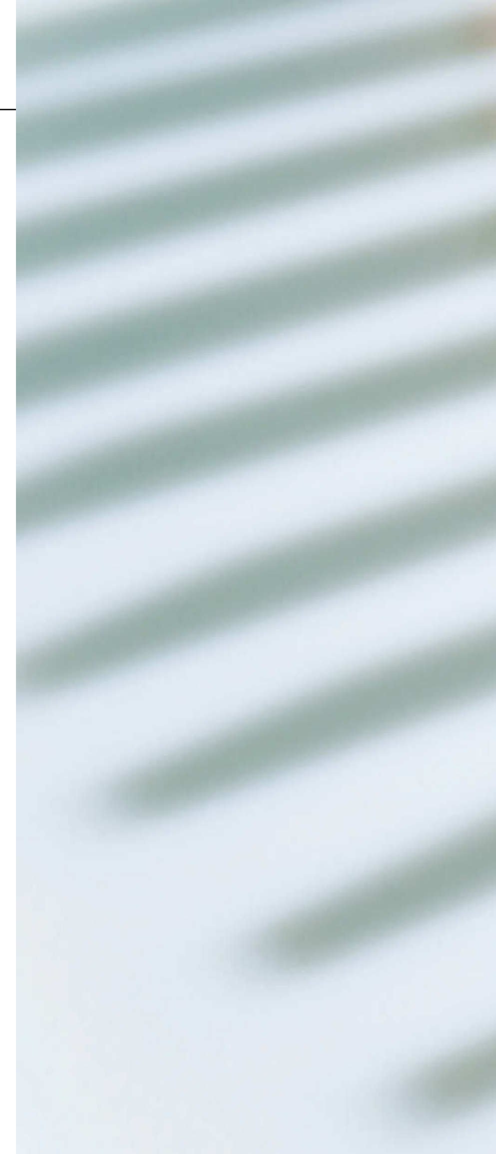

Risk management tools for property investors

Property is generally considered a low-risk yet strong investment medium, so while many investors research locations and property types, few have a comprehensive and structured risk management strategy

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ONE OF the cardinal rules of investing, regardless of asset class, is to ensure you have a well-researched risk management plan in place. Here are a few of the most powerful risk management tools that can help reduce risk for property investors.

Insurance

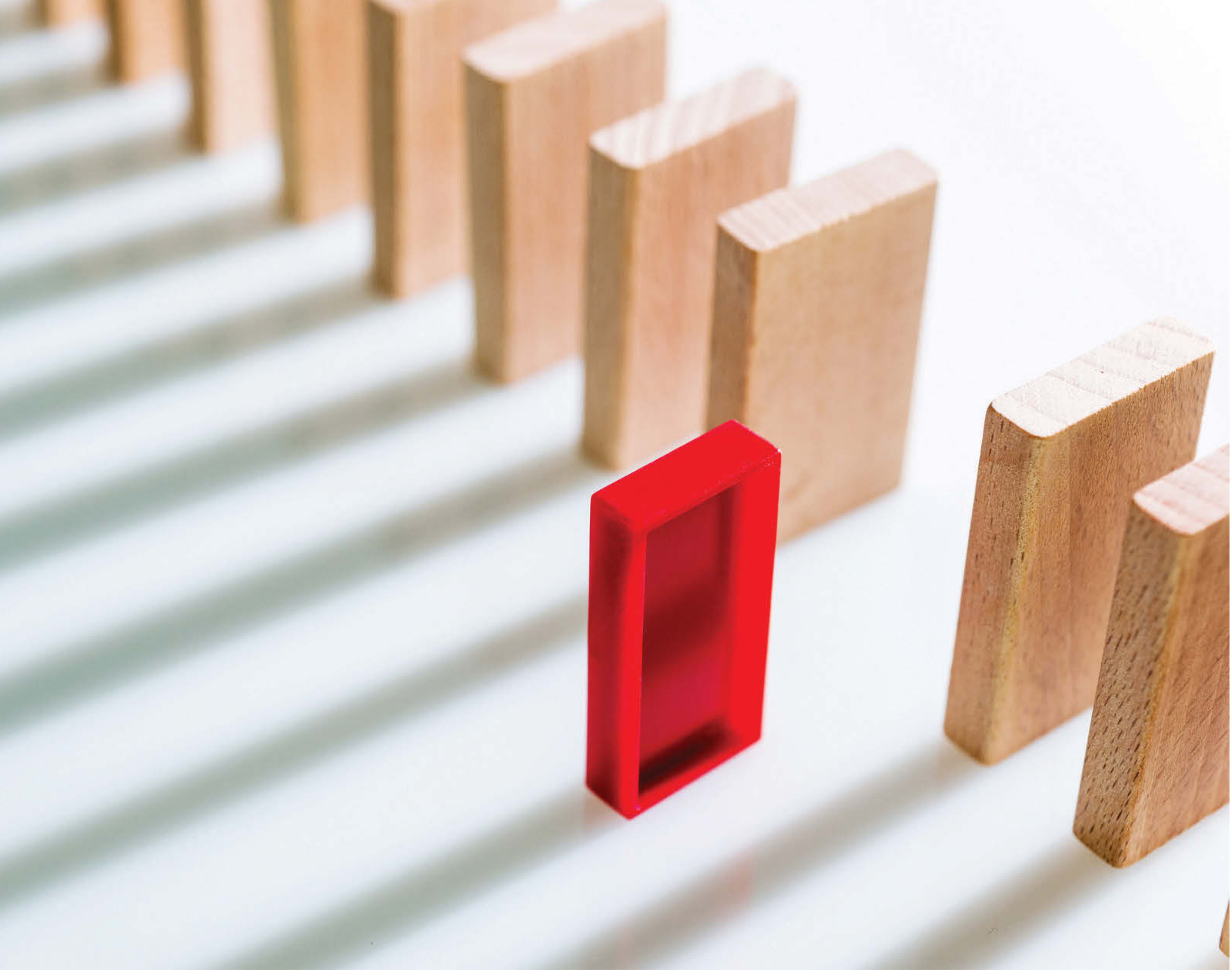
This is a wide-ranging tool that any investor would be crazy to ignore. Types of insurance to bear in mind include:

