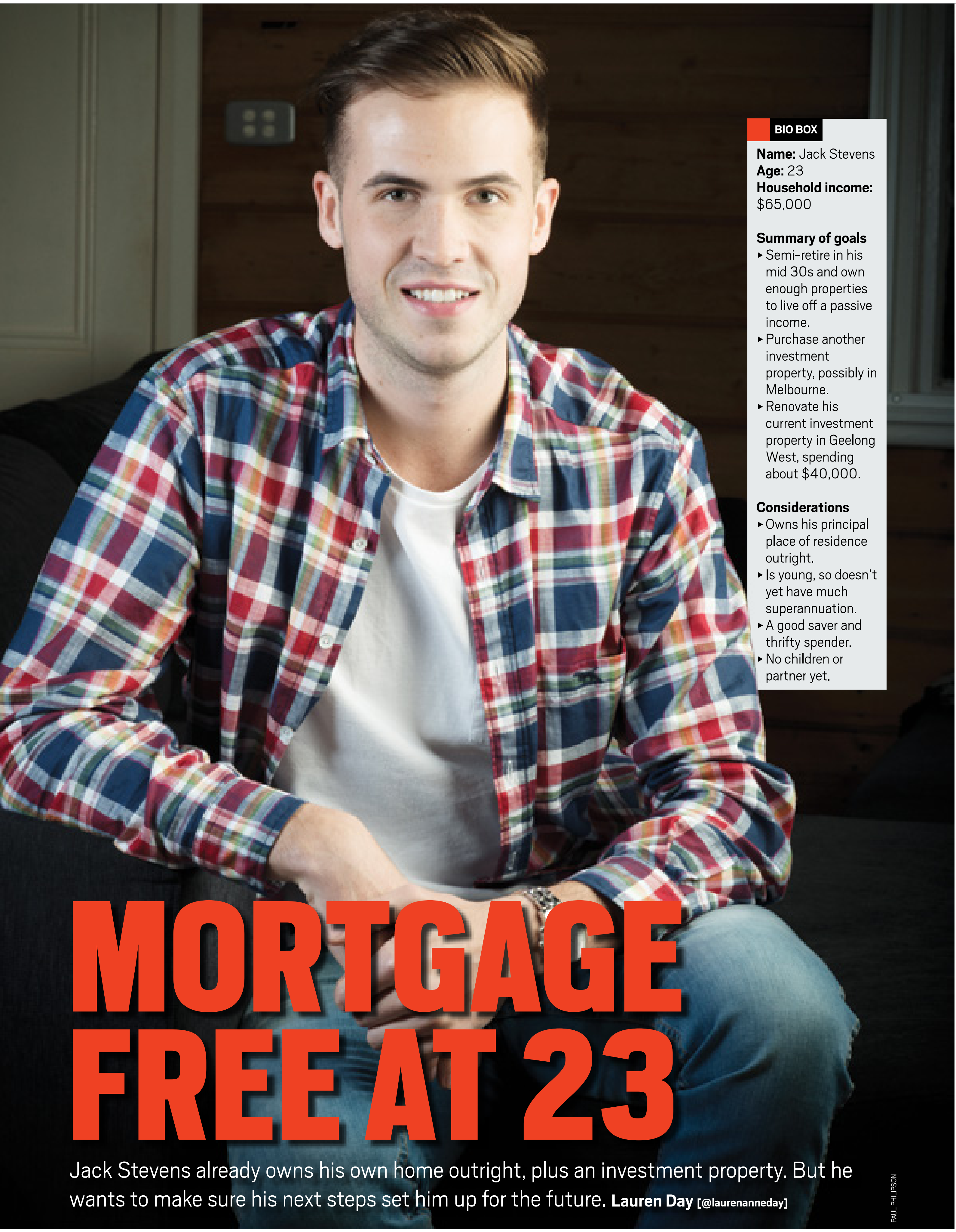

MORTGAGE FREE AT 23

Jack Stevens already owns his own home outright, plus an investment property. But he wants to make sure his next steps set him up for the future. **Lauren Day** [@laurenanneday]

PAUL PHILIPSON

BIO BOX

Name: Jack Stevens
Age: 23
Household income: $65,000

Summary of goals

- Semi-retire in his mid 30s and own enough properties to live off a passive income.
- Purchase another investment property, possibly in Melbourne.
- Renovate his current investment property in Geelong West, spending about $40,000.

