PART FOUR – STAGED ACQUISITION PROGRAM

Introduction

As the end of the year draws near, it is time to review 2014 and look a little forward towards setting new goals for the future. Finances, investments and saving for retirement are often a big part of that forward planning for many average Australians.

Over the last few months we have looked at a number of aspects of property investment, including my Three Rules for property selection, which locations to invest in and the correct way to structure your investment. We culminated this discussion by using a live example of an investment property in Brisbane to achieve real numbers on a real investment. Click here to review parts one, two and three.

On paper, most people understand that investing in property makes sense. But the real question might be, why should I bother? The answer might lie in comparing our savings ability, that is breaking it down to how much we might be able to save each week long term for retirement, and what options we have with that amount of money.

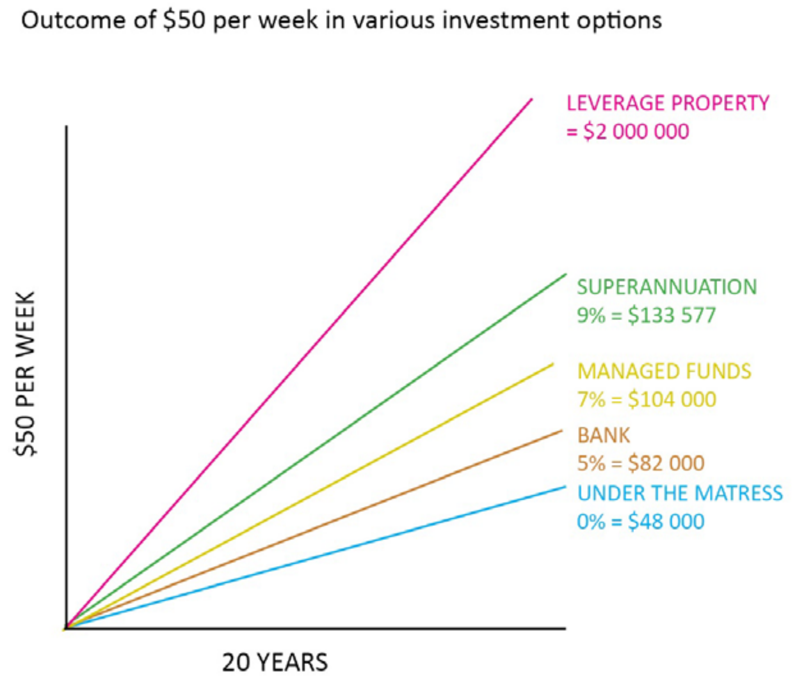
Out of all the clients we have spoken to over the last 15 years, one clear thing is apparent, and that is that regardless of how much money you earn it is often difficult to save, because as you earn more so to, do you spend more. For most of our clients, they are not DINKS (double income no kids), they are in fact DIAMONDS (double income, awesome mortgage and no dough).

This article explores your savings options, compares the option outcomes and includes leveraged property and some information for building a property portfolio.

Scenario

In this scenario let's say you set a goal that you need to put some money away for retirement but you are restricted in the amount you can save because you probably have a mortgage, family, bills and let's face it, not a lot of spare money to put towards retirement at the end of every week. But you're committed and you make a decision to save $50 per week, or $2500 per year every year for the next 20 years and put those funds toward that retirement goal. The graph below compares the fundamental options available to you over those 20 years.

Investment options



Let's see where the $50 per week gets us.

Firstly the most basic of all savings methods might be '**under the mattress'** or **'cake tin'** and believe it or not, it's always been an old-fashioned favourite. It's a tangible alternative, there's no risk and it's always available to you. But the downside is also its accessibility – it's easily able to be spent and there's no return on your investment. This gives our average mum and dad just $48 000 after the 20 years for retirement.

The next most fundamental savings method might a **Bank with a regular savings account** options, and although it provides more security, it generally comes with a low interest rate. Let's suggest however, that you are able to find an account with a 5% average return with no fees or charges (we would all like to have one of those). If you could find that account and you resisted the temptation to withdraw those funds, then the money saved at an average 5% compound interest over 20 years would amount to just $82 000. Of course this figure does not take in to account income tax and the standard fees and charges that a bank will charge.

Some people might look for a more sophisticated way to save money and might choose the option of **Managed Funds** as a better alternative. Our research shows that the average return on a managed fund has been somewhere around 7.4%[i]. We have adopted 7% for the exercise. And if in the same way we invest $50 per week over 20 years our investment would grow to $104 000 over the same period. Certainly better than the cake tin, but a long way short of a comfortable retirement.

