7 Reasons Property Investment Just Makes Sense

Learn how property investing can help kiwis build generational wealth

By Thrive Investment Partners

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Introduction

Deciding on a suitable investment plan is hard enough for many people in New Zealand, and people ultimately find themselves looking around for the silver bullet that will get them rich quickly, and last forever.

Unfortunately, such a thing doesn't exist.

Property investment has been a tried, trusted, and true method of investing your money for decades and there's a reason why it is so popular in New Zealand and around the world. Retiring takes a lot of capital, so it's important to find a suitable investment strategy over your working years to make your dream retirement a reality.

The decisions you make now will become the base for your success in the future, so if you've got ambitions of retiring early, with a passive income, it's crucial to make wise investment decisions while you're in your working years.

Let's see 7 reasons why property investment just makes sense when investing for retirement.

Reason 1
Property Is Tangible

Unlike other assets, property is real.

That sounds simple, but when you look at it, alternative investments are often abstract – think of stocks & bonds for example. Stocks & bonds are ultimately just words and numbers that are conceptual. Yes, there is certainly a place for investing in these markets, but in the simplest sense, property is an asset that can be visited, seen, and touched which gives people more confidence in the market and the investment itself.

However, there is a caveat to that. Completed properties are physical, but each property starts as an abstract concept as plans, renders, and designs. While properties at this stage of the process are arguably a conceptual investment, properties are a three-dimensional asset that can be experienced both physically and virtually. VR applications are mainly used for marketing purposes on existing properties, but the ever-growing world of digital renders makes video walkthroughs more accurate and lifelike. For this reason, property investors can make informed decisions from the comfort of their living rooms.

Think of an off-the-plan property for example. If you purchase a property off-the-plans, perspective investors still can view virtual plans, the physical site, or in some cases a display unit which gives the tangibility to property that is sought after by investors.
What about income?

Property is also the only "hard asset" (other hard assets include precious metals, stamps, artwork, antiques, etc.) that produces an income in the form of cash flow. All other hard assets solely rely on capital gains to make a profit, whereas property has the double-edged sword of capital gains & cash flow. As a result, property investors can subsidize the cost of owning the asset by having cash flow coming through in the form of rent.

Kiwis undeniably enjoy investing their money into property. Residential property investment is the most popular asset class in New Zealand and the returns these investors have generated have mostly outperformed alternative investments.

Reason 2
Returns Can Be Measured

Before entering any investment, it is important to weigh up the risks & benefits of all potential outcomes.

Yield & capital growth are the two big factors that come into play when making this consideration.

Yield is a calculation of annual rental income compared to purchase price. This determines the amount of revenue your property generates before any costs are considered. Capital growth, on the other hand, is how much the value of your property increases over the time you own it. Capital gains are where the vast majority of your wealth is made.

Properties in areas of the country that tend to be less expensive to invest in (such as Southland) might produce a better yield, but there could be a sacrifice for lower potential capital gains. The other way around is also true. Investing in a city such as Auckland has shown consistent capital gains performance over many years, but generally has a lower yield because of higher prices.

The yield and forecast capital gains are important and can be measured.

Gross yield is calculated as such:

