

Special Edition

4th April 2012

Dear Owners and Investors,

I was asked a question this week about investing in Cairns, and what would be a good investment. This answer has been rattling around my head for the past few days, and I thought I would write it as a Special Edition as it may help someone else at the same time. This isn't a simple answer, and it comes in three parts.

Part One - What do you want to achieve?

When Ramon and I first started investing, we just did it. We didn't really have a plan but we knew it was a good idea and when we could buy units for less than \$40,000 we really couldn't go wrong. To be totally honest, we knew sort of where we wanted to go, but didn't have a real plan. We wanted to be able to have an income from the rental properties but never really sat down and thought about it realistically.

The first thing you need to do is make a budget of what you need as an income when you retire. Sit down and write down all your living expenses, you may be shocked when you see just how much it costs to just live a year. You need to include everything - mobile phone, internet, pay TV, health insurance, food, insurance, car registration, fuel, electricity, house expense etc. This list should be your "needs list" it should have the things you absolutely have to have just to live a life similar to what you currently have.

The next part is the wants list. I may need a car, that has its registration paid for, with fuel in the car but I WANT to be able to go and get my nails done, my hair done and go shopping for things that I really don't need but want. Separating out the needs budget from the wants budget isn't easy. I sent through this link some months ago
<http://www.superannuation.asn.au/RS/default.aspx>

For a couple to live a "comfortable" life they need \$55,249 annual income. I can't make comments for you, but I will pick it apart for Ramon and myself. They have allowed \$32.55 per week for Communications or a yearly allowance of \$1692. If I add up the cost of my mobile, Ramons mobile, the house phone and the internet that comes to just over \$3000. I don't think they made an allowance for the Ipad or buying the new one when it comes out in this budget.

I don't know where in their budget I will pay for Austar - how could I live without my daily does of East Enders and Coronation Street? They have an allowance under Leisure for \$1.77 per week for TV and DVDs - that won't even pay for one months subscription. Clothing allowance of \$58.72 per week - sorry whilst I fall off my chair laughing! I spent our monthly allowance last night on line as Events have a fantastic sale - I saved Ramon lots of money by buying it whilst it was on special!

They have allowed \$8.43 per week for home improvements and \$14.76 for repairs and maintenance. This combined is \$1205.88 per annum. Guess on this we won't be upgrading the kitchen or bathroom for some time, and I will have to send Ramon up onto the roof to clean the gutters. He does it now, but lets be honest here, what happens when he can't or shouldn't?

Same can be said for the garden, the pressure cleaning of the paths, man stuff he does around the house now. I may be younger than Ramon but I am not going to take over any of these roles.

Barber or Hairdresser of \$20 per week, yes a grand total of \$1040 per annum - for both of us. This may sound like a lot to a man that doesn't go to a hair dresser and get a full head of foils.

I love this one - Cosmetic and personal care items \$2.98 per week for two people. Household appliances \$11.48 per week - guess we have to save up to buy a new plasma or fridge - can't have both in the same year.

As for household goods and services of \$85.94 - that doesn't even cover the cost of the cleaning lady per week. If you think I am going to retire just so I can clean the house, think again.

Now onto the important one - Leisure of \$15,851.16 per annum. You are now retired and have nothing to do all day, every single day of the year. You will go and do more things, and soon wonder how on earth you had time to go to work as well. What would you call leisure? Lunch with the girls, stopping to have a coffee, going out to dinner, seeing a movie, a weekend away, travelling to visit family, a holiday - or a cruise? They have allowed \$13.42 per week for a couple to go to the cinema, plays, sport and day trips - looks like you can go to the movies once a fortnight and forget about a ticket to the footy as well.

This \$55,249 does assume you own your own home outright and not renting. It also does not allow for you to upgrade your car when it needs to be (or you want to). It doesn't allow for real holidays, and there are certainly no wants in there. There has been an allowance of \$40 per week for alcohol, and this can be added to your \$80 for lunches and dinner out. If you drink more than that a week, or smoke - well that isn't included in the \$55,249.

