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CYCLES • TRENDS • FORECASTS

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Rentier, Not Renter

By Catherine Cashmore, with Phil Anderson

You certainly don't want to be like the Marquis de Maussabre.

Taxes in France are known to be heavy. The Marquis grew so fed up with them he discovered that it would be cheaper for him if he blew up his family mansion to evade them.

So he did.

You can watch a video of what he did, here.

The Marquis lived in Poitiers, France. He blew up his own house in 1955.

Here at Cycles, Trends & Forecasts, we make every effort to make your issues current and show you how we think you can best take advantage of the cycle. Sometimes it's with themes on the stock market. Infrastructure has been one of them. At other times, we look at property.

We certainly don't want to suggest you do any home 'improvements' by demolishing it! Unless of course this might actually increase your land value…

For this issue its back to property — or more especially — land. After all, as Mark Twain reputedly told a friend: *'They ain't making any more of it.'*

So I (Phil) have asked Cycles, Trends & Forecasts contributor Catherine Cashmore to take up the topic once again.

Over to her.

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It's been a while since I wrote for *CT&F*.

My name is Catherine Cashmore.

ALSO IN THIS ISSUE

- Affordability or the lack of it
- The capital growth king
- The winners of the current real estate cycle
- Life-changing profits

If you haven't done so already, you can read some of my views about the Australian real estate cycle in The Cashmore Files.

I am also President of Prosper Australia. A tax reform think-tank based on the teachings of Henry George.

Prosper Australia is the oldest Henry George association in the world.

If you haven't heard of Prosper Australia, you should check us out here.

Prosper Australia is where Phil obtained most of his market knowledge about the real estate cycle and land economics. With this knowledge, you are at a huge advantage when it comes to real estate investment.

You should know this by now.

My message to you is simple: become a rentier, not a renter.

We're currently heading into the half-way point of what I think will be — yet again — the greatest real estate boom of all time. Just like the last time — and the time before that.

But even bigger this time. History suggests this is likely.

As an Australian resident, you are in a front row position to take advantage of it. So my message to you? Become a rentier, not a renter.

I believe there are no greater gains to be had than right here in Australia's second biggest city: Melbourne.

Sure, there are lucrative opportunities overseas.

America is the capital of 'flipping'. It typically nets the investor 30–60k depending on which state and the property type.

Additionally, it's hard to beat the rental yields in the USA.

It's not unusual to see 13–14% ROIs (Return on Investment). And that's after you have taken your property management fees, tax, periods of vacancy and maintenance into account.

North America is one of the only countries I know of that can give an investor both capital growth and positive rental income. And you don't need $500,000 to start a property portfolio! You can get a foothold for under $100,000.

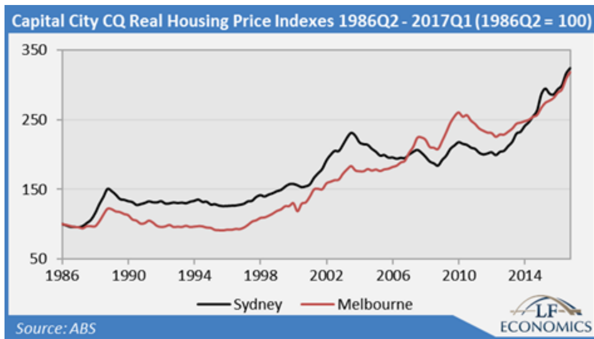
There are significant risks investing overseas of course. I'll write more about that in another edition of *CT&F*. (Or you can contact me directly for a chat.)

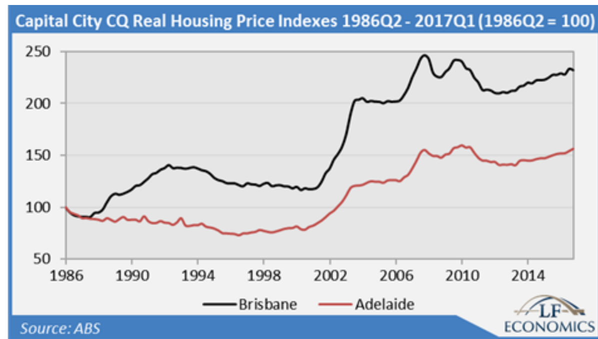
But back to Australia.

