctuated to substantial highs and then record lows. When fixed interest rates were offered as low at 4.99% for three years, thousands of borrowers jumped at the opportunity to lock in their mortgages.

Many investors made this decision without paying any attention to their investment goals or intentions.

It’s like seeing a really cheap airfare advertised and booking it to save money, before you’ve even settled on your destination. You’ve booked half-price tickets to New Zealand, which is great, but now New Zealand is where you’re going on your next vacation. What if you really had your heart set on Fiji, though? Tickets might be a little more expensive, but if you budget correctly and make plans in advance, you can make it work. I’m not saying there’s anything wrong with a holiday in New Zealand – it’s a beautiful country! But if you had your heart set on a tropical escape, what good are two cheap airfares to go skiing in Queenstown?

This is all a really long-winded way of demonstrating that it’s better to know where you’re going *before* working out how you are going to get there?

Let’s say that your intention with property investing is to eventually own 12 investment properties that you can live off in retirement. Right now you own three investment properties, so you’re 25% of the way there.

The only problem is, they’re all on variable rate loans, and you’re worried about increasing interest rates. Even though your goal was to own 12 investment properties in retirement, you’re thinking that maybe you should sell one to ease your financial burden.

On the surface, this could make sense. You’re still 20 years away from your 55th birthday – the age at which you want to retire on our real estate portfolio – so you have plenty of time to acquire property. And selling one property would alleviate some interest-rate related stress…

But there are other alternatives available to you.

You could revisit your budget and cut out a few unnecessary expenses. If you commit to three months without dining out – that means taking your lunch to work every day and skipping restaurants and takeaway meals in favour of home-cooking – you could easily save $150 per week, allowing you to bank a couple of thousand dollars in your “rainy day” account.

If interest rates do increase as you fear they might, you’ve just added to your buffer account to help you manage the repayments – and don’t forget, you can always increase the rent being paid by your tenants.

Alternatively, you could reach out to friends, family members and colleagues to see if anyone is interested in a joint property ownership venture. As an example, they could possibly buy a half share in one of your existing investment properties, which would take some of the financial burden off you, without you needing to take a giant step back from your goal.

Or – and this is my personal favourite option – you could invest in a positive cash-flow property, which puts money back into your pocket each week. This is what Ed and I did, and it helped us to double the number of properties in our investment portfolio, without drastically cramping our lifestyle.

This is just a hypothetical scenario but it mirrors situations that many new and established investors experience – and it demonstrates how important it is to remember that there are plenty of options out there. Many people make fear-based decisions that they might regret later on, because they’re worried about what “might” happen down the track.

But if you’ve set yourself SMART goals and you’ve planned for emergency situations, then you won’t be forced into knee-jerk reactions.

As an investor, your actions should match your intentions every step of the way – and having SMART short-term, medium-term and long-term goals will help you to do just that.

Think of these goals as your personal road map to help you make all of your property related decisions, from buying and selling to renovating and refinancing.

Ideally, you should aim to review your goals every six months or so, to make sure you're still on the right path. They should be flexible working documents, as your lifestyle is bound to change in ways that can impact on your investing choices. And most of all, your goals should be tailor made to suit your personal and financial positions, so that you can then be sure that you're making every last dollar – and every last decision – work for you.

[Case study] The motivation to succeed

For 21-year-old property investor Matt Moloney, thinking about and preparing for his financial future wasn't high on his agenda. In fact, like most people of his age, he didn't give much thought to anything beyond his plans for the forthcoming weekend. "I had trouble setting goals because I didn't have a 'big picture' in mind," he says.

Twelve months on, and Matt now owns three properties and is well on his way towards reaching his goal of retirement before his 30th birthday.

"When my partner Kate first enrolled us in the Real Wealth Australia mentoring program, I was wondering if she had done the right thing, or whether I'd been sucked into a program that I didn't know anything about.

"I agreed to give mentoring a go, on the condition that if I went to the first session, I could then decide whether to continue doing it or not.

"After the first session I became more interested in the program. I told Kate that what we learnt on the first day was worth the $7,000 that we paid for course. What really sparked my interest was meeting Helen and Ed, and seeing the panel of experts. I realised that they were there to help and wanted to see people achieve their goals.

"As part of the program we had to set goals, which I had some trouble with. I knew I wanted to get involved in property investing, but I didn't know exactly where I wanted to end up.

“Unbeknown to me, Kate rang Helen for advice, because I was having trouble setting goals as part of the homework task we’d been given. I just couldn’t do it – thinking ahead, and planning what I wanted to achieve was new to me and I just didn’t know where to start.

“At the second session, Helen asked the question in class: "Who had trouble setting goals?" I felt like the question was directed at me, which I later found out was aimed at me!

“We had a conversation, and Helen asked me how many properties I wanted to own by the end of the year. Being 'realistic' and reserved, I said one property. Helen said, “Aim for two. Two properties is the stars and one is the moon; if you miss the stars and hit the moon, that’s okay, but if you aim for the moon and miss it, you’re left with nothing.”

“In one of the breaks, we had a one-on-one meeting with Helen, which helped me to realise the importance of goal setting and how it could affect our investing if I didn't have a plan. Helen helped us work out how to set goals by starting with the end result and working backwards.

“Only 11 months after this conversation, we settled on our second investment property in one year, and we also own our home, which by the way, we’ve now rented out. So we now have three properties in total at the age of 21.

“With the goal setting issue out of the way, we are now looking forward to purchasing five properties throughout 2010, with the big picture goal being to be financially free before age 30.

“Twelve months ago, I would have thought that this was a completely unrealistic and unachievable goal, but with coaching from Ed and Helen – and a huge amount of support from my partner Kate – I now realise that this is possible.

“You just need to forget about any reason why that goal wouldn't be achievable, and focus on how you can achieve it. The worst you can do is land on the moon – and that’s not a bad result.”

Chapter 3 – The Power of Budgeting

As much as this subject may be painful to address for many of you, the purpose of this chapter is to get you to review your budget to see whether there is any available spare disposable income that can be used for property investing. My experience to date with many clients is that when they delve deep down into their spending habits they find more than they thought they had.

I have to admit, I'm one of the lucky ones: I wake up every day and I actually enjoy doing what I do.

I think that it has a lot to do with the nature of my business. One of the most rewarding aspects of the work I do is that I encourage people to actively readjust their attitudes toward real estate and wealth creation – and that right there is the real key to success.

It's all about attitude. If you actively participate in your own journey towards financial freedom, you commit to doing whatever it takes to take yourself out of the rat race and create your own real wealth.

When you shift your attitude and adopt a goal-oriented hedgehog mindset, you begin taking positive steps toward creating a more financially stable and successful future. This is a journey that many Australians will never make, because it takes time, effort, motivation and commitment. A huge part of this process lies in getting your personal finances in order, as this is what can really make or break your property-investing career.

Far too many people prefer to keep their heads buried in the sand when it comes to personal finance, as they view budgets as being limiting or restrictive, but I view them as being precisely the opposite. In my opinion budgets are empowering, they give you all the information you need so you can make decisions and take positive action, based on real facts and figures.

A client of mine recently told me that she was as nervous about sitting down to do her budget as she was when she goes to the dentist: she knew she had to do it, but she wasn't looking forward to it in the slightest. She wasn't ready to face up to reality and find out the true state of her finances, even though it would help her to get ahead at the end of the day.

The fact is, creating a personal budget is something that most people don't do – but without one, you'll never be able to successfully invest in property and make every dollar work for you.

It's often those who earn the highest incomes that are usually the worst offenders, because they generally earn enough money to cover their lifestyle without needing to budget. But just because you're not on Financial Struggle Street, it doesn't mean you can afford to be relaxed about the way you spend your money.

Regardless of your income, completing a budget gives you a reality check and allows you to see where you stand from a financial perspective. It gives you the ability to identify any issues, rectify them, and tighten your belt if necessary. And it also helps you to avoid having to just survive from week to week and from paycheck to paycheck as you work towards a financially free future.

Drastic times call for drastic measures

Sometimes, when you feel like your situation is spiraling out of control, you need to take drastic action to get back on track. This was the case with Katharina, an investor I met in back in 2004 at a property seminar we both attended.

Katharina and her husband were in a dire financial position. They were hocked up to their eyeballs in debt – including a massive tax debt – and paying off a huge mortgage. Their situation was crippling them financially to the point that it was sending them backwards fast.

It all started when they bought an investment property. Katharina's dad had always reinforced the value of investing in real estate, so they decided to take the plunge.

"We didn't really know what we were doing, so we bought our first investment property just by guessing," Katharina says. "It was in our local area, it looked attractive, the carpets were a beautiful deep plum colour and they matched the curtains. We thought, this one looks nice. We just dived in."

It turned out that they'd invested wisely, as the property value increased in a relatively short time. So they did what most every-day Australians would do: "We took out all of the profits and bought a brand new mansion of a house to live in."

The only spoiler? Katharina and her husband didn't know about capital gains tax (CGT), and had no idea that the profits they'd drawn out of their investment property were subject to a CGT. So come the end of the financial year, Katharina and her husband were completely floored when they received a CGT bill for tens of thousands of dollars!

They'd already used their profits to buy their new home, so they couldn't pay the bill. After some negotiation, the tax office came up with a payment plan, with the debt accruing interest at a rate of 13% per annum. It was around this time that Katharina and I met.

She made it clear that she was willing to do whatever it took to turn their situation around. We sat down and went through all of their expenses line by line and then created a current budget position. As stated previously they were literally going backwards. When you laid out all of their income and expenses, they were $4,000 in the red each year.

I then devised a plan for Katharina and her husband to get back on track and in the black, but it was also going to take a huge commitment on their behalf.

You see, the only solution to their problem was to rent out their beautiful new home – temporarily, at least.

I suggested to Katharina that they move out of their home and rent it out as an investment property. That way, all of the mortgage interest and related property expenses would become tax deductible. Also, because the house was virtually new, they would be able to enjoy good levels of depreciation benefits.

So they took my advice and packed up all of their belongings and moved out of the family home. Katharina admits that moving into a rental home was a difficult decision to make. “One of the things that Ed and Helen taught us was that it’s only property, and people do become so emotionally attached to it,” she says. “But it’s really a mindset. It’s just a house – your home isn’t where your house is, it’s where your family is that’s important.”

They’ve been renting out their home now for close to five years. It took them just two years to pay their tax debt back in full, and since then have also bought another investment property and have plans to move back into their home in the next twelve months.

Katharina says her mindset is completely different now; she’s made the metamorphosis from fox to hedgehog, and she couldn’t be happier. “When I met Helen, we were $4,000 in deficit each year, and we were going backwards in a big way. Now, we’ve paid all of this debt off out and made the sacrifices that were needed for us to get ahead – and last year, we went on our first holiday in five years. That was our reward!”

As Katharina’s story illustrates that property investing really does have the potential to turn your life around no matter how hopeless your situation might seem to be at the time – but there maybe sacrifices that you will have to make along the way. To know exactly where you stand, you will need to get your finances in order so that you can plan your next step.

Creating your personal budget

When you start to create your own budget, it's important that you approach it with an honest and open mental attitude. There's no point in underestimating costs or rounding debts down, as that only serves to give you a false outcome.

I recently worked with a young corporate executive who, in her late 20s was earning a six-figure salary, but had no savings in the bank. She had no assets, but had personal loans and credit card debt totalling $35,000. The ironic part of this story was that she worked in financial planning. She spent her days dishing out financial to others, but when it came to working out a budget and financial plan for herself she had failed miserably.

After our initial meeting, it took her almost 12 months to come back and commit to a program. She was feeling ashamed that she'd let her finances get this out of control, and she was hoping that she'd work out how to fix her situation on her own – but it wasn't working. In fact, during that 12-month period, her salary had reduced by 10%, thanks to the GFC, and she'd racked up another $4,000 in credit card debt!

My personal philosophy is, "When you know better, you do better." There's no point beating yourself up over mistakes you've made in the past, as those negative feelings will just hold you back. Instead, you need to leave any sense of shame, guilt or personal failure at the door, and commit to making the right decisions from that point onwards.

To do this, you need to be completely upfront. You need to get a clear picture of your true financial position, which means including every single debt, loan and expense you can think of, so you can work out an action plan to shed your "bad" debt and begin to grow your wealth.

In order to do this start with the basic essentials that you need to survive on. These include rent/mortgage, groceries, gas and electricity.

Next, list your "must-haves"; these are things you absolutely don't want to give up, but they're not as vital to your survival as food and shelter. This might include phone and internet access, car expenses, home and contents insurance, etc.

Lastly, list your "wants". This could include things like your gym membership, buying your lunch, pay TV or magazine subscriptions.

It's important to be as detailed as possible, so that you are armed with all the facts when you're working out your budget. When you're creating your personal budget, you should also include a provision for emergencies, as you never know when an unexpected car or health emergency is going to crop up. Also, make sure you pay yourself first. As a general rule, at least 10% of your net pay should be put aside into a 'not to be touched' savings account each month. This will eventually grow to a deposit on an investment property one day.

HEDGEHOG ACTION ITEM: In the Real Wealth Australia CD ROM, "Getting Started in Property Investment – The Right Way", I've included a budget planner that can help you get your personal finances in order. The planner automatically calculates your weekly, monthly and yearly expenses, and gives you a realistic estimate of your genuine financial position as it stands today.

Be warned: this planner leaves no stone unturned. It accounts for every possible expense, from club memberships and magazine purchases to fuel, insurance and school fees. The point is to get your head out of the sand and show you exactly where your paycheck goes each week, and it helps you to clearly see where you are spending money on "wants" on "needs".

The idea behind reassessing your finances and budgeting is to see how much disposable income you can create, income that then can be used to purchase more investment property.

Eliminating bad debt

Some people naturally "get" the difference between good debt and bad debt (I wasn't one of those people!) but regardless of how long it takes, it's always exciting for me to watch people go through this process. To see the transformation and watch them learn about the potential wealth that property investing can bring is literally like seeing a light bulb being switched on.

Good debt is essentially any borrowings that are used for purchasing an investment property. For instance if you take out a loan to purchase an investment property, that will increase in value and contribute to your overall financial health, then that's a positive thing and because it is an investment property the interest payments on that loan are tax deductible, so that loan is considered to be "good" debt.

Bad debt is the absolute opposite. When you use debt to finance something that can be consumed or that declines in value, it creates an unhealthy financial situation. For most Australians, credit card debt is the most common form of bad debt because your credit card balance increases in exchange for purchases of everyday items, like clothes or food and not for an investment asset. A $3,000 credit card bill that attracts a non tax deductible, 18% annual interest charge is the definition of bad debt.

When you create your personal budget, you need to highlight all of your good and bad debt so you can create an action plan to eliminate all toxic debts. Your primary goal should be to wipe out bad debt – such as personal loans, credit cards, store cards and car loans – so you're in a position to acquire more good debt, ie. investment property loans.

Different budget strategies work for different people, but I always find that people respond well to progress. When you can see your position improving week to week, it helps you to stay motivated and committed to your action plan.

My suggestion is to start by developing a list of all of the bad debts you wish to clear – be sure to include every debt, no matter how big or small, so you can accurately track it's impact on your finances.

The following is an example of Jan's bad debts and hoe they can be cleared:

BAD DEBT	AMOUNT	INTEREST	PAYMENT (MONTHLY)
• ANZ VISA	$4,000	18%	$250
• NAB Mastercard	$1,700	17.5%	$120
• Myer store card	$850	25%	$45
• Car loan	$6,250	13%	$300
• Money owed to A family member	$500	0%	$250

In the above example, Jan has a commitment to repay $965 per month. Even though she's not paying any interest on the debt to a family member that should be the first debt she clears, as money and family tend not to mix well.

Provided that Jan removes all credit cards from her purse and she commits to not using them, in two months time she will have cleared one debt, and her debts should then look like this:

DEBT	AMOUNT	INTEREST	PAYMENT (MONTHLY)
• ANZ VISA	$3,620	18%	$250
• NAB Mastercard	$1,510	17.5%	$120
• Myer store card	$795	25%	$295
• Car loan	$5,730	13%	$300
• Money owed to family member	-	-	-

This then leaves her with $250 more to pay off her Myer card each month so that in three months time, that card will then be completely paid off. It should then be cancelled for good. In only five months, she will have shed two debts and paid $1,000 off of her highest credit card limit. Now, her bad debts look like this:

DEBT	AMOUNT	INTEREST	PAYMENT (MONTHLY)
• ANZ VISA	$3,030	18%	$250
• NAB Mastercard	$1,220	17.5%	$415
• Myer store card	-	-	-
• Car loan	$4,950	13%	$300
• Money owed to family member	-	-	-

Using the spare cash from the paid off 'family member' loan and Myer Store card she can in another three or four months time pay off her NAB Mastercard.

Once that debt is gone, she can then re-purpose the payments that she was making to pay off her NAB Mastercard, Myer store card and 'family member' to pay down her ANZ Visa and after a few months that card will also be paid off.

If Jan sticks to this plan, within a period of around 18 months she will have eliminated all of her "bad" debt – and she'll then be in a position to use the $965 per month that she was using to pay down the debt as savings towards her first investment property.

How to trim your budget

I've worked with many people over the years that have presented me with their personal budget while proclaiming, "This is it – this is our budget, stripped back to the bare bones – and we're still behind the eight ball."

A quick glance however usually reveals that their budget is nowhere near as trim as it could be. Now, I'm not saying that you should stay in every night and eat baked beans for dinner while you pour every spare cent into property investing – not only is that boring, but it's totally unrealistic! If you feel like you're missing out you're never going to stick with it, so it's a matter of striking a balance between "wants" and "needs".

If you're the type of person who needs a cup of coffee every morning on the way to work to get your motor started, then you don't have to give that up. But there may be other compromises you could make in order to create disposable income for investing in property.

Here are some money-saving tips that could help you to grow your bank balance, without drastically changing your lifestyle.

Tip 1: Can your credit card

Credit cards basically act as rotating lines of credit. Unfortunately most credit card holders use their credit cards in exactly the wrong way... they charge more to their cards than they can afford to repay each month and then don't fully pay them off when payment is due. They then watch the interest charges on the outstanding card balances stack up. Credit cards used this way are the ultimate purveyors of "bad debt". They can drag your financial situation down rapidly with their exorbitant interest rates and expensive annual fees.

Consider this scenario and see if the 'shoe' fits you: you have two credit cards each with a limit of $3,000, and even though you pay $400 off each card every month, you continue to spend on the card so that the balance hovers around $3,000 indefinitely.

At a standard annual credit card interest rate of 18%, you will be charged around $1,000 per year in unnecessary interest fees. Add annual card fees, additional card holder charges and the odd late payment or overlimit fee, and the cost of your credit cards just ballooned out to $1,500 per year. That's equivalent to a week-long holiday in Bali!

Now consider how much you earn each year? The average Australian salary is around $50,000, which works out to be roughly $41,000 after tax. Are you willing to continue voluntarily spending 3-4% of your annual income on credit card fees and charges?!

Unless you're incredibly disciplined with money, you should aim to get rid of all of your credit cards except one. This card should preferably have 55 days credit before payment is due and should then be kept at as low a credit limit as possible. The card should then be paid off in full when payment is due.

HEDGEHOG ACTION ITEM: In order to pay off your credit cards and avoid the temptation to spend, take all of your cards out of your wallet or purse. If you don't have your VISA or AMEX on you, you'll be forced to pay for items with your own cash, so you'll be much less likely to spend money on things you don't need!

2. Tip 2: Go on a spending hiatus

A spending hiatus is precisely what it sounds like…it's a period of time during which you agree to spend no money, other than on the bare essentials.

It's the equivalent of going on a short yet dramatic diet if you're trying to lose weight, as it's not realistic to keep it up long term, but it can help you to achieve a short-term goal without too much pain.

A group of online bloggers in the United States recently participated in a series of linked spending hiatus', whereby each person pledged to stop spending for set period of time, and they then blogged about it.

Some people agreed to stop spending for one week or one month. Others committed to a much longer financial fast of up to 12 months. The length of your own spending hiatus is up to you, and depends on your own situation –

you may decide to mix it up and go on a spending hiatus for one week per month? Whatever works for you.

One mum, Amanda, committed to two weeks without spending. She wrote on her blog that she'd noticed her two-year-old son's pants were too small, so her first thought was, "I'll pop into Target this afternoon and pick up some new clothes for him."

She was on a self-imposed spending hiatus so she sent him off to day-care wearing his slightly-too-snug pants, and threw on a load of washing so he'd have something to wear the next day.

Now, a pair of pants wasn't going to cost much, but the purpose of this exercise is to show you exactly where you're spending your money, so you can work to "plug the leaks" in the future.

For Amanda, Target was one of her weaknesses. She would go shopping for pants for her son, and walk out $50 later with two pairs, a dress for her daughter, some stationery and a table lamp that she picked up on sale.

By resisting the urge to spend, Amanda saved $380 in two weeks and she's keen to take up the challenge again. Another blogger, Susie, made her month-long spending hiatus work by going on a "clean out the pantry" diet with her husband; rather than ordering in takeaway once or twice a week, they went through their pantry and fridge and made meals based on what they already had available.

HEDGEHOG ACTION ITEM: Commit to a spending hiatus, even if it's for just one week, so you can see whether you can create disposable income that can then be used for investing in property. If you save $200 in that week, you could pay that amount straight off a credit card debt and save yourself the extra interest payments too. Find a way to make this work for you!

Tip 3: Edit your shopping cart

Have you ever popped into your local supermarket to pick up some milk and eggs, and walked out $80 lighter carrying four full bags of groceries?

It has certainly happened to me in the past – there's just something about the endless aisles of shiny packages and goods on sale that temps me, and I can usually justify my full shopping basket by convincing myself that groceries are a "necessity".

In reality, our shopping trolleys are usually over-flowing with "wants", not "needs". Often, they're items that we grabbed on impulse because they looked good or were on sale – or we've gone shopping on an empty stomach, so we grab twelve different options for dinner that night, because everything looks so appealing!

To save money on your grocery bill, start by buying generic brands where possible, unless a higher-quality branded version is offered on sale for a cheaper price. On groceries like tinned fruit, milk, muesli bars and rice, you won't notice much of a difference (if any) in the taste, but it can provide huge savings.

A tin of diced tomatoes, for example, is usually available in a generic brand for half the price of its colourfully labeled cousin. The saving might only be 50c on a single item, but if you save 50c on 40 different groceries in one shop, that equates to a total saving of $20 per week.

Also, the next time you're doing your grocery shopping, look at the contents of your trolley before you get to the register. Take out any items you don't really need and place them in a basket, then spend five minutes going up and down each aisle again replacing your unwanted items back on the shelves.

You might save yourself $30 or $40 by following these suggestions, which doesn't sound like a lot of money – but if you save an average of $40 per week for an entire year, that's more than $2,000 that remains in your bank account.

Add this to your credit card savings and the money you socked away during your "spending hiatus", and you could see your bank balance grow by an extra $5,000 in just 12 months – all without dramatically changing your lifestyle.

HEDGEHOG ACTION ITEM: Approach your grocery shopping with a definitive list, and don't allow yourself to stray from it. If you're not a list person, then try and mentally tally up the cost of everything you need to buy, and then only take that amount in cash, with you. It's very difficult to spend money you don't have, and you'll be much less tempted to pick up groceries you don't need for fear of coming up short at the checkout!

Final budget-booster:

We all have one or two treats that we enjoy on a regular basis, which we would be loath to give up. For some of us, it's that morning cup of coffee we order on the way to work; for others, it's grabbing lunch at your favourite sandwich bar, or buying magazines to read on Sunday morning.

There's no need to give up your favourite things entirely, but it's worth thinking about whether these small indulgences have simply become habits? If you order a hot chocolate and turkish toast from your local café every morning for breakfast, that's become less of a treat and more of a habit – so ask yourself, does it really feel like it's worthwhile spending $25 per week, or $1,300 per year, for breakfast? What else could you spend that money on?

If you cut down to ordering breakfast twice a week and eat cereal at home on the off days, you'll not only save money, but you'll also start to look forward to your morning indulgence again!

Consider whether some or all of the following items are those that you could cut back on:

- Hot beverages from local cafés

- Buying your lunch during the work-week
- Vending machines snacks
- Bottled water
- Manicures/pedicures
- Cigarettes
- Alcohol
- Eating out/ordering takeaway
- Barely-used gym memberships
- Pay TV – if you really want it, could you cut back to the basic package?
- Mobile phone – are you on the best-value package for your usage?
- Home internet – is the rate you're paying competitive?

[case study] Short-term sacrifices for long-term rewards

Justin Bohlmann says he has "always been money-conscious", but admits that he didn't really appreciate budgeting in detail until he started investing in real estate in 2000.

"Fortunately, I never really had any bad debts so I didn't have to work to pay them down.

"I've always been good with money, but once I started investing in property, I realised how much more I could be doing.

"Over time I recorded my day to day expenses, so I could see where I was spending the most money.

"It can seem like an effort to record all of your expenses in the beginning but you only really need to do it for a couple of months and then you're set.

"The more data I had, the more accurate my budget became, until I got to the point where I knew exactly how much money I needed in each account each month.

“It has definitely been easy to stick to a personal budget, although it wasn’t like that in the beginning.

“It does feel like you are making sacrifices in the beginning, but you need to change your mindset – and view the short-term sacrifices as being necessary for the long-term rewards you get from investing in property.

Soon enough, these rewards will be realised and I’ll have less stress and more money, as a result of careful budgeting.”

4. Creating your dream team

There are thousands of different ways in which we can achieve financial success. The wealthiest, most successful people in the world have each walked their own path to reach the top of their game, but they all share one very important thing in common, they have a highly qualified and dedicated support team behind them.

This is true regardless of what industry you're in – to be seriously successful, you simply can't do it alone. The world's most accomplished business leaders, entrepreneurs, moguls, celebrities and athletes know that personal skills, insight and talent can only take you so far. At some point however, you will have to create your own qualified "dream team" to take you to the next level.

Billionaire property developer Donald Trump summed it up perfectly when he said, "Surround yourself with smart, truthful, honest people." It's the quickest and easiest step you'll take towards fast-tracking your wealth creation journey.

As a property investor, it's vital that you surround yourself with experienced, qualified professionals every step of the way. You need to work with people who know what they're doing.

It's fair top suggest that if it's a mortgage brokers job to organise loans worth hundreds of thousands of dollars if not millions of dollars, then surely they must know how to get you the best results, right? It would also be fair to suggest that with the level of responsibility they have, then they must be fairly switched on, and adept at working with the numbers and that they'd be the type of person who pays close attention to the detail. Right?

Unfortunately, in so many situations, this is not the case! There are plenty of every-day Australians who are not passionate about what they do for a living – we've seen it all before. Some of us are still there now. And when you're working in a job that you don't particularly love or where you feel unmotivated or under-appreciated, you're usually not giving 100%.

Consider then that you're planning to engage an accountant to guide you through your financial decisions, or a property manager to help you maintain and manage your assets. You don't want to work with someone who is giving the bare minimum. Ideally, you want them to be passionate, motivated, experienced and proactive – the type of person who loves going to work each and every day!

That's why I personally interview every expert on my dream team, from accountants, through to mortgage brokers, solicitors, quantity surveyors and real estate agents. I make sure that I interview every new business contact so that I can evaluate their suitability for dealing with my property.

To be frank, I prefer to work exclusively with people who invest in property themselves. It's the hedgehog in me. I believe that accountants, solicitors, brokers etc who are a vital part to my investing, need to invest in property like I do so that they understand and appreciate the nuances associated with investing.

In a similar vein, I wouldn't take stock market advice from a financial planner who didn't successfully invest in shares that they are recommending, or visit a dentist who had crooked yellow teeth! Why should it be any different with property investing?

My feeling is that if they have first hand, personal knowledge of investing in property, then they will most likely know and understand the pitfalls to avoid and the best strategies to use to maximise my investments. One of the first questions I ask when I interview a prospective new contact is, "Do you invest in property?" If the answer is "no", I thank them for their time and move on.

Building your dream team

Depending on your property investing goals, your expert panel could include a range of professional contacts, including:

- Accountants
- Architects
- Builders
- Consultants/contractors
- Conveyancers
- Finance brokers
- Interior designers
- Landscapers
- Property managers
- Property Valuers
- Solicitors
- Quantity surveyors
- Real estate agents

The two main players are most likely to be your accountant and your finance broker – with most of the others, you use them when you need them, but your accountant and your broker will be working with you fairly regularly.

The following is a typical example of how I use my accountant and broker when I am buying a property. The first thing I do after analysing the deal and deciding that it's a good one, is to call my mortgage broker and ask – can you get me the finance?

Once I get the go ahead from my broker, I then call my accountant and ask, how do you think I should structure this? Being a hedgehog, I always have a specific plan in mind for every property I purchase, so I'll let them know what the goal is with this particular property, and how long I plan to keep it. Based on that discussion, he then tells me which structure to use – for example, buying in a discretionary trust, company or my own name.

