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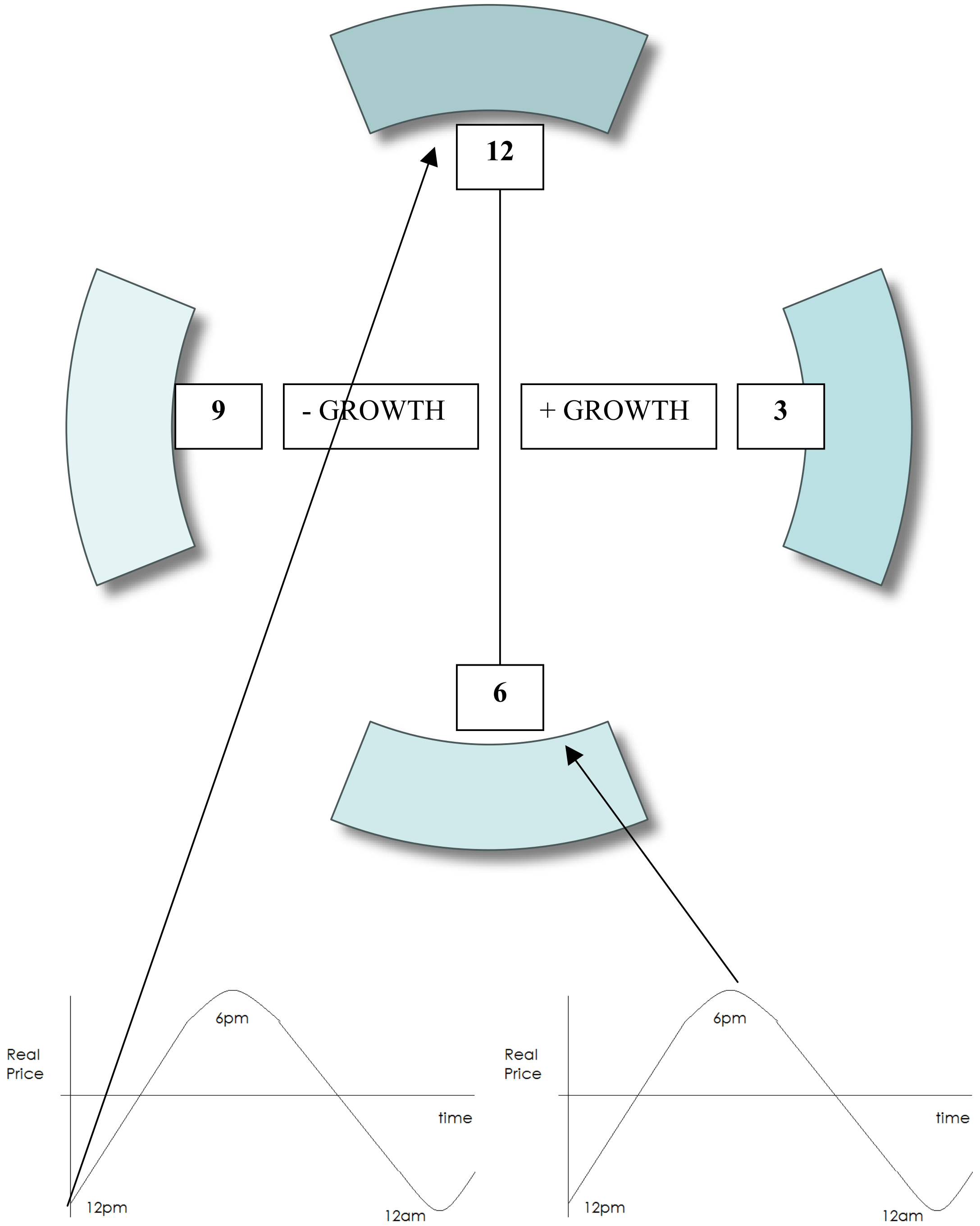
[PLEASE VIEW IN 'WEB LAYOUT' ACCESSESD FROM 'VIEW' TOOL BAR]

'RIDING THE PROPERTY CYCLE – UNDERSTANDING THE PROPERTY CLOCK TO EXPLOIT FOR MAXIMUM GAIN'

1. The property clock's existence

Property prices follow a cyclical pattern. Property prices rise and then property prices fall. The reasons why will become apparent further down, but for some reason they rise and then fall. So what is the best time for an investor to become interested? When the prices start to rise of course!

If we were to speed up this process over a notional 12 hour period, with 12 o'clock being the point at they first rise and 6 o'clock being the first point they first start to fall then we would have the following diagram:



So at 12pm prices increase until 6pm and then they start to fall. So we can see that anyone that has any sense gets interested anywhere between 12pm and 6pm. So who buys during 12pm and 6pm? Everyone! So who is everyone and why do they buy? The following people exclusively buy and their reasons are:

Buyers	Why?

Professional Property Investors	A professional property investor will buy a property that will enable him to buy other properties AND put money in his pocket. That is it will enable him to benefit from capital growth so as he can remortgage and buy further properties and when rented out it will, after voids, letting agent fees, tax and other expenses provide a positive cashflow.
Novice/Speculative Investors	A novice/speculative investor will invest in a growth area because they will believe that the trend upwards in price will continue. They are less concerned in fundamentals as they are not aware of the fundamentals – they simply believe that the trend is upwards.
Owner-occupiers	The owner-occupier will buy because if they delay buying it will cost them more. So it is in their interest to buy sooner rather than later as their overall purchase price will be higher the longer they leave it.

So who buys between 6pm and 12pm? Well prices are falling now so the Novice/Speculative investor becomes disinterested as there are no capital growth prospects and the owner occupier will wait until the prices drop further. The only buyer remaining is the professional investor:

Buyers	Why?
Professional Property Investors	The only time a professional property investor will buy in this market is if the investment puts money in his pocket. He will invest in a falling market due to the property market providing him with a better return on his other investments such as the stock market, other businesses or a bank or building society. It is the professional property investor that prevents the property market falling to nothing. It is the professional investor that provides the cushion to the fall.

Based on the table above we can see that:

- The professional investor buys on known information i.e. the property purchase puts money in their pocket.
- The novice/speculative investor and owner-occupier buy based on the fact that the trend of the prices are rising ONLY.

So how does the professional investor estimate whether a property will put money in his pocket? Well its called gross yield. Gross Yield, in mathematical terms, is:

$$\frac{\text{Annual Rent}}{\text{Property Purchase Price}}$$

Now annual rent is a pretty static figure. Rents do not rise and then fall. They simply rise slowly and steadily the same way wages do. So in real terms they remain the same.

However property prices are far more volatile. Property prices gather momentum far in excess of the rate of wage inflation and hence rise and fall greater than the rate of inflation - but we will get to that later.

Assuming we agree with the stability of rental prices and the volatility of property prices, we can show that:

Property Prices are inversely related to Yield

That is to say as property prices rise the yield falls. Let me show you this example:

Annual Rent: £10,000
Property Price: £100,000

Yield is then:

$$\frac{£10,000}{£100,000} = 10\%$$

Now lets say property prices increase to £110,000 in 6 months. A professional investor considering the market will now consider the yield to be:

$$\frac{£10,000}{£110,000} = 9.1\%$$

So we can see that as the property price INCREASES from £100,000 to £110,000 the yield DECREASES from 10% to 9.1%.