Considerations

- Owns his principal place of residence outright.
- Is young, so doesn't yet have much superannuation.
- A good saver and thrifty spender.
- No children or partner yet.

Jack Stevens knows just how short life is. He was only a teenager when his father sadly passed away from cancer at the young and unfair age of just 58.

It was a tough time in his life and all the more painful by the fact his father had been working hard to build a large property portfolio – one that would have provided him with a comfortable retirement.

Instead, his father's modest assets were sadly sold off and divided among the family. It gave Jack a small head start in life, as he landed some inheritance. But of course, no amount of money can ever make up for losing his dad.

"He was very property savvy and I think that's where I get my passion for property from," Jack recalls.

Also like his father, the 23-year-old primary school teacher is a hard worker. Impressively, Jack already owns his own property in the Melbourne suburb of Geelong West outright. The two-bedroom cottage was purchased for $365,000 a couple of years ago, using the inheritance and a big chunk of savings. In just 24 months, Jack paid off the rest of the loan and is now sitting on a large equity nest.

That's why he has come to *Australian Property Investor* for help. In a new series called 'Fork in the Road' we'll be helping property owners and investors like Jack make the right decision at the right time. Just like a fork in the road, there are always two possible options and outcomes for everything in life. Choosing the right path can make a huge difference in capital gain, equity and ultimately, financial freedom.

Obviously with a firm foot on the property ladder, Jack wants to make sure his next financial decisions will set him up for an early retirement. After the devastating loss of his father, he'd understandably like to semi-retire in his 30s so he can make the most of life while he's still young and healthy.

Of course, semi-retirement within a 10-year timeframe isn't an easy task. But Jack is determined to make the right moves now while time is on his side.

"Life is too short to work full-time and I think I'm already on a good track," he says.

"If I can continue the way I'm going, I might have some kind of a chance."

When Jack isn't singing the ABCs to his year three class at school, he's usually working for council during the school holidays. That earns him double pay and money he can put away for his next property venture. It might sound like a lot to take on, but Jack has always worked hard to save money.

He got his first job when he was just 15 and has no problems missing out on socialising to get ahead.

"I'm a good saver. I try not to go out much and be pretty savvy with spending and groceries," Jack says.

"I always check prices and go to the markets. It's so much cheaper there."

Jack recently bought a second property in the same area of Geelong West. The Victorian miner's cottage set him back $385,000 and it's renting for $300 per week. Jack will probably move into this second property to undertake a small cosmetic renovation when his tenants move out in about a month's time.

He's already put $40,000 aside for that project and hopes to create more equity through scrubbing, sanding and sweating. He has no problem doing most of the work himself and perhaps hiring tradies for some of the bigger jobs.

WHERE TO NEXT?

Jack would ideally like to buy a third property in Melbourne, but doesn't know if he'd be putting all his eggs in one basket.

"Should I give the second property a cosmetic renovation and then take a breather? Should I wait another year and then buy something else?" he wonders.

"Then I think, maybe I should use the equity in my current home. But I'm also happy just sitting on it, with no loan. Everyone tells me I'm moving too fast and I should be living while I'm young."

It's easy to understand why people tell Jack he's moving too fast. Let's not forget he's just 23 and most of his friends are still living with their parents and studying.

It's a huge accomplishment to own two properties at his age, with one of them paid outright.

But Jack is a big dreamer and for him, it's only the beginning. He tried renting with mates but couldn't stand the dirty dishes and wasting money on rent each week. After all, rent money is dead money. And why pay rent when you can actually charge rent, and get someone to pay off a loan for you?

"I'd like another property, something local, but not as close as the other one in Geelong West," he says.

"I think I'd still buy in Melbourne because it feels safe."

Jack's income is around $65,000 a year. The property he owns outright would now be worth around $410,000 and the second property in Geelong West would be worth about $384,500. The loan on this second property is $357,000. His monthly outgoings are about $2000, including about $700 a month for mortgage repayments after rent has been taken out, $300 per month on food, $400 on bills, $150 on petrol and $200 on social activities. He'd like to meet a partner one day, but has no plans for kids in the next 10 years.

