Roadmap to wealth - Making the most of a good start

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By Shannon Molloy

Now that she's back from a few years of living and working abroad, Belinda Davis is ready to knuckle down and work towards her goal of financial freedom. And she hasn't wasted any time.

Melbourne's southwest is a far cry from the ski fields of Canada or a super yacht in the Mediterranean. For Belinda Davis, 34, who wrapped up a remarkable overseas adventure earlier this year, it's now her home.

The Victorian native spent much of her late 20s traipsing across the globe, backpacking and working her way through the United Kingdom, Europe, Asia and North America.

"My first overseas trip was backpacking through southeast Asia and Europe, followed by nine months working in Manchester in the UK," she explains. "Then I spent nine months working on a yacht in the Med and southeast Asia, followed by another backpacking trip through Asia."

After returning home briefly, Belinda took off again – this time to work in Canada for two years. The community dietician is now settled into a new job back in Melbourne and taking her plan of wealth creation through property seriously. She lives in a shared rental house, but don't let that fool you.

"I own a rental property in Hastings on the Mornington Peninsula that I bought six years ago. It's been a pretty good investment – I've never had any issues with tenanting the property and I think it has a reasonable rent yield."

Belinda grew up in the area and still has family nearby, so the house's location appealed. Also, when she bought it, she knew there were plans to develop a major new port in the suburb.

"I thought it'd make a good investment for future capital growth. Work on the port is just going ahead now."

The solid fundamentals of the property aside, maintenance bills this year have spiked thanks to some pesky and hungry rats that chewed through water pipes in the ceiling.

"They got to it in seven places causing water damage to the plaster in five rooms throughout the house. It's not covered by insurance so it'll make for an expensive year!"

When she returned from overseas this year, Belinda was keen to make her second purchase and successfully applied for finance pre-approval. With a $600,000 ceiling, Belinda went shopping and eventually found a two-bedroom cottage in the western suburb of Seddon.

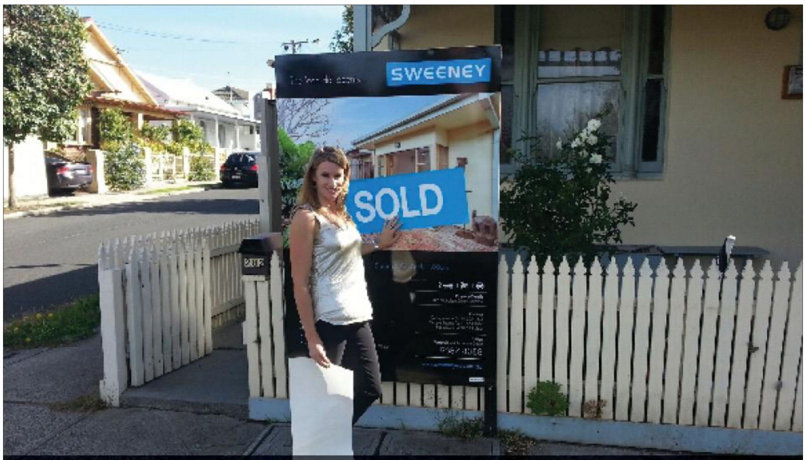
"It settles at the end of the month. It's a cement block cottage built in 1890."

Belinda's long-term goal is to create a "substantial portfolio" that builds her personal wealth and allows her to retire earlier than she might've otherwise been able to.

"I like the thought of investing to be wealthy in the future. I like the security of investing in bricks and mortar as opposed to something less tangible like the stockmarket."

Given she's just bought a property, she admits her borrowing power and serviceability will take a while to recharge. When she's ready, she'd like to buy again – striking the right balance between capital growth potential and cash flow.

"I want to maximise my potential future wealth but I don't want to overextend myself too much either."