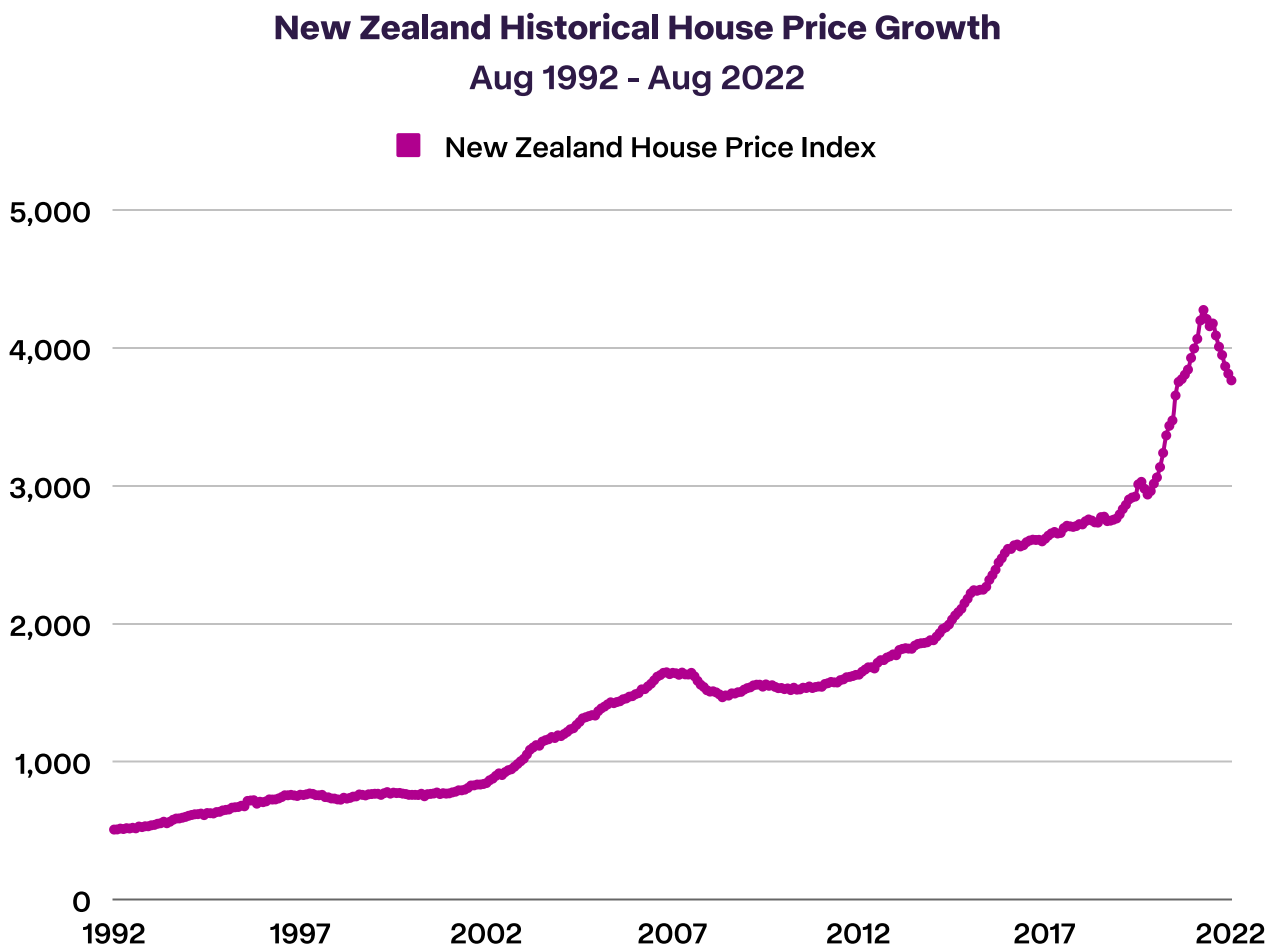
$$\text{Gross Yield (as \%)} = \frac{\text{Annual Rent}}{\text{Purchase Price}} \times 100$$

Investors have different priorities they chase – some invest for higher yield, and some for higher growth properties. So, depending on what your investment strategy is, will define what an appropriate yield is for you. In general, yields of 4% plus are attractive, but this is determined by the type of property (i.e., apartments, townhouse, house) and location.
To measure gross yield, you need access to the rent and purchase price. When working with a company that specialises in property investment, they will lay this all out for you and explain the calculations in real time.

Capital gains can also be measured to a certain degree by using historical data. No one has a crystal ball so there is no way to guarantee what the capital gains will be in 10 years, but if you look back in time, we can make informed decisions on performance. For instance, data on 20-year average capital gains is often used to demonstrate suburb performance and can be used when researching potential future gains in a location.

However, it pays to stay on the conservative side when estimating capital growth so when we forecast growth for properties outside of Auckland, we use a 5% capital growth rate. This allows investors to have reasonable foresight into the future performance of their assets and they can reassess their plans as the market moves by using data in real time.

Investment property should be seen as a long-term investment (7-10 years). Over this period, based on REINZ data, the investor should receive a return of around 6% (annualised). This is not a linear gain (year-on-year consistently) but on average.



Source: REINZ House Price Index

Reason 3
There Are Established Rules

Property investment has rules which put restrictions on investments and allow everyone to operate mainly on the same playing field. Some of the main rules that are established and enforced include (but are not limited to):

- Loan-value ratios (LVRs), which is a percentage of the value of an investment property compared to the debt outstanding.