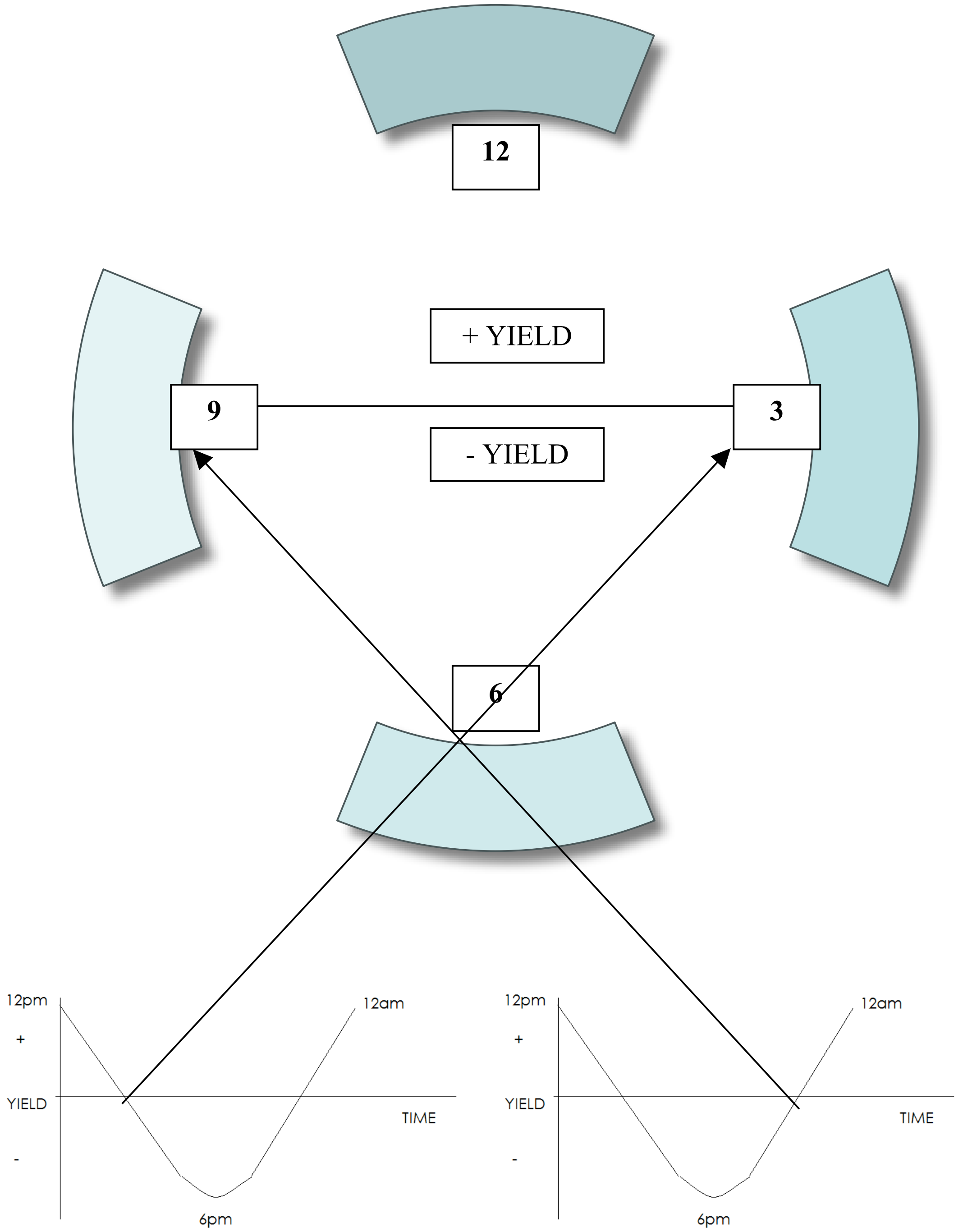
Using this same example lets say property prices fall from £100,000 to £90,000 in 6 months. A professional investor considering the market will now consider the yield to be:

$$\frac{£10,000}{£90,000} = 11.1\%$$

So we can see that as the property price DECREASES from £100,000 to £90,000 the yield INCREASES from 10% to 11.1%.

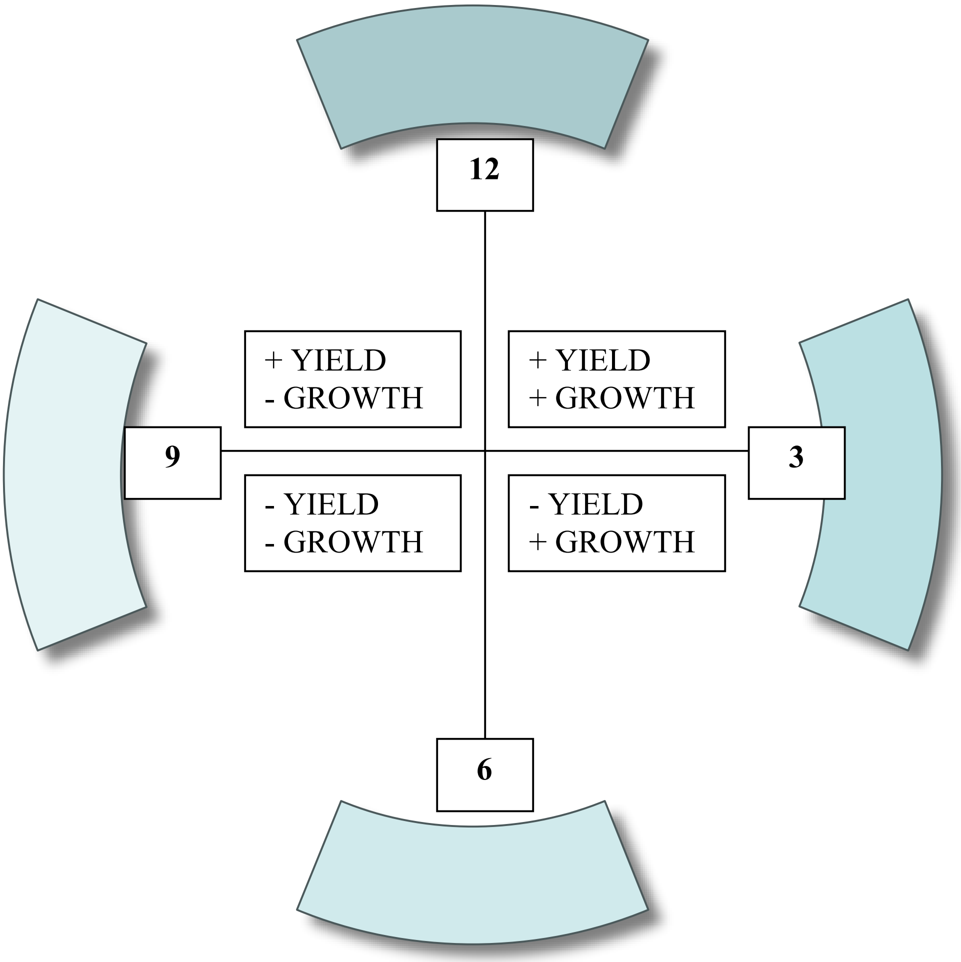
This is called an inverse relationship as the yield and property price move in different directions. So if we were to create a Yield vs Time graph then it would be the exact opposite of the Real Price vs Time graph.

Fitting the yield curves in to the clock it will look like:

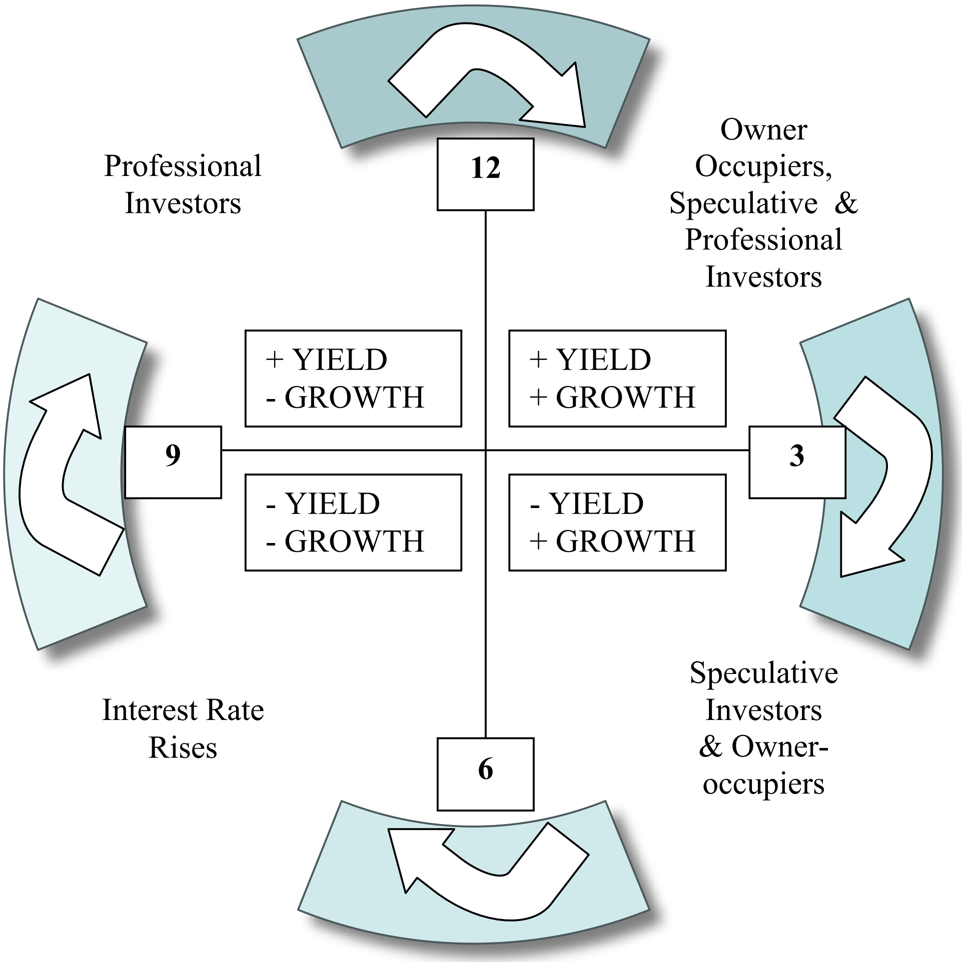


So if you're a sensible investor then you will invest during 12pm to 3pm and 9pm to 12pm. This is because with any investment you make, you will make money as the investment puts money in your pocket because it's a positive yield.