By turning to my dream team and getting the information I need, I know that when I do put in an offer on a property, I can do it confidently. There's no second-guessing, because I've already sought out expert advice. I'm going in prepared and forearmed, which just makes the negotiations far more easier and powerful.

When it comes time to engage a professional to work for you, I recommend that you interview them, just as you would interview someone who had applied for a job with you.

Assess them using the same criteria you would use if you were wearing your "employer" hat. To demonstrate this, let's say you're meeting your potential new mortgage broker. First of all, qualify their personal experience by asking if they invest in property themselves, and ask a few questions about their career history.

Next, take notice of their attitude and behaviors. Did they arrive on time, or were they late to your appointment?

Is he or she well-presented and showing pride in appearance, or did they turn up looking frantic and hurried?

Are their emails professional and free from spelling mistakes and grammatical errors, or do they shoot off brief sloppy messages riddled with short-hand and typos?

The spelling prowess of your mortgage broker is probably something you've never given any thought to, but it's actually quite important. How a person presents themselves over the phone and via email is a representation of their communication skills and gives you an indication of how they operate in other situations.

Someone who pays close attention to their grooming and communications is someone who most likely pays close attention to the nitty gritty details of your mortgage application. Someone who is frequently forgetful, misses deadlines and always looks rushed and flustered has probably got too many balls in the air – they're displaying the typical traits of a fox. Clearly, that's not the type of person you want handling your financial affairs!

That's not to say you should jump on board with the first person you interview, who's wearing a slick suit and offers a professional sales pitch – it's easy for someone to look the part, and then fail to deliver the goods. First impressions are usually a good first indicator, but you should ask as many questions as you can think of and wait until you're completely comfortable before you sign on the dotted line.

Qualifying your experts

Keep in mind that unless you're on a tight deadline, there's no pressure forcing you to move quickly. You can interview three of four mortgage brokers before you settle on the right fit – or even 30 or 40, if you want to be really thorough.

Ed and I have personally been through five mortgage brokers and 12 accountants in the last decade, and numerous other property managers and conveyancers.

With mortgage brokers, we have often moved on because we felt the brokers were more driven by the commission they received, rather than by finding the best product for us. Or they become so busy that their attention to detail diminished. With our accountants, it was quite easy to knock them off the list if they didn't invest in property themselves.

Other times, we moved on because we felt we weren't getting the best service. For example, our last accountant was very complacent. We found that we were paying anywhere up to $8,000 per year in accounting fees, and we didn't have much to show for it. Then when we got audited we discovered there were errors. Lots of errors.

I wasn't concerned about being audited; in actual fact it was Ed that got audited, not me, but we have so many joint assets that we're basically a packaged deal. We're all going to be audited at least once in our lifetimes, and I was under the impression that our accountant had done everything by the book, so I didn't panic.

But when the Australian Tax Office (ATO) keeps coming back to you asking, where did this figure come from, and how did you calculate this amount, you begin to question the value of your accountant!

Thankfully, I'm a paperwork queen, so I had all of the paperwork required, and we were able to go back and verify all of the information that the ATO asked for.

It's so important to keep everything on file for several years because over time, it's easy to forget the details. You might refinance from one lender to another, and then the ATO is suddenly asking you where you got the deposit for a property purchase three years earlier. Unless you have a photographic memory, it pays to have a nice solid paper trail to back up your responses.

The major mistake we uncovered during our audit was that an incorrect calculation that had been entered into a spreadsheet years earlier. We'd been using that same spreadsheet year after year on several different properties, so the mistake had far-reaching consequences, and we actually had to go back and amend our tax returns for several years. Talk about frustrating.

Our accountant at the time had a very relaxed attitude, and it really boiled down to the fact that he hadn't been checking the figures closely enough. To be fair, we didn't pick up on the error either – but that's why we were paying him $8,000 per year! You can have all the right intentions, but if you've written a calculation that's incorrect and it flows through to 10 spreadsheets, that's a pretty major mistake.

At that point we decided to move on and we found another accountant to work with us. He helped us manage the audit and clean up all of our bookkeeping, because I wanted our books to be squeaky clean. The last thing anybody wants is to be in the bad books with the ATO, but I felt it would be especially bad considering the line of work I'm in!

Our new accountant is fantastic: he's very proactive and he shows initiative, which is just what we needed. During our audit, he was able to find us some additional deductions that our previous accountant had missed. Not only did he cover his fees and the back taxes we owed, but we also ended up with an additional $2,000 back in our pockets. What an unexpected silver lining.

I believe that if you're not happy with the service you're getting, you're completely within your rights to shop around for a better deal. At the end of the day, you're the one handing over your cold hard cash for services rendered, so make sure you're getting what you paid for – or move on!

HEDGEHOG TIP: Find experts who *genuinely understand and love* the detail. Ideally, they should have a real passion for going to the nth degree in seeking out the finest details. That way, you know that they'll pick up on anything that you miss.

Example interview questions

Before you interview a potential new member for your expert panel, I recommend that you write down a few questions so you can make sure you're 100% comfortable with your decision. This is a list of 15 questions that I use when I'm interviewing for a new accountant:

1. How long have you been in your practice?
2. Are you an accredited CPA?
3. What other qualifications do you have that may assist me with my property investing?
4. What do you specialise in (eg. Business, Property, Shares etc)?
5. How many clients do you have?

6. Of those clients, how many own investment property?
7. Do you own investment property yourself? If yes, how many, and for how long have you owned them?
8. How many of your clients own investment property in trusts?
9. What type of trusts are they owned in?
10. What is your knowledge of asset protection structures in regard to investment property?
11. How many audits have you had on your clients?
12. When purchasing an investment property, what entity would you recommend I personally purchase in and why?
13. Do you lodge returns electronically?
14. How quickly can you turnaround my queries?
15. How do you charge for your time – ie, what is your schedule of fees?

HEDGEHOG ACTION ITEM: For access to more resources, including over a dozen question checklists and worksheets, consider investing in the Real Wealth Australia CD ROM, "Ultimate Resource Guide".

Appointing the right person

When you appoint someone to work with you, whether it's a mortgage broker, a property manager or a plumber, it's important that you make the decision using your head, not your heart. All too often, people – especially women! – get swayed by "niceness". I'll explain what I mean by this.

A few years ago, a friend of mine sold an investment property in Townsville, in far north Queensland. She owned several properties and had bought and sold may more, so she knew the process pretty well.

When she was appointing a selling agent, she interviewed three real estate agents. Agent 1 was a referral from a friend, and Agent 2 was someone she'd bought from in the past. Agent 3 was a woman she'd sold a house through years earlier, and Christie knew that this agent was very good.

During the interview Christie asked all of her usual questions including, how she would market the property, what her fee structure was, and what her recommended listing price was and why?

The three agents came back with similar responses and they were all similarly qualified. In terms of personality, Agent 1 was all business, and Agent 2 was a friendly, jovial man in his late 30s. Agent 3 was a tough old character, aged in her early 60s, and quite well known throughout the area as she'd been a practicing real estate agent for more than 30 years.

Aside from their vastly different personalities, the main difference between them were their fees. Agent 1 and 2 were both willing to cover the advertising and marketing expenses, while Agent 3 was going to charge $1,000.

Christie tried to negotiate but Agent 3 wouldn't budge. So which agent do you think Christie chose?

She went with Agent 2. He was very warm and open, and she figured this would make prospective buyers feel more comfortable at open home inspections. Her gut was telling her that Agent 3 was a gun, but she was a little miffed that she wasn't willing to negotiate over the advertising expenses, and Agent 2 seemed like a really nice guy.

And he was – Agent 2 was lovely! But can you guess what happened next?

The property sat on the market for eight weeks with barely a nibble. Only one offer was forthcoming, and it was 30% less than the asking price.

Christie had signed a contract with the agent for two months, so at the end of that period they parted ways and she called up Agent 3. Within two weeks, Agent 3 had an unconditional contract signed for $10,000 less than the asking price, which is exactly the price Christie was hoping to get.

So what was the difference between Agent 2 and 3? It's not that Agent 2 wasn't necessarily qualified or experienced – it's that Agent 3 was *more* qualified and experienced, and as she'd been in the industry for a long time, probably had the best network of contacts. There's the chance that the right buyer simply came along at the right time, but it's more likely that it was due to Agent 3's stellar networking and negotiating skills that they gleaned the top-dollar offer.

Looking back, Christie was frustrated that she had wasted eight weeks and several thousand dollars in holding costs – all to save $1,000 on advertising costs. After all of that, she ended up paying for the advertising campaign with Agent 3 anyway.

You'll come across many situations like this in your property investing career, particularly in the early stages. You'll ponder decisions and outcomes for many weeks as you learn to navigate your way through the process.

There's often no hard and fast, "right" or "wrong" answer when it comes to building your dream team. It's a mixture of qualifying your experts, informing yourself and following your instincts.

The positive thing to remember is that the more you invest, and the more that you become an expert yourself, the better you become at making the best possible choices. In much the same way that the hedgehog learns to quickly rebuff the fox's myriad of attacks, you'll learn to quickly recognise quality, expertise and experience in the people around you. Don't beat yourself up if you don't get it right the first time, after all, it took me almost a dozen attempts to find our current accountant. The process of property investing is a life-long learning process!

[case study] The $7,000 learning curve

Carolyn and Nick bought their first investment property in 2007, so they're fairly new to the game – but already, she's learnt the value of surrounding herself with qualified experts.

"We purchased our first investment property in 2007, and despite doing lots of reading and a number of short courses, we had no strategy or real clues as to what we were doing. Our singular focus was positive cash flow, without accounting for growth or using our resources efficiently.

When we started the Real Wealth Australia course, we completed extensive budgets and financial health checks, so that we could ascertain our individual investment abilities and limitations.

For the first time, we were able to understand the reality and power of the equity that we already had. We identified the ideal strategy – including property locations, types and values – according to our income and goals. This process was incredibly empowering and enormously useful.

As it turned out, we were in a much stronger position than either of us could have imagined. We had assumed that we would need to buy existing median houses in regional centres or far outer suburbs of capital cities.

Helen and Ed showed us that we were in the position to buy new properties in capital cities and benefit from the high growth of these houses before balancing our portfolio with cash flow properties. We were truly amazed at how wrong our previous assumptions had been, and quickly purchased two fantastic high growth city houses.

Working with experts like Helen and Ed has been empowering, we've also learnt the impact that having the wrong experts can have.

The biggest issue we've had so far has been 'over quoting' on rental appraisals for two of our properties. In both cases, both the sales agents and independent property managers gave us consistent 'over the top' rental appraisals. We ended up losing several months' rent on both properties while we waited for tenants to come along – which cost us around $7,000 all up – due to the rental price being set too high.

After an adjustment, both properties were rented quickly as they are highly desirable. In the meantime, though, we were very frustrated, as the prices were set by people that we believed were experts who knew the market, and thus knew how to approach it with our properties."

Chapter 5 – Financial Health Check

One of the biggest lessons I've learnt throughout my property investing is just how vital a financial education is and this includes a property education.

Financial planning and purchasing property are two of the biggest and most stressful activities that people will face during their lifetime, and therefore I believe it should be something that is taught to every child at school. Kids are taught all about numbers anyway, so why not add a "budgeting" and "personal finance" component to their senior school classes?!

Before I invested in real estate, I didn't pay too much attention to my bank statements, and I rarely knew what the balance of my bank account or credit card was.

Today, I could tell to you virtually to within $10 how much money is in my savings, offset, home loan and "spending" accounts – and I know when each fixed loan expires, and what interest rate each mortgage is locked into.

The reason I'm so "in the loop" about all of the nitty gritty details of my financial life is not because I'm particularly interested in it, or because I'm skilled at it – it's simply a matter of necessity. To get ahead and master the property investing game you need to know the exact state of your finances and your financial position.

If a brilliant opportunity reveals itself, I know instantly whether it fits into our strategy and whether we can afford it – and I don't have to meet with the accountant or go through our spreadsheets to work that out, because I know exactly what our balance sheet looks like on any given day.

Every six months or so, Ed and I sit down and conduct a full Financial Health Check to make sure we're still on the right track, and ensure that we're still using the best financial lending products and structures to suit our needs. Most people's financial situation will change over time, and what worked well last year, for whatever reason, might not work this year. It's a case of being able to adapt to changing circumstance as they occur.

So just what is a Financial Health Check, and why is it so important?

A Financial Health Check is basically a fiscal check-up and review of your personal income, expenses, debt, loans, savings, spending habits, and credit rating in order to then asses what your borrowing capacity is.

When you begin investing in property, you need to ensure that you have access to borrowed money so that you can buy real estate on your own terms – because when you're in a position to negotiate quickly, that's when the best deals happen.

One of the most common mistakes that people make is to take on too much "bad debt" – the kind of loans that are non income-producing, and/or that attract interest that is not tax deductible.

Credit cards are the worst culprit, as they gobble up your money on purchases that all-too-quickly add up. On top of that it's all too easy to accumulate several different credit card accounts from several different sources, which makes it even easier to spend on them. According to the Reserve Bank, Australians owe a total of $45 billion on credit cards, with the average person owing around $3,100 each.

Having bad debts such as credit cards and personal loans loaded up to the max is the quickest way to stall your opportunity to invest as the credit card limit is considered to be spent or accumulated debt even though you may not have actually spent all of it.

The message is simple: how do you expect banks to lend you money to build a property portfolio, if you have a stack of unpaid credit card bills, personal loans and a mortgage over your own home? It doesn't give them confidence in you as a borrower, as you don't look like an applicant who has control over your spending habits.

The fact is these types of bad debts can seriously eat through your borrowing capacity – so much so that they could actually prevent you from being approved for finance.

When it comes time to apply for a mortgage to buy an investment property, the lender will assess your monthly income against your monthly expenditure. The amount of income that is required to service your expenses – including repayments on your bad debts – will be deducted from your total income, and your lender will then calculate the amount that you can borrow based on your remaining income.

Many people don’t realise how much of an impact credit cards and personal loans can have on their borrowing power. You might assume that if you have a personal loan of $10,000, then the bank will take $10,000 off the amount that they’re prepared to lend to you – but it doesn’t work like that.

Your bank or lender doesn’t care how much you actually owe on your credit card; they want to know what your credit limit is, because they need to take into consideration the entire amount that you could possibly be in debt at any time.

Said another way, if you have a credit card with a $20,000 limit, for example, the bank will consider that to be a $20,000 debt, even if you have only spent $500 on the account. Your minimum monthly repayment on a $500 balance would be around $20. Your minimum monthly repayment on a $20,000 would be closer to $400. When the bank is working out how much you can afford to repay each month, they will then deem your monthly credit card repayment to be $400, because that’s how much you could potentially owe, if you were to spend up big on your credit card.

When viewed in this light, it’s easy to see how quickly your borrowing power can shrink based on your bad debt credit levels. Even just two credit cards can have a significant impact. As a guide, it’s estimated that if you have a credit card (or several credit cards) with a total credit limit of $30,000 it could reduce your borrowing power by up to a whopping $110,000.

This is why it's so crucial that you meet with a trusted mortgage broker as early as possible, well before you plan to actually buy your first property, so you can perform a full Financial Health Check and get an understanding of your overall financial position. You may need to pay off some bad debts or rearrange your accounts prior to applying for a loan, so it's best to get in early.

This is precisely what a client of mine, Libby did. Libby first came to me when she was only 22 years old. She was very passionate about real estate and very keen to get into her first property. She was a definite hedgehog with serious goals. While all of her friends were out spending their money, she and her boyfriend Tim had worked hard and sacrificed to save a $25,000 kitty to begin their property investing.

She and Tim went through the Real Wealth Australia Property Investing Coaching and Mentoring Program, and part of the course included a Financial Health Check.

Libby and Tim's credit card and debt situation was as follows – it's a similar story for many Australians:

Card	**Credit Limit**	**Outstanding Balance**
VISA (Libby)	$2,000	$1,900
MasterCard (Libby)	$5,000	$4,500
Personal loan (Libby)	$10,000	$1,200
VISA (Tim)	$3,000	$3,000
AMEX (Tim)	$11,000	$4,000
MasterCard	$5,000	$0
TOTAL DEBT	**$36,000**	**$14,600**
Savings on hand	***$25,400***	

Between them, Libby and Tim had six bad debt credit facilities with credit limits totalling a whopping $36,000. Thankfully, the amount that they actually owed on their credit cards and loans was far less than the combined $36,000 credit limit. It amounted to less than $15,000 all up, so they were able to take action.

To get their finances looking healthy, their broker advised them to close some credit cards and loan accounts, and lower their credit limits on their other credit cards.

He suggested that they take some of their savings and pay off Libby's personal loan balance of $1,200, so they could then close that account. He also advised Tim to close his MasterCard account, as he'd only recently paid it off, so it was a good idea to cancel the card before he was tempted to spend on it again.

With the remainder of their credit cards, their broker suggested that they lower the credit limit to the nearest possible $1,000, and continue lowering the limit as they paid off each card. Lowering the limits helps you avoid the temptation to spend on the card again, which is how you would normally stay stuck in that debt roundabout.

Libby and Tim followed their broker's advice and within two weeks, they had made all of these changes – and their accounts suddenly looked like this:

Card	**Credit Limit**	**Outstanding Balance**
VISA (Libby)	$2,000	$1,900
MasterCard (Libby)	$5,000	$4,500
Personal loan (Libby)	cancelled	
VISA (Tim)	$3,000	$3,000
AMEX (Tim)	$4,000	$4,000
MasterCard	cancelled	
TOTAL DEBT	**$14,000**	**$13,400**
Savings on hand	***$24,200***	

They went from having six bad debts with a total debt liability of $36,000, to having four bad debts with a total liability of $14,000 – and their overall savings position had only decreased by $1,200.

Which applicant do you think the bank would prefer to do business with?

Not only did Libby and Tim put themselves in a better position to be approved for finance, but also, they boosted their potential borrowing power by tens of thousands of dollars.

Even more importantly, they learnt a valuable lesson about bad debt and the impact it had on their future property investing. Ever since their meeting with their broker, they've continued to be committed to wiping off their bad debts.

Can you imagine if Libby and Tim had approached a less experience broker, or applied for a loan directly with their bank? Their application for finance may have been rejected, or they might have been approved for a far lower amount.

By conducting a Financial Health Check before they applied for a loan, they were able to get all of their fiscal "ducks in a row" well in advance of when they required it, which gave them the best possible chance of success.

It's vital that you get your finances in order by making any changes you need to make before you even think about applying for finance, as you want to be able to put your best foot forward in the first instance.

Changing your mindset

Conducting a Financial Health Check is not a once-off affair – if you want to remain in control of your finances and move forward with your property investing goals, you really need to make a commitment to get involved on an ongoing basis.

To successfully build a property portfolio, you need to adopt the right mindset and attitude, which means you'll probably need to review your spending habits and financial behaviour on a regular basis. It's not a matter of restricting yourself or your spending – it's more to do with identifying what you want to achieve, and working out what you need to do to make it happen.

For many people, the biggest thing that holds them back is fear. Fear of failure prevents a lot of would-be investors from getting off the ground and moving forward.

How often do you hear the following from non investors? What if I lose my job and can't afford the repayments? What if the tenant does a runner? What if a storm hits and damages the property? What if the hot-water system bursts, and I have to pluck $1,000 out of the air to install the replacement?!

They're all very valid fears, and they're concerns that I held early on in my property investing career. I'll address them more thoroughly in later chapters, as there are actions you can take to counteract or mitigate all of these fears.

A little bit of fear is healthy, as it makes you ask questions and helps you to learn. But too much fear will cause you to procrastinate and hold you back. If you lie awake at night worrying about your mortgages and fretting about what your tenants are going to do or not do, you'll never succeed, because you'll always be making decisions from that place of fear and anxiety.

On the flip side, you can be too brazen and relaxed in your approach, so it's a matter of striking a balance. People that adopt a fox-like "act now, think later" attitude are the ones that find themselves in trouble, when they realise that they've over-committed, bought dud properties, or bitten off more than they can chew.

Realistically, your Financial Health Check should be the first step you take towards readjusting the way you approach your finances. Your attitude towards wealth, spending and money dictates the actions that you take on an ongoing basis. Once your personal finances are in order, you can then move towards a financially free future.

HEDGEHOG ACTION ITEM: Evaluate your spending habits regularly.

How to Increase your Borrowing Capacity

When you receive your credit card bill each month, do you:

a) Pay the entire balance off by the due date?
b) Pay more than the minimum amount due, but less than the full amount owing?
c) Pay the minimum amount that is due?

If you reviewed your credit card statements for the last year, would you find:
a) Very few or no late payment/ overlimit fees?
b) A handful of late payment/ overlimit fees?
c) Late payment/ overlimit fees virtually every month?

Have you ever rolled a credit card balance to a new card, or consolidated several credit cards into one account? If so, did you:
a) Immediately cancel your old credit card/s?
b) Reduce the limit on your old credit card/s?
c) Continue using your old credit card/s as before?

When you get paid every week/fortnight/month, do you:
a) Pay yourself (in a savings account) 10-15% before paying any bills?
b) Pay all of your bills, and then save whatever you haven't spent at the end of the pay period?
c) Rarely save any money – there's usually nothing left at the end of the pay period.

When your bank statement comes in each month or quarter, do you:
a) Go through the statement line by line, looking for hidden fees and charges, and highlighting any errors?
b) Glance at your statement before filing it?
c) Open the statement then drop it in a shoebox with all of your other statements and bills?

These are just a few sample questions, but you get the basic idea. These are just a few every day money habits and behaviours that can have a huge impact on your financial future.

If you answered mostly a's, then you're on the right track to financial freedom. You're clearly careful and conscious about your money, and you dedicate time and energy towards maintaining your personal finances.

If you answered mostly b's, then you're on the right track, but you still have to make a few adjustments. You're halfway there, but it would be ideal to establish some solid processes and systems to really streamline your finances and get you in the driver's seat.

If you answered mostly c's, then you need to seriously re-evaluate your spending habits, and decide whether you're willing to commit to a new regime to get ahead financially.

When I meet people who fit into the 'c' profile, I find that on the odd occasion, I'm not able to help them. My experience is that these types of spenders usually favour instant gratification over long-term rewards, and so I end up battling with their egos and their need to look good.

It saddens me to have to do it, but I occasionally have to leave them to wallow in it. I'm forced to do this because they have the inability to "give up" any of their lifestyle choices, or they simply can't change their mindset about money management.

For you to begin investing in property, you might need to downsize your car, or sell your second car. You may need to consider renting out your home while you rent, so that all of your home ownership expenses become tax deductible – or you might need to reign in your every day spending.

To get ahead in real estate, you very well may need to make some sacrifices – but if you have your eye on the prize and you're committed to growing your own wealth, it will make the journey that much easier.

Having said that, playing the game of property investing isn't meant to be a burden; if it was, how quickly do you think you would become tired of funding mortgages that rob you of your lifestyle?

There's no point busting your backside and living like a pauper while trying to create wealth – but there is a way you can balance your wants in the present (cars, gadgets, electronics, overseas holidays) with your property investing goals for the future.

HEDGEHOG ACTION ITEM: Seek out a qualified and experienced finance broker. Remember, you want to find a broker that invests in property themselves. Even if you're not planning to buy or sell right away, ask them to conduct a Financial Health Check on your current financial situation, so you can make sure you're on the right track.

6. Financing the deal

This is where all of your hard work is about to pay off!

If you have prepared a personal budget as outlined in chapter three, and you've conducted a full financial health check as highlighted in chapter five, then gaining finance approval should practically be a walk in the park.

Having all of your financial information on hand makes the process of applying for a loan so much easier, because you simply refer to your files when you're filling in your application paperwork.

However, I do say that it is "practically" a walk in the park, because getting a home loan for an investment property can be the most stressful and headache-inducing part of your property ownership journey! The good news is there are definitely steps you can take to simplify and streamline the process – and as with many things in life, it all comes down to preparation.

By now you should have a good understanding of your overall financial position, including your total income and all of your monthly outgoings, and you should be working to get rid of your 'bad debt'.

This is probably a good time to mention how important it is to be present and accountable in all aspects of your personal and family financial health. I bring this up because there are a lot of couples – in fact, most couples! – who share the every-day responsibilities of life, including bills and finances.

Usually, one person in the couple takes charge of managing the household budget, and that's perfectly fine. But if you're on the other side of that equation, and you typically deflect all financial responsibility to your partner, I would strongly urge to sit down with your partner every few months and "check in" on the state of your finances.

You don't want to be a passenger in this journey – you're playing with so much money and making such big decisions that I really believe you'll both be more comfortable about your investing outcomes if you feel that you contributed evenly to the decision-making process.

Also, I have to add this word of warning. This recently happened to a friend of a friend – I don't know the woman involved personally, other than having had a brief conversation at a Christmas party a few years ago, but my heart goes out to her.

She works in sales and my friend tells me she's quite successful, pulling in a decent income of around $90,000. She lives in regional Queensland, where the cost of living is far less than Brisbane, Sydney or Melbourne, so her income affords her a lifestyle that is more than comfortable.

Her husband is a cabinet maker who also earns a good income, and together they have a two-year-old son. This woman – I'll call her Sue – survived quite a tough childhood, and she's really worked hard to build herself a great life. Over the years she'd scrimped and saved until she had a little over $200,000 in the bank. In 2007, she and her husband decided to build their dream home at a cost of $500,000, so she sank $100,000 into the home as the deposit, and kept $100,000 in her saving account as a nest egg.

A few months ago, Sue looked into buying a small business in the town she lived in. She would need to invest around $30,000, but even after paying staff to run the business (it was a small beauty bar in the centre of town), she would still pull out profits of around $20,000 per year.

She and her husband (let's call him Matt) had a few meetings with the owner, who was happy to stay on and manage the shop as an employee, and they made plans to buy the business around Christmas 2009.

One day in October 2009, Sue went to the shop on her lunch break for a quick manicure and to chat about the buy-out plans with the owner. The owner pulled her aside and said, “Sue, I think you need to take a look at your bank accounts. This morning I had a phone call from Matt, and he said he was having a cash-flow problem. He asked if we could hold off on the sale until next year, and he asked me not to say anything to you, but I think there might be a problem.”

Sue bolted to her bank and asked for her account balance. The teller delivered the devastating news. In the account that she thought held $110,000, she had just $250.

“Also while you’re here,” the teller said, “you should also note that your mortgage is several months in arrears.”

Sue was in complete shock. She asked how the mortgage could be behind, when it was paid automatically each week as soon as her pay was deposited into her account.

“Actually, every week your pay gets deposited on a Tuesday, and it’s withdrawn on Wednesday,” the teller replied.

Sue asked for a print out of all of her accounts, and discovered that her mortgage was five months in arrears, her savings account had been wiped out and her three credit cards were all maxed out to their limits, totalling $45,000 in debt.

It turned out that Matt had a chronic gambling addiction, and he had literally gambled all of their money away.

He had been expertly hiding his addiction and for several months, as his losses accrued, he’d been gambling more and borrowing more in a manic effort to win back the lost money. Because he managed all of their accounts, Matt had been able to hide the overdue and arrears notices. She discovered he’d even set up a P O Box and redirected their mail to keep Sue from noticing her dwindling account balance.

Sue immediately left her husband and is now back living at home with her mum and son in a small apartment. Her house is on the market and she's starting to rebuild her life.

Now, I didn't tell this story to frighten you, or to suggest that your partner might have a debilitating gambling addiction! I just wanted to demonstrate how important it is to be present in matters of finance, even if your partner is completely competent, and even if you trust them 100%.

You need to consider – what if they were sick for several months and they couldn't take care of the bills? How would you cope then? Wouldn't it be better to be informed and prepared to deal with your finances *now*, rather than waiting and negotiating your way through the process *then*, during a time when you're already stressed and worried? It always pays to be in the know; they don't say that "knowledge is power" for nothing!

Here's the moral behind the story. In Sue and Matt's household, Matt had always paid the bills. Every week he gave Sue a few hundred dollars for her own spending, so she always had money in her purse, and he managed all of their finances.

HEDGEHOG FAST FACT: The key point that I am making here is to always take an interest in your financial affairs. Don't take the easy quick fox route and leave it up to someone else.

Quality is key

So, now that you're ready to apply for a loan, it's time to start working with your mortgage broker.

As discussed in chapter four, working with a qualified mortgage broker is essential.

A qualified mortgage broker will be able to offer advice and guide your lending decisions. A mistake that a lot of first-time borrowers make is that they assume that if a lender is prepared to lend them a certain amount, then that's how much you should borrow. Wrong!

Let's say your bank is willing to lend you $500,000. You do the sums and work out that you can afford the repayments on that mortgage quite comfortably, particularly once you account for your tenant's rent and your tax return. You're then ready to sign on the dotted line.

