Real Estate

Here's how to make money from property without actually owning property

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Buying, selling, renting and renovating investment properties aren't the only ways to make money from real estate.

Several strategies and products give investors exposure to the property market without the need to directly own property.

The minimum outlay and transaction costs for these investments are much lower than for an individual property, allowing those who haven't yet saved a deposit to invest.

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Real estate funds and trusts

It's possible to invest in real estate through various funds and trusts that directly own property assets, with minimum investments generally starting at $500. Investors can buy shares in real estate investment trusts (REITs), which are companies that own large property portfolios, typically consisting of commercial properties such as offices, hotels or apartment buildings.

REITs are traded on the stock exchange, making the asset quite liquid. Net rental income from properties held by the trust is paid as a dividend to shareholders, with yields often between 5 and 7 per cent.

Finance commentator and The Money Mentor Way founder Nicole Pedersen-McKinnon said REITs provide diversification within the fund, but volatility can be an issue.

"The price at which you can buy and sell your chunk of the fund may fluctuate due to investor sentiment, along with the underlying value of the properties," she said.

Fractional property investing

Fractional investing involves purchasing shares in a property, along with potentially thousands of other investors.

REITs typically own large-scale commercial properties such as shopping centres and office towers. **Supplied**

A number of fractional investing platforms have sprung up in recent years including DomaCom and BrickX, which facilitate the transaction and charge a management fee.

"Fractional investment is a natural progression and innovation of a property market that has moved out of the reach of many," said Pedersen-McKinnon.

"Property traditionally has big upfront costs, compared with other asset classes like shares. But fractional investment removes that barrier to entry and also the necessity to first stash lots of cash."

Models differ between platforms. DomaCom uses a crowdfunding model, requiring a set level of commitment before a property is purchased. Investors can join an existing crowdfunding campaign or set up their own private campaign, creating a means of investing with friends or family.

A DomaCom crowdfunding campaign has been set up for a townhouse in the Little Grenfell development in Adelaide. **Supplied**

Properties on DomaCom range from townhouse developments to wind and solar farms, and shares in properties can be sold on a secondary market on the platform.

BrickX on the other hand selects and purchases a property, divides it into 10,000 shares called bricks, which are then sold to investors for as little as $33. Investors receive rental income proportional to their share, and the value of each brick moves in line with the value of the property. Like DomaCom, bricks can be sold on a secondary market, allowing investors to realise capital gains, or losses.

The majority of properties available on BrickX at the time of writing were geared, with loan-to-value ratios of between 17 and 40 per cent. Most properties were apartments and houses in Sydney's inner suburbs, with yields ranging between 0.88 and 2.87 per cent.

Low yields mean returns are largely reliant on capital gains. This may create challenges for investors who own shares of properties concentrated in Sydney and Melbourne, where median prices have fallen.

This one-bedroom unit in the inner Sydney suburb of Enmore has a net rental yield of 2.87 per cent, the highest of all properties on BrickX. **Supplied**

The small scale of fractional investing platforms means liquidity can be an issue, according to financial planner and The Wealth Mentor founder Jackson Millan, because investors can only sell their shares to other users of the same platform.

"If we're buying ASX shares there's a much broader range of participants in that market so liquidity can be higher," he said.

Millan warned investors to thoroughly investigate the fractional investing platform they are considering before diving in, including the methodology of asset selection and ongoing costs.

"Because this is such a new investment and can be quite exciting, it's still very much untested."

Pedersen-McKinnon said a risk of fractional investing was overexposure to just one property.

"You need to create your own diversification by also investing elsewhere, whether that be in other properties and also in shares."

The gearing problem

Banks are willing to lend large amounts of money to buy residential property because it's less volatile than other investments. Median values tend to increase in the long term, making the asset a suitable security that can be sold if a borrower defaults.

It's this aspect that sets traditional property investing apart from other investments, according to Millan.

"One of the main reasons why people love direct property so much is you can leverage your money quite aggressively," he said. "The big factor that influences the ultimate outcome is the gearing."

It's possible to borrow money to invest in shares or other investments, known as margin lending, but it's more complicated and riskier than borrowing to buy property, and rates are higher. Lenders that offer margin loans require borrowers to keep their loan-to-value ratio below a set level, which can be problematic if the market falls.

"One of the key pitfalls of that type of investing is the risk of a margin call," said Millan. "If there is a flash crash, or there is some type of correction in the market, you have 24 hours to correct the LVR of that portfolio which results in much of the investment being sold down, which crystallises your losses."

Lenders also have lists of investments that are approved for margin lending, which generally include many ASX-traded shares and REITs. Fractional investing platforms and funds were not included on the more recent approved-investment lists of 10 major margin lenders, including the big four banks.

Being able to invest in property without debt could be considered an advantage of fractional investing and REITs, according to Pedersen-McKinnon.

"You don't have to take on that additional risk of leverage, particularly with markets volatile at the moment," she said.

Wise investments can help grow a deposit, but a bad one can set you back. While innovative investment products may offer exposure to the real estate sector, the risks and limitations need to be understood before putting money on the line.

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