The 3 Rules for Property Investment Selection – Part 1

Martin Josselyn – Rule Three Property Performance

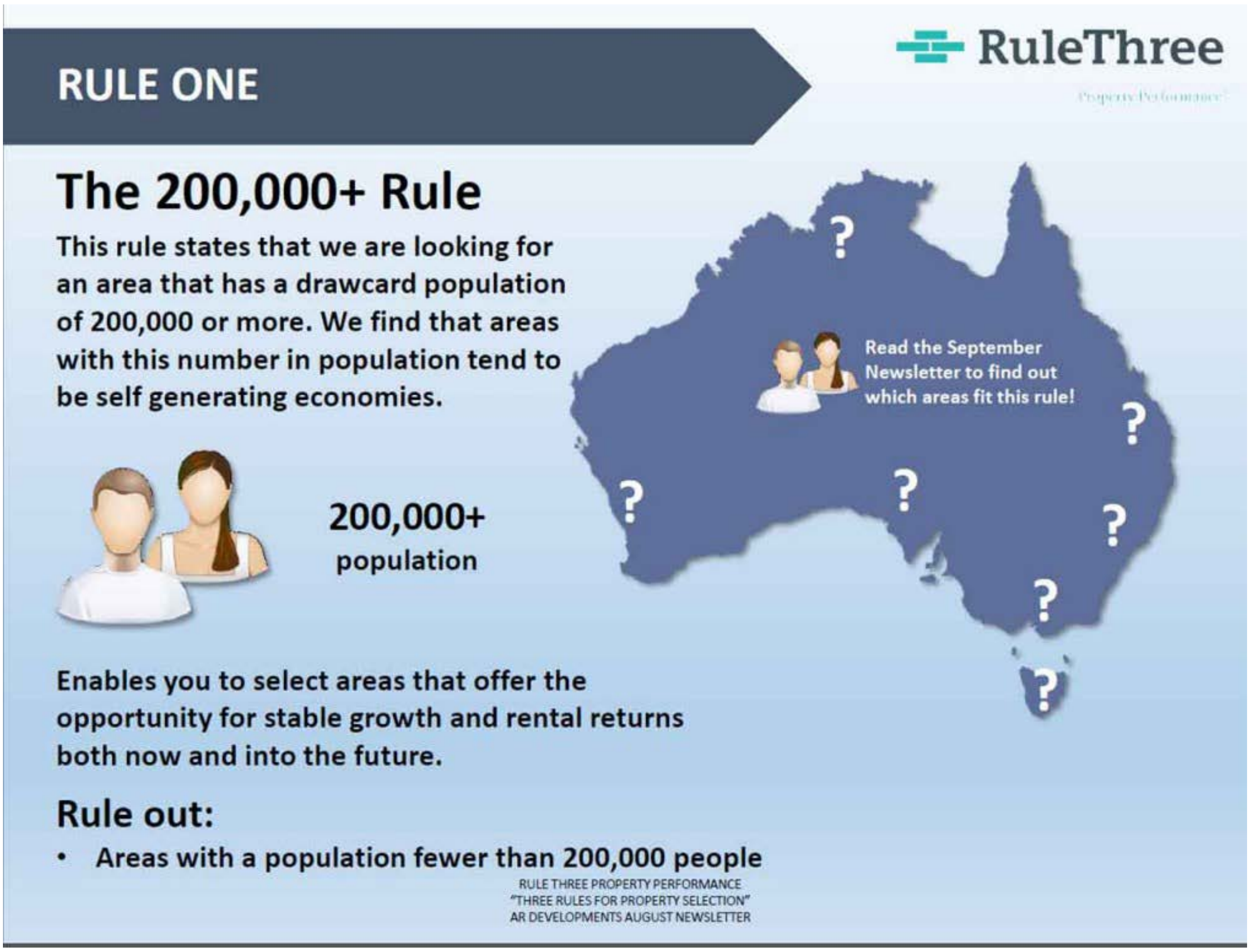
My Rule Three, 'Three Rules©' are fairly simple and easily understood and they are as follows:

Rule 1 is 'The 2000,000+' Rule – and that rule relates to population.

Rule 2 is 'The $1/$1000' Rule – and that rule relates to yield v's value ratio.

Rule 3 is 'The 4 Pillars' Rule – and that rule relates to employment options.

RULE 1: ‘The 200,000+’ Rule



This rule relates directly to the population of an area. I have found in the past that areas that have a drawcard population of 200,000 people or more tend to ride downswings and upswings in the economy far better than those areas that have a smaller population.

I would loosely term these areas as self-generating economies, that is to say that in general, these areas have sufficient momentum within their immediate area in terms of broad spectrum business & service activities to weather a storm and come out the other side not too badly bruised for the experience. From a property investors perspective, this gives confidence and the ability to rely on asset within these areas to perform at a reasonably consistent level in terms of average yield & growth potential.

