How to keep buying properties

— even when your cash runs out

Savvy investors know that you have to be in the game to win. But how do you keep on buying when cash dries up? *Helen Collier-Kogtevs*, director of Real Wealth Australia, explains

When it comes to the game of property investing, cash is always king. So to run out of cash yet still have the desire to buy property requires a little creative thinking. For savvy investors who want to continue buying, you now enter a new level of the game.

Personally speaking, I remember how frustrated I felt when, after acquiring a few properties, we ran out of cash. I had the bug! The bug being the love of property and the enjoyment of sourcing, researching, negotiating and settling deals.

I made the most of hunting down the elusive 'deal of a lifetime' but, by property number five, cash was quickly running out, which made it difficult to continue buying. So what could I do?

1 Joint ventures

This was exactly the position that I found myself in when I stumbled across and negotiated a fantastic deal. I didn't really want to buy it in the first place, but the numbers were too compelling for me to walk away.

The deal that I found was a two-bedroom apartment in an award-winning block of 60 that was next to the water in one of the most sought-after areas of Perth. I had no idea how I was going to buy it because I had no cash for the deposit. The upside was that I had ample borrowing capacity – but that was all I had.

It wasn't until I shared my dilemma with some friends over dinner one night that I discovered the power of joint ventures.

To my surprise, I found that they were in a position of having lots of cash but no borrowing capacity – and they were definitely interested in sharing in the opportunity as a joint venture. To cut a long story short, this was my first foray into joint ventures. Four years on, the property has doubled in value.

Joint ventures have since played a big part in the growth of my portfolio. My philosophy is that I would rather own 50% of something rather than 100% of nothing. It becomes an excellent way to continue buying when you run out of cash, as joint ventures allow you to leverage other people's money to grow your wealth.

If done properly, the benefits of joint ventures can be fabulous. However, there are risks. Unless you mitigate the risks, then my advice would be not to go into joint ventures.

The primary way to mitigate the risk is to have a written joint venture agreement between the partners. This is quite distinct from the Contract of Sale agreement between the vendor and buyer. The joint venture agreement is an agreement that governs the arrangements, accountabilities and responsibilities of all joint venture parties involved in the transaction.

This agreement should outline each party's roles and responsibilities, making sure that everyone is clear and understands the results and impact of all actions and outcomes associated with the property. It's also vital that an exit strategy be included in the agreement. The exit strategy should outline what would happen should one or both joint venture parties wish to sell or are forced to sell.

In particular, the following should be considered:

- How long do you intend to retain the property?
- Who owns the property?
- How are the rent and/or expenses apportioned?
- Who does what in managing the property?
- When selling, how will you share the contributions/profit?
- If things go wrong, what is the solution, the plan, the way out?

We're all optimistic in the heat of the buying moment and believe that everything will work out fine. However, at this point careful consideration must be given by joint venture partners to consider how you might handle future hurdles, and how things will be managed should things go wrong.

> We're coming into tougher financial times and it will be even more important for savvy investors to be creative so they can keep buying

For me, having the opportunity to participate in joint ventures has enabled me to appreciate the importance of written agreements between joint venture partners. It's vital to have everything written down in an agreement, as it's difficult enough remembering what you said last week, let alone trying to remember what you said two years ago. Better to be safe than sorry.

2 Borrow the lot

You may be thinking at this point that, if I had heaps of borrowing capacity, then why not borrow the lot to secure the deal for myself? In this way, you would get to keep all the capital gain – less capital gains tax (CGT) and selling expenses – yourself, if and when you choose to sell. It's plausible, but be prepared to pay a premium interest rate.

As to whether you choose this path or not will depend on your circumstances. I discovered joint ventures as a vehicle for continuing to buy before learning about and understanding the power of borrowing 100% finance.

It wasn't until I nearly hit the financial brick wall that I took a real interest in finance and wanted to understand it in more detail. The reality is that in the game of property, finance is the key. Without finance, you can't unlock the full potential to growing your wealth.

Due to the credit crisis in the US, many lenders no longer offer 106% loans, and many are even pulling back on 100% loans. These are still available but are becoming more expensive.

Even though they're available and can be a good way to secure property, I don't really like them. I understand their benefits, especially when the market is booming, but I see them as a high risk. When the market stagnates or falls, it's too easy to end up in a negative equity situation with this type of strategy. Also, it costs more in interest payments.

If the market is booming, I'm more comfortable with the concept of borrowing the lot at a higher interest rate. I would then look to refinance to normal lending rates about a year after

Top tip!
Be aware that when the property market has slowed, interest rates could go up again and the cost of living will become more expensive. In these circumstances I would prefer a joint venture equity partner who has cash instead of borrowing the lot.

the purchase, to take advantage of any capital growth in the property, which then becomes the deposit.

3 Rejuvenate

If you have a few properties and you've maxed out your cash, look at your current properties to ascertain if you can grow some equity by adding value through renovating.

By this, I mean a light renovation such as painting, new carpets, polishing existing floorboards or cleaning up the garden as ways of increasing the value of the property.

Should the market stagnate or fall, as some pundits are predicting, renovating may be an excellent vehicle for increasing your property's value. However, I don't think you'll be able to spend $5,000 and increase the property value by $100,000 like so many did during the boom.

But if you keep your expectations realistic, then renovation may be an excellent way to increase the value of your property, and then you can draw down on the increased equity to buy another property or two.

A rejuvenation can work in two ways:

1. By potentially increasing the value of your property
2. By potentially increasing the rental return

One thing I do enjoy doing is improving my properties in consultation with the tenant. For example, on inspecting one of my properties in Queensland, I could see that the kitchen was getting old and was in need of replacement.

