

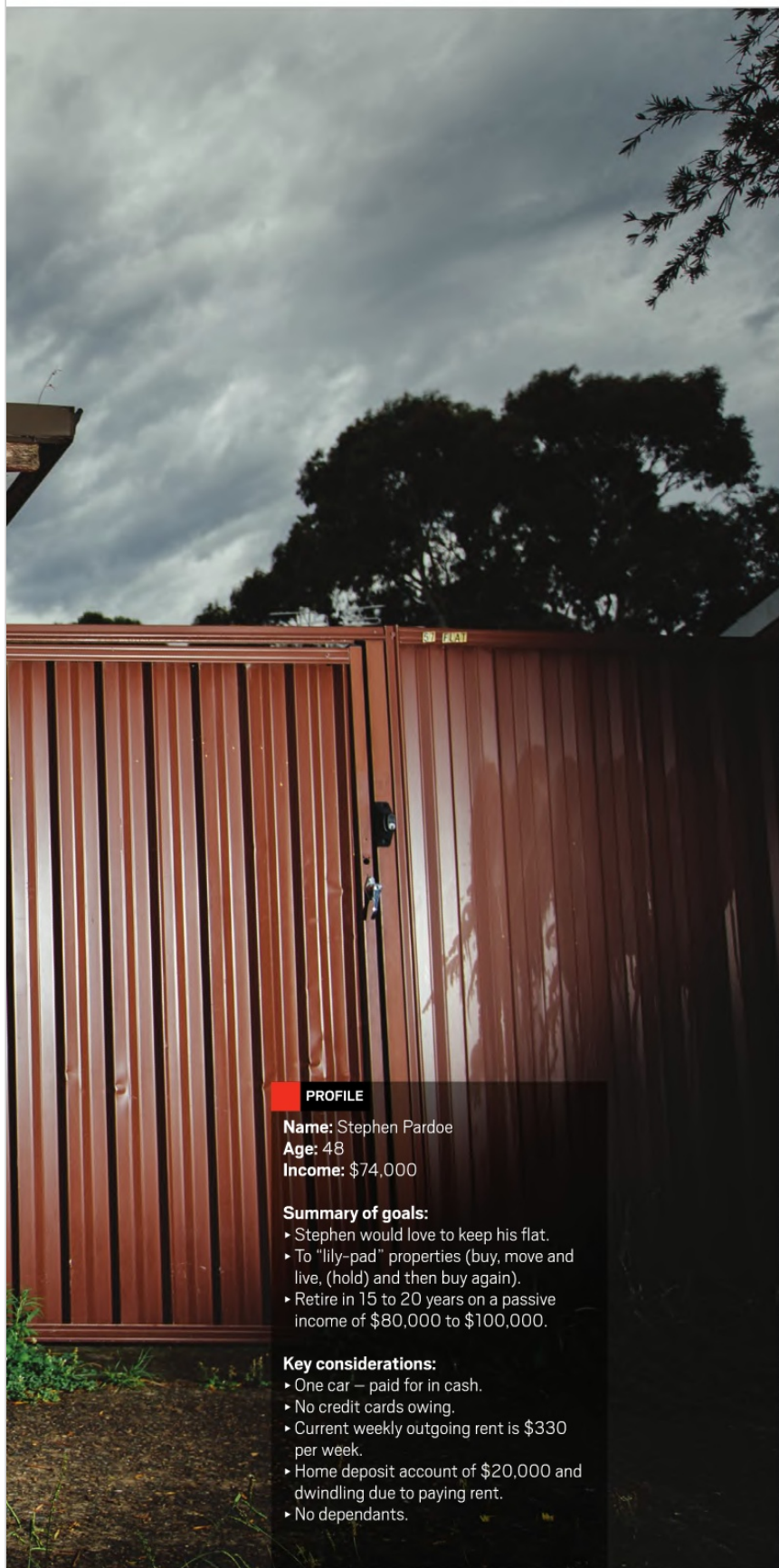
FORK IN THE ROAD ■ Stephen Pardoe

EYES ON THE PRIZE

Stephen Pardoe wants to multiply his one property into a successful portfolio but is unsure where to start. **DINAH LEWIS BOUCHER** [[@DinahBoucher](#)]

“In a perfect world I’d like to lily-pad properties.”

