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THE 7 PILLARS OF BUY-TO-LET WISDOM

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Introduction

Buy-to-let is simple – you buy a property and you rent it out, right? Wrong! Successful buy-to-let is backed by a science that is based on business fundamentals which have been refined over time since the first brick was laid on the first investment property ever built. There are seven fundamentals to property investment:

1. YIELD
2. MANAGEMENT
3. GEARING
4. AWARENESS
5. APPRECIATION
6. RISK
7. EXIT

To understand these fundamentals we need to go back, way back, to when the first property deals were taking place.

1. YIELD

A long time ago, when there were no homes people used to live in caves. When the caves became in short supply man had to seek shelter elsewhere so he had to build a home. Now, I imagine there were no building firms in those days – let alone cowboy builders! So man had to build his own home, with his own sweat, with whatever materials he could find.

Now, there was this one man, Romulus, who had to build his own home. He found out that he was actually quite good at it. In fact he realised that he was better at building homes than actually hunting and gathering food. There was another man, Remus, who noticed this as well. Remus used to admire his home, it was far better than his, but noticed that Romulus's family didn't have much to eat.

Remus was good at hunting but not good at house building so Remus approached Romulus and made him an offer.

"I'll hunt and gather 200 deers for you if you build me a home" he said.
"What will I do with 200 deers? After 3 months my family and I would have only eaten 10 deers and the rest will go stale" Romulus replied. "How about you give me 2 deers a week for the next 5 years"

Remus thought about it and thought it will not take him more than 2 hours per week extra to meet Romulus's quota but if Remus tried to build his own home it would take twice as long and be only half as good. So Remus agreed.

This deal, or something similar, was the first property deal that ever occurred. Romulus evaluated what he would get out of it relative to what he put in. So what did Romulus actually put in? Romulus has invested his time – about 3 months worth. What has Romulus got out of it? Well, 2 deers a week for the next 5 years – probably equating to 6 months worth of Romulus's time. So there is a clear profit element to this transaction of 3 months. It could be 1 month or even 5 months worth of profit but there is no assurity that it will be 3 months. Romulus had to make an estimation.

In property investment you have to make an estimation of the profit element. There is no assurity of the profit element in property investment. You can only make an educated guess. The best tool to estimate this is **YIELD.**

[Chapter 1 deals with yield, what it is, why it is important, how to calculate it, what to compare it to and key thresholds that should trigger you to buy]

2. MANAGEMENT

After Remus's house was built word spread. He got approached by many in the community to build them homes in exchange for resources. Romulus was building homes as fast as he could physically build them in return for animal skin, metal, wood and tools.

Soon Romulus had a well fed, well clothed and well housed family due to his efforts of house building and the 'rent' he was receiving.

Romulus was now earning more than he could use so he decided to use the excess to pay other men to build more homes. Before he knew it Romulus had a fully fledged building company making him enough resources – without actually having to build any homes himself!

Things were not all rosy however. Some of the people were not keeping to their side of the bargain. Romulus would not get the full quota from his residents as first agreed. He would get 1 deer instead of 2 a week, sometimes none. Romulus realised that if he was to pay his workforce on time and in full and maintain his family he would have to take on someone to ensure that all the quotas were paid in full and on time.

Romulus knew of Conan. He was a strong and well respected man. He approached him to collect the quotas in return for a share of what he collected. Conan agreed. Soon all quotas were being met in full and on time. Romulus's building company was becoming a strong force and the homes he was building were better due to the amassing of other resources other than just food.

The key to Romulus's continuing success was **MANAGEMENT.** Romulus realised that not only did he have to calculate what he'll get back but also that he'll be able to collect it. If you invest money you need to know that you'll be able to get a return – for real! Theoretical profits can easily become a real loss.

> [Chapter 2 deals with managing the people surrounding you namely: You, The Bank, The Tenant, The Letting Agent, Your Employees, The Contractors, Your Solicitor, Your Mortgage Broker, The Local Authority, The Freeholder & Managing Agent, Your Accountant and The Law.]

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3. GEARING

Back to Romulus's story. A few years later came the introduction of money. Money avoided all the hassle of doing deals in terms of food, wood, metal etc. Now Romulus wanted to grow bigger. He was growing by simply re-investing his earnings into wages to build more homes, but Romulus was ambitious and wanted to grow faster. With the emergence of money came the money lenders. Romulus met up with Barclay, a local money lender, who offered to lend to him to enable him to build 10 times more homes per month at the cost of 1 home per month. Romulus agreed to this and soon the land was filled with Romulus's homes.

Romulus's rapid expansion was due to his willingness to borrow. He realised that he would grow a lot quicker if he borrowed. He evaluated the cost of borrowing and found there was a pay off by borrowing. Its what's known in the game as **GEARING.** Gearing is key to business, but even more key to property. With the use of manageable long term debt he was able to structure the cashflows so that he could pay the money lender and builders and still make some money on top.

[Chapter 3 deals with gearing increases your return, how to make infinite returns, how to achieve 100% financing, the cost of holding money and the opportunity cost of money]

4. AWARENESS

Due to the success of Romulus's building company he found that his homes dominated the market. Properties that he had originally built were coming up for sale. The prices being charged seemed quite low in comparison to what he was paying out to build them. It was in Romulus's interest to buy these homes and rent them out than to actually build them and sell them on! So Romulus decided to start buying homes rather than build them.

Romulus was aware of the market enough to change his strategy. You have to be aware of the whole market surrounding you to ensure that you are making the right business decisions. This is what I call **AWARENESS.**

[Chapter 4 shows you how to calculate the real value of a property, how to calculate the bubble element, why the bubble element exists, what to be aware of to avoid properties with a bubble element and predictions on the bubble bursting]

5. APPRECIATION

Due to population movements he was seeing certain areas fall in value as well as rise in value due to the increased and decreased demand for properties in that area. Romulus would watch these movements and predict the areas which offered growth of his investment. He realised that if he could buy a property and make a gain without actually having to do anything it would be easier to make even more money.

APPRECIATION is money for nothing. It's the easiest way to make money. It's the ability to predict the way the market is going. This is very difficult to do as there are many variables involved but you can make informed predictions over the short, medium and long term.

[Chapter 5 shows you how to get capital appreciation without foresight, with foresight and potential, explains what negative bubbles are and how they make you rich and how to calculate the immediate profit from an extension or loft conversion]

6. RISK

Romulus had bought in predominately two areas. This is because he knew the areas well and did not want to cast his net too far. However, there was a terrible flood in one of the areas wiping out all his properties in that area. Romulus's wealth had been halved. He had to reduce his living costs to accommodate for this tragedy and his expansion plans were blighted.

Romulus had put all his eggs in two baskets! He did not understand how to mitigate his RISK and thus not apply amongst others, the principle of diversification being the science of spreading your investments over different uncorrelated markets.

[Chapter 6 shows you what systematic, leverage and specific risk is, how to eliminate these risks where possible and manage what remains]

7. EXIT

Romulus was old now. He had many houses but he was too old to run and manage them and his off springs showed no interest. He approached Barclay and asked him if he knew anyone that would be interested in purchasing his business. Barclay suggested that he sells at the right time and get all the right statistics that would attract the right buyer. 6 months down the line he approached Barclay again and presented him his business. Barclay found a buyer within 3 months.

With the monies realised he invested it in Barclay's bank on a long term deposit account and Romulus earned a healthy interest for him and his family risk free. A happy ending to Romulus's story.

With any investment you need to know when you will **EXIT.** Its knowing when to sell and getting the most for your investment.

[Chapter 7 shows you what is a hotspot, cooling spot, coldspot and warmspot and why you should only sell in a cooling spot]

So we know the seven most important factors when it comes to property investment – lets get in to the detail. Now these factors are not sequential. You do not need to master them one after the other. All of them have to be understood and applied to get the most out of your investment. You need to think about all of them as a whole to ensure your success.

This book is NOT about how to do buy to let. You will not find out about the nitty-gritty of renting of properties or buy to let mortgages like types of tenancy agreements or discount tracker mortgages. This book is for the investor that's already taken the plunge and is in the property game. It will prompt you to think about the wider aspects of buy to let, the variables involved and how to understand and exploit them.

1.YIELD

The first question of any professional property investor when considering a purchase is – what is the yield? This should only ever be the starting point. If the yield is good then go for it. If its not then forget it! But first we need to know what yield is and then what is a good yield. Yield in its purest form is:

'what you get out relative to what you put in'

Lets look at this in more detail. Yield really has only two key variables:

1. What you get out
2. What you put in

So to calculate yield you simply divide what you get out by what you put in and express it as a percentage. In mathematical terms:

What you get out x 100.

What you put in

1.What You Get Out

So what do you get out from property? – RENT! But its not just as simple as that. Do you consider the rent received, rent received less mortgage costs or the amount of cash you receive after all expenses including tax? Do you include capital growth? Do you consider it on a weekly, monthly or annual basis? Well I have come up with the key outputs you should only ever be interested in if you are considering purchasing a property. The key outputs from property investment are:

Buyer	**Output**	**Definition**
CASH BUYER – a buyer that is using only their own	Annual Rent	This is the amount you expect to receive from your tenant for use of your property only. You do not include any payments from your tenant that are considered expenses such as water rates or

savings to purchase the property and not borrowing any funds at all.		council tax if you do include this in your rent. You calculate it on an annual basis as returns are always calculated annually – its industry standard. You assume a full year with no void periods. Void periods are dealt with below.
	Annual Rent - Expenses	This is what you expect to receive back in your hand before tax. So this is the annual rent less the annual expenses. Typical expenses will be: • **Service charges & ground rent** – if you rent out a flat you are responsible for all the service charges and ground rent due. These are the costs to maintain the block and to keep the freeholder happy! These expenses can never be the responsibility of

		your tenant as non-payment of these charges can result in the loss of your flat as it is leasehold. These costs need to be considered before you buy a flat as some service charges can be extortionate. • **Insurances** – You need buildings insurance to cover the property against damage or vandalism. Some areas are expensive to insure so if you can get an idea of insurance premiums for the area before buying so you can see how much it will affect the overall output. You may want rent guarantees and maintenance insurances so these premiums will need to be accounted for. • **Letting agent fees** – You may need to use

		a letting agent as you have a full-time job or simply do not want to deal with the hassle of renting out the property. Some letting agents charge 7% of the rent others charge 17%! So the cost can vary widely. Get an idea first as the charge is applied to the rent so it hits the top line. • **Repairs** – This is a cost that has to be estimated but you are in the hands of the gods! This expense alone can make the difference between making a profit or a loss. Over the long term repairs even out through the life of the property but if you get hit for large repair bills early on it can leave you out of pocket for a while. • **Void Periods & Bad Debts –** If you are

		investing in a high demand area then voids will be minimal but its always good practice to assume 1 month to be prudent. I invest in medium demand areas and I assume 2 months for some areas. Remember also that sometimes tenants do not pay! So the non-payment of rent is as good as a void. I charge 1 month as standard. So in total I charge 3 months worth of rent to this expense which is equivalent to 25% of the annual rent. • **Admin costs –** There will be letters, tenancy agreements, postage and other office costs involved with running a property which need to be estimated. The more properties you have the less the

		overall cost as the cost is split between the properties. • **Other costs** – This will be specific to the property. If you are considering buying a flat in Chelsea then your marketing costs may require an advert in The Times and a glossy brochure being produced – this will be a lot! However if you're buying a small bedsit up North then only minimal costs for advertising will be needed but extra security costs for the property during void periods will have to be budgeted for. Its good to calculate this output as it will determine whether it is a good investment. If the output is not what was expected then you can walk away

		from the deal. If it meets your expectation or even surpasses it then its worth considering. This output is commonly called the expected net profit of an investment. We would hope that this figure is positive!
	Annual Rent - Expenses - Tax	This is another important output. This is what you expect to get back in your hand after everything – including tax. Things to consider when taking into account the amount of tax you'll have to pay are: • Allowable expenditure – you have to check that the expenses above are tax deductible. Expenses have to be incurred necessarily, wholly and exclusively to the business for them to be deductible. If they're not then

		they will have to added back when calculating your tax liability which will result in a higher tax charge. • Allowable reliefs – there will be certain reliefs available to you such as Wear&Tear allowance and capital allowances which the Inland Revenue allow you to apply to the profit. Even though these are not out of pocket expenses i.e. no money has passed hands, you still can claim these reliefs to lower your overall profit thus reducing your tax charge. • Basic or Higher Rate Tax Payer – if you are a higher rate tax payer then you are taxed at 40% compared to 20% for a basic rate tax payer. This means you receive less of

		the profit. It may be more beneficial to invest in other more tax efficient investments geared towards higher rate tax payers. Tax free investments benefit the higher rate tax payers the most. Tax free investments such as ISAs and Private Pensions are out there as alternatives to property investments. You have to look at the yields from these investments and compare them to property. I can tell you now that property yields way in excess of any other of these investments but ultimately its up to you where you invest!
	(Annual Rent – Expenses) + Annual Capital	This is the expected net profit before tax plus

	Growth	capital growth for the year. Not only do you receive a rental profit but hopefully there should be an appreciation of your property. There are many investors that invest in property solely for the growth. They are not concerned with making a rental profit (sometimes happy to make a rental loss!) but making an above average gain on their initial investment. Annual Capital Growth (ACG) can be determined by: Current Market Value after 1 year of purchase(CMV1) - Purchase Price (PP) = Annual Capital Growth (AGC1) Basically its how much your property has gone up by in a year of ownership. For future years ACG is:

		CMVn – CMVn-1 = ACGn In simple terms it's the difference between the value of the property now and one year ago.
MORTGAGED BUYER – a buyer that uses their own savings and borrows funds to purchase the property.	Annual Rent – Annual Interest Cost	This is the same as Annual Rent above but the costs of borrowing are deducted. This will be the interest cost applied to the loan. This gives a quick approximation of what you'll get back after you've met the immediate payment of the mortgage as the mortgage payment has to be met without fail.
	Annual Rent – Annual Interest Cost – Other Expenses	This will be the same as above but also deducting the expenses detailed above. This gives an

		expected profit figure before tax.
	Annual Rent – Annual Interest Cost – Other Expenses - Tax	This will be the same as above but deducting tax also under the same rules and reasons above.
	Annual Rent – Annual Interest Cost – Other Expenses + Annual Capital Growth	This will be the same as above and including growth calculated as above.

What you get out should only ever be assessed by what you put in. So lets look at what you put in.

2.What You Put In

Well you can be assured that you'll have to put in some of your hard earned cash! But how much depends on what you've got and how much you're willing to borrow. There can only ever be two sources for investment – your cash and borrowed cash. Lets look at the following table:

What you put	**Your Cash**	**Borrowed Cash**	**Description**

in			
Nil	None	None	Here you put in nothing! This scenario would occur if you were an employee as an employee never puts any cash in to a venture – they only take out. The yield of an investment is of less interest as the employee is not assessing the risk of an investment. An employee will only be interested in what pay packet they are going to receive and the possibility of it going up in the future. This situation can be ignored as I am assuming you are an investor. If you were to calculate the yield the yield would be infinity as you have put nothing in and got something out! The only other way this could occur would be if you took on a financial partner. Here the financial partner would put in their cash and borrow the cash but would rely on your expertise to make the investment work. If this is the case then yield is important and hence all the

			calculations below are valid.
Nil	None	Purchase price + Acquisition costs = Total cost of investment	Here you still put in nothing! The difference is that you borrow the whole of the cost of the investment. That is the deposit, the mortgage amount, solicitor costs, arrangement fees and valuation fees. On the surface the yield would again be infinity. However because you have borrowed all the money your ability to service the debt will be dependent on the yield so yield becomes very important. In fact out of all these four classes the yield of the investment is the most important as it has to be compared to the average interest rate you're borrowing at. If the yield is lower than the average rate then the investment will lose money. See further below.
Some	Deposit + Acquisition costs	Purchase price – deposit = Mortgage	This is the normal way people invest in property. You put in some but the bank put in the lion share. Typical ratios of your money to the bank's money are anywhere between 15:85 to 40:60. So ultimately

			you want to know what return you expect to get on your own money invested. This is called Return On Capital Employed (**ROCE**). Capital being another name for your own personal contribution to the investment.
All	Purchase Price + Acquisition costs	None	If only! This investor is rich enough to fund the whole purchase price and acquisition costs from their own savings. There are no borrowings. This investor needs to calculate the yield so he or she can make a direct comparison with other investments.