- **Building and contents insurance.** This covers building replacement and damage to building and contents, for example from fire, water, and the like.
- **Landlord insurance.** This protects against losses related to tenant issues, such as loss of rent due to defaults, damage caused by tenants, and tenant claims.
- **Life insurance.** This depends on the investor's personal circumstances. Life insurance for a single person may not be needed as there is no beneficiary. However, for a couple, with or without children, cover should be in place to ensure that the remaining family members will be financially secure.
- **Income protection.** Not enough people have this cover. If for any reason you become permanently disabled (in a car accident for example), this cover provides you with an income of about 75% of your salary until the age of 65. Beware of policies that are much cheaper and cover you for only two years.

Insurance can be complicated, so using a good insurance broker is paramount.

Cash buffers

When structuring a strategy and financial plan,



an investor should always ensure that they have 'buffers' in place.

If releasing equity in a property to invest in a new one, ensure that you do not use all the equity to purchase the property. Keep a comfortable amount available to cushion against unexpected expenses, interest rate rises, etc.

I also recommend that investors have an additional buffer, usually in the form of savings in an offset account, for personal expenses (medical emergency, car purchase, holidays, etc.). The quantum of these buffers will depend on many factors, but, as a simplistic example, I would recommend at least a $50k investment buffer when buying a $400k–$500k property.

Location

A common-sense risk management strategy will be guided by the timeless 'do not put all your eggs in the same basket' idiom. If you are building a portfolio, consider investing in different states. It reduces the economic risk of investing in a single state, and avoids (or reduces) land tax.

Cash flow management

Investing in property is a numbers game. In order to make a decision on the acquisition of a property it is essential that you understand what impact this property will have on your cash flow. After all, you will have to cope with the property's cash flow for 15 to 20 years!

It would be reckless to invest in something that turned out to be cash flow negative by an amount that you could not afford. Cash flow projections should always be reviewed against actual figures to ensure there is no slippage. Research on costs/revenue is important.

It sounds elementary, but many people do not know where to start and how to analyse these cash flow numbers.

Advice

The above are some of the important considerations, but there are many more relating to financing, legal structures and other matters. In my mind the best risk management decision an investor can make is to seek professional help in this field. There are a few excellent knowledgeable experts out there, and any investor going it alone is certain to benefit from getting the right advice on the classic and costly mistakes that can be easily avoided. YIP