But what about those rainy day scenarios – like the global financial crisis? If you don't include a buffer for things like the GFC, or losing your job, or getting sick, or starting a family, you could get yourself into serious financial trouble.

A qualified and experienced mortgage broker will already be thinking of these issues and others. For instance, a good mortgage broker will know all about your bad debt and they'll encourage you to minimise this and any personal debts before you add another massive good or bad debt to your loan portfolio. Personal debts really can have a massive impact on your borrowing power, so if you're serious about creating serious wealth by investing in property, then you should genuinely work towards eliminating all of your bad debts.

HEDGEHOG FAST FACT: To get ahead financially, you will need to keep your credit card balances to a bare minimum. If you're tempted to spend on your credit card, reduce your card limit to $500. The simple fact is if you can't pay your credit card balance in full each month, then you're living beyond your means – and the best you thing you can do is to cut it up.

Planning your lending

I had a client just recently who was in the position to borrow up to $1.2 million to invest in property. Then he went and bought a $36,000 car using a hire-purchase agreement. It reduced his borrowing capacity to $760,000! I was furious. I felt like yelling at him, “Haven’t you learnt anything?!” Needless to say, he was very sheepish when he came in to see me, because he realised that he’s just taken a huge step backwards in terms of time to achieve his investing goals – and worst of all, at the end of the day, he didn’t even own the car!

Ideally, when you appoint your mortgage broker your goal should be to find a hedgehog broker that knows the ins and outs of investment finance better than anyone else in their field. You don’t want to employ a broker who claims to be an expert in finance for first home buyers, investors, home owners, upgraders and retirees… this displays the classic signs of a fox who is a jack of all trades and a master of none!

Instead, you want to work with someone who is experienced at working with investors and who takes into consideration your long-term goals for the future. You need to look ahead of this deal and come up with a 5-10 year mortgage plan, so you can begin to prepare for future investments now with products such as split loans and professional packages.

Split loans allow you to apply for one mortgage, but ‘split’ the loan into different sub accounts. One sub-account could be linked to property A, and the other sub-account could be linked to property B, so you effectively have two loan accounts linked under one banner.

Or, the loan might be split so that part of it is attached to a fixed rate, while the rest of the loan is on a variable rate. For instance, you might want to borrow $250,000, and for repayment certainty you lock $150,000 into a fixed rate, but for flexibility you leave the remaining $100,000 on a variable rate.

Meanwhile, professional packages are perfect for those who plan to build a multi-property portfolio. Offered by most banks, professional packages will cost you between $300 and $500 per year in the form of an annual fee, but for that cost the bank will shave a percentage off the standard variable rate (usually between 0.5% and 0.8%), and they'll also waive monthly account keeping fees, credit card annual fees, application fees, etc.

These are just two of the products that can help you to meet your investment goals, and having an expert mortgage broker on your side will help you to decide which ones will work best for you.

Some people turn straight to their bank when it comes time to apply for an investment loan, but I'm not a huge fan of that strategy. Granted, it's the path of least resistance, but you can't be certain that you're getting the best deal unless you actually see what else is out there.

Formal pre-approval

I'm also not a big fan of pre-approval, and the main reason for this is that pre-approval only means that you're 95% guaranteed for finance. A lot of investors believe that pre-approvals are important, but I think they can actually work against you. Let me explain.

Loan pre-approval means that based on the criteria you've provided, you are approved for the loan. But in the two months between being given pre-approval and actually finding the property you want to buy, if anything changes, the lender can all of a sudden deny you finance.

Perhaps during that time you increased your credit card limit, or you applied for a personal loan. All of a sudden you have a new ping on your credit report, which might make the difference between the bank approving or denying your loan.

If you have an experienced broker on your team, they should be able to find out "in principle" if the bank will lend you the money, based on the specific details of your situation, without formally submitting an application for finance. With most lenders this shouldn't be an issue, as it's as simple as the lender plugging in the details of your situation into their system to find out if, "in principle", they would ordinarily approve the loan.

Essentially it's the same thing as getting pre-approval, but the very important difference is that no entry will show up on your credit report.

The thing about pre-approval is, it only lasts two to three months per lender, so if you're shopping around for investment properties, you can end up with dozens of hits on your credit report. I have clients that have had up to four hits on their credit report over one property – can you imagine what that's going to look like to a prospective lender?

It may or may not have an impact on your application for your loan, but you don't want to give a lender any excuse to decline your finance application.

If you are starting to look at buying your own home and you shop around to say four lenders for finance, you might end up with four pings on your credit file and if the same thing happens twelve months later with the purchase of your first investment property then the banks may take a serious look at your capacity to borrow.

This means that within the space of a year, your credit profile would have been hit with eight entries. At this point you may decide to think about investing in another property, but when your lender looks at your credit report and finds several requests for finance, their thinking is usually something like... "Why are there so many entries on their credit report? Were they shopping around because they were being refused finance?" As stated previously, there is no information in your credit file for banks to find out whether finance was or wasn't approved.

It raises an eyebrow with lenders because they can't categorically see whether you were approved or denied for finance, so question marks can appear over entries that may have been as simple as, your pre-approval expired and you had to re-apply.

Honestly, if I went for formal pre-approval every time I bought a property, I'd have a telephone book full of paperwork! At the end of the day it just doesn't make sense – and if you have the right mortgage broker on your team, they'll be able to utilise their network of lenders without compromising your credit profile.

To market, to market

A very heavily debated question is which loan product should you get?

There's always a lot of discussion about fixed loans and variable loans, and the pros and cons of each.

Fixed rates can save you money. There are people who locked in three-year fixed rates in 2006 for around 6.5%, and they were able to avoid the 8.5-9% heights of 2008 and early 2009. By the time they came out of their fixed terms in 2009, mortgage interest rates were down to around 5%, so they managed to escape paying high interest rates altogether.

Fixed rates can also cost you money. There are people who were fearful in 2008 that ever-increasing mortgage interest rates were going to continue climbing, so they locked in their mortgages for several years when rates were as high as 9%.

The truth is, as evidenced above, choosing a fixed or variable rate on your home loan is always going to be a bit of a gamble. No one can precisely predict what the market is going to do, but what you can do is educate yourself and pay attention to what the experts are saying – and then follow their lead.

Historically, interest rates average out at around 7.5%. That means that anything above that is considered to be higher than normal, and anything below that is a good deal.

With this in mind, I wasn't too concerned when interest rates hit 9% in 2008. I knew that they couldn't stay that high for too long because it was such an anomaly against the historical trend, the anomaly being caused by the global economy not being in great shape. At the time when interest rates were near 9% I advised all of my clients to avoid fixing rates and buckle down into "survival mode". All they needed to do was just get through the next twelve months, and then reevaluate the situation down the track.

Those people that locked in their interest rates in 2008 were borrowers who were driven by fear, not by knowledge. There were commentators in the media at the time that predicted that interest rates would soar past 10%, which was certainly a frightening concept.

But if you looked past their "doom and gloom" headlines and avoided getting caught up in the hype, you could see that the state of the market didn't support double digit interest rates – at least, not for any real length of time.

As an investor you need to plan for rainy days such as double-digit rates interest rate rises. This is why I recommend that you don't borrow the full amount that the bank is willing to lend you. If you borrow $300,000 instead of $400,000, you'll be much better equipped to deal with the shock of higher interest rates if and when they do occur.

In regards to fixed or variable interest rates, there really is no right or wrong answer because it depends on your investing goals.

If you plan to hold your investment properties for the long-term – at least ten years – and you don't see any scenario under which you might want or need to sell, then fixed rates could provide you with a level of investing certainty and possibly long-term savings if you pick the interest rate trend correctly.

Personally, most of my mortgages are fixed. When interest rates dropped to a variable rate of around 5% in early 2009, we locked the majority of our mortgages into 10-year fixed rates of 6.19%. Many people thought we were crazy to be paying more than 1% over and above the standard variable rate, but we were happy to be paying more than 1% *below* the historical average standard variable rate of 7.5% for the next decade, because history showed that the variable rate would not stay that low for long and it didn't.

I'm not suggesting that fixing interest rates is always the way to go. If you need flexibility, then variable rates could be the right solution. If you want to sell and your mortgage is fixed, you could be hit with expensive exit fees of thousands (or tens of thousands) of dollars to end your fixed interest mortgage contract.

When you sit down with your mortgage broker, you should discuss your short and long term goals for your property investing career and your lifestyle. They might be able to suggest options that you haven't thought of and maybe able to tailor a finance solution that suits your property personal investing strategy.

[case study] Beware the inexperienced broker

Karina Farris bought an investment property in Sydney. She already owned three properties and had bought and sold several others, so the process of applying for finance wasn't new to her.

"In the past I've always used my own bank, so arranging finance was as simple as calling my personal banker and having him crunch the numbers," she says.

"But this time around, I approached a mortgage broker so I could see if there was a better deal available. I'd heard people say that brokers can save you money, and I found a company in a property magazine that would give cash back at the end of the deal, based on your loan size. I thought it was win-win!

I called them up and arranged an appointment at my house that evening after work. They were young couple, recently married, and they were very professional and seemed to know what they were doing.

We'd had a brief discussion on the phone and after another chat about the property I wanted to buy, they opened their laptop and plugged in a few numbers. They then recommended a product from a smaller bank, which offered the lowest rate on the market at the time. This bank was prepared to waive the application fee, and the rate on offer was 0.3% lower than my current standard rate with my bank – one of the 'big four'.

I thought I was ahead of the game already – with a lower interest rate and cash back at the end, I was thinking I can't go wrong!

But this process was a whole new ball game for me. I had to supply lots of paperwork including bank statements, pay slips and mortgage documents relating to my other properties to prove my application to the new lender. It was exhausting and time consuming. But, I kept reminding myself, at least I'm saving money!

A week after the property settled, I called the bank as my paperwork hadn't yet arrived in the mail. My call was answered via a call centre in Asia. With my other bank, I had a personal banker who worked in an office in the city, but this time I was talking to a nameless, faceless call center operator in another country. It was so frustrating – can you imagine how difficult it was to track down lost paperwork in Sydney through a call centre in Asia?!

There were a few more small hiccups in the first few weeks, and each time I rang up, I would have to explain my story all over again to a new person at the other end of the line.

They were all small inconveniences and in the end, they weren't that bad – it just made everything a little more stressful. It's frustrating that I still have to go through a call centre to discuss my loan every time I need to check on something or ask a question, but it's not that big a deal.

The thing is, I was making decisions based on such shortsighted goals – to receive a cash back bonus of $1,000, and save 0.3% interest on the loan. Ironically, that margin was gobbled up in an interest rate hike the week that I settled!

And it all could have been avoided if I had known which questions to ask the broker in the first place, and if they had known which aspects would be important to me as an investor. I'll never again work with a broker who isn't an investor themselves, because they would instinctively know that the loan I've ended up with isn't right for an investor – there's no flexibility, limited service and I can't even attach an off-set account. I've definitely learnt my lesson for next time!"

7. Buying Structures and Asset protection

Buying your home. Buying an investment property. They may seem like the same thing on the surface, but they're actually two very different transactions.

When you're shopping for a home to live in, you think about how you would live in the property. You possibly ponder ways in which you could renovate the kitchen, or whether your table setting would fit comfortably on the paved area in the backyard.

When you buy an investment property on the other hand, you think about the property from a landlord's perspective. You wonder how much life the oven and stovetop has left before they'll need replacing, and whether the raised tiles in the bathroom could constitute a legal liability if your tenant was to trip on them. We'll discuss these issues in more detail in Chapter 9 – Buying Rules, but you get my point – the two buying scenario "wish-lists" are completely different.

Similarly, the purchasing processes are poles apart. Yes, the mechanics are virtually the same, you still need to perform due diligence to ensure the home is structurally sound, and sign contracts, and obtain finance from a lender, but each step demands a new thought process when you're buying as an investor as distinct from an owner-occupier.

When you invest in real estate, you have to consider all aspects of property ownership, including tax minimisation, asset protection and ownership structures. These aren't "after the fact" issues that you can consider once you've found and bought your investment property – these are things that you have to think about before and during the buying process. Doing it correctly first up will ensure that you're set up to continue growing your property portfolio and that you don't make costly mistakes.

As an example of this, many people will buy their first investment property in their own name. Sometimes and in fact quite frequently with novice investors, they don't realise there's an alternative. You might think, that's what you did when you bought your own the home, so why should it be any different with an investment property?

Often, buying in your own name might be the right way to go. But if you want to be really successful in property investing, you need to treat it like a business. The properties that you buy become your incoming-producing assets. The rent that you receive becomes your business income. And the expenses that you incur become the costs associated with running your business.

Now, when you're operating a business, you need to structure your finances appropriately. This is why it's so important to have a qualified accountant on your team. Your accountant will play a pivotal role in your wealth creation journey, so if you plan to successfully build a serious property portfolio, it's a good idea to engage a property savvy accountant as soon as possible.

The financial and investing decisions that you make now can impact on you and your wealth position well into the future, so you need to get it right from the very start.

As far as our accountant goes, he's very proactive – and by that I mean, he doesn't wait for us to make a move. He'll ring us several times during the year and say, "We need to review your tax planning strategies. Why don't we sit down and work out how much tax you're looking at paying, so we can make plan how to minimise it?"

When it comes to tax law, he is a hedgehog in the truest sense of the word – I'd be shocked if there was a single question related to tax and investing in property that he couldn't answer! It's very reassuring to have an expert like that on our team, because it takes the pressure off us and buys us time because we know that he's always thinking ahead.

An expert on your side

As I mentioned in a previous chapter, it hasn't always been this way with our accountant.

Our previous accountant was a little too complacent, and he wasn't as details-oriented as we actually needed him to be.

A few years ago now, we were looking at buying an investment property in Queensland, and I asked our accountant whether we should buy it in our own names, or in a trust. "Buy it in your own name, Helen," he assured me, and so that's what we did – or so we thought.

When the contract and paperwork for the purchase was processed our accountant advised us to purchase the property in my name instead of in my name as trustee for our trust, and because we trusted our accountant with this level of detail, we didn't double-check that he had it right.

For several years, we thought the property was owned in our trust and come tax time, that's the entity that we processed our tax returns in – that is, until the ATO picked us up on it during a tax audit. We then had to put in revised tax returns for the years that we had owned the property.

Once our new accountant took over, he quickly rectified the mistake.

He had to dig back through several years of tax returns to redistribute all of the income and expenses, but in doing so he managed to find some extra deductions that our previous guy hadn't picked up

Using a good accountant is not just for buying property. They should be part of developing your long-term investing goals, that in turn will help you to identify and set up the best ownership structures that will best suit you now and well into the future.

When we first met with our current accountant, the first thing we did was to sit down and discuss our goals. We told him how many properties we owned, how many we wanted to own, and the date by which we wanted to own them.

We also discussed our superannuation needs, and he helped us set up our DIY super fund. He knows all of our hopes and goals for the future and he works with us to ensure that each financial decision we make takes us a step closer towards our target. Who doesn't want someone like that on their team?!

Worth their weight in gold

Some people avoid using an accountant because they feel like they can manage their financial affairs on their own. This may well be valid in your particular circumstances, but more often than not this will not be the case. I believe that a good accountant will be able to recoup their fees many times over, both in tax savings and in their professional advice.

When we were first starting out, we met with a bigwig accountant in the city. He had a beautiful corner office on a high floor of a skyscraper, and his client list read like a who's-who of Australia's business elite.

After we told him about our situation and our plans with property investing, we asked: "Who is the richest client you've got?"

He rattled off a couple of high-profile names, and we asked, "How many of those types of high-roller clients do you have?"

He told us he had several wealthy clients, and even a few outrageously successful, obscenely wealthy clients, which was just what we wanted to hear.

"Of all of these very successful, very rich clients that you have," we asked, "which structure do they use when investing in property?"

The answer was unanimous, of all this accountant's most wildly successful clients, most of them had purchased their investment properties in discretionary trusts. Their reason was that they offered the best asset protection for their properties.

Well, we had our answer. It was simply a matter of following the leader – why reinvent the wheel, when so many wealthier, more experienced business owners and investors had already worked out the best solution?

Since that point on we've always used a discretionary trust (I'll discuss the various ownership structures in more detail later in this chapter), because my motto is, "Slow and steady wins the race."

There are plenty of other trusts you can use, some of which have benefits that discretionary trusts don't have. But my feeling is, why do it the difficult way? You can go to all the trouble of setting up elaborate trusts and seeking a ruling from the ATO, but I just like to be a hedgehog. My motto is use a tried and true formula that doesn't draw attention to yourself.

There are so many options available to you, options that your accountant will be able to help you to navigate through. In particular they can help you in areas such as:

- Tax minimisation – how to make the most out of your investments and ensure you're claiming every last legal dollar
- Ownership structures – buying in your own name versus buying in a trust, and which option you should use
- Capital Gains Tax (CGT) – the ideal time to buy and sell to minimise your CGT bill
- Asset protection – keeping your real estate assets safe

Tax minimisation

When you invest in real estate, End of Financial Year (EOFY) takes on a whole new meaning!

One of the benefits of owning an income-producing asset – such as a house or apartment – is that most of the expenses associated with owning that asset are deductible from your taxable income.

Hard costs such as mortgage interest, council rates, body corporate fees and maintenance expenses can also be claimed as a deduction in the tax year in which they occur. Other costs can be depreciated over a number of years.

There are also costs that you cannot be claimed immediately, but instead they are added to your “cost base” so that when you eventually sell the property it can be claimed. Stamp duty falls under this category. In this instance your “cost base” is the purchase price of the property (for example, $300,000), plus any capital expenses that you couldn’t claim as a tax deduction (for example, stamp duty at a cost of $9,000).

This would bring your cost base to $309,000. If you sell that property for $350,000, you will make $50,000 against your purchase price of $300,000, but the ATO will only view your profit for tax purposes as being $41,000.

Yet another tax deduction is depreciation, which is so complex that it deserves its own chapter! Depreciation is essentially the government’s way of acknowledging that the property you own will deteriorate over the years. The tax office will allow you to “depreciate” the value of the property over a period of 40 years, but you need to engage a quantity surveyor to prepare a depreciation schedule in order to make sure that you maximise your depreciation allowances. Depreciation schedules cost around $600 to produce, and this fee is tax deductible.

Depreciation can put up to thousands of dollars back into your pocket each year, but any depreciation claims you make must be added back onto your cost base when it comes time to sell.

For instance, let's assume you depreciated your $300,000 property at a rate of $7,000 in year one, $6,000 in year two and $5,000 in year three. This equates to $18,000. Your cost base has been increased to $309,000 to account for stamp duty paid, but it will now be reduced by a further $18,000, to account for your depreciation claims over the years. Thus, the ATO will view your cost base as being $291,000. If you were to sell for $350,000, the ATO would determine your profit as being $59,000.

As you can see, there are many different categories for tax deductions, including same-year deductions, multi-year deductions, depreciation and cost base adjustments.

The ATO has very specific rules and regulations regarding which expenses are tax deductible and which ones are not. I would highly recommend that you work with an accountant who is experienced in working with property investors. This will ensure that you take advantage of all possible tax deductions, without stepping outside of the law!

HEDGEHOG FAST FACT: Filing a tax return can be complicated when you own investment properties. The ATO has highlighted some common mistakes that taxpayers make in relation to rental properties, such as claiming full mortgage and ownership expenses when the property is only available for rent for part of the year – or claiming the full cost of a visit to inspect a property, when the visit was combined with a holiday. If in doubt, seek out an expert – it's not worth the hassle of an audit when a professional can handle all of the paperwork and stress on your behalf!

Ownership Structures

The property ownership structure that you use will, among other things, depend on what your plans for the property are, your requirement for asset protection and your financial situation.

Most people who are just starting their property investing journey will buy their first few investment properties in their own name. We did initially, because we were in jobs that paid well but which also meant that we paid a lot of tax, and the best way for us to minimise this tax burden was to negatively gear our properties against our personal incomes.

Depending on your own particular circumstances, it generally makes a lot of sense to maximise the amount of PAYE tax that you get back from the ATO by buying property in your own name.

Buying property in a company name is rarely the best option. Companies are not entitled to receive the 50% CGT discount on profits from an asset that is held for more than 12 months. Unless you plan to buy, renovate and sell quickly, you stand to miss out on significant tax breaks by buying property in a company name. If you're considering this option, I would strongly urge you to consult with your accountant before you proceed.

If you do plan to build a sizeable portfolio, you will reach a point where you exhaust the tax benefits of buying your properties in your own name. Eventually, when you own four or five properties, you may find it more beneficial to buy property in asset protection trusts. This also can have the side benefit of minimising your tax bill and maximising your profits.

There are three main types of trusts that people use when investing in property. These are:

Unit trust

Each individual purchases an equal number of units in the trust. Your ownership of the property in that trust is then directly related to how many units you own, against the total number of units owned. For example, if there are two of you, each person owns 50% and at tax time, you'll each receive 50% of the profits. If there are three unit holders, you each own 33.33% of the units and receive 33.33% of the profits, and so on. It is possible to negatively gear any losses in a unit trust.

Discretionary trust

A discretionary trust allows you to decide where the profits will go each financial year. It gives the Trustee of the Trust the flexibility to choose where to distribute the profits generated from the trust. So for instance, a couple in a discretionary trust might have one high-income earner and one low-income earner. The Trustee could then direct the lion's share of the profits generated by the Trust to the low-income earner, so that less tax is payable. It should be noted that it isn't possible to negatively gear in a discretionary trust, because losses cannot be distributed and must be quarantined in the Trust.

Hybrid trust

A hybrid trust is a combination of the two. It provides you with asset protection and gives you a choice as to how profits are distributed, but it also allows you to negatively gear any losses. Sounds like the best of both worlds, right? Well it is – and because of this the ATO can view Hybrid Trusts in a negative light if they believe that they are being used as a means of avoiding tax.

Personally I'm not big fan of hybrid trusts – we only use discretionary trusts, because they don't seem to raise a red flag with the ATO. Our attitude is, if the tax office is comfortable with us using a discretionary trust to buy property, then that's what we'll use.

Remember: when it comes to investing in property, I like the hedgehog process of keeping it simple and playing within the rules.

When tax time rolls around, we lay out all our discretionary trust tax accounts and as the Trustee, I distribute the profits to the nominated beneficiaries. Some trusts run at a loss and some at a profit but because the trusts are also beneficiaries of each other, the various profits cancel out the losses, making no tax payable.

But just because a discretionary trust suits us and our situation, that doesn't mean it will necessarily be right for you. You should always check with your accountant as to their suitability for you and your circumstances.

Because losses are quarantined in discretionary trusts, it may not be ideal to use them if you are a high income PAYE earner who invests exclusively in negatively geared properties.

The ownership structure that is most suitable for you will depend on your short-term and long-term goals for investing. You need to look at a range of issues to decide which structure will be best for you now and in the future, which is why it's so important to meet with a tax professional as early as possible in your property investing journey. It can be expensive and complicated to "undo" mistakes in the future, so it's worthwhile spending the time and money to set things up correctly at the beginning.

Capital Gains Tax (CGT)

CGT is the tax that you're required to pay when you sell an investment property for a profit. It can best be described by using an example. Let's say that you buy a house for $200,000, and you sell it three years later for $300,000. Your profit margin is (without taking into consideration stamp duty, purchasing and selling costs and depreciation allowances) around $100,000. You are required to declare this to the taxman who will apply a CGT on the net profit from the sale.

I can't tell you how many clients I've had over the years who have been caught out by CGT. I worked with one couple who had no idea what CGT was. They'd bought an investment property in their street to 'dip their toe' into the property investing market, and they were thrilled when they sold it five years later for a $150,000 gain!

They immediately commenced renovations on their own home and bought new cars and went on a holiday with their profits... and then end of the year tax time rolled around. My client told me she had thought it had been too good to be true, and unfortunately it was! They'd spent all of the profit from the sale of their property and couldn't pay the $30,000 tax bill that they were confronted with. Fortunately for them the ATO allowed them to pay off the debt over several years.

There are ways that you can reduce your CGT bill, which is why working with an experienced accountant is so crucial. They can advise you on the best type of structuring to suit you and your circumstances and when the best time is to sell a property.

With the $100,000 gain above, let's assume there are some "cost base" adjustments such as stamp duty that reduce the gain to $90,000.

The ATO allows a 50% reduction in CGT if you hold an asset for longer than 12 months, and this property had been owned for three years, so the taxable income from the sale of the property for CGT calculation purposes is reduced from $90,000 to $45,000. You'll then be required to pay tax on this amount at your nominal tax rate.

If Ed and I are thinking of selling a property, we actually discuss our intentions with our accountant *prior* to listing it on the market. He can tell us the impact of selling in the current financial year or the next financial year. For instance, we may have an accumulated tax loss that could be used to neutralise the capital gain amount that we are required to pay tax on, and therefore it would be advantageous if we sold now.

Asset protection

I believe that there is no better way to protect your hard earned property assets from litigation than by holding them in a discretionary trust.

When you own property in your own name, you are open to the risk of potentially losing one or more of your properties if you are litigated against, for any reason.

The way that this works is that if you own your own business and experience financial troubles, any personally owned properties may be at risk if creditors begin digging to recoup the money owed to them and find that you have built up assets that are worth pursuing.

If you are personally sued for any reason such as, if a friend of a relative trips in your backyard and injures themselves and then sues you for negligence, it's possible that your property assets could get caught up in the lawsuit. It sounds far-fetched but in reality people get sued for all sorts of serious and frivolous reasons every day, so you might as well prepare yourself now for the possibility that it might happen to you one day.

When you buy property in a discretionary trust, the trust owns the asset not you personally. You are just a beneficiary of the trust who benefits from any distribution of profits that the Trustee chooses to push your way. Because you don't technically own the asset, a potential litigant will be able to see this and will think twice about suing you.

When it comes to property investing, discretionary trusts are, in my opinion, the ultimate strategy to protect you from litigation.

That's not to say that using a trust is the only way to protect your hard won property assets, even if they're held in your own name. To do this, simply get a second mortgage over the property through a trust and/or take out litigation insurance – it's cheap.

In explaining the above second mortgage option, your first mortgage will generally be a standard 80% lend with a standard bank or lender. Your second mortgage, for the remaining 20% of the property's value, will be obtained using a trust.

If anyone attempts to sue you, they're going to see that your first mortgage is with a bank and your second mortgage is tied up with a trust – so there's no point in pursuing you, as you own no assets and they'll therefore most likely end up with nothing.

HEDGEHOG ACTION ITEM: I'm by no means a tax expert, so make sure you speak to your accountant before considering any of this advice. Tax law is a huge and complicated beast, and having a professional property-tax hedgehog on your team will save you plenty of time, money and heartache in the long run!

In recent years, the ATO has begun to pay close attention to property investors, because more than 1.5 million people claim rental property deductions worth tens of billions of dollars each year. If your tax return displays unusually high claims for rental deductions, low rental income, or high claims for interest and borrowing expenses, then they'll most likely be paying extra special attention to you.

If you're not 100% sure of what you're doing, don't risk it – your accountant can steer you in the right direction and make sure you're claiming every possible dollar, without breaking the law.

8. Creating your investment strategy

When it comes to property investing, there are literally dozens of ways that you can make money – and I'm not going to cover every single one of them!

From wrapping and flipping to holding for the long term, developing, subdividing and renovating, the options available to you as an investor are virtually limitless.

But I think it's important to mention that for every opportunity that presents itself, there are also pitfalls and risks to be aware of. That's why you need to devise and implement a personalised property investment strategy that matches your immediate and long-term goals and your lifestyle.

Developing an investment strategy is the single most important thing that you will need to do on your property investing journey. An investment strategy will provide you with direction and focus and minimise the probability of you making one of the two biggest mistakes that property investors make:

1. Overextending themselves so that they have to live off baked beans to invest and
2. Hitting the financial brick wall when banks stop lending to them

This can be explained in more detail as follows. During an investor's property accumulation phase, creating wealth should primarily be about capital growth. Rents will generally only cover the property's expenses while you wait for capital growth to occur.

This therefore means that the accumulation phase will be at least a 10 year game. It needs to be this long because it takes 8 to 12 years for the value of a property to double in value, the time being dependant on the type and location of the property you purchase.

The problem with going for a high capital growth strategy though is that this type of property generally has expenses that exceed the rental income received from the property. The difference needs to be funded from your regular day–to-day income.

If you do this several times, two things will occur and most probably around the same time. The first is that your lifestyle will more than likely be adversely impacted as your properties eat into your disposable income. The second is that the banks will begin to think twice about lending to you because your investments are income-dependant. Also, if you lose your job then you're in danger of losing your properties because you can't pay the mortgages.

Unfortunately, this is what many Australians falsely believe that property investing equates to – sacrificing your current lifestyle for future gains – but I think that's the wrong way to go about it.

Investing in property should be a positive, empowering and financially rewarding experience, which ultimately delivers profits to make your lifestyle more comfortable.

