The Buyers Advocate

Connecting People and Property

PETER ROGOZIK Property Consulting

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Editorial

Hello and welcome to the Peter Rogozik Property Consulting six-monthly newsletter. 2011 was certainly a tough year for all players in the game of real estate

Buyer confidence plays a critical role in healthy real estate markets. Unfortunately this was lacking throughout 2011. A difficult property market accentuates the difference between quality real estate investments and property selections that are substantially inferior. During 2011 inferior property experienced a downward price correction, while the small percentage of quality property has continued to appreciate.

Since starting my buyer advocacy business over ten years ago I have always steered my investor clients away from secondary locations and high-density developments. In this edition I include some research in relation to how these properties have performed over the medium to long term. The results have been absolutely astounding. Despite being located in traditional blue chip suburbs, properties can substantially reduce in value. This type of real estate purchase truly puts the buyer into the property investor's graveyard.

Also in this edition I discuss the shambles that is our building conciliation system. The current system does not provide a clear and definite process for aggrieved building owners should a dispute arise with the builder in relation to the quality of workmanship. If you are considering building works the correct choice of builder is vitally important. The wrong choice is a one

In this issue:

The Property Investors' Graveyard

Purchasing residential real estate in a traditional blue-chip inner-Melbourne suburb like Hawthorn would guarantee some capital growth in the medium to long term, right? Wrong.

In fact buyers have actually made substantial losses after owning properties for as long as seven years. That's right - you are reading this correctly. Substantial losses. In a seven-year period where quality real estate has doubled in value these properties have returned negative growth.

You would expect appalling returns from apartment towers in Southbank, Docklands or the CBD. However this is leafy green Hawthorn, blue-chip Hawthorn, bourgeois Hawthorn.

Here are examples from the same Hawthorn apartment block:

1. apartment purchased March 2004 for $549,900; sold May 2011 for $495, 000, a loss of $54,900
2. apartment purchased April 2004 for 799,900; sold June 2010 for $680,000, a loss of $119,900

These losses don't include the buying and selling costs associated with the transactions, not to mention the opportunity cost of not having made the optimum property choice. In the case of example 2, the individual real loss equates to around one million dollars.

The marketing spin for the above examples spruiked superlatives such as "sensational north facing sundrenched terrace", "superb view", "brilliantly positioned", and this gem: "excellent investment".

Many of the buyers of this type of property are from interstate or overseas. They have purchased these properties either off the plan or, if an established property, without conducting an inspection.

How do investors get sucked into buying these types of properties? Firstly they are lured by glossy photos of swimming pools, tennis courts and brand new kitchens. Unfortunately these features are not the prime drivers of capital growth.

way ticket to the poor house and the mad house.

The carbon tax has certainly been a much discussed issue here in Australia. How will this new tax impact on the construction industry and property buyers in general? I discuss this controversial new piece of legislation and give my opinion as to the impacts it will have.

This newsletter has been quite a serious edition; amongst other things we have discussed real estate graveyards and potential death traps being backyard fish ponds. To lighten things up I have included an article that encourages my readers to sing in the rain. There is nothing better to lift the spirits than belting out a favourite tune. Singing in the rain at the property you are contemplating buying ensures you can observe all the building faults only a good downpour will identify. Inspecting a property while it is raining puts the buyer into property inspection utopia.

As usual, in this edition I include the regular article Market Snapshot. Market Snapshot gives a summary of the Melbourne market for 2011. I also give my predictions for 2012.

Feel free to contact me if you have any questions in relation to real estate or building matters. Also, if there is a specific topic you would like covered in our next newsletter, I would like to hear from you.

I wish all our readers a very happy and prosperous 2012.

Regards,

Peter

RBP
REGISTERED BUILDING PRACTITIONER

Secondly, the sales pitch by the promoters of this type of property sounds convincing, however in reality is seriously flawed.

Sales pitch one is the perceived advantage of stamp duty savings of buying off the plan. In the above examples investors have saved tens of thousands of dollars on stamp duty, but have forgone hundreds of thousands of dollars in lost capital growth.

Sales pitch two revolves around the tax deductions available through depreciation of fixtures and fittings. Again, as with sales pitch one, the investors have only saved a few thousand dollars through tax deductions compared to the substantial loss incurred through poor capital growth performance.

Sales pitch three is in relation to rental guarantees that are given by many developers. The reality is the guarantee is factored into the price of the apartment. Also, the rental guarantee amount is usually artificially high. When the guarantee period expires, the investor can experience financial pressure because they have to lower the rent to attract a tenant. In some cases this leads to a forced sale.

