6 IMPORTANT WAYS TO MITIGATE RISK WHEN INVESTING IN PROPERTY.

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INTRODUCTION

There is a real difference between a successful property investor and an off-the-shelf speculator masquerading as an investor. For the most part, the former analyses the inherent risks involved in property investing and prepares for the future, while the latter skips the hard yards (research and relationship building) follows hypes, jumps in, buys any old available property and hopes its value goes up later.

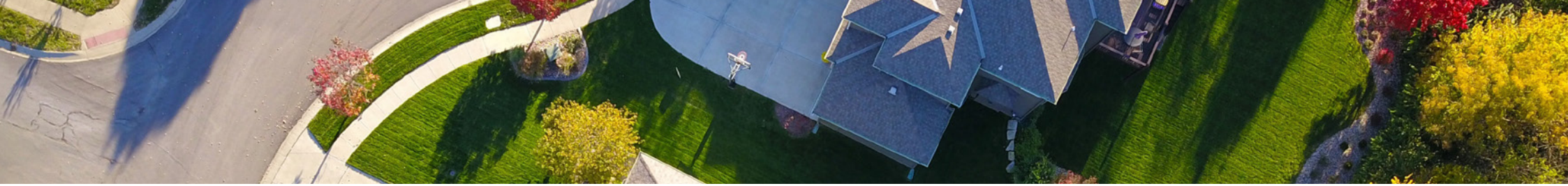
Property investing, just like any other type of investment has its own risks, and these risks often tend to prevent people from investing in properties. If you understand these risks and know how to mitigate them, you will improve your chances of making profits from your property investments.

Usually, people's investment risk appetite is often dependent on many factors including age, financial situation, experience as well as their personal circumstances. For instance, someone who is almost at the verge of retiring will have an investment risk appetite different from that of a young adult who is just dabbling into the investment space newly. So, one of the ways of mitigating risks when investing in property is to understand your property risk profile. Another way of mitigating risks when investing in property is to understand the difference between investing and speculating.

Some people are only speculating rather than investing. There are many other ways of mitigating risks when investing in property – in this guide; we have compiled some of them.

SECTION ONE:

FIRST THINGS – INVESTOR AND SPECULATOR



Before talking about ways of mitigating risks when investing in property, we want to be sure that you are really a property investor instead of a speculator. That being said, what is the difference between a property investor and a speculator?

To invest in property means to purchase with the intention of earning a return on the property, either through rental income, the future resale of the asset or both.

Most people think investing is to buy or sell in expectation of profiting from market fluctuations. They usually say something like, "I am going to buy it and sell it to make money when its value goes up over time."

However, that is not what investing in property entails. Most people are speculating rather than investing. With speculation, people want to buy and hope to sell "if" the value of the property goes up in the future. Emphasis on the word, "if".

We see speculators in several asset classes – when it comes to stock, for instance, it is easy to find people who will say, "I am going to buy this stock at the current price and make money when its value appreciates in a month, a year, or ten years." You will also see people who will say, "I will buy some gold and make money when the market appreciates in a year or two."
In the property industry, we also have a lot of speculators. They will sound something like, "I will buy this property and make money when the market appreciates or when I increase the rents or when there is a decrease in vacancies, etc."

Now, the problem with all of these is that they all depend on "when something happens" or "if something happens." So, speculators only make money if something happens and those "ifs" are often out of the control of the speculator.

AN INVESTOR HOWEVER, ATTEMPTS TO CALCULATE AND PLAN FOR FUTURE EVENTS.