The bit I love is the last line - Gifts, alcohol or tobacco - ZERO!!! I am guessing that Santa will stop visiting you after you retire, and birthdays well by then you don't need to celebrate or get gifts.

Each person should work out the figure they need to aim for. Be realistic as it is you that will have to live off this sum when you retire and not me. Working out that figure is the easiest part of this exercise. Now you have this figure you need to work out how you are going to get this income, every year without fail until you go and visit the big man in the sky - and you won't be working.

Part Two - What type of Investor are you?

Every investor will fall into a different bracket, and to be honest the type of investor you are today may not be the type of investor you are in ten years time. Ramon and I have changed over the years. Initially started to invest in units within body corporates. They were the best value and to be honest, they were all we could afford when we started out. Because we only had to look after the inside, and not worry about the gardens and grounds it worked for us. As our portfolio and equity grew we went to the next stage.

Because we were hands on and could do everything, we bought whole complexes that we could "value add" to and bring them up to cash flow positive properties. It has been incredibly hard work with long hours, but it has paid off.

The last complex we bought in Whitfield didn't need as much work as the others we have bought and we bought it for the potential to use the existing land to build two more units on.

Right now, if we were to look at another investment it would be an easy one - one where we don't have to do any work, where you buy it and just rent it out.

There are investors that have the ability to be hands on and do the work. You will need to be honest and look at the investment and what it requires. If it needs a total renovation inside and out that will take weeks or months working on it full time - and you have the ability, the funds to finish the job and most importantly the time to spend on this project then it could be the sort of investment to look for.

We recently went to an auction for a client. It was a partially finished house. It has tilt slab walls, the roof was on, the battening had been done for the ceiling, the outside had been rendered and painted, it even had windows and was to lock up stage. There were no internal walls, no plumbing, no wiring - nothing inside at all. Ramon and I could see the potential profit to be made. If you could do the work yourself you could have a four bedroom, two bathroom home for \$200K. For our client it was a great choice of investment - they have the time, the knowledge, the funds and the DESIRE. Ramon and I have the ability to do this, if we pushed we could find the time but do we have the desire to do it - no thanks. For us this isn't the right investment for us at this point in our lives. For us to buy this property would actually be a bad investment as it wouldn't get finished, and in the mean time it would be costing us money each week.

We recently helped a client buy a duplex pair. These were at a great price, and the long term capital growth potential is there. There is very little to be done to the interior or exterior of the property. It is a simple, effective investment where the client has very little to worry about. We looked at a complex of four unit on Aumuller Street recently. It has potential, but my goodness there is an awful lot of work to be done internally. What I did like about this property is the ability to still rent out three of the units to bring in the cash flow and renovate just one unit at a time. If we were investing in this type of property we would do it in stages rather than fully renovate the entire unit.

Each time a unit became vacant, you would do one thing - repaint, new kitchen, new bathroom or floor coverings. You would wait for the next unit to become available and upgrade that next. For this to be a successful investment you have to be able to do all the work yourself, and you have to do it quickly. You have to have the time to be able to spend a week or two working full time on it so you can get it finished and rented again. You also have to have the funds in reserve to buy the necessary materials.

No point in having the time and ability to fit a new kitchen when you don't have the money to actually buy the kitchen. This would have been the perfect project to add to our portfolio - ten years ago when we were happy to roll up our sleeves and do the work ourselves.

There are investors that have a fantastic income but not the spare time. For these people it may be better to buy investments that give you good tax benefits but don't need a lot of work. Whilst you have this good income you should use it wisely.

Part Three - What type of Investment

Before I start, I have to say I will be writing about Cairns property - because this is what I know. If I went to buy in Perth - I don't know what is a good investment, what the history of the property cycle is, what the achievable rents are, but I do know Cairns and what it has achieved for us.

Units - many people have stopped looking at anything that is involved in a body corporate due to the insurance increases. I will study a bedsit at City Park and a two bedroom unit at Scotsdale for this exercise.