It's all about living and investing within your means, and creating a balanced investment strategy that helps to grow your wealth position, rather than take away from it.

A few years ago I met a woman named Shirley at a property expo who owned three properties, including her own home. The three properties were valued at around $700,000 in total, with a combined mortgage of roughly $300,000, so she was sitting on equity of around $400,000.

Do you want to know the most remarkable part of this story? Shirley worked part time and earnt $10,000 per year. Her husband worked full-time and took home an annual salary of $40,000. Their combined household income was just $50,000, and on that amount of money they were able to pay their bills, put two teenage children through private school, and invest in property.

“My goal was to just make enough money out of investing to put the kids through private school,” Shirley told me. “We never expected to do so well out of property, so we’re thrilled about our current position. Eventually, we hope to buy one more property, and then one day we’ll retire off them.”

Shirley didn’t have grand plans to own 20 properties or be a multi-millionaire, she simply wanted a more comfortable life for her family. I’ve always found Shirley’s story to be inspiring, because it proves that if she can do it – *on a family household wage that equals less than the Australian individual wage!* – then anyone can do it.

To have a successful investing career, you’re ideally looking to achieve one goal, buy the right property, at the right time and the right price, using the right property investment strategy – and then rent that property to the right tenant. Sounds simple, right?!

Actually, it is that simple – if you know what you’re doing.

By developing a personal investment strategy, you’re essentially building a “road map” to guide you through the process.

If you’ve implemented what I’ve taught you up to now, you should have:

1. Got your budget in order to find out how much disposable income you have for property investing,
2. Organised a financial health check from your mortgage broker,
3. Gathered a team of trusted professionals around you, and most importantly,
4. Set some SMART goals for yourself and your investments.

Now it’s time to create an investment strategy and action plan, so that you can actively work towards achieving your goals.

Your investment strategy will help you identify the type of property that you need to buy so you are never over-extended and you don't hit the financial brick wall.

There are literally hundreds of different strategies that you can use to achieve your wealth creation goals, the difference being that some are a higher risk than others. The ones you that you choose will depend on your appetite for risk and your goals. Some of the more commonly adopted property investing strategies include:

1. Buy and hold

This is the most common property investment strategy used by the majority of serious investors. Under this strategy, you would buy a property and rent it out with the intention of holding the property for a significant period of time… at least 10 years.

Investors who use this strategy might:

- Plan to sell the property after 10 years, so that they can release the capital growth to reinvest in more property
- Continue to hold and rent the property out indefinitely, so that they can enjoy the increasing capital gain and rental returns
- Actively work at paying off the mortgage, so they can eventually enjoy the rental return as a full-time income

2. Buy and renovate

As Australians, we generally fancy ourselves as being quite handy when it comes to DIY renovation projects – just look at the number of Bunnings warehouses and hardware stores popping up in every city and town! The idea behind this strategy is that you add instant value to a property through structural or cosmetic improvements.

Investors who use this strategy might:

- Plan to renovate and sell straight away, so they can enjoy an immediate short term profit

- Renovate the property to boost the rental appeal, and then hold the property and enjoy the higher rental returns
- Renovate and then get the property revalued, so they can access the new equity as a deposit on further investments

3. Buy and develop

Under this strategy, you would buy an investment property with plans to demolish or renovate the existing house, and/or construct an additional new house or unit on the property.

Investors who use this strategy might:

- Keep the existing property, but subdivide the block so they can construct more property/s
- Keep the existing property, but subdivide the block and sell the excess land, so they can instantly enjoy the profits
- Knock down the existing property to allow for construction of a duplex/triplex/block of apartments
- Transform the existing property into a duplex or other multi-dwelling complex – this is popular with unique property conversions, such as churches

4. Joint venture

A joint venture involves a property purchase between two or more individuals or groups. Joint ventures are particularly useful for people who want to invest but are having trouble getting finance approval from banks. It will mean that you will have to share the spoils of your labour with someone else but my philosophy is, it's better to have 50% of something rather than 100% of nothing.

Investors who use this strategy might:

- Be equity poor but have good borrowing capacity with the banks. They might then find an equity partner to joint venture with

- Have great equity in their existing house and/or investment properties but little or no borrowing capacity. They might then find a borrowing partner to joint venture with

FOX WARNING: There are many other investing techniques that are spruiked by so-called property “experts” throughout Australia, such as wrapping, flipping, lease-options and vendor finance. These types of investing techniques can work but can also be high risk, which means they’re generally not suitable for investors who are just starting out. If you plan to pursue one of these options, I would strongly recommend that you meet with a trusted mentor with experience in that field, so you can be sure you’re making the best decisions that align with your long-term goals.

Developing an investing strategy that suits your circumstances is a major step forward in your investing journey but it is not the total equation. Your action plan, which includes a buying strategy that best suits your situation, is the next piece in the puzzle.

When you buy an investment property, there are several ownership costs you need to take into consideration. As well as the mortgage repayments – which are usually the largest expense in owning an investment property – you’ll also need to consider expenses such as council rates, water rates, property management, maintenance, insurance and possibly body corporate fees.

Fortunately, you will have a regular income stream from the property in the form of rent to help you cover these expenses. A negative difference between the rent that you receive and the cost of owning the property is often referred to as your “shortfall”.

Depending on the property you buy, the shortfall might cost you a little or a lot each week, or it may even put money back in your pocket each week.

Positive cash flow property

A positive cash flow from a property is achieved when your rental income exceeds all of the expenses associated with that property. This is without tax benefits being taken into consideration. Another way of saying this is, there is enough rent money left over after expenses for you to spend and/or reinvest. Property that delivers a positive cash flow most commonly occurs in regional areas where property prices are low, but rental demand is strong.

Example: Let's say you buy an older house in regional Queensland for $200,000, and your weekly expenses including the mortgage, rates, insurance and property management fees come to $280 per week. Let's also assume that the rent is $310 per week. Your investment is a positive cash flow deal that returns you $30 per week.

Positively geared property

A positively geared investment property is one in which the investment property produces more income than it costs to run and in order to achieve this tax benefits are taken into consideration.

Example: Let's say you buy another house in regional Queensland for $275,000, but this time let's assume that it is brand new. Let's also assume that the property's weekly expenses including the mortgage, rates, insurance and property management fees come to $380 per week. Let's further assume that the rent is $360 per week. Let's also assume that the depreciation schedule – which you have had a quantity surveyor produce – allows you to depreciate the property at a rate of $70 per week.

At end of financial year, the taxman views your property as costing you $450 ($380 real costs plus $70 depreciation). This leaves a technical shortfall between rental income and expenses of $90 per week. The ATO will permit you to claim this $90 shortfall as a deductible expense on your taxable income and depending on what your tax rate is, you will receive between 15-40% of that shortfall back at tax time. Your investment will therefore have become a positively geared property that returns between $13-$36 per week.

Neutral cash flow property

A neutral cash flow property is one in which the investment produces the same income as the costs that it incurs and in order to achieve this tax benefits are taken into consideration.

Example: Let's say you buy a new property in a major regional centre of Queensland for $350,000, and your weekly property expenses including the mortgage, rates, insurance and property management fees comes to $450. Let's also assume that rental income is $450, so the property is financially balanced. If tax benefits were taken into consideration then this would be a positive cash flow property.

Negatively geared property

Negatively geared property is one in which the incurred costs of owning the property are greater than the rental income, even after tax benefits are taken into consideration. This means that you will have to dip into your income each week in order to support this type of property.

You might rightly ask, why buy such a property? The reason is that this type of property generally exhibits higher than normal capital growth, which is what investor's should primarily aim for. You should however take into consideration the impact that owning a property like this will have on your lifestyle and borrowing capacity.

Example: Let's say you buy a new property in Brisbane for $450,000, and your weekly property expenses including the mortgage, rates, insurance and property management fees comes to $575. Let's also assume that the rent is $500 per week. This means that that your property will be negatively cash flowed to the tune of $75 per week. If the depreciation deduction amounts to $60 per week then you would effectively be out of pocket by between $20 and $45 per week.

The government likes to encourage people in invest in property – after all, private landlords provide rental accommodation for millions of Australians who cannot afford their own accommodation, and without investors, the government would be forced to provide alternative social housing solutions which it patently cannot afford to do.

For this reason, the tax man is willing to cut you a break come tax time, and allow you to claim depreciation and offset any property losses against your personal taxable income.

If your negatively geared property is costing you $45 per week, it equates to $2,340 per year that you can claim against your taxable income at tax time. If your nominal tax rate is 30%, that'll be around $702 back in your pocket at the end of the year – so in effect, the property will only cost you around $1638 per year, or $31.50 per week.

HEDGEHOG FAST FACT: Property investors provide shelter for more than one million households, or around three million Australians, each year.

Tenure type	***Total***
Home fully owned	2,430,727
Home being purchased	2,436,110
Rented through:	
Real estate agent	1,024,191
State or territory housing authority	304,431
Person not in same household(c)	473,984
Housing co-operative/community/church group	50,165
Other landlord type(d)	99,451
Landlord type not stated	58,243
Total	*2,010,465*
Other tenure type(e)	60,079
Tenure type not stated	206,715
Total	**7,144,096**

Source: AUSTRALIAN BUREAU OF STATISTICS 2006 Census of Population and Housing

On the surface, it may seem that positive cash flow or positive geared properties are the obvious choice, but that's not always true.

Finding positive cash flow property will more often than not mean you will have to go searching in regional towns. The problem with regional towns however is that populations in these areas are generally stagnant and capital growth, which is related to demand, is usually not as strong as it is in capital cities. Therefore if you want/need this type of property to satisfy your investment strategy, you may need to sacrifice long-term capital growth in order to enjoy current cash flow.

Alternatively, if you're a high income-earner with good borrowing capacity and you pay more than your fair share of income tax, you might consider looking for a negatively geared investment property with high depreciation levels that will help you to decrease your tax bill. Generally, negatively geared properties are located in capital cities where long-term capital growth is virtually assured. Negative gearing investors must be prepared to be able to sustain a hit to their hip pocket each week in order to sustain their negatively geared property. The positive to this is that they should be able to create wealth faster than with positive cash flow properties.

As you can see, there are plenty of investing pathways that you can choose, and while none of these are definitely "right" or "wrong", some are higher risk than others. In the end however, you'll usually settle on a strategy that suits your goals and circumstances.

Balancing your portfolio

I've found that in most cases, a balanced investment portfolio is the ideal pathway to real wealth. By this I mean that for every negatively geared property, it makes sense to add a positively geared property to neutralise the balance sheet. However this does depend on your personal financial situation and your goals, so it is important that you create the right strategy to fit your circumstances.

That doesn't mean you should stick with that one strategy forever – far from it. Your investment strategy should be continually updated to account for changes to your lifestyle, financial borrowing capacity and goals.

Developing your strategy

An investment strategy that suits you and your lifestyle can take up to three months of effort and planning to properly develop. Once developed you will then need to develop an action plan that outlines how you intend to implement the strategy.

Generally I like to work with my clients to create a two-phase investment strategy that will move them towards creating real wealth for their retirement.

Phase one is the accumulation phase. This is the period where you build your investment portfolio and grow your wealth.

Phase two is the retirement phase. This is when you stop working for someone else and begin living off of the rental returns of your property investments.

When and how you implement phase one and phase two will obviously depend on your age and your financial situation. For instance, if you're in your 20s, 30s or 40s, you have decades ahead of you to accumulate your property assets before you retire. If you're in your 50s, 60s or 70s, you'll need to develop a more targeted and aggressive strategy.

The aim of the retirement game is to financially retire off the income that your properties produce. This will mean that by the time you retire, your portfolio should be net positively cash flowed.

When creating your buying strategy it's extremely important that you take into consideration your lifestyle, because if buying properties results in you not being able to afford to go out to dinner or the movies, how long do you think you will stick with it? My advice is to aim for a balanced buying strategy that doesn't adversely impact on your lifestyle.

The best way to keep a balanced portfolio is to purchase properties with values that roughly match up with your income level.

Generally speaking, the greater your income, then the easier it will be to buy negatively geared properties. Conversely the lower your income level, the harder it will be to purchase negatively geared properties, therefore neutrally geared and positively cash flowed properties may be the better option for you if this is your circumstance.

As stated in previous chapters, there are five key elements that support a good investment strategy including:

1. Credit Rating
2. Goals
3. Budget
4. Finance
5. Asset Protection and Tax Minimisation

Strategy planning, coupled with a solid set of buying rules (we'll get to that in the next chapter), will put you in good stead for setting up a profitable and successful property portfolio.

HEDGEHOG ACTION ITEM: Use your investing goals and the following checklist as the basis for developing your personal investment strategy. During this process, consider all of your plans for the future, including things such as retirement or starting a family, so you can financially factor in any major life changes.

Checklist for developing an Investment Strategy

Questions for you to ask yourself when developing your investment strategy are:

- Capital growth (often negatively geared), cash flow neutral, positively geared or a cash flow positive property?
- What kind of return do you need to get from the property in order to sustain it and/or your lifestyle?
- Can you afford to be funding the balance of a negatively geared property out of your own pocket, if there is a shortfall between the rent and expenses? If so, how much and for how long?

Preparing for change

Change, both good and bad, is an inevitable part of life, and there's no guarantee that your path towards financial freedom will be easy. In fact, it's likely that you will face many challenges along the way. But if you put strategies in place to mitigate those risks and challenges, the process will be much less fraught with fear and anxiety.

There are certain changes that will be beyond your control. Property damage due to bad weather conditions and/or tenant neglect are occurrences that you'll hopefully never have to deal with, but ones that we'll explore in more detail in a future chapter nonetheless.

Other changes that impact how you develop your investment strategy may originate closer to home. These are changes that many investors don't often consider because they believe them to be irrelevant.

These include major life changes such as pregnancy!

Starting a family is one of the most wonderful journeys you can embark on. We were over the moon when we welcomed our baby girl, Alexandria, into the world in April 2009. She is really so delightful!

But having a baby can be expensive and time-consuming. Many mothers take some time out from the workforce when they have a baby, or if they do return to work, they have to pay for day care. This is something that many investors fail to factor in when they develop their investment strategies. If you're a two-income household and you predict that you'll be dropping down to one income for any length of time, or that your regular expenses are likely to climb when your new bundle of joy arrives, you'll need to financially prepare for that in advance.

As well as changes in lifestyle and income, you also need to be prepared to put in the hard yards when it comes to research and conducting due diligence.

In 2009, when I first met with a new client Lee, she told me she had been interested in investing in property since 2002, but she did nothing about it for several years because "the fear of debt was too overwhelming".

Finally, in 2009, Lee and her husband Nguyen made the decision to bite the bullet, and invested in a house and another vacant block next to it in a central location. It was in the same neighbourhood that they currently lived in which around 5km from the centre of their town.

"We started building on the block, but had to stop as it turned out the development approval had expired. So it's currently at a stand still, and we're in the process of re-applying for the DA," Lee told me at our first meeting.

"I have a long term plan to invest so that I can retire from work in 10 years from now, but I'm finding that the road can be very bumpy at times."

I could immediately see that Lee had a passion for property investing, but she was missing the practical tools she needed to turn her retirement goal into reality.

I advised her to create an investment strategy so she could become clear on her intentions, and begin taking action so that she would give herself a better than even chance of reaching her goal in 10 years. To do this, she needed to target properties that would get her there sooner rather than later.

A well-researched investment strategy helped enable Lee to continue building her portfolio, without being derailed when sidetracks like an expired DA crop up.

Lee wasn't necessarily wrong when buying the property she bought, but if she'd done her due diligence, she would have known that the DA was due to expire. She could have then taken steps to request an extension or apply for a new DA, saving herself precious time (and anxiety) in the process.

When you understand your strategy, you will also understand that you will need to stick to your buying rules and have an exit strategy developed. By doing so it will make the whole property investing journey a lot easier.

Your exit strategy

Working out your investment strategy is only half of the story. Just as important is your exit strategy, which, more simply put is your back-up plan "in case of emergency".

You must have developed an exit strategy for each property before you actually invest in the property, so that if and when disaster strikes, you're prepared to deal with the consequences.

Many investors fail to prepare an exit strategy because they want to focus on the positives and hope that everything works out exactly the way they had planned. But in reality you will more than likely face some bumps along investing road. No one has a crystal ball for predicting the future so you will never know what challenges lie ahead. This includes career, family, financial and relationship changes. A properly constructed and thought out exit strategy, in case one or more of these occur, will alleviate your concerns and fears.

When you develop a clear, realistic exit strategy, you're effectively preparing a safety net to catch you should one of your worst-case scenarios eventuate.

The great thing about an exit strategy is that you are preparing for the worst at a time when you're feeling calm, are present, relaxed and motivated, so that you're likely to make better decisions than you would when you're stressed, anxious and desperate.

In Chapter 15, Risk Mitigation, I'll discuss in more detail the various risks and mitigation techniques that you can use as part of your exit strategy. For now, it is a good opportunity to touch on the fears that many property investors have, and the options you can pursue should one of your fears actually come to fruition.

Despite all of your best efforts to create a hassle-free investment, the situation can sometimes turn sour. There are several reasons why you might need an exit strategy, including:

- **Unexpected property management expenses.** Costs such as tenant or weather damage to your property, where you don't have insurance, or insurance won't cover the repairs, can throw you for a loop. A colleague of mine once bought a property and the building and pest inspection turned up nothing suspicious. Two weeks after settlement, the ducted air-conditioning exploded and caused a small fire in the living room. She hadn't yet arranged building, contents or landlords insurance, so she was forced to foot the $18,000 repair bill.

- **Change in income.** If you or your partner are made redundant or lose your job for any reason, how will you pay your bills – let alone, the bills associated with managing your investment property?

- **Interest rate hikes**. Interest rates fluctuate depending on various factors, including inflation and the state of the national economy. A good rule of thumb is to assume that interest rates will increase by 2% above their current rates, so you can work out whether you'll still be about to afford them at that level.

- **Death or major illness of a family member.** If someone in your immediate circle suffers serious health related issues, or if they pass away, the last thing you'll be thinking about is the status of your property investments.

- **Personal illness**. If you become sick and as a result you no longer work and draw an income, you might struggle to pay the bills – and as a result, your investment portfolio may suffer.

While these scenarios paint pictures of doom and gloom, it's important to face up to them so you can create realistic exit strategies should they occur.

Exit Strategy #1: Use equity to sustain your mortgages

You may be able to access the equity in your property portfolio so that at a minimum you can ensure that your mortgages are paid. To access your equity, you'll probably need to apply for a line of credit or refinance an existing loan – which is just one more reason why it always pays to keep your budget and financial information up to date.

Exit Strategy #2: Find joint venture partners

If you're struggling with your investments, perhaps you could find a joint venture partner to help you meet the financial burden? If you've already supplied the deposit, you may be able to arrange for a relative, colleague or like-minded investor to partner with you and take over the monthly shortfall for a set period of time.

Exit Strategy #3: Sell down non-performing properties

Sometimes there's no way out of the situation other than selling one or more of your investment properties. If this is the case take the time to sell your least-performing property – that is, the one that returns the lowest yields and/or lowest rates of capital growth – so that once it's sold, you'll be left with only prime performing properties.

Exit Strategy #4: Sell part of your portfolio

If your situation demands action, you could look at selling some of your properties so you can reinvest the profits in better-performing properties, or pay down your other mortgages to ease your financial burden.

Exit Strategy #5: Sell all and cash up

This is the ultimate exit strategy, as it involves selling all of your property assets and cashing out. Keep in mind that you'll need to pay capital gains tax, (payable on any profits you make from the sale of your properties).

So which is the right exit strategy for you?

At some stage, perhaps some or all of them will be the right exit strategy for you. As with investment strategies, your exit strategy is likely to vary over the years as your situation changes. It's important to know what your exit strategy is at any given point in time because not having a properly prepared exit strategy will be a sure-fire way to lose money.

HEDGEHOG ACTION ITEM: Jot down a list of your worst-case investing scenarios, including health-related issues to career and money woes. For each fear, list an "action plan" detailing the steps you can take, should the proverbial hit the fan.

[case study] 10 properties in 10 years

The "10 in 10" property investment strategy has proved to be a popular strategy for creating real wealth through property investing.

It's not a "get rich quick" scheme. Rather, it's a very strategic, disciplined and measured plan to purchase 10 properties in 10 years and is also one that will help you to attain a quality property portfolio that will support you financially well into your retirement years.

Going through the following exercise will help you to get into the long-term mindset of a property investor.

Imagine that you purchase one property per year for the next ten years, without selling any of them. These might be houses, apartments, or a mixture of both. Imagine also that they are located all over Australia. Most importantly, imagine that they'll be a mix of positively and negatively geared properties so that your weekly out of pocket expenses don't impact too much on your day-to-day lifestyle.

As a rough example, and without taking into account inflation, tax and miscellaneous expenses, the simplistic equation for the above scenario would be as follows:

<u>1. Accumulation</u>

One property purchased each year at $350,000 per property
$350,000 x 10 = $3.5 million

@5% rental yield = $175,000 rental income per year
@7.5% rental yield = $262,500 rental income per year
@10% rental yield = $350,000 rental income per year

<u>2. Sell Down</u>

Assuming that the properties double in value in 10 years time, you could sell down half of your portfolio and use the deposits and profits generated by the capital growth of these properties to pay down the loans of the remaining five properties.

You will then own $1.75 million worth of property outright, with no loans attached

<u>3. Live off rental income</u>

You could then quite conceivably replace your income with the rental income from the remaining properties.

@5% rental yield = $87,500 rental income per year
@7.5% rental yield = $131,250 rental income per year

@10% rental yield = $175,000 rental income per year

It’s easy to see that by using the “10 in 10” method, you could fully replace your income within 10 years, allowing you to and give up your day job and become a full time investor all within that time frame.

Should you want to purchase more than 10 properties, then the above figures will only improve. Either way, by following this strategy, you will be in a position to secure your financial future and have a sizeable portfolio to sustain you in your retirement.

Chapter 9. Buying Rules

For many property investors, the first step towards creating their real estate portfolio begins next door – literally!

It's quite common for people to invest in property that is located in the same suburb that they live in, because it's a comfortable entry into the market. You know the area and the people that live there, and you've seen the value of your own home go up over the years – so why not buy your first investment property in the same neighbourhood?

The thing that first-time investors often fail to take into consideration is that tenants usually want very different things out of their accommodation, compared to owner-occupiers.

You might live in an established suburban neighbourhood where houses typically include three or four bedrooms with double garages, plonked on large blocks of land. There's a university and a hospital nearby, and a couple of primary and high schools.

This type of house could be perfect for a homeowner or tenant with a growing family, but other tenants will have different needs. For university students, a large garden and outdoor area isn't high on their priority list, instead they want convenience and personal space. Ditto for hospital employees who are often shift-workers, and therefore value things like extra bathrooms and separate living areas.

When you invest in property, it's a matter of matching the features and benefits of the property that you buy with tenant demand. If you buy a property that only appeals to a small section of the renting community, you limit your potential rental pool, which is a step in the wrong direction.

Depending on the type of property that you're looking to buy, there's a chance that investing in your own suburb might be the right way to go – but until you've developed a set of buying rules, you can't know for sure.

In the last chapter, we went through the process of creating your own personal investment strategy. In a nutshell your investment strategy is a blueprint that maps out your investing goals and shows you the best path to take to achieve them.

Now comes the fun part. This is where you transform your intentions into action!

When you establish your buying rules, you are essentially creating a set list of criteria to measure potential properties against. It makes it so much easier to sort through the hundreds, if not thousands of houses, apartments and townhouses that you'll come across during your search for the right property.

Consider this for a moment. When you go grocery shopping, do you take a list and check off each item as you go? Or do you wander the aisles grabbing items, based on what you think you need?

I have to confess, I actually do both – I'm generally a list person so I find that it's much more efficient to go in with a shopping list, but sometimes I wing it and hit the shops with only my memory to rely on.

Usually I remember to pick up all of the things we need, so that's not the problem. The issue is that when I shop without a list I often pick up more than what's actually necessary. The shiny promotional offers tempt me into buying the ingredients for five possible meals that evening and before I know it I've spent $100 – and I was only popping in to grab milk and toilet paper!

The same principal applies when it comes to shopping for real estate, except this time round you're dealing with hundreds of thousands of dollars rather than hundreds!

If you start shopping for an investment property without your shopping list, how will you know when you find the right home? Yes, it's got beautiful hardwood floors and a skillfully renovated kitchen, but does this property fit into your overall investing strategy?

There are so many real estate opportunities out there that it can be easy to become overwhelmed when it comes time to decide which one to buy. And when people get overwhelmed and flustered, one of two things usually happens.

The first is “analysis paralysis”, which is typically the result of information overload. This happens when you do a lot of research on properties located in many different areas and you investigate every possible aspect known to man. You do this to the point that you become so overwhelmed with information that you can’t possibly make a clear and logical decision.

It’s a classic fox move – learning a little about a lot – and it’s easy to see why people get flustered under these circumstances. There are property experts all over Australia who recommend different investing strategies and locations, and headlines in newspapers every day that predict upcoming property boom’s or crashes. All of this just adds to the confusion, and you end up so overwhelmed that you simply do nothing.

The second way that people often react to the feeling of being overwhelmed and unsure is to do the exact opposite, and take immediate action. They make a decision to buy a property, but often that decision is hasty and impulsive and doesn’t come about as a result of careful thought and planning – it’s a decision that’s been made so that they feel like they’re moving forward.

It’s evident that neither of these scenarios puts you in the best headspace to create long-lasting wealth.

HEDGEHOG HOT TIP: The best decision-making happens when you are relaxed, calm and moving towards your goals. That’s why you need to develop a set of buying rules that complement your investment strategy, as they will ensure that you stay focused in your property search.

Creating your buying rules

Your buying rules are just like the shopping list that you create when you go to the supermarket – but instead of looking for the juiciest fruit in the bin, you're seeking undercover parking and the right number of bathrooms!

Let's say your goal is to own 10 properties, including your own home, by the time you turn 50, like my client Damon. At 34 years of age, Damon owned his own home (partially – the bank still owned the biggest portion!), but he hadn't yet purchased any investment properties.

In order to reach his goal, Damon had 16 years to acquire nine properties. If we space out Damon's potential property purchases over the next 16 years, we can see that he needed to buy an average of one property every 18-24 months to stay on track.

With this in mind, Damon began shopping for an investment property. He was actively looking for a property that he could renovate or, preferably, develop or subdivide it in the future. Damon believed he would have the best chance of reaching his goal if he bought three or four properties in the next five years, and then to demolish each house and redevelop the land into an apartment block or duplex.

So, Damon was no longer simply looking for "an investment property".

He was now looking for an investment property located on a large, flat block of land with the potential for future subdividing and/or redevelopment.

He has completely knocked apartments, villas, townhouses and duplexes from his search criteria, as he needs a freestanding house on a clear block of land in order to redevelop it down the track.

It needed to be in a suburb that supported development through local neighbourhood support for gentrification and council encouragement.

And the property also needed to be located in an area where the population was growing and there was increasing demand for multi-dwelling properties.

Can you see how having such a specific goal sharpened Damon's investing focus, and helped him to develop a specific buying criteria?

This is only the first draft of Damon's buying rules, he's yet to cover things related to the property's location, such as tenant demand and proximity to amenities.

When you develop your own set of buying rules, they become a tangible "wish list" of features that you need to find in an investment property.

To kick things off, start by asking yourself the following Buying Rules questions.

Buying Rules – cheat sheet

- ☑ Are you buying for cashflow or capital growth? Cashflow deals will put money back into your pocket each week, but capital growth investments deliver long-term wealth.
- ☑ What level of short and long term capital growth do you want?
- ☑ What type of property do you want to buy, a house, apartment, townhouse, unit or development site?
- ☑ Do you want properties that are established, brand new or off the plan?
- ☑ What price range have you set? Be realistic and make sure you leave yourself a buffer to deal with emergencies.
- ☑ How much yield do you need to make the deal work?
- ☑ What suburbs/towns are you targeting? It's best to approach your property search as a hedgehog and limit your research to three regions, rather than trying to learn everything about every area.
- ☑ What features must the property have? Think of your tenants and what features they will want, rather than what you would want.
- ☑ What buying entity will you purchase the property in, your personal name, company or trust?

- ☑ Do you want properties that require value-adding through renovation or subdivision? If so, how do you plan to finance future renovations or construction?
- ☑ How many bedrooms and bathrooms must the property have? Again, think of your tenants. If you're likely to rent the property out to three single tenants, will one bathroom be sufficient?
- ☑ What type of infrastructure must be close by? eg. Public transport, hospitals, shops or schools – again, keep your tenants in mind, and try to match your wish list to their needs.

You will need to be flexible with your buying rules because the circumstances that you originally use to create them may change. As your financial and family position changes so too will your plans and goals for your investment properties.

There are no hard and fast rules here, and no "one size fits all" answer, as a set of buying criteria that suits one investor won't necessarily suit the next.