So to calculate yield, as mentioned above, you simply divide what you get out by what you put in and express it as a percentage:

$$\frac{\text{What you get out}}{\text{What you put in}} \times 100.$$

So the magic calculations that need to be computed, based on what you put in and get out detailed above, are:

Buyer	Name	Calculation	Why it’s a key performance indicator
CASH BUYER – a buyer that is using only their own savings to purchase the property and not borrowing any funds at all.	Gross Yield (GY)	<u>Annual Rent x 100.</u> Property Purchase Price + Acquisition Costs	This is a quick calculation to compute. It can give you a quick idea if the investment is worth pursuing. If you calculate the gross yield to be 2% then you quickly know that it wont be too long before that 2% yield diminishes to below a 0% yield and hence make a loss. Armed with this calculation you can quickly walk away from an investment or on the flipside get very excited!
	Net Yield (NY)	<u>(Annual Rent – Expenses) x 100.</u>	This calculation gives us a figure to

		Property Purchase Price + Acquisition Costs	compare directly with a bond yield o bank deposit account.
	Net Yield After Tax (NYAT)	<u>(Annual Rent - Expenses - Tax) x 100.</u> Property Purchase Price + Acquisition Costs	This is the real cashflow inward to yo after everything including tax based o what you put in.
	Net Yield Including Capital Growth (NYICG)	<u>(Annual Rent – Expenses) + Annual Capital Growth x 100.</u> Property Purchase Price + Acquisition Costs	This is the return on the investmen including any appreciation the propert may have experienced in the year. Thi return can be directly compared to stock or equity investment on the stoc market.
MORTGAGED BUYER – a buyer that uses their own	Gross ROCE (GR)	<u>(Annual Rent – Annual Interest Cost) x 100.</u> Deposit + Acquisition Costs	This is a relatively quick calculation to compute. You can get an idea of the return you'll get on the money you have personally invested.

savings and borrows funds to purchase the property.			
	Net ROCE (NR)	(Annual Rent – Annual Interest Cost – Other Expenses) x 100. Deposit + Acquisition Costs	This calculation will give you the net profit figure for the investment based on what you put in. A true measure of the profitability of the investment.
	Net ROCE After Tax (NRAT)	(Annual Rent – Annual Interest Cost – Other Expenses - Tax) x 100. Deposit + Acquisition Costs	This is the real cashflow inward to you after everything including tax based on what you put in.
	Net ROCE Including Capital Growth (NRICG)	(Annual Rent – Annual Interest Cost – Other Expenses) + Annual Capital Growth x 100. Deposit + Acquisition Costs	This is the true return on your money after taking in to account any appreciation on the property. This return can be directly compared to a stock or equity investment on the stock market.

An Example

So lets look at an example to calculate the yields:

David buys a property for £100,000 and funds the purchase with £25,000 of his own money and £75,000 of the bank's money. He also pays out £2,000 for acquisition costs from his own savings.

He estimates that he can rent it out for £1,000 per calendar month. He also estimates the following annual expenses:

Mortgage Costs	£4,500
Void Periods	£1,500
Service Charges&Ground Rent	£1,000
Repairs	£500
Agents Fees	£1,050
Sundry	£450
Total	**£9,000**

He's a higher tax rate payer so his profit gets taxed at 40% so he estimates a tax charge of:

	With Borrowings	Without Borrowings
Rental Income	£12,000	£12,000
Expenses	(£9,000)	(£4,500)
Profit	£3,000	£7,500
Tax@40%	**£1,200**	**£3,000**

He estimates 10% growth of £10,000 of the property price after one year of ownership.

So we have all the figures to calculate the yields:

Name	Calculation	Figures	Result
Gross Yield (GY)	Annual Rent x 100. / Property Purchase Price + Acquisition Costs	(12 x £1000 x100)/(£100,000+£2,000)	11.8%
Net Yield (NY)	(Annual Rent – Expenses) x 100.	(12x£1000 - £4,500)x100/	7.4%

	Property Purchase Price + Acquisition Costs	(£100,000+£2,000)	
Net Yield After Tax (NYAT)	<u>(Annual Rent - Expenses - Tax) x 100.</u> Property Purchase Price + Acquisition Costs	(12x£1000 - £4,500-£3,000)x100/ (£100,000+£2,000)	4.4%
Net Yield Including Capital Growth (NYICG)	<u>(Annual Rent – Expenses) + Annual Capital Growth x 100.</u> Property Purchase Price + Acquisition Costs	(12x£1000 - £4,500+£10,000)x100/ (£100,000+£2,000)	17.1%
Gross ROCE (GR)	<u>(Annual Rent – Annual Interest Cost) x 100.</u> Deposit + Acquisition Costs	(12 x £1000 - £4,500) x100/ (£25,000+£2,000)	27.8%
Net ROCE (NR)	<u>(Annual Rent – Annual Interest Cost – Other Expenses) x 100.</u> Deposit + Acquisition Costs	(12 x £1000 - £4,500 - £4,500) x100/ (£25,000+£2,000)	11.1%
Net ROCE After Tax (NRAT)	<u>(Annual Rent – Annual Interest Cost – Other Expenses - Tax) x 100.</u> Deposit + Acquisition Costs	(12 x £1000 - £4,500 - £4,500 - £1,200) x100/ (£25,000+£2,000)	6.7%

Net ROCE Including Capital Growth (NRICG)	(Annual Rent – Annual Interest Cost – Other Expenses) + Annual Capital Growth x 100. / Deposit + Acquisition Costs	(12 x £1000 - £4,500 - £4,500 + £10,000) x100/ (£25,000+£2,000)	48.1%

So what do we do with these yield calculations? Well we should compare them with alternative investments. Alternative investments being other non property investments and other property investments. Once compared you can make a judgement. So a comparison table may look like this:

Name	**Results**	**Non-property investments**	**Another property investment being considered**
Gross Yield (GY)	11.8%	2.2% - dividend from a stock or equity holding	10.4%
Net Yield (NY)	7.4%	4.2% - from a bank	6.5%

Net Yield After Tax (NYAT)	4.4%	3.3% - from a bank after tax	4.6%
Net Yield Including Capital Growth (NYICG)	17.1%	6.8% - from FTSE Fund	19.3%
Gross ROCE (GR)	27.8%	2.2% - dividend from a stock or equity holding	22.6%
Net ROCE (NR)	11.1%	4.2% - from a bank	12%
Net ROCE After Tax (NRAT)	6.7%	3.3% - from a bank after tax	6.3%
Net ROCE Including Capital Growth (NRICG)	48.1%	6.8% - from FTSE Fund	44%

You have to compare the yields from property with every other investment to be sure that your money is not better invested elsewhere and this includes other properties, stocks, bonds, managed funds, banks or other businesses that you can invest in. Be sure to ask the proposer of any investment whether their return is stated before expenses, interest charges, their management charges, tax, capital growth etc, so you can really compare the investment directly with your proposed property purchase.

Assuming property is your chosen investment then you should set yourself some thresholds. You should set desired yield figures to be met and then go out and get them. Once you are sure of what you want then acquiring them will be mere formality – as long as your demands are within reason!

My Policy

I adopt the following policy: If Gross Yield is in excess of **12%** and the Gross ROCE is in excess of **20%** then BUY! This will mean you will have sufficient rental income to cover the mortgage costs and you are being cash efficient with your capital. The threshold of 12% & 20% is purposely set high to counteract the risk of borrowing (see chapter 6 – Risk).

If only one of the thresholds are met then tread carefully. If yield is in excess of 12% but ROCE is below 20% then you are not borrowing enough to maximise your overall return. This in itself is not a problem if you have chosen not to borrow so much. It is a problem if your borrowing is restricted by the lender due to the lender requiring a high deposit.

If the yield is below 12% but ROCE is in excess of 20% again tread carefully. As long as the yield is not too far off 12% (I would say 10% being the lowest) and the likelihood of voids is minimal (due to the property being near a train station, shops or in a desirable area) then buy – otherwise stay away.

If neither threshold is met then walk away - no matter how pretty the property is!

One tip in using all these calculations above is - be prudent. Do not over estimate the likely rent achievable, capital gains and estimated profit and do include all the costs associated with buying the property within your acquisition costs.

To find out all the yields, ROCEs and capital growth indices for over 330 areas in the UK then visit www.propertyhotspots.net.

2. MANAGEMENT

Management is a very woolly word. So what do I mean when I say management? Well there are twelve parties involved within property investment that have to be managed to ensure that the business is run efficiently and lawfully. To grow in any business you have to manage the parties around you. Some businesses grow too big and neglect the management of these parties – even I am guilty of this! What eventually happens is that you become too removed from the business to the point where you do not know what is going on. The twelve parties that surround property investment specifically, in order of importance, are:

1. You
2. The Bank
3. The Tenant
4. Letting Agent
5. Employees
6. Contractors
7. Solicitor
8. Mortgage Broker
9. Local Authority
10. The Freeholder & Managing Agent
11. Accountant
12. The Law

Notice that even though you are involved in property investment, which is essentially bricks and mortar, the things you have to manage are people! Property is a people business so if you don't like dealing with people then this may be the wrong industry for you. So let's look at these twelve parties more closely – starting with YOU!

1. You

Everything starts with you. If you're not with it then nor will the property business be! You have to be a good manager of yourself to start with. The rest will always ultimately follow. But before I start preaching like a self-help guru let me get in to what you have to manage about yourself specific to property:

Manage Your….	**How**
Space	Its no point thinking you can run a property portfolio from a lever arch file on top of the TV! You need to designate a place in your house to put a computer, telephone and your files. It could be a section in your living room or it could be a whole

	room. When I started the property business I *lived* in one room – that's all I could afford! But I had one corner of the room designated as the office with my computer, fax/telephone, printer, stationery and files. Now I have a 300 sq ft office at home where I can get away from all distractions so I can focus on my portfolio and all the admin it brings. Having this space can certainly keep your stress levels down.
Time	Property can be a relatively passive way of making money but its not completely passive – no matter what Rich Dad said! You need to make time to look at all the admin that ownership brings, all the mortgage deals out there, current property prices and the market in general even if you only own one property. You have to keep abreast of all matters relating to property if you want to succeed at this game (see chapter 4 – Awareness) and this requires your time. I generally do my

	admin first thing in the morning so my mind is free to consider more taxing considerations such as other investments. If you hold down a full-time job then maybe its time to sacrifice your Saturday mornings for this task. If you do succeed at property investment and leave work then don't worry, you'll get all your Saturday mornings back as every day is a Saturday!
State of mind	You can be sure of one thing – there will be set backs. Tenants wont pay, repairs will need doing and interest rates will rise! The way you deal with these setbacks will determine whether you sink or swim. If you deem every setback as a catastrophe then you'll find that you wont last long in this business. If however, you tackle each problem with a positive and clear head then a logical solution will follow. One thing with me is that I'm persistent. I refuse to allow any investment that I've acquired not make money – if I did then I would

	question my own judgement and I wouldn't make anymore investments! You have to rely **100%**on yourself.
Expectations	Your expectations of others should be reasonable. No-one will ever care for your investment as much as you would as its success does not directly affect their income. So if you instruct an agent to look after your property then do not trust them to have an urgency that you would have. Do not expect your tenant to treat your property as if it was their own as the property is not! If you have a sceptical view of all the people surrounding your property investment it will ensure that you keep on top of things. These people have to earn your trust – do not assume it! As mentioned above always rely 100%on yourself - never rely 100% on others.

2. The Bank

There's only one thing the bank is interested in from you – that you pay the monthly mortgage payment in full *and* on time. That's it! The only way you can ensure this is that there are sufficient funds in your account from where the bank can take payment. Adopt the following practices:

Practice	Description
Keep a float	Ensure that there is at least 3 months worth of monthly mortgage payments in the account. If it comes out of your current account then ensure there is 3 months worth plus whatever else comes out of your bank on a monthly basis. I personally keep 6 months worth of mortgage payments in my current account as I am extra paranoid. I nearly went bankrupt a couple of years ago due to me forgetting that the bank wanting their money on time! As a result I hold a large balance as I do not want to go through that stress again.

Do what ever it takes.	Don't get hung up with where the money comes from to pay the mortgage. If you have to transfer money from your credit card to your current account to meet the payment then do it! You can always iron out the problems that led to you paying the mortgage with your credit card later but all that matters is that you pay the bank on time and in full.
Bank cash	Bank cash payments regularly. Don't be carrying bundles of cash in your pockets or purse. Mortgage payments are made through the bank not from your left pocket! This will keep your bank balance healthy and your pockets lighter.
Check balances often	Keep abreast of your bank balance as often as possible. I have internet banking so I know my bank balance every day. If you don't then you can check your balance from any cash machine if you have a cash card. It is good practice to check

	your balance daily to see what is coming in as well as going out. This way you will ensure that you can react to shortfalls promptly if they arise.

3. The Tenant

If you've decided to instruct a letting agent then the management of tenant relations *should* be handled by them. Your job is to subsequently manage your letting agent – see below. If you've bravely opted to manage your tenants yourself then read on.

Its no good having an investment property without a paying tenant. Its like a shop without any customers. To ensure you have a paying tenant you have to manage the relationship between you, the landlord, and the tenant in a proper way. Businesses spend fortunes managing their customer relations so we should learn from them. After all your tenants are your customers. Consider these pointers:

Pointer	**Description**

They are not your friend	Your tenant is not your friend! If your friend approaches you wishing to live in one of your properties then say no – make some excuse. We all know the feeling when we've lent a friend £20 on a night out and then we have to ask for the money back – we all hate doing it. There is a good reason why we don't like doing so and that is because money and friends don't mix. Many friends in the past have fallen out over very small amounts of money, let alone a month's rent. If your tenant tries to become friendly with you, like inviting you to their Christmas party, always decline. The relationship between landlord and tenant is strictly a business relationship and if this becomes blurred, then you are heading for trouble. This does not mean you have to be overly distant. Remember that you are in business with

	each other and that is the only reason why you know each other. For the relationship to last, the following simple contract needs to hold – you are supplying a safe property for the tenant to live in and the tenant is paying you the rent on time. Do not complicate matters by drifting into a friendship/business relationship.
Look after them	Having an absent landlord can be very frustrating for them and can sometimes result in damage to your property through neglect by you and ultimately the tenant. If your tenant calls you then answer the phone. If they leave a message then get back to them. And if they don't call then call them once in a while to make sure everything is alright. Now I'm not saying to respond to their every whim. If they call you asking for a new toilet because its dirty (which has

	happened to me!) then you politely tell them that even though it is a dirty toilet it still works. Suggest a strong cleaning agent that could rectify the problem but do not give in to anything more than your contract commits you to. If however, they have been good paying tenants and have hardly called you with any problems for a period of over 2 years or so then consider it – is the cost of a new toilet worth it thus maintaining the relationship with the tenant and lowering the risk of losing them? You have to use your judgement.
Have an agreement	The standard contract that binds a landlord to a tenant is the Assured Shorthold Tenancy agreement (AST). Its important to have one to start off with and to renew it when it expires. This will set out what is expected from both parties thus avoiding potential disputes. If there is

	something particular you want to include in the contract, such as responsibilities for garden maintenance, then do so. Its an idea to talk through the terms with the tenant so that you are both in agreement verbally as well as written.
Stepped credit control	What I'm saying is don't go in 'all guns blazing' if the rent doesn't come in on the due date. Follow a system like the one below or something similar: 1 day late – polite phone reminder 3 days late – another polite phone reminder 7 days late – polite letter 14 days late – letter threatening eviction and court action 21 days late – give 7 days to pay with copy of post dated eviction notice 28 days late – hand deliver eviction notice

	29 days and beyond - commence court proceedings

4. Letting Agent

Choosing the right agent.

This is harder than you think! Its not like choosing the right tenant. With a tenant you can credit check them, get references and take a deposit off them. With an agent it would be hard to get a reliable reference or check whether they were any good. There are several measures you can take to help you choose the right agent:

Measure	Description
Ask around	Speak to independent parties about the letting agents in the

	area. If you have an agent in mind then ask specifically about that agent. The estate agent who you are buying the property from may know of a good letting agent. Ask how long they've been in business and how many properties they manage.
Look around	See which agent's advertising boards are around the most. Biggest is not usually the best but if you have an agent that is keen to get his or her name about it would be likely that they will want to do a good job. Visit their offices – are they in the town centre? Can the tenants get there easily enough to pay their rent? Are there enough staff to handle the calls? When you ring does someone answer? Are their staff smart looking and keen to provide a polished service?
Check their	Are they easy to read and fair? You don't want to instruct

terms and conditions	an agent to find out that you have to pay a fortune to de-instruct them. I was asked to pay £1,000 to get out of a contract because they had found the tenant. I never paid it and they threatened to take me to court. Eventually they went away without payment. If you find that you've chosen the wrong agent you want to be able to get out from their management easily.
Speak to the shortlist	Based on the two procedures above you will quickly get to a shortlist of agents. You would have eliminated the cowboys and the over-priced agents. Now you have to go and meet the others! The three things you need to know from any agent, no matter what anyone else says is that, are they: 1. Knowledgeable 2. Trustworthy

	3. Hard Working The only way you are ever going to find this out is through time and time only.
Choose	If the shortlist is only one then the choice is easy! Otherwise you just have to take the plunge on the agent that you feel you best get on with, that speaks the most knowledgeably and appear to work the hardest. Do not get bamboozled by fancy letterheads, state of the art offices or smooth speaking representatives. All that you are interested in is that you get your rent in full and on time.

If the agent is a member of ARLA, the Association of Residential Lettings Agents, then this should give you some comfort. The real (and only!) benefit of choosing an ARLA member is that you are covered against fraud by the agent without having to prove who is at fault. Do not let your selection process be simply choosing an ARLA letting agent. A letting agency is a people's business and it doesn't matter what professional standards bodies they are members of, if they have the wrong people the job will never be done properly.

