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Greed, Ignorance and Fear – a recipe for property disaster

Risk exists in every investment domain. Even cash in the bank has risks. The risk of cash in a bank is that it loses its value over time. The purchasing power of cash declines over time. There is some safety in cash over the short term but cash is not really an investment.

Investing has other risks not the least of which is that you potentially stand to lose your money!

Investing in a high risk start up business can wipe out your capital.

Overly-gearing up on a property investment can wipe out your equity if you are forced to sell in a down market. Investing inherently is risky and each of us has a different perspective when it comes to risk.

At some point in our lives we may have a higher appetite for risk than at other times. A young investor in their 20s or 30s has no fear about not having adequate savings for their retirement. Hence their investment decisions even with all their associated risks, are much less burdensome than for say a 55-year old who is probably making investment decisions based on building a nest egg.

All this decision-making will be based on a personal risk profile bearing in mind the age of the individual and stage of their life as well as the type of investment being made. How much to borrow? What is the strategy behind this investment? Buy and hold or renovate for profit? What are the risks of this property not performing?

There are many types of potential loss to consider:

- Financial loss
- Equity loss
- Cash flow loss
- Relationship loss
- Lost opportunity

Protection will vary depending on the investment:

- Formal Insurance
- Landlords Protection Insurance
- Structures
- Finance
- Ownership Entity (trust / company etc)

Emotion plays a huge role when investing your resources into property. To be successful, investors must always be aware of the effects of the three 'killers' of sound judgment: greed, fear and ignorance.

We need only look at the buying frenzy that took place over the period 2000 - 2003 on the east coast and 2004-2008 on the west coast, to see how investors stretched themselves to the limit in order to buy property.

There was an amount of greed and ignorance prevailing. **Greed**, in relation to short term capital profits, were the motivating factor rather than long term strategic investing. **Ignorance**, in that markets cannot sustain the sorts of gains being achieved before correcting, was another major error many folks made.

On the other hand we have witnessed over the period from late 2008 to mid 2009 a period of some prevailing fear. The level of investment activity in most property markets (except the first home buyer market), dropped dramatically over the period, a fair indicator of **fear**. This was understandable given the concern that the Global Financial Crisis (GFC) would spiral out of control and the financial world as we knew it was facing extermination.

Emotions are natural but investing is about managing the emotions and having the capacity to be self reflective. It's about rational decision-making. Emotions should play no part in investing.

Consider the case of buying your first home. There is excitement: the first home. Wow! It's memorable; it's significant; it's scary. Even the language the first homebuyer uses is distinctive. "Oh I just love this house. It's so charming!" These are warning signs for the committed investor who needs to operate dispassionately from his or her emotions.

There is simply no room to fall in love with a property in investing. Nor is there room for fear and loathing.

We need to be on guard against emotions entering our analysis. For sure this can be difficult, particularly if we are buying at an auction which is choreographed by an auctioneer and their selling agents to create tension, excitement and often irrational exuberance in the bidding. It is definitely a danger spot and one we need to be on guard against.

Even in the process of investigating a property and scanning the market we are influenced at an emotional level, the various things we come across will arouse some emotion. Sometimes an unkempt house that presents as a real "turnoff" can be a gem. What is beneath the long grass? What is under the dirty carpet? How can the property be reconfigured to create light and space? These are the workings of an investor's mind.

So there you have it. The worst mistakes many property buyers make are based around greed, ignorance and fear. When you make a mistake buying property, it's usually significant and potentially very long-term. Best not to make the mistake in the first place. Learn from others, find a good mentor or real estate buyers agent to work on your behalf.

Good investing.