It may seem like a lot of work, but it's worthwhile putting the time and effort in to develop and update your buying criteria regularly, so you can avoid making costly investing mistakes that you'll need to fix in the future. With the right buying rules in place, you'll stay focused on your journey towards finding the best investment property deals that suit both your budget and your lifestyle and also help you create long-term wealth.

HEDGEHOG ACTION ITEM: On the "Getting Started" CD ROM, you'll find the worksheet "17 Critical Steps to Investing in Property". It features a "Buying Rules" resource to help you fine-tune your property wish list, including a table that can guide you step-by-step through the research and buying process. It allows you to analyse potential properties and neighbourhoods side by side, so you can clearly compare properties and made an educated decision.

Using a Buyer's Agent

I've been running the Real Wealth Australia mentoring program for several years now and I often get asked about buyer's agents, particularly when we begin talking about buying rules.

A buyer's agent is exactly like a normal real estate agent, except they are paid by the buyer rather than the seller.

It's their job to handle the property purchase on your behalf, from researching and viewing potential properties to arranging building inspections and negotiating the price.

If you want to short cut your journey towards property ownership using a buyer's agent is one way to go about it. You could discuss your investment strategy with them and they would then come back to you with their expert recommendations on which properties you should invest your hard-earned cash in.

For some people, a buyer's agent provides that extra bit of expert reassurance that they're on the right track. However, personally I'm not a big fan of buyer's agents, especially if you plan to create a multi-property investment portfolio. Here's why...

Imagine for a moment that I am engaged by you to buy a property on your behalf, the so-called 'perfect investment'.

I've done all of the research and view hundreds of properties in my quest to find you the ideal investment. When I find the winning piece of real estate, I negotiate the price down and secure a huge discount for you.

The property is located in an area that has historically enjoyed strong capital growth, which looks set to continue into the future. And to top things off, the current tenant has lived there for several years and has kept the property in immaculate condition – and they would like to sign another long-term lease. It sounds like the dream investment, right?

Wrong!

As a property investor, what have you learnt?

Absolutely nothing as it was all handed to you on a silver platter.

What will you do when things go wrong? How will you manage the property should the tenants stop paying the rent for three months? What will you do if there is negative capital growth, and interest rates go back up to 9%?

And because you've purchased the property sight unseen, what do you know about the suburb and its economic conditions? How does this property compare to neighbouring houses in the area? How will you know if the suburb is on the decline, or whether the local population is forecast to grow?

Unless you do your own homework and spend time doing your own independent research, you will never know. All you will know is what the buyer's agent told you, and who is to say that what he told you is accurate?

Instead, I'd recommend that you take the money you would use to pay a buyer's advocate and invest it in yourself by getting a proper education in property investing, so that you can manage your own property decision making into the future. No one will look after your money better than you!

By investing in your own education and taking the time to become an expert in your own financial health and wellbeing, you'll set yourself up to make educated choices again and again. Doesn't that sound like a true recipe for success?

Case study: Investing without a road map

Ben Muzzell was just 25 years old and earning six-figures when he first thought about investing in real estate. But without a plan or a mentor to guide him, his five-year property investing journey hit a few snags.

“A few years ago, I was working in IT sales. I earnt $80,000 one year, $150,000 the next year, and $250,000 the year after that, and I was in my 20s. It was more money than I knew what to do with. I’d go out Friday, Saturday and Sunday and spend $1,000 a night. I was blowing all of the money I was earning.

I reached the point where I was making more money than I could reasonably spend, so I decided to invest in something. I didn’t want to go and buy a Porsche or go on five-star holidays because I wanted to set myself up rather than continue to blow it all.

Stuff it, I thought – I’ll go and buy a house. I set a limit of $300,000, thinking, ‘I can’t blow it too badly if I only spend that much’.

I looked around and spoke to my accountant, who told me that her brother had bought a house in Rye. It’s an hour from Melbourne and it wasn’t expensive and there was a lot of talk at the time about buying a little bit out of the city. At the peninsular at Rye there’s only a small section of land and that seemed okay to me.

I bought an old beach shack in 2005 on a 1500m2 block of land. It had ocean glimpses and if I was able to build up I’d have ocean views, but it’s a crappy old place. They wanted $320,000 and they were desperate to sell, so I ended up paying $285,000.

The property had a shortfall of about $800 month, but after negative gearing it wasn’t costing me too much. At the time my quarterly bonuses were worth more than the deposit, so it wasn’t a big deal.

But at the end, after the deal was done and I owned the place, I thought, “I haven’t learnt anything about the science of investing in property.” I hadn’t really learnt anything at all.

I was reading magazines and trying to educate myself, and after about six months I decided to buy something else. I read a lot about the Redcliffe peninsular in Brisbane, so I waited for another couple of commission cheques to come through and jumped on a plane to Brisbane one Saturday morning.

I organised to look at as many houses as I could, watched loads of auctions and drove nearly every street in the area in just one day. I didn't even eat lunch because I was meeting with as many agents as I could to get a feel for the area.

I liked Scarborough, the northernmost suburb, as it was quiet and it was the premium suburb in the area. I still didn't really know much about investing in property so I went for a large block of land thinking that I couldn't hurt myself if I went in that direction.

After checking I found that I could subdivide the block if I wanted to. The next-door neighbour was in fact doing just that, so I thought it would be the perfect opportunity to watch what they were doing and see how it all panned out. I bought the house the following Saturday right at the peak of the market, paying $525,000. Everyone was just snapping stuff up there at the time, it was a bit of a frenzy, so I thought the price was fair.

This was just before the downturn, so when the valuer went through it, he valued the house at $450,000. I was still in the cooling off period but I looked at everything else that had sold in the area and just figured that he was off. It's a pretty ballsy move to make when you're new to property!

It is quite heavily negatively geared. After the rent, I still had to pay $2,500 per month, but at the time it wasn't a big deal. I was making enough money coming in to make sure that there was little impact on my lifestyle, so I didn't really care.

But by now I was thinking, I'm out of pocket a few grand a month and I still don't know anything about investing in property. I can keep doing this, but eventually I'm going to hit a brick wall. Also, I had read about people who earned far less than me who owned many more properties than I did and I didn't know how they were doing it.

I started searching around and I saw Helen's article in a magazine. When I rang her, she just made sense. I called a few other places and they were too scammy, so I ended up joining Helen's course, even though it had already begun a month earlier.

It was really good. Helen taught me the formula, all the ingredients and the science behind investing. I learnt all about investment strategies and buying rules. And I realised all the mistakes I had made along the way!

I had a strategy meeting with Helen towards the end of the course, and I decided I needed some cash flow properties to balance out my portfolio. I ended up buying a house and a block of land on Moranbah in regional Queensland, with plans to develop a block of flats. At around the same time, I changed jobs.

It was a better job, but just after I started one of our major government contracts got pulled unexpectedly – so my salary literally halved. I had all of the approvals and I was ready to develop in Moranbah, but I wasn't ready to go ahead, I didn't want to go bankrupt and lose everything!

I had told my uncle about Moranbah and he bought a block of land at the same time as me. He pushed through and built his three-townhouse development. Now he's getting $1,000 a week in rent for each of the three properties he built. His investment returns 16%.

Had I gone ahead and built as well, the properties would have made my portfolio so cash flow positive that they would have completely balanced out the negatively geared properties in my portfolio. At the time, you only needed a 5% deposit, but the rules have since changed, and now I need 20%. So, I'm just waiting until the finance market recovers a bit so I can push forward with my plans.

I’ve had to go through a fair bit of pain to get through to this point and I’ve made plenty of mistakes along the way! But now I have a plan to help me, and my property portfolio, move forward.”

10. DIY Hotspotting

Every month, real estate magazines promote different hot spots and investment opportunities around Australia, and first-time investors can be tempted to jump on the bandwagon and blindly follow that advice.

Instead, I encourage you to do your own ‘hotspotting’. Throughout this chapter, we’re going to explore strategies you can use to blaze your own pathway, and find secret hotspots of your own. It’s all about finding the ideal investment property that suits you, your lifestyle and your investment goals.

DIY hotspotting is a time-consuming process, because there is so much research involved. Once you select the area you want to invest in, it’s important that you do your homework by checking out past and present capital growth rates, and investigating the level of infrastructure and amenities in the area, including roads, public transport, hospitals and schools.

All of this takes a commitment of time and energy, but this is definitely not an area in which you should cut corners. Trust me, I know, I learnt the hard way.

Not doing your homework is one of the grand faux pars that investors, particularly first time investors make – and it can end up costing you a bundle.

There was a property we bought many years ago in Kalgoorlie in Western Australia. It was our eighth property purchase and at the time I thought, “I’m an experienced property investor, I know what I’m doing!”

And, I took short cuts.

I live in Melbourne and the property we were looking at was on the other side of the country. We had done some research and identified Kalgoorlie as our next place to invest because we wanted to add a cash-flow positive property to our portfolio. In Kalgoorlie property prices were low and rental yields were high and there seemed to be plenty of opportunities to invest.

We were looking at a small house with an asking price in the high $100's with a fantastic rental return of $330 per week, which suited us perfectly.

The lease was a little bit unique in that it wasn't a private rental, it was actually leased by the government. The government department was called GEHA (Government Employee Housing Association), and it's their sole focus to source and rent appropriate properties for their staff.

The brilliant thing about GEHA is that they like stability, so their leases tend to be long term – a minimum of three to fives years with automatic CPI rent increases and options for lease renewal built into the lease contract. From an investor's perspective, it sounded ideal.

At $330 per week the rental return was more than enough to cover the mortgage and ownership costs and the GEHA lease had another full year to go on its five-year lease. At that point the department had the option to renew the lease for a further three years or terminate it.

The real estate agency that I was dealing with at the time was exclusively a sales agency and didn't have a property management arm. I asked the agent what he thought the property would rent for in an open market, just in case GEHA didn't renew the lease.

"Helen, you'll get $330 per week easily on the rental market," he assured me. It was exactly what I wanted to hear, so we put in an offer of $173,000 and thirty days later we settled on the house and celebrated the arrival of our first cash-flow positive property.

What was my big mistake? I didn't do enough homework – I just took the selling agent's word for the rent on the open market. I didn't try to validate the information he gave me, or get the opinion of property management agents in the area. I didn't do anymore research on GEHA to see whether they regularly renew their leases nor did I check whether the property we were buying was even the type of property they still wanted for their employees.

You can guess what happened next.

Twelve months later, at the expiry of the lease, GEHA decided not to exercise their right to extend the lease.

At the time I thought, "Okay no problem. I'll still get my $330 a week with another tenant – in fact I was even thinking that I might even be able to increase the rent a little! This was too easy."

I asked a property manager to look through the house and after doing so, called me back right away. "Helen, you'll be really excited," she said. "The market's really buoyant right now, there's lots of demand for rental property, particularly this style of house."

"I can easily get you $260 a week," she said.

My jaw dropped.

Several seconds of silence passed before I regained my voice.

"You mean $360 per week, right?"

"No, no, $260 per week," she confirmed.

I couldn't believe it – I was truly gutted.

At a rental return of $260 per week the investment was slightly negatively geared – and the whole reason why we went to regional Western Australia was for the opportunity to secure a cash flow deal!

We had bought it because it was earning $330, which was great cash flow. In one phone call, our investment had gone from being our shining star to a bit of a lemon.

We offloaded the property at the first opportunity and we were even able to make a little money out of the re-sale. But as a result of that experience, I now always do detailed due diligence research when I'm in the market to buy and I generally end up with a 40-page document on each property and that's because I certainly don't want that sort of thing happening again.

This is now your opportunity to learn from my mistakes. Don't take short cuts when it comes to your research. Yes it takes time and effort to make the right decisions but if you put in the hard yards now, you'll be rewarded with a robust investment property portfolio that will deliver great returns for years to come.

DIY Hotspotting – the search begins

So just how do you locate the perfect investment property?

The first step you need to take is to create a shortlist of locations that you are considering. The mistake that most investors make is that they fail to properly plan their property search, and as a result they enter a fox-like process, whereby they try to absorb information about potential investments from each and every source available.

They read newspaper headlines and magazine articles, they browse real estate shop windows, and view property sales online. They end up knowing a little bit about a lot of different real estate locations instead of knowing a lot about two or three locations. Because they don't do enough detailed research on a few locations, they can end up buying the wrong property in the wrong location, or they pay too much for it.

Instead of this, I suggest that you adopt a hedgehog approach to your research. The hedgehog limits your final shortlist to no more than three locations, so you can really knuckle down and become an expert in those particular areas.

The first step in being a hedgehog researcher is to choose which state you want to invest in. A lot of people default to their own home state, but that's not always going to be the best and most effective property investing choice.

Properties in different states can experience a significant variance in capital growth rates due to a range of factors, not least of which is supply and demand.

Some states simply don't have enough housing to cope with the level of new residents arriving each month, which means that the housing that is available is highly sought-after. If an area is experiencing high population growth and at the same time there aren't enough new houses being built to accommodate the growing population, then that's going to translate into rapidly increasing property prices and higher yields.

Supply and demand is not the only factor that you need to take into consideration when doing your property research. Generally, the most important factors that you will need to consider include the health of the local economy, population growth, private investment in industry and housing, and government spending on infrastructure, housing and employment.

You can learn most of what you need to know, about what's happening in various states, through the magic of the internet (what did we do before it?!).

By browsing internet sites you can learn all about government plans for growth and development in different regions. You'll find updates and fact sheets about new infrastructure projects and information about upcoming large-scale projects that will inject money, resources and employment opportunities into local communities.

You can also access data about population growth across the state, so you can see which areas are experiencing the highest influx of new residents, and thus, which has the largest potential rental pool for you to tap into.

HEDGEHOG ACTION ITEM: Plug each of these websites into your bookmarks folder, and spend some time really studying each state. I'd recommend at least 1-2 hours per site, so you can learn about all of the different projects and plans for the short and long term.

- www.australia.gov.au
- www.qld.gov.au
- www.vic.gov.au
- www.nsw.gov.au
- www.wa.gov.au
- www.sa.gov.au
- www.act.gov.au
- www.nt.gov.au
- www.tas.gov.au

HEDGEHOG FAST FACT: Don't forget Land Tax, an annual charge levied by most state governments. The amount charged varies from state to state, but it is usually charged as a percentage of the current unimproved land value. The more land you own the more land tax you'll pay, so you'll need to cost payment of this tax into your budget. One benefit of townhouses and units is that they occupy less land, which makes them more attractive from a land tax perspective.

Fine-tuning your search

At this point, you should now have selected the state that you are interested in investing in. The next step is to locate the city or town that you want to invest your money into.

This is where you need to put your buying rules into action, so you can match your investing strategy goals to the ideal location.

For instance, do you want to invest in a regional town or a capital city? This will depend on your budget and also your investment strategy. If a high-quality property and strong capital growth is the aim of your game and you have a decent amount of money to play with, narrow your focus to the capital city option. If high yields and positive cash flows are your priority, go regional.

If you opt for a capital city investment, do you want a city residence, a suburban house, or a coastal investment?

If you're going regional, do you want a major regional centre with several employment nodes that drive the town's economy, or do you want to invest in a mining town?

Consider your tenants. Do you plan to rent to students, young families, professional couples or retirees? Depending on your answer, should you then look for property that is located near schools, hospitals and/or universities?

FOX WARNING: As you begin to work through all of these questions, you may begin suffering from information overload. This is when investors will be tempted to skip these steps and invest in that suburb that their brother/ cousin/ workmate/ hairdresser/ accountant told them about. Don't be discouraged! If you put the hard yards in now, you'll put yourself in a position to enjoy enormous financial rewards in the long term.

As you ponder these questions, take the opportunity to consider what each local government is doing. Most investors underestimate councils, but they're actually my first port of call when doing my research.

My experience has been that when a council has a plan for the future, and is pro-development and spending money on housing and infrastructure, then the town and areas surrounding it thrive.

I've gone to councils in the past during the course of my research and when I ask the town planner, "What are your plans for the future?"

They often reply, "We're still working that out."

If I'm looking at investing in that area, a response like that doesn't give me great confidence!

If the council doesn't know what they're doing and where they're going, then I'll think twice about investing in their town. If they're not pro-development, pro-infrastructure and pro-family, it makes me wonder whether I'm buying in a high-risk area?

On the other hand, if they have a clear vision for the future, with plans to manage growth in housing, population and infrastructure, then that fills me with confidence that I am dealing with the right people.

FAST FACT: The following link is a goldmine of information, as it will take you to a nationwide listing of every local council website in Australia. Add it to your bookmarks right away! **www.alga.asn.au/links/obc.php**

One thing to look out for during your search is large-scale infrastructure projects that have been initiated by local and state governments.

These areas are always a good indication of growth, because it means that a number of intelligent and qualified key stakeholders – including town planners, economists, surveyors, migration experts and policy makers – are paying attention to these areas.

They have combined their collective resources to pinpoint areas where they believe local employment will support population growth in the future, and as a result they want to make sure that the infrastructure is there to support that growth.

Examples of these types of initiatives include:

Melbourne 2030

This is the Victorian State Government's plan to ensure sustainable growth throughout the state. The blueprint aims to create a greener, more livable city with closer links between regional and metropolitan communities, via improved transport links.

Melbourne 2030 has nominated 6 Central Activity Districts, 25 Principal Activity Centres and 79 Major Activity Centres across the state as the preferred locations for future higher-density residential and mixed-use developments.

What this means is, nominated suburbs are on the priority list. Case in point: in January 2010, a proposed $100 million development in Box Hill – one of the listed Central Activity Districts – was fast-tracked by the state government.

For more information, visit:
www.melbourne2030.vic.gov.au

Planning WA: Network City

The Network city strategy for Perth and Peel outlines a change in direction for Perth, not only in how the city develops, but also in how planning is done. The goal is that "By 2030, Perth people will have created a world-class sustainable city that is more vibrant, compact and accessible, and one that will have a unique sense of place."

The state government is aiming to develop the plan through participative

decision-making at local and regional levels. The strategy has been able identify a number of Activity Centres, (Activity Corridors and Transport Corridors) that they plan to focus on.
For more information, visit:
www.planning.wa.gov.au/Plans+and+policies/Publications/273.aspx

QLD South East Queensland Regional Plan

The South East Queensland Regional Plan 2009–2031 is the Queensland Government's plan for managing growth and protecting the region's lifestyle and environment.

The plan responds to issues such as population growth, traffic congestion, koala protection, climate change and employment, and aims to balance population growth with the need to protect the lifestyle that residents of South East Queensland value and enjoy.

For more information, visit:
www.dip.qld.gov.au/seqregionalplan

Even if the city or town that you're researching doesn't show up any major initiatives like those mentioned above, they might still have a proactive council that is keen to revitalise the region. A browse of their website and a couple of well-placed phone calls to the local town planner will put you in the best position to evaluate a region.

HEDGEHOG ACTION ITEM: The Real Wealth Australia CD ROM, "The Ultimate Resource Guide" includes a Council Questions guide sheet, which lists pertinent questions you should ask local council members. For example: "What prime industries support the town?" and, "Are there any residential subdivisions currently underway?"

Your top three search locations

By now, you should have narrowed your search down to your top three location finalists.

Your next step is to find out what the local population is, how much it has increased in the last 20 years, and what proportion of local residents rent.

All of this information can be found via council websites, RP Data statistics, and the Australian Bureau of Statistics (ABS). The ABS website provides valuable information with respect to household debt and home ownership levels, which can be really helpful in giving you an overview of your tenants' needs.

For instance, if ABS stats showed that 45% of households in an area have young children, you know that a house with a small backyard will appeal to those tenants. If the ABS data reveals that 60% of households comprise of couples with no children, then high-end apartments that suit professional couples may be a better option.

The real gold is in the housing tenure data, which shows how many people own their home outright, how many are paying off a mortgage, and how many people rent.

Ideally, you want an area that has a robust rental population, so that tenants are always in plentiful supply. At the same time, you don't want so many renters than properties are always readily available, and you're therefore constantly competing for quality tenants. I always look for suburbs where 30-40% of residents rent, as this seems to support a balanced supply and demand system that keeps my property tenanted year-round.

Finally, look at vacancy rates. The lower the vacancy rates, the less competition you'll have from competing properties, which gives you the best opportunity of securing quality tenants and regular rent increases. Information on vacancy rates can be found by contacting your local real estate agent.

The journey continues

It’s important that you keep up the research once you become a property owner, as the journey doesn’t end when you sign on the dotted line!

Once you’re a property investor, you need to continue educating yourself, because if you become a passive player, that’s when problems can arise.

If the lease on your investment unit is coming up for renewal, for example, your property manager might suggest that you raise the rent from $200 to $210. They’re professionals in their field and you’re paying them for their recommendation, but that doesn’t mean you can’t conduct a little research of your own.

When my property manager makes a recommendation, the first thing I do is jump on www.realestate.com.au and check out what similar properties in the area are renting for.

If they seem spot on, I follow their advice. But if I think there’s a case for a bigger price movement, I gather the evidence and ask for my property manager’s feedback.

An example of this is when I bought an investment property in 2006. It was under-rented at $340 per week. I knew this because two other townhouses in the complex were renting for $360 at the time, and they were smaller.

When I bought the property the lease was periodical, and the property manager recommended that we ask the tenants to sign a six-month lease at $350. I disagreed.

In doing my research thouroughly, I discovered that $370-$380 was a more of a realistic rental return for that type of property. The property manager thought that it was too much of an increase, but I wasn’t overly impressed with the tenants anyway, as when we viewed the property during the buying process, it was a pig sty. The tenants were two young girls who worked as nightclub waitresses, so they were in that partying stage of life.

Notwithstanding the mess, I persevered. We asked the current tenants to sign at $370, and they moved out – as we expected – and we advertised it at $375. Within a week, we received three leasing applications, and we ended up renting it to a pastor and his son on a twelve-month lease. FYI, he's now paying $410 per week – I believe in being fair, which I believe means regular rent increases! At a minimum, I try to raise the rent by the equivalent of CPI each year, (that is if and only if the market can support it.

Had I listened to my property manager's initial recommendation, I would have kept the old tenants on for an extra $10 per week. But because I had spent ten minutes online undertaking research, I was instead able to secure new, better tenants at an increase of $25 per week, or $1,300 per year.

The moral of the story? If you want to create real wealth and an easy future, you need to be an active player in the game – every step of the way.

HEDGEHOG ACTION ITEM: Add this hot list of websites to your internet bookmark browser right away – they'll prove invaluable when you commence your property search. On the Real Wealth Australia "Ultimate Property Resource Guide", you'll also find a list of 120 'need to know' websites to help you along your research journey.

- www.realestate.com.au
- www.domain.com.au
- www.homepriceguide.com.au
- www.rpdata.net.au
- www.abs.gov.au
- www.reia.com.au

11. Pinpointing your investment property

This is where the fun begins!

Now that you've done the groundwork and established your top three buying locations, you can now commence your search for your next investment property – which means leaving the computer behind, and heading out into the world to actually view properties.

You can do this by simply pinpointing your locations and going out to view every single open for inspection property that fits your buying criteria. Doing this will give you an insight into the types of properties in the area and the asking prices for such dwellings.

It pays to do a lot of research in the areas that you've short-listed so you can then isolate the best streets in the suburb that contain those properties that meet your specific buying rules. After about a dozen viewings, you'll start to notice trends to do with architecture, room sizes and layouts. After a dozen more, you'll be able to tell within minutes of walking into a property whether it's overvalued, undervalued, or priced appropriately. You'll become the "expert" in the area, and therefore you will be able to spot a good deal when you see one.

You see the real value in property is generally determined by its location. You can always renovate to improve the aesthetic appeal of a property, and you can even extend or modify a house to change the view, but you can never change its location.

You can't bring the beach closer, or decrease the distance between your property and the CBD, so your first priority will be to establish the location that you want to buy in.

HEDGEHOG ACTION ITEM: The Real Wealth Australia CD ROM, "Getting Started in Property Investing" includes a handy guide sheet called '10 keys to

Research'. The worksheet holds your hand through the entire research process and shows you how to evaluate the benefits and drawbacks of each location and property you pinpoint.

For example, the Area Profile Checklist asks, does the area have the following?

Restaurants	yes/no
Shopping centres	yes/no
Medical centres	yes/no
Primary schools	yes/no
Secondary schools	yes/no
TAFE/Universities	yes/no
Close to water	yes/no
Hospitals	yes/no
Ambulance/Fire brigade	yes/no
Public transport	yes/no
Airport	yes/no
Parks	yes/no
Freeways/motorways	yes/no
Industry	yes/no
Many local businesses	yes/no
Solid employment	yes/no
Sporting clubs	yes/no
Community groups	yes/no

Targeting renters

As I mentioned in the previous chapter, it's important that you pinpoint locations that are densely populated with renters.

By selecting a suburb that has a minimum of 30% renters, you'll put your investment in the best position to enjoy a steady steam of ready tenants. This information is easy to find, as it's often included on local council websites, or it can be sourced via the “Quick Stats” function on the Australian Bureau of Statistics (ABS) website. You can also back this research up by asking property managers in the area.

Let’s say for example that you are looking at two adjacent suburbs, Frankston and Seaford, in Victoria. I haven’t selected these two suburbs because I necessarily believe they offer outstanding investment potential – this is simply for illustration purposes.

By looking up each suburb in ABS Quick Stats, I can learn the following:

Franskton has a population of around 35,000 people.
Seaford has a population of around 15,500 people.

Frankston residents have a median age of 38.
Seaford residents have a median age of 39.

Over 23% of Frankston residents were born overseas.
Over 20% of Seaford residents were born overseas.

In Frankston, 40.7% of local residents aged over 15 are married.
In Seaford, 40% of local residents aged over 15 are married.

In Frankston, more than 10,000 of local residents – or 28.5% – are not in the workforce.

In Seaford, more than 4,400 local residents – or 28.4% – are not in the workforce.

In Frankston, 30.4% of residents own their home outright; 30.4% are paying off a mortgage; and 31.3% are currently renting. The remainder did not state their tenure.

In Seaford, 29.4% of residents own their home outright; 32.4% are paying off a mortgage; and 28.1% are currently renting. The remainder did not state their tenure.

If you were analysing these two suburbs, and you were trying to decide which one represented the better investment, which would you choose and why?

HEDGEHOG FAST FACT: I obtained all of this information in a matter of minutes by visiting www.abs.gov.au. If you haven't already added this to your bookmarks, do it now!

Knowing where the largest number of renters live is one thing, but tailoring your investment to their needs is quite another.

Right at the top of the list of "wants" for most tenants is access to amenities, public transport and infrastructure. Different features will be more or less appealing to various tenants depending on the suburb, so it's important that you research those features that most closely suit your target tenants.

If the suburb is located right near a large university and a TAFE, for example, then you could consider buying a residential property and using it for student accommodation. If you're buying in an area populated by young, single professionals, then a high-end executive style apartment could be ideal. If you targeted the same high-end executive style apartment in a suburban location, where growing families live, you would probably find that it wouldn't rent. .

Let's say that your buying rules have highlighted a one-bedroom unit in the inner city as being your ideal investment. In this instance, you'd probably be targeting a single person or a couple who work in the CBD to rent your property. Because of the small size of the property, they're not likely to have any kids, so amenities such as schools, parks and childcare may not be as important. Instead, they'll want to live near restaurants, bars, cafes and gyms, so those are the local businesses that you should be looking for as infrastructure that supports your investment.

It's all about identifying what property suits your strategy and then finding a property that fits it, so you can make sure the property fits the tenant needs for the area.

The best way to establish what tenant needs are in an area is to get into the same headspace of your would-be tenant and consider what they would want access to if they lived here. You could also ask property managers in the area what tenants are looking for in the type of property that you are considering buying.

Hitting the pavement

Now you can begin the process of actually honing your search and selecting one location and then viewing selected properties in targeted streets in that chosen location.

By getting out there and viewing your list of selected properties, you'll quickly identify which ones are ideal and which ones aren't, based on your previous research into the area

If you've viewed say 20 three-bedroom houses listed in the area for between $320,000 and $350,000, for example, and then you walk through a three-bedroom house with similar features and benefits listed for sale at $299,000, you'll know that you've stumbled across an undervalued property.

That doesn't necessarily mean you should snap it up straight away. There's usually a reason why it has been listed at such a low price. There is usually a reason why it was discounted and it will be up to you to find this out before you buy, as it could be a significant reason such as underlying structural damage. There could also be a perfectly understandable reason, such as the fact that the owners have already bought and moved in elsewhere, and they don’t want to continue paying two mortgages. That’s why it’s always so important to ask real estate agents every question that pops into your head, as you never know what valuable information might be revealed.

One of the things I do when talking to real estate agents is to write down the conversation in a logbook. I keep a record of everything they tell me about the area, or about houses, prices, local issues, or the sort of things that may affect my rental property.