The 'freddo frog' kitchen consisted of lime green bench tops and chocolate brown cupboards, which really didn't meet the criteria of a 'modern kitchen'. The tenant standing beside me noted that she would love a dishwasher, and I happened to suggest that it's time for a new kitchen. The tenant, in all her excitement at hearing this, immediately offered to stay on and rent the property for another two years. At this point, I also explained that the rent would need to increase to help cover some of the costs. She consented, and we had an agreement.

A new kitchen added value to the property and the extra $100 per week in rent helped with cash flow. Plus, I got to depreciate the value of the kitchen come tax time.

I often negotiate with tenants. If they want improvements made, I'm generally happy to oblige – within reason – provided that it's a win-win situation and benefits both of us, as the tenant and the landlord.

Top tip!
Follow a strategy of a light rejuvenation first. This will enable you to limit the amount of money you pour into the property. If you spend more than 10% of the property's value on the rejuvenation, then you may be over-capitalising.

Top tip!
Be good to your tenants. My experience is that tenants will pay the extra rent and stay longer if you give them what they want. The bonus is that they care more about the property, which makes it easier to manage. Having been a tenant myself, there's nothing worse than a stingy landlord!

4 Subdivide

Is your house sitting on a large parcel of land? Why not subdivide as a means of creating extra equity?

A subdivision is a simple way of creating equity, and many councils have ample information on their websites regarding the requirements for a subdivision.

It may cost around $30,000 to complete the process with council (for a simple subdivision), but the extra block of land may be worth hundreds of thousands.

Top tip!
If you're going to go down the subdivision path, make sure you do your homework on land values to ensure it's worth doing. There's no point in subdividing if the value of the extra block of land only equals the cost of doing it.

5 Reduce your bad debt

I recently received an e-mail from a reader who had three investment properties plus $80,000 of bad debt. He was asking for some suggestions on how he could continue to buy property, as the banks were not interested in lending him any more money.

To have credit cards and personal loans loaded up to the max is the quickest way to stall your opportunity to invest.

Banks love to lend money on credit cards – in fact, they're forever trying to increase my limits but I know how quickly I could shoot myself in the foot by increasing the credit limits on my cards.

Credit cards are handy to have, but most investors fail to understand the impact high credit limits have on their ability to borrow.

For example, a $15,000 credit limit could reduce your borrowing power by $54,750.

To any investor wishing to buy more property, consider reviewing your level of bad debt. Do you pay off your credit cards in full each month? My philosophy is that, when it comes to buying your plasma television or iPod, if you don't have the cash, then you can't afford to buy it.

Do you really need the brand new, fully imported car that has you making large monthly repayments which then reduces your potential borrowing power?

Top tip!
Why not curb your spending or your need for 'looking good' and downsize your car in order to reduce your bad debt? Use the extra cash flow to buy more investment properties, and then have the investments pay for your 'swanky' car.

Alternatively, you could take a step back by selling a property to reduce or clear all your bad debt and then move forward again. Whatever you do, build your portfolio and then have the investments pay for your 'doodads'.

By structuring your portfolio in a balanced way, you'll have the properties continuing to grow in value and continuing to provide you with a cash flow that will fund your lifestyle, without you having to work harder or longer.

6 The white elephant

Is there a property in your portfolio that's like a big 'white elephant', draining your cash flow due to it being heavily negatively geared? Has it not performed quite as well as you would have liked in the capital growth department?

What about considering offloading it and reinvesting the funds into a better performing property?

I have a client who purchased a property in Queensland through a property spruiker. They were looking for cash-flow opportunities at the time, and paid $350,000 for a property, which after some research, turned out to be more than it was worth. They only received a rent of

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$400 per week – hardly cash-flow positive. Obviously, this wasn't a good deal, but with some mentoring they decided to sell it and got the amount that they purchased it for, using the funds to reinvest elsewhere. Their new property cost $350,000 and attracted rent of $700 per week… a much better deal!

I had a property in Kalgoorlie that I purchased for $173,000. It had a Government Employee Housing Association lease, and I received $330 per week rent. Unfortunately, when the lease ran out and the property was leased on the open rental market, the rent fell to $260 per week. This property went from being positive cash flow to negative cash flow overnight. It became a drain on my cash flow and the market at the time hadn't enjoyed any real capital growth for a number of years – a double whammy!

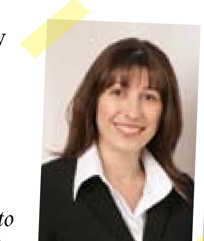
I decided to sell the property and, when I did, I managed to sell it at a small profit. I then re-invested the money into a better performing property, this time in Queensland.

The deal I got was a $240,000 property that brought a rent of $450. Today, the same property earns $700 per week in rent, and has grown significantly in value. Also, the extra cash flow I receive from this property helps to support my portfolio's negatively geared properties.

We're coming into tougher financial times and it will be even more important for savvy investors to be more creative to ensure that they can keep buying. Gone are the days of buying a dog box, giving it a lick of paint and putting it back on the market for $100,000 more than you paid for it.

It's now time to be clever with your money, by making each and every one of your dollars work harder for you. I believe things will probably get worse before they get better, which makes now an excellent time to prepare yourself financially for the abundant buying opportunities that are out there. There are 900,000 households struggling to meet their mortgage commitments, so use your money wisely and avoid becoming part of these statistics.

Until next time, happy investing. ■



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