PROPERTY VS SHARES VS CASH
Why property still trumps other asset classes

THE BEST MISTAKE I EVER MADE
Investors reveal how they turned mistakes into huge profits

SELLING IN A BUYER'S MARKET
Why now might be the right time to sell a poor asset

INTELLIGENCE REPORT
SUBURBS SET TO BOOM!

your investment
property

April 2012

yourinvestmentpropertymag.com.au

$9.95 (GST incl.)

9 771834 583007

$9.95 (GST incl.)

REAL LIFE!

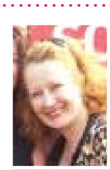
RAGS TO RICHES

Inspirational Aussie investors tell how they beat adversity to succeed

Gina Lednyak
Self-employed new migrant beat bank's strict rules and made $55k in equity in just four weeks

Monique Ledden
Started on $46k income to amass six properties worth $3.5m on her own

Mark Frew
Broke and suddenly single: still built $1.1m cash flow positive portfolio in less than two years



Cleo Glyde
Savvy single mum cashed in on unwanted properties and reaped double-digit reno profits

PLUS

INTELLIGENCE REPORT: SUBURBS SET TO BOOM

NSW | VIC | QLD | WA | SA | NT | ACT | TAS

106 Suburbs that have bottomed out and are set to rise

- In-depth analysis
- Recovery indicators
- Best streets
- Units and houses
- Discount rates
- Priced from $200k

FAST-TRACK YOUR RESEARCH
Insider secrets to spotting a boom suburb revealed!

TAX: 6 THINGS YOU MUST CLAIM TO BOOST YOUR SAVINGS

Statistical vs fundamental research

When identifying locations to invest, an investor undertakes two types of research: statistical research and fundamental research. Each has its own merits and shortcomings. So when should one use statistical research and when fundamental? *Jeremy Sheppard* explains

At the risk of sounding repetitive, some investors need to be reminded that there are only two factors affecting price change: demand and supply. Prices will rise if demand is high relative to supply. As property investors we want to find markets to buy into that have a high demand to supply ratio. But what affects demand and supply? What causes these to change?

Fundamentals

The fundamentals affecting changes in demand for a market might include:

- new roads
- new bridges
- new railways
- new shopping centres
- new schools
- new universities
- new hospitals
- new businesses
- government departments relocating

The underlying fundamentals affecting changes in supply of property in a market might include developments such as:

- new housing estates
- new subdivisions of land
- increases in dwelling density like demolishing houses and building new duplexes, villas, town houses and apartments

These events are the basis for triggering changes in supply and demand that eventually affect prices. The magnitude of changes in price will depend on the degree of imbalance between the supply of property from sellers relative to the demand from buyers.

What is 'short-listing'?

Shortlisting is the process of finding some markets that have potential for capital growth. The idea is to target where more in-depth and time-consuming research is to be performed. Locations can be shortlisted from:

- reviews in this magazine
- expert recommendations and paid publications
- online searches for locations with positive fundamental changes
- respected friends and family who mention a location with promise

Statistics

I use the DSR – Demand to Supply Ratio – to create my shortlist. See the data section at the back of this magazine for a sample of this figure.

I don't use any of the fundamentals when searching for potential hot spots to put on my shortlist. Instead, I use these fundamentals to verify the potential hot spots once I already have my shortlist. That is, I use the fundamentals to confirm if a potential hot spot does indeed have great prospects for capital growth in the immediate future.

The reason why I ignore the fundamentals initially is because they can't be easily used to compare many suburbs. I want to invest in the best location in all of Australia. I don't want something that is good enough – I want the best. That means comparing all suburbs around Australia – about 15,000 of them.