In theory, Jack has a huge $328,000 equity base to play with, (80 per cent of the value of his principal place of residence).

He could possibly borrow more, if he pays mortgage insurance.

But is it too much, too soon? Should he slow down and pause at the junction, or consider the road less traveled but perhaps more rewarding?

He asks API's experts for help.

> "Life is too short to work full-time and I think I'm already on a good track."
> JACK STEVENS

BEN KINGSLEY
Empower Wealth

You've certainly gained some wisdom from your father before his sad passing, an interest in property; a strong work ethic and sound money management skills in the form of understanding how to make one's money work harder to build wealth.

Your decision to invest your father's inheritance into something that appreciates in value, property, and learning the merits of how to save and to live within one's means puts you on a sound pathway to achieve even bigger financial goals.

Not many people your age would've done what you've done, given the temptation to maybe buy a shiny top-end new car or some 'boys toys' like a boat or jet ski or spending up big, on upmarket overseas travel.

Your decision to make some adjustment to not living too much in the now and instead investing your money at such a young age will, over the long-term, provide you with the multiplier effect of what having a good wealth base provides, which is a more constant source of higher passive income and an appreciating capital base, with age and time on your side.

Like every investor who's focused on achieving their financial and personal goals in life, there comes a time when they have to put further planning in place to take their next steps forward. You appear to be at your first 'fork in the road' moment. As with investing and life in general, we all experience these 'decision' moments, which require us to take stock, think, explore options, build knowledge and understanding, and then move forward with conviction and confidence.

As a property investment advisor, helping clients work through and solve these problems everyday is certainly the most rewarding part of the work I do. In your case Jack, as with any client, it's about understanding what you're trying to achieve. I often refer to this as 'what big rocks are we trying to put in the jar?' meaning, what are the most important things in order of priority for you and what are your motivations behind them?

For you Jack, at such a young age, your life is really just starting. Your future plans could include meeting a life partner, potentially starting a family down the track and maybe even a new 'family' home. These types of events have a real financial impact attached to them. Yes, there might be a second income which could go a long way to helping service the debt and continue to build up the wealth base, but this income could stop for a while, if family plans are being considered.

One needs to balance out these considerations and also look at the property investment ideas being canvassed. In your case, your options include a possible Melbourne purchase, spending some money on your current investment property and finally, to make the situation even more challenging, one of your 'big rocks' in the jar is semi-retirement in the next decade.

Let's address the semi-retirement first. When I'm helping clients build their property investment plan, early retirement or the option to choose to work or not is often a key motivator for many clients. And like you Jack, anyone who's keen on this financial goal needs to 'qualify' what they mean by it. In very simple terms they need to decide the date and passive income target they're looking to obtain. So, if we expand on your desire, what we're talking about is being semi-retired in 2026, aged 35, and how much investment income would be required to

Investment property in Geelong West

Investment property in Geelong West

Principal place of residence in Geelong West

Principal place of residence in Geelong West

THE NUMBERS | JACK STEVENS

Location	Description	Purchase Date	Purchase Price	Purchase Costs	Loan On The Property	Current Value	Rent Per Week
Geelong West, Vic	2-bed, 1-bath house	Aug 2012	$365,000	$18,000	$0	$410,000	PPOR*
Geelong West, Vic	2-bed, 1-bath house	Jun 2014	$384,500	$20,000	$357,000	$384,500	$300
Total			$749,500	$38,000	$357,000	$794,500	$300

*Principal place of residence (PPOR).

make this a plausible reality, say $50,000 in today's dollars?

In this general assessment of your situation it's clear that only one investment property currently returning a gross rental income of $15,600 isn't going to get you to your desired outcome. You'll need to accumulate at least another one, but more likely, two more investment properties, to build up the passive income for your target for an early retirement, while also being conscious of the cash flow impacts of any decision you make about your life journey.

On the current information and plans, you're in a financial position to act now, rather than wait another year or so, because you have the surplus household income and ample equity in your own home to allow for the accumulation of more investment properties.