Managing your chosen agent.

Do not think that once you've handed your property over to an agent its all sorted – because invariably its not! You need to keep updated on what is going on. To manage your agent you need act if things don't go to plan. Have a look at this table:

Problem	**Action**	**Description**
Statement arrives late	Ring the agent	A letting agency is run usually by young people. We all know the majority of young people have other things on their minds! If the support staff are late getting the paperwork to you then let them know that its

		late. This way they may prepare your statement before other landlords.
Payment from agent arrives late	Ring and/or write to the agent Speak to the tenant	Again let them know that you know that its late. Agents holding on to cash really annoys me. Its your money, not theirs. You want the interest that it can earn or more importantly the money it can make from further property investments.
Rent not received on the property	Ring the agent Ring the tenant	You need to know the full answers on this. Simply saying they have wrote to the tenant is not good enough. Have they visited? Ask them what THEY are going to do about it.
Excessive fees from agent	Ring and/or write to the agent	If they've added excessive fees to your account and its not clear where they've come from then get a full justification for the charge. They have to deem the charge

		reasonable for what they've charged for and outside of their normal management duties. Estimate the amount of hours they have spent and assume a rate of £15 - £25 per hour rate.

5. Employees

If you are in the fortunate position to be able to have employees then you need to be able to control, motivate and inspire them to run, manage and grow the business. The employees you are likely to have are:

- Rent collector
- Handyman
- Bookkeeper
- Secretary
- General manager

There are four management styles that can be identified which you should be able to identify with one. The key to success is to identify with one, namely being the last one of four. Lets look at them:

Management Style	**Definition**	**Suitable For Property Investment?**
Exploitive authoritative	Management uses fear and threats; communication is top down with most decisions taken at the top; superiors and subordinates are distant.	No! We are not operating a sweat factory. Let me remind you again this is a people's business. This includes the people within your business. So dictating your ideas is not the way forward.
Benevolent authoritative	Management uses rewards; , information flowing upward is	No again! You need to know what is going on at base levels. The best

	restricted to what management wants to hear and whilst policy decisions come from the top some prescribed decisions may be delegated to lower levels, superiors expect subservience lower down.	people to know this, and hence set new policies, are the people dealing with the tenants, agents, authorities etc. So you must listen to your employees that are dealing with these people so you can construct the right policies.
Consultative	Management offers rewards, occasional punishments; big decisions come from the top whilst there is some	Maybe. This all depends on your employees. If they are self starters then this may not be applicable.

	wider decision making involvement in details and communication is downward whilst critical upward communication is cautious.	If they need little supervision, believe in the common goal and are hard working then you can adopt the style below. Otherwise consider this style to make sure that what you ask to be done – gets done.
Participative group management	Management encourage group participation and involvement in setting high performance goals with some economic rewards; communication	Yes! To manage a property portfolio you need buy-in from ALL your staff where possible. If an employee has an idea

	flows in all directions and is open and frank with decision making through group processes with each group linked to others by persons who are members of more than one group called linking pins; and subordinates and superiors are close. The result is high productivity and better industrial relations.	then find out the depth of it. If you have an idea then get buy-in from all your employees. Once you have people on-side then you have the magical collective known as a TEAM! Once you're a team then its very difficult to stop you.

Source: Likert, R. (1967), *The Human Organization: Its Management and Value*, McGrawHill.

http://www.businessknowhow.com/startup/manyhats.htm

6. Contractors

What ever you do – do not consult your local Yellow Pages for a builder. There are many rogue contractors that spend a small fortune on advertising in the Yellow Pages posing as many different firms. You will ring around from the different ads but ultimately you will speak to the same few contractors that employ this scam.

Builders

My advice is to use a builder from the National Federation of Builders (NFB).

The key features of the NFB and their members are:

- The National Federation of Builders is the industry's longest established trade association with almost 3,000 member companies, ranging from smaller builders to large contractors.
- It has a network of regional offices across England and Wales - each one can provide a list of reputable, professional companies in your local area.
- Member companies of the NFB have satisfied the most stringent entrance criteria for any building trade association.

- Companies must provide at least eight references from accountants, previous clients, suppliers and professionals such as architects and surveyors.
- All references are followed and, if satisfactory, applications are then put before a panel of existing members who are local to the potential new member for assessment.
- Every potential new member is also visited on site before they are accepted.
- If the panel is satisfied with the company's technical competence, health and safety standards and financial probity, the company is admitted into membership.
- All member companies must be VAT registered (if applicable) and CITB-registered.
- They also have a regional network of officers in the field meeting member companies day in, day out to ensure that the highest standards are being maintained.
- The Federation also operates a Code of Conduct and a full complaints procedure, which involves a mediation and arbitration service. Complaints are thoroughly investigated by the NFB and if a member is found to be in breach of the Code of Conduct they are expelled from the organisation.
- All NFB members can offer customers the ‘Benchmark Plan’ - an insurance-backed guarantee scheme which pays out the cost of correcting any building work defects for periods up to 20 years.

You can find your nearest NFB member by visiting www.builders.org.uk. The NFB also encourages its members to use the JCT building contract for homeowners and occupiers - a straight-forward, plain-English contract - which sets down in writing what's expected of you and your builder, such as payment terms and agreements, helping to avoid any potential disputes. For a copy, priced £9.95, call Construction Industry Publications (CIP) on 0121 722 8200 or order it online at www.buildingcontract.co.uk).

Plumbers

Again avoid the Yellow Pages for the same reason. Visit The Institution Of Plumbing at www.plumbers.org.uk where they have the same strict admission procedures for their members. The Institute's Top 10 tips for choosing a plumber are:

1. Ask friends/relatives/neighbours who they use.
2. Use a member of the Institute of Plumbing - members have to hold recognised qualifications in plumbing and/or extensive experience.
3. Get at least three quotes - when asking for quotes find out if there is a call out fee and many people will be doing the job and if the price per hour includes all the workmen/women or if more is charged per plumber.
4. Ask for a written quote - unless there are any unforeseen costs, the final bill should not deviate too far from this initial written quote.
5. clearly explain all of the work you need doing - write it all down if possible.

6. Ask how long the job will take.
7. When you have found a plumber and the job is completed, ask for a full breakdown of the bill so you know where your money has gone.
8. Never pay upfront before a job is completed.
9. Good plumbers will be busy no matter when you call. Don't give up on quality to get a job done quicker.
10. Don't be scared to ask questions, a Registered Plumber will be knowledgeable and able to answer anything you need to know.

Electricians

As with the builders and plumbers you need to go to an electrician that's a member of a professional standards body. The **National Inspection Council for Electrical Installation Contracting** (NICEIC) was set up more than 45 years ago and is the electric industry's independent, non profit-making, voluntary regulatory body covering the whole of the United Kingdom. They are not a trade association and do not represent the interests of electrical contractors. In order to protect users of electricity, the NICEIC endeavours to register as many electrical contractors as possible that are able to comply with its Rules. Every contractor that applies for registration is subjected to detailed assessment by the NICEIC, including the technical standard of their electrical work, before being admitted to the Roll of Approved Contractors. They employ more than 50 Area Engineers who make annual visits to Approved Contractors to assess their technical capability, and inspect samples of their electrical work.

You can find a suitable electrician in your area by visiting www.niceic.org.uk.

7.Solicitors

Your solicitor acts for you and you only. They have to act in your best interests. Any deviation from this and they are in breach of The Law Society rules. To ensure you get the best from your solicitor or conveyancer adopt the following principles:

Principle	**Description**
Fix the fee	Do not let them charge you on an hourly basis for their fees. If you choose a solicitor that specialises in conveyancing then they will know how long a purchase takes and should be able to quote you a ceiling limit fee. Be careful of hidden charges such as telephone calls and letter charges. Make sure there are no hidden surprises. Be careful of useless insurance policies they add to

	the bill. Tell them you do not want any insurances covering you for unspotted defectives. If the solicitor doesn't spot it then you can have a claim against them instead of the insurance company. A solicitor is more likely to pay out as no solicitor wants the wrath of The Law Society.
Fee free for abortive purchases.	If you can try and arrange a nil charge if the sale doesn't go through. This may be difficult if you are buying only one or two properties but if you are buying a few and intend to buy in the future then it is good to set up this arrangement. The worst thing is having a solicitor's bill on top of survey costs for a property you have lost due to the vendor pulling out.
Pay for searches last	Where possible apply for local searches last. This

	way if the purchase does fall through in the meantime you haven't paid out on searches.
Don't hassle them	Buying a property is a very slow process. There is no need to phone your solicitor every week. As long as you provide all the information they ask from you then there is no need to call. If you've heard nothing for 6 weeks then maybe its worth a quick call for an update.
Make sure they communicate with all parties.	Estate agents like to be kept up to date with the sale as their commission depends on it. If the agent doesn't hear anything from the solicitor then the agent tells this to the vendor and sometimes the vendor places the property back on the market. Speak to the estate agents to ensure they are

	getting feedback from the solicitor and they are fully informed. Find out that both yours and the vendor's solicitors are in communication with each other through the estate agent.
Do not exchange contracts until mortgage offer received	Under no circumstances should you exchange without knowing you have the funds to complete. This means a proper mortgage offer being received by your solicitor with all outstanding terms of the mortgage offer met.

8. Mortgage Broker

A good mortgage broker can be key to the whole buying process. Its not about getting the best deals. The difference between the best mortgage deal and the worst is nothing to write home about if you have bought at the right yield – see the chapter on yield above. Its all about getting your broker on your side.

Most brokers are small businesses anyway so they will understand your thinking. Many brokers dabble on the buy to let market so they will understand your situation as they have been in your situation also. Here are some requests that you should ask. They may seem a little bit pushy but if they are a truly good broker they should not be surprised by your requests – this assumes that you're serious about property investment:

Requests	**Reason**
Get them to fill out the forms	I hate filling out forms. I think we all do! I do about 100 remortgages and purchases and if I had to complete them all myself I probably couldn't find the time to buy any properties! Brokers are only too willing to fill out

	these forms as they only have a chance to earn their commission if they submit a completed application form.
Let them tell you what to do	Take direction from them rather than you direct them. They know what they're doing. My broker finds the lenders and I go with her recommendation. The only say so in the matter is what rate I go for but I have to admit if she told me what rate to go for I would go for it- no questions asked.
Try and avoid an upfront fee	Now this may not be possible in all circumstances as the best brokers do charge a fee. Look for the broker to

	waive their fee after say 10 deals a year.
Negotiate with estate agents	Try and get the broker to keep the agent updated on your case. The last thing you want is pushy agents ringing you up all the time asking questions that only your broker can answer.

If you're struggling to find a suitable broker then try my one. I cannot promise she will grant you the same terms that I have (because I'm serious about property investment!) but its worth a phone call. Contact Liz at Connect IFA on 01708 443334 and mention my name and you'll get a 50% discount on her fees.

9. Local Authority

If you've decided to accept the low paid, unemployed, sick or invalid as your tenant (which I suggest you do) most or all of your rent will be paid by the local authority. Getting the first rental payment from them can be a mission but after that its an easy ride. Let me tell you a little bit about how it works.

If you are a landlord wishing to rent out property, you may have tenants entitled to help from their local council towards paying their rent. Should a tenant make a claim for this help, called Housing Benefit, the local council will normally ask you for some simple information about the tenancy.

Below is how Housing Benefit is calculated, what information the tenant will be asked for and what information you will need to provide in order that an assessment of the level of Housing Benefit payable can be made.

What is Housing Benefit?

Housing Benefit is a government scheme administered by local councils that gives help towards housing costs for people on a low income including those who receive Income Support or Job Seekers Allowance.

How is a claim made?

A claim is made by completing a Housing Benefit Application form. A tenant does not need to tell you that they have claimed benefit. The Council can only discuss a benefit claim with a landlord if the tenant has given his or her permission in writing for this to be done.

<u>What tenancy information is needed?</u>

In addition to proof of income, every applicant for Housing Benefit must provide the following details:-

date the tenancy started

date the tenant moved in

rent charged

number of rooms in the property

rooms occupied by the tenant

the name and address of the landlord; and a tenancy agreement or a letter from the landlord which should show the date the tenancy began, the amount of rent charged and any services included in the rent (such as heating, meals etc)

How much housing benefit will be paid?

Almost all claims for Housing Benefit are referred to the Rent Officer for a decision on a reasonable market rent for the property. Rent Officers are employed by the government to help the Council work out how much Housing Benefit a tenant can have. If a rent is considered to be unreasonably high, then the amount of Housing Benefit paid could be restricted. Housing Benefit may also be restricted because a tenant is living in a property which is larger than needed.

For example, a couple with one child needs only two bedrooms, so their Housing Benefit may be restricted to the level for a two-bedroom house and not the three-bedroom house they actually occupy. The following criteria are used when deciding whether a property is or is not overlarge.

One bedroom is allowed for each of the following:-

a married or unmarried couple

a single person aged 16 or over

two children under 16 of the same sex

two children under 10

a child under 16

Housing Benefit cannot be paid for that part of the rent which covers services such as water rates, fuel costs or meals. The costs of these items are deducted from the rent payable before Housing Benefit is calculated.

For example:-

Actual rent charged	£80.00
Water Rates	£5.00
Part-Board	£13.00
Eligible rent for Housing Benefit	**£62.00**

The remaining figure is called the Eligible Rent. A person who receives Income Support could be entitled to their full eligible rent. A person not on Income Support but on a low income will receive only part of the eligible rent.

Housing Benefit is always paid on a four-week cycle. If a calender monthly rent is charged, the appropriate weekly rent will be calculated and then paid on the usual four-week cycle.

For instance:-

		£	
Rent charged	=	500.00	per calender month
x 12	=	6,000.00	per year
÷ 365	=	16.438	per day
x 7	=	115.07	per week

So, if a tenant is entitled to full Housing Benefit they would expect to receive £460.27 every four weeks, which is 4 x £115.07 weekly rent.

Pre-tenancy Determination

If you are looking for rented accommodation and need to know the maximum amount of housing benefit you may be paid you must obtain a Pre-Tenancy Determination.

How is Housing Benefit paid?

Housing Benefit is paid every four weeks, in most cases 4 weeks in arrears. Housing Benefit is paid to the tenant unless a rent direct form is completed, in which case the benefit will be paid to the landlord.

If the Housing Benefit is paid to you as the landlord you will also receive a schedule showing which tenants' Housing Benefit are included in the cheque and how much benefit is in respect of each tenant.

How long is housing benefit paid for?

All benefit claims are reviewed at least once a year. Benefit will continue as long as there is entitlement and providing the claim review form is returned on time. Housing Benefit is only paid while a tenant lives in the property. Entitlement to benefit ends as soon as a tenant leaves the property. This condition also applies if a tenant dies, as entitlement ends on date of death.

Entitlement may continue during a temporary absence from home. If a tenant moves out or dies and you have been paid Housing Benefit beyond your tenant's change of address or death, then you will have been overpaid. You will have to repay this money.

There may be times when the Housing Benefit Section finds out a tenant has left before you do. Housing Benefit will still end on the date the tenant is known to have left - any further rent due is a matter for you to pursue with your tenant. Also if the council find out that he is working and is not entitled to housing benefit anymore the council will come after you if they have paid the rent directly to you.

I have been the victim of this many a time. I have had to pay back anywhere between £70 to £2,400 back to the council due to my tenant being ineligible for housing benefit. The law has to change as there are many landlords losing out due these claw backs. You have to decide whether you trust the tenant to receive their benefit directly and pay it over to you or get it paid direct to you but take the risk of clawback. I always favour getting the rent paid direct and risking a clawback.

<u>What does the Council need from the landlord?</u>

accurate information about the tenancy details including the start date, rent charged and any services provided

prompt information regarding tenants moving out recognition by the landlord that the tenancy agreement is with the tenant. If there are difficulties with payment of rent, the landlord's first point of contact is the tenant

prompt repayment of overpaid Housing Benefit

Council tax

Under normal circumstances the tenant is responsible for paying their council tax. If however the property is empty then YOU are responsible for paying the council tax. The council tax departments are hot! They somehow know how to track you down to pay the tax so there is no point avoiding their charge. If you do you could face being up in front of a magistrate and ultimately having your goods seized by registered bailiffs.

There are ways of reducing you council tax bill if the property becomes vacant:

- 100% exemption for the first 6 months when the property becomes empty – unfurnished only, 50% exemption for the 6 months after
- 50% exemption for a vacant furnished property
- 100% exemption for the duration the property is uninhabitable

Please ensure you communicate to the council the status of the property to ensure you can claim all the exemptions allowable to you.

10.Freeholder&Managing Agent

This section applies only to leasehold properties i.e. flats and maisonettes.

This is a book in itself. There have been many changes to the law giving more rights to leaseholders due to the unscrupulous behaviour of certain freeholders and managing agents. If ever I have seen criminal behaviour within property investment the majority of times it has been within this sector.