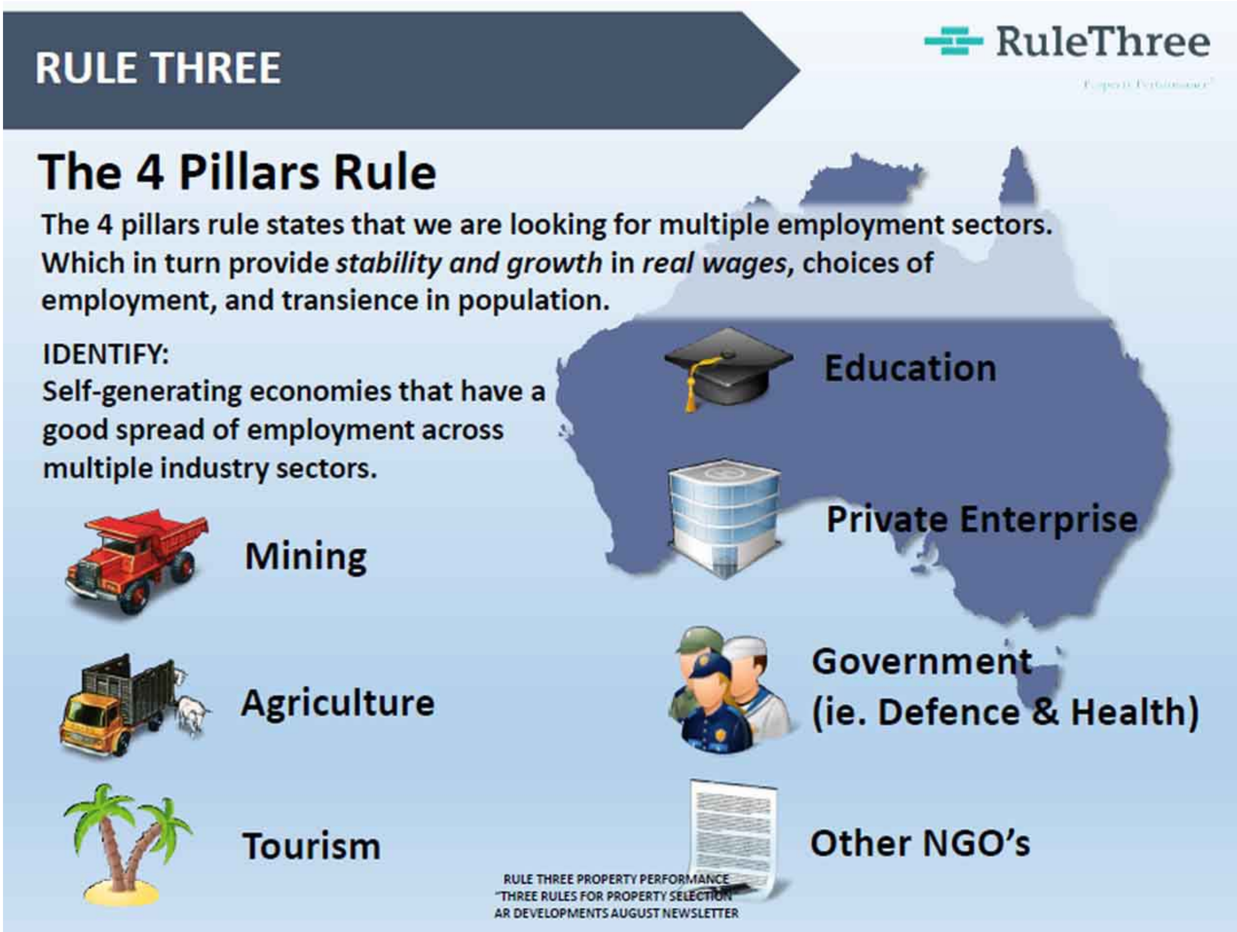
RULE 2: 'The $1 / $1000' Rule

This rule relates to the optimum sustainable level of rental income v's value of property. When I look for property for my clients, I look at this formula to assess both the true value of the property and the sustainable level of rent that the property can readily achieve without guarantees or other incentives offered by sellers.

In the main if I can achieve a $1 in rent for every $1000 spent and if I can readily achieve this on a consistent basis then I know that the tenants can afford to pay rent based on average wages and there is a strong likelihood that the buyers are paying the right amount of money for the property and will be able to hold it in the long term because the cash flows associated with the property will not be too onerous on the investors.

It's important that as the value of the property rises that this ratio hold parity albeit not immediately but as an average over time.

RULE 3: 'The 4 Pillars' Rule



This rule relates to the employment sectors to be found within the considered areas for investment. When I am searching for properties within areas and if they meet rules 1 & 2 then the final test for me, is to look at the variance in employment options for both tenants and owner occupiers in an area. The most important issues here can be sorted into 2 broad categories;

a) The choice of alternative employment options which in-turn provides sustainability of real wages and growth in real wages, which means that your tenant has the ability to continue to pay rent at a reasonable market rate and further that a tenant has choices for employment in case one sector or another suffers a downturn

b) A transience of population through employment sectors within areas which means that there is always people renting, buying, selling, & renting, buying, selling in a cycle that seems to repeat itself over and over again as people move with employment opportunities. This in itself creates a reasonably buoyant real estate market.

Summary

In summary when I adopt these rules for investment property selection and find property in areas that meets all the rules outlined here, then I'm on the home stretch. However it does not mean that every property within these areas is a good investment it simply means that the parameters for reasonable growth in value & yield are aligned and therefore if property as an asset class does grow in value, then it stands to do so in these areas. Careful dissection of the markets in these areas is still required.

I have found that when I apply these rules together with data from reputable research houses that there are in-fact only 8 areas across the Australian Property market that meet these rules and some of them are still questionable because they are weak in one of the rules or another.

Next month in Part II of this segment…I will further explore those areas in detail and dissect the markets within them.

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