NEXT MOVE

The idea of a Melbourne-based property acquisition is certainly worth serious consideration, as Melbourne is a top 100 global city by population base, and a highly desirable and very livable city, with forecast population increases of over 1.3 million more residences by 2028, according to Australian Bureau of Statistics modeling. Still, not every suburb or property makes for suitable investment grade areas or properties, so our focus for you will be getting an 'outperform capital growth property', as statistically these properties also have higher incremental increases in rental income over a shorter time, meaning they can turn positively geared quicker than other properties.

Furthermore, taking into account your ambitious early retirement target, a growth property over a yield property will serve you better, looking further into the future post your semi-retirement target.

In my modeling I've recommended a purchase price of $450,000 for the next Melbourne investment property, targeting an eight per cent annual compounding return and a 3.75 per cent gross rental yield. Area selection is where you get most of your capital gain returns, so I'd be focusing in on blue-chip suburbs with young professionals and great lifestyle and convenient factors.

Opting to invest in Melbourne would, in my view, mean that we wouldn't undertake any further investment exposure in the Geelong area, as we've enough exposure in this market. Diversifying into other major cities and/or towns in other states would be a more balanced bet for your portfolio.

Furthermore, in terms of your idea to undertake a cosmetic improvement of your existing Geelong investment property, I'd want to ensure the principal renovator's rule of 'double your reno dollar' is adopted. This means if you wanted to put $40,000 into the reno, then we'd like to see the value of the finished product deliver a revaluation of $465,000, based on the existing value provided. This is the equivalent of a $40,000 reno adding $80,000 in a revaluation outcome. So before pushing the green light we need to do the research on whether or not we're overcapitalising for the area.

In summary, you're in a very good financial position for your age. As you build up your nest egg, you should also be building up strong relationships with professional and qualified advisers, to help you keep making smart decisions.

You're well positioned to move ahead and use the equity in your current property to accelerate your position, in an effort to achieve your desired early semi-retirement outcome.

Consideration needs to be given to future plans, in terms of your cash flow position today and into the future and any life events that will impact on these cash flows. With all investing there are risk/reward considerations and further investigation and research will ensure you keep making each post a winner when you have 'fork in the road' decisions to make.

> "I've recommended a purchase price of $450,000 for the next Melbourne investment property, targeting an eight per cent annual compounding return."
>
> **BEN KINGSLEY,** Empower Wealth

TRENT ALEXANDER
Financial Planning Expert

Considering your primary goal is to semi-retire in 10 years, you need a property plan delivering three broad outcomes: sufficient rental income to supplement your reduced salary; the potential for rental increases so that rental income keeps pace with the rising costs of living – inflation; and capital growth potential for financial security and to provide a hedge against longevity risk (more on longevity risk later).

Building a portfolio to deliver one of these outcomes would be reasonably straightforward but satisfying all three outcomes is more challenging.

For this reason, Jack, the first thing you should do is obtain advice from a property expert. This could be a financial planner, buyers' agent, strategic mortgage broker or the like but regardless, one of the most important things to look for is independence. Dealing with independent professionals will ensure no conflicts of interest exist and they act in your best interests. Property is a big dollar investment and typically triggers significant transaction costs upon purchase and sale, so it's important to invest in advice upfront as it's usually more costly to reverse a poor decision later on.

It's also prudent to seek advice beyond the property itself. Identifying the right property to purchase is clearly important, but hard work can be undone if ownership structures aren't properly considered, inappropriate lending arrangements are in place, effects on cash flow aren't accounted for and the tax implications of owning and later selling haven't been considered and planned for. Further, the need for personal insurances such as income protection should be evaluated upfront and an exit strategy should be in place from day one.

You also need to be mindful of longevity risk by ensuring your property plan is able to sustain you financially with respect to increasing life expectancies.

As part of the Generation Y, on one hand and from an investment perspective, you have time on your side. This, to an extent, means you have more time to recover from poor investment decisions today than someone who's older. You also have more time to realise profit outcomes from your portfolio.

