

Your Risk Profile

Effects of Risk

This chapter is not intended to detail a full analysis of how your risk profile is created or determined. It is however about taking time to think about characteristics of your personal risk profile and applying logic that can assist you as a real estate buyer.

Decision making is a required skill of making a good entrance into a real estate purchase. People that have excessively risky and reckless profiles often make poor decisions.

While people who are very cautious and worry too much, without identifying what it is that actually causes their real estate fears, end up stifled and struggle to make decisions at all.

In order to make good decisions and build the momentum required to take you from toying with the idea of buying real estate to actually becoming a happy and successful landlord, requires recognition of your risk profile.

A key reason for investing in real estate is to get a great return on your investment. However some people are not prepared to expose themselves to a sensible entry level on price. People with cautious risk profiles sometimes focus on cheaper real estate prices and cheaper entry points. Unfortunately the entry cost savings can be completely lost and compounded by poor returns from a substandard real estate investment. These are the people that want to enter the real estate market with too little exposure.

There are people who have high risk profiles and gladly enter the market of quality real estate but do so without adequate finances and funding for a rainy day. They may make a good start but if they do not have the ability to provide reliable repayments they are at risk of making losses if forced to sell. These are the people who enter the market over exposed.

The real estate market is full of tragic tales, where a normally cautious real estate buyer has become comfortable with a high risk position because of lucrative financial scenarios and slick marketing campaigns. Be very cautious of false rewards and those that sound too good to be true.

Know Your Risk Profile

There is nothing wrong with being cautious, as is there nothing wrong with being ambitious – both have a significant place in the mindset of a happy and successful landlord.

If you are frozen with fear or foolhardy reckless, becoming a landlord is not yet for you.

To better understand your risk profile, identify your position in readily answerable areas of your day to day life.

Answer each of these questions and then summarize your feelings overall for each group with only the answers comfortable, uncomfortable or unsure.

Work

Are you in stable employment?

How long have you been employed?

How many different employers have you had in the last 5 years?

Are you self-employed? If so are you thriving or just surviving?

Is your monthly income steady or like a roller coaster?

Is your income likely to go up in the next 5 years or come down?

Home

Do you live in your own home?

Have you paid your own home off?

How much maintenance work does your own home require?

Are you renting?

How long have you lived in the same place?

How many places have you lived in the last 5 years?

Do you live with parents or in-laws?

Do you live abroad?

Does your employer provide for your accommodation?

Is your home filled with all the latest gadgets and furnishings?

Is your home minimalist?

Relationships

Are you Single?

Are you in a long term relationship?

Have you just begun a relationship?

Have you just ended a relationship?

Does your partner have the same interest in real estate?

Do you have children you care for?

Do you have parents you care for?

Lifestyle

- Do you travel a lot?
- Do you entertain at home?
- Do you entertain out?
- Do you have pets?
- Are you a homebody?
- Do you like to feel as if you are active at all times?

Savings Capacity

- Do you have long term accumulated savings?
- How much savings do you have in the bank?
- Have you just received a windfall pay out or inheritance?
- Do you have a regularly automated transfer of deposit savings taken from each pay?
- How much money is tied up in shares, managed funds and other investments?
- Do you have superannuation?
- How much superannuation do you have?
- Do you make additional voluntary super payments?

Liabilities

- Do you owe money on assets?
- Do you owe money on cars and depreciating toys?
- How many credit cards do you have?
- What are your credit card limits?
- Do you have outstanding business debts?
- Have you been bankrupt?

This is also a good time to make an honest opinion of your health, which may not seem relevant at first, but it will be helpful to know whether your physical abilities compliment or hinder your intellectual ability to become a happy and successful landlord.

Moving Forward

With an identification of the areas in your life where you feel comfortable and areas where you feel unsure, you can begin to take appropriate actions. The key to making good decisions that will compliment your future as a Landlord will be maintaining a balance of possible real estate variables with your risk profile.

Make sure you have a fall-back position you can retreat to. This is a planned course of action that provides a safety net and can get you out of the worst case scenario. The fall-back position should allow you to realistically adjust personal circumstances without causing extreme loss of comfort to the important and most valued areas of your life.

Ideally you should be comfortable and certain about the impacts of your real estate decisions and the influences they are having on the rest of your life. In a perfect world you would have identified that you are comfortable in every group identified above. What a great place to be, why not maintain it or try and achieve it.

If you are coming across decisions that are drawing you away from your sense of comfort then you are either taking on too much risk or lacking all the required knowledge to make an informed decision.

If a choice makes you more certain about your feelings then you are making a decision of significance.

Choices that take you away from comfort may not necessarily be bad but require very close attention. Make sure you seek out genuinely independent professional advice from people who can be trusted and have a track record of helping other people with the same decisions you're facing.

An Example

This is an example of an investment purchase I made that didn't go to plan. However my risk profile was clear and I had room to stretch personal comfort levels in many areas of my life.

It was a purchase for two warehouse shells with the intention to fit them out as residential homes. On completion one would sell and the other rented out as an investment. My risk profile at the time was certainly ambitious and I went in a fraction over exposed.

I had some experience at residential renovations, knew the property market in the area very well, had the money for the deposits and some funding for early stages of renovation work.

I was comfortable with everything except for the loan not being formalised, as the bank wanted to see the plans and permits for the conversion before they would lend on the building (there was a verbal promise, which as we all know means nothing from banks). This was my area of discomfort and risk.

If I sold my own home I could get out of any mess this may cause and as a single man with no kids it wasn't going to cause extreme discomfort. This was my fall-back position.

Of course as settlement approached and plans and permits had been approved the bank did a back flip, it was a time when banks decided to get really tough on self-employed applicants.

Despite the banks tightening, the local market had been strong, with some reservation I gave the agent an opportunity to sell them both with plans and permits for someone else to complete. I didn't want things to get worse.

Within 2 weeks both were sold for a touch over \$90,000 gross gain.

The original plan took some twists and stretched myself a little too far, I was nearly forced to sell my own home but the market was kind and it still turned out profitable.

This example demonstrates that even though things didn't go to plan, my risk profile was still a fit for the variables that the market created. Decisions could be made without feeling extremely uncomfortable and I could maintain a positive and clear attitude to the process.

It's important to pay close attention to your risk profile, make suitable decisions and plan for variables in the market. For someone who sets out to buy their first investment property it is critical that they identify the areas where they may take a significant hit to their comfort levels and ensure a fall-back plan is in place.

Moving forward as a happy and prosperous landlord might be as easy as recognising that \$5,000 rainy day money, will maintain the personal peace of mind you need to take an impulse holiday when required or pay for an unexpected bills.

Feedback

We welcome any comments you have regarding the contents of this document. If you feel we should be including an expense that isn't here please get in touch. We would love to hear your suggestions for improvement and contributions that could benefit the next reader.

Thank You.

Yours Sincerely,

Jason Wier CEA (REIV)



B.Eng (Building)
Licensed Estate Agent

Real Estate Angel – “Protecting the Buyer”
www.realestateangel.com.au

Facebook fan page
<http://www.facebook.com/buyeradvocate>