STEPHEN PARDOE

**PROFILE****Name:** Stephen Pardoe**Age:** 48**Income:** \$74,000**Summary of goals:**

- ▶ Stephen would love to keep his flat.
- ▶ To “lily-pad” properties (buy, move and live, (hold) and then buy again).
- ▶ Retire in 15 to 20 years on a passive income of \$80,000 to \$100,000.

Key considerations:

- ▶ One car – paid for in cash.
- ▶ No credit cards owing.
- ▶ Current weekly outgoing rent is \$330 per week.
- ▶ Home deposit account of \$20,000 and dwindling due to paying rent.
- ▶ No dependants.

Stephen is an eligible bachelor who, like many, has found himself a bit stuck since a relationship breakup. After recently separating from his fiancée he’s also still picking up the pieces from his broken property investment plans.

Stephen owns a two-bedroom unit in Hornsby, an upper North Shore suburb approximately 25 kilometres from Sydney’s CBD.

He purchased the property in 2008 but the new home wasn’t the only thing he found that year.

“I also met and became engaged to one of the other owners in the building,” he explains.

The couple’s original property plan together was to rent out both their Hornsby flats and move in together much closer to his fiancée’s workplace. They’d combine their incomes and use both units as collateral to secure a third property that would be their principal place of residence (PPOR).

While these shared plans went astray when the relationship ended, Stephen’s property ambitions are still intact, he’s just not sure of the best way forward.

MOVING ON AND OUT

“After confirming the relationship was over, I left my flat,” he says.

Stephen put his home up for rent and moved in with his parents initially, before finding a spot to call his own.

“It’s not a dogbox but a converted garage in Illawarra right next to the railway line.”

Stephen says he’s a railway enthusiast, so the proximity to the train line isn’t a deal-breaker.

He’s also very pleased his Hornsby property has experienced some healthy equity growth since its original purchase price.

“In the seven years I’ve owned it I’ve

FORK IN THE ROAD ■ Stephen Pardoe

managed to get the mortgage down to \$247,000," he says.

■ LILY PADS

Stephen's ideal property acquisition strategy involves a leapfrog-type approach, with a fitting title.

"In a perfect world I'd like to 'lily-pad' properties," he says.

Stephen describes this process as living in and owning one property then renting it out and buying another one to live in, then renting that out, then another and another, thus repeating the "lily-pad" process.

For now, however, Stephen says the main villain in the story is cash flow – or the lack of it.

While he receives \$435 per week rent for his Hornsby flat, he's paying \$330 a week to rent the Illawarra converted garage, and he'd rather be putting that money towards a deposit.

Ideally, he'd like to keep his unit, but Stephen feels financially pressured to sell it and release some of that built-up equity to enable the next property purchase.

"If I do sell then I can make a re-start, but if I don't sell then it looks like I should budget for permanent renting," he says.

"Now that I'm single again, my bank will currently allow \$350,000 for a second mortgage."

In the short term, Stephen says he simply doesn't want to run out of money, and considering he's living in a converted garage, he'd absolutely love some storage space as soon as possible.

■ KEY QUESTIONS FOR EXPERTS

Turning to our trusty experts, what plan can Stephen put in place to achieve his goal of retiring in 15 to 20 years?

He's open to advice on the best way forward, and would like to know:

- ▶ If he decides to sell the Hornsby property and get another mortgage, should he try to buy two smaller properties – one to rent and one to live?
- ▶ Would it be advantageous if the second, rental property was in an area set for retirement later?
- ▶ In what areas would you recommend buying two smaller properties?
- ▶ Is there any other way to increase the amount available to him as a second mortgage?
- ▶ Is there any advantage in permanently renting while owning a property?

WALTER NANNI
Cohen Handler



Firstly, Stephen, good on you for buying a property back in 2008, as it's served you really well with some equity, as well as getting your mortgage down by \$70,000. So, all things aside you're in a healthy financial position in that you're sitting on approximately \$373,000-worth of equity, have no other debts or credit cards, have \$20,000 in savings and have an income of \$74,000 per annum (not to mention that you're keeping your living expenses down to \$330 per week or \$17,000 per annum). Well done.