If we super-impose these two strategies then we come up with the face of the property clock:



But with every clock it needs power to move round the face. These I call drivers. The clock needs power to take it round the clock. So what moves the clock round?
The following drivers push the property clock round with regularity:



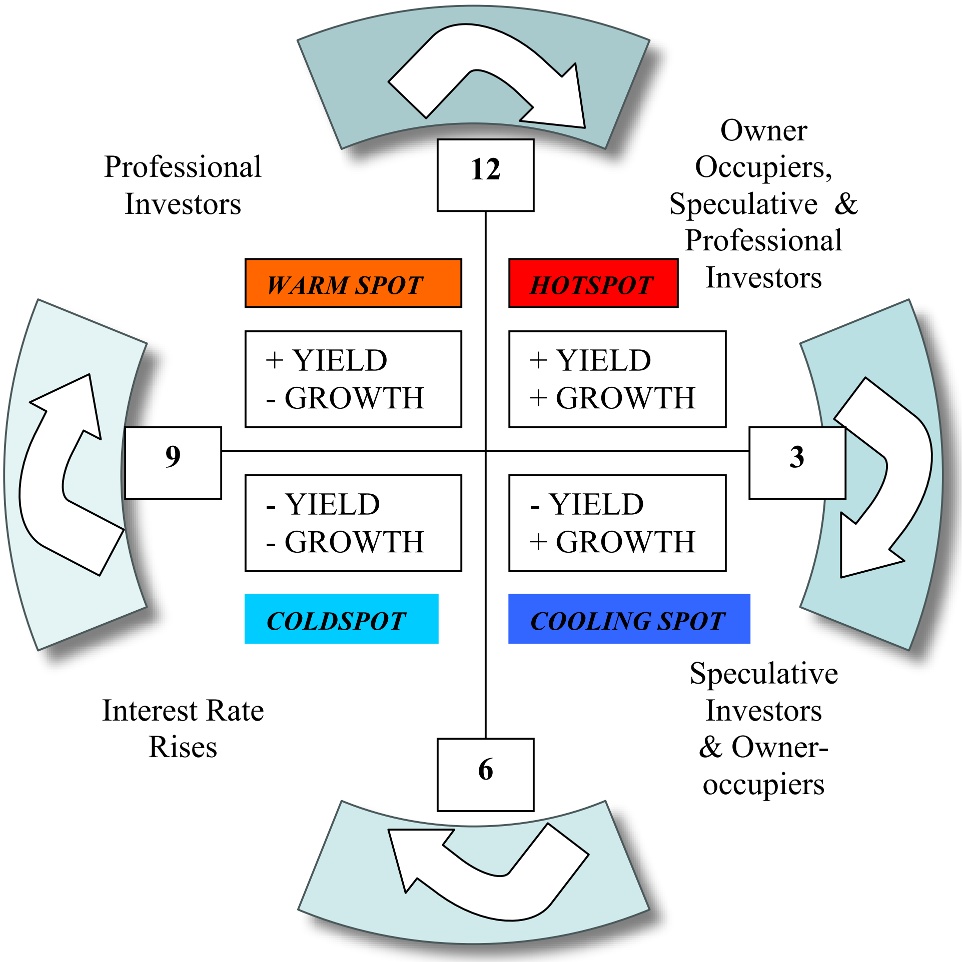
So we can see that:

- everybody drives the price from 12pm to 3pm,
- speculative investors & owner occupiers only drive the prices from 3pm to 6pm,
- interest rate rises drive the price then downwards from 6pm to 9pm and
- professional investors drive the price downwards even further from 9pm to 12am but prevent the prices falling to zero.

The clock quarter regions (being 12pm-3pm, 3pm-6pm, 6pm-9pm & 9pm-12am) can be named quite specifically as:

Clock quarter	Name
12pm – 3pm	Hotspot
3pm – 6pm	Cooling Spot
6pm – 9pm	Coldspot
9pm –12am	Warmspot

The reasons why they are named so will be explained later. However, we have the complete face, drivers and names for each clock quarter for the property clock:



This clock is relevant to any property market that exists within a:

1. Variable interest rate environment
2. Easily obtainable buy-to-let mortgage
3. Lack of long term fixed interest rate mortgages (typically greater than 10years)

The UK market fits this model. If any of these conditions are eliminated then the clock slows down. If all conditions are eliminated then the clock STOPS! Assuming that none of these things happen then the strategy is:

A) Know when the clock strikes 12pm most importantly AND
B) Know when the clock strikes 3pm, 6pm & 9pm

In the rest of this book I am going to ignore wage inflation. Even though a house costs twice as much in 20 years you can be sure that you will be earning twice as much. I am going to assume real prices. This makes the figures simple. Actual prices rise and fall but real prices remain the same.

2. Growth

Calculating Growth

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(CMV_1) - Purchase Price (PP) = Annual Capital Growth (AGC_1)

Basically its how much your property has gone up by in a year of ownership. For future years ACG is:

$CMV_n – CMV_{n-1} = ACG_n$

In simple terms it's the difference between the value of the property now and one year ago.

Understanding +/- Growth
Understanding why property prices rise and then fall is very important if we want to make money! It is property prices that drive yield NOT the other way round hence what affects property prices is everything. Property prices are volatile and rents are stable. Experts call the rise and fall in property prices the boom bust cycle. The boom bust cycle will be directly related to:

1. The general economy and
2. Land values

This is because property is:

- *built* on land, and
- *bought* with money

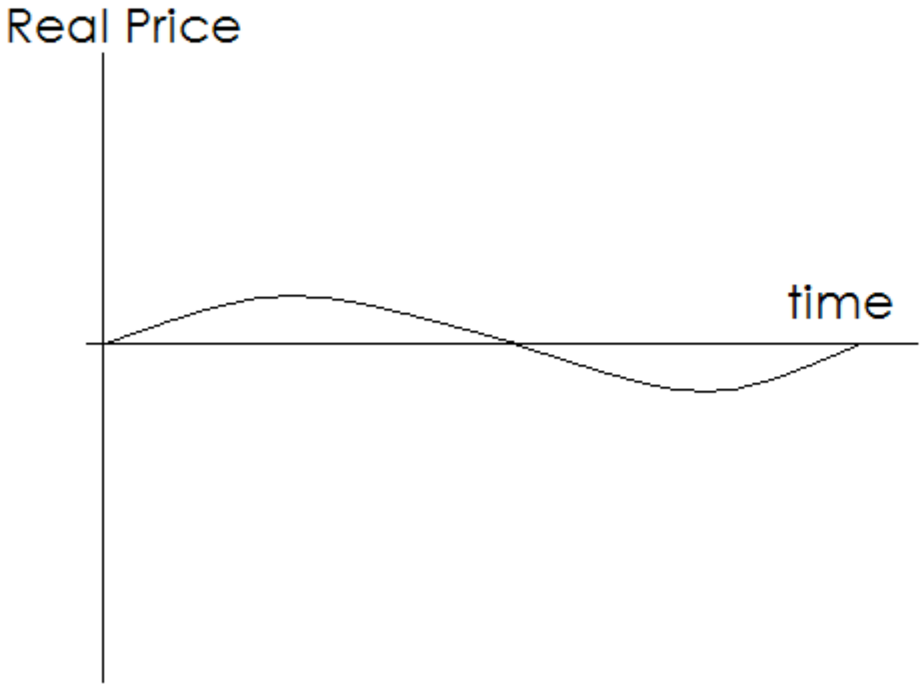
So a full understanding of the limited nature of land and the dynamics of the economy will enable you to see where we are in relation to the boom bust cycle.

Certain principles need to be explained before we enter the boom bust cycle.

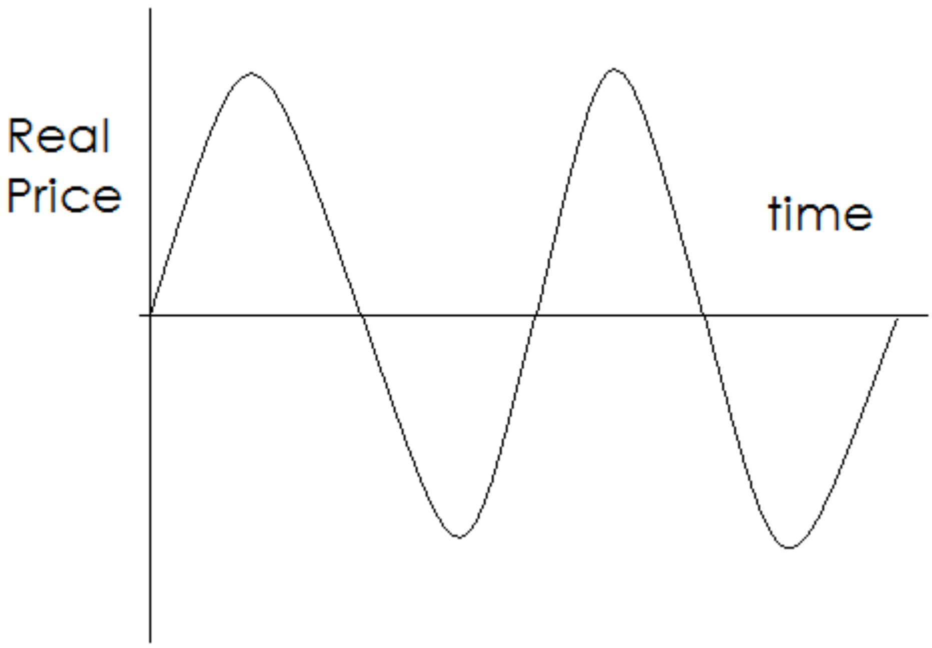
Principle	Description
Land is in limited supply	No matter what we do there is nothing to increase the supply of land greater than the surface area of the UK. Undeveloped land belongs predominately to the aristocracy or local councils. The 'super rich' land owners such as earls, barons and dukes own land that they have inherited from their ancestors. Local councils own land that was passed down through the Magna Carta in 1066. London is not going to get any bigger. What we have is what

