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BUYERS' AGENT BRIEF

Our hypothetical brief

Joseph is a single 27-year-old carpenter from Fitzroy in Melbourne. He's helped build plenty of houses in his time but alas has yet to buy his own. He really likes living in Fitzroy because of its funky cafe and bar scene but knows buying a property there is financially out of his reach. He's been saving for a few years now and has a $50,000 deposit thanks largely to a lot of overtime. His parents have offered to top up the deposit to $65,000 if necessary as a gift. He's decided to stay renting in Fitzroy so his first property will be purely an investment. He currently earns about $60,000 a year and has no dependents or loans. Joseph wants to find out where he can get the best bang for his buck. He doesn't mind doing a little bit of renovation on the property given his skills.

It's never been easy to buy your first property but there are still options available for those with determination and a realistic goal.

NICOLA MCDOUGALL [@API_Editor]

> "I'd guide Joseph to rule out investing in an outer suburban property."
>
> PAUL NUGENT

We all have to start somewhere on the property ladder and that's exactly what our "first-time investor" wants to do in our latest *Buyers' Agent Brief* scenario.

Joseph is a young, enthusiastic would-be investor, who has even roped in mum and dad to help him realise his real estate dream. The question is, with new lending restrictions now in play, what options in Melbourne are there for first-time buyers just wanting a secure reasonable foot in the door?

NUGENT

Director, Wakelin Property Advisory

Almost our first request to Joseph would be to go and visit a reputable mortgage broker who's experienced in property investment loans to establish how much he could borrow. By reputable, I mean a broker who won't try and encourage Joseph to borrow the absolute maximum amount of money possible. It's important the loan is manageable even if the Reserve Bank raises interest rates by one or two percentage points.

Let's assume the mortgage broker advises that Joseph has the capacity to safely invest in a $450,000 asset. On paper, that gives Joseph a few options in the current Melbourne market. He could buy a new two-bedroom house in an outer suburb such as Craigieburn or Doreen; he could invest in a two-bedroom villa unit in a middle suburb (say Greensborough); or he could consider one-bedroom apartments in our inner suburbs.

Our approach to property investment is to identify assets with a track record of strong and consistent capital growth. Capital growth is the engine room that builds the equity he'll want to support his future goals (such as buying a home). Joseph ideally wants a property where there's evidence (either through its sales history or that of similar properties) that it has doubled in value at least every 10 years.

In light of this philosophy, I'd guide Joseph to rule out investing in an outer suburban property. Capital growth in these areas tends to be weak as there isn't the intensity of demand for land we see closer to the city.

Joseph's inclination and ability to renovate is a definite plus and it'll allow him to buy a well-located asset that many buyers without his skills will pass over. Furthermore, there's scope for him to add significant value to the property. Joseph is therefore an exception to our rule, which isn't to make "adding value" the centrepiece of an investment strategy. Too often investors underestimate the time, heartache and cost of bringing a renovator's delight up to standard and over-estimate the return. But with Joseph, it would be a reasonable assumption that he'll have the skills, experience and industry contacts to complete a successful renovation relatively painlessly and on a budget.

Saying that, he's probably wise to rule out properties that require major structural remediation such as a new roof, re-stumping and major rewiring. Firstly, they can take a long time to complete, which delays when Joseph can start earning a rental return, and secondly, these sorts of renovations tend to be "invisible" to the casual observer so aren't usually rewarded with a sufficient uplift in rental dollars or the property's value to justify the expense.

Joseph can probably get the biggest bang for his buck by focusing on cosmetic renovations – fresh coat of paint, re-carpeting, etc. – and on refitting work that plays to his skill set, say a new kitchen and new cabinetry in bedrooms and other living areas. He might also refit the bathroom if he's confident of his tiling skills (or has a mate in the industry who is).

With all this is mind, I'd recommend to Joseph that we try to find an unrenovated one-bedroom apartment in an inner northern suburb – Brunswick, North Carlton or even Fitzroy where he currently lives. Although the apartment would benefit from his skills, the associated apartment block would be attractive and in good condition. I'd only consider smaller-sized blocks, built between the 1920s and 1970s, with allocated parking and located on a pleasant, residential street close to a village-like shopping strip and good public transport. The apartment would have a good position in the block and a pleasant aspect. It's these characteristics that distinguish the top performing properties from the pack.

MIRIAM SANDKUHLER

Author and Managing Director, Property Mavens

It's great that Joseph has saved a healthy deposit and is keen to get into the property market, applying a "first home investor" strategy, which means he can start his property portfolio.

Firstly, I'd clarify Joseph's objectives. These include his long-term financial goals, how many properties he wants to buy and in what timeframe, if he's investing for capital growth or income and what his risk profile is (so that the strategy and property type match it).

Given the information available, I assume the following: He aims to build a portfolio of at least two "investment-grade" properties ASAP. His strategy needs to be to invest for cash flow first due to his low income, so that he can generate income to service his debt and hold on to the property. This will enable him to borrow more money in time to buy more growth assets, however it doesn't mean he has to forgo capital growth in the process.

Due to the recent APRA lending changes, Joseph's circumstances and financial position only enable him to buy a property for $260,000, with a deposit of $65,000, a loan for $206,000 and stamp duty at $12,000. The property will need to earn $270 per week rent (5.4 per cent yield) for loan approval purposes.