By writing everything down it helps me to avoid getting confused, especially when I’m looking at dozens of properties and speaking to many different agents. Best of all, if I get serious about a particular property and I’m considering making an offer, I have pages of notes to help me work out the best course of action when I begin price negotiations.

It’s crucial that you ask the agent as many questions as possible, because when it comes to real estate, everything is not always as it seems.

I once had a client, Effie whose sister Gia wanted to invest in the lower north shore in Sydney. Even though research at the time suggested that it wasn’t the best place to invest, Gia had her heart set on buying a two-bedroom apartment in the area.

After keeping an eye on the market for a few months, Gia stumbled across what she thought was the Holy Grail property. It was a good quality, executive style two-bedroom apartment with a parking spot and an internal laundry and was listed on the market for $395,000.

Similar quality properties were being listed for between $450,000 and $550,000 at the time, so it represented quite a huge discount. Gia was beyond thrilled, and was bragging that she’d found the bargain deal of the decade, but Effie wasn’t convinced – it looked too good to be true, so warning bells started ringing for her.

When Effie came to me asking for advice, I admitted that I knew very little about that particular area, so I couldn't give a fully formed opinion. However from the information that Effie had given me, it was clear that something didn't quite add up.

Vendors usually don't list their property at a 20% discount to what the market would normally comfortably support, unless they have a very good reason. I strongly urged Effie and Gia to have a conversation with the real estate agent to find out why it was listed so low.

At first, the agent played coy with vague responses like, "They're really keen to sell as they've committed elsewhere." But before long, she revealed the real reason behind the low sale price.

The building was only about six years old, but it had been cheaply and poorly constructed. Owners in the complex had experienced cracking and splitting in their ceilings and walls, so a few months earlier the strata manager had engaged a building inspector to review the entire structure.

It turned out that there were several major, serious structural issues with the foundation and framework of the building that required immediate work. The bad news was that the works were not covered by insurance and each of the sixteen apartment owners would be required to kick in their share of the rectification costs.

All of this might have been okay if the repair bill was going to be $20,000, or even $30,000. However the total cost to each owner was estimated to be between $80,000 and $90,000. Overall, the repairs were going to cost at least $1.3 million.

It was a giant, over-sized, million-dollar red flag that clearly indicated, "This property equals trouble!"

Thankfully, Gia had not signed any contracts, so when she discovered how big the problem was, she was eager to move on. Even if Gia had signed the sales contract, she would hopefully have learned about the building issues – and the subsequent giant repair bill – during her due diligence. But what if her conveyancer had somehow overlooked it during legal searches? Who knows how much time and money she would have wasted?

It shows you just how important it is to develop strong relationships with real estate agents, as they can be very valuable sources of information. In fact, you may even be able to get local real estate agents working with you to fast track your property search. I do this by using a strategy I recommend to my clients all the time. It has paid dividends, for me and for them, many times in the past.

It works like this. When you have isolated your ideal suburb, contact two or three local real estate agents in the area. Explain to them that you want to invest in the area and give them an outline of your buying rules and your budget and then ask them to contact you with any properties they list that fit the profile that you've provided to them.

This can save you loads of time and energy as it's like having a small network of personal real estate agents working for you. They may bring to your attention properties that have just been listed but which haven't been posted on the internet yet. They may also have access to private listings that you wouldn't ordinarily know about.

Keep in mind though, that it's important that you let them know you're serious about buying. If you can demonstrate that you're pre-approved for finance and you have your deposit ready and you're keen to buy right away, then that will really get their attention and get them working for you.

HEDGEHOG ACTION ITEM: In the Real Wealth Australia CD ROM, "The Ultimate Property Resource Guide", you'll find a PDF guide that lists "28 Research Questions to ask about the specific property." This will help you to collect all of the information you need on each property your short-list, so you can easily compare them at a glance.

Buying without emotion

Of course, throughout the entire process of pinpointing your ideal investment property, there's one hugely important point that I can't reinforce enough and that is - "BUY WITHOUT EMOTION".

When it comes to investing, this is singularly the biggest problem that is unique to property, because you don't often hear about people who fall in love with shares. You'd never choose to invest in shares in a company because you like their brand colours, or because they use a cute mascot. You invest in shares because of their expected financial performance, and that's exactly what you should do with property as well.

You need to remember that when you invest in property, you're doing so to create wealth. The property isn't going to be your own home, so don't fall in love with the double-sink bathroom or any potential renovations that would enhance the property without getting back a higher yield. You're not going to live there so it doesn't matter that you love the kitchen. It's all about the numbers, so check your emotions at the front door.

Of course this is easier said than done. Real estate agents earn their living by making the properties they sell look as attractive as possible.

There are entire companies that specialise in property staging and styling, and their sole aim is to make each property look so inviting and comfortable that you can actually imagine yourself living in the home. And this is precisely the first mistake I ever made when I began investing.

The very first property that we ever bought was a lovely three-bedroom townhouse in Melbourne with a view of the city. It was truly beautiful, and spacious and well-designed, with modern appliances and ample storage.

At the time we were living in an older property in the suburbs and this property had everything that we didn't have in our own home. By comparison, I thought the townhouse was sensational, and I was really quite desperate to live in it, although Ed didn't. I cared about it. I went out and spent thousands of dollars on curtains. I painstakingly planned the colours that I wanted to paint the walls, running back and forth to the hardware store many times for yet more paint samples to find "the perfect shade".

I was so emotionally attached that I almost convinced Ed that we should move into it the place.

But Ed being the logical one crunched the numbers. He worked out that if we moved into that property we would have been going backwards financially, and we had agreed that digging ourselves out of our money woes was our number one priority.

I could have just as easily bought inexpensive basic curtains for $500, they would have equally served their purpose, and at the same time put $1,500 back into our pockets. But the thing that happens when there's emotion involved is you actually don't think about the tenant. Instead you're buying for yourself and when you don't think about the person that's going to live in the property, it can create a problem.

You need to buy property that suits your tenant's wants and needs, not your own, so remember the property investor's golden rule – fall in love with the deal first, and then the property.

Once Ed presented me with the financial analysis, it helped me to overcome all of the emotion that I had attached to investing. I'll admit though that I had a little trouble the first time we rented out that property – I wanted to know everything about the tenant that would be moving in, so I could be sure they were going to take care of it.

I’ve moved on since then. Now I just focus on the numbers. As long as they are presentable to tenants, I now don’t care about the carpets or curtains or decorating finishes. I just want to know:

1. That I have a quality tenant.
2. That the rent that I will get is market value and
3. How much it is going to cost me each week.

Crunching the numbers

Okay, so you’ve found the property and it fits all of your buying rules, so now you want to work out whether it fits within your budget.

In order to do this you do need to analyse the property financials, to ensure that it matches up with your buying strategy. This can be done quickly using reputable property analysis software.

This type of software allows you to input all of the purchasing costs and expenses, in order to come up with a net weekly pre-tax and after-tax loss or income estimate.

If the property doesn’t quite fit your buying rules at the price being asked by the vendor, you should be able to manipulate the purchase price figure in the software until you get a scenario that has the deal stacking up to your required buying rules. This then becomes your upper price limit when you start negotiating the price.

For instance, you might be looking at a property listed for sale at $330,000. You enter all of the information into the analysis software, and discover that at $330,000, the deal is negatively geared by $65 per week.

But you’re goal is to find a property that is 100% neutrally geared. After entering a few different scenarios, you calculate that the deal will be neutrally geared at a purchase price of $297,500.

If you secure the deal for any less than this amount, then you'll enjoy a little extra money in your bank account each week. But you now know that your "ceiling" is $297,500, and not a penny more.

If you find the ideal property but the numbers don't add up, walk away – it's too easy to talk yourself into paying $25,000 more than you wanted to, in order to secure "the perfect property" but you need to know how it will impact on your long-term wealth creation plans? Does over-spending now mean that you'll be in the workforce another two years as a result? Make sure you think of the long-term impacts of your buying decisions.

FOX WARNING: Some property analysis software can be misleading, especially if offered by developers that have a vested interest in the outcome. Make sure you only use reputable software offered by qualified, successful people who are investors themselves.

Case study: The properties no one else would touch

For Melbourne-based investor Dr Zaman, finding the right property is all about locating the diamond in the rough.

The savvy investor, who at the time of writing this book owns six properties including his own home, says he goes for houses and units that "nobody else would go near".

"All of the houses that I've bought no-one would even walk into them – even the smell in some was overpowering," he explained.

"I bought my first property a few years ago. I came to Australia from Bangladesh in 2001, and I noticed that in Bangladesh that property prices always increased.

Every seven to ten years, property prices double, so when I came to Australia I thought it was a good idea to invest in property.

I joined Helen's course at the time when I was already preparing to buy. I started reading property magazines and journals, but the course gave me the confidence to take action.

The first property I bought was a house on a decent sized block of land. It was in such bad condition and all of my friends thought it was very risky. But I went ahead and bought it and I also bought my second investment property at the same time, which was in a similar condition.

I bought my third property in Bentleigh in June 2007. I paid $421,000 at auction, and it was in a really bad state – just to clean it up cost me $35,000, but I think it was worth it. Now, it's worth at least $700,000.

My fourth and fifth purchases were also older homes, and we've now renovated them. They've increased in value as a result so I believe they were all good investments.

I'm very comfortable buying in Melbourne. I have my own buying strategy and rules down pat and I know how to pinpoint the right properties that fit with my goals. I'm very cautious about buying in other states but I'm always looking on the internet – hopefully, that will be my next step."

12. Due Diligence

If you've completed every step of the process so far, then you're 80% of the way to getting where you want to go. By now you should have:

1. Reviewed your financial position
2. Developed your investment strategy
3. Established your exit strategy
4. Created a dream team of experts to work with you, and
5. Conducted exhaustive research on locations and properties that fit your strategy.

So, you're now more than ready to take the plunge and become a property investor.

But if you're thinking that all of the hard work is behind you, unfortunately you're mistaken!

The research part of the equation is complete, but to go into the investment with your eyes wide open, you need to conduct extreme due diligence in order to validate the information that has been provided to you from real estate agents, etc.

Due diligence is the process of investigating the purchase to ensure that it stacks up from every perspective, including the quality of the asset, financials and long-term investment return.

When you go about crossing all of the t's and dotting all of the i's, it gives you peace of mind that you've checked out every possible risk and that you have put measures in place to either minimise the risk or eliminate it entirely.

Generally when you buy an investment property, you'll cover each of the following areas when you conduct your due diligence:

- Property inspections

- Building and pest reports
- Strata reports and meeting minutes
- Online searches
- Legal issues
- Property management

When you find the right property that you want to purchase, it's time to conduct extreme due diligence on the property which usually means pest and building inspections. In order to do this it's a good idea to include "subject to" clauses in the purchase contract that allow you to gain access to the property to do your extreme due diligence research. This will also give you the time and opportunity to organise any inspections and valuations you need, without the threat of being 'gazzumped' by another buyer. More importantly, it will allow you to pull out of the deal should you find something extremely unpalatable in the property.

One such example of a 'subject to' clause is, " the purchase is subject to the results of the professional building and pest inspection, to the satisfaction of the buyer". This type of clause can potentially save you thousands of dollars in future costs and more importantly, future headaches. It can also be a great bargaining chip when you begin negotiating on price, but we'll save that for the next chapter.

I strongly recommend that you follow these due diligence guidelines whether you're buying a property that you've personally viewed twenty times, or a property located in another city that you're considering buying sight unseen.

I once heard a 'property guru' say that in his opinion, investors should not buy property sight unseen until they have viewed at least 100 properties. I tend to agree, as buying sight unseen can be risky, but it's possible to reduce the potential dangers by conducting extreme due diligence.

I can't even begin to tell you how many properties that Ed and I have viewed over the years. For several months at the beginning of our investing career, it was all that we did every single weekend.

We would get up early on Saturday morning and view more than a dozen properties during the day, before collapsing into bed that evening for a good night's sleep, all so we could do it again the next day. It's obviously the hedgehog in me, when I set my mind to something I can become obsessive about absorbing as much information as possible. It's a trait that has served me well so far!

Unfortunately though, many property investors, including those that already have a few properties under their belt are so keen to grow their portfolio that they don't view enough different properties to fully appreciate what they're buying.

They take a leap of faith, buy sight unseen and hope that it will turn out okay and do you know what? In most cases it does work out okay, only because property is a pretty forgiving investment.

But wouldn't you feel more comfortable knowing that your investment property has the best possible chance of real success? Don't you want an investment property that doesn't just turn out okay, but one that turns out brilliantly?

FOX WARNING: In my line of work I hear far too many horror stories from investors who have bought sight unseen, without proper due diligence, and bore the consequences. Not doing due diligence can lead to many problems for the unsuspecting investor, so if you do buy sight unseen, make sure you're extra vigilant in conducting your extreme due diligence.

Property inspections

At the end of the day, nothing can replace the information you get by physically viewing a property. Your level of knowledge increases ten-fold when you check it out for yourself, as you will get the opportunity to spot any special features, as well as any flaws or potential problems.

The property photos found on real estate websites or provided by real estate agents are only going to tell you so much. Unless the agent has categorically snapped pictures of every nook and cranny in the house, you're going to miss out on seeing details such as the state of the cupboards in the bathroom vanity and whether the kitchen drawers stick when you open and close them. They're small details sure, but they can help you to gauge the overall quality of the property.

I remember looking for regional property opportunities a few years ago and through the course of my research I came across a town with high yielding properties. It caught Ed's attention too and within a few months we had purchased a cozy three-bedroom cottage that was about 25 years old.

The photos we received from the real estate agent showed the property to be in fairly good condition, so it wasn't until we personally viewed the property some months later that we received the shock of our lives. It was in a much, much worse state than we could have ever anticipated.

The tenant obviously had not maintained the property and even though we had only settled about six months earlier, it wasn't in the same good condition that we had seen in the photos. The carpet was filthy, the walls were grimy, and the whole house had a musty smell. As well as this, the backyard had become home to a stockpile of beer cans and mechanical spare parts. It was definitely a less-than-ideal scenario.

Had we seen the property before buying, we may not have bought it. Thankfully, we had conducted some due diligence on the property and overall we felt that it was still a good purchase because the numbers stacked up and the area was experiencing high capital growth at the time. So in this instance buying sight unseen worked for us.

More importantly, our long-term plan for the property was always to bulldoze it and build a set of three apartments on it, so the actual condition of the property wasn't too much of a concern. I'm grateful that there was the opportunity to do that, because without that option, it could have become the lemon of our portfolio!

If you can't personally view the property, the next best thing is an inspection by the selling real estate agent. You have to keep in mind though that they're usually always going to highlight the property's best features and benefits and over sight its flaws because naturally, they want to make the sale.

But it also pays to remember that the sales agent has viewed and appraised the value of the property, so they need to know what the best features of the property are and what, if any, concerns there are with it.

When we find a property that we're interested in, we start off by obtaining as many photos from the sales agent as possible, especially the kitchen and bathrooms. These rooms are the most expensive to repair or replace, so ideally it's best to obtain photos that are close up and clear, so you can see if any repairs are required.

You should also request photos of the streetscape and the surrounding properties, so you can see what the local neighbourhood is like. I had a client who looked at buying a sweet little house that looked lovely in the photos. In reality, it was right next door to a large industrial Laundromat, which had trucks coming and going all day. The photos saved my client from a potential disaster.

Building and pest reports

As stated above, building and pest inspections are vital due diligence for ascertaining the true condition of any property you are considering buying.

Sometimes, even though you physically inspect the property, you may not see the hidden problems that lie underneath it or behind wall plaster. Bringing in experts to conduct detailed building and pest inspections will reduce your potential risk and provide you with a level of comfort when buying.

A qualified building inspector should be used to identify any building issues. They are an extra set of professional eyes that should be able to appraise all aspects of the building on your behalf. This will generally include photos that highlight any concerns that they may have.

Building inspections should be thorough and provide a clear indication of the structural and non-structural condition of the property.

Building inspections should also be completed prior to auction or unconditional sale, and a satisfactory building inspection report should be included in the special conditions of the sales Contract, as a pre-condition to the agreement to purchase the property unconditionally.

It's important that you get a building inspection done regardless of whether the property was built last month or last decade, because even brand new properties can be plagued with problems.

I recently worked with a building inspector John, whose job was to go in and evaluate properties on behalf of buyers, sellers and insurance companies to find out whether there were any faults present. He had seen everything from sinking houses to bedrooms covered in black mould. Once, he was even called out to a property that was built on ground so unstable that the Porsche parked in the driveway had been literally swallowed up by gapping cracks that opened up in the ground supporting the house!

John told me that in his experience, he had found that many people who buy newer properties, up to four years old, often fail to get building inspections done, believing that the property is too new for any problems to be present.

John went on to say that in actual fact, people could literally save thousands of dollars by having a professionals inspect their building before they buy it. If they turn up any issues within the builder's warranty period, they might, depending on the issue, be able to go back to the builder's insurer and have them rectify the issue under their insurance cover. If you leave it too late though the warranty may expire, leaving you to foot the bill.

Building inspections rarely cost more than $500, so it really doesn't make sense to **not** invest such a small amount of money in getting a building inspection report, especially when you're about to commit hundreds of thousand dollars on buying a property?!

Similarly, a pest inspector will be able to assess the property to ensure there aren't any creepy crawlies present that could cause potential damage to the property you are planning to buy, especially termite damage. The pest inspector's report should contain photos of damage and any concerns that they may have with the property and should also identify any current and potential risk from termites and other insects. It should also include recommendations for minimising any future pest invasions down the track.

Pest inspections should also be completed prior to auction or unconditional sale of the property, and a satisfactory pest inspection report should be included in the special conditions of the sales contract, as a pre-condition to the agreement to purchase the property unconditionally.

Pest inspections generally cost around the $250 mark.

Body corporate reports and meeting minutes

If you're investing in an apartment in a block of apartments or a villa unit or townhouse, you will generally need to work with a body corporate. A body corporate is a legal requirement and is made up of all the owners of the properties in the block, in order to maintain and look after the common areas and facilities in the block of apartments/units/townhouses.

Before buying a property that has a body corporate it's a great idea to try and get access to any body corporate reports and meeting minutes. They can reveal so much valuable information, including recent or upcoming large repairs and/or expenses.

Legally, the seller is not obliged to provide you with any body corporate documents, but if they are serious about selling and don't have anything to hide, they may be willing to provide you with this information upon request.

In big apartment block a professional strata management company is usually employed by the body corporate to manage the day to day running of the body corporate affairs. Every body corporate is required to hold an Annual General Meeting, which is where major issues are discussed and voted on. Issues can include major upcoming repairs, body corporate levies for the forthcoming year and any changes that maybe being proposed to the body corporate by-laws.

If you can't get access to the official body corporate meeting minutes, you can call the real estate agent or better yet, the strata management company, to ask questions about the property.

When doing this it's worth finding out:

- How much is in the sinking fund? The sinking fund is the reserve of money that is set aside for minor and large scale repairs and renovations, such as repainting the exterior of the property, or re-tarring driveways. A low sinking fund balance could indicate issues in the body corporate, because if there aren't enough funds to undertake a major expense, then all of the property owners in the building will be forced to contribute a one-off "special levy" to fund the expense.

- How much is in the admin fund? The admin fund covers the day-to-day running of the complex and the managing of any body corporate affairs, such as pool cleaning, garbage collection, maintenance, gardening and landscaping in common areas and fees for gas and electricity that is used in common areas.

- How much the current annual sinking fund and admin fund levies are and are they expected to increase in the next twelve months?

- When the last time the common areas in building were painted, inside and outside? Painting generally needs to be done every 7-10 years, and can be an expensive job when it crops up.

- Are there any major renovations or repair jobs forecast within the next two years?

I strongly recommend that you have a pen and paper with you when you make this phone call to the strata management company or chairman of the body corporate, so you can scribble down as much of the conversation as possible. This information can save you from making a costly mistake.

I once had a friend who signed a purchase contract to buy a two-bedroom apartment on the Gold Coast. She had completed full due diligence and was about to send the signed contract back to the real estate agent, but before she did so, she read through it one final time.

In Queensland, when you're selling a strata titled property you legally have to include a strata disclosure statement, which outlines a lot of the above information including the amount in the current sinking fund, admin levies, the balance of the sinking fund, details of the strata manager, etc.

On her final inspection of the paperwork, my friend noticed one small line tucked away in the bottom left corner of the statement, which said, "Roof needs fixing".

It was so small that she had overlooked it during her previous reading of the document. She called the strata manager straight away and asked just what "Roof needs fixing" meant, exactly.

The strata manager was candid enough to reveal that off the record, the roof had been leaking for more than two years, but she couldn't get all eight of the apartment owners to agree to fix it. Initially, the repair bill was around

$8,000, but because it had been left to get worse for two years, it would much more expensive to fix now.

In addition to this she said that there would most likely be additional expenses as the leaks had caused damage in several of the apartments, such as mould and damp, so some of the walls would need to be stripped back and repainted as well.

The only way the strata manager had been able to manage the issue properly was to increase the sinking fund contributions. The sinking fund currently held around $12,000 and the strata manager hoped to commence repair works using those funds within the next six months.

Needless to say my friend didn't proceed with the deal. The reason being that if the other property owners had been procrastinating over major roof repairs for two years, who knew what other issues might be festering? Those three little words and that phone call to the strata manager saved her from buying into a potential property nightmare.

Legal issues

This is an area for your solicitor or conveyancer to handle, but it's still important for you to be aware of the legal due diligence that is required to be done when buying a property.

Generally as part of the buying process, your solicitor or conveyancer will do several searches to ensure that Certificate of Title is registered to the vendor, and that there are no outstanding issues relating to easements, covenants, caveats, mortgages and other interested parties who have a stake in the property.

I have heard of many horror stories, including one frustrating situation experienced by a woman I met at a property expo. Her long time solicitor had failed to do adequate checks on a property she was purchasing. As a result, she had bought an apartment where the weekly body corporate contribution increased from $25 per week to $90 per week within months of settling the purchase of the property.

Her solicitor should have identified that the body corporate was going to increase during his searches. I didn't want to say so at the time, but if she had conducted thorough due diligence herself, she probably would have discovered the impending hike in body corporate fees on her own. As it was, she was stuck with the property and had to pluck an additional $65 per out of thin air to cover her expenses. It's a situation I'm sure we'd all prefer to avoid!

Property management

Obtaining rental appraisals from experienced local property managers is vital when considering the purchase of an investment property, because you need to find out how much it will realistically rent for. The rental income from a property is used to support the property expenses including the mortgage interest payments and a poor assessment of rental yield could leave you significantly out of pocket.

I always recommend to buyers that they obtain at least three rental appraisals in writing, because it will then give you a confident outlook of what the expected rental income will be.

I also recommend to buyers that the property managers that are used to obtain rental appraisals from, are not linked in any way to the selling agent or their agency, for obvious reasons.

A property manager can assess how rentable the property is, as well as its general condition. Their inspection will also confirm for you that the property is in keeping with what tenants in the area want.

The last thing a property manager wants is a house or apartment that has been neglected and requires continuous attention, as it becomes difficult for them to manage and even more difficult for them to let. Properties like that usually represent a great deal of work for property managers, so they’re likely to give you an honest appraisal.

One of my clients recently conducted due diligence on a potential property purchase in Queensland. The following are summaries of her phone conversations with four different property managers in the area.

Following these four phone calls, my client had a pretty realistic idea of what tenants wanted in the area that she wanted to buy in. It also indicated how each real estate agency operated and the rental return that she could expect to receive on the type of property she wanted to buy.

Blundels Rentals

Type of property most sought after by tenants: Crème brick veneer, modern kitchen and bathroom essential, north and east parts of the suburb most popular areas. Must have double garage, three bedrooms, and must have a bathtub. Expected rent around $290-$320 per week.

Has quite mix of tenants, no predominant group, but low vacancy rates so can be choosey.

Generally rent properties out within a few weeks. Managing 360 properties, 13 are vacant (3.6%). 80-90 properties per staff member.

Best rent range is $250-$300 to attract the widest pool of tenants. $350 a week is the boundary for most people, but with the current shortage this is being pushed higher. Recommends not buying units, less demand.

Ray White

Type of property most sought after by tenants: 3-4 bedrooms, study or second living area, ensuite and a double garage. Areas sought after are central, east and north.

$250-$300 a week rent is in most peoples range. $350 probably the limit, but they are pushing that as properties are often gone within days.

Influx of gas plant workers coming in, on high incomes, looking to rent something in the area.

245 properties on the books managed between two managers and two support staff. Four properties are vacant (1.6%)

Falks

Type of property most sought after by tenants: At least three bedrooms, double garage, two toilets, two living areas and up to $350 per week rent. Good area, take note of the schools, especially Merrivale, people want to live in that zone to send their school children there. Avoid Wansteed Street.

Area rental range is $280-$310.

300 properties managed between two managers. Four vacancies overall. (1.3%).

McNally

Type of property most sought after by tenants: strong market for rentals. Tenants want three bedrooms, two living areas. One bathroom is no limitation, provided you have good-sized bedrooms, central gas heating, neat and tidy condition overall. Expect to lease out a property within 4 weeks.

Garage not essential, but it can add $10-$30 per week to the rent. Most people can afford a modern house, $260-$320 a week range.

People like central location (but there is a shortage), east and north. Jamieson Primary (central) is in demand for families that have school aged children.

Managing 800 properties between four managers and two support staff. Have 10 vacancies (1.25%).

HEDGEHOG ACTION ITEM: Don’t stop asking questions – even if you’re buying an investment property in your own city or town. Each neighbourhood has its own quirks, so talk to other locals, neighbors, council members and local businesses to obtain their feedback on the area or street you're proposing to buy in. Contact the pastor at the local church, who has probably lived there most of their life – you'll be amazed how much they know about the area. Next door neighbours to the house you are proposing to buy can also be a goldmine of information, including the *real* reason why the current owner is selling…

Case study – The Power of due diligence

Kate Johnstone and her partner Matt Maloney enrolled in the Real Wealth Australia course in 2009. Within twelve months, they had invested in three investment properties – and Kate says it was all possible because of what they learned about due diligence.

"Initially, we began looking at investments in Warnambool, the town that we live in," Kate says.

"We spent around four months researching – I'd say we spent about 50 hours all up online and making phone calls and we found the whole process quite incredible. It's amazing what you can find out about a place if you just look.

"We began by looking at the different projects going on, looking for growth corridors. Once we found the corridor we thought, we'll plonk a house right there.

"We looked at capital growth and rental growth and researched the rental population in the area. We interviewed four property managers. We went and inspected dozens of properties, and it was a huge learning curve with regard to dealing with real estate agents. Obviously when you're 21 and you look through a property, agents wonder whether you can afford it!

"We eventually found a block of land and after some investigating with the council, we discovered that the neighbouring Gateway Plaza was planning to triple in size by 2014, plus there were applications from larger stores, like

Safeway, to build new shopping complexes in the area. That's was fantastic we thought as we had planned on holding the property for the long term, so it confirmed to us that we were on the right track.

"Our block is now valued at $20,000 more than what we paid for it – and we haven't even settled on the land yet! For us, it represented the power of due diligence and what it can do for you. It increased our chances for success tenfold just by doing our due diligence. Most people just buy any old house, any old where, but we spent the time, money and effort to make sure that we made the best decision.

"In fact, one of the real estate agents we dealt with told us that we needed to 'get over doing all this due diligence stuff' and just make the decision to buy a property in ten minutes. Matt's response was, 'Most people would spend weeks researching if they were to purchase a new car, TV or stereo, so why would I spend hundreds of thousands of dollars based on a choice made within ten minutes?'

"To us, due diligence is the different between having an average investment and a great investment."

13. Negotiating strategies

Some people find the process of negotiating stressful and intimidating. In this country, haggling is generally not a common practice and there can be negative connotations associated with asking for a discount.

Back in my early days of investing, I felt embarrassed to negotiate the asking price as it made me feel stingy. However, it’s important to remember that your ability to successfully negotiate the purchase price of your investment property could save you tens of thousands of dollars, and takes you one huge step closer towards creating real wealth.

Every dollar that you save at the beginning of the journey is another dollar in your pocket, which could allow you to invest in more property or finance renovations.

I’ve found that the most common mistake that investors make when negotiating is failing to ask for what they really want. So my golden rule now is to always ask for what I want, even if what I want may sound unreasonable to the vendor.

After all, what’s the worst that can happen? They can say no? If they do I can then amend my offer if I want to, but at least I know I’ve asked.

This rule has formed the basis of every negotiating strategy I’ve used over the last decade. I’ve learnt to treat the negotiating process as a game. It’s all about gaining the position of power and there are a number of different strategies that you can use in order to do just that.

One of the most powerful things that you can do to boost your negotiating position is to become an expert in the area that you’re buying. When it comes to property investing, there’s nothing more powerful or persuasive than facts and figures because they allow you to challenge the sales agent’s claims if and when they try to gain the upper hand during the negotiations.