You've laid a really good foundation for yourself, although you mentioned your savings are dwindling (which they shouldn't be as you're not bleeding anywhere, as your current mortgage of \$247,000 should only be costing you approximately \$1,450 per month, or \$17,400 per annum) compared to your rent of \$330 per week or \$22,620 annually. So, you should be cash flow positive with your property even after rates and expenses.

Which brings me to the main point – don't sell it. Let me say that again – don't sell it! Selling a property (unless it's for

other reasons I don't know about) sets you back in the scheme of things and your main driver is to own a property portfolio. You'll lose a lot of your equity by selling as it has many expenses and given that you've lived in the property, you'd be better off using this equity for now. I understand that you're keen on getting more storage as well, but don't confuse this need with the need to sell your only asset. Consider solving your storage problems another way.

Your bank would lend you a lot more if you were buying another investment property (instead of buying a property to live in, as you'll receive rental income on it). In fact, my broker tells me you should be able to get a loan for around \$600,000. Part of the strategy you should also consider is to convert your loan over to an interest-only one, which will get your repayments down to \$1,030 per month, or \$12,360 per annum, giving you the cash flow to buy and renovate properties and really build your portfolio.

Let's also quickly talk about building a portfolio and helping you achieve your goals of retiring in 15 to 20 years on \$100,000 per annum, a subject close to home as I've been on that myself for the past 10 years and own nine properties,

“You'll need to own five properties outright in order to achieve \$100,000 per annum of income.”

WALTER NANNI

THE NUMBERS | STEPHEN PARDOE

| Location | Description | Purchase date | Purchase price | Current value | Loan on property | Rent per week |
|-----------------|--------------------|---------------|----------------|---------------|------------------|---------------|
| Hornsby, Sydney | 2-bed, 1-bath unit | Nov 2008 | \$318,000 | \$620,000 | \$247,000 | \$435 |

soon to be 10, and love to help others do the same.

Firstly, it's OK to pay down your mortgage when you live there as it's your principal place of residence (PPOR), so you're literally paying down your home for 25 years. It's a typical story for many Australians. This strategy changes if you want to play the property portfolio game. Then, it's more about holding properties on an interest-only scenario (unless you can afford to do both) and building an empire that relies on capital growth (by cyclical changes in the markets as well as fabricated by renovating) as you proved it by making a \$300,000 gain versus a \$70,000 dent in your mortgage.

You'll need to own five properties outright in order to achieve \$100,000 per annum of income (one property to live in and four to provide you with \$25,000 each). You'll actually need to purchase around 10 properties in total (double it

and renovate, then play the waiting game for one to two cycles that happen every seven to 10 years whereby properties double in price. Ultimately you can sell down half to pay off the other half when you're ready to retire (instead of paying down loans yourself).

You could live in some of these properties and even "leapfrog" and use them as lily pads if you wanted to, but I'd suggest it'd be more sensible to renovate them while you're there and then move onto the next one when you can afford to go again, or back into your rental property.

I'd suggest you buy your next property in the best possible area you can, depending on your budget. Blue-ribbon areas are the best for capital growth but you may not be able to buy there, so do the best you can.

Always buy in areas that are already established, have a brand and are in demand for both rentals and sales.

CATE BAKOS
Cate Bakos Property



First, I had to analyse Stephen's current lending situation. His appetite for reducing risk and exposure to volatility is evident in his move to take on a fixed loan, however by doing so he has eliminated his offset opportunity.

His original loan amount was \$318,000 at the time of purchase (indicating that he borrowed on a high loan-to-value ratio (LVR) and took on mortgage insurance), but between the purchase date in 2008 and now, he's managed to accumulate savings and, unfortunately, by reducing his loan to \$247,000, he has paid down his debt and reduced this deductible debt.

An alternative could've been a fixed portion of the loan, with an amount remaining as variable in order to maximise his deductible interest level and offset account usage. Offset is

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“Stephen’s financial position remains optimal if he can rent-while-investing, as his tax-deductibility position places him (cash flow-wise) in front.”