City Park - 85 Birch Street.

\$89,000 - listed price for a bedsit

Body Corporate Levies in 2007/08 were \$480 for administration and \$220 for sinking fund. A total of \$700 per annum.

Body Corporate Levies in 2012/13 are \$1043.87 for administration and \$220 for sinking fund. A total of \$1263.87 per annum

Over five years the levies have risen a total of \$563.87 per annum or \$10.84 per week.

\$89,000 interest only @ 7% = \$6230

Body Corporate \$1264

Council Rates \$2200

Management Fees \$1030

Less Rental income at \$150 per week = \$7800

Cost to hold property = \$2924 or \$56.23 per week.

There are lots of things that could be added or deducted from this equation. I have not made any allowances for tax deductions or building depreciation allowances.

Scotsdale - 93 Birch Street

\$137,000 - listed price for a two bedroom unit

Body Corporate Levies in 2007/08 were \$1011 for administration and \$520 for sinking fund. A total of \$1531 per annum.

Body Corporate Levies in 2012/13 are \$2380 for administration and \$520 for sinking fund. A total of \$2900 per annum.

Over five years the levies have risen a total of \$1369 per annum or \$26.32 per week.

\$137,000 interest only @ 7% = \$9590

Body Corporate \$2900

Council Rates \$2200

Management Fees \$1440

Less Rental income at \$210 per week = \$10920

Cost to hold property = \$5210 or \$100.20 per week

This is the body corporate that I got the insurance down recently. It looks like it is a saving of \$12000 per annum, and this will reduce the levies \$360 per annum for the two bedroom unit. Not a lot but it all helps.

What many investors don't appreciate is that once you have paid for your body corporate levies, you are only then responsible for the inside of your unit. When you look deeper into it - it means the pool man comes every weeks to service the pool and put chemicals in, the electricity to run the pool pump and common lights are paid for, the gardener comes and does the gardens and even mulches when they need it, the gutter are cleaned out, the pressure cleaning is done when required, the insurance is paid, if there is a burst pipe the plumber comes out and the money is there to pay for it, if the building needs a new fence the money is sitting there waiting. Many owners of duplexes and houses just don't allow for these expenses when doing a comparison. You do have the option of when you will do the work, but in the end it will still cost you money to get things done to a house.

The other factor is that a well run body corporate should have all the maintenance either done or the money in the bank to do it. With both City Park and Scotsdale they have lovely gardens and grounds, the building was repainted, all the ongoing maintenance is done and each has \$70K plus in the bank to do work as it is needed.

The prices for body corporate properties have been dropped significantly. At the height of the market the bedsit units were selling for \$115K and a two bedroom unit for \$240K. With prices this low you have to look at the possibility of them increasing in value when the market turns.

I believe they will go back up to this for the following reasons

- The rental vacancy rate has dropped since the beginning of the year
- We are starting to see rental returns increase. On the units they are only \$5 and \$10 but this will continue to increase.
- The economy in Cairns has only just started to get better.
- There has been no building of high density units for the past five years.
- The units that were developed in the last building boom were luxury units
- There have been no budget styled unit blocks built since 1995.
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With the rents, I don't have a crystal ball but I would like to think that by the end of 2013 we will see the bedsit units renting for \$170 and the two bedroom units \$250 per week. This is assuming they are well presented internally and fully furnished. It will come down to supply and demand. If we are tight on rentals now and the economy hasn't started to boom, I think these are achievable.

The question is when will the market turn for unit sales and how quickly will it turn? I don't have the answer for this. A lot will depend on how they resolve the insurance issue and how much of a financial affect it will have on the levies.

A property in a body corporate is still a good option for someone with a smaller budget, or even some one that is not able to do the work themselves outside. Units are pretty tenant proof investments and with a small budget of \$5000 you can make a huge difference internally - even if you have to pay someone else to do it. If a unit is all you can afford to buy, then it is worth looking at. One investment is better than no investment.