- Debt-income ratios (DTRs) restrict an investor's lending ability to a multiple of the purchaser's income–which in the current environment is a 6x multiple of income.

- Deposit requirements. Investors purchasing newbuild properties are required to have a 20% deposit, while investors purchasing existing properties require a 40% deposit.

Having these rules in place (among others), allows for a better-planned roadmap for investing and some consistency across the industry. Of course, finding ways to get around these rules puts investors in a position to beat the pack. The best way to maximise your limits within these rules is to surround yourself with a team of experts that know how the system works.

Banks in New Zealand have long supported residential investment. Unlike most other forms of investment, banks are prepared to fund the purchase of residential investment property up to 100% of its value depending on the investor and their overall position. In a stand-alone scenario where the investor wishes to have the investment "stand-alone" from their other assets, banks will fund between 80 and 90 percent of the purchase price. This is unlike commercial property where a funder will only cover about 65 percent of the purchase price meaning the other 35 percent must come from the investor (i.e., you).

As compared with commercial property investment, residential investment attracts favourable lending terms:

- Interest-only terms for up to five years.
- Principal and interest terms for up to 30 years.
- An absence of "test dates". With commercial property, there is usually an annual test date where lending to value and interest covered by rental must be evidenced and satisfied.

Reason 4
Data

Many of the inputs for residential property are part of the Consumer Price Index (CPI) calculation which measures inflation. Where inflation is present in an economy, particularly in New Zealand, property prices and rentals increase. This makes freehold residential investment property popular as a source of retirement income.

Data should be at the heart of every investment decision you make in your life and that rings true when considering property investments too.

There is no shortage of data on almost every property in New Zealand. Type an address into Google, and you can find publicly available information that outlines estimated prices, recent sales, photos, and more. This is great for investors who aim to make an informed decision based on available evidence to back it. Having real-time data at your fingertips also allows more efficient purchasing that wasn't available in years gone by when data wasn't as readily accessible.

For example, if an investor is Auckland based and wants to buy an investment property in Christchurch, they will have access to all the data they need to make an informed decision and purchase sight-unseen. A team of experts will be able to collect the data, produce investment reports (cash flow analysis, retirement modelling, etc.) and advise you on the best way to proceed.

Reason 5
Market Depth

Unlike other alternative assets such as art where there is a niche buying pool, property has a large purchaser base which makes it accessible to buy and sell. Accessibility to buy and sell is a large part of what makes property investment such a popular investment tool.

When referring to "normal", mass-market type housing, there is considerable market depth. Should the investor need to liquidate (sell) the investment, to reduce exposure or outgoings, a buyer can be found subject to price. However, this investment strategy is not recommended for investors who are subject to a significant risk of having to sell at short notice and that's because property isn't a liquid asset.

“Liquid investments” can be turned into cash quickly. Take shares for example, if you needed to liquidate any shares it'd only take a couple of days before that money is in your bank account. Property takes between 30-60 days to sell depending on the property and market fluctuations.

Despite this, reputable firms like Realestate.co.nz still reports that more than 1.2 million people browsed for properties during April 2022 which goes to show that even when the market is slow, there is still a huge number of people in New Zealand that are interested in property.

Reason 6
Transparency

Property is a very transparent industry because there is so much accessibility to data on housing in New Zealand. Market transparency allows investors to make important decisions with confidence. Without high levels of transparency, real estate markets will not function effectively.

Property is a direct investment. The investor is the registered proprietor (owner) of the asset. This significantly reduces the threat of theft or fraud.

Recent examples of fraud risk due to lack of attachment/transparency concerning asset holdings with indirect investments include Ross Asset Management (NZ) and the Bernard Madoff Ponzi scheme (US).

Reason 7
Leverage

Leverage can be described as "using borrowed money to make more money than it costs to use borrowed money" and makes up one of Thrive's five key investment concepts.

Put simply, leverage is using the banks' money to make money for yourself. So, how can we achieve this?

Leverage comes from the ability to access borrowed money, and this can be broken down into three key concepts:

1. Character
2. Security
3. Serviceability

Character

The vast majority of people have no problem meeting the character requirements because they pay their bills, do what they say they'll do, and act in good faith. The character test is run by the banks to qualify that the prospective purchaser will pay back the mortgage as the terms are agreed upon.