CATE BAKOS

entirely appropriate for investors who are renting or owners who wish to “lily-pad” off the property and convert it later into an investment property.

Although Stephen has lost some of his deductibility through this move, I still don’t recommend he sell the property for three reasons:

Firstly, Hornsby is a great area with good growth prospects, and this apartment in the boutique development and near to local amenity sounds like he chose well (obviously more assessment would be required to specifically talk about this property in closer detail).

Secondly, the entry and exit costs associated with selling it down and re-purchasing a similar asset will negate the gain he’d experience with the tax deductions, because stamp duty, agent’s selling fees, legals and mortgage exit (particularly on a fixed loan) will be higher than the potential upside gains.

Finally, Stephen is about to potentially embark on a negatively geared property as his “more-rapid-equity-creator” and he’ll capture back his tax gains along the way with that move. I note that tax gains shouldn’t be a motivator, however in the case of a growth-asset with negative cash flow, the tax deductions are a welcome relief at tax time for many investors.

Based on principal and interest (P&I) repayments, an estimated fixed interest rate of five per cent and paying Hornsby down over a 30-year loan term, the monthly repayments I calculated are \$1,326. For the purpose of keeping this simple I’ve kept this loan as fixed and P&I throughout.

Taking into account Stephen’s risk profile, his earnings (and basing my proposed strategy on his unsecured debt position and dependants situation not changing), I’ve mapped out a plan to retain Hornsby, keep renting in his garage for another two years if he can, and to make his boldest move his second property acquisition.

By doing this, I’m planning for his

EXPERTS’ SUGGESTIONS IN A NUTSHELL

Walter Nanni

- ▶ Convert your loan to interest-only to reduce repayments and increase cash flow.
- ▶ Stay renting and keep your costs down.
- ▶ Don’t sell the Hornsby home! Instead, increase your borrowing power by renovating it.
- ▶ Own five properties outright to achieve \$100,000 income per annum.
- ▶ Purchase 10 properties in total, renovate and play the waiting game.
- ▶ Sell half of the portfolio to pay off the other half.

Cate Bakos

- ▶ Don’t sell the Hornsby home.
- ▶ Keep renting for two more years.
- ▶ The second purchase: look for a well located, four-bedroom home at 4.5 per cent yield.
- ▶ Cate’s detailed 15-year property plan will generate a gross income of \$95,000 per annum.



2031: See Cate’s 15-year property plan.

Tap or click this button or visit scan.me/mjppnxq to see more details of Cate Bakos’ response.

equity-generation to be as maximised as possible in an effort for him to then continue to purchase more moderately priced, cash flow neutral assets, which will be his income-generating properties to lead him into retirement on his desired passive income.

The twist is that I’ll recommend Stephen lives in his higher-priced, equity-generating property for at least

a year in order to claim it as his PPOR, because in due course he’ll need to sell it down, take the gain, extinguish all debt and re-purchase one more stable cash flow property to seal his portfolio and then enjoy his retirement.

Stephen’s “lily pad” idea is a great start and it’ll be useful in particular for the higher-priced property number two, however he won’t need to lily-pad onto the others during this time, as they’ll be buy-and-hold assets in diversified (interstate) areas, which he won’t ever need to claim as PPORs and he won’t need to sell them down at any point. The rationale behind this strategy is for Stephen’s rental to slowly grow over the years and for him to engineer a plan for each property to be paid down in full into retirement.

Obviously Stephen would prefer to upgrade his current living conditions – and he certainly will be able to. I’ve modelled a rental upgrade from \$330 per week to \$450 per week at year three.

Stephen’s financial position remains optimal if he can rent-while-investing, as his tax-deductibility position places him (cash flow-wise) in front.

Even upon retirement, when he will have a taxable income of a similar level due to his incoming rents, Stephen will still benefit from renting while he invests – however if he chooses to move into his own PPOR at the end, he’d be able to do so with a much lower LVR loan.

Obviously, the implication is that he’d reduce his surplus income with the burden of a small mortgage but it would still be possible for him to borrow based on his rental income. **API**

Do you have your own Fork in the Road? Email editor@apimagazine.com.au to ask API’s experts for advice.

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