All the apartments in the above-mentioned Hawthorn block have returned abysmal capital growth. Why? There are many factors that contribute to capital growth.

In this particular situation the main reasons for such poor capital growth are that the apartments are part of a high density complex combined with a mediocre location. There is excess supply and limited demand. You don't have to be an economics professor to conclude this will not lead to perpetual capital growth. Unfortunately the above examples are not isolated cases.

If you compare these results to a low-density apartment block in a different part of Hawthorn, the contrast in capital growth performance is substantial. More examples:

1. apartment purchased March 2001 for $210,000; sold August 2010 for $600,000. In nine years, the apartment almost tripled in value.
2. blue-chip one-bedroom apartment in Prahran purchased July 2005 for $235,000; sold September 2010 for $464,000.

In both these examples there were no significant improvements made to the properties that would enhance the final sales price.

The Hawthorn capital growth disasters have a human face. A portion of the buyers would include first homebuyers - young couples and singles looking to establish their future through the Australian home ownership dream. Instead of accumulating hundreds of thousands of dollars, they have been the victims of a financial kick in the guts that would be difficult to recover from.

This phenomenon occurs more often than most people would believe and is rarely reported. If you have been the victim of such a poor property recommendation, it doesn't make for great dinner party conversation.

So who is to blame for this financial debacle? Certainly not the selling agent, they are merely providing a service. In some situations this type of property is being recommended to people by some financial planners and other so called "property experts". These people have no expertise in real estate and are not independent. They are being paid a commission of up to ten per cent of the property's value by the developer to recommend these dud investments.

These unscrupulous people are recommending these properties to their clients not based on the quality of the investment, but to line their pockets as quickly as possible regardless of the consequences.

The buyers themselves must shoulder some of the responsibility. We operate in a system that says "buyer beware". Buyers should always obtain independent - and I stress the word independent - advice before making a purchase.

Recently there has been planning approval given to a record number of these residential towers in and around the Melbourne CBD. No doubt this will result in thousands more disappointed and disillusioned property investors being persuaded to purchase these "excellent investments".

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Melbourne Property Market Snapshot February 2012

The Melbourne property market in 2011 was difficult, the likes of which have not been seen for many years. That essential ingredient - droves of people wanting to buy property - was missing. The September-quarter figures show an annual overall increase of just 1.4%.

However, it was not all doom and gloom as some commentators may have you believe. Clearance rates hovered around the 55% mark. This is only one gear below what is considered a balanced market, which is a clearance rate of 60%.

That small proportion of quality real estate - properties between 2kms and 10kms of the CBD in streetscapes with high architectural appeal possessing scarce and unique features - continued to be fiercely contested. The remainder of the market floundered. These conditions are not characteristic of a property market in distress.

The slowdown of the market was based more on lack of confidence than economic reality in Australia. The fundamentals of the Australian economy remain strong with positive GDP growth, and relatively low unemployment and inflation.

We were constantly bombarded with negative sentiment from Europe and the United States. Continued negativity does impact on the psyche of buyers and sellers.

In 2009, we reached the peak of the cycle as a result of substantial price increases. The correction that occurred throughout 2011 mainly affected properties in secondary locations.

With the recent reductions in interest rates and the likelihood of further reductions, there is no doubt we have reached the bottom of the cycle. The Melbourne market as a whole bottomed in October of 2011. The litmus test of property markets bottoming is when secondary locations cease to lose value. This occurred in October.

In 2012 we will see a return to clearance rates of around 60%. This is a situation that is considered a balanced market, where neither vendor nor buyer has the advantage.

This year will be the final window of opportunity for investors to enter a market before any substantial price increase. This may occur over a short period of time, as was the case in 2009 where prices increased by around 20% in an eight-month period.

In 2012 the quality segment will increase by at least 10%. The remainder of the market will increase by less. As it is a segmented market the statistics will only tell half a story. The saying 'lies, damn lies and statistics' certainly applies when analysing property markets. The overall increase for 2012 will show a modest figure of around 4%.

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Disaster Waiting to Happen

The current rules regarding safety requirements for backyard fishponds and water features in Victoria are a disaster waiting to happen.

Swimming pool fence regulations have been well documented. Amazingly, backyard fishponds and water features do not require any type of barrier.

Recently, I have seen examples of unfenced backyard fishponds that represent a serious hazard for a young child. A child can drown in as little as two inches of water. The depth of your average backyard fishpond or water feature can be greatly in excess of this.

All exposed external structures that hold water should require some form of barrier.

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Carbon Tax: How it will impact Property Buyers?