	we've got. Due to this fact it will ALWAYS attract the speculator. Massive profits can be made by simply holding on to a piece of land and holding out till the surrounding land gets developed.
The population is growing	With a growing population means that there are more ideas, inventions and businesses hence more is produced which causes a pressure on land requirements to locate all the people and their businesses. Overall land values *have* to increase.
Increase in land values cause an increase in development of land sites	A land owner will happily hold on to a piece of land as there is no cost to him holding. If land values rise due to the overall state of the economy rising then he will be tempted to sell. Then either the land owner sells, at a profit, to a developer who then develops on the land or the land owner decides to develop it himself.
An increase in development of land causes an increase in infrastructure	As development occurs more services are required to service the developed areas such as train stations, better road links, schools etc. this causes the overall land values to increase further.
Due to the rise in land values saving increases	Considering that money can only be spent or re-invested the general public become attracted to the returns to be had from property developments and hence save. This results in people spending less on the high street and hence consumption falls.
The fall in consumption is hidden by the feel good factor	Because home-owners have experienced an increase in their home they use this security to borrow and spend it on the high street. This increase in borrowing to spend is greater than the amount saved to invest (mentioned above) thus overall consumption increases.
A trade deficit occurs as a result in the rise of consumption.	Imports exceed exports to cope with the rate of consumption. This causes a deficit and hence the government must raise rates to attract outside investment to finance the deficit.
As rates rise the returns from property look less attractive	The whole boom is due to property looking attractive to speculative investors because of capital growth. If rates rise property price growth stabilises and thus expected growth is no longer factored in to the overall return.

If the availability of land was not restricted then real prices would fluctuate like this:



However, the availability of land to be developed on is restricted due to speculation, thus real prices fluctuate like this:



You can see that real prices rise and fall to a greater degree and over a shorter period of time.

The Start of the Boom

Okay so lets start at when everything is at a sensible price. There are no rapid increase or decrease in prices, supply equals demand and so prices are stable. As the population is growing so is the demand by businesses and individuals to buy commercial and residential property. This means that:

- properties are either knocked down and built even higher (i.e. the number of floors) to accommodate the increase in demand
- properties are built in the undeveloped areas to cope with the increased demand
- Infrastructure increases to cope with the increase in population

This is what is supposed to happen but invariably doesn't! Certain land owners do not develop and hold out for even greater increases in value. This in turn causes:

- Development in areas out of the city centre that put a strain on the infrastructure. i.e. if one can only build in a small village near the city centre then the road connecting the village to the city centre has to be upgraded and the construction of a train station in the burgeoning village is imminent.
- Undeveloped land in the city centre then becomes even more valuable because of the increased infrastructure surrounding the city centre thus creating a vicious cycle of surrounding villages becoming over developed and undeveloped land within the centre being worth potentially millions. Look at city centres with affluent village/towns surrounding it but with under-developed budget car parks within it being worth a fortune.
- Commercial and residential property within the city centre becoming over-enhanced i.e. knocked down and built again to a high spec (i.e. skyscraper) which costs a fortune to the investor but with the hope of an even bigger return.
- Developers buying sub-prime land to develop a long way in to the future thus bypassing greedy land owners with high prices on prime plots. However this money, invested by the developer, is removed from the economy.

So in all, due to the limited supply of land, rising prices being seen by everyone and the number of property programmes or friend's stories of how they made a small fortune, its only a matter of time before - the *property speculator* emerges. The speculator assumes that you can buy a property, do nothing and sell it in a year and make more than the average annual salary!

Middle of the Boom

Due to the introduction of the speculator, who is really only a novice investor, property prices are over predicted. This means that:

- existing buildings can be sold to them at inflated prices or
- plots of land sold to developers (who are speculators also) re-sell the newly built properties to other speculators

because the speculator's view is that the property's value is heading in only one direction – UP!

As prices rise artificially high it encourages even more to be spent on them to gain a higher profit. This results in people saving more, to invest in property, and thus spending less on the high street lowering overall consumption. However this is masked temporarily by what's known as the 'Feel Good Factor'.

Due to some home owners feeling 'richer' they spend on the high street by obtaining unsecured debt such as credit cards or loans. They know that the increase in the value of their home can be accessed, by remortgaging, if they struggle to meet the debt. I'm sure we've all seen the newspaper and TV ads that dominate the advertising spaces offering all types of secured lending. So consumption is maintained by credit provided by the banks.

Towards the end of the Boom

As consumption is now fuelled by over-borrowing, consumption increases to an all time high. This causes a trade deficit to occur. This is because:

- Due to people saving to invest in property, money is taken out of the domestic economy and the production in goods at home naturally fall. Importation of goods abroad is the only way we can satisfy the increase in consumption.
- To also satisfy the increase in consumption we have to export less to further meet consumer demand.

So we end up importing more that we export thus creating a trade deficit. A trade deficit is where imports exceed exports. That is to say we buy more from abroad than we do from goods produced at home. As a result the government cannot raise enough revenue through taxes due to companies not producing enough to tax so the government has to borrow to pay for its spending. The only people that are willing to lend will be from abroad. To attract investors from abroad the government gilt rate has to be increased. This means raising gilt rates so that overseas investors will be attracted which ultimately results in rising interest rates.

At The Peak

Its not a pretty place at the peak! The following misunderstandings and interpretations are occurring:

- Investments are being made by speculators who are basing their returns on historical growth. Fundamental principles have gone out the window and investment decisions are being based on previous (and successful) speculative trades and success stories of other investors.
- Consumption is being fuelled by credit cards and 2nd charge secured loans by home owners feeling good AND the reluctance of the consumer to save due to continued increases in their property values.
- Lenders are lending on perceived equity to homeowners which are only as a result of speculation.
- Investing, consuming, lending and borrowing are in excess
- Interest rates are rising to cope with the trade deficit, consumer price inflation and to attract people back to saving.

The Crash

Something has to cause the crash. Crashes do not happen overnight but they do happen a lot quicker than a boom. Think of a roller-coaster. You know that bit where you hiked up by the machinery to the top of the slope, you can hear the clunking, you get to the top, the clunking stops, you think the cart will rest at the top but it just tips over the edge………..

Well at the top of the slope the following will and can only happen and at a greater pace than the climb:

- Interest rate rises are increased to hurt! They are set to control inflation as we have been spending too much on the high street.
- With the increased interest rate the projected positive cashflows fall. This lowers the overall return on uncompleted capital intensive projects such as the erection of skyscrapers or new builds of luxury apartments.
- The calculation of possible investments now include the higher rate of interest rate and now no longer look so attractive.
- The property development market slows……

Now if all this speculation had been done with private money then we wouldn't care. The problem is that its been done with other people's money i.e. THE BANK'S! It's the pulling of the plug by the bank that cause the rapid decline in property investment. Let me show you by a clear train of reactions:

The projected returns to be had from major property investments had factored in growth. Monies lent by the bank based on the growth look risky now as the interest rate increases have killed both the growth and the net yield.

The banks get scared and restri lending. This means that less people are able to buy.

Due to less people being able to buy land and property due to the restriction by the banks – land and property prices have to fall.

People that have bought a are now facing negative e Their debt is greater than of their home.

The credit boom cools. Lenders now know that the consumer's property value has fallen hence there is no security to raise finance to clear the lender's debt. Lenders stop lending on an unsecured or a 2nd charge security basis.

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Due to the banks not lending then investment in land and property falls AND consumption falls due to the bank not providing credit to fuel consumption.

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Projects are aborted. They now know that if they carry on they will certainly lose money due to the over-speculation. Exit losses are necessary for damage limitation purposes only.

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The feel good factor is non-existent! Borrowing AND spending both decline.

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As property prices fall the potential buyers wait till they bottom out hoping to get a bargain.

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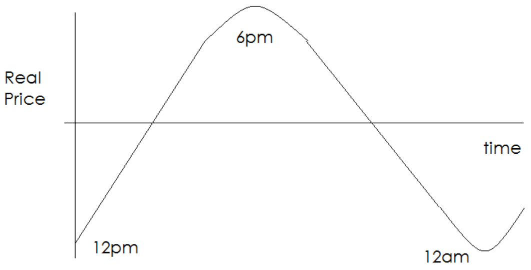
Source: www.landvaluetax.org

This is why property prices move up and down as explained in chapter 1. Looking at the graph:



12pm being the beginning of the boom and 6pm being the beginning of the bust. Now I really want you to understand this boom bust cycle. It is the understanding of these fundamentals which will ensure that you NEVER lose in property investment. Please re-read this chapter as many times as it takes so you understand how the boom bust cycle works. Once you've understood this then we can move on to understanding yield which is the ultimate tool for any serious property investor.