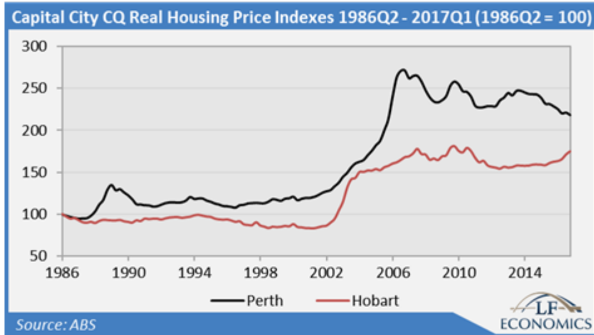
In terms of capital growth, Australia — Melbourne and Sydney specifically — cannot be rivalled.

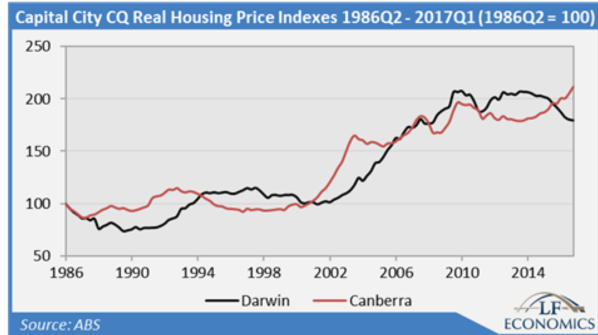
In every real estate cycle Australia has witnessed, Melbourne and Sydney have consistently experienced the greatest gains over the course of the cycle.

But Melbourne is still the winner.









Source: LF Economics

This doesn't mean you can't benefit from investing in the other states. You can.

But Melbourne offers the best opportunities in terms of capital growth. (And, as a consequence, the worst for rental yields.)

But more on that later.

Australia is merely a teenager compared to Europe and the US.

It has a small and rapidly growing population with limited serviceable land.

Australia's population growth is faster than India or Indonesia for example.

Most overseas migration floods into Sydney — followed closely by Melbourne. However, Melbourne benefits from Sydney's high prices, by gaining the most people in interstate migration.

This is one reason Sydney consistently peaks early in the cycle and plateaus: high real estate prices and a landscape that is not conducive to sprawl.

Meanwhile, Victoria is adding more than 2800 people per week to its population. It has also picked up interstate migration from Perth due to the (prior) mining downturn.

Incidentally, Perth is an area I have my eye on. There could be lucrative opportunities in the second half of the cycle. I will write about that in a future issue.

Back to Melbourne.

At this rate, Melbourne's population will surpass five million by 2020.

Additionally, we have a tax environment in Australia that adds significant volatility to the cycle. Negative gearing, halving of capital gains tax for investors, first home-buyer benefits such as elimination of stamp duty, or generous grants...

And ongoing debates about allowing first home buyers to dip into their super.

Banking innovations such as crowd funding for mortgages (and the list goes on), I think, ensures there will be plenty more fuel to throw at the fire to keep the cycle ticking along.

As for affordability…

And to be clear, for all the talk about affordability in the coming election, no government will let land prices drop significantly on their watch.

Allowing land prices to drop is the only way to create affordable housing. However, to do so would invite a financial crisis to a highly leveraged banking system. This is why the debate only tinkers at the edges.

You can read more about my opinion on that in The Cashmore Files.

As part of my role as President of Prosper Australia, I spend a significant amount of time talking to policy makers about reforms such a replacing stamp duty with land tax.

The economics of the switch is never in question. It makes sense.

Stamp duty is a terrible tax. It acts as an incentive to 'stay put'. The more often a homeowner sells one property and purchases another — the more tax they will pay.

In an age where job mobility is essential to long-term employment, stamp duty should have been abolished years ago.

However, if it were stripped away completely without imposing a land tax, house and land prices would absorb the gains and real estate would be no cheaper.

That's exactly what happened in New Zealand in 1999, when the government removed stamp duty and replaced it with a GST. You can read about New Zealand in previous reports I have written. The boom in prices was, and has been, significant for New Zealand.

Regardless, selling affordable policies to an Australian public that has been breastfed (in a supportive tax environment), on the notion that the way to gain wealth is to speculate on rising land values, is not easy!

Especially if you want a second term.

Hence why these types of policy reforms never gain traction. So, the boom continues — at least until 2026.

Policies promoted under the guise of affordability (such as first home buyer grants) will be imposed.

Banks will continue to commit acts of fraud — such as those already uncovered in the Royal Commission.

Phil's book 'The Secret Life of Real Estate and Banking' (which you all should have read by now if you're serious about investing in real estate) makes this clear.

My message to you is to become a rentier, not a renter. The system dictates this — and you would be wise to take advantage of it.

The capital growth king

I know of only a small handful of cities that can present the same capital growth opportunities that Melbourne has to offer.