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This means Joseph's options are to either a) move back home to save rent to increase his deposit and buy a more expensive property in time or b) buy a property in a large regional centre, which has adequate growth drivers to support the required yield and still earn capital growth as a secondary factor.

The only Melbourne-based option for this tight budget would be to buy a studio apartment in the CBD, however it would require a 20 to 30 per cent deposit due to the property size being less than 50 square metres.

The property would also be compromised due to no car park on title, high owners corporation fees, low land value and an oversupply of apartments for sale, therefore inhibiting capital growth over time.

All is not lost, however. The option of buying a three-bedroom house in a regional centre with the right growth drivers can generate a great outcome for Joseph. It would need to include the following – a population of more than 90,000, plenty of amenities such as schools, hospitals, shops and public transport. There would need to be a strong economy supporting local employment, future population growth, affordability and a desirable lifestyle.

The property should have a high land value component of 50 to 70 per cent (it's the land that increases in value, while buildings depreciate) so it'll be an older property. To manufacture immediate equity and to utilise Joseph's skills and trade network, it should be in need of some cosmetic refreshment such as new paint, carpet, window furnishings and a new kitchen, bathroom or outdoor decking in time (and when funds permit).

Buying locations could include Geelong, Bendigo or Ballarat, as all of these centres are within one to one and a half hours' travel time to Melbourne, allowing for prospective tenants who commute to the city for work. In each instance, the property would need to meet the criteria of the tenant to ensure longevity of tenure, so understanding who the tenant is, is vital. Factors to consider are local climate, tenant lifestyle and housing needs. While the cafe lifestyle and proximity to CBD may appeal to Melbourne locals, regional folk may put more importance on having a large shed for storage and decent heating throughout.

Suburb selection will also be critical. Joseph should buy within two to five kilometres of the town centre. He'll need to ensure he isn't buying in a street with high Department of Housing ownership, as this could make renting and resale of the property difficult.

Taking into consideration all of the above, buying a three-bedroom house priced at $260,000 and yielding 5.4 per cent will definitely be achievable for his first investment property.

KEN PREMTIC

Buyers' Agent, Secret Agent

Firstly, we'd want to discuss with Joseph the current state of the market and the conditions to expect over the coming years. Growth over the next few years isn't a sure thing. A slowing Chinese economy, a domestic terms of trade decline, US interest rates increases and a slowing Australian economy are global and domestic issues that produce significant headwinds to capital growth over the short-term. We'd want to drive the point home with Joseph that he needs to think about building wealth with a long-term strategy, instead of just a quick short-term profit.

Joseph's budget is restricted and this will limit the available opportunities to him. We have a tough choice to make; while we want to avoid the oversupplied CBD apartment market, we don't want to purchase too far away from the CBD. Our view is that urbanisation is pushing more and more demographics to live as close to the CBD as possible for work and lifestyle reasons.

The $65,000 deposit will limit Joseph to a purchase price of just under $400,000. Stamp duty and other costs will be incurred as part of this purchase and we wouldn't want Joseph to leverage his position to a risky loan-to-value ratio.

> "Good views and lots of natural light are proven to increase tenant retention and bolster future resale."
>
> KEN PREMTIC

In terms of the brief, we'd focus on the inner urban areas of the inner-west, which is one of the last affordable markets within close distance of the CBD. We'd narrow our search to include only 1960s and '70s apartments because of the structural stability of the buildings and the extra-large internal areas, which help differentiate the units from most of the new construction in the locale. We're looking for a solid rent return and a longstanding tenant without the churn and burn of short tenancies, which eat into precious margins by having to find new tenants regularly and bearing the associated costs.

Joseph would be wise to settle on a market such as Seddon. Only seven kilometres from the city centre and with a train line close by, this suburb has a great village feel with plenty of shopping and amenities provided by Seddon Village. Universities are also in the vicinity so Joseph will have a substantial pool of possible tenants and future buyers seeking to either rent or buy the property from him in the near future.

Sometimes it's most valuable to have the more abstract things catered for in the purchase. Good views and lots of natural light are proven to increase tenant retention and bolster future resale. These features, combined with a good internal layout and smaller block size, will help Joseph in his quest for the best property matching his deposit conditions. He should seek a tightly-run building and low owners corporation fees, providing the building is well managed.

Joseph should leverage his carpentry skills. By upgrading a daggy kitchen and bathroom, Joseph can add immediate value and increase rent to improve the investment. It may be possible to be creative around the accommodation, such as turning a large one-bedroom property into a two-bedroom apartment by being smarter around the use of space.

We'd like to see Joseph be in a position to command $450 per week in rental income from the investment and settle on a five per cent gross yield with a good long-term tenant in place. Getting tenant selection right will ensure that his hard work isn't undone by loose selection criteria. As always, the tenant should be screened for coverage of the asking rent as well as the ability to service future CPI increases.

If Joseph can get the first property right then he'll put himself in a great position to free up equity for the next purchase. A gradual acquisition process of building the portfolio without "risking the farm" should be the priority for Joseph over the coming decades. API

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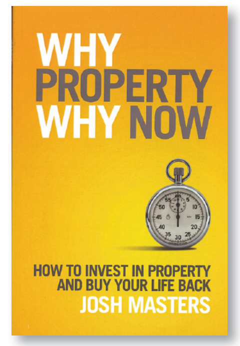

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