3. Yield

Calculating Yield

So how does a professional investor know that a property purchase is going to put money in his pocket? Well its called yield. Yield is defined as:

'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:

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

1.What You Get Out

So what do you get out from property? – RENT! But its not just as simple as that. You have to consider the *expected* rent to be received and *expected* costs. But does the professional investor include capital growth? – NO! This is because it is unknown even though the professional investor may have an inkling. So the output for a professional investor is:

What you get out	**Term**	**Definition**
Annual Rent – Annual Interest Cost – Expenses - Tax	**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 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 Interest Cost	This is the annual amount you pay to the bank as a result of obtaining borrowings to purchase the property. Essentially it is the monthly mortgage payment you pay on an interest only basis multiplied by twelve.

	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

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<td>Tax</td>
<td>Unfortunately we all have to pay tax. Tax is an unavoidable expense. 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!</td>
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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. Decide which one of the three type of investors you are to then decide which yield calculation is applicable to you. Lets look at the following table:

Investor	What you put in	Your Cash	Borrowed Cash	Description
High Risk Investor	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 by way of a mortgage and unsecured borrowings. 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 three 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.
Medium Risk Investor	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.
Low Risk Investor	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:

Investor	**Calculation**	**Des**
High Risk Investor	(Annual Rent – Annual Mortgage Cost – Annual loan cost – Expenses - Tax) x 100. Deposit + Acquisition Costs	This to yo inclu theo borr mort loan prop put i whe on a retur
Medium Risk Investor	(Annual Rent – Annual Mortgage Cost – Expenses - Tax) x 100. Deposit + Acquisition Costs	Unlil is no as y You yielc mon
Low Risk Investor	(Annual Rent - Expenses - Tax) x 100. Property Purchase Price + Acquisition Costs	Unlil is no you yielc mon

An Example

So lets look at an example to calculate the yields:

Tom, Dick & Harry are all higher rate tax payers but they have very different risk profiles. They see a property advertised for £100,000 but all have very different strategies to buy the property.

Tom	High Risk Investor	Tom will borrow £27,000 on an unsecured basis to raise the deposit of £25,000 and £2,000 acquisition costs. He will then obtain the other £75,000 by way of a mortgage to purchase the property.
Dick	Medium Risk Investor	Dick will fund the deposit and acquisition costs from his savings. He will then obtain the other £75,000 by way of a mortgage to purchase the property.
Harry	Low Risk Investor	Harry will fund the property price and acquisition costs

		with his savings.

They estimate that it can rent out for £1,000 per calendar month. They also estimate the following annual expenses to derive a profit and loss account:

	Tom	Dick	Harry
Rent	£12,000	£12,000	£12,000
Unsecured Borrowing Costs (interest only)	£1,750	N/A	N/A
Mortgage Costs (interest only)	£4,500	£4,500	N/A
Void Periods	£1,500	£1,500	£1,500
Service Charges&Ground Rent	£1,000	£1,000	£1,000
Repairs	£500	£500	£500
Agents Fees	£1,050	£1,050	£1,050
Sundry	£450	£450	£450
Profit	**£1,250**	**£3000**	**£7,500**
Tax @ 40%	£500	£1200	£3,000
Net Profit	**£750**	**£1800**	**£4,500**

So the yields for each investor are:

Investor	**Calculation**	**Res**
Tom - High Risk Investor	<u>(Annual Rent – Annual Mortgage Cost – Annual loan cost – Expenses - Tax) x 100.</u> Deposit + Acquisition Costs <u>£750 x 100</u> £27,000	2.8%
Dick - Medium Risk Investor	<u>(Annual Rent – Annual Mortgage Cost – Expenses - Tax) x 100.</u> Deposit + Acquisition Costs <u>£1800 x 100</u> £27,000	6.7%
Harry - Low Risk Investor	<u>(Annual Rent - Expenses - Tax) x 100.</u> Property Purchase Price + Acquisition Costs <u>£4500 x 100</u> £102,000	4.4%

Now all these yields are positive so the property purchase is expected to put money in the investors pocket. Depending on each of Tom, Dick and Harry's thresholds for investment will determine whether they will buy. So for example if Tom's threshold is 4% to buy then he will not as the investment is below his 4% threshold. If Harry's threshold is 4%

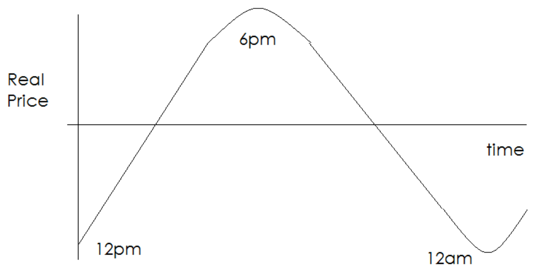
then Harry will buy as his yield is above his threshold. All of their thresholds will be based on their own personal criteria and alternative investments. But you can be assured that if the yields were negative then the professional investor would NOT be interested. This is because the investment will take money out of his pocket.

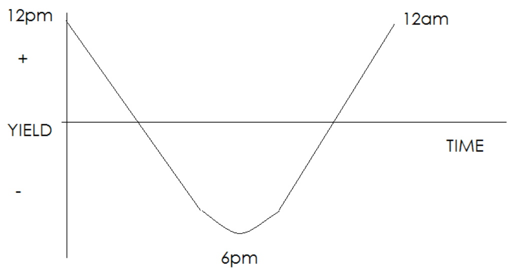
Understanding +/- Yield

Well its obvious to see that when the clock strikes 12pm then you are winning on both counts. That is to say that:

- The yield is positive and at its highest point
- The capital growth is positive and at its highest point

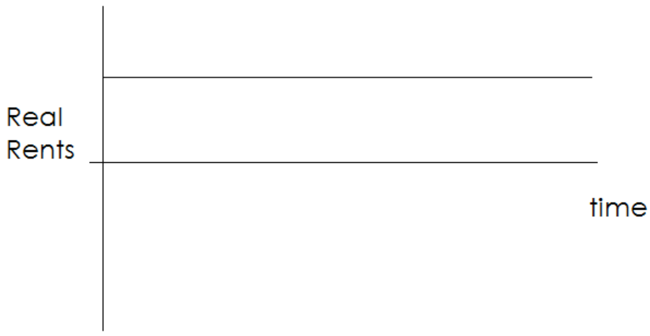
Looking at 12pm graphically:





So we can see that at 12pm the price of the property is at its lowest real price. As a result of this the yield is at its highest. Now due to the fact that rental prices are directly proportional to wages, which rise religiously with inflation, we can show that it's the property price alone that drives the yield. In other words the yield is only high due to the property purchase price being ARTIFICIALLY low due to market conditions.

You have to draw on your own experiences to really believe what I'm saying. Just because house prices have risen by 20% in a year - do you ever see rental prices rising accordingly? – probably not. Rental prices are directionally proportional to wages. This makes sense. If you had volatile rental prices you would find that people would be on the streets! If interest rates rose dramatically, landlords would raise their rents to meet their mortgage payments and then 'forget' to reduce them as their mortgage payments fell. So as we have eliminated inflationary influences from this model we would have the rent vs time graph looking like:



So we can see that rents do not change over time. Another great thing about rents are that they are:

- Known and
- Predictable

They are known as it is very easy to gather the market rental value for a 1, 2 or 3 bed property as there should be plenty of these type of properties to rent on the market. As long as the property you are thinking of buying is not unique in any way then the market rental value will be easily comparable to similar properties on the market. The rental market will not entertain a property that is over priced on rent as the tenant will simply go elsewhere. So the market rent of a property will fall within a small range.

They are predictable as rental values only every increase with wage inflation. So we can assume that the rents will rise but only modestly. Since we are ignoring inflation we can predict that rents will remain the same in real terms.

So using the graphs above we can see that over the four key points on the clock the yield is the inverse to the property purchase price, in other words, as property prices increase yields decrease:

	12pm	3pm	6pm	9pm
Property Price	£50,000	£116,667	£233,333	£116,667
Annual Rent	£10,000	£10,000	£10,000	£10,000
Annual Mortgage Cost @ 6% interest of property price	£3,000	£7,000	£14,000	£7,000
Other Costs	£3,000	£3,000	£3,000	£3,000
Net Yield	£7,000	£nil	(£7,000)	£nil

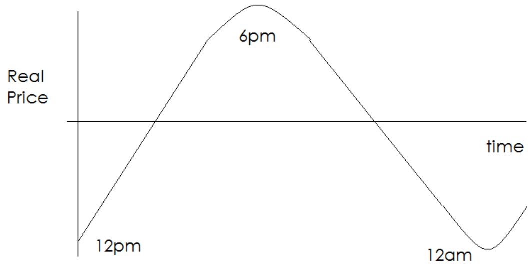
So we can see that its property prices that drive yield. In other words:

THE PROPERTY PRICE IS EVERYTHING!