Definitions

Term	Definition
Leaseholder	The leaseholder owns the right to occupy the premises for a certain period of time, typically 100 years. He is allowed quiet enjoyment of his lease like you would expect with the ownership of any asset. He is expected to contribute to the maintenance of the building, insurance and cleaning of common areas. He is also expected to pay a ground rent to the freeholder.
Freeholder	The freeholder owns the building and has granted leases to the various leaseholders. The building belongs to him but he has no right of access to any areas covered on your lease. He only has access to the common areas. The freeholder is your landlord and expects the ground rent from you and any cost associated with the building. He can take

	your lease away from you (through a lengthy court procedure) if you consistently breach the terms of the lease.
Managing Agent	IF the freeholder wishes to outsource the management of the building they instruct a managing agent to handle the day to day organisation of cleaning, maintenance, building works and administration.

The freeholder or managing agent will send you a bill for the ground rent and service charges either monthly, quarterly, half yearly or annually. There are some that will charge you what they think they can get away with. I have a flat where the service charge is more than the mortgage!

If you get extortionate service charge bills then you can do the following:

Action	Description

Not pay	The service charges have to be reasonable. If the managing agent has charged you £50 for changing the lightbulb in the common area then this would be excessive. Reasonableness is determined by the Fair Value Tribunal (FVT). If you think they are unreasonable then you can wait for the managing agent to take the matter to the FVT. You have to write to them to dispute their charge. Do not simply refuse to pay. I have one managing agent charging me 29.5%APR on late payment, £23.50 per letter or email sent which he sends every week and charging me £48 per hour for his time in dealing with my case. I haven't paid him for any of these charges. I have simply paid the service charge without all of his fees added on. He hasn't taken me to court as I know that the tribunal or court will laugh at his extortionate charges.

Offer a settlement	Just pay what you think is reasonable. It will be down to them to take you to the FVT or court for the difference. If the court deems that what they are charging is correct then you have to pay it as you do not want to lose your lease. Usually they wont take you to court and you can carry on paying what you think is fair.
Ask for the financial statements	The managing agent has to provide you with the latest financial statements within 28 days of your request otherwise it is a criminal offence. IF you dispute the service charge bill then look at the expenses they are incurring. Then you can pinpoint where the over charge is – its usually the management fees! You are well within your right to visit the premises to inspect each and every invoice that make up those accounts and to

	challenge them.
Seek outside help.	The obvious place to go is to your solicitor. But there are other organisations that can help such as www.lease-advice.org.uk, www.leaseholdadvice.co.uk or www.arma.org.uk.

11.Accountant

If you've instructed an accountant to handle your affairs because the thought of filling in your own tax return seems too daunting then you have to mange him or her.

Ensure that:

Action	Description

You go to an accountant that has been recommended to you	This is the best way to get anyone to do work for you. If you can afford one go for a chartered or certified accountant. If You can't find one from recommendation then visit www.icaew.co.uk or www.acca.co.uk to find the nearest accountant in your area.
You get all the info to the accountant on time	For your accountant to give your case the time it deserves then ensure you provide him or her with all of the information on time. I know this sounds obvious but you would be surprised how many people leave their tax affairs to till the last minute – including me! I think it has something to do with the fact that we all hate paying tax so leaving it to last means that we some how stall paying over the tax – this is completely untrue! If you can get your form in by 30th September as the

	Inland Revenue will calculate your tax for you.
They are knowledgeable in land and property tax	In order to pay the least tax they should know how to obtain all the reliefs due to you to shelter your profits from tax. Ask them if they have any clients that are involved in property investment. See if he or she is aware of allowances such as 'wear and tear' allowances for furnished properties.
The fee is agreed in advance	Do not let the accountant charge you by the hour. Once you have shown him or her your type of records, the size of operations and number of transactions it should be easy for them to calculate the fee. Be clear what you want from your accountant. If its just your tax return completion or the whole package including bookkeeping, payroll etc.

12.The Law

Apart from the standard contractual law that exists between a landlord and tenant under the Housing Act 1988 there is two other categories of law you have to adhere to:

- Regulatory
- All - encompassing

Regulatory

There are there main regulations governing the renting of properties:

1. Gas safety
2. Electrical safety
3. Fire resistance

1. Gas safety

If there is gas at the property then you have to get a landlords safety record from a CORGI registered engineer. They will inspect:

- The central heating boiler
- Oven and hob
- Gas fire
- Gas meters

If you do not get one of these certificates and someone suffers or even dies from carbon monoxide poisoning then you could face a hefty fine and imprisonment. The guilt will be even worse.

2. Electrical safety

A yearly inspection is needed for all electrical appliances supplied with the property by an NICEIC contractor. Basically anything electrical will need to be examined and passed by the NICEIC contractor.

So it's quite obvious - keep the number of electrical items to a minimum! The fewer electrical items you supply the less there is likely to go wrong. This limits the reasons why your tenant can ring you up telling you about a problem. You don't need your tenant ringing you up at 6am complaining about the kettle not working.

There is no certificate issued but an inspection will cover you from being sued if any electrical appliance were to harm your tenants or their guests.

3. Fire resistance

All upholstered furniture must comply with the Furniture and Furnishings (fire) (safety) Regulations 1988. You can tell if the furniture is compliant because there will be a label in the cushioning. Any furniture purchased after 1990 will automatically comply with all fire regulations.

Although not a legal requirement, I would recommend that smoke alarms be installed in rented properties to cover you against any negligence claim if you were to be sued.

All-encompassing

You will also be legally bound by the normal all-encompassing laws of the land. This includes:

1. The law of tort - negligence and personal injury.
2. Criminal law.

We are all bound by the above two laws even if you are not a property investor.

1. The law of tort

Even though you may have all the safety records in place you still owe a duty of care to your tenant and anyone that enters your property. If it can be shown that you were negligent in any way then you could be sued and ordered to pay damages.

As a landlord you are liable for any damages if all of these conditions are satisfied:

i) Your tenant or anyone entering your investment property were to suffers an injury; and
ii) You owed a duty of care to the person entering your investment property who suffered the personal injury; and

iii) You breached that duty of care.

So for example if Zak, the landlord, failed to fix the cooker socket in the kitchen and the tenant's guest, Liz, suffered an electric shock burn then Zak would be liable to compensate Liz for her injury.

This is because:

i) Liz suffered injury;
ii) Zak owed a duty of care as it is realistically expected that a tenant would invite a guest into their property;
iii) Zak breached that duty of care, as he did not fix the socket when asked to by the tenant.

2. Criminal law

Even if your tenant hasn't paid you any rent for two months you cannot 'send the boys round'. Threatening your tenant or being violent to your tenant because he hasn't paid you any rent is no justification for your behaviour in the eyes of the law. Investing in property can sometimes challenge your ability to remain calm and situations can become quite heated.

Remember, it's only money! This is the phrase I say to myself when I get stressed when a tenant 'does a runner' and leaves me with £1,500 owing. Like I said in my introduction, you have to be a responsible person and realise that if you want to take investing in property seriously then you have to act lawfully in *every* way.

3. GEARING

We are in a low interest environment. When I say low interest I mean below 8% base rate and 9.5% actual borrowing rate. Now you may think this is high but this was what deals were be struck at back in 1997 when I first started. Back then you could buy a studio flat within the M25 for less than £30,000 and rent it out at £350 per calendar month. Looking at this equation the profit would have been:

Rent	£350

£30,000 purchase

Mortgage@85% Loan To Value @ 9.5% Interest only £202

Service Charge £40

Profit **£108**

Now this does not seem much. Looking at the gross yield its:

£350 x 12 = £4,200 = 14% yield

Purchase £30,000

Which is fantastic and lets look at the return on cash:

£108 x 12 = £1,296 = 29% ROCE

£30,000 x 15% £4,500

So borrowing at 9.5% interest rates back in 1997 was a good thing EVEN though rates were so high! So even at a 9.5% borrowing rate you can still get a 29% return on your money. If you had left the money in the bank you would have received only 8%. So by borrowing and investing in property you more than treble your return. The key to all of this is that the gross yield is in excess of 12%.

Correlation between Yield & ROCE & Interest Rate

So why do I say 12% yield. I'll be honest with you. The main reason is because its easy to calculate whether a property is a 12% yielder. Let me show you:

If you see a property advertised for £50,000 and it's a 12% yielder it should rent out for £500 pcm. i.e. you knock off the two zeros of the purchase price and it gives you the expected rent. So if you find out that it rents out at £600 pcm you buy it without looking at it! If you find out it rents out at £300 pcm you put the property out of your mind – no matter how pretty the property is!

Now for the science. Look at the following table. It details the ROCE based on the yield and interest rate being charged. I've assumed full occupancy, no repairs and £10pcm buildings insurance.

ROCE Based on Yield & Interest Rate (85%

Gearing)

		YIELD								
		4%	**5%**	**6%**	**7%**	**8%**	**9%**	**10%**	**11%**	**12%**
	5%	-2.5%	4.2%	10.9%	17.5%	24.2%	30.9%	37.5%	44.2%	50.9%
	6%	-8.1%	-1.5%	5.2%	11.9%	18.5%	25.2%	31.9%	38.5%	45.2%
	7%	-13.8%	-7.1%	-0.5%	6.2%	12.9%	19.5%	26.2%	32.9%	39.5%
	8%	-19.5%	-12.8%	-6.1%	0.5%	7.2%	13.9%	20.5%	27.2%	33.9%
	9%	-25.1%	-18.5%	-11.8%	-5.1%	1.5%	8.2%	14.9%	21.5%	28.2%
INTEREST RATE	**10%**	-30.8%	-24.1%	-17.5%	-10.8%	-4.1%	2.5%	9.2%	15.9%	22.5%

If you look at the 5% interest rate row (which is the approximate buy to let borrowing rate currently) you can see the ROCE increases with yield. If you look at even closer you will see that with every 1% increase in yield the ROCE increases by between 6.6% and 6.7%. It actually increases by 6.667% but due to rounding it is either 6.6% or 6.7%. This means for every 1% increment in yield your ROCE increases by 6.667%.

This is why yield is important. Its easy to think 'oh there's not much difference between an 8% yielding property and a 9% yielding property' but there is – 6.667% ROCE!

So why do I say 12% yield? Well look at the 12% yielding column. At current interest rates of 5% your ROCE is 50.9% which is very nice. But at interest rates of 10% your ROCE is 22.5% which is still very nice even though you are in a high interest rate environment. If you had bought at 8% yield, which is still quite a respectable yield, your ROCE is -4.1% i.e. loss making. This assumes full occupancy and no repairs! In a rising interest rate environment investors that have bought between 4% and 6% yields will be forced to sell, as they will hold a liability (as it will cost them money to hold) rather than an asset (supposed to put money in your pocket) which is what they first thought they were buying!

Okay, so we've established that a 12% yield threshold is what we should be aiming for, but what about the level of borrowing? Well look at the same table above but this time only 50% level of borrowing:

ROCE Based on Yield & Interest Rate (50%

Gearing)

		YIELD								
		4%	**5%**	**6%**	**7%**	**8%**	**9%**	**10%**	**11%**	**12%**
INTEREST										
RATE	**5%**	2.8%	4.8%	6.8%	8.8%	10.8%	12.8%	14.8%	16.8%	18.8%
	6%	1.8%	3.8%	5.8%	7.8%	9.8%	11.8%	13.8%	15.8%	17.8%
	7%	-4.1%	- 2.1%	- 0.1%	1.9%	3.9%	5.9%	7.9%	9.9%	16.8%
	8%	-5.8%	- 3.8%	- 1.8%	0.2%	2.2%	4.2%	6.2%	8.2%	15.8%
	9%	-7.5%	- 5.5%	- 3.5%	-1.5%	0.5%	2.5%	4.5%	6.5%	14.8%
	10%	-9.2%	- 7.2%	- 5.2%	-3.2%	-1.2%	0.8%	2.8%	4.8%	13.8%

Looking at the 5% interest rate row we can see that the ROCE for a 12% yielding property is 18.8%. Compare this to the ROCE for 85% gearing above of 50.9%. You can see that if you raise your borrowing by 35%, i.e. from 50% to 85% gearing, you almost triple your ROCE!

Now look at the ROCEs for a borrowing level of nil, 50%, 85% & 100% for a 12% yielding property.

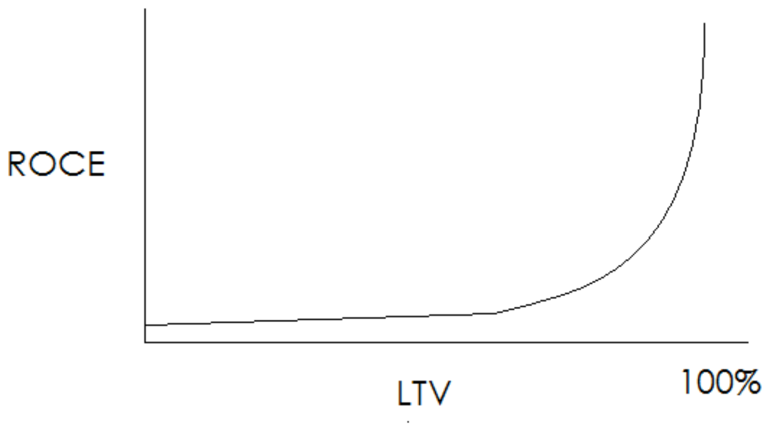
Interest Rate	Nil	50% LTV	85% LTV	100% LTV
5%	12%	18.8%	50.9%	∞
6%	12%	17.8%	45.2%	∞
7%	12%	16.8%	39.5%	∞
8%	12%	15.8%	33.9%	∞
9%	12%	14.8%	28.2%	∞
10%	12%	13.8%	22.5%	∞

So we can clearly see that the ROCE increases rapidly the more we borrow. If we do not borrow all we can expect to make on the ROCE is the yield itself – which is not that exciting. We can see that the ROCE is higher for 50% gearing and even higher for 85% gearing. We can also see that it grows from 50.9% at 85% gearing to infinity at 100% gearing. It seems strange that this extra 15% level of borrowing would make such a difference – but it does!

Okay, I want you to follow this one simple rule and then you're ensured a steady path to property millionairedom:

IF THE YIELD IS IN EXCESS OF 12% THEN BORROW THE MOST YOU CAN!

Look at this graph:



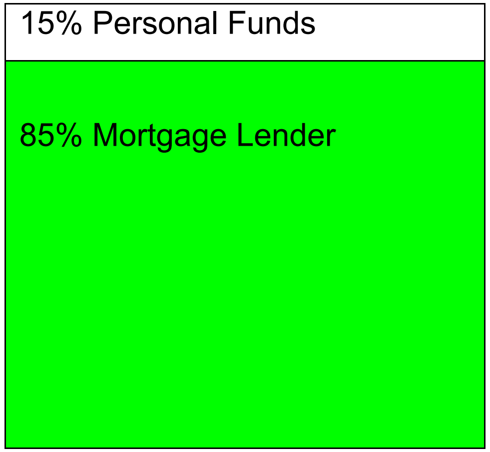
You can see that the closer you get to 100% LTV financing your ROCE tends to infinity. So if you want to maximise your ROCE you should aim as close as you can to 100% financing. I started with £500 7 years ago. I bought a house worth £49,000 with my £500. This equates to 99% financing. If I sold up now I would net £3m after clearing all my borrowings. My ROCE over the seven years is:

£3m/£500 x 100 = 600,000%

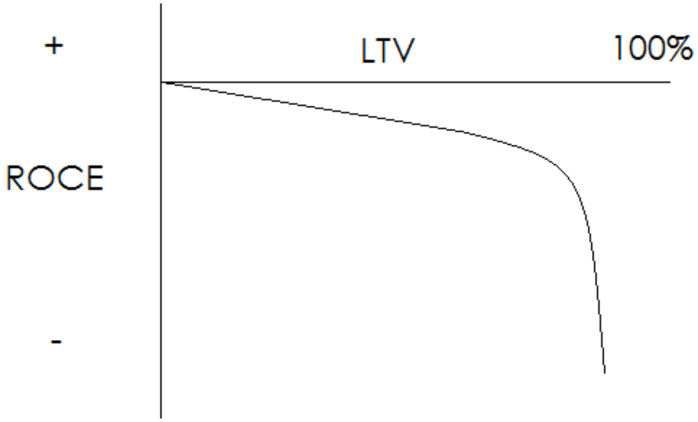
Now 600,000% is not infinity but its not bad!

Achieving 100% LTV Financing

So how do we reach close to or true 100% financing? Well lets look at how you are expected to fund a buy to let property:



So the majority of the purchase price comes from a mortgage lender and the rest from you. There is a very good reason why the banks expect you to contribute. Look at this next graph:



This shows the ROCE if the tenant didn't pay you any rent at all. You can see that as the borrowing increases the ROCE tends to minus infinity! This is how people go out of business very quickly. If they are over borrowed and cash doesn't come in on time or at all then its game over. The banks job is to make sure you're not over-borrowed. The way they do this is by lending you only 85% of the purchase price and making you come up with the rest to ensure they don't encounter a minus infinity situation.

