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Stay the course to reap rewards

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A new report suggests that young people are overstreching their finances to get into the market.

Many young buyers sell their properties before fully realising the potential profits.

One of the most common mistakes made by residential property investors — especially those from generations X and Y — is that they don't stay in the market for long enough. A new study shows that one in four Australian investors sell their investment property within a year of buying it.

This is the startling main finding of a report called Factors Shaping the Decision to Become a Landlord and Retain Rental Investments by RMIT University academic Gavin Wood and a West Australian colleague, Rachel Ong, produced last year for the Australian Housing and Urban Research Institute (AHURI).

Professor Wood and Dr Ong use housing and income data and property sales figures to show that younger, negatively geared investors on modest salaries are very likely to sell their property investments within a short period. If you sell a property only 10 or 12 months after you acquired it, you expose yourself to a tremendous risk of loss.

There is no doubt the "pick and flick" approach to real estate buying, where a property is bought and resold for a tidy profit within a year or two, can deliver windfall profits in boom economic conditions. But the AHURI report suggests twentysomething and thirtysomething investors are overstretching and over-gearing themselves. It says younger investors often sell their property investments because they consider their rental returns aren't high enough.

Many also find negative gearing doesn't work for them and the amount of after-tax money they have to sink into their loan repayments as well as rent is just too much. Little wonder Professor Wood and Dr Ong believe young investors are "churning in and out of rental properties".

One of the basic rules for investing in housing, highlighted by financial planners and advisers the world over, is that it's best to hold on to a property for at least seven to 10 years if you want to achieve a decent rate of capital growth. A buy-and-hold strategy is commonsense, really. While many properties, particularly inner-city ones, historically double in value in seven to 10 years, house prices rarely go up in a consistent or even way from one year to the next. There's a real chance that a quick turnaround sale could be hit by one of the market blips that drag prices down.

Think of 2008's global financial crisis or the sluggish sales periods that always precede a federal election. You should also factor in your buy-in costs of stamp duty and legal fees.

Buyers' advocate Paul Osborne, of the Carlton North-based firm Secret Agent, says his top piece of buyer advice is: "Don't leverage yourself to the hilt." Mr Osborne says it's vital to buy an asset that can be either an investment proposition or a home. "When you resell the property, you want to sell it as either a home or an investment and have two markets to appeal to," he says.

Terry Burke, a professor of housing studies at Swinburne University, says several AHURI studies that looked at the motivations of residential investors have found most buyers do little research. "These investors just operate on gut feeling," Dr Burke says. "The research process for investment in the residential sector is very different from other sectors. It's shoddy compared with the research undertaken to invest in shares."

The investors who do conduct adequate research and who often succeed in property investment tend to be older. They are also less likely to be negatively geared.

According to Professor Wood and Dr Ong, after one year of ownership, there is a steep decline in the rate of investors leaving the rental market. They point to a second group who "stay the course". This group largely consists of middle-aged, high-tax-bracket investors with modest superannuation and little unsecured debt.