Duplexes - these are a great option for someone with a bit more to invest. I personally like this type of investment as it gives you two incomes. If you buy the right one it will allow you to value add long term. You can enclose the garage to make a third bedroom and second bathroom. You could look to strata title it and sell one half off to pay the other outright.

There are very few duplexes that are being built now. This will add to the value of the existing ones as the market tightens up. At the peak of the market you couldn't buy a duplex for under \$450K - and they were the rubbish ones that needed lots of work. The duplex market has increased its sale prices over the past six months, but if you look hard enough you can still pick up a good one. You still need to match the right duplex to the investor that you are. No point in buying a cheap one that is run down if you don't live here, don't have the skills, or the time. It will not be a good long term investment for you.

<http://www.realestate.com.au/property-duplex+semi+detached-qld-white+rock-107188137>

This is the duplex I wrote about last time at 22 Arizona Street, White Rock. It is what we would call a debt reducer rather than a keeper.

\$310,000 interest only @ 7% = \$21700

Maintenance \$3000

Insurance \$2500

Council Rates \$3900

Management Fees \$2880

Less Rental income at \$420 per week = \$21840

Cost to hold property = \$12140 or \$233 per week or \$116.50 per unit

I have not allowed for the extra upgrading this property would require inside and out. I have allowed for the rent to be at the lower end at \$210 per week. The rents are going up and we should see rents for a duplex around the \$250 mark soon.

If this duplex were the same price as the others on the market, we wouldn't look at it. When you look at the others that are on the market you will see that a great majority are around the \$400K mark. Yes, they are in better condition and probably in slightly better areas - but at \$310K it is worth looking at for the right investor.

Houses - The biggest mistake people make when comparing houses to units is they don't allow the same maintenance amount to be able to truly compare the two. The prices, particularly on the southern corridor have come down and you can pick up a good three or four bedroom home for under \$250K

<http://www.realestate.com.au/property-house-qld-white+rock-107548685> this is a three bedroom, one bathroom better block house at 6 Atlantic Close, White Rock. It looks like it is run down but solid. At the asking price of \$199,000 it is worth looking at. I don't know this area street by street. We look after some on Tiffany Street, and the duplex on Arizona seems like a good street - but this one I honestly don't know.

\$199,000 interest only @ 7% = \$13930

Maintenance \$3000

Insurance \$1000

Council Rates \$2200

Management Fees \$1850

Less Rental income at \$270 per week = \$14040

Cost to hold property = \$7940 or \$152 per week

For this particular house, I have allowed a bigger maintenance fee every years as it is run down. The place needs to be repainted, fences replaced, new floor coverings and new kitchen. I have also been low on the rent achievable at \$270. If it presents well and it is fully fenced you may get up to \$300 - especially if you allow pets.

Blocks of Units - you will need a far bigger equity base to be able to secure finance on this. It is better than a duplex as it is more value for money. It is also better for some owners than a body corporate - as long as you continue to do the maintenance to keep the building up to scratch.

This one is identical to one that we look after for some clients - it is on Tiffany Street, White Rock.

<http://www.realestate.com.au/property-unit-qld-white+rock-106877183> It has been reduced down to a list price of \$730K. It is a block of four, two bedroom units that haven't been strata titled as yet. The cost per two bedroom unit is \$182,500 which is much higher than a two bedroom in a body corporate, but cheaper than some of the higher priced duplexes. The beauty for the investor is they can nominate when they do the maintenance, rather than pay the body corporate each year.

\$730,000 interest only @ 7% = \$51100

Maintenance \$4000

Insurance \$3000

Council Rates \$8000

Management Fees \$5220

Less Rental income at \$760 per week = \$39520

Cost to hold property = \$31800 or \$677 per week or \$169 per unit.

There is the potential to increase the rents as I have just rented out one identical to this for \$210 per week - because I would allow pets! Even with this, it is still not as easy to hold as the cheaper bedsit units at \$56.23 per week.