Belinda outside her new Seddon investment

THE NUMBERS | BELINDA DAVIS

Property	Purchase price	Purchase date	Weekly rent	Current value
Hastings, Vic – 4-bed house	$340,000	2007	$390	$430,000
Seddon, Vic – 2-bed house	$505,000	2013	$420	$505,000
TOTALS	**$845,000**		**$810**	**$935,000**

ANNUAL INCOME: $73,000

SUMMARY OF GOALS

- Continue to grow portfolio
- Build future wealth
- Retire a bit earlier

CONSIDERATIONS

- Don't want to overextend finances
- No other debts
- Only $20,000 in super

MARGARET LOMAS | DESTINY

Belinda's past certainly shows she isn't afraid to take risks, but I feel that it's now time to begin to look ahead and ensure her future property investments safeguard her retirement.

Her aim should be to ensure she doesn't buy property that's going to cause a major drain on her finances. She must be aware of the cash flow but also that she accesses growth too. Cash flow will help her to stay in a market, but it's growth that'll get her out!

Belinda's current position is that she has just over $200,000 in net assets, taking into account only those she owns that can produce an income and grow. At this stage in her life I'd like to see her ensure she always maintains a 20 per cent buffer between her debt and her assets, which means that she isn't ready to buy again just at the moment.
However, her personal cash flow is pretty good and if Belinda knuckles down, watches the budget and undertakes a mortgage reduction program on her investment debt, she should be in a position to buy another property within 12 months.

While many investors think they should leave debts as interest-only, if there's no personal debt as in Belinda's case then it makes sense to repay investment debt. Doing so will have the effect of speeding up equity acquisition – as the properties grow in value, her debt will reduce and that gap between what she owes and what she owns will increase.

It's this equity that then becomes so important in adding more property to the portfolio – the sooner another 20 per cent can be created for a deposit, the better. The loss of tax deductions is small in comparison to the benefits to be gained by getting further exposure to a growth market, in the form of more property.

I've done some projections for Belinda based on adding properties within the $300,000 price range. I've chosen this price range, as I believe the most significant opportunities for growth exist in the outer metropolitan areas of some of our major cities – Brisbane, Perth and Sydney.

Belinda already is heavily weighted in the Melbourne market and I see that as the weakest market in the coming year or so. More property there will only stifle diversification opportunity and result in land tax problems.

Once Belinda has secured that third property in 12 months or so, my projections show that she can then acquire:

- Property four in Month 23 (mid 2015)
- Property five in Month 34 (mid 2016)
- Property six in Month 40 (late 2016)
- Property seven in Month 47 (mid 2017)
- Property eight in Month 53 (late 2017)
- Property nine in Month 59 (mid 2018)
- Property 10 in Month 71 (mid 2019)
- Property 11 in Month 82 (mid 2020)
- Property 12 in Month 88 (late 2020)

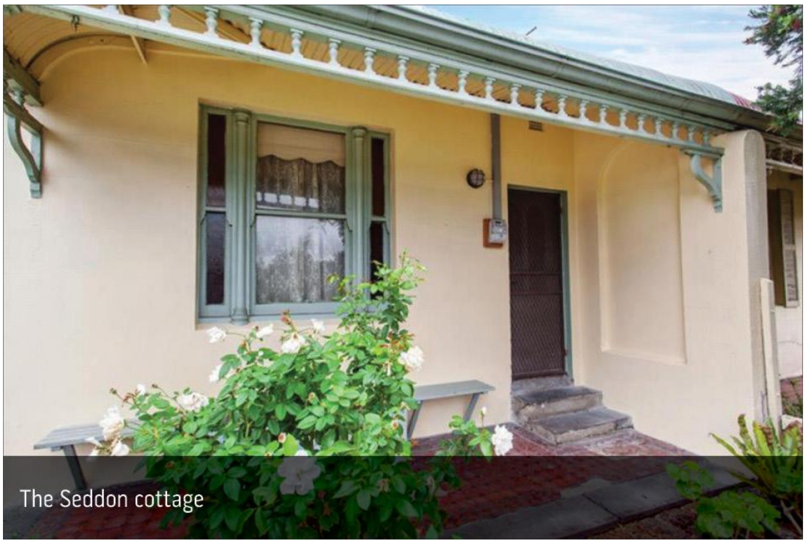
I'd like her to then sit on this portfolio of properties a further eight years, giving a total of 15 years for the entire portfolio to work. At the end of this time, and considering a moderate five per cent per annum growth rate, Belinda's portfolio should be worth around $7 million and she will owe just over $2.5 million.