For instance, the agent may insist that the house you're looking at buying is worth "at least $350,000 and the vendor won't accept a cent less". It would help your argument considerably if you could produce evidence of a recent sale in the area of $325,000 – particularly if you have it in writing.

Before I start the negotiating process on a specific property, I usually study the suburb for some time. This research enables me to understand what the best streets are in that suburb, where the schools are in relation to the property, where the childcare and shopping centres are located, and where the other infrastructure is located that supports the local community.

Because I don't physically live in the suburb, this research gives me the information I need to become the expert and have as much knowledge as a local would.

Watching the property market in my area of interest allows me to monitor what types of properties are being listed, what types of properties are selling the fastest and how long properties typically remain on the market before being snapped up.

Armed with all of this knowledge, I can spot an opportunity quickly when it becomes available and once I've found myself an opportunity, I'm in the position to act quickly.

Because I like to do things hedgehog-style, the extent of my expertise doesn't stop there. Once I've isolated the property I want, I become the expert on that property – and that's where I really start to see some financial rewards.

As mentioned in the previous chapter, I always use "subject to" special condition clauses in order to make the purchase conditional. This allows me to take the property off the market so I don't get gazzumped by another buyer, and more importantly, it buys me time to do more detailed research into the property.

As a rule, these clauses always include pest and building inspections and any other inspections that I feel may enable me to learn and understand more about the property.

If you want to become the expert in that property, then conducting these inspections it vital, as it allows you to uncover anything untoward that even the vendor may not be aware of. Any flaw that you find, no matter how big or small can become a point for price negotiation.

I can recall one specific instance where this strategy has paid off for me. It was when one of our building inspections on a property that we wanted to buy uncovered asbestos sheeting in the laundry. The owner was completely unaware of the asbestos and was completely horrified because he'd been living in the property for a number of years.

As a result, I gained the upper hand in price negotiations and he was keen to offload the property as quickly as possible. The asbestos issues had the affect of discouraging other buyers at the auction because they weren't too keen to buy what they perceived was a huge problem. The lower levels of interest from other buyers served to reduce the vendor's price expectations, which opened the door for me to ask for a big discount.

I asked for a substantial price reduction to compensate me for having to remove the potentially hazardous asbestos – and I got it! At the end of the day I achieved a significant saving worth several times the cost of removing the asbestos. Had I not become the expert, I would have missed the opportunity and paid dearly for it.

I've also seen other investors use lesser issues to negotiate significant purchase price discounts

Many years ago, I met a woman who owned property in Townsville. She recalled to me how she had put in an offer of $245,000 for a two-bedroom townhouse near the beach and close to the city and it was accepted. The listing price for the property was $269,000 and the woman had bought the property in a booming market. This was an excellent result. She was savvy enough to have achieved a discount of more than 9% during her negotiations for the property.

Then her building inspection turned up a slight issue in the internal roof cavity, whereby part of the fireproofing between her apartment and the neighbouring apartment was coming loose. It turned out that it wasn't a big deal; the building inspector said that in the event of a fire, it would be unlikely that the fire would spread.

In any event, it was something that the strata manager would organise at no additional cost to any of the owners in the building, as it would be paid out of the sinking fund. But as an experienced investor, she took the opportunity to negotiate a discount on the purchase price.

Keep in mind that the purchase contract had been signed conditionally and the "subject to building and pest inspection clause" was going to expire that same day. The woman knew that the vendor didn't want to lose the sale and go through the hassle of re-listing the property, so she asked for another $2,000 reduction in purchase price and got $1,000.

Her reasoning was that she said she was uncomfortable moving ahead with the deal when she knew that she would have to get the ceiling fixed – even though she had confirmation in writing from the strata manager that they would manage the repairs entirely.

HEDGEHOG FAST FACT: As a guide, we aim for the following discount amounts when negotiating the asking price:

In a boom market, we seek a 5-10% discount
In a flat market, we seek a 10-15% discount
In a bust market, we seek a 20%-plus discount

If you can’t achieve these amounts, try to achieve at least some sort of discount, as every saving you make at this step is money back in your pocket.

The value of knowledge

It’s important to understand what a vendor needs and what their constraints are when you are negotiating with them. You can then formulate a buying strategy to create a win-win outcome.

The question is, how do you find out what the vendor’s constraints and needs are? A good place to start is with the selling agent, as they have an understanding of the vendor’s position and what their desired outcome is from selling the property.

Usually, the selling agent will know if the vendor needs to sell by a certain date, what their price “floor” is and whether they’re committed elsewhere. Strictly speaking, they shouldn’t be providing you with this type of information, but more often than not they will if they sense that you are a serious potential buyer.

For instance, when we purchased our own home, I discovered that the vendor was building their dream home elsewhere and needed to sell to help them secure the finance for its construction.

They were in the unique position of needing to sell quickly in order to obtain finance from the bank for their new home, but they needed a longer settlement period so they could remain living in the house until their new home was built and ready to move into.

By becoming aware of their situation, I was able to obtain a discount off the purchase price in return for the longer settlement period that they needed. We allowed them to stay on until their new home was complete, which made the transition easier for them, and more cost-effective for me.

The more you know about the needs of the other party, the greater will be your opportunity to negotiate a better deal.

If you're buying an apartment or townhouse, another great source of information is the strata management company or body corporate committee. You should be able to obtain information including how much the vendor currently owes in strata fees, which can be very telling. If they're up to date, that's fine, but if they're several months or several years in arrears – I've seen it happen! – then you know that they might have a financial incentive to sell.

An investor friend of mine bought an inner city apartment last year, and he discovered during his due diligence that the vendor was $8,000 behind in payment of their body corporate fees – equivalent to around two years worth of strata levies!

Upon learning this, my friend prodded the agent for a little more information and eventually found out that the current owner was facing financial hardship over a relationship breakdown and was therefore desperate to sell. Needless to say, he was able to negotiate a significant price reduction in exchange for a prompt 30-day settlement.

Distressed sellers provide investors with plenty of opportunities to negotiate a discount because they usually need to sell in a hurry. You can match their need for a quick settlement with your desire to reduce the price, creating a win-win situation.

Examples of distressed sales include:

- When the vendor is committed elsewhere
- Divorce
- Relationship breakdown
- Financial hardship through redundancy, loss of job, business hardship
- Mortgagee sale

- Threat of mortgagee sale
- Family illness, creating the need to upsize
- Family illness, creating the loss of income in order to provide full-time care
- Family changes such as pregnancy, forcing the vendor to upsize
- Trustee sale, when the vendor has passed away and their trustee is negotiating the sale of their assets

Using time to your benefit

How often have you made a bad decision when you've been under pressure?

I've seen many investors make snap financial decisions worth hundreds of thousands of dollars without putting enough thought and effort into the decision making process – simply because they felt pressured into taking action.

In order to gain the upper hand in your negotiations, the only person that should be under pressure is the vendor. If you find yourself under pressure then you're in a vulnerable position.

To overcome this, you can use time to your benefit by setting deadlines with your offers. When you add an expiry date, the vendor is under pressure to make a decision and you won't be waiting around for days or even weeks while they consider your offer.

Setting a deadline on offers also prevents the agent from silently bidding you off against other buyers in a quasi 'Dutch' auction.

If a vendor or agent is putting you under pressure to make a decision, the trick is to buy yourself some time. You need to be able to make clear choices based on facts and figures. You can't do that when you're feeling coerced into making on-the-spot decisions, so if you feel pressure, tell them you need more time to think about your response. However, you must be prepared to walk away should they not agree to give you more time. Remember, negotiating is a game and sometimes walking away is the best strategy.

For this reason, it’s important that you develop options so you have a back-up plan if things go wrong. Having a back-up plan has saved my bacon many a time. I would never commence negotiations on a property without having a back-up plan in place, as it gives me options and the freedom to move should a vendor not accept my offer and conditions.

Having alternatives up my sleeve for a ‘just in case’ scenario allows me to create a win-win situation without losing the opportunity. If you go into negotiations without any options and your offer is rejected, then you have nowhere to go and negotiations quickly stall. It’s often difficult to come back to the negotiating table after you’ve failed the first time around, because it becomes difficult to regain your position of power in the negotiations.

However, if you have other options in place, this makes you a better negotiator and gives you a stronger bargaining position. The bonus is that it also gives you more confidence in your dealings. People will sense that you’re well prepared and under no pressure to negotiate with them because you have lots of options.

You also need to be wary of flogging a dead horse in your negotiations. Some buyers just won’t budge and if that’s the case, then it’s probably best you walk away from the deal.

HEDGEHOG FAST FACT: If your vendor won’t negotiate on price but the deal stacks up beautifully, look for other ways to create savings and/or add value. For instance, if there are any major repairs that need attention, ask that the vendor attend to the repairs at their own expense as a condition of settlement.

Making an offer

When you’ve found the property you’re interested in buying and the numbers work for you, it’s time to put an offer in writing – but this must be done quickly.

It’s important that you strike while the iron is hot, making sure that you add “subject to” clauses in the special conditions section of the of contract. By doing this, you can put your offer in quickly to prevent other buyers from gazzumping you on the deal and it gives you the opportunity to conduct your due diligence during the “subject to” clause validity period.

If the vendor accepts your conditional offer, the property is termed to be ‘under contract’ and will be withdrawn from the market until such time that the subject to clause timeframe expires, or you decide to buy the property unconditionally. This is why it’s so important that you have a qualified and experienced solicitor or conveyancer on your team, so they can guide you through this process.

Many property spruikers advocate a strategy whereby investors put in unconditional offers on a property in order to secure the deal and obtain big discounts, but I am never a fan of this buying strategy. The reason for this is, it’s far too risky. Even if you have finance pre-approval or equivalent, you can never be certain that your finance will definitely come through until your lender has conducted their own valuation, and they provide you with written unconditional finance approval.

If you had employed this strategy in 2008 and 2009, you may have found yourself in deep trouble. The banks were changing their lending policies almost daily, and most lenders withdrew 100% lending products off the market altogether.

I had one client who organised a 100% loan for $500,000 to finance his new investment property. The Lenders Mortgage Insurance (LMI) payable on the deal (insurance designed purely to protect the lender), was $12,000. By the time the property was preparing to settle six week later, the LMI premium had increased to $18,000!

See how things can quickly change in just a matter of weeks? He negotiated with his bank, they agreed to split the difference, so he ended paying an LMI premium of $15,000.

A few weeks after the property settled, his bank withdrew their 100% mortgage product from the market and began demanding a minimum 10% deposit for all loans. His personal banker told him his application would not have been approved had he applied at that time, and he would have been required to find a $50,000 deposit – on top of the $15,000 stamp duty and $15,000 LMI – to proceed with the deal.

Can you imagine how stressed out he would have been if he'd signed an unconditional contract, and his lender had gone ahead and changed their lending policy?

When you sign unconditionally, you can become locked into a situation with very serious financial consequences – and if you're a smart negotiator, there's simply no need to do it.

Instead, you can use less risky "weapons" to secure the best deal, such as contract settlement dates. If timing is important to the vendor, a 30-day contract could help you negotiate a lower price.

Even if time is not of the essence, the vendor will usually appreciate a fast turnaround. It is worthwhile asking the sales agent to find out. If the seller is presented with two virtually identical offers and one contract settles in 60 days and the other settles in 30 days, which contract do you think they're going to favour?

My experience has taught me that negotiating is really about confidence and how comfortable you feel about asking someone what you want.

Once you have mastered the concept of asking, then implementing the negotiation strategies that gain you the upper hand become easy. Just remember, the better your position of power, the more money you can save yourself. This will lead to more money to put towards your next investment. If you want to build real wealth, then learning the skills of negotiating will save you many thousands of dollars over your lifetime.

14. Property management

You're now at the point where you've bought the investment property – congratulations! You've taken your first step towards creating real wealth. Your next step is to put into place a process to successfully manage your investment property.

The way that you manage your property, including the types of tenants that you let your property to can make a big difference to you the rental yield that it will attract and even its long-term capital growth potential.

Ideally, you will want to secure great tenants that look after the place and treat it as if it's their own home. In that way, you will be assured of a regular and reliable income stream with minimal stress.

Also, quality tenants will extend the life of the property and its contents and ensure that you're not forking over cash every other week to pay for excessive repairs and maintenance expenses.

As an example, carpet is one of those features in a house that can age very quickly and shabby looking carpet serves to bring down the aesthetic appeal of the entire house. It will only take six months of having the wrong tenant to destroy even the best quality of carpet.

With good quality tenants however, and regular steam cleans, the carpet should stand up to at least ten years of wear and tear before it needs replacing.

Tenant selection can have a huge impact on your investment. In fact, I would go as far as to say that the difference between having a good tenant and a bad tenant in place can be the difference between an easy, hassle-free investment and a property nightmare!

One of the most common questions I get asked, usually by new investors is: should I use a professional property manager, or should I manage the investment property myself?

My answer is the same every time: always engage a professional property manager. The internet has completely transformed the real estate industry, as it's now the primary media for property rental and sales listings. Renters no longer pore over the newspaper classifieds on a Saturday morning looking for open houses – instead, they jump online.

These massive advances in communications technology have brought with them the temptation for landlords to self-manage their properties, as it's just as easy for Joe Blogs investor to list a rental property online as it is for a property manager.

So why should you pay someone else to manage your investment property for you?

There's much more involved in property management than simply collecting the rent, and I'm of the belief that it's always better handled by an expert. I'm a hedgehog, and I seek out other hedgehogs. Why spend my weekends chasing up a locksmith for a tenant who has lost their keys, or listening to a tenant explain why they can't afford a rental increase, when I can pay a professional to manage the issues on my behalf?

I also believe that a good property manager can actually increase the rental yield of an investment property, because part of their brief is to conduct rent reviews and ensure that your rental yield is in line with what the market expects to deliver.

Often, DIY landlords get to know their tenants personally and as a result, they fail to pass on regular rent increases, because they feel that having a good tenant is worth the trade off of a lower rental yield. But why should there be any trade off at all? Why can't you have great tenants, and regular rent increases at the same time?

In my view, landlords shouldn't become involved in property management if they are serious about deriving profits from their investment property. I'd much rather pay a professional, licensed property manager to handle the management of my property and the following are several major reasons why I say this:

1. **Legal issues**

   You have a legal responsibility to lodge tenants' bonds with the Residential Tenancies Bond Authority, provide receipts for rental payments, and have respect for your tenants' privacy. Failure to do so can result in significant fines being imposed on you.

   For instance, you can't simply "pop over" and knock on your tenant's door. Legally, you need to give them at least 24 hours notice of your visit, unless of course there is an emergency situation.

   If you fail to abide by these rules, it could result in an appearance at the Residential Tenancies Tribunal and if you haven't strictly followed the letter of the law in managing your tenant, you will leave yourself open to charges and possible compensation payments to the tenant.

2. **Notice periods**

   Depending on the state you're in, there are different notice periods that you need to be aware of when managing your tenant. Again, failure to comply could result in charges again you as the landlord.

   For example, if you wanted to increase the rent, in some states you would have to provide up to two months notice of any planned increases.

   In NSW, your tenant only has to give you three weeks notice of their intention not to stay on during a periodical lease. In Queensland, tenants are only required to give you two weeks notice of leaving –

whether their fixed lease is coming to an end or they're on a periodical lease.

There are also rules and regulations regarding how you advise your tenant of a rental increase. Generally, it must be in writing and in most cases, you must include the start date when the new rental amount takes effect.

If you forget to include the start date, your tenant could wait until the day before the new rent payment is due to kick in before informing you that his notice isn't valid. You would then have to supply a brand new letter with a fresh two-month waiting period.

I have a colleague in Sydney who avoided a rental increase for eight months because the landlord kept providing the wrong information on the written notice. The rules and regulations are different for each State, so if you don't comply, you could cost yourself a lot of money, as well as wasted time and energy.

3. Professional access to tenant databases

When processing any lease applications top professional property managers will maintain memberships of the top tenancy databases in Australia,

One of the greatest fears that property investors have is that their tenant is not going to pay the rent or cause damage to their property, which is where these databases come into play.

These computer systems allow your property manager to see whether an applicant has been entered into the database, for things such as defaulting on the payment of rent, breaking a lease or damaging the property.

Private landlord access to these databases is limited. It can be done at the discretion of the property manager – but it can be expensive.

TICA processes an average of 120,000 tenant checks per month. The minimum casual membership package is around $200 for 10 enquiries, which allows you to check up on 10 potential tenants. If you have five applications with two people on each, you could end up going through all of your enquiries just on one property.
www.tica.com.au

The National Tenancy Database reports on both residential and commercial sectors Australia-wide. ntd has provided quality risk assessment information to the property industry for more than 21 years. Currently, private landlord enquires are only available by request.
www.ntd.net.au

Trading Reference Australia, formerly known as Tenant Reference Australia (TRA), is a national database for residential and commercial rental information. TRA charges a one-off fee of $38.50 per enquiry to private landlords.
www.tradingreference.com

4. **Insurance**

Some landlords insurance policies are not valid if you don't have a current lease and a property manager in place, as they want to know that you have taken all possible steps to protect your investment. If you choose to DIY, make sure you read the fine print on your landlords insurance policy to ensure that you're covered.

5. **Professional distance**

If the hot water system blows-up or the plumbing in the bathroom explodes in your own home, you're never going to be happy about it. Usually there's a few choice words thrown around while you figure out who you need to call to fix the problem – and then you drown your sorrows in a glass (or bottle!) of wine that night, as you lament at the unexpected repair bill you've just been hit with.

Imagine, then when something similar happens with your investment property. You can't lose the plot in front of your tenant. You need to take all of the emotion out of the equation and remain professional, even if it's clear that tenants potentially caused the problem themselves.

A friend of mine, Jennifer, once rented out her near-new investment property to a young family with a dog. One day they called to complain that part of the fencing was broken along the side of the house, and they wanted it fixed so their dog wouldn't escape.

A quick visit revealed that the fence was broken, alright – because the dog had dug massive holes around the support posts and chewed at the wood, with the express purpose of creating an escape route!

The tenant refused to accept any responsibility and insisted that the fence was like that when they moved in. Jennifer had a property manager in place that arranged the repairs to the fence and needless to say, they elected not to renew the tenant's lease a few months later.

Can you imagine how stressful and frustrating that situation could have been if Jennifer had been managing the property herself? In situations like these you want to be able to turn to a professional who can quickly and calmly solve the problems.

6. Dispute management

This is where having a professional property manager really pays off.

Property managers are not emotionally attached to the houses and apartments that they manage, so they're in a much better position to liaise with the tenant and handle disputes. Often, they also have training in negotiation techniques, so they are skilled at finding a win-win solution for all parties.

With your consent your property manager will be able to handle small issues without needing to involve you at all, or if a dispute goes to a tribunal hearing, they will appear at the tribunal on your behalf.

HEDGEHOG ACTION ITEM: In the Real Wealth Australia Ultimate Resource Guide CD ROM, the resource "What Tenants Want" will help you to ask the right questions about tenants, when you're interviewing your property manager.

To be a successful DIY landlord, you will need to have systems in place and plenty of time on your hands. In addition, you will have to be prepared to put in the time and effort to look after the property and the relationship with your tenant. If you don't then managing your own property can turn into an ugly experience.

How would you react if your tenant came to you crying about their sick child, or that they had been fired? Your relationship should be businesslike and unemotional but that can be difficult when you don't have the "buffer" of a property manager between you.

Overall, property management fees are a small price to pay for peace of mind and the knowledge that a professional is responsible for handling your property and mediating any issues that might crop up with tenants.

However, some people still choose to DIY manage their investment properties. If you are one of them then make sure you have the time to research all of the relevant laws that are required for you to properly manage your properties.

Before you decide let's work out how much it really costs you. The property management fee is usually around 8% of the rental income received.

If you have a property rented for $300 per week, it's therefore going to cost you around $24 per week to have a professional property manager handle the management of your investment property for you.

When you work that out over twelve months, it equates to $1,248, which might seem like a lot. But when you look at what your property manager will do for you, it's more than reasonable. A property manager's duties will include:

- Provide local knowledge and experience of want renters in the area want
- Recommend effective ways to present your property
- Advise on lease conditions and rental figures, at the beginning of the lease and during lease renegotiations
- Organise advertising in newspapers and online for new tenants
- Coordinate inspections for prospective tenants
- Evaluate applications and conducts references checks
- Screen applicants through tenant databases such as www.tica.com.au, www.ntd.net.au and www.tradingreference.com
- Collect and forward bond payments
- Deal with the legalities of leases and the rights of tenants
- Fill out a condition report at the commencement of every new lease
- Take photos of the property at the commencement of each new lease, upon request
- Set up and maintains property and rental records
- Disburse monthly rent payments
- Provide you with monthly and annual revenue and expenditure statements
- If required, pays expenses such as rates, insurance, repairs and body corporate fees on your behalf (funded out of your rental income)
- Respond to tenant requests and deal with problem tenants
- Arrange and attends to any routine repairs – including sourcing several quotes and presenting them to the landlord
- Attend to after-hours emergencies

- Meet with contractors, valuers, suppliers etc to provide them access to the property when required
- Conduct regular (at least six-monthly) inspections, and reports back to you
- Chase up late rent payments
- Represent you in any negotiations with the tenant and/or dispute resolution bodies
- Keep up to date with tenancy legislation, and therefore keeps you abreast of relevant changes
- Advise you on current rental market trends
- Pay rates and utilities bills upon your request

When you look at what you actually receive for just $24 per week, it's pretty clear that you're getting value for your money. It's almost like having a personal assistant to cope with all the responsibilities that are required to successfully manage your property.

HEDGEHOG FAST FACT: Professional property managers can better maximise the level of tenant enquiries on your property than you can. They do this via newspaper and online advertising, window display advertisements, newsletters to their databases of current and prospective clients, and professional signage erected on your property.

Finding the right property manager

When you're looking for a property manager, treat the process like a job interview. You have a set of criteria that you want them to be able to address, so develop a series of questions that you can ask each property manager.

HEDGEHOG ACTION ITEM: The Ultimate Resource Guide CD Rom includes a handy spreadsheet, "Find the Right Property Manager – 24 Must-Ask Questions". Use this as a guide for your property manager interviews. It includes questions such as:

- How large is your rent roll? If it's too large, your property – and your tenants – may get "lost in the crowd" and not receive sufficient attention. If it's too small, that might indicate an inability to retain business.
- How many staff do you have managing your rent roll? Ideally you want no more than 80 properties per staff member, as that equates to roughly 30 minutes per property per week.
- How often do your property managers receive training and how do you stay up-to-date with industry standards?
- What accreditation or professional qualifications do you have?
- Do you have a roster of reliable suppliers such as plumbers, electricians etc and do you receive any financial kickbacks for recommending their services? If so, how much?
- Do you have references, or can we speak to some of your current clients for personal testimonials?
- What are your contract termination terms if we decide to end our partnership?

To select your property manager, it's a matter of matching up their answers with your preferred criteria. Don't simply go with the property manager that offers the cheapest fees – saving a few dollars might mean that your investment isn't as well looked after as it would be with a more qualified manager.

I recommend that you interview at least three different property managers so you can adequately compare the services on offer in the local area. Don't be afraid to negotiate on the fees, either – it comes back to that golden rule of asking. You never know what you're going to get if you don't ask for it.

Generally, property managers charge a percentage of less than 10% of the weekly rent, plus a flat monthly fee of $5 to cover administration costs. I would start by asking if they're willing to reduce the percentage fee by 0.5-1%. If not, at a minimum, ask them if they'll reduce the monthly admin fees by emailing you your statement instead of posting it.

If your property manager looks after more than one of your properties, then you have even more leverage to negotiate. Flip back to chapter 13 to brush up on your negotiating skills, to ensure you get the best deal – but don't play too hardball. At the end of the day, if your property manager is calm, qualified and experienced, they can be worth their weight in gold for all of the stress and work that they save you!

Keep in mind that property management fees are tax deductible, so you'll receive 30-40% back at tax time anyway, depending on your income.

On our calculation of $1,248 per year for a property that rents for $300 per week, that brings your real cost down to less than $1,000.

You also need to consider the amount of money and time that you save on phone calls, tenant database checks, inspections and reporting. Multiply this across several properties, and you could find yourself virtually working a full-time job just to keep up with the demands of managing our investments!

I don't know about you, but I'd much rather pay someone a small percentage of the rental income every week to be a professional property manager. That way, I can relax and take a step back, with the security and peace of mind that my property is in safe hands.

HEDGEHOG TIP: At the beginning of the tenancy, ask your property manager to conduct a complete and thorough inspection, taking plenty of photos of the property both inside and out. Keep these on file for your record so you can compare them to the state of the property when the tenant eventually moves out.

Chapter 15 – Risk management

Most investors experience fear at some point. Usually, it stems from concern about the magnitude of the purchase under consideration, or when you're first starting out, it can be fear of what you don't know about property investing.

If your fear is severe enough, it may hold you back from moving forward with property investing altogether.

The biggest breakthroughs I've experienced in my own property investing journey have been to do with risk and how I manage it; in other words my mindset towards how I handle risk. I have learnt to worry less about things that really don't matter, because a good risk mitigation strategy always allows me to sleep at night without fear.

As human beings, we tend to worry about things more than we probably need to. When talking to people who have achieved serious success in their lives, I have found that they're more relaxed than I am, despite the fact that they have more debt, more risk exposure and more responsibilities than I have.

I remember back in my early days of investing when my two biggest concerns related to taking on loads of debt and how would I ever be able to pay the bank back if I lost my job. I wasn't too worried about the property itself – I was more worried about my own peace of mind.

Even though I had started to get an education in property investing and I was very excited about the concepts of creating wealth through real estate, I was still really nervous about the whole thing.

I found that most of the people that I spoke to about investing – such as my friends, colleagues and relatives – were quite negative or cautious and they were always ready to share "horror stories" about property situations they'd heard of or been through. “My cousin lost everything in a dodgy off-the-plan development,” or “We got badly burnt in the late 80’s – interest rates were at 18%! It could happen again…” It really caused me to think twice about moving forward.

Before we’d even purchased our first property, I was chatting with a friend who said her brother had had nothing but negative experiences in property investing. This was somewhere around 2003 when he’d bought a brand new apartment in Sydney. I can now look back and see that it was the peak of the cycle in Sydney at the time, but when speaking to my friend, I didn’t even know what a property cycle *was*!

“He bought an apartment for $420,000 and twelve months later, similar apartments were selling for $390,000,” she told me, wide-eyed and full of concern.

“If he sells now, he’ll lose $30,000,” she said. “He’s stuck. The same thing happened to him a few years ago, when he bought and sold an apartment and lost $40,000 on the deal overall. He’ll never invested in property again, and I just want to warn you to be really, really careful.”

She almost had me convinced that real estate was the root of all evil. I was terrified at the prospect of buying a property and losing money on the deal, and I was also worried about looking stupid in front of my friends and family. I didn’t want to hear the dreaded words: “I told you so”.

It’s easy to see how someone could be stopped before they even begin, when all they hear are so many negative opinions and remarks.

Eventually I got past the negativity and as I continued to educate myself, I discovered that people really do make money out of investing in property – and a lot of it!

To help overcome my fears, I found that the best thing to do was to not speak to anyone about our plans to invest in property, especially if they were family and friends who had never successfully invested in real estate before.

Instead, I began mixing with like-minded investors who supported me rather than discouraged me. That doesn't mean I walked away from my previous social circle, they were still my friends, they just weren't people that I discussed property investing and wealth creation with.

I found that it was such a relief to share my concerns with other investors, and to learn that they too had experienced the same doubts, fears and concerns that I was going through. Better yet, some of them were more advanced through the process than Ed and I were and could provide solutions to issues or problems that we were currently facing.

FOX WARNING: We all know that our friends and family mean well, but in your early days of investing, it can be beneficial to only share it with people who know and understand what you're trying to achieve.

Overcoming fear

There's one surefire way that I know of to get rid of fear and it involves education. When you learn all about the different aspects of property investing from people who are successful investors themselves, it helps you to become an expert. It's that hedgehog mentality coming back into the equation.

The best way I can explain it is by likening property investing to your own career. If you want to become an architect, you don't just read a few books about architecture and then go, "Alright, let's give this building design game a shot."

Instead, you invest in an education. You enroll in a university and study under qualified architects. You intern with an architectural firm and absorb everything you can about the industry. You spend time with experienced architecture professionals and tap into their knowledge. Then and only then, do you embark on your career and begin designing buildings.

Imagine if you didn't get an education and you tried to design a house without any training. You would have no idea where to start, or what steps you need to take.

And yet, so many people think they can invest in property without dedicating any real time or energy to learning about the science of property investing. To be a successful investor, there are procedures and processes you need to follow, and part of that process is risk mitigation.