The Clean Energy Act 2011 was passed by parliament on 8 November 2011 without amendment, meaning the Carbon Tax will now become law in Australia. The tax will commence on 1 July 2012.

Facilities that emit more than 25,000 tonnes of carbon dioxide per year will pay a fixed carbon tax of $23/t from 1 July 2012 increasing to $24.15/t in 2013/14 and $25.40/t in 2014/15. There will then be a transition to an emissions trading scheme from July 2015. The carbon tax will be paid by around 500 facilities.

The important question is how this tax will impact the Australian economy and more particularly the building and real estate industries. The impact of the tax on established home owners will be a rise of approximately 10% to gas and electricity bills.

The impact on new dwellings will be more significant. Builders will not pay the tax directly, however the industry will be significantly affected by the tax through increased costs of materials and energy, which are expected to flow through to the price of homes.

Most building materials have high levels of carbon intensity, particularly bricks, tiles, concrete slabs, steel, timber and aluminium. The manufacturers and suppliers of these and other building inputs will be hit hard by the carbon tax.

The Housing Industry Association estimates the aggregate cost increase of the inputs (building materials, products, assemblies, administration, etc.) on an average new house and land package will be between $5000 and $6000. The size of the increase will also depend on the style and design of the home, the material specifications and inclusions, and site conditions.

I believe the carbon tax is an initiative that must be introduced; quite simply the industries that pollute the environment must pay a price. The introduction of a tax will encourage these high polluters to change their manufacturing techniques.

However, I also believe the building industry must be provided with some protection from the inevitable negative consequences that a carbon tax will cause. There is no doubt that an unregulated carbon tax will negatively impact local building product manufactures more than any other industry.

The building industry is the cornerstone of the Australian economy. A buoyant building industry equates to a strong economy that is the backbone of job creation. The tax burden on new housing has grown substantially over the past decade and there exists an inequitable treatment of new housing compared to existing housing.

An unregulated carbon tax will have severe consequences on the building industry particularly on the small- and medium-sized building product manufacturing and fabricating businesses. These small to medium businesses are the backbone for providing jobs in Australia. The government needs to provide adequate compensation to these businesses to soften the carbon tax blow.

A tax that hits the polluters hard while protecting our most vital job-creating industry, the building industry, should be the aim of government. This policy should be combined with offering further incentives to home owners to make their homes more energy efficient.

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Property Inspection Utopia

"**I'm singing in the rain, just singing in the rain, what a glorious feeling I'm happy again**"

This is what every property buyer should be singing if they are lucky enough to be inspecting a property while it is raining.

Over 80% of domestic building faults are related to water. Hence when it is raining the prospective property buyer has a unique opportunity to see exactly where the water is flowing and pooling, assess the quality of construction and potential faults that will lead to premature deterioration of the building.

The following are some of questions that will be answered during a downpour. Is the water running away from the building or under it? Is ground surface drainage adequate or is water pooling around structures? Is water draining adequately from the roof or is it pooling in areas that it is likely to cause corrosion to roofing materials? Is the fall on the roof guttering adequate or leaking? Are balconies draining properly or leaking? Are the downpipes coping with the downpour?

So next time it's raining, get out and attend that open for inspection. Get your raincoat, head to the inspection and observe the water flow while belting out "singing in the rain ". Not only will you learn a lot about the valuable asset you're contemplating buying, you could psyche out some of the other buyers.

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The Building Defects Debacle

The current system and regulations for consumers seeking redress for defective work and substandard workmanship by a builder are vague and complicated. The rules regarding this area of building law are contained in three different sets of regulations and guides: the Domestic Building Contracts Act 1993, the Building Code of Australia and the guide to Standards and Tolerances.

You would think things would get easier for the building owner if, after wading through three different sets of vague and complicated regulations, they managed to identify the relevant piece of legislation that relates to the building fault in question. Unfortunately this is not the case.

The building owner then has to contend with five different so-called umpires, the Building Commission, the Building Practitioners Board, Consumer Affairs Victoria, Building Advice and Conciliation Victoria, and the Victorian Civil and Administrative Tribunal. Building owners are often placed on a merry-go-round between all five. The result is delays, cost blow-outs and no real solution.

To add to the confusion, many consumers believe the building warranty insurance they are compelled to take out for all domestic work over $12,000 can be accessed at any time, however this is not the case. Warranty insurance will only provide protection to the consumer if the builder dies, becomes insolvent or disappears.

The consequences of engaging the services of a dodgy builder can be horrific for a building owner. There are many Victorians who will testify to this. My advice to anyone contemplating hiring a builder is to undertake comprehensive screening of all candidates before making an appointment. A bad choice could lead to financial ruin.

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