Let me give you a few examples

In May 2016 I purchased a house for an investor 12km north of Melbourne's CBD in Glenroy for $480,000. We secured the deal off market, although still faced competition from other buyers that the sales agent had informed.

Sitting on around 650 sqm of land, the home was in original weatherboard condition — with an estimated rental of $350 per week.

By January 2017 (7 months later) the home (or more accurately, land — the house was worth little) was revalued in excess of $600,000.

Using the equity, we purchased another property for the investor 15km west of the city (Sunshine West) for $620,000. Twelve months later, the price had appreciated over $100,000.

These suburbs — and others I will mention below — still have a stigma over them. They are areas traditionally thought of as undesirable — 'poor suburbs'.

However, if you haven't visited recently, then you will not be aware of the gentrification that has occurred. Gentrification that has pushed some results — renovated houses or larger blocks of land — well over $1,000,000.

Another example.

In September 2016 I purchased a house on 670 sqm of land, 17km north of Melbourne's CBD in Lalor for an overseas investor.

The appraised rental was $400–$420 per week.

We negotiated an off-market deal at $620,000. Today (April 2018), the same block is worth over $900,000.

Nothing has been done to the home.

It's simply an example of the real estate boom that is occurring on select land blocks in Melbourne — and I can site numerous case studies.

Another example.

A client of mine purchased a home in Braybrook (9km west of Melbourne's CBD) in 2002 for $220,000

The property — a rundown weatherboard — sits on 580 sqm with good development potential. The block is not walking distance to the train station. But in a good location for local schools and shopping facilities.

Over the ten-year period, the owner did nothing to the property aside from add a few solar panels to the roof. We sold the home for him mid last year for $730,000.

Land values on select blocks of land have not doubled in the last 10 years or so (as is so often spruiked).

They have tripled!

I have not witnessed similar rises on any other type of property investment. Not double story townhouses, and certainly not apartments. (Although inner ring Sydney, due to its geographical constraints, can offer some exceptions to the rule.)

As I've mentioned previously, you have to be very careful when purchasing apartments due to the rapid supply coming onto the market.

Apartments are not necessarily a bad investment altogether. They are good for balancing a portfolio that requires a better yielding investment. You just have to be careful, that's all.

I laid out clearly in The Cashmore Files why this is the case. But here's just a quick example.

I'm currently assisting in an investor's sale of a two bedroom apartment in Melbourne's St Kilda East — 6km from Melbourne's CBD.

It's a 1970s building with 15 units in the block. The property was purchased in 1988 for $70,000.

It's recently been valued at $420,000.

Over the last ten years it has appreciated roughly $50,000. Over the lifetime of the investment, its capital growth has not exceeded 6% per annum.

Had the investor chosen to purchase a house on a block of land in 1988, a few suburbs out for the same amount of money, Clayton for example, 19km south east of Melbourne's CBD, this investment would be worth well over $1,000,000 now.

If you're going to invest in Australia — and you want to maximise capital growth — buy well-located land in Melbourne.

But this issue is not only just about capital growth. It's also about how you can make a lot of money, in a short period of time. The key to doing that is to develop!

The winners of the current real estate cycle are…

The advantage of land is that you can do SO much with it.

Unlike cities in Europe, we have only just started to infill our suburbs with smaller subdivisions and apartment blocks.

Roughly three years ago, the Victorian government rezoned Melbourne to allow for this. They — the urban planners and government — decided we no longer wanted 'sprawl', and placed a permanent urban boundary some distance around Melbourne's greater metropolitan area.

Most of the land within the urban boundary was quickly purchased — via options — by Melbourne's biggest housing development companies. They hold around 14–16 years' land supply.

It'll be drip fed onto the market in 'staged releases' to maintain prices. And typically in small subdivisions of around 350sqm. Not the 600sqm + subdivisions that are still available in the middle ring suburbs of Melbourne.

Consequently, for the first time in Melbourne's history, we are building more up, than out.

Following the rezoning, some owners, sitting on suburban land blocks, won fabulous windfall gains. Those that had purchased close to rail lines or on main roads prior to the rezoning, suddenly found themselves in 'Activity Zones' or 'Residential growth zones', allowing for construction of 4–8 story (or more) apartment blocks in some circumstances.

The land value immediately appreciated 10–20%.

Other blocks fell into Neighbourhood Residential Zones. Stricter development conditions applied. However, potential to split the block into two, or build behind the existing home, still saw opportunities to profit.

Rapid subdivision followed.

And now the only thing disappearing in Melbourne is land — unbroken blocks of land.

The owners of the land are benefiting from capital growth. But the ones really maximising their profits are Melbourne's savvy developers.

An example.