So knowing that the property price is everything we theoretically can ignore the yield curve as it is simply as a result of the property price curve. An analysis of the property prices is essential if we want to gain heavily – so read on!

4. Property Prices – Actual Prices, Real Prices & Bubbles.

So lets look at the property price curve again:



So at 12pm we can see that the property price is at the lowest point below the real price. Now in order to find out if you have found an area that is in the 12pm to 3pm range you need to compare the real price with the actual price the property can be bought for. So the two key figures in all of this are:

- The actual price
- The real price

If the actual price is less than the real price then BINGO!

<u>The actual price</u>

We determine this as being 95% of the advertised price of a property. As an average properties sell at 95% of their asking price. So for example if we see a property advertised for £60,000 then the actual price will be:

£60,000 x 95% = £57,000.

In reality the actual price is the price you can get the property for. It could be 95%, 100% or even 105% of the asking price dependent on how competitive the market is. However, under normal conditions 95% is about average.

<u>The real price</u>

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 a professional 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 minimum of 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:

$$\frac{\text{His salary x 4}}{(0.95)}$$

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.

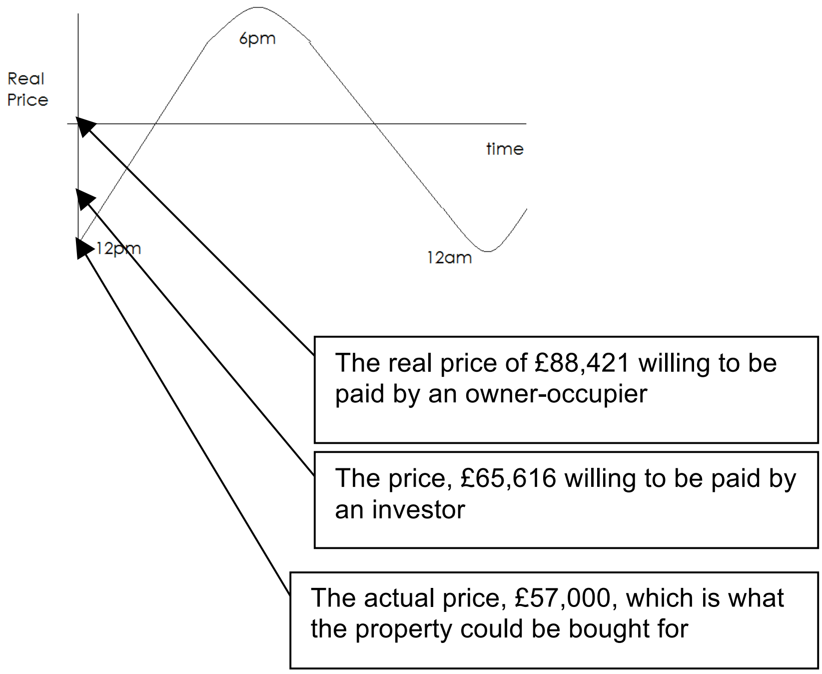
So looking at the actual price compared to the real price we have:

Actual price	£57,000
Real price	£88,421
Under-valuation	**£31,421**

Looking at it split between the investor and the owner-occupier:

	Owner-occupier	Professional Investor
Actual price	£57,000	£57,000
Real price	£88,421	£65,616
Under-valuation	**£31,421**	**£8,616**

So we can see clearly that we are within the 12pm to 3pm quarter. This is because both the investor is interested as well as the owner occupier due to the prices willing to be paid by each are above the actual price. We can see that the owner occupier has more to gain in buying than the investor so aggressive bidding will occur thus pushing the price up quickly and dramatically. Looking at it in relation to the property price graph:



So we can see who drive property prices – We all do! Its our attitude that drives a property price NOT interest rates – even though all the city analysts believe that it does so. Interest rates do play a part but its our propensity to borrow, the availability of borrowing, the willingness of lenders to lend and our fear of missing the boat that causes prices to rise.

So what is happening between 3pm and 6pm. Well effectively properties are being sold above the asking price. Using the same example above lets say asking prices have rocketed to £100,000. Then we would have the actual price as:

95% x £100,000 = £95,000

Both the professional investor and owner occupier prices will remain the same as nothing would have changed. That is to say over the period of rocketing property prices the following would have remained stable:

- Gilt Rates
- Salaries
- Rental Value of the property

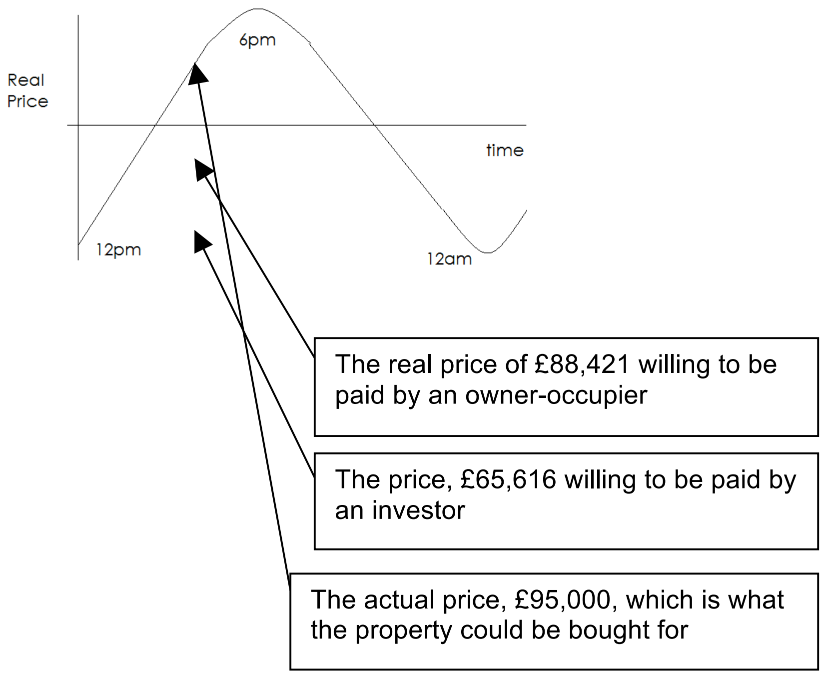
- Lending criteria by the banks

So we would have the following table:

	Owner-occupier	Professional Investor
Actual price	£95,000	£95,000
Real price	£88,421	£65,616
Over-valuation	**£6,579**	**£29,384**

This over-valuation is what I call the bubble element to the actual property price. Specifically the bubble element is £6,579 as it will be the lower of the two over-valuations. So in this case it is the owner occupier because an owner occupier has a higher valid bid price than the investor.

Looking at the graph again:



So who are buying at £95,000? Well it certainly ISN'T the:

- Professional Investor or
- Standard Owner Occupier

The people that are buying at inflated prices are:

- **The speculative investor** – This investor is banking on prices rising at the same rate as in the past. Also if the stock market is under-performing then the attraction of the property market is heightened. He can buy and sell within a number of months or years and make a tidy profit. This type of investor can make money if he knows when to sell but he will only be selling to another speculative investor or ……….
- **The scared owner occupier –** This type of owner occupier is scared of prices rising beyond affordability so he buys a property for more than what its worth. i.e. a

professional working couple buying an unsuitable property to live in like a studio flat or an ex-local authority 1 bed flat. They should wait for prices to fall so they can get a 2 bed flat but their fear makes them buy a smaller property for an inflated price.

- **The over borrower –** This type of buyer will buy by using a deposit that has been raised by borrowing from a bank, credit card or loan company or get a self-certified mortgage where they lie about their income. Either one of these strategies results in over-borrowing.They also think, like the scared owner-occupier and speculative investor, if they do not buy now they will miss out.

The best way to spot a bubble element is to calculate it. The equation holds:

$$P_{actual} = P_{real} + P_{bubble}$$

P_{actual} - The actual price of the property defined above

P_{real} - The real price of the property defined above

P_{bubble} – The difference between the actual price and the real price

So the bubble element exists when the actual price is greater than the real price. To spot bubble elements look at:

What to look for	**Why**
Type of property	If you're buying a studio flat for the price equivalent to 5 times the salary of the typical purchaser then a bubble element may exist as the property you are buying is unaffordable to the typical purchaser. It may not have a bubble element if the rental value stacks up – see below.
Type of purchaser	If you are considering to buy a small 1 bed flat that's in a city centre then consider what the average salary is for a worker in that city centre. Calculate what the average city worker could afford as they will be your main buyer as they invariably pay more than an investor. Can the city worker afford what you are paying? If they can't then you may be buying at an artificially high price unless it has a decent rental value – see below.
Rental Value	What does the property yield at? If the property yields greater than a 2% loading on the 20 year gilt rate then its priced correctly. If it yields below then there may be a bubble element to the price.
2nd & 3rd time buyers	Bear in mind that people move up the property ladder and so there is a gain from the sale of their original property which contributes to the overall purchase price. If you are buying a 2 bed home then it may be a second-time buyer that is the typical purchaser of this property. The real value will be 4 times their salary PLUS the estimated gain on their previous property. If you are paying more than what they can afford then a bubble element may exist.