The last and perhaps most fundamental and popular savings method in Australia today is **Superannuation.** With the advent of the government's superannuation guarantee levy most working Australians now have superannuation. According to our research the average return on industry fund shows an average return of 8.7%[ii]. The unfortunate thing about superannuation at that return, is that for those people solely relying on super for retirement, they will have only amassed $133 000 for the same $50 per week saved.

As you can see it is almost impossible for most average people to save their way to retirement. And that most savings require the ability to leverage to get a better return so that the amount received becomes sustainable for retirement.

In 1997 I said at a conference and the same remains true today that if there was a secret to wealth creation at all…then surely it must be 'that it is important to try to control as much of an asset base as possible for the smallest amount of out of pocket cash-flow, so that when you get growth, you get growth on what you control not what you contribute'. The above graph surely adds weight to the argument that it is almost impossible to save your way to a sustainable retirement, and therefore I maintain that sensible leveraging as and when cash-flow and equity levels allow…is a viable option.

You have many other options available to you, one of which is investing in property. Using a staged acquisition program, I can show you how to leverage property so our mum and dad example still invest the same $50 a week over the same 20 year period. And that they invest in 3 properties over a 20 year period as and when their cash flow and equity levels allow. Using the assumptions shown in the following diagrams it is potentially possible for a result to exceed $2 million in nett assets for the same out of pocket cash-flow.

Well worth consideration!

Building your property portfolio

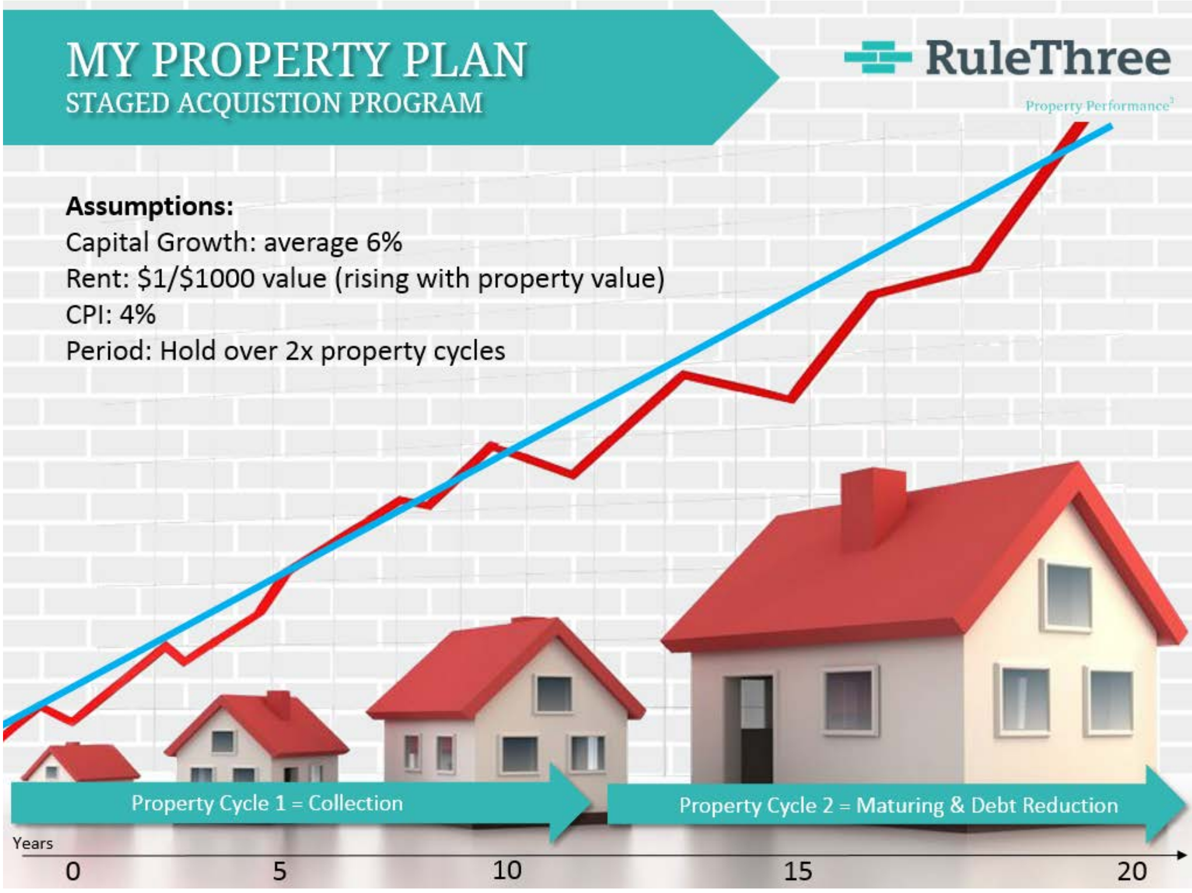
As we saw from the savings options graph, there could be potential gains to be had by investing in property, but it takes careful planning and consideration. So how do we actually go about it?