Making you come up with the other 15% however restricts you to the number of purchases you can make. So if you wish to buy a £100,000 property then you need to come up with £15,000 out of your personal funds. This is not an easy thing to do. On an average salary of £20,000 it would take you at least 9 months to do if you lived on the streets and ate only bread and drank only water! More realistically it would take you 3 years to save this kind of deposit. If you could only buy a property every 3 years then you should keep the day job. It won't be until retirement age before you could say good bye to the rat race and retire on the income produced from your property portfolio.

If you did find a lender that would lend to you 100% then you could theoretically buy all the properties in the world subject to your credit limit. There would be nothing to stop you earning what you desired. The only thing that would limit you is the time to actually acquire all these properties! What a luxury to be only constrained by time and not money. The truth is that this luxury is achieveable but you have to be brave, believe in your abilities and be willing to persist.

Achieving The Other 15% Deposit

If you want to grow quick then you need to access the other 15% quick! As detailed in my other book, The Buy to Let Bible, I told you how to raise a deposit quickly in 4 ways:

I Vendor Incentives – Vendor Gift or Cashback

This is where you basically get the mortgage lender to pay most of your deposit! This is best explained by the following example of Vendor Gift below:

Gavin has agreed to buy a property advertised for £60,000 for £51,000 but he has no money for the deposit. He tells the vendor to sell it to him for £60,000 + £9,000 vendor deposit.

	Without Vendor Gift £	With Vendor Gift £
Purchase Price	51,000	60,000
Deposit Required	8,100	9,000

(assume 15% of purchase price)		
Gavin's Actual Investment	0	0
Shortfall Of Investment = Deposit Required minus Gavin's Actual Investment	8,100	9,000
Vendor Contribution = Advertised Purchase Price minus Actual Purchase Price	N/A	9,000
Actual Shortfall = Shortfall Of Investment minus Vendor Contribution	8,100	Nil

Without Vendor Gift Gavin has a shortfall of £8,100 so he cannot buy the property.

With Vendor Gift Gavin has no shortfall. The vendor gets:

£60,000 - £9,000 = £51,000

The inflated purchase price - vendor contribution = original asking price.

Gavin gets:

His first property costing £51,000 for no money down. His borrowings are however greater than 85% loan to value. His borrowings are 85% of £60,000 = £51,000. This equates to 100% loan to value. In effect Gavin is borrowing all of his deposit from the mortgage lender. Note he is not borrowing any of the deposit from the vendor as the vendor has got his full asking price of £51,000. The vendor deposit figure is purely a notional figure. So Gavin’s buying power has risen from nil to £51,000 without changing any level of his deposit, income or creditworthiness.

This trick is completely legal but relies on the property being valued up to £60,000. This is likely because of three reasons:

- **Valuers do not like to down-value a property** - unless there is something wrong with it! If they think the purchase price is only slightly higher than what it is worth they will always value it at the purchase price. This is because the valuer knows that valuations are not an exact science. Valuations are based on what people will pay for a property and he will assume that if you are willing to pay £60,000 then the property is probably worth £60,000. A 15% gross inflation of the purchase price is not a lot considering you are only talking about an inflation of £9,000. Even if they do down value it you still get some vendor contribution which takes you closer to 100% financing. For higher value properties (greater than £200,000) I would suggest a 5% vendor deposit contribution as £10,000 purchase price inflation could be contested.
- **You may be getting a bargain property -** i.e. the property is worth £60,000 but you are actually getting it for £51,000, hence it values up to £60,000.
- **Valuers are under pressure to value properties at the purchase price** - Lenders make money by lending money. If they instruct a firm of valuers that keep on down-valuing properties then it becomes difficult for the lender to lend and hence make money. The more the valuer values property at the purchase price the more money the lender makes. Especially in the current rising property price conditions, even if the valuer thinks that the purchase price is 1% or 2% inflated he will assume that it will reach the valuation in a few months anyway.

Cashback works in the same way. In the above example the deal would be structured as:

£60,000 purchase price + £9,000 cashback.

So when you buy the property you put down £9,000 as your deposit, which you may have borrowed on your credit card, and get £9,000 back when you complete the purchase enabling you to pay back your credit card company.

There are tax issues. The vendor has to declare the inflated sales price to the Inland Revenue and thus will have to pay more capital gains tax as his gain is deemed to be higher. For the vendor this may not be a problem as the Inland Revenue gives you an allowance in excess of £7,900 for a capital gain. If this inflated price does not take the gain above this allowance then there is no increased capital gains tax to pay.

II 100%+ Mortgages

If you find saving too painful then there are mortgage companies that will lend you the whole amount. There are even lenders out there that will loan more than the value of the purchase price. The excess amount over the purchase price can be used to improve the property thus pushing up the value of the house. You have to aim to live in it however. So the theory is to buy the property as a residential property and then inform the lender after the deal is completed that you want to let it out.

This is best explained with an example.

Joanne, who has no deposit, decides to buy a property for £100,000 but the kitchen and bathroom is in poor repair. She gets an estimate for the work and she finds a builder that will do the complete job for £5,000. Joanne decides to go for the property and apply for a 105% Mortgage. This will mean that she will get:

£100,000 to purchase the property
£5,000 to repair the property

After the repair the property will be worth between £110,000 to £120,000 as the property is more saleable now as the property is more presentable to the market. Now depending on the lender she can inform the lender that she wishes to let it out. If they agree they will charge her anywhere between £nil to a 2% loading on the interest rate. If the fee is too much she can then remortgage the property on a buy to let mortgage. If it gets valued at £120,000 they will lend £102,000. This will clear most of the original £105,000 balance leaving a shortfall of £3,000 which she will have to contribute to. So in effect she gets a £120,000 property for £3,000. That's 97.5% financing!

III Loans

You can get one instantly by simply borrowing it! I would suggest that you only take on this credit (if you are borrowing from a credit card or bank) after your mortgage application has been submitted and you have been credit checked otherwise this borrowing will show up. This in itself may not be a problem but if you can try and get it after submission.

You can get the deposit from the following sources:

Source	**Description**
Remortgaging Current Assets	• **Your Personal Home** – This is the cheapest form of borrowing you can get. You could be sitting on a nice little nest egg but doing nothing with it. If you've got equity in your home then get to it and put it to work! There are literally thousands of deals, far more than buy-to-let deals, for personal

	residential mortgages. I have even seen introductory rates of 0.99%. These introductory rates are perfect for when you start the property investment game as it gives you the breathing space in the initial months to carry out any works required on the property. • **Your Investment Properties –** If you have any investment properties then remortgage them up to the hilt. If you believe in your investment decisions then get the cash and buy more. Do not worry about the mortgage payment increasing on the original property as the profit made on the future purchases will fully compensate this increase in payment and more!
Credit Card	Now credit card companies have had a lot of bad press in

Companies	the past and present and will continue in future for as long as they're around. The reason why that get bad press is not because *they* do anything wrong, it's the *cardholder* that does wrong. Certain cardholders spend the credit granted on items but have no plan on how they will pay the credit card company back. Is this the fault with the credit card company or the cardholder? I would say the cardholder. Others would say these companies give credit cards to anyone and they make it too easy. Making it easy is a good thing! Why make something hard if you can make it easy. The key to playing the credit card game is having a plan to pay them back. Many businesses have been funded by credit cards during the bad times and have saved

companies going bankrupt – but you never hear about it in the press as it doesn't make good news. I have several credit cards with a total credit limit of £13,000 which will only ever be used if really needed. I used my credit cards a couple of years ago to buy a really cheap investment property as they advance you the cash immediately. Careful use of my credit cards made me £15,000 profit!

Credit card companies are begging us to borrow. So much so they offer 0% for balance transfer. The trick to obtaining your deposit is to:

- Apply and obtain for a standard credit card
- withdraw cash on this card to the full amount
- Apply and obtain a 0% APR credit card
- Transfer the balance on the standard card to the

	0% APR card • Pay off balance before introductory period is over • If the introductory period expires apply, obtain and transfer the balance to another 0% APR card You have to start this process after you have submitted your application form and you have been credit checked by the mortgage lender. But please, please, please note: CREDIT CARDS ARE EXPENSIVE when you either default or go over the introductory period. Have a plan on how you are going to pay back this balance and for how long. If you do not then you can end up in unmanageable debt and then the whole property investment game with all its associated debts will become a nightmare. [Barclaycard offer a

	lifetime period of 0% until the debt is repaid but this requires you to have a minimum spend per month]. One way to plan the repayment of the credit card balance is to take up a cashback mortgage which gives you cash when you buy the property on completion.
Overdraft Facilities	It's the same principle as the credit card trick above. You simply obtain the deposit from your overdraft provider and pay it back within a set time period. You may be able to get an overdraft facility from your bank. Simply ask! They will need to see your salary being deposited every week or month for at least 6 months. This should not pose a problem if they have been your bank for more than 6 months.

	Unlike credit cards they do not offer introductory rates. They usually start from 5% above Bank of England base rates so at today's rates they start from 8.5% and can rise to 15% so they do work out expensive. The beauty of an overdraft is that it can be redeemed whenever you want to. A good way to redeem it is like above with a cash gift mortgage like a cashback mortgage.
Personal Loans	You can raise the deposit by simply taking out a loan. The loan will be paid back over a number of years in equal instalments. You have to consider whether you can pay back the loan and the mortgage in total otherwise there is no point! So for example if you need £5,000 to put down for a £95,000 mortgage then your total cost of borrowings would be:

£5,000 Loan	£ 111.45
£95,000 Mortgage	£ 412.98
Total	**£ 524.43**

So make sure you can afford both repayments. Unlike the credit cards and overdrafts a loan is less easier to redeem as there are penalties. Sometimes the penalties are not too extortionate so it may be well worth redeeming the loan with penalty to save on interest you will pay over the duration of the loan.

Some lenders require a second charge on your personal property. This is not a problem but be really careful of their redemption penalties. If they are in excess of 5% of the loan then steer clear as these penalties can ultimately trap you in your home.

	Be sure to apply for the loan after submission of your mortgage application form.
Loan from friend or family	I have been on both sides of this equation! I have borrowed and I have lent. In the first instance I borrowed £500 to kick start my first property purchase from my Mum. In the second instance I lent £1,800 to one of my good friends to clear their credit card debt. This friend immediately paid me back using his credit card cheque book when the mortgage completed! You'd be surprised how helpful the people are around you. I would suggest approaching your family members first and then move outside of the family once all avenues have been exhausted. Do offer them an attractive rate of

	interest as no-one does anything for nothing!

IV Get A Partner

The other way to raise the cash is by taking on a financial partner. This means that the financial risk is borne by the partner but you end up doing all the work. The partner will be entitled to a share of your profits and you will not be free to do what you want with the property. Equating the cost to you will depend on how successful the property is as the cost will be the share of profits made. Even though this is the most expensive way to finance a property business it can also be the cheapest way if the whole project fails as your partner has taken the full financial risk. If this is the only method you can use to get into property I would still advise taking on a partner as you will still be participating in a share of the property market.

Consider the drawbacks that joint ownership brings:

1. Loss of full freedom of sole ownership. When you have to sell you will need to get the partner to agree on whether you want to sell and the price.

2. The gain on the property will have to be shared with the partner involved.
3. You will be liable for the mortgage payments if the other partner defaults.

I am involved in a TV programme which will exactly about this concept. It will be following first-time buyers put together so that they can purchase their first home together and sell within 2 years, make a gain, split the gain and then use this gain to buy their own property individually. You could use a partner in this way where you both mutually benefit. It is worth planning the exit route and only enter in to this type of agreement with people you trust.

My Real Life Experiences

I do or have done all these 4 ways of raising a deposit. Let me give you a history of what I have done:

Trick	Description
Vendor Gift	I bought a house for £30,000 + £1,500 vendor deposit. This had two effects. I had to put down less as I was getting a £1,500 vendor deposit and it took the purchase

	price to the £30,000 bracket where you can get higher loan to values.
Cashback	I bought a house for £40,000 + £2,500 cashback. Again I had to put down less as I was getting a cash gift of £2,500. I had to put the £2,500 down initially but got it straight back after completion.
Cashback Mortgage	My first house was bought on a cashback mortgage. I had to put 5% down as a deposit to get 5% cashback. So I simply borrowed the 5% using my overdraft facility, approximately £2,500, and got the £2,500 back when I completed.
92% Residential Mortgage	The second property I bought was on a residential mortgage. I had to put 10% down as a deposit to get

	2% cashback. When it completed I got a 2% cashback, around £1,000, and then told the lender that I wished to rent it out. They charged me a £75 annual letting fee and gave me permission to let it out.
Remortgage personal home	I'm always doing this! I recently remortgaged my house to 90% LTV, the maximum my lender would go to, to access another £35,000. With this money I bought another 5 houses!
Remortgage investment properties	I'm always doing this also! I'm aim to keep my portfolio at 85% LTV of its current market value. Recently I instructed my broker to carry out 31 remortgages in one hit – it certainly kept her busy!
Credit Cards	As mentioned earlier in the book I accessed £13,000,

	the maximum credit limit I have over 3 cards, to fund deposits for new purchases. When the remortgages came through on some other properties I paid back off the credit card balances. The cost of borrowing was no more than £500. The amount I made on the deal was £15,000. Who said credit cards are bad?
Overdrafts	As mentioned earlier I used my overdraft for short term funding purposes. Remember that overdraft facilities have a maximum term, usually 1 year, and have to be renewed. Don't get caught out and be forced to pay back the overdraft as you never checked when the facility expired.
Unsecured Loans	I have over £100,000 in personal loans. I got these at the time I was starting. The properties that I've bought

	with this money have netted me around £500,000 in equity. Now that's not bad by anyone's standards!
Borrow off girlfriend	I sail very close to the wind sometimes and I got in to a situation. I was forced to make the choice of going to a bridging finance company who were going to charge me 22% APR, and £1,000 in arrangement fees to borrow £10,000. I decided to ask my girlfriend and I offered her 16% APR. She generously agreed and I paid her back in 3 months plus interest PLUS a set of diamond earrings!
Get a partner	I'm currently doing a deal with someone who has money but not the expertise. They will be fronting all the money and I will be investing it. We'll be going 50:50 on ownership and profits generated. I'm doing this because

	it's a sizeable amount of money. This will give me a greater market share than I already have – this is why it works for me.

Cost of holding money

I hate having money! Now when I say this I mean I hate having money that's un-invested. Anything in excess of float is not only making you no money but is costing you money. If I go out and raise £10,000 on an unsecured loan repayable over 5 years then I have to start making payments of around £200 pcm one month after the bank has advanced me the money. Lets say I don't find an investment. I will have to pay back 60 months x £200 = £12,000. That's not good business.

If I find an investment property the day I get the money (requiring a £10,000 deposit) and complete on the purchase 3 months later and find a tenant 1 month after that which provides me a positive cashflow of £100 pcm then the figures look like this:

Positive cashflow from investment 56 months x £100 =	£5,600
Cost of holding 4 months x £200	(£800)

Profit arising from £10,000 loan **£4,800**

Two important things to notice about this example:

1. £4,800 profit is generated from taking out the £10,000 over 5 years. Even more profit will be generated after the 5 years due to the loan being redeemed thus increasing the cashflow assuming all other factors remaining the same.
2. Profit is reduced by £800 due to it taking four months to complete on the property and to find a tenant.

As a result of these findings two principles will hold:

1. Its good to borrow – as established above and,
2. The quicker you make the investment the more money you make.

Now I'm not saying go out and buy the next property that comes on to the market. But what would make sense is to try and find suitable property investments before you get the loan and as far as possible try and line up a tenant in advance.

Opportunity cost of money

I specialise in low value properties. I typically buy a property for around £30,000. This requires a £5,000 initial investment from me which includes the deposit, legal fees etc. Every time I get hold of £5,000 I'm itching to buy a property.

Now consider this. I'm walking past a car showroom and I see my favourite car, a Mercedes 300SL for £20,000. it's a bargain, I've got £20,000 in the bank and its in my favourite colour – BLACK! Should I buy it? If I did buy it for cash it wont cost me £20,000. it will cost me what I will lose in the future as a result of the purchase. Let me show you what I would lose:

Purchase Price of Car	£20,000
Initial Investment for a house	£5,000
Number of houses that can be bought £20,000/£5,000	4
Expected profit generated from each property	£150 pcm
Total profit expected from 4 properties	£600 pcm

So if I buy it for cash I lose £600 pcm. This is £7,200 per year and this excludes capital growth. If the houses have risen by 10% in the year then the capital growth is 4 x £30,000 x 10% = £12,000. So total loss including capital growth is £12,000 +

£7,200 = £19,200 – almost the cost of the car! And what would the car be worth in a year? Well it wont be worth more than £20,000 that's for sure! Lets say £15,000.

So looking at the true loss of buying a car relative to buying 4 investment properties after 1 year:

Net Worth After Buying Car – Market Value of Car		£15,000
Net Worth After Buying 4 Properties		
4 Deposits x £4500		£18,000
Rental Profit	£7,200	
Capital Growth	£12,000	
Total	£37,200	

So after 1 year the difference in net worth of buying a car and investing in 4 properties is:

£37,200 - £15,000 = **£22,200**

That's an annual salary for someone! If the £20,000 that I had in the bank was as a result of a remortgage then the figures are even worse. £20,000 borrowed at 5% makes you a further £1,000 worse off. And if you don't redeem the debt after 1 year then it will cost you £1,000 year after year after year. If you let it run till the end of your mortgage term you may end up paying more interest than the price of the car! Very bad for your wealth.