AWARENESS TABLE FOR CHAPTER 4	
20 year	Being aware of this will make you able to calculate the real value of the

government gilt figure	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 Market Value of Property	For you to really exploit all the possible opportunities then you 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.

So in the last 4 chapters we have set out the basis for the property clock. Now lets get in to the detail of each quarter.

5. 12pm to 3pm – Hotspot

At The Start….12pm

Well the clock strikes 12pm – but there's no gong! At 12pm hardly anyone knows the fact that this area is a gold mine. It's a buyers market. No one wants these properties and there are plenty of vendors desperate to sell. You walk in to the estate agents saying you want to buy and they roll out the red carpet! These agents have become accustomed to only vendors walking in to their office wishing to sell but at last they have stumbled across a BUYER! You, with your hard earned cash *and* the bank's money, want to buy big time.

So you ask the agent what has he got? He then proceeds to pull out of his filing cabinet details of over 20 properties all yielding in excess of 12%! You ask him what the areas are like and he says they're fine. You're not so sure. You are always told never to believe an estate agent. You flick further through the details and you're seeing studios and 1 bed flats yielding in excess of 20%. You ask to view all of the properties and to your surprise he says no problem. He then books half the day to show you all the properties. A lot of them are empty as no one wants them as investments and some of the areas look a bit rough. However, you can be assured that it is only a matter of time before other investors follow and regenerate the area to a solid rental area.

Now you have to a brave man to buy when its 12pm. However, if you are brave, you will make the fortunes I have done as you have understood the concept of supply and demand. I had an email from someone who asked my advice. He was concerned that there was an oversupply of housing in Hull, East Yorkshire, and that if he bought a property it would not let out. I asked him well what would it be like if it was the other way round – there was an under supply of housing? He would not have been sending me the email as the property prices in Hull would be much higher thus not worth considering. So you have to go where there is LOW demand for property and wait for the demand to rise. And you can be sure they will rise as the only way is up.

12pm → 3pm

12% - 20% yields are unsustainable. If you were to find such a place that remained at this level you would be silly not to plough all of your savings and future income in to this area. This is because you will make a solid £50,000 out of every £100,000 invested if you geared up and bought wisely. If you took a risk you could make far more. However a good thing never lasts forever. I will show you how it goes from 12pm to 3pm. That is to say that the area goes from +growth and +yield to +growth and –yield.

Lets just say that it is only me that has found this magic area that is yielding in excess of 12%. So I buy as much as I can afford from every estate agent in the area. As soon as something comes on the market that meets my criteria I buy without hesitation. It wont be long before another professional investor finds this area too as there a number of professional investors looking for these exact areas! Some professional investors have a high buying quota, sometimes in to the hundreds. Even I have a high quota, typically around fifty, but there are much bigger sharks out there. So when other professional investors get wind of this magic area a bidding war commences.

It starts with properties being sold within 24 hours of the property coming on to the market at full asking price. This sends signals to the vendors that they are selling their properties too cheap so they increase their selling prices. Usually the vendors under estimate how much to put up their prices by (due to the market being stagnant only several months before and simply cant believe that they can get any higher) and professional investors pay over their asking price. This is because a professional investor has a set criteria to buy to. So for example I have a criteria of buying at 12% yield. So if I see a property for

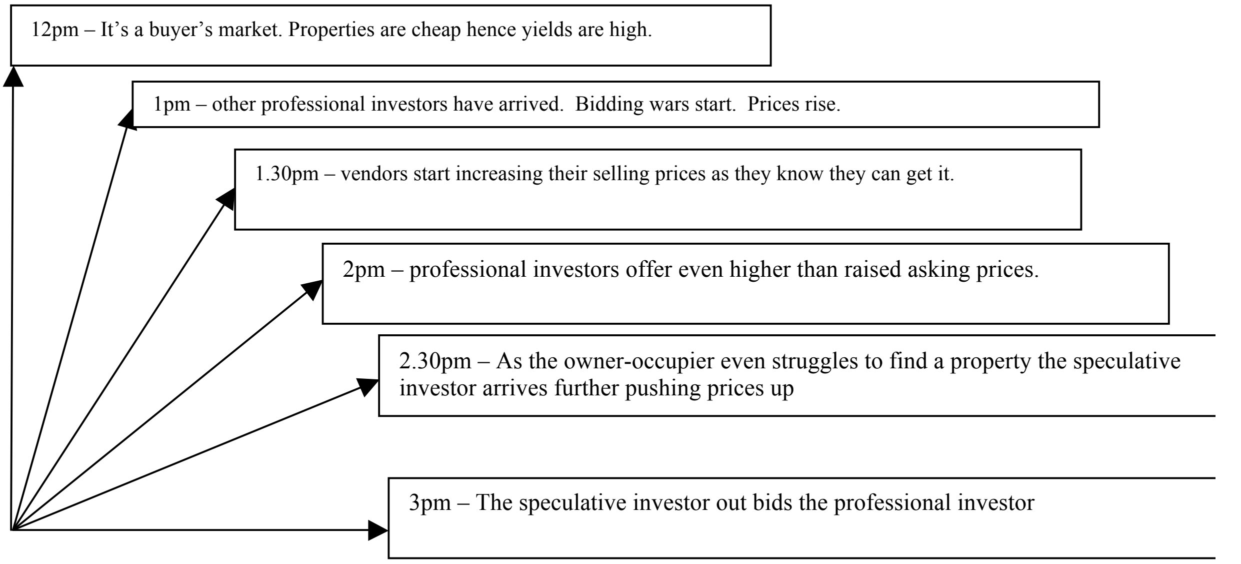
£30,000 and I know it will still yield 12% at £35,000, and it's a competitive market then I would be silly not to offer £35,000 so as to ensure that I got the property.

What we then see is a rapid increase in prices. It's all about who will accept the lowest yield. The market quickly changes from a buyers market to a sellers market. All why this is happening the owner occupier is trying to get a look in – typically first time buyers. They are even struggling to get properties as the investors are snapping them up before they've had a chance to even look at them.

Now, there are professional investors and owner occupiers bidding in this market. Prices have risen dramatically. The speculative investor now gets wind of what has been going on. He has heard the stories of dramatic price increases and properties selling for over their asking price. The speculative investor is now thinking that he can buy a property, hold for a year or two and then sell at a massive profit. Lets welcome the speculative investor as a new entrant to the market.

The speculative investor is not the most clever of investor. Its unlikely that he does this as a full time profession but as a secondary source of income to his full time job. He may never have bought a property before apart from the one he lives in (is this you?). This is where the errors start to occur. The speculative investor is not familiar with net yield and over-estimates what the property will return. He over estimates the rent, under estimates the void periods, mortgage payments and repairs. However, blinded by the historic growth the speculative investor will push prices beyond the reach of the professional investor (as the professional investor now knows at that price it is a negative yield i.e. the property will take money out of his pocket) and out bid the professional. Say good bye to the good times because now at this point - the clock strikes 3pm.

Looking at this as a sweeping hand of the clock:



Strategies Within A Hotspot

In a nutshell:

BORROW FROM EVERYWHERE AND BUY EVERYTHING!

This may seem a bit extreme. But this is the only way you win at this game. You’ve got to bite the bullet and go for it. Hotspots do not last for long. I’ve seen hotspots go to cooling spots in 3 months. I’ve made £200,000 in capital growth for literally 10 days work of finding the right properties. And the funny thing is that this £200,000 will be accessed to buy in another hotspot and I’ll simply repeat the process. This is how I have made a consistent £500,000 per year. So if you lock in your position in a hotspot early then you can sit back and watch your investments rocket as late entrants to the market bid prices up. The more you buy the more you make. Its as simple as that. This strategy has really only two real components:

1. Borrow from everywhere and
2. Buy everything

Borrow From Everywhere

You need to raise cash fast if you are going to exploit as much as you can within the hotspot. This cash will be used as deposits for each flat or house you choose to buy. Here are some quick ways of raising cash, starting with the cheapest first, to pump into a newly discovered hotspot:

Source	Cost	Narrative
Personal Assets	0%	Assets that are no longer being used but have some resale value. This may be jewellery, cars, furniture, pieces of art, electrical equipment etc. The cost is nil as the assets are not being used but they could be used to realise some cash in order to invest. Look in the garage or attic - you may be surprised! Think about it like this – you're trading in your Ford now for the Ferrari in five years time!
Savings	BOE Base Rate	You may have savings in a deposit account or cash ISA. If you use this money the cost will be the lost interest that would have been earned if you had left it in the account.
Endowment Policies or Company Shares	BOE Base Rate + 3%	You could surrender an endowment policy or liquidise a current share portfolio to raise the cash. I recommend you talk to your financial adviser and stock broker before taking this action as you could be better off holding out on some of these policies or shares. But it could be time to let go of some poorly performing stocks and enter the property arena as so many of the share market investors are doing now. The cost of this on average is equivalent to the average return the stock market delivers. This, of course, will be different depending on the type of policy or stocks you hold.
Borrow from Family	BOE + 4%	You may have a family member who has cash sitting in the bank and is willing to lend it to you. You can offer them a better rate of return than any deposit account could. If he or she is a close member of the family they may lend it to you for 0%, but if you proposition a family member offering BOE+4% you might get quite a few more positive responses than expected. You could access your inheritance early, as many families do, to avoid inheritance tax. As long as the donator lives seven years beyond the date of the gift there is no inheritance tax to pay and is thus beneficial to both parties. A family member may be more willing to give you assets if you are proposing to invest it further rather than to just simply squander it on a new car or holiday.
Secured Borrowings	BOE+2-7%	To do this you must already own a property. The cheapest way to do this is to remortgage the whole property and release the equity tied up in your home. It pays to shop around. A good mortgage broker could probably beat the current rate that you are paying now and even reduce your monthly payments whilst still raising you some cash on top.