You already know the Three Rules, the areas to invest in, and how to structure it, but from a macro level how does it all fit together and if you want to achieve a sustainable amount to retire on, what should your property portfolio look like?

Like anything in life, you need to set your goals, and have a plan as to how to achieve that.

This is where Rule Three's 'my property plan' comes in - a staged acquisition program which builds your property portfolio gradually over 20-30 years, fitting in with general lifestyle changes and stages.

The example used for this staged acquisition plan is executed over two property cycles, the first being the collection phase and the second being the maturing and potential debt reduction phase. The assumptions used are capital growth rates of 6% per annum, interest rates of 5%, rental yield correlating with property values of $1 of rent for every $1000 of value, and that the government maintains a stable monetary policy and that 4% CPI is achieved as a result, and that interest rates remain at a reasonably stable level and that the individual/s makes a commitment to the plan which is executed over the full two property cycles which could potentially take between 20-30 years.



So, using the Three Rules, you purchase your first investment property on day one, and we have used a $400 000 example, which we think is about optimal level for investment property in Brisbane. Over the next 3 or 4 years there's a good chance that property prices may well increase and that rents will also rise in accordance with value. And so, on that basis you will have built up more equity in your portfolio and should have achieved a cash flow neutral status.

This means that by about year 5 you are now in a position where you can afford to add to your portfolio and purchase another property. Repeat this process again in another few years, and you should be able to collect at least three properties in your portfolio over the first 10 years.

From here you move into your second phase, where you leave your portfolio to mature over time, and as your lifestyle situation changes (maybe you have paid your mortgage off, have a better paying job or your kids move out of home), you may also be able to do some debt reduction. This phase continues through the next property cycle over 10 - 12 years.

Over the 20 year period, if the three properties in your portfolio achieve the 6% per annum compounding growth rate then the portfolio will grow to a value of $3.849 million, after retiring debt the net asset positions would yield the owners of the portfolio a net position slightly north of $2 million. And with the added bonus of debt reduction in the second phase, that could be even further improved. Furthermore, if you refer back to part three, then you should know the average cost to the investors if structured correctly, over the 20 year period should have been less than $50 per week (indexed accordingly) to control this total portfolio.

Certainly then a much better result than might have otherwise been achieved in some of the more traditional methods of saving. Of course better yields come with higher risks, but if all parts of the equation are put together correctly then there is a much higher likelihood of managing any risks that might occur.

Obviously, this is an example only, and this example should not be used as a guide for an individual's position. Whilst best endeavours have been used to construct the scenario, the average individual's financial situation, growth rates, rental yields and other external factors may vary the outcome of the staged acquisition program.

Summary

So, as you sit down and relax over the Christmas period and begin to start thinking about your goals for the future and a plan to achieve that, make sure you consider this information provided in this article.

If you are ready to look to property investment as part of your retirement plan, then I would like to invite you to register your interest below. Rule Three's role is to help you to put your property plan together, guiding you through the process of building your portfolio and assisting you to make an educated decision on your investment choices, and give you the opportunity to potentially build your wealth for the future.

I will be holding a number of workshops at the start of 2015 to expand further on the information provided in this article, as well as further discussion around property investment. If you are interested in meeting one-on-one we can also arrange an individual client meeting. Register your details in the form provided.

Merry Christmas to all, and have a safe and relaxing holiday.

Martin Josselyn, Rule Three Property Performance

Martin Josselyn is a licensed agent, qualified financial planner and mortgage broker and has over 15 years experience in direct property investment portfolios

[i] We have used this figure based on research obtained that show average return for a managed funds of 7.4% over the last 10 years: http://www.smh.com.au/money/investing/harsh-truth-about-managed-funds-20130528-2n7yi.html

[ii] Average industry super fund of 8.7% over the last 5 years. Source: http://www.industrysuperaustralia.com/tag/superannuation-performance