

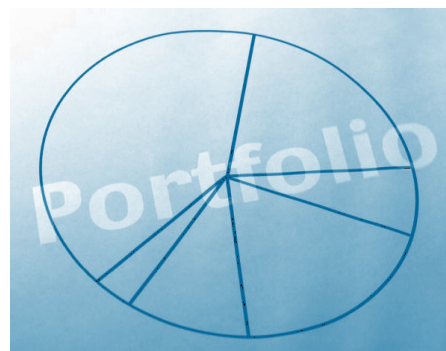
# What's the Right Mix for My Property Portfolio?

A Property Investment Article from Pinnacle

*The simple answer to this question is that there's no right or wrong mix. Investors in property have to weigh up all key areas, and the whole ethos of mix could be placed under one generic banner of diversification.*

*Looking up the word in the Oxford English dictionary, you'll find the description of the verb to diversify as "enlarge or vary its range of products..."*

*So, does this mean we invest in a range of properties across different countries, off-plan, built.... and the job is done? Not quite...there's a bit more to consider.*



Diversified Support

## Types of Markets

There are three types of property market: primary, secondary and tertiary. Knowledge of these is essential.

**Primary markets** such as the UK and Australia are typically easy to enter and have established banking systems, a reliable infrastructure, finance availability and proven capital growth. Inward investment drives capital growth along with regeneration, and there is an established and strong rental market.

**Secondary markets** like Malaysia and Spain generally exhibit signs of growing oversupply as a result of extensive initial development and therefore these markets can present potential renting challenges. The valuation system is inconsistent, producing a volatile secondary market, and there's a general lack of flexible financing options.

**Tertiary markets** are represented by developing countries such as Thailand and Brazil. Here there is perceived political instability or certainly recent political instability. Financing or the mortgage market is relatively non-existent, or in the early stages of development.

Given this breakdown, should you stick only to primary markets? If your risk appetite is low, the answer is probably yes. However, if you remember that bigger reward can follow a bit more risk, there's a case for some exposure to secondary and tertiary markets- Yes, that's the diversification bit! Generally, it may be prudent to start first in primary and then progress to the non-core secondary and tertiary markets.

## Currency Exposure

Let's say your income is in HKD, you want to send your kids to Australia to study and you'd like to buy property in Melbourne. As we all know too painfully, currencies do move against each other.

For example buying an AU\$300,000 flat in Melbourne at the start of 2007 cost HK\$1,839,000. In 2010 an AU\$300,000 flat costs in 2010 HK\$2,106,000, so in currency terms alone you'd be paying HK\$267,000 more.

Be aware of this, but don't be scared off by it. No one, not even currency experts, can predict what currency movements will take place. If you sit waiting for the right time to pounce, you're likely to miss good opportunities as there are always so many other factors affecting the value.

## Different Lending Options

As already mentioned, some markets offer little or no financing facility, so if you're buying there and requiring leverage, you may have no choice!

Where financing flexibility exists there are two basic options:

- **Interest Only:** You pay the bank interest on the loan and have to repay the balance after say 20 years.
- **Principal & Interest:** You pay interest and capital every month. This is more expensive than interest only, but if you maintain payments, you guarantee the mortgage is repaid at the end of the term.

Start building your property portfolio now:

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For interest only and repayment, you may consider a *multi-currency option*, in which you draw down the loan in a different currency to that in which the asset is denominated. This is where we all need to take a step back and understand the dynamics.

Take an example of Mr A who borrows £250,000 to buy a dream flat in London from “The Bank that Likes to say Yes” - interestingly not many of these around at present!!

On drawdown date he decides to borrow in HK\$ at an exchange rate of 12.2%. So Mr A now has a mortgage of HK\$3,050,000 and is probably pleased that the interest rate is some 1% lower than that for UK mortgages and hears his mate's endorsement of “the pound's bound to strengthen against the dollar soon” ringing in his ear.

Low and behold the pound weakens more and drops to 11.2. So in effect Mr A now has a mortgage in sterling of £272,321, so owes £22,321 more to “The Bank that likes to say Yes”, who are now asking him to provide more funds immediately by way of their ‘margin call’. A margin call is where the bank will ask you to inject cash funds into the mortgage, as a result of adverse currency movement meaning your “loan to value” has exceeded what was previously agreed.

The general rule of thumb for borrowing is borrow in the currency of the asset you are purchasing, which takes away any currency risk. Ask those who have had large margin calls when the Japanese Yen moved dramatically against the Aussie dollar and the Swiss Franc tangoed with the GBP!

Financing - or good debt for buying - is compliment to a diversified property portfolio, but again the savvy investor knows the ways to manage risks for maximum benefit.

## Legal & Tax Implications

Always, always, always get the right legal representation in place, and ensure your property investment partner helps with this.

You need to know things such as:

- Have I got full title ownership; is it leasehold?
- Do I need documents apostilled? This is common when buying in places such as Portugal.
- Do documents for lawyers for conveyancing need certification?
- Will I have to pay tax on rental income, what allowances exist?

For example. in the UK mortgage interest expenses are offset against income as are reasonable costs. Aussies can offset losses on negative gearing for the tax year when they return to Australia in gainful employment.

Non resident UK people, Brit expats pay no Capital Gains Tax, whereas in Australia you do. And as for our unlucky American friends Barack and his bunch of highwaymen chase you down wherever you are!

Know your facts; get good legal and tax advice.

## The Bottom Line

To diversify your property portfolio is potentially a good strategy, as in any investment portfolio. However, in doing so make sure you are armed with the knowledge and information required. Quality support is needed along the way from trusted partners, your lawyer, tax adviser and property broker and will prove invaluable. Diversified support!

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