		The other way is to get a second charge loan where you keep your existing mortgage and borrow on the remaining equity on the house. You've probably seen the TV ads promising you a new car or holiday just from one phone call. Well forget a new car or holiday – we're going property hunting!
Unsecured Borrowings	BOE+2-15%	The cheapest way to do this is by transferring a current credit card balance to a new credit card with introductory rate offers. You draw out as much cash as you can on your current credit card and then apply for a credit card that has a low introductory rate for balance transfers until the balance is cleared. Once your new credit card has been approved you transfer your existing balance on your old credit card to the new credit card at the introductory rate, typically BOE+2%. This rate is fixed until you clear the balance. You may, however, not get this new credit card. The other way is to draw down the cash on your existing credit card at the credit card rate. This can be expensive but if the property you have found has a high income yield you could use the cash on a short term basis, say one to two years, and use the profits to clear the credit card balance. You may be able to arrange an overdraft with your bank or a personal loan at around BOE+6%. You need to speak to your bank manager. You can also go to other unsecured lenders but there are high arrangement fees and the interest rate can even go up to BOE+35%! You need to shop around but I would advise steering clear of anything with an interest rate higher than 25% unless you are really desperate and the property you have found has a very high income yield.
Get a partner	Dependent	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.

This is not an exhaustive list. You may have other good ideas for raising finance but if you can't raise the finance then you can forget the 'get rich quick' dream. It's as simple as that. You need money to make money. The great thing about property investment is that you do not need that much to participate. This is because the majority of the purchase price is funded by the bank (typically 85%). So if you want to buy £100,000 worth of property you need £15,000. If property prices double in a year (which happens sometimes in hotspots) then your £15,000 makes you £100,000. That's not bad for doing nothing!

Buy Everything

Don't hang about in other words. Check how much cash you've got AND what you can get your hands on to work out how many properties you can buy. Once you have a set quota then see everything that's on the market. The way you get to see everything so you get the best of what's available is:

Action	Why
Get on every estate agent's mailing list	Find out all the contact details for every estate agent in the area. You can get this by visiting www.yell.com. Ring them up and tell them you are looking for properties up to £xxx,000, any type and any area. This will ensure that you will get a constant flow of opportunities through your front door every other day.
Ring every estate agent	Properties come on to the market before the details have been printed. The only way you are going to find out about these properties is if you ring up and ask if anything new has come on since you last received their mailshot.
Visit every estate agent's website and set up email alerts	One way of getting details before they go to print is to go on the agent's website. If the agency is run well the site will be updated regularly and if you sign up with their email alert system you will instantly get the details of the new property as it is added. Some agents even have mobile sms text alerts!
Stay up there for a week	You may be competing with locals in the area. The only way you can compete with them is to be a local too! Find a cheap B&B, take a week off work and get hunting. A week's work in a hotspot can earn you 4 times your ANNUAL salary – and more!
Pay someone to look on your behalf	If you do work fulltime and you have a high buying quota then pay someone (you can trust!) to look on your behalf. Get them to take digital photos and get them to email them to you. I do this and pay them £10 per property. If he finds one property worth buying out of 25 then he's done well. He actually finds one property out of every two that's worth buying so he does fantastic.
Check local press	Some deals I have found have been in the local paper. Some people hate estate agents and refuse to pay their high selling fees. Why pay over £1,000 to a slick agent when you can pay your local paper £10 for a small box ad? Scan ALL local press for property ads.

6. 3pm to 6pm – Cooling Spot

Cooling Starts….3pm

Picking up from the last chapter – the speculator has out bid the professional. So all that remain are the speculative investors and the owner occupiers. These type of purchasers have very different agendas. The speculative investor is looking to make money and the owner-occupier is looking for somewhere to live. Bearing in mind that the speculative investor is essentially a novice, his buying choices will be largely be drawn on his own experiences with property. This will be likely limited to purchases that he has made for himself to live in. In effect the speculative investor has the same buying requirements as the owner-occupier as they are the same being but with different agendas! The speculative investor will buy on emotion rather than fundamentals just the same as the owner-occupier. So he will be lured in to the same property developer traps as the normal owner-occupier falls into. Common errors made by speculative investors are:

- A higher purchase price will be paid by a speculative investor for a property that conforms to his higher décor standards disregarding the prospective tenant's lower décor standards. The standard of décor that is required for rental properties will be over-estimated with the belief that the tenant will pay for this higher standard AND that the tenant will maintain it so.
- A bias towards private up market areas as the speculative investor feels 'safe' in these areas. A speculative investor will be typically earning above the average UK salary and will expect his tenants to be 'young professionals'. What he fails to understand is that the young professional sector are either looking to buy themselves and may very well be a competitor for the type of properties the speculative investor is looking at. Or the young professional will have assistance from his or her parents in the buying process. Soon private developments become a fierce bidding ground with only one winner – the property developer!
- Properties that require refurbishment look like the only type of properties that the owner-occupier can afford due to their 'perceived' undesirability. Unfortunately only the opposite is true! Speculative investors look at the past historical growth and consider these type of properties another goldmine. They assume that after refurbishment they can make a nice tidy profit AND giving them the opportunity to display their interior design skills for all to see. Again the speculative investor over estimates the sale price and under estimates the repair work and bids higher than the owner-occupier.
- Assuming that a tenant will be grateful and less fussy when deciding on whether to rent a property. Box rooms will be tolerated by the owner occupiers but not by a tenant who may have to sleep in this box room! There is an arrogance element to the speculative investor for the tenant to be grateful for the high finish of the property even though the property is under-sized.

So as these two type of purchasers walk in to the estate agents the red carpet is definitely not rolled out! The estate agent would have seen at least 20 of you already and to be honest fed up with either of them saying "I'm looking for a property to buy to rent out" or "I'm looking for a property to get me on the property ladder" – Change the record! You, as a professional investor, look around at their display of properties on the wall, you see a property that looks cheap, but damn it says 'UNDER OFFER'. You look further around and you see that all the properties on the wall are under offer or sold. You ask the estate agent what she's got under £100k and she hands you one sheet. It's a studio flat, requiring upgrading and its on a lease less than 50 years! Any property that looks mildly interesting is above £150k and yielding less than 6.5%. You leave, leaving the speculative investor and the owner occupier to battle it out.

3pm → 6pm

So what causes an owner occupier to out bid a speculative investor? Well an owner occupier will buy a property based on what they can afford, a speculative investor will pay whatever covers his estimated expenses. So based on who is higher will win. Look at this example:

Advertised Property Price	£100,000
Rental Value pa	£7,000

The Speculative Investor

If the rental value is £7,000 then his mortgage company will allow him £7,000/130% = £5384. This is because any buy to let mortgage company will lend only if the rent is 130% or greater than the mortgage payments. He can now use the rent to pay the mortgage and benefit from the expected capital growth that he estimates at no cost to himself – essentially money for nothing! So at current borrowing rates of 5% the amount the speculative investor can go to is:

$$\frac{£5,384}{5\%} = \mathbf{£107,680}$$

The Owner Occupier

The typical purchaser for this type of property looking to live in the property is earning £20,000. His buying power will be his level of deposit and the mortgage he can raise. Based on a £10,000 deposit and 4 times lending the owner occupier could stretch to:

£10,000 + (4 x £20,000) = **£90,000**

So we can see that the speculative investor wins and thus will out bid the owner occupier and push the price beyond £90,000 in to the hands of the speculator. So the speculator will get the property between £90,000 and £100,000. Then you are left with just the speculator battling it out between other speculators and thus pushing the price to £107,680. What the speculative investor has not factored in is:

- Void periods
- Tenant default
- Interest rate rises
- Repairs
- Exit strategy

The only thing that can push the price beyond the £107,680 mark is other owner occupiers increasing their buying power by teaming up together or by the individual seeking high income-multiple lenders. So in this example if you had two owner occupiers deciding to live together and buy, both on the same salary and deposit then their combined buying power would be:

£10,000 + £10,000 + (2.75 x £40,000) = £130,000

This assumes a 2.75 times joint salary which is standard within the mortgage market.

So now the properties value has risen to what a couple would be willing to pay for it. This couple could quite comfortably afford it even with expected interest rate rises as this is the home that they have chosen and their borrowing has been underwritten to be no more than 2.75 times joint salary.