I'll be honest with you however. I do own a Mercedes 300SL worth £20,000! But you'll be damn sure I didn't pay for it for cash. I bought the car on HP at 17.3% APR. It costs me £462 per month which is paid for out of my £600 pcm profits generated from the property purchases made.

The principle is – preserve your cash! Wherever you can get sensible credit (less than 20% APR) then take it. As long as you are willing to invest the money you have you can always service the credit you get with the profits you generate.

4. AWARENESS

I want you to study this equation hard so you really understand it. The *actual* price of a property is made up of 2 elements, the *real* price of the property and the *bubble* element:

Pactual = Preal + Pbubble

Pactual - Current Market Value of the property
Preal - The real price of a property based on fundamental principles
Pbubble - The surplus or deficit of the actual price over the real price

In a perfect market the actual price of a property should equal the real price of a property. Unfortunately this never happens! This is because we live in an imperfect market which is driven by people's own opinions and views (including mine!) which are impossible to predict.

To determine each element we need to first determine the current market value of the property, then the real value of the property and then calculate the bubble element as the difference between the actual and the real value of the property.

Pactual - Current Market Value of the property

We determine this as being 95% of the advertised price of a property. As an average properties sell at 95% of their asking price. This is the only way you are going to get an up to date value of a property as best you can. The land registry figures are too out of date to really use as a current market value as there is around a 9 month lag from agreed offer price till published price.

So for example if we see a property advertised for £100,000 then the estimated current market value will be:

£100,000 x 95% = £95,000.

Preal - The real price of a property based on fundamental principles

The real price of a property is based on fundamental principles. The fundamental principles that apply to the property price are:

The greater of:

1. The price willing to be paid by an investor

2. The price willing to be paid by a first time buyer

So whichever is greater out of these two figures will be the real price of the property. So we need to calculate both of these prices.

The price willing to be paid by an investor

The price willing to be paid by an investor will be function of what he could get elsewhere in the market. If an investor wished to take no risk then he could stick the money in the bank and earn interest. If he were to invest in property he would look for a premium as he was taking on risk. As property is a long term investment he would look for a comparison of the same timescale that is risk free. The best rates you would get would be from a:

20 year fixed interest government gilt

A government gilt is a loan to the government. As it is assumed that the government will not go bankrupt we can assume that it is risk free. Property is considered to be the next lowest risk investment out there. As an average property investors require a

2% loading on a 20 year fixed government gilt for them to invest. This will determine the yield required and hence set the real value of the property. Lets look at an example:

Variables:

20 Year Fixed Interest Government Gilt	5.62%
Property Investor Loading	2.00%
Annual Rental Value of Property	£5,000

The real value would be:

£5,000 x 1/(5.62%+2.00%) = £65,616

This will be the maximum value an investor would be willing to pay for a property with a rental value of £5000. If the property price was higher then the investor will place it in a risk free investment like a government gilt. The property price could be higher due to a first time buyer being able to *afford* the property.

The price willing to be paid by a first time buyer

The price willing to be paid by a first time buyer will be:

His salary x 4
(0.95)

This assumes that lenders will lend 4 times his salary if he puts down a 5% deposit on the property. So, in the same example above, if a first time buyer wants the same property and his salary is £21,000 then he could afford a purchase price of:

(£21,000 x 4)/(0.95) = £88,421

So in this example the first time buyer ‘wins’ and thus the real value of the property is £88,421.

Pbubble - The surplus or deficit of the actual price over the real price

The bubble element is simply the difference between actual and real prices:

Pactual - Preal = Pbubble

So using the example we would have the actual price being £95,000 and the real price of £88,421 then the bubble element will be:

£95,000 - £88,421 = £6,579

The key to property investment is to NEVER buy a property at a price where there is a bubble element to it i.e. make sure Pbubble = 0 or less. To do this it is important to know why bubble elements exist and what you need to be aware of to ensure that you never buy a property that is over priced.

Why Bubble Element Exists

Bubble elements exist due to the following:

Factor	Why

Self-certified Borrowing	In the UK we borrow at the current variable base rate and not at the long term average rate. Currently the long term rate is around 5.7% and the variable base rate is at 4%. This is why we have a boom bust cycle. When rates fall below the long term rate first time buyers over borrow, as they can afford it, by obtaining a self-certified mortgage thus increasing their buying power. Their increase in buying power creates the bubble element as their buying power takes them over the real value of the property.
Novice Investors	Due to the buy to let mortgage also operating under the current variable base rate the same problem occurs here. Instead of demanding a 2% loading over the long term rate they demand a 2% loading over the current variable base rate. This means you

	get novice investors buying at 6% yields and below hence superceeding the first time buyers highest price.
High Income Multiple Lending	Some lenders are offering in excess of 4 times salary. This enables a first time buyer to borrow in excess of the real value of the property thus creating a bubble element.
Speculative Investors	Due to the poor performance of the stock market in recent years the property market has attracted the traditional stock market investor. Here the investor will invest for capital growth and so will be happy to take less than a 2% loading. The speculative investor will make the estimation that the growth experienced in the past will happen in the future over

	the short term. The speculative investor's bid then superceeds the property investor's bid and if this is in excess of a first time buyer's bid then a bubble element will exist.
Consumer Debt	Some people borrow the deposit for the property by way of loan. This means you can enter the property market very quickly as you do not have to wait to save up for a deposit. This increases the number of buyers thus increasing demand for property hence pushing up the price of the property.

Assumptions

Now I have made several assumptions in this calculation and I welcome you to challenge them. Assumptions are drawn to make the theory simple but property is not an exact science. Understanding that assumptions can be wrong will help you get beneath the theory and allow you to take a practical approach when making an investment decision. The assumptions I made that need to be challenged are:

Assumption	**Why**
95% of advertised price as current market value of property	This is an approximation in a rising market. It may be 100% or even 105% for a competitive market. Decide for yourself what the market is like by your own experiences.
2% loading for investor on government gilt rate	It could be more than 2%. I expect a 6.5% loading for my investments resulting in a 12%+ yield requirement but I reckon it bottoms out to 2% loading (equating to 7.62%) but I could be wrong!
4 times salary lending	This is currently what most lenders offer but there are lenders that offer up to 5 times salary. Now if this type of lending grows then the real value of property will rise.

First time buyer having only 5% deposit	You can buy a property with no deposit. 100% mortgages are popular but do not form a significant part of the market – but they could do in the future.
Including only first-time buyer properties	I've assumed that first-time buyer properties are the type of properties that investors go for. This is not a hard and fast rule. Some landlords invest in executive detached properties with lower yields and class A1 tenants. One needs to incorporate this in our thinking.

Awareness Table

Based on all the theory above we can narrow down what we should be aware of if we really want to understand and thus exploit property price movements:

Aware of:	Description

Global Rates	Our rates are restricted by global rates. We cannot be out of sync with the rest of the world. This is called interest rate parity. The formula holds: $\frac{F}{S} = \left(\frac{1+R_A}{1+R_B}\right)^T$ Where *S* is the spot exchange rate, expressed as the price in currency *A* of one unit of currency *B*. *F* is the forward rate, $R_A$and $R_B$are the interest rates in the respective countries, and *T* is the common maturity for the forward rate and the two interest rates. It assumes that if interest rates were 10% in Europe then we would convert all our Sterling to Euros, place them on deposit in a European bank and then convert them back after a year and enjoy the profit. This theory states that the profit would be nil as it would be money for nothing and so when you converted back in sterling you would get an inferior exchange rate. So we are all

	locked within each country's interest rate. The world has been in a recession. Interest rates have been low in the major economic countries which has kept our rates low even though we are not in a recession. Once rates start moving upwards over the borders then our rates will rise. You need to be aware of the financial indictors of the major economic countries. They will be the same as 'Home Rates' see below.
Home Rates	Taking into account the interest rate parity above there will still be some freedom within the UK to set rates. The rate is set by the Bank of England and they use the following reports to set them: • Consumer Price Index – This measures price inflation. The target for the bank is 2.5%. If it goes over then rates

	are expected to be risen by the Bank. • Employment Cost Index – This measures wages growth. If wages rise above expectations this causes an increase in spending and thus results in inflation. Expect the Bank to put rates up. • GDP Report – This measures the overall performance of our economy. If it falls 2 quarters in a row then we are in a recession and expect rates to be lowered by the Bank. • Unemployment Rate – This measures the number of people out of work. If its too low then it causes an increase in spending thus inflation and expect the Bank to rise rates. • House Price Inflation – Very under-rated by the Bank! I don't know what threshold they set here but they are willing to see massive inflation here and do nothing about it. However be aware that the Bank do consider house

	price inflation when setting rates. Keep abreast, where possible, of the UK and Global reports surrounding their economies. Here is where you will be able to see the triggers to movements in the UK and global interest base rates.
20 year government gilt figure	Being aware of this will make you able to calculate the real value of the property as the real value is a function of a 2% loading of this rate.
Differential between long term rate and current rate	If there is a significant difference between the long term rate and the current rate then the property prices can abnormally rise or fall from their real property value. At the minute there is nothing to worry about and the differential is reducing. However close inspection of the differential will keep you ahead of the pack as you will see how the lenders react and how property prices

	change. Also be aware of heavily discounted mortgage products coming to the market. They can distort prices if these deals become popular forcing other lenders to reduce their rates and making the whole mortgage market even more competitive than it already is!
Rental Value of Property	For you to really exploit all the possible opportunities then you need to be aware of the rental values of property. Based on this you can calculate the real value of a property in conjunction with your required return which you can then compare to the actual asking price. If the real value is in excess of the asking price then take a look at the property!
Current	For you to really exploit all the possible opportunities then you

Market Value of Property	need to be aware of the current market values of property. This involves searching on the net, looking in local papers and talking to estate agents. Based on your real value of property calculations you can see if the current market values look attractive.
Negative Equity	If there are a significant number of property owners in negative equity then this reduces the feel good factor. In turn it reduces spending and productivity. This can trigger a recession which results in higher unemployment and a fall in property prices.
Ratio of earnings to property value	If property values are in excess of 4 times salary then you know that there is a bubble element to the property price. Try to get local data on people’s earnings to help you determine the real price of the property.
Lending	Check to see if lending multiples are increasing. Currently the

multiples	standard is 4 but there are a growing number of lenders offering 4.25 times salary which is causing the real price of property to rise.
Number of First time buyers	This needs to be a healthy number to keep the market buoyant - especially where the investors have refused to invest. If these stop buying then prices will fall in that area to the price that an investor would buy at.

So Are We Heading For A Crash – Will The Bubble Burst?

The short answer is **no**.

The reason is because the size of the bubble is small and will only burst for a small section of people. Let me explain.

There are only 3 parties involved *within* property that can cause a crash:

1. The lender
2. The investor
3. The first time buyer

The Lender

The lender can cause a crash by over lending. All lenders set parameters for lending criteria. Their key lending criteria is 4 times salary for owner-occupiers and 130% of the mortgage payment for buy-to-let investors. Based on these parameters mortgages should never become unaffordable. They only become unaffordable if interest rates rise sharply or we enter in to a recession. See below about interest rates and likelihood of a recession. As the lenders are willing to lend then buyers are able to buy thus keeping the market active.

The investor

The investor can cause a crash by miscalculating his returns. If an investor has done his homework then this will not occur. He will never buy over the real price of a property.

The first time buyer

The first time buyer can cause a crash by over borrowing. To over borrow requires the first time buyer to mislead the lender to obtain higher borrowings than he is entitled to. The majority of first time buyers are unable or unwilling to mislead a lender.

The only people for who the bubble will burst are the people that hold a property where a bubble exists. That is the table above. Namely:

- First time buyers on self certified borrowing
- Novice investors
- High Income Multiple First time buyers

- Speculative Investors
- First time buyers that have borrowed the deposit

This is a very small section of the market!

Even where bubbles exist the size of the bubbles are small. There will be the professional investor or the standard first time buyer that will purchase their property off them at the real price which will only be a fraction less than what they paid.

<u>Outside The Property Market</u>

The basis of this thinking is because interest rates will not rise beyond affordability and we are not heading for a recession for some while. There can be shocks to the market which no-one can predict but based on the information we have at hand now there will be no crash like the 90s. The main reason is that we will not see the days of 15% base rates in the UK for a long time or any major unemployment figures of the past.

5. APPRECIATION

Capital appreciation can be amassed by one of three ways:

1. identifying properties without foresight
2. identifying properties with foresight
3. identifying properties with potential

1.IDENTIFYING PROPERTIES WITHOUT FORESIGHT

Capital appreciation has to be real. Remember the equation:

Pactual = Preal + Pbubble

Pactual - Current Market Value of the property

Preal - The real price of a property based on fundamental principles

Pbubble - The surplus or deficit of the actual price over the real price

Real capital appreciation has to be based on the real price then *and* now. Anything else is just a bubble! Okay, one should sell when a bubble exists as you maximise your exit price but that is dealt with in chapter 7. Hopefully you will see through several bubbles during your time in property investment before you exit. However you should only ever be interested in real capital appreciation during your ownership period. Why? – Because its real! You know that the real price is the bottom price that you can expect for your property. Bubbles are temporary inflations or deflations to prices which burst back to the real price. Bubbles only distort things and are washed out in the long run, anyhow.

The way to guarantee real capital growth is to buy when there is a negative bubble. I always invest in negative bubble areas. That is to say when the bubble bursts then – BINGO! Instead of a bubble bursting and prices fall dramatically it happens the other way round – when the bubble bursts prices rise dramatically.

Look at this example based which are based on real life examples that have happened to me only recently:

I was buying properties in Hull, East Yorkshire. A property I bought was advertised at £29,995 and rental value £295. Working out the figures:

Pactual = £29,995 x 95% = **£28,495**

Preal = the higher of:

What an investor would pay for it: annual rental/(long term average rate+2% loading) = (£295x12)/(5.62% + 2.00%) = **£46,457**

What a first time buyer would pay for it: (salary of someone willing to live in property x 4)/0.95 = (£14,000 x 4)/0.95 = **£58,947**

So the Preal is the higher of £46,457 and £58,947 hence **£58,947**.

So:

Pactual - Preal = Pbubble

£28,495 - £58,947 = **-£30,452**

So I bought a property for £28,495 that is actually worth £58,947. That's £30,452 locked in capital growth because its REAL! So what is it actually worth now? Well its worth about £36,000 which is far from £58,947, its real value. The negative bubble of

£30,452 is however exploding. The growth that I have experienced of around £7,500 has occurred in the last 3 months. The rest will occur over the next year. But I know with certainty that the £30,452 will blow up in my face far quicker than the average growth rates for the UK ever will do.

Remember that this certain capital growth is independent of both the following principles holding:

1. We are not in a recession so there are an abundance of first time buyers
2. The buy to let market exists so there are an abundance of buy to let investors

As long as *one* market exists then you are certain of capital growth.

So why does negative bubbles exist

There is really only one answer to this:

We live in an imperfect market!

There are a limited supply of funds offered to us from the lenders so they have to make a choice – do they lend to:

1. An investor that is unaware of superior markets such as Hull in this example and lend to him to buy a lower yielding property in a more conventional and favoured area OR
2. To a private individual who wishes to buy a property in an area that is not considered 'low value' OR
3. To an investor or private individual that wishes to buy in a low value area

Usually lenders opt for either 1 or 2 and forget out about 3. This is because they think their money is safe within a property that is valued more than a 'low value' property, typically £60,000. This is very short-sighted and to be honest a plain stupid view of property lending. But this is where people like me succeed. There are some lenders, although be it a handful, lend on properties of 'low value'. If you buy low down enough then the only way is up!

Speak to your broker about low value lenders. If your broker isn't fluent in these type of lenders then speak to my broker, Liz Syms at Connect IFA on 01708 443334. If you mention my name then you will receive a 50% discount on her fees.

Using Lenders To Our Advantage

Okay so I've told you how lenders favour higher value properties. Its time to look at the flipside of the equation. Lets forget low value areas and look at high value areas. Consider a flat in Kensignton, London. Lets assume you've done the research and you've found the average salary for the first time buyer in this area is £75,000. A 1-bed property comes up for sale for £250,000, rental value £1,000pcm.

Pactual = £250,000 x 95% = **£237,500**
Preal = the higher of:

What an investor would pay for it: annual rental/(long term average rate+2% loading) = (£1,000x12)/(5.62% + 2.00%) = **£157,480**

What a first time buyer would pay for it: (salary of someone willing to live in property x 4)/0.95 = (£75,000 x 4)/0.95 = **£315,789**

So the Preal is the higher of £157,480 and £315,789 hence **£315,789**.