Given an average rent return of five per cent and taking into account only the portion of the portfolio that she owns – that is, around $4.5 million – she should be able to create a solid retirement income somewhere in the $20,000 per month mark. It's a great position to be in, however it's not magic and Belinda has some strict rules to follow:

- This outcome relies on her being pretty strict with her budget. Overseas holidays and big spends will impact how quickly she can accumulate further investment properties.
- Belinda will need to ensure the properties she buys have a good, solid cash flow or she won't be able to financially support them. This means either buying property that already has a return of around six per cent or is in an area with rental pressure, meaning rents are likely to rise soon.
- She needs to be buying in areas about to come under buying pressure, hence my suggestions for finding these in outer metropolitan areas. Many of these areas have fast-growing populations, a commitment to service provision and infrastructure by local governments and a housing shortage. Those factors, when combined with low unemployment figures, usually result in housing that goes up and rents that accelerate too.

I'd like to add that Belinda should be buying property which doesn't need renovating and that can be 'set and forget'. Her career is going to be important to her and she doesn't need her focus taken away with a renovation strategy.

It's important for any property investment strategy to consider all of the investor's circumstances – time until retirement, available time to oversee the strategy, funds available now and in the future, risk profile and capacity to support the portfolio if tough times occur.


The Seddon cottage

BRAD CALLAUGHAN | CALLAUGHAN PARTNERS

Firstly, I would like to say I'm very jealous of Belinda's extended holiday. It sounds like she has explored the world and is now ready to put in the hard yards when it comes to property and investment.

Her first investment seems to being doing well and it looks as though she bought well, especially with the construction of the port beginning shortly. This will only increase the rental yield and the demand for property in the area.

However, with her second property in Seddon, I wish this Roadmap to Wealth came in a month before she purchased it. While I'm sure the growth of Seddon will be strong in the long-term, given it's seven kilometres from the centre of Melbourne, the hurt of the cash flow and reduction to Belinda's lending power will be her biggest struggle moving forward.

Being a sole investor using one wage, such a highly negatively geared property isn't a great strategy.

To get into her next investment, Belinda will need to manufacture growth through the two properties she currently owns or save up enough cash and pay lenders' mortgage insurance on the next purchase.

Given she has already purchased the property in Seddon, we now need to look at a strategy to help her move on to the next property. Just as a side note, I'm not saying the Seddon property is a bad investment – I'm just saying it most probably wasn't the right one for Belinda at this time given her income and portfolio loan-to-value ratio.

Now back to moving forward. To get the next investment, Belinda will have to show increased borrowing power, meaning income and a large deposit of 20 per cent. This is the normal process of buying property.

As she's no doubt aware, she's at her capacity of borrowing given the current situation. So we need to get creative to manufacture growth in the properties so she can access the equity to use as our next deposit and we need to get creative about the properties earning an income.

Let me point out, this doesn't mean creative accounting, but rather strategies such as splitting the two-bedroom house into a duplex or subdividing off the back land to sell, putting a granny flat out the back to increase the rent, lease the bedrooms separately, etc.

If she doesn't want to go down this path, Belinda may look at a couple of other options. She could negotiate early access and start renovating the new property to manufacture the growth and increase the yield on the property. She can move into the property and renovate it over a six to 12-month period and then either sell it or lease it out.

Belinda can also look at these options for the Hastings property. Given the port is about to be built, companies will be looking to put their workers somewhere, so shared houses are a great idea and can double the rental if done correctly. Or she could look at putting a granny flat or some storage sheds out the back.

The issue we all face with property investment is moving on to the next one. Without strong cash flow and increased growth to provide the deposits, you become stuck waiting for the natural increase in the value of the property.

For Belinda to move forward, she'll need to look for higher yielding properties with a twist or a strong expected growth rate. These will give her the income and the growth she'll need to increase borrowing power and accumulate more property quicker.

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