Fundamental problems

Fundamentals have their place in the whole research procedure, but that place is not in the early stages of shortlisting. There are a number of problems with using fundamentals to find your short-list of potential hot spots:

1 Fundamental searches are time-consuming

Ideally, you'd like to open your favourite search engine and enter the suburb name and then one-by-one all the fundamental terms such as:

- O'Sullivan Beach new school
- O'Sullivan Beach new hospital
- O'Sullivan Beach new businesses
- O'Sullivan Beach new roads

And then you'd pop on to various government websites including the local council to see what infrastructure projects and developments are planned or underway. You'd also check out some of the better known large private enterprises to see what they're doing. Perhaps Gloria Jean's is opening a new cafe. Perhaps BHP is expanding a mine. Perhaps Westfield is opening a new shopping centre, etc.

With 15,000 suburbs and literally dozens of fundamental search terms, that equates to a lot of 'Googling'. But if it were possible to research all of that, you'd be able to compare suburb against suburb for the best fundamentals for demand. Now all you have to do is repeat that again for supply fundamentals.

As you can see, comparing suburb against suburb using fundamental research of this nature is simply not possible with so many locations Australia-wide.

A second option, which makes more sense, is to enter the fundamental search term one-by-one and see where the infrastructure is being introduced, like:

- new school
- new hospital
- new road

This means only entering a few dozen search terms. But there may be literally thousands of suburbs with new small businesses that are starting up right now. Google will only show the most prominent ones like large franchises that have hit the news headlines.

What about a suburb that has had a new accounting practice start up along with a new solicitor, a new real estate agent, a new cafe, a new electrician, a plumber, etc all in the last six months. A suburb like this might not appear in these types of Google searches.

This method is a little 'hit and miss' but at least it's more targeted than the first method. You would have to treat this like a full-time job to have enough information to claim you've found the best location in the whole country.

2 Fundamentals aren't objective

Although I believe it is time well spent visiting a location before buying, I don't believe many property investors use what they see well. Many will try to get a 'feel' for the location. This has little to do with price changes in the future.

How you feel about a location has more to do with your biases from your upbringing and preferences or whether you're tired, ate too much, or someone cut you off in traffic. These feelings will have no effect on the property market.

Objectivity is crucial for investors. You can't guess that a market has growth potential. You need to know it. Subjectivity creeps into our thinking with statements like, "I have a good feeling about that town". If you find yourself saying things like that, you need to do more objective research.

3 Fundamentals aren't quantitative

OK, so the suburb you're researching is going to get a bridge across the river cutting travel time to the other side by 10 minutes. All of a sudden the properties on the other side are now 10 minutes closer. That means there is a good chance they will increase in value. By how much do you think?

In another suburb there is a new school being built. That suburb really needed one too. Families will find the location more attractive now. That means there is a good chance that properties in this suburb will increase in value. By how much?

Which suburb has the greater potential for capital growth? It is very hard to quantitatively say that fundamental 'A' is better than fundamental 'B' by 20%.

4 Timing the response to fundamentals is difficult

Imagine a massive shopping centre is proposed for a suburb. You'd be right in assuming this will have an effect on property prices, but when? Will the project even get the green light? Will approval be held up by council or some environment court? Will construction be delayed? When will it be completed?

The most important question here is: when will this fundamental change to the suburb start to affect demand and supply of property? The answer is: we don't know. Two years can be a long time to hang on to a negatively geared property waiting to see some price growth.

5 Fundamentals can miss opportunities

Quite often I find statistics that suggest a suburb is hot, but there's very little I can find in terms of fundamentals like a new shopping centre or school or infrastructure, etc. Perhaps it took a while for these fundamental events to take effect and since they occurred quite some time ago they may no longer appear in online searches, especially with the word 'new'.

Sometimes markets can reach a state of imbalance in terms of supply and demand without any infrastructure or special economic activity. Some markets can be quietly ignored for many years until they appear to be really good value compared to neighbouring suburbs. This is the ripple effect. Googling fundamental research terms will not uncover these types of markets.

As you can see there are some problems with fundamental research. However, I wouldn't for a second suggest you ignore them. On the contrary, you need to be exhaustive in your fundamental research – all the more reason to limit it to a short list of suburbs that have great potential.

