BONUS CHAPTER

Understanding The Property Market And Making The Most Of It

When investing in property, there are really just two possible outcomes – make money, or lose money. Statistics show that Australian property investors lose billions of dollars investing in property every year. That means that the vast majority of investors are not getting it right.

Whilst there are many factors that influence this, one of the least taught, and least understood factors, is a basic understanding of how the property market works.

This is vital to your success, and this bonus chapter will give you an introduction to the factors that affect property markets, thus enabling you to make better and more informed decisions in your investing.

Some people look at this information and get scared. Other people look at it and don't believe it. The wise people, the investors who make money, look at it, take it on board, and use it to identify opportunities and to protect their portfolios.

For this bonus chapter, we are going to share with parts of a transcript of a talk on the market that Jennie did a few years ago.

TRANSCRIPT…

Spending Cycles

So when we start life, do we earn or spend any money? When do we start spending? In our teens. What happens when we get into our 20s? Why do we start to spend more money? We earn it. And what factors influence that? We might move out - what type of property would we move out into? Rentals ... so we start to rent. We get a job or something like that. And what happens with our life, like our personal life? So we probably start to date and in some cases partner up. So our spending goes up.

And then in the 30s, what happens? We possibly buy a house, might have kids, and of course we're spending more money.

Our 40s is actually our peak spending in Australia. In our 40s, we buy bigger. Kids are in school, so uni is very expensive. And we also spend on cars, holiday houses or investment properties. So this is where we are more likely to start adding investment.

Then we hit the 50s, and it's all downhill from here! Spending is less; the kids move out hopefully; we downsize our properties because we don't need all that room.

Sixties, your income is less. We tend to start to look at downsizing again into retirement living or smaller properties.

Then we go into our 70s and our health is going down. By now we're looking at maybe some sort of care. And then at some stage, we die. This is called a spending curve, and it's applicable to every single country.

And in Australia we tend to live into our 70s or 80s and often more.

In Australia, the largest section of our population is the baby boomers. And the second largest generation in Australia are the young ones.

You can see where the majority of the population in Australia is and you need to look at what types of properties the majority want to be able to maximize your investing dollar.

In Australia, the high end of the market has had the highest falls. And the reason most likely is that the high end has not got enough people coming up to buy it, and so the prices fall.

Supply And Demand

Where there's supply and not enough demand, it drives prices down. If there is a huge demand and very little supply prices go up. We've just come through a phase in Australian history in the 2000s where the demand exceeded the supply. This drove prices up at a steep rate because the population was in the peak spending curve.

These cycles happen all the time. The only difference is where we are on the cycle.

Government Influence

Another thing that affects property markets is government "interference". A number of years ago, we got a "baby bonus" – designed to stimulate our child birth rates. The government did this, I believe, to increase the population because they knew that there would have to be support for the more elderly population.

Another example of government "interference" is housing grants and building grants, and first home owner grants. These are all designed to stimulate the housing market, or to stop it from falling. In addition, the $500 bonus from the Rudd government was also designed to stimulate spending. These types of grants give people a false feeling of affordability, and encourage them to spend more, which in turn stimulates the economy, which is turn keeps things ticking along. It also creates a false demand, which of course keeps prices up.

All it really does, however, is delay an inevitable economic bust, and often puts people into positions where they are paying more than they should, and likely putting themselves into debt they cannot afford.

A good picture of what is happening here is that of a balloon. You keep filling it up with air (grants, false economies, false demand) and eventually, when there is just too much air, the balloon bursts. That means that the economy will, eventually, crash – and there will be many caught unawares by it.

Employment

This is an important factor in the property market. Basically, if employment is good, housing prices will generally be high. If unemployment is rising, housing prices will be affected. People will downsize, pay less, or move in together if they have to tighten their belts.

This goes both ways. If the economy is feeling the pinch, the unemployment rates go higher, and people start to lose their jobs.

This is one of the strongest indications of a change in the market – always keep your eye on what is happening in business, it flows through to the property market.

Property Cycles

Property markets have cycles.

The 1920s was called the Roaring ‘20s. What do we know about the Roaring ‘20s? Prohibition; Development; cars; The Charleston (indicates having a good time); lots of money. The stock market was going up and there was easy credit, interest rates were low, and property was booming. It was a time of great innovation and inventions to make life easier.

Now, we hit the 1930s and The Great Depression. Stock markets crashed; property went down. Credit was hard to get. There was huge unemployment. Banks closed. Only a few businesses in each sector survived, based on quality.

The 2000s mirrored The Roaring 20's. It was another innovation period. Property went up. Interest rates went down. Party time. Credit was easy. Shares went up.

Then we come to 2008 and we had the GFC. This period mirrors The Great Depression. And I believe we are still in it.

In short, property markets and economics generally go in 80 year cycles. Good times followed by a massive crash.

Knowing and understanding this will help you to invest accordingly, and be one of the ones to make it through on the right side of the ledger!

What affects your portfolio

There are four major areas that can affect your investing.

Market Changes

The first one is market changes. If the market is going up, you will have capital growth or positive equity. If the market is going down you will have negative equity.

Rents

The second one is rent. Rents are exactly the same as property markets - it's all about supply and demand. If there is oversupply, rents go down. And if there's an undersupply, rents go up. If you own rental property, and there is an oversupply, you will have longer vacancy periods and new tenants will want lower rents.

Interest Rates

Please do not be fooled into thinking that interest rates will stay low. Ask anyone who went through "the recession we had to have" (and if you don't know what that is, ask an older person) and you will quickly learn a lesson from the past. If interest rates increased, how would you be affected? And please understand this, they will increase.

Illness or Unemployment

We all think it won't happen to me, but ask anyone who has been made redundant or had someone close to them have a serious illness, and they will tell you that it comes from nowhere, it is totally unexpected, and it usually hits very suddenly.

The question you have to ask yourself in investing for profit – assuming that's what you want to do – is, if any of these four factors happened, how would I be affected? If even one of them would send you under, then your investment is not working for you.

In investing, you should always be looking to the future, and planning how to move your portfolio so that it makes you money.

Now for the smaller picture

All of the above applies on a general overall level. However, in order to succeed you also need to be able to grasp the specifics of the property market in the area you are looking to invest.

Make sure that you do your research, learn what the market wants, and then meet that demand.

Just because you want to live in a 5 bedroom mansion, does not mean that everybody else does, or that they can afford to.

Check out who will live in the property you are looking at, what type of family are they? What facilities do they need? What size property do they want? What do they want to live nearby?

There was a story in a woman's magazine a few years ago about an Australian entertainer who was going broke because of a property investment they had undertaken.

This person had bought land in an area where people lived close together in small housing. He had developed it into acreage lots. Can you see the contradiction?

This person did not understand the property market – he was attempting to cater for the high end market, at a time when the high end market was falling on its knees due to the GFC and the shift in spending cycles, and he was attempting to put high end in amongst low end.

This development was NEVER going to work, and it was blatantly obvious to us as to why he was going broke.

Here's our best tip …

Give the market what it wants,
not what you want …
this is where the money is!

Investing in the future …

So, where should you invest to make money? Looking at all the factors above, what type of housing will people need? The answer right now is small, low-maintenance, low-cost, with security. However, that will change as the demographics change, the property cycle moves on, and economics move.

The challenge for us all is to work out where it's going.

If you understand the property market, you will meet it, and reap the rewards. Go against the property market, and you will suffer the consequences.

Make some decisions about where you think the market is headed, research the area you are looking at to find out what people want, and adjust your investing accordingly. This is the safest way to safeguard your investments.