Security

For residential investment properties, security is all about having headroom between the value of your property and the maximum lending-to-value ratio. For your own home, you can borrow up to 80% of its value and for any existing properties, you can borrow up to 60% of the value.

Complications arise when you spread your borrowing across different lenders but if done right, this will allow you to access more capital without increasing the interest rate risk. Likewise, having a mix of growth and yielding properties allows you access to the optimal amount of leverage based on sufficient equity and serviceability.

It is also worth noting that banks will only secure your mortgage against quality assets that they believe they can sell to re-claim their money in the event the loan doesn't get paid. For instance, it's unlikely banks will accept a tiny house as security because it's not fixed in one place and has no land, therefore making it a risky security from the bank's perspective.

Serviceability

Serviceability is often the main hurdle for investors, and this refers to your ability to service the mortgage you're trying to draw down.

Again, this is heavily influenced by the split between growth and yield properties. Choosing properties with strong cash flow even though the capital gains prospects are less rosy than other options can make sense because it enables you to increase scale. This trade-off is central to building a property portfolio.

Equity is the difference between the value of your property and the mortgage outstanding. As the value of your properties grows, so does your equity. When this equity is not being used, it is essentially dead money.

The power of leverage ultimately comes down to using 'dead money' in your properties to purchase assets that are expected to grow in value over time. Unless you do renovations or other fast-growth strategies, investors often need to do very little other than wait to build equity in their portfolio and therefore put themselves in a position to grow their portfolio.

When the properties you've purchased go up in value, you take all the gains.

Summary

Retiring is hard and finding the best investment tool to get you there can be just as challenging. Property investment has been tried, trusted, and true for decades and there is a myriad of reasons why this has been the case.

With the preceding seven reasons why property investment just makes sense, you should now have an understanding of what it is that drives investors towards using property as a tool for retirement. There is no silver bullet, nor should there be so it is down to individuals to make informed decisions and take their future into their own hands.

What's the best way to do this?
Building a team of experts around you is one of the best ways to exemplify your success. A successful team will have a combination of experts including:

- Investment advisor – portfolio growth, cash flow forecasting, analysis & risk management
- Mortgage broker – interest rate management and facilitation of portfolio growth
- Lawyer – independent and dedicated professionals concerned only with the investor's interests
- Accountant – financial reporting and taxation
- Property manager – dedicated tenancy risk management
- Registered valuers – expert assessment of asset value

Perhaps the most important piece of the puzzle is finding someone who can analyse your numbers and come out with advice on the best way to structure your investments or maximise your capacity to invest. Investment advisors who know the New Zealand property market and specialise in property investment are wonderfully important.

Real Estate agents tend to "sell the dream" on any number of listings they have access to because that's what they have available to you, but with an advisor, you are getting much more robust advice across the board, including wealth planning.

How Thrive Investment Partners Can Help

Thrive Investment Partners is an expert financial advice company that is property centric. We help Kiwis build wealth through property investment.

We understand that everyone's knowledge, experience and investing risk appetites are different – we partner with you to develop a financial plan and execution strategy that supports your wealth goals. Each investment we recommend is backed by research. Our advisers like nothing more than a client who asks 'why'. We 'deep-dive' opportunities to manage risk but also to fully understand the 'upside' for you.

If this sounds like you, book a time to speak to our team using the link below and take the first steps.

Talk to our team

FAQs About Thrive Investment Partners

What do we do?
We help Kiwis build wealth through property investment. Our advisors will take the time to understand your individual needs and recommend suitable investment properties to help you build wealth and set up your retirement.

What does this look like?
We use a 3-step process:

1. We start with a Discovery Meeting where we learn about you, your goals, etc. and you learn more about us.
2. This is followed by a Strategy Meeting where we model your retirement plan, understand key investment concepts and briefly touch on some investment choices.
3. Finally, an Asset Selection Meeting where we discuss investment options in more detail and make any recommendation adjustments based on what we now know about you.

Who are we right for?
We help people with limited knowledge of the property market make smart investment choices and set up their futures. From first-time investors to experienced investors, we can cater to a wide range of people and help set up their futures through research-based property investment.

How much does it cost?
Nothing! We get paid a fee from the developer when a property is transacted so you are getting expert advice at no charge - it's a no-brainer!

How do I start?
Start the process now by booking a time to talk with our advisor by clicking on the button below:

Book a meeting with adviser

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