Statistics to the rescue

I use statistics rather than fundamentals in my early phases of researching. Statistics don't precisely correlate to the underlying fundamentals. Instead, statistics correlate to the changes to demand and supply. Since that's really what we're after, the stats should actually be more important than the fundamentals initially.

Stats can help with all four of the problems mentioned earlier:

1 Country-wide stats are readily available

You can get all sorts of figures for the entire country from the back of this magazine and some other websites. Also, there are some data providers that collect this kind of data and make it available, although usually for a small fee.

The easy availability of property statistics make comparisons of property markets across the country possible and using a like-for-like method too.

2 Stats are objective

A statistic has no emotional bias in how it was derived. A statistic is not guesswork, it is a repeatable independent calculation based on maths that doesn't change depending on whether we're grumpy or not.

3 Stats are quantitative

Contrast an auction clearance rate (ACR) of 72% in suburb A with one of 67% in suburb B. You immediately know which suburb has better supply and demand qualities (at least for auctions anyway). And more to the point, you know that suburb A has a higher ACR to suburb B by 5%.

Statistics are quantitative in nature and that gives investors a lot in terms of making accurate investment decisions. You can now easily compare one suburb's stats against another. You'll not only know which is better, but by how much.

4 Stats give good timing indicators

Stats show the state of the market in terms of supply and demand right now. That is, they show how buyers and sellers are responding to the changes in the fundamentals. If there was any doubt about what a change in some infrastructure would have on the market, it is evidenced by the stats.

Now you may think that the stats might be a bit behind the eight-ball. That is, the fundamentals change the market's supply and demand and the stats are then recorded and we investors hear about it too late. That is dead wrong.

Firstly, property markets move a lot more slowly than many people realise. It takes a lot of thought before buyers make a decision to buy a property. It takes time to arrange finance.

Secondly, it takes a long time for markets that are out of balance to re-balance. If demand exceeds supply, it takes a long time for prices to rise, for example, and to subdue demand. Similarly, it takes a long time for more dwellings to be constructed to rectify a demand shortage and restore balance.

If the statistics you're viewing measure the imbalance between supply and demand, you're effectively measuring when and for how long it will take the market to re-balance. You want to find locations with the greatest imbalance to maximise the pressure on price change and maximise the period of growth.

So the stats can actually give an indication of the timing of when prices will change where fundamentals couldn't. And similarly, the stats can indicate by how much prices have to grow to restore demand to match supply.

Problems with stats

If there's one thing against stats, it's statistical anomalies. I remember receiving an email years ago from an online search portal. They were offering a free report on the top 10 locations in the country by yield. I performed some very rudimentary research starting with the first market at the top of the list. I wanted to see if rents and prices matched the yield quoted. Some of the yields were in the double-digits.

I checked the properties currently for rent and for sale. I tried to get a quick idea of what a typical dwelling might cost and rent for. The yield was less than half of that quoted. So I moved on to number two, same story. After getting down to number eight on the list I gave up. Every single market's yield was a statistical anomaly. There wasn't a single one with a yield greater than about 5.5%.

Think about this: if there is a statistic for 15,000 localities in Australia and only 1% of these suffer from statistical anomaly, then the top 150 are all statistical anomalies.

But what are the chances of the same suburb having five different statistics and all five are anomalies? This would be much less than 1%. This is why it is so important to compare a large range of different stats. In fact, getting stats from multiple providers can be helpful here in averaging out such anomalies.

Verifying

So when do you use your fundamental research skills? This comes into play when you have a small set of suburbs to research, like a few dozen at most.

Along with performing a sanity check on the stats, you can also look for fundamental indicators to confirm or deny what the stats are suggesting.

Jeremy Sheppard is director of research for DSR Data and a keen property investor. He created the Demand-to-Supply Ratio (DSR) and is the author of How to Find Property Hotspots. visit www.DSRdata.com.au