My team purchased a property for a client 18 months ago in a south eastern coastal suburb of Melbourne, prior to auction, for $1,000,000 on a 12 month settlement.

The property sits on a circa 600 sqm block of land, with the existing home far enough forward to allow for construction at the rear. The cost of renovating the existing home and building a new 4 bedroom townhouse at the rear totalled around $400,000.

Upon competition, the project was valued at $2.1 million. A 30%+ return on the initial investment.

The investor now has numerous options. If he rents out both properties, with depreciation included, he will cover his loan repayments. The end value of the block allows him to draw on equity and invest elsewhere.

If desired, he can live in one of the properties and rent or sell the second…

Of course, even if he had done nothing at all to the block, he would have benefited from over 10% capital growth for the period held.

You don't need to have a lot of money to develop. You can do it too. And I can certainly help you get started.

Of course, if you are already sitting on a block of land, you don't have to purchase another.

The previous owner of the above property could have done it alone, by borrowing against the equity in the home and developing the backyard!

Another client of mine went one step further.

He owned a home on 600 sqm of land. His principal place of residence was valued at $550,000. He gained approval for the construction of three dwellings.

Total cost of construction was $600,000.

The process took around 18 months.

Following construction, the value is now $1,520,000 and he has a positive rental return.

Another example.

Last year we purchased a block of land in a beachside suburb 31km southeast of Melbourne that is tightly held and well facilitated. We paid $985,000 for the block. The developer is constructing a mid-rise block of apartments.

Life-changing profits

The total cost of construction (including development approval) is circa $2.2 million. Once completed, the assessed end value will be in excess of $5.1 million.

That's a potential 300%+ profit on the initial cash investment.

Of course, if it were easy, everyone would be doing it. Believe me — many are! But not all are profiting.

The profit is really in the buying.

And there's nothing more rewarding for me than seeing people come out with life changing profits.

Additionally, it never ceases to amaze me how real estate sales agents neglect to check the details of the zoning specifications, prior to appraising a listing and promising the vendor big profits.

For example, take two neighbouring properties on a similar land size in an 'Activity Growth Zone'.

It may not be immediately evident that one allows construction of up to four stories, another eight stories. The devil really is in the detail. This is why one of the most valuable members of my team is the developer Stephen Fries.

You can read some of Stephen's comments here in an interview he did for *CT&F* a few years ago.

Of course, knowledge of the cycle is vital.

Knowing where to buy and the timing of those investments is vital as well.

And the media is always behind the eight ball. As with the stock market, the insiders (usually the developers) know where the gains are likely to be made before anyone else.

For example, the REIV (Real Estate Institute of Victoria) named Epping as one of the suburbs to 'watch' this year. However, they were too late! The median price in the suburb appreciated more than 20% in 2017.

I targeted Epping in 2015.

Investors got in ahead of the crowd and are already reaping rewards. I can name a dozen other suburbs that are doing the same.

How much do you need? Not as much as you may think.

Most investors have $600,000–$800,000 to spend, however, you can do it for less.

There are areas of Melbourne that have experienced rapid gains over the past six months, which still offer homes on sub-dividable blocks for around $500,000.

If you have less — regional areas such as Geelong and Ballarat are also experiencing their own mini boom in development, subdivision, and capital growth. Once again — knowing where to buy is the key.

Of course, the major disadvantage of capital growth is that rents can't keep pace.

Put simply — you can borrow to buy, but you cannot borrow to rent.

Rents are tied to wages and additionally affected by current vacancy rates.

Yields are less than 3% gross in some cases. Until property prices moderate, demand falls, construction slows, and vacancy rates tighten, rents are unlikely to improve markedly. This is actually happening now — so rents should rise over the next 12 months.

For those doing a development, following completion, investors often find themselves positively geared.

However, if you are investing in an old house on a block of land, the low rents will eat into your cash flow. Hence why it is important to balance your portfolio with listings that are not all negatively geared.

If you haven't taken the plunge and invested in real estate — seriously, now is the time!

There are many options for all budgets.

In future editions of *CT&F* I'll share more tips.

However, if you're currently thinking about it call me for a friendly chat. I'm always excited to talk to *Cycles, Trends & Forecast* subscribers and share a few hints about getting started.

Best of luck with your investments!

Note the Marquis de Maussabre may have blown up his house, but he kept the land.

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Please note, any property advice should seek to know a client's personal circumstances. Talk to an independent broker before committing to any property investment.

How you could bank a potential 2,880% gain from a revolutionary tech innovation one in-house expert describes as: *'a combination of iTunes, Amazon and PayPal ON STEROIDS.'*

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