When you're able to overcome your initial fears about property investing, more fears will develop as the actual process of buying and managing investment properties begins. These are a new but very different set of fears that are often referred to as risks. Learning how to manage your early fears will help you to deal with these risks. If you don't identify each risk and how to deal with them, they could consume you with fear to the point of stifling your investing.

You can never completely eliminate risk because you're not in control of some of them. This includes government legislation changes and rising interest rates. However, it's important that you identify all known risks and create a plan of action to mitigate any high and medium category risks, so that you only ever have to deal with low risk issues.

Ideally, you want to mitigate all possible risks to low risks before buying the property. If you can't mitigate the risk to a low, then don't hesitate – run from the deal as fast as you can.

Identifying risks

As stated earlier, risk is another name for fear. Generally speaking, the greater the fear then the greater is the risk. Your mind is a great tool for raising alarm bells when there's risk involved in doing something, so listen to it, but don’t be dictated by it.

These are some of the most common risks/fears that property investors experience, and the strategies that can be applied to mitigate them to a low category risk.

Risk #1:

Increasing your debt level by hundreds of thousands of dollars

When growing up, my personal experience of debt meant that the money I borrowed was used to buy high depreciating, non-income producing items such as cars, clothes or just having a good time.

This type of debt only kept me working longer hours to try and pay off the debt and I was dealing with relatively small amounts of money, in the ‘tens of thousands of dollars’ range. Therefore, the thought of borrowing ‘hundreds of thousands of dollars’ to buy property really gave me a few grey hairs.

“Good debt” is defined as borrowed money that is used to purchase income-producing assets such as investment properties. The income or rent from these assets is used to pay the mortgage payments and property expenses, while the owner reaps the rewards of the increasing capital growth in the property.

In short, my main aim is to always have a tenant in the property. By doing so the property will pay for itself (minus the shortfall if the property is negatively geared) and will be making money for me while I sleep, work or play. This is a vastly different scenario to racking up thousands of dollars of debt on my credit card buying rapidly depreciating clothes, shoes and expensive restaurant meals.

I was never ever taught the concept of good and bad debt, but since learning the difference, increasing my level of good debt has never been an issue for me again. In fact my attitude towards borrowing money for investment purposes is, ‘the more the merrier’!

Risk #2:

I won't be able to secure a tenant

This is one of the most common risks that investors talk about. For some reason, investors develop an irrational fear that somehow, even though millions of Australians rent, there won't be a single person interested in renting their specific house or apartment.

I remember when we purchased our first investment property, I didn't consider getting a tenant until after we had settled on the property purchase. At that point, I panicked. I needed to get a tenant straight away, and I remember freaking out.

I can quite clearly remember the words that went through my mind at that time:

"What will happen if I don't find a tenant in a hurry?
If I find a tenant, how long will it take for them to move in?
How long can I afford to sustain the mortgage before the bank comes knocking on my door?
Why did I ever think investing in property would be a good idea?"

The stress of the situation ate away at me and I actually put a lot of negative time and energy into worrying about 'what if I couldn't find a tenant' – instead of just getting down to the business of finding one!

There are a couple of ways to mitigate this risk, and the first one is to only buy properties in high rental areas where the vacancy rate is consistently less that 3%. This will ensure that there's constant rental demand, and your property will be untenanted for no more than a couple of weeks per year, if that.

The second one is to start looking for a property manager in the early part of the purchasing process. I usually contact three independent property managers and request a written rental appraisal from each of them. I also interview them and work out which one I will select if the property purchase is successful.

By approaching property managers early in the buying process, it means that I don't have to worry about when it counts. Once the sales contract on the property becomes unconditional – which means that come hell or high water, we're going to own it! – I ask my new property manager to advertise the property for rent, which is usually several weeks before settlement. By following this process, I normally have tenants moving into the property on the day of or just after the date of settlement.

The effort I put into finding a good property manager early helps me lower my risk of not finding a tenant on or near the day of settlement and also avoids the costly experience of having a long vacancy on the property.

Risk #3:
I'll end up with tenants who don't pay rent and destroy the property
I've been a tenant myself and I have never imagined ever destroying someone else's property or not paying my rent, but unfortunately it does happen. So as a landlord, I had a whole new set of challenges to deal with.

Watching programs on television about bad tenants caused me to worry about what I would do if someone destroyed my property or took off without paying the rent.

My thoughts were that it could possibly take weeks or even months to repair the damage, during which time I may not be able to rent it out until the property was once again habitable. The fears started to get the better of me and I went back to accumulating grey hairs. That is until I found out about landlord's insurance.

Landlords insurance protects the landlord from bad tenants, and it costs next to nothing. It usually only costs a few hundred dollars per year, and as an added incentive, it's tax-deductible as well. It is by far the cheapest way to lower your risk of a experiencing a bad tenant. I'm at a loss as to why any investor would not have it!

By having landlords insurance, the risk of tenants defaulting on their rent or destroying my property is no longer a high risk for me, as the insurance will kick in to cover the costs if and when they eventuate. The result is, I no longer have heart burn worrying about what tenants might do to my property because I know that I'll be covered by my landlords insurance policy.

However, you have to make sure you get the right policy. There are many insurance companies that provide landlords insurance, so when you're doing your research, make sure your policy covers you for rent default, loss of rent while the damage is repaired, malicious and accidental damage and indemnity insurance.

Unfortunately, I know only too well how important landlords insurance can be. A couple of years ago we encountered our first ever tenant from hell. It was totally unexpected as the tenant had been there two years and had led a fairly quiet life. Up until he defaulted on his rent and trashed the place, he had paid his rent, albeit a little late occasionally and he generally looked after the place pretty well for a single guy, except for the gardens.

Then one day he decided to stop paying his rent. When it reached the three-month point (poor property management – too late) the property manager made an appointment with him to inspect the property, and discovered that he'd caused almost $5,000 worth of damage!

He was immediately evicted and my property manager lodged a claim with VCAT (Victorian Civil and Administrative Tribunal) for the release of the bond money to me, which was granted in total. VCAT stated that the bond could be used for loss of rent and/or damage that had been inflicted by the tenant on the property.

I met with our insurer's assessor at the property and he viewed the damage, and to my utter dismay, he said there were no grounds for an insurance claim for loss of rent or malicious damage. Apparently, he thought that the property had been sublet without a relevant lease agreement, which meant that the claim for loss of rent was rejected. He also said that the damage was not malicious damage, but was accidental and was therefore rejected.

I queried how he distinguished between 'malicious' and 'accidental' damage. He responded that accidental damage is defined as 'one-off' damage, and that malicious damage is defined as multiple damage of the same thing. He further elaborated by saying that if there were several holes in the wall, it would be deemed malicious damage. If there was just one hole in the wall it was considered to be accidental damage.

On further questioning by me, he confirmed that a scenario whereby there was one damaged window, one damaged stove, one damaged cupboard, one damaged oven, one damaged clothes line and one torn curtain, would all be deemed to be accidental damage, and not malicious damage.

I sent a letter of complaint to the insurer about the assessment and asked for their evidence of the unit being sublet, and I also challenged the assessor's view of malicious damage.

Following my complaint, the insurer undertook an internal reassessment of the claim and eventually agreed to the loss of rent claim in its entirety, as the assessor did not have any evidence that the unit was sublet.

They also agreed to repair all of the damage except for the hole in the wall in the lounge, and the car engine oil that had been poured onto the lounge room carpet. The total value of this damage was $1,600.

I still objected to this assessment and the insurer advised that the next step of appeal was to the Financial Ombudsman Service (FOS). I promptly filed a letter of complaint to the FOS, including a copy of all relevant correspondence, but the FOS ruled that the damaged walls and oil poured on the carpet was not malicious and therefore agreed with the insurers assessment.

It wasn't the response I was hoping for, but at least we only ended up being $1,600 out of pocket instead of the $5,000 we would have experienced had we not had landlords insurance.

To give yourself the best possible chance of successfully making a claim, make sure you keep detailed notes. Also ensure that your policy covers the three big risks:

1. Loss of rent whilst damage is repaired.
2. Rent default and theft by the tenant.
3. Accidental and malicious damage to the property.

As a rule of thumb, when it comes to insurance, if you pay peanuts, you will get monkeys. My advice is to seek several quotes, but don't blindly accept the cheapest one – read the insurance policy carefully and check to see what you're paying for.

HEDGEHOG FAST FACT: Landlords insurance is not the only policy you need to protect your investment. As a condition of your finance approval, your lender will require that you arrange building insurance. When this happens it will also be an opportune time to obtain house, contents and landlords insurance before the tenant moves in. Remember to include contents insurance, as it covers things such as carpets and curtains. The tenant should also have their own contents insurance to cover their furniture.

Risk #4:
Supporting an investment property if you lose your job

A common fear of many potential property investors is how do they go about supporting their investment properties if they lose their job, especially if the property is negatively geared and they need to supplement the property mortgages from their income each week?

The answer is relatively simple: don’t put yourself in a position where you can be financially pushed to the edge in the first place. Always keep some money in reserve for a rainy day. You might be wondering how you can do that if you barely make ends meet now, but there are plenty of options:

- Refinance the property mortgage

Only borrow up to 80% of the value of the property initially. Then later on, extend the loan to 90%, and put the additional 10% in an offset account as a buffer.

- Purchase a positively cash flowed property

If you are not in a position whereby you can afford to dip into you pocket each week to support an investment property then you would best be advised to only purchase positive cash flow properties. This type of property is one where the rental income exceeds the mortgage payments and the property expenses and in addition, puts some money back into your pocket each week. This extra income can then be put into a mortgage offset account to be used as a buffer. Alternatively, it could be used to offset a second negatively geared investment property.

- Tax return

Your many property deductions should help you to get a tax refund at the end of the financial year, so consider putting it in a mortgage offset and using it a cash buffer. The good thing is that after a couple of years of not having to use it, you’ll most likely end up with an amount that is large enough to use as a deposit on another property.

- Tap into your equity

If your property has grown in value, you might consider refinancing after six months of capital growth and then putting the extra money into a mortgage offset account as a buffer.

- Obtain an income protection policy

Income protection and life insurance policies can help to offset risks such as not being able to work because of an illness. These premiums can often be paid directly out of your superannuation.

Risk #5:
Interest rate increases

The one thing that investors have no control over is interest rates. The Reserve Bank of Australia (RBA) and the banks can increase or decrease them at will.

When the RBA and/or banks increase rates, it becomes the 'talk of the town' as property owners discuss how to manage the increased mortgage rates.

It's important to remember, however, that in Australia, we're experiencing a housing shortage, which means that the demand for rentals is high. It's likely to stay this way for some time as analysts such as BIS Shrapnel consistently report that we're not building enough new housing to keep up with the demands of our growing population.

As part of my risk mitigation strategy, I have committed to a schedule of increasing my rents regularly, so that any interest rate increases are at least partially offset.

Interest rates are just part of the cost of doing business, and whining about them doesn't solve anything. So instead allow a little extra fat when calculating the numbers on a property deal to ensure that you can afford to keep it today and tomorrow.

I have met many investors who were on the borderline of losing one or more of their investment properties and it's a tragedy to watch them in such despair. In most instances the reason that they were in trouble was because they hastily purchased a property when interest rates were low and didn't take into consideration that interest rates would rise.

Interest rates are a fact of life and if you're going to use property investing to create your wealth, you need to factor in potential increases and only purchase properties that you can afford to hold onto. After all, it's no fun living off baked beans while trying to get rich.

HEDGEHOG ACTION ITEM: Get a blank sheet of paper and copy the headings of this table across. Write down your worst fears to do with property investing, including the worst possible result that this could bring about, and then try to work out how you would mitigate that fear so that it became insignificant.

QuickTime™ and a
TIFF (Uncompressed) decompressor
are needed to see this picture.

Chapter 16. Your budget and tax

Incorporating your new investment property finances into your personal budget is one of the final steps you will need to take as a property investor.

It should be a relatively easy process, as you've already crunched the numbers and worked out what the shortfall will be between the rental income and your overall property expenses each week.

So, it's simply a matter of taking the figures you've already calculated and incorporating them in your budget so you'll be prepared to pay bills such as council rates notices, body corporate fees and insurance premiums when they fall due.

Obviously the more properties that you acquire, the more ongoing bills you will need to manage. That's why it's so important to create a thorough budget and set up payment processes early on in your investment journey. If you set up the appropriate procedures and infrastructure at the beginning, you will be in a position to manage the financial side of your investment properties with ease, whether you own 2 or 22 properties!

Managing your "good debt"

Throughout this book I've touched on the concept of investment debt as being "good debt".

One example of a good debt property expense is council rates. No matter where in Australia your property is located, half-yearly council rates usually fall due every July, give or take a few weeks.

When you're paying council rates on several properties, they quickly add up and you can find yourself handing over many thousands of dollars at once. If you don't have the correct procedures in place to manage your ongoing financial commitments, these types of bills can become a source of stress and turn your property ownership dreams into a nightmare!

I remember receiving the rates notice for the first house that Ed and I bought. The bill was $800 and I hadn't been expecting it at all, because I'd never owned a property before. When we had settled months earlier our solicitor arranged to pay the vendor a certain amount to cover the council rates that they had already been paid, and I thought that was us done for the year.

Little did I know that council rates are due annually, but can be paid quarterly or half yearly. I hadn't budgeted for this expense or even really given much thought to the fact that regular rates bills were now a part of my life. I remember looking at the notice and thinking, "So we have to pay $800 in three weeks time – that could cover a return airfare to Fiji!"

At the time, my mindset was still in the wrong place. I considered the bill to be a "negative" expense that took money out of my pocket and prevented me from spending my money on something that I enjoyed, rather than seeing it for what they really was: the cost of doing business.

I quickly came to the realisation that I had to develop a system to pay for our investments, in the same way that I developed a system for paying our regular monthly bills and expenses. Fortunately, I had set up a budget at the beginning of our investing journey when we committed ourselves to eliminating our credit card debt, so half the work was done. Hopefully by now you've done the same, as it will make this process so much easier if you have.

I've found that the best way to manage your investment expenses is to treat investing like a business, with its own separate bank account.

Start by working out exactly how much your investment property costs you each week. Make sure you list all of your expenses, for example:

Mortgage interest	$325
Property management fees	$36

Council rates	$40
Body corporate fees	$35
Insurance	$7
Repairs, maintenance & emergencies	$27
TOTAL	**$470**

In this scenario, if the rent charged is $410 per week, it will cost you $60 per week to cover the shortfall between your rental income and rental expenses.

Note that the above scenario doesn't take into account negative gearing and depreciation benefits, which will kick into gear when you file your tax return at the end of the year. If your shortfall is $60 per week and you pay tax at the 30% tax bracket, you'll receive the equivalent of $18 per week (30% of $60), or $936, back at tax time.

If you organise for a depreciation schedule to be completed for the investment property, you'll pocket even more of your tax at end of financial year. Make sure you engage a property savvy accountant to do your tax returns so that you maximise your deductions and enjoy the highest possible tax refund.

In your personal budget, I suggest that you create a line for your investment and title it "Investment Property 1". It should sit in your budget alongside your phone bill and your groceries allowance, and should become a non-negotiable expense.

Next, set up a dedicated "property investment" account that is ideally linked to your mortgage as an offset account. If not, make sure it's a high interest-earning account so you're getting the best return for your money.

Each week, fortnight or month, whenever your normal pay cycle falls, transfer the total amount of money that you'll need to cover all of your investment bills into that offset account. In the above example, you would transfer $60 per week, $120 per fortnight, or $260 per month.

Make sure that your rental income is deposited into the same account, so that you have all of your property income and expenses tied to this one account.

This way, when a rates notice for $800 or an insurance premium for $350 arrives in the mail, you will have the money set aside to pay for it. Also each month when the mortgage repayment is due, you don't need to worry about where the money is going to come from, because it's all right there. All of your expenses will be accounted for, taking any potential stress and anxiety out of the situation.

At tax time, all you need to do is simply print out the twelve months of transactions from this account from July 1 to June 30 and hand it to your accountant. What could be easier than that?

Keep in mind that the monthly rental income you receive from your property manager will vary from month to month, depending on the timing of your tenant's payments.

For instance, one month your tenant might pay three weekly rent payments before your property manager's processing cut off date, and then the next month they might pay five weeks of rent. At $410 per week, your net total rental income (minus property management fees) could be $1,119 one month, and then $1,865 the next.

For this reason, I think it's a great idea to open your property investing account with a small "buffer" to get you started. If you can manage it, $1-$2,000 is ideal, as that will usually cover the first months' mortgage payment and give you a decent buffer to cover any unexpected expenses during the first six months of ownership.

As the months and years pass, that buffer will hopefully increase because you should be adding a small amount for "emergencies" into the account each week. It's always smart to prepare for the unexpected, as you never know when a ceiling fan is going to need replacing or a hot water system is going to burst.

In my previous example, I included $27 per week, or $1,404 per year for miscellaneous repairs and maintenance expenses. If nothing crops up, that money will continue to accrue into a healthy little buffer account. In five years time if you haven't used the funds, you could put it towards renovations, or even withdraw it to use as part of a deposit on another investment property.

HEDGEHOG ACTION ITEM: Included in the "Real Wealth Australia Ultimate Resource Guide" is a tax spreadsheet to help you keep track of your investments. You can enter all of your loan information, expenses and income to help you keep a record of your investments, and come tax time, simply hand this spreadsheet over to your accountant.

Investments and tax

The great thing about investing in property is that the Australian government wants you to do it. The more homes that private investors provide for everyday Australians, the less homes the government has to supply, and as a result, they're very encouraging of keeping you in the market.

For this reason, investors enjoy pretty generous tax benefits in Australia. Almost every expense that you incur that is related to your income-producing investment property is tax deductible, minus a few exceptions that I'll outline shortly.

In addition to these deductions, the Australian Tax Office (ATO) also understands that the value of your investment will diminish in value over time as it becomes older and the overall condition of the property worsens. In recognition of this the ATO is prepared to allow you to claim, as tax deduction, the depreciating value of the building and chattels.

In general, there are three categories of rental property expenses. These are:

1. Those for which you cannot claim as deductions.
2. Those for which you can claim an immediate deduction in the income year that you incur the expense.
3. Those for which you can claim deductions over a number of income-producing years.

1. No deduction

Expenses for which you are not able to claim tax deductions include:

- Acquisition and disposal costs of the property
- Expenses not actually incurred by you, such as water or electricity charges borne by your tenants
- Expenses that are not related to the rental of a property, such as expenses connected to your own use of a holiday home that you rent out for part of the year

The important thing to note here is acquisition expenses. Many people make the mistake of assuming that conveyancing fees, advertising expenses and stamp duty on the transfer of the property are tax deductible, but unfortunately they do not qualify.

All is not lost, however. These expenses can all be used to form part of the cost base of the property if and when you eventually sell it. This has the effect of decreasing the amount of capital gains tax (CGT) that you'll need to pay, but more on that later.

2. Immediate deduction

The list of expenses for which you can claim an immediate tax deduction in the income year that you incur the expense, is much longer. This includes:

- Advertising for tenants
- Bank charges
- Body corporate fees and charges (excluding special levies)
- Cleaning
- Council rates

- Electricity and gas
- Gardening and lawn mowing
- In-house audio/video service charges
- Insurance (building, contents and public liability)
- Interest on loans (not principal, only the interest component)
- Land tax
- Lease document expenses, including legal fees for preparation, registration, and lease stamp duty
- Legal expenses (excluding acquisition costs and borrowing costs)
- Mortgage discharge expenses
- Pest control reports
- Property agent's fees and commission
- Quantity surveyor's fees
- Repairs and maintenance
- Secretarial and bookkeeping fees
- Security patrol fees
- Servicing costs (for example, servicing a water heater)
- Stationery and postage
- Telephone calls and line rental
- Tax-related expenses, such as the cost of an accountant preparing your tax return
- Travel and car expenses (when visiting your investment property)
- Rent collection
- Cost incurred in inspecting the property
- Maintenance of property
- Water charges

3. Multi-year deduction

Those expenses for which you can claim deductions over a number of income years generally include borrowing expenses such as Lenders Mortgage insurance (LMI), valuation fees and title search fees.

These expenses must be added together when you purchase the property, and the deductions can then be deducted across the first five years of ownership.

For example, if your borrowing expenses included $11,000 LMI, $400 valuation fee, $600 mortgage brokerage fees, and $250 loan establishment fees, the total would be $12,250.

This amount can then be divided over five years and a portion claimed each year as a deduction against your taxable income.

Renovation costs are considered to be a capital expenditure, and as such they must be claimed or depreciated over a number of years. They can be claimed as either a decline in value deductions over the asset's effective life, or as capital works deductions over 25 or 40 years.

If you renovate your property, the costs that you incur during that process are not immediately tax deductible – but if you repair your property, those costs are immediately tax deductible. The tax office makes a distinct definition between the two, so if in doubt, contact the ATO.

Depreciation

Depreciation is another expense that can be claimed over a number of years.

Technically, depreciation is not an "expense". It doesn't cost you anything, as there's no bill to pay. Rather, depreciation is an allowance or an acknowledgement that the value of your property will decrease as each year passes, and as a result, you're going to be required to spend more money on maintenance, repairs and renovations.

A quantity surveyor is the only person that the ATO recognises as being qualified to estimate the cost of installation on depreciable items, and thus provide you with a depreciation schedule.

On settlement, or as close as possible to settlement day, you should arrange for a quantity surveyor to prepare a depreciation schedule for each of your properties. They usually charge a fee of around $500 to do this, but the fee is fully tax deductible and the annual depreciation tax deduction can be thousands of dollars.

Depreciation schedules on buildings can be claimed over 40 years at a rate of 2.5% per year, which means that even older properties can return decent depreciation benefits.

I have a client who owns a 20-year old apartment worth around $200,000, and she was able to claim $3,000 in the first year, $2,800 in the second year, $2,100 in the third year, $1,400 in the fourth year, and so on. The deduction significantly decreased after that, but it still provided a strong tax write-off considering that the cost of the depreciation schedule was just $500.

HEDGEHOG FAST FACT: Each year, the ATO produces a comprehensive booklet titled “Rental properties” to help you navigate your way through the many tax responsibilities you have as a property investor. You can obtain a copy by calling 1300 720 092 or visiting www.ato.gov.au

The rules and regulations relating to tax and investment properties are complex and exhaustive. Unless you’re an expert with numbers yourself and you keep impeccable records, it can be difficult to know how to file your tax return at tax time.

This is why it’s so important to have a qualified, experienced accountant on your team. Ideally they should be someone who is a property investor themselves and who also has clients who invest in property. This means that they work with property investors every day and therefore should be able to guide you through the process and avoid making costly mistakes. They can also help you to manage your ongoing financial commitment to your investment properties.

There are two ways that you can receive your tax returns. Option one is to pay any shortfall that may be due each week and then claim them all back at the end of the tax year. In this way you will enjoy a nice lump sum cash bonus at the end of the financial year.

Option two is to fill out, with your accountant's assistance, a "Request for amendment of income tax return for individuals" form with the ATO. With this form, you can enjoy your tax savings each week rather than waiting until end of financial year. You can then use this money to help fund the ongoing expenses of maintaining your investment property.

It's probably easiest to explain how this works by way of example. In the scenario I created earlier in this chapter, the property in question was negatively geared to the tune of $60 per week.

Let's say this investor was also able to depreciate the value of the property by $3,250 in the current financial year. This works out to be a weekly tax deductible expense of $62.50.

As a result the ATO acknowledges that the weekly expenses on this property total $122.50, comprising $60 in 'hard' costs and $62.50 in depreciation allowances.

If the investor's nominal tax rate is say 31.5% including the Medicare levy, then they will receive 31.5% of these expenses back at tax time. This equates to a tax refund of $2,000, or $38.50 per week.

In effect, this means that the investment property is really only costing $21.50 per week, as $38.50 out of the $60 is refunded by the ATO.

If the owner of the property fills out the appropriate form with the ATO, they can receive that $38.50 in their pay packet each week, to help meet the ongoing costs of maintaining the investment property.

The choice is with the investor as to which way they want to go. There really isn't any one way that is better or worse than the other. Some people prefer to receive a large cash bonus at end of financial year, while others prefer to have access to the money on a regular basis. It's a personal choice that depends on your own situation, and how easily you can manage your ongoing financial commitments.

Capital Gains Tax

In Australia, tax law has been structured in such a way that it's more attractive for you to stay in the market than it is for you to sell.

Capital Gains Tax (CGT) is a tax levied by the government on the sale of a property. It can literally strip away tens of thousands of dollars from your profit, so you need to be aware of your CGT obligations if you're planning to sell.

Effectively the way that CGT works is that if you buy a property for $300,000 and sell it six months later for $350,000, you will be required to pay tax on the "gain" of $50,000. The tax rate that is applied is your nominal tax rate.

Currently, the ATO offers a 50% discount on all taxable CGT amounts, provided that you hold the property for at least 12 months. Therefore, if you were to hold the above property for 12 months before selling for $350,000, you would only be required to pay tax on $25,000, rather than $50,000.

There are many elements that impact CGT, including depreciation. Also, I mentioned earlier that acquisition expenses cannot be claimed immediately, but instead are added back to your cost base when selling. This is where those expenses come into play.

Using the above example, let's assume that at the time of purchasing your $300,000 investment property, you paid $9,000 stamp duty and $3,000 in other acquisition costs. Your adjusted cost base for the purpose of CGT would then increase to $312,000.

When you sell for $350,000, you will only be required to pay CGT on the difference between your adjusted cost base of $312,000, and your selling price of $350,000, which is $38,000. If you hold the asset for 12 months or longer, you'll receive the 50% CGT discount and only be required to pay tax on $19,000.

Any depreciation deductions that you claim over the life of owning the investment property will also need to be added back to the cost base. This really only has an impact if you hold the property for several years and make significant depreciation deductions during that time.

As an example of this, let's say you bought this property for $300,000 and held it for six years. During this time, you claimed depreciation of $40,000 in total.

If you then sell the property for $450,000, you can add back your acquisition costs of $12,000, bringing your adjusted cost base up to $312,000. However, you also have to take into consideration your depreciation deductions, which means you must reduce your cost base by $340,000.

So your cost base increases to $312,000, and then decreases to $272,000. Your capital gain in the view of the ATO will therefore be the sale price ($450,000) minus the adjusted cost base ($272,000) = $178,000.

Because you've held the asset for longer than 12 months, you'll have access to the 50% CGT discount, and be required to pay tax on just 50% of the $178,000, or just $89,000.

CGT, depreciation and tax law in general can be very complex, so it's always advisable to discuss your situation and your plans with your accountant prior to making any decisions.

Avoiding common mistakes

Over one million investors claim billions of dollars worth of rental deductions in their tax returns each year and there are some common mistakes that people make again and again. To avoid catching the attention of the ATO, make sure you abide by the rules and don't make the following mistakes:

1. Claiming deductions for rental properties that are not genuinely available for rent. For example, when the property is being tenanted by you prior to being made available for rent.

2. Incorrectly claiming the full amount of expenses for properties when they're only available for rent part of the year, such as if it was being used as a holiday home.

3. Incorrectly claiming the cost of structural improvements as repairs when they are capital works deductions. This includes things such as remodelling a bathroom or building a pergola.

4. Overstating deduction claims for the interest on loans that were only partly taken out for the purchase, renovation or maintenance of the investment property. A loan can be taken for both income-producing and private purposes, including buying a car or going on an overseas holiday, but the interest on the private portion of the loan is not tax deductible.

5. Incorrectly claiming the full cost of an inspection visit when combined with a private purpose, like a holiday. In this case deduction claims can only be made for the portion of travel directly related to the property inspection.

(Source: Australian Tax Office)

Final word

If you've read and comprehended everything this far, congratulations! You're well on your way to becoming a hedgehog property investor.

I hope that you've found this book to be useful as you boldly embark on your journey towards creating real wealth.

Property presents so many opportunities to get ahead financially, but there is much more involved in investing in real estate than simply choosing a house and finding some tenants.

Throughout the pages of this book, hopefully you've learnt more about investment strategies, personal finance, lending and hotspotting and have become more confident in developing your own investment goals and in taking control of your financial future.

If you're yearning to learn more and I'm willing to bet that you are, because property education can be addictive, make sure you commit to at least a couple of hours a week of jumping online to property websites to keep up with your research. The Real Wealth Australia site is a great place to start, as it's packed with information, articles and resources to help you along your journey. Visit www.realwealthaustralia.com.au

Of course, if you're really serious about getting an education, Real Wealth Australia runs ongoing year-long mentoring programs that really walk you through the nuts and bolts of property investing and guide you every step of the way.

We are proud to boast that over 80% of clients in our programs successfully invest in property during their time in the program. In fact, 40% have invested in their second deal by the end of a program, while 17% move on to their third deal before even finishing the course. If you're interested in learning more about the program, feel free to contact me personally at helen@realwealthaustralia.com.au or phone 1300 85 88 96.

Until next time, happy investing!

Helen Collier-Kogtevs