So:

Pactual - Preal = Pbubble

£237,500 - £315,789 = **-£78,289**

The negative bubble is £78,289. Remember what I said earlier that this certain capital growth is dependent of both of the following principles holding:

1. We are not in a recession so there are an abundance of first time buyers
2. The buy to let market exists so there are an abundance of buy to let investors

Well, actually only certain capital growth will occur if the following holds:

1. We are not in a recession so there are an abundance of first time buyers

This is because the buy to let investor is not interested. Your only market is the owner-occupier. The price willing to be paid is £315,789 and will only be paid by an owner-occupier. This is what I call the speculative market. You are basically aiming to sell to the owner-occupier which can be a fickle market. However, if you get it right then you can make massive gains. Property programmes such as the Property Ladder have fuelled this type of investment of selling to the private individual. But please,

please, please understand this is not the basis of property investment. This is only as of a result of rocketing prices (or negative bubbles bursting – depends on your view point!) that has made these type of property programmes credible.

Look at the disparity of the numbers:

What an investor would pay	£157,480
What an owner-occupier would pay	£315,789
Difference	£158,309

So when or if the owner occupier market collapses, if it does, you're left with a property that you thought you could sell for £315,789 but is actually worth, in real terms, £157,480. That is why trying to sell to the owner-occupier market is high risk.

2.IDENTIFYING PROPERTIES WITH FORESIGHT

Okay, so you want to be clever! If you don't want to make money the easy way by identifying properties available that will lock in certain growth then lets play the speculative market. Property prices will rise, in real terms, due to:

An increased demand for:

- Unique properties that are scarce such as riverside apartments, 3 bed properties where there's a glut of 2 bed properties, or houses in central districts as opposed to flats
- Properties that are considered 'safe' and more profitable investments to overseas investors compared to the what's available back home
- An increase in a desirability of an area due to major employers locating in the area, improved transport links such as an a addition of a train station, tube or carriageway or improved services to an area such as a good school, leisure facilities or shopping centre.
- Properties being next to an area that is booming so as to make the area in question highly desirable as its cheaper than the booming area even after travel and time costs
- Properties being brand new and a qualitative effect being experienced due to new properties being most sought after
- An area undergoing a regeneration programme thus resulting in a general uplift in an area

This type of speculative investment is less certain. This is because you are either:

1. not in full information, or

2. asking the prospective purchaser of your property (even if you're not selling it will ultimately determine the real value) – what are all these extras worth?

The reason why it is difficult to quantify these extras is because they are qualitative as well as quantitative. What is the true worth of a property next to a train station compared to a property 10 mins away from the station? Is it £5,000 or is it £50,000? It is this that determines the average selling price.

Take for example a riverside apartment on the north side of the river in London. How many properties are there for sale – say 10 properties. Out of those, how many need to sell? Very few. How many people are actively looking for a north side riverside apartment? Loads! So for scarce, highly desired properties – it's a seller's market. This means you simply have to wait for the buyer to come along unless you are forced to sell. The only reason for you to be forced to sell is if you need the proceeds to buy your next place or interest rates are on the up to the point you cant afford the mortgage payments.

If you have a desired property then you can wait for the buyer to come to you AND your price as long as you can hold out for a buyer.

Having a desired property like listed above will incorporate a qualitative factor within the price. Current thinkings say that there is no way to quantify these qualitative factors hence you can receive ridiculous amounts for seemingly basic extras such as being next door to a tube station, offering a brand new property or being next to a booming area as it is highly desired.

One thing I am noticing in the market these days is the increased value of time. There is a real perceived value in a property that is located in an area that saves you time on the commute. A property located 1 minute closer in travel time can have a disproportionate increase in value if measured to the worker's hourly rate. This is because the worker's leisure time is worth more than what they earn. Its worth looking at the properties that are or potentially able to save the buyer/tenant over 15 mins in commuting time.

3.IDENTIFYING PROPERTIES WITH POTENTIAL

okay, this section is for people who like to make money the hard way! You can add value immediately to a property if you are willing to enhance it. You can enhance a property in a number of ways:

1. Refurbish it

2. Extend the property
3. Convert the loft

1. Refurbish It

There is real synergy to be created if you get this right. Synergy means the sum is greater than its parts, or some people like to say 2+2=5. Let me explain.

Joe buys a house for £100,000. Spends £5,000 refurbishing it and sells immediately for £125,000. So he makes £125,000 – (£100,000 +£5,000) = £20,000. So in this example:

£100k + £5k = £125k.

£20k has miraculously appeared from nowhere! The reason for this £20k appearing is due to:

1. **Joe saving time for the buyer** – if a buyer saw the property for £100,000 still requiring a refurbishment then the buyer would not be interested in it as he neither has the time to do the refurbishment nor the time to supervise someone to refurbish it.
2. **Joe having £5,000 to refurbish it and the buyer not** – Joe is a businessman. He has £5,000 to refurbish the property and the buying power to buy the property. Whereas its likely the buyer will only have enough for his deposit on the property only. So on a 5% deposit of £100,000 a private buyer would need £5,000 to buy the property and £5,000 to refurbishment totalling £10,000. If the buyer buys the property after Joe has refurbished the buyer will only need 5% x £125,000 = £6,250. So the buyer needs less money to buy the property after refurbishment.
3. **Joe is an expert** – Joe will probably have the contacts, know-how and expertise to get the refurbishment done cheaper than a private individual as he is in the trade. So if Joe views the property alongside an amateur investor Joe will cost the job at £5,000 and the amateur investor may cost the job at £8,000. With Joes ability to price the job lower than the amateur Joe can go in with a higher offer than the amateur – well in theory anyway! Due to programmes like Property Ladder, House Doctor, Selling Houses etc everyone thinks they are a property developer! So amateur investors are under budgeting for the refurbishment and over estimating the eventual selling price thus pushing the professional investor out.

Now I'll be honest with you. I know absolutely nothing about the construction of property or refurbishment or building works! I have done refurbishments before only because the properties were so cheap and I couldn't resist them. I bought a 7 bed property, yes

7 bed, for £42,000 in Corby. I never saw it but I heard it was completely vandalised inside as it was an old crack house. I knew that it could let out at £500 pcm after refurbishment so I thought it must be worth £50,000 at least. If the refurbishment would cost less than £8,000 then it makes sense. So I got a quote - £5,000 they said. So I said okay. That was my involvement in the refurb!

Now there are loads of books on how to add value to a property by making it look pretty and this ain't one of them! If you want to play this game you have to look at the numbers carefully. You need to check there is a safe profit margin in it for you. So what is safe? You should always be prudent. That is you should always over estimate your costs and under estimate your proceeds. Look at this example:

There's a property for sale for £100,000 that would be worth £150,000 if it was refurbished under current market conditions. The cost of the refurbishment is estimated at £10,000 and will take 2 months. I would adopt this forecasted profit & loss:

Selling price - 90% of anticipated selling price = 90% x £150,000	£135,000
Estate Agents fees 1% +VAT	(£1,586)
Net proceeds	£133,413

Costs:

Purchase Price	£100,000	
Refurbishment 150% x estimated costs	£15,000	
Loan repayments 6 months interest	£2,500	
Total costs		(£117,500)
ANTICIPATED PROFIT		**£15,913**

So prudently it will take you 6 months to make £15,913. Annualised its £31,826. Now is this worth your time? Are you worth more than £31,826 p.a. For me it isn't but for you maybe. You'll be surprised how people don't do this simple profit & loss account to really see if a project is really worth their time. And remember its anticipated. It could be more OR it could be less!

Extend The Property

It is NOT a blanket rule that if you extend a property it increases the value of the property more than what you spend on the extension. It all depends heavily on where your property is located. I have created a rule of thumb measure of how much your property will increase by if you splash out on an extension.

Its all to do with the ratio of land to buildings cost. If you build on desired land then you win, if not you lose! So how do we find out if we own a property sitting on desired land. Well its all to do with the rebuild cost of your house. This you can find this from your buildings insurance policy which should have the rebuild cost stated. It would have been determined when you last had the property surveyed.

Now to decide if the land is desired you simply calculate the following ratio:

$$\frac{\text{Current Market Value}}{\text{Rebuild cost}}$$

If the ratio is greater than 1 then its desired. If its less than 1 then its not desired.

So if Jack has a property that is currently worth £100,000 and the rebuild cost is £60,000 then the Current Market Value Rebuild Ratio is:

£100,000/£60,000 = 1.667 which is greater than 1 hence Jack should extend.

If Jill also has a property worth £100,000 and it has a rebuild cost of £120,000 then the ratio is:

£100,000/£120,000 = 0,833 which is less than 1 hence Jill should not extend.

You should use this ratio as a multiplier to determine how much value will be added to the property. So in the above examples if they both decided to spend £30,000 on a downstairs extension then their properties, as a rule of thumb, increase by:

1.667 x £30,000 = £50,000 for Jack
0.833 x £30,000 = £25,000 for Jill

So Jack makes £50,000 - £30,000 = £20,000 profit as a result of the extension
Jill makes £25,000 - £30,000 = £5,000 loss as a result of the extension

Now this is only an approximation. It all depends on how you extend, the choice of materials and whether you add a bedroom or a dining room. There are many books written on what adds value more than others and you should read them if you intend to extend. This multiplier should help you decide whether you should extend or not. If the multiplier is greater than 2 and you are willing to take on such a project then the decision to extend is a no-brainer i.e. yes you should!

Convert The Loft

Its difficult not to justify such an improvement to a property. They are cheap to do and add one of the most powerful increases to a property price – an extra bedroom! To calculate whether you should or you should then use the multiplier above but multiply it by 3. Let me show you using the same example above:

Jack's multiplier 1.667 x 3 = 5.00
Jill's multiplier .833 x 3 = 2.5

These are both Jack and Jill's loft multipliers. So if Jack and Jill both spend £5,000 on a loft conversion then they can expect an uplift in the values of their homes by:

Jack: 5.00 x £5,000 = £25,000
Jill: 2.5 x £5,000 = £12,500

So Jack and Jill can expect to profit from their loft conversion to the tune of £20,000 and £7,500 respectively.

6. RISK

If we want to earn a greater return than a risk free rate, such as a building society rate or a government gilt rate then you have to accept a degree of risk. There is no such thing as a free lunch - I think we all understand that! Therefore the risk we are thinking to accept when entering or remaining in the property market has to be:

1. Understood
2. Eliminated (where possible) and
3. Managed

I want you to apply this to any business investment – not only property. The key to long term business success lies within this chapter. You have to understand the risks involved, eliminate them where possible and manage the risks that remain.

Understanding Risk

The following mutually exclusive risks exist in property investment:

Risk	Description
Systematic Risk	Systematic Risk is simply the risk in being in the property market. The mere fact that you are in this market means that you will experience risk.
Leverage Risk	Leverage risk is the risk associated with borrowing. If you borrow money to buy a property then you have to pay it back – with interest! If you default on repayments then you can be out of business very quickly – and be declared bankrupt.
Specific Risk	Specific risk is the risk you face with the individual property and tenant. It has nothing to do with the property market or borrowing.

They're mutually exclusive as they operate under very different conditions. The property market as whole is dependent on demographics, the borrowing rates are set largely on global and home economies and your relationship with your tenant is individual. This means that you can tackle each risk independently. If you manage to eliminate any of risks then they will 'stay down' and not rear their ugly head and allow you to focus on the risks that remain. Well I will tell you now which following risks can be eliminated:

Risk	**Eliminated?**
Systematic Risk	Yes
Leverage Risk	Yes
Specific Risk	No

So you can see that both Systematic risk and leverage risk can be eliminated. Specific risk is an individual risk which can be managed – you will find out about this below.

Eliminating Risk

Systematic Risk

Systematic Risk is the mere fact that you are investing in the property market. The property market is here to stay. People will always need to live somewhere. It may not be necessarily in your property but people will always need somewhere to live. This is the difference between this business and a new product business. With a new product you have to estimate the market in order to gauge demand. With the property market there will always be demand for somewhere to live and this demand will be here forever. So as long as you can ride the boom bust cycles you will ALWAYS win as property delivers a higher rate of return than the risk free rate.

Systematic risk is eliminated the same way systematic risk is eliminated in holding a stock portfolio. There will always be the stock market. There will always be businesses to invest in. The key to eliminating systematic risk is to invest in stocks that are uncorrelated. That is to say that if one stock was to collapse then it would have no impact on any other stock. This is called diversification. If you have a well diversified portfolio then the stocks held will have a near zero correlation with the others.

They way they do this is to invest in uncorrelated markets such as:

Uncorrelated Markets	Description
Industry – i.e.	If you invest in a number of industries that have a

Pharmaceuticals v Financial Services	low correlation then if one industry suffers it should not affect your holdings in the other industries. In the example you could probably find a link between drugs and the financial services but it would be very small. These markets should act independently.
Area – i.e. Asian Markets v Atlantic Markets	If you invest in different countries then you can expect a lower correlation between stocks held in each individual country than if you invested in individual stocks within the same country. Now we all know the saying 'if the US sneezes we all catch a cold'. But in this example the Asian market does have its own economy that does largely function on its own independent variables. If their was an Asian crash it should not largely affect your holding in the US.

Type – i.e. Stocks v Bonds	The bond market operates on different fundamentals to the stock market so there is a low correlation between the two. A well diversified portfolio will have a bond holding also.

So how does this transfer to the property market. Well we have to look at the markets within the property market and ensure that your portfolio is well diversified. That is to say that your property portfolio is spread amongst several uncorrelated markets.

Now when I say uncorrelated I mean significantly but not absolutely. Nothing is 100% uncorrelated. You can always find a link to something no matter how unrelated the two markets appear to be. The tern uncorrelated is used in a broad sense. The broad uncorrelated markets that exist within the property market are:

Markets	**Uncorrelated Markets**	**Description**

Industry	Private v DSS Tenant	The DSS market will largely depend on the local council's ability to operate efficiently and pay market rents. The private market will depend on employment rates and rates of pay. These are independent hence uncorrelated.
	Single v Family Tenant	The single person market is fuelled by the property's proximity to bars, restaurants and gyms etc and a high tenant turnover is expected. The family tenant is more concerned with the proximity to schools, parks and leisure facilities. The single person let and the family let operate under different conditions hence uncorrelated.

Area	Area 1 v Area 2	Significant un-correlation exists between regions. That is SE, SW, East Anglia, London, East Midlands, West Midlands, The West, Wales, NW, NE, Scotland & Northern Ireland. They operate to their own fundamentals.
	UK v Overseas	Significant un-correlation exists between countries. They operate to their own fundamentals.
Type	Private v Ex-local Authority or low value homes	Its quite normal to see the prices of low value homes boom and the executive developments fall or vice versa at the same time. These markets act independently as the purchasers or tenants for each of these

		type of properties lead very different lives and have different jobs. If executive jobs are reducing but manual work is increasing then the above will happen.

So to have a well diversified portfolio thus eliminating systematic risk you would need a fair mix across the portfolio of:

- Private and DSS tenants
- Single tenants and family tenants
- Properties located in all regions of the UK
- Properties located around the world
- Private properties and low value ex-local authority properties

Now I can already hear you saying 'yeah great, but I'm not a billionaire to buy every type of property in every region in the UK and every country in the world!' It would be nice to have a well diversified portfolio constructed as above but we have to live in the real world. What I am saying here that this is an ideal. You should always aim for this ideal even if you never reach it.

Leverage Risk

So lets assume you are not a billionaire but you do try to achieve a well diversified portfolio. If you want to do it quickly then you have to borrow as you will have to buy a number of properties in differing markets to achieve this. This then introduces Leverage Risk. This risk is the risk that you will over borrow and end up defaulting on your loan repayments and eventually go bankrupt.

The way to eliminate leverage risk is to acquire a well diversified portfolio immediately or over time without borrowing. You will not grow as fast as an investor willing to accept leverage risk but once achieved you will be sitting on a major cash generating machine. This method is really only suitable for people that are:

- **Of high net worth** – they have large reserves of cash at hand or have recently liquidised their poor performing property or stock portfolio and wish to buy a superior property portfolio for cash.
- **Not Relying On a Property Portfolio** – They have a high income already which they can live on and their income is also high enough so they can save and buy a property for cash.
- **In receipt of a large inheritance or cash windfall** – They have come in to a significant amount of money and intend to earn a rate in excess of the risk free rate such as a building society savings account.

- **Managing a significant investment fund** – if you're in the privileged position of managing other people's money collectively then you may not need to borrow to achieve full diversifaction as the fund will be large enough to spread around a large number of properties.

If you're not in any of the fortunate positions above then the bad news it that you will have to accept leverage risk. The good news is that it can be managed along with specific risk.

Managing Risk

Leverage Risk

Let me remind you of what leverage risk is:

'the risk that you will over borrow and end up defaulting on your loan repayments and eventually go bankrupt'

This is the main reason why businesses go under. Even the big boys get it wrong such as Worldcom and Swiss Air as they did not manage leverage risk. If they had managed their debt then they would not have gone under – its called debt management.