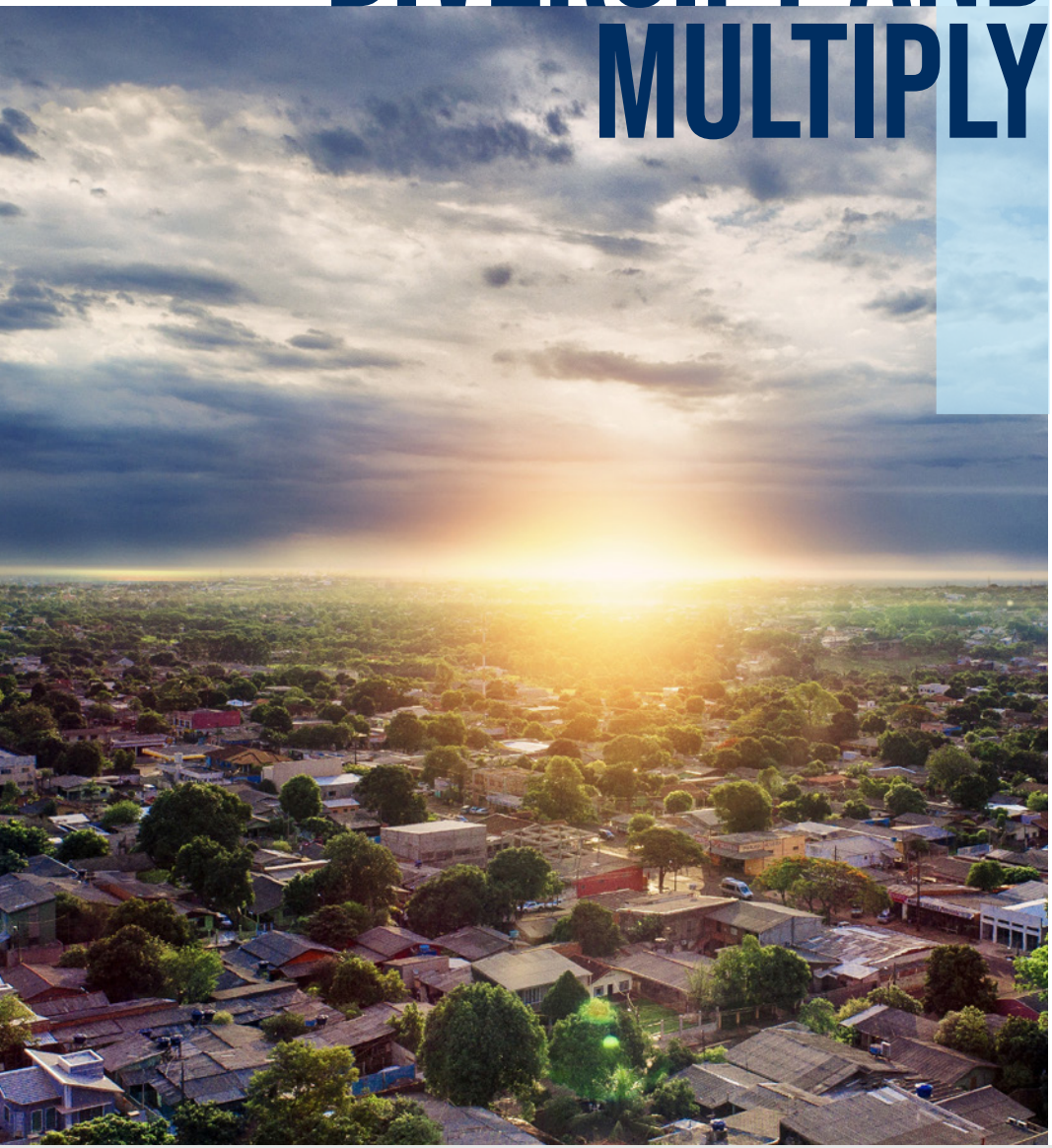
So, an investor says, "okay, I am going to buy this property that produces a minimum of say ten percent cash from the very first day. This property may have some sort of problem that I can fix and force the appreciation over time." So, with an investor, everything is in their hands – they are not relying on factors that are outside of their control.

If you really want to mitigate risks when investing in property, then you should be an investor in the real sense of the word, not a speculator, as we cannot predict the future. You cannot say if the market will appreciate tomorrow or not. Real investors do not leave their profits up to chance, so, they devise means of mitigating risks with a view to maximizing profit.

SECTION TWO:

HOW TO MITIGATE RISK WHEN INVESTING IN PROPERTY

1 DIVERSIFY AND MULTIPLY



When it comes to real estate investing, the good old saying, "don't put all your eggs in one basket" holds. One of the best ways to mitigate risk remains to consider other asset classes like bonds, shares, etc.

However, for many property investors, diversifying into other asset classes can be quite difficult as they don't often have enough cash for this purpose. To diversify, an investor would still have to use their property equity to obtain loans to purchase other assets, which means that property assets will still form a bulk of such an investor's investment portfolio.

Now, if you cannot diversify into other asset classes like bonds, shares, etc. you can still consider diversifying your property assets by investing in different types of properties. This way, if the market for one type of property is not performing optimally, you could rely on the other properties in your portfolio and stay afloat.

When it comes to property types, the most common direct investment made in property in Australia is in residential. Residential property is tangible, can offer tax advantages, and is an asset that many investors understand and have experience with. However, investment portfolios that hold direct residential property can be poorly diversified due to having a large percentage of capital concentrated in one illiquid asset.

As an alternative to direct property, investment through direct property trusts and funds can provide many levels of diversification and flexibility to a portfolio. While providing exposure to capital growth from property price appreciation, they are also easier to trade off as they are unitized investments.

In addition to investing in different types of properties, you also need to consider investing in different locations. This way, if the properties in one area are plateauing, you can be hopeful that the market in other places may be different.