On the other hand, however, you need to consider the impact from increasing life expectancies, from a financial perspective, is more significant for younger generations. To illustrate this point, if we consider your life expectancy today – age 81 according to the Australian Government Actuary (AGA) in conjunction with your goal to semi-retire at age 33, we can determine that your property portfolio has to contribute to your existence over a 48-year period. Furthermore, the AGA data also reveals that as you get older, the likelihood of you living longer than your life expectancy at a younger age increases every year. In other words, today's projected funding period of 48 years is likely to increase.

Compounding all of this is the reality that government assistance (such as the age pension) probably won't exist once your generation retires. You'll therefore need to be 100 per cent self-funded and investing in professional advice now will maximise your chances of achieving this.

In terms of a property plan, my first move would be to make the third purchase now. Maximising your equity and rental income position over the next 10 years needs to be a priority if you want to wind back at work. Time in the market is important in this regard.

With the renovation, make sure it's planned and executed well to maximise the increases to capital value and rent.

I agree that Geelong West offers capital growth potential, however, another benefit of the area is that rental yields on houses are higher than the Melbourne average, making them more affordable to own. This also frees up more cash flow for your next purchase, which, from a diversification perspective, should be in a different part of Melbourne.

In this regard, I'd focus on established areas within 10 kilometres of the Melbourne CBD. All amenities should be in place and transport links to the city well established. Compared to outer suburbs, buyer and rental demand is typically stronger, which can mean a lower-risk investment and more scope to increase rents. The flipside however are higher prices, which make the negotiation skills of an independent buyers' agent invaluable.

Budget wise, I'd focus around $450,000. Your borrowing capacity is possibly more than this but I'm mindful of maintaining a healthy level of surplus cash flow so you can reduce debt over the next 10 years. A lower purchase price also keeps debt against your principal place of residence to a minimum.

At this price point an apartment or townhouse would be the options. Either way, I'd look for something existing in good condition that could be rented straight away, but with scope to manufacture value/increase the rent later on e.g. cosmetic updating, converting the existing courtyard to an alfresco area. Character properties may offer greater growth potential and saleability.

Off-street parking is desirable near the city and for apartments, it's worth checking with the council to see if a car park can be separately titled. Focus on suburbs that have tight regulations surrounding apartment developments. If high-rise development is permitted look elsewhere. Properties meeting the criteria discussed will be negatively geared, however, your surplus cash flow of $20,000 per annum plus should be more than sufficient to cover the loss, while still making extra loan repayments.

Once settled and tenanted, set about reducing the loans over the next 10 years starting with the equity loan against your principal place of residence. Consider a cosmetic renovation/value add on the new purchase down the track. Structure all loans on an interest-only basis for the maximum available interest-only term. Borrow 80 per cent against the new purchase and the remaining 20 per cent plus fees and a buffer amount against your principal place of residence. Keep the buffer amount in an offset account. Buy another 15 years of flexibility by refinancing, just before semi-retirement. API

__Are you facing a fork in the road__ and not sure what to do next with your property investment journey? Email editor@apimagazine.com.au and we'll do our best to share your story in an upcoming 'Fork in the Road' segment.

This information is of a general nature only and does not constitute professional advice. You must seek professional advice in relation to your particular circumstances before acting. This information is also to be read subject to the disclaimer on page 6.

GEE HE LOVES GEELONG WEST

Jack Stevens owns not one but two properties in Geelong West. The commercial and residential suburb of Geelong recently copped a lot of media attention after hundreds of workers were sacked when the Ford car manufacturing plant closed its doors. But Jack is still confident about the area and is even considering buying a third property nearby.

"Geelong West is an area with expected capital growth," he says.

"It has had strong capital growth over the past five years and it's close to shops, cafes, quality schools, transport and the CBD."

Ford plant

EXPERTS' SUGGESTIONS IN A NUTSHELL

Ben Kingsley
- Purchase another property in Melbourne, spending about $450,000 and focusing on eight per cent return per annum.
- Avoid the Geelong area for diversification.
- Make sure every renovation dollar creates two, i.e. spend $40,000 on a renovation to create an $80,000 equity gain.
- Work out your goals and priorities and how to achieve them.

Trent Alexander
- Obtain advice from independent professionals only.
- Focus on established areas within 10 kilometres of the Melbourne CBD.
- Spend about $450,000 on a unit or townhouse in a smaller block.
- Take out interest only loans and keep a buffer against your principal place of residence.