To manage your debt you need to ACT prior to taking on new debt and REACT to the changing conditions during the term of the debt. The risks you face from debt and the actions and reactions you can do are:

Risk	Action	Reaction
The loan amount is too big to pay in full and on time	• **Do your homework! -** You must budget for what you can afford. Be sure to factor in the tenant not paying or unexpected repair bills. • **Borrow Less** - You do not need to gear up to 85% LTV if the figures	• **Reduce the loan amount** – if you have any monies in a savings account that could ease your problem then use it to redeem some of the debt • **Refinance** – You may be able to refinance the debt by switching lenders offering a better rate or

	don't stack up. If you can finance the purchase with only 60% LTV borrowings then do so.	increasing the term of the debt • **Sell** – if you cant do any of the above then get out before it gets you!
Interest rates rise making the loan repayment too big to pay in full and on time	• **Fix your interest rates** – This is a common way to manage an interest rate rise risk. • **Spread your borrowings over different lenders** - Lenders have different rates and adjust to	• **Reduce the loan amount** – if you have any monies in a savings account that could ease your problem then use it to redeem some of the debt • **Refinance** – You may be able to refinance the debt by switching lenders offering a better rate or

	interest rate rise differently. • **Borrow Less** - You do not need to gear up to 85% LTV if the figures don't stack up. If you can finance the purchase with only 60% LTV borrowings then do so.	increasing the term of the debt • **Sell** – if you cant do any of the above then get out before it gets you!

Okay, so we know how to manage leverage risk, now down to the detail of managing specific risk associated with each individual property.

Specific Risk

The Risks Involved In Investing In Property

The way to mitigate against the risks involved in investing in property and hence manage them is to take countermeasure actions. There are 5 specific risks that can happen to an individual investment property and the corresponding countermeasure actions you can take to manage these risks are:

	Risk	**Countermeasure**
1	Cant find a tenant.	• Buy a property that can be easily let out, like near a major train station or in a desirable area. • Reduce the rent.
2	Get caught in negative equity trap.	• Don't sell the property and realise your loss. Continue to rent it out. Wait for the recovery and then sell. • Buy the property without a mortgage so that negative equity is not a

		possibility.
3	The tenant does not pay the rent.	• Take out landlord insurance that covers your for loss of rent due to tenant default.
4	Major repair becomes due and can't afford to carry out works	• Take out a thorough and comprehensive buildings and contents insurance. • Take out specific policies for specific items i.e. British Gas offer full insurance on your boiler from £8 per month.
5	Buying a property you can't sell	• Avoid difficult to sell properties such as studio flats, ex local authority flats, flats above shops, non-standard construction properties or any property that is difficult to get a

		mortgage on. • Buy a property near a train station city or major road junction.

Overall Risk

Knowing, understanding and addressing all the risks you face in business is a hot topic. Risk and business go hand in hand so it is fundamental to grasp the whole notion of risk if you want to take business seriously.

You should examine your overall exposure to risk and see how well you are managing these risks. Remember – you can always do something to lower your overall risk. This chapter only touches on risk management. There's a whole science out there that's worthy of a read.

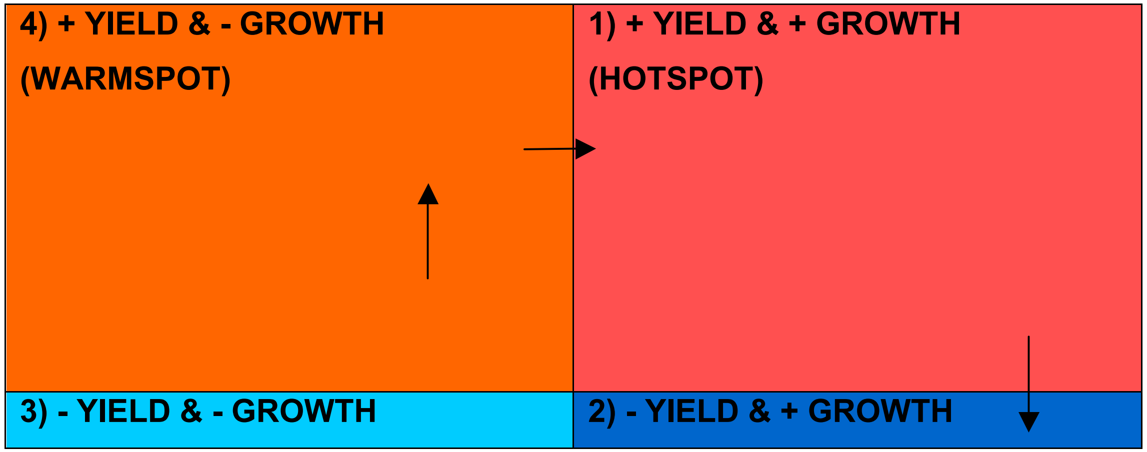
7. EXIT

Its all about going out on a high! They always say to leave on a high note and this also includes property investment - except you leave on a high price!

To know when to sell you have to understand, what I call, the property quadrant.

The Property Quadrant

Look at this quadrant:



(COLDSPOT)	**(COOLING SPOT)**

Negative and positive yield growths can be defined as:

Term	Definition
+/- YIELD	A positive yield means that as a result of your investment cash is put in to your pocket. So ALL expenses are taken into account. This includes interest payments, void periods, repairs, management fees and tax. A negative yield means that as a result of your investment cash is taken out of your pocket. This will be due to

	increased interest payments (caused by an increase in interest rates or over borrowing), higher voids (caused by over supply of the rental market) and large repair bills.
+/- GROWTH	A positive growth means that the property's value is on the trend upwards. A negative growth means the property's value is on the trend downwards.

The definitions of a Hotspot, Cooling Spot, Coldspot and Warmspot and the type of buyers for properties located in these areas are:

	Description	Typical Region	Buyers
1) + YIELD & + GROWTH	Since overall we are in a rising property	North	Professional Investor

(HOTSPOT)	price market this should be the only ever place you should be investing. This investment puts money in your pocket and it also enables you to grow quickly because you can access the capital growth by remortgaging. As prices rise (due to the professional investors competing for the same properties) the yields fall until they		Owner-occupiers

	go negative. Then the hotspot goes to a cooling spot. See below.		
2) - YIELD & + GROWTH (COOLING SPOT)	This is where even though the investment takes cash out of your pocket the investor is banking on capital gain to give him a return. This situation can only last until his or money runs out. At some point they *have* to sell which	London	Band wagon Investors Amateur Investors Owner-occupiers

	causes the market to become a buyers market rather than a sellers market and prices fall hence negative growth. It then becomes a coldspot. See below.		
3) - YIELD & - GROWTH (COLDSPOT)	No one wants these properties as investments! These investments are bad for your wealth. The only buyers are owner-occupiers buying to live there	Posh areas such as Kensington, Cambridge and Oxford	No investors as it is negative yield AND negative growth. Owner-occupiers only.

	rather than to buy and rent out. When owner-occupiers are unable to buy due to unaffordability then a rapid decline happens. Certain areas will become warm spots. See below.		
4) + YIELD & - GROWTH (WARMSPOT)	Along the way down of the rapid decline certain areas will still put cash in your pocket but will still further decline.	None currently.	Professional Investor in a falling market. The professional sees that these investments are

	Considering the market is only heading downwards only professional investors will take the chance as the investment is cash positive. Owner occupiers will wait for the market to bottom out. Property prices will recover due to rental price increases, falling interest rates and properties becoming affordable and hence		better than leaving their cash in the bank. No owner-occupiers.

	a warm spot becomes a hotspot – see above!		

There is no point in selling when your property is currently in a hotspot (unless you want to sell your portfolio in one hit – see below). This is because there is still room for the price to grow and its currently profitable thus its not costing you to hold. It only becomes worth selling when the property becomes unprofitable but the price is still growing. **The highest point in the market can only ever exist within a Cooling Spot**. This is because the property price has risen to the point that it is unprofitable but it is still on the trend upwards. The professional investor drops out of buying in this market and only owner-occupiers and novice investors remain.

You are able to sell within this market as it exists as there are owner-occupiers that are not concerned about the profitability of a property as they wish to live in it rather than rent it out. There are also speculative investors out there that are banking on the property price to keep on growing and the novice investor that doesn't do his sums right. These buyers are able to buy your property at an inflated price above the real price because:

Type	Ability	Reason
Owner-Occupier	Self-certified Borrowing	In the UK we borrow at the current variable base rate and not at the long term average rate. Currently the long term rate is around 5.7% and the variable base rate is at 4%. This is why we have a boom bust cycle. When rates fall below the long term rate first time buyers over borrow, as they can afford it, by obtaining a self-certified mortgage thus increasing their buying power. Their increase in

		buying power creates the bubble element as their buying power takes them over the real value of the property.
	High Income Multiple Lending	Some lenders are offering in excess of 4 times salary. This enables a first time buyer to borrow in excess of the real value of the property thus creating a bubble element.
	Consumer Debt	Some people borrow the deposit for the property by way of loan. This means you can enter the property market very quickly as

		you do not have to wait to save up for a deposit. This increases the number of buyers thus increasing demand for property hence pushing up the price of the property.
Novice Investor and Speculative Investor	Buy to Let	Due to the buy to let mortgage also operating under the current variable base rate the same problem occurs here. Instead of demanding a 2% loading over the long term rate they demand a 2% loading over the current variable base rate. This means you get novice investors buying

		at 6% yields and below hence superceeding the first time buyers highest price. Due to the poor performance of the stock market in recent years the property market has attracted the traditional stock market investor. Here the investor will invest for capital growth and so will be happy to take less than a 2% loading. The speculative investor will make the estimation that the growth experienced in the past will happen in the future over the short term. The speculative

		investor's bid then superceeds the first time buyer's bid hence a bubble element will exist.

It is these type of buyers that do cause the bubble in the property market – so use them to your advantage! To find out about where all the hotspots, cooling spots, coldspots and warmspots are in the UK then visit www.propertyhotspots.net. This site also has a national yield and capital growth index for over 330 areas in the UK.

Selling The Portfolio In One Hit

If you want to sell your portfolio as one job lot then you have no choice but to sell to the dreaded 'Professional Investor'! You are not then selling to the public or even your standard investor but the professional investor. The professional investor will look beyond whether the tenant pays the rent on time, a tenancy exists or the décor as he will assume all these headaches. What he wants to know are the core fundamentals.

Professional investors will only ever invest in warm or hot spots. Since there are hotspots that exist the professional investor will only invest in a warm spot for non-financial reasons. This could be due to living near the warm spot, knowledge of the area or the preference not to invest in a hotspot due to type of tenant. So you either have to sell when the portfolio is in either a hotspot or warm spot.

You should preferably position your property portfolio for sale when it is in hotspot. At least the property portfolio value is growing and the professional investor may over speculate and give that little bit more, banking on further rises which will be probably likely. You should avoid selling in a warmspot as the value of the property portfolio is falling and the professional investor will use this to his advantage and over discount his offer to you.

One thing to learn in all this is never, never, never sell in a coldspot. This is where the general property market loses but the professional investor survives as he never realises his losses. Selling in a falling market is can cost you dearly.

The professional investor will want to know:

- Individual prices wanted for each property
- Individual yield information on each property

- Overall yield on the whole portfolio
- Profit & Loss Account for the portfolio
- Types of tenancies existing on all properties
- Anything unique to any of the properties such as flying freeholds etc

Capital Gains Tax

This tax only arises when you sell the property. The capital gain is worked out as:

Sale price - purchase price = Capital Gain

The sale price is deemed to be the price achieved after deducting estate agent costs, solicitors' fees and any other expenses that were incurred wholly, necessarily and exclusively in the sale of the property.

The purchase price is the cost of the property plus all survey and legal costs.

How to reduce your Capital Gain

<u>The Calculation</u>

The way to reduce your capital gain is to understand the capital gain calculation. If you dispose of a property the following calculation will be made to work out your capital gain:

	Sales Price			£125,000
Minus	Allowable Costs			<u>£100,000</u>
		Purchase Price	£80,000	
	(a)	Incidental costs of purchase	£2,000	
	(b)	Home improvements	£15,000	
	(c)	Costs of establishing or defending title	£1,000	

	(d)	Selling costs	£2,000	
Equals	Chargeable gain			£25,000

The sales price and the purchase price are fixed. You cannot change what you sold the property for or what you paid for it.

Allowable Costs

To reduce your capital gain you have to maximise the other allowable costs. Lets look at the other allowable costs and what you can include. This part is paraphrased from the Inland Revenue themselves:

	Allowable costs	**What you can include**
(a)	Incidental costs of purchase	• fees, commission or remuneration paid for professional advice • the costs of transferring the property

		• stamp duty • the costs of advertising to find a seller • the costs of any valuations needed to work out your chargeable gain (but not the costs of resolving any disagreement with the Inland Revenue about your valuations)
(b)	Home improvements	These are costs which • you incurred for the purpose of enhancing the value of the property, and • are still reflected in the state or nature of the property at the date of its disposal. You may not claim the cost of normal

		maintenance and repairs.
(c)	Costs of establishing or defending title	• fees, commission or remuneration paid for professional advice
(d)	Selling costs	• fees, commission or remuneration paid for professional advice • the costs of transferring the property • the costs of advertising to find a buyer • the costs of any valuations needed to work out your chargeable gain (but not the costs of resolving any disagreement with the Inland Revenue about your valuations)

So in a nutshell you can include:

- Solicitor's costs
- Accountancy fees
- Mortgage broker fees
- Redemption penalties on cleared mortgages
- Stamp duty
- Advertising
- Estate agent fees
- Valuations needed to calculate your gain
- Any improvements that still remain in the property
- Legal costs in defending your title to the property

So the first part of reducing your capital gain is to include ALL costs involved with the purchase, ownership period and sale of the property that fall within the definitions stated by the Inland Revenue. But it doesn't stop here! You can further relief on the gain. Read on.

Personal Allowance

You can still reduce your gain further. Everybody gets a capital gains tax allowance of £7,900 per tax year rising year on year with inflation. So if you have a gain of £10,000 then it is reduced by £7,900 to £2,100.

If you are selling a couple of properties then if you can straddle the sales either side of the 5th of April year end date of the tax year. This way you can apply your capital gains allowance for the tax year prior to 5th of April on one of the properties and your capital gains allowance for the tax year after the 5th of April for the other property. This way you can make full use of your yearly allowances.

There is one final trick – Principal Place of Residence.

<u>Principal Place of Residence (PPR)</u>

Your own personal residence is not liable for capital gains tax so any gain you make is all yours. If part of your strategy is to let out your home and move in to another home and you sell it within 3 years of leaving your home then there is no tax to pay! If you sell after the 3 years then you still get relief for 3 years. Lets look at this example:

Roger lives in a house that has been his personal place of residence for 8 years, when he bought it, but decides to move out and rent it out. If he sells 2 years after he rented in out there is no tax to pay. If he sells it 5 years later then only:

(5-3)/13 of the gain is chargeable.

The equation being:

(Amount of years rented – 3 years)/Period of ownership.

SIPP & FURBS

You may have heard of these terms fly about in connection with properties and pensions. Let me explain their relevance to this subject.

SIPP

This stands for Self Invested Personal Pension. The reason why it is mentioned is that you can buy *commercial* property within this pension and enjoy all the tax breaks a normal pension has. The reason why a SIPP is not applicable in this situation is because we are investing in *residential* property. Residential property is not allowed under the SIPP scheme.

Commercial property is not as attractive as residential property. The reasons being:

- The yields are lower
- Borrowing is restricted to 70% loan to value
- Business risk is doubled – your are reliant on your tenant's business to trade well out of your property as well as the normal risks associated with owning the commercial property itself

This is my own personal opinion. You may think that commercial property is for you. If you do get in to this game I would seriously consider investing in commercial property under this umbrella of a SIPP as the shelter to tax is quite significant.

<u>FURBS</u>

This stands for a Funded Unapproved Retirement Benefit Scheme. Its main beneficiaries are the higher rate tax payers only. So if you're not a higher rate tax payer and don't expect to be one then ignore this bit.

If you buy a residential property under this umbrella then:

- Profits from the scheme are taxed at 22% rather than 40% if you are a higher rate tax payer.
- Capital gains tax is 34% in comparison to 40%. A FURBS also attracts the normal taper relief explained above.
- You can pass a FURBS down to your family. There is no Inheritance tax to pay when passed on after death as opposed to being subject to the normal inheritance tax limits (currently £259,000). A traditional pension fund is not passable down.
- There is no limit on the contributions to a FURBS but you do not get any tax relief on your contributions.
- The whole of the fund can be withdrawn tax free compared to a traditional pension fund being restricted to 25%.
- Retirement can be even after the age of 75. Traditional pension funds are restricted to age 75.

The two key things you need to consider on deciding on whether to invest in property using a FURBS is:

1. You can only access the money at retirement. If you want to retire prior to normal retirement age then its not possible under this scheme. FURBS restrict your freedom. Once you invest your money in a FURBS you can't get at it till retirement.

2. There are administrational costs involved. You have to use an accountant and the accounting for such a scheme has to be spot on.

Personally I like the freedom that I have. Maybe when I'm over 45 and FURBS are still about then I'll consider one. I think if you're target earning is more than £50,000 p.a. profit from property, you don't require any of this £50,000+ p.a. to live on today and you're aged over 45 then a FURBS may be for you. Seek professional advice.

And Finally

Once you've sold up you can buy that yacht that you've always wanted and retire to the South of France. But I suspect you'll be back in a year looking to buy and build up a portfolio again…….