Also, look at buying at different prices. This is particularly relevant when you want to free up equity but still maintain a strong asset in your portfolio. For example, let's say you have $900,000 to burn on a property. If you purchase a property for $600,000 and another for $300,000, you'll be able to sell the $300,000 property and free up the equity if required (or desired) while the other property keeps accruing income. Once again, you've dispersed your risk and opened yourself up to a promising scenario.

2 LIQUIDITY

Liquidity is the ease in which you can gain access to the money you have within an investment. One disadvantage of real estate investments is the lack of liquidity compared to other types of investments, which can force the investor to think long-term.

When contemplating which type of investment option suits you, consider your need for liquidity in funds for risk management. Do you need access to your investment quickly if necessary? If so, property investment may be a risk for you, as selling a property is not a quick or simple process, and selling quickly or under pressure could result in taking a loss on your investment.

Property investment forces investors to buy and hold for longer than most other types of investments, which can be a great risk management strategy for those who have not had much financial gain from other forms of investments in the past.

Investors can mitigate liquidity risk by setting aside a certain portion of loan funds to serve as a buffer. This way, if an investor has an urgent need for money, they will have something to fall back on, rather than resorting to the forced sale of properties, in which case, they may suffer a loss.

3 INSURANCE

Landlord insurance and mortgage protection insurance are two products that will help reduce your property investment risk over the long term. Landlord insurance covers your investment property's building and permanent internal structures and provides protection against a tenant defaulting on their rental payments or damaging the property.

Insurance companies structure their policies differently, and while some are all-inclusive, others separate the tenancy protection as an optional extra. It is wise to check the insurer's policy definitions, particularly when it comes to 'internal structures and permanent fixtures' and fine print around water damage. It's important that you pay close attention to the details – a technicality could render your coverage inapplicable.

If life takes an unexpected turn and you are unable to earn an income – such as in the event of illness, unemployment or injury – mortgage protection insurance ensures you are still able to make your mortgage repayments.

4 RESEARCH

This may sound basic, but many people, especially those new to property investing still go ahead to purchase properties without doing proper research.

Before you embark on a new venture, such as investing in properties, you need to do proper research and ensure you have understood all the inherent risks and how to mitigate them.

Without proper research, you are likely to buy a property:

1. that is located in an area where there is little to no growth – when you buy properties in such an area, it is hard to make profits
2. that doesn't achieve rental growth
3. that has zoning issues
4. with poor cash flow
5. with high vacancy rates.

When doing your research, employ all available means, including using the internet and talking to a trained professional.

5 USE TRAINED PROFESSTIONALS

As you can see above, mitigating risks when investing in property can be complicated. You have to do a lot of things including doing proper research and diversifying your portfolio. It also requires a strong knowledge of the various asset classes, markets, and sectors.

To do all of the above properly, you need the help of trained professionals. Trained professionals in this context include conveyancers, accountants, solicitors, building and pest inspectors, property managers, quantity surveyors, and qualified property investment advisers. There is no doubt that working with any or all of these mentioned professionals will help you mitigate risks.

Remember, do not just choose any professional, make sure the one you are choosing has the training and qualification to provide you with useful advice. Also, you should be wary of using professionals who tend to have their own personal agenda – for instance, watch out for that professional who is only passionate about convincing you to buy a property under their care.

The property industry has a low barrier of entry, so, it is not unusual to find many bad eggs in the industry. Don't just work with anyone on a "first name and handshake" basis; you have to ensure they are willing to assist you in making the right choice.

Before you approach any professional for advice, make sure you have done your own due diligence and don't just follow the lead of a so-called professional without having a second thought. Most importantly, make sure you are not approaching a professional that has their own hidden agenda. For instance, if they have a property they want to sell to you, they may biased in their judgment or counsel.

YOUR RISK PROFILE

A person's risk profile is composed of four elements:

- RISK TOLERANCE
- RISK APPETITE
- TIME COMMITMENT
- MONETARY GOAL

Both risk tolerance and risk appetite of individuals vary from "none" (you can barely afford to invest in the first place, and a loss would directly affect your lifestyle) to "extreme" (you have enough disposable income and time that you have trouble deciding what to do with it). Most people fall around the "low" category — they could manage if they suddenly lost a few thousand dollars, but that's about it.

Having an in-depth understanding of your own property risk profile allows you to make wise choices, which reduces many risks.

SO WHAT DO I DO NEXT?

We hope you have found all the tips in this guide useful. Remember, there is no set in stone way to go about mitigating risks when investing in property. The real estate business is vast and filled with opportunities that you need to analyse to determine whether or not you will make a profit or loss. Don't be in a hurry, do your due diligence and you will be able to mitigate the various risks associated with property investing.

We wish you the best of luck and if you have any questions make sure you jump into our Facebook Group, where we have a community of like-minded people in the same boat. It's a supportive group to help investors get through the maze of all the hoops they need to jump through and find the property.

You can join here

All the best,

James and the mrkts.com.au team

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