I hope this has made some sense to you, and if nothing else has made you think about how much you need to retire - and how you are going to achieve this. If you would like me to detail more potential investments specific to your needs and wants, send me an email I will help you as best I can.

To finish off, it will be a tenant story - combined with "I collect old people" and I am my own worst enemy. This was at a two bedroom unit, in a block of four. Three of the tenants have been there since we took over the management - and they are going to be there for a lot longer. We have Cranky Ms B, who is a lovely but cranky old lady with a blind and deaf dog and Ms H who's loves to have a chat and tell you all about the family. When you go to visit her you have to allow a lot of time for a chat. Both are now into their 70's but active and able to live on their own. We then have Ms S, a young Japanese single lady with her son. I tend to lock horns with her a bit more than most of my other Japanese tenants, but most of the time all is happy and lovely in the block.

Ms S fitted in perfect as she was an older lady on her own. She decided to move back to Adelaide and it was all booked for the end of the March. The removalists were coming, she had her flights booked and it was just a matter of the day coming along. I listed it on the internet for \$210, although I knew that the one two doors down was only on for \$190. I had time up our sleeve and I had one thing the other unit didn't - we would take pets for the right tenant. Mrs V called and I arranged for her to pop over to see Ms S and the unit. Within a day, it was all applied for and sorted out. Mrs V was just a street away currently; she is a nice mature lady and has a small dog.

Mrs V's daughter booked her flight to come up and help her Mum move. I did get a lot of other interest in the property, but it is not just about renting it out - it is getting the right person in to the property that will get along with the neighbours - and hopefully cause me the least amount of problems whilst they are there.

Everything is now done, we just had to wait for the removal date to come and it would be one out - one in and \$20 per week extra. Sounds simple enough, less you live in the wet tropics and you get a huge monsoonal rain that dumps nearly a metre of rain over the region. I had Ms S ring me in tears to say the removalists were stuck and couldn't get up and they would be delayed from Monday until Wednesday. I called Mrs V and she was in tears because the daughter was due to fly in on Friday to help her move and she was desperate to move from where she was. I said it wasn't Friday yet, so let's not panic.

I knew that there was no way the truck would get through on Wednesday, and Ms S confirmed this on Tuesday night. They now said Friday. Ms S is beside her self worried about what to do with all her stuff. I called Mrs V and it was more tears. At this point I could have said - sorry all too hard, go find somewhere else or just wait until the unit is ready, but that wouldn't be me. I told them both not to panic as it could be Friday and it would all turn out.

Friday morning comes, Mrs V's daughter flies in and the truck is still the other side of the flood water. The truck may come on Monday - but still no guarantee. Time for Plan B - I call to say it will all get sorted out. When the truck does get through we will send someone around with a ute to give Mrs V a hand to move the big stuff. Enjoy the time you have with the daughter, go to lunch and leave the worrying to us.

Sunday night, the truck finally gets through and loads up half of Ms S's belongings and will be back in the morning to finish off the rest. I give Mrs V the call to start getting ready as the boys and the ute will be there first thing Monday morning to move her. The daughter flies out on Tuesday so they got to spend a few days together and she still got to move into the new house before she left.

Ms S came to the office to say good bye and thank us as she was so stressed and thought we would throw her out onto the streets. The owners get \$20 per week extra, and every one is happy. I now have another old person in my collection. I hope the big guy in the sky is watching, surely that must be more brownie points for us.

Yesterday the "cleaner" came into the office. She has moved out and back to the husband and things are going well. She has a regular job and has given up the cleaning work. She brought in a present, which was lovely as she really didn't have to. It is nice when things turn out well - she is happy again, the owners had their property rented for a short time with an increase in rent, it is now rented out again with another increase and I have Ms M a 74 Iranian grandmother to add to my old people collection.

I hope you have got something out of the Special Edition. If I can help anyone to make that first step on the property ladder, just send me an email.

I hope you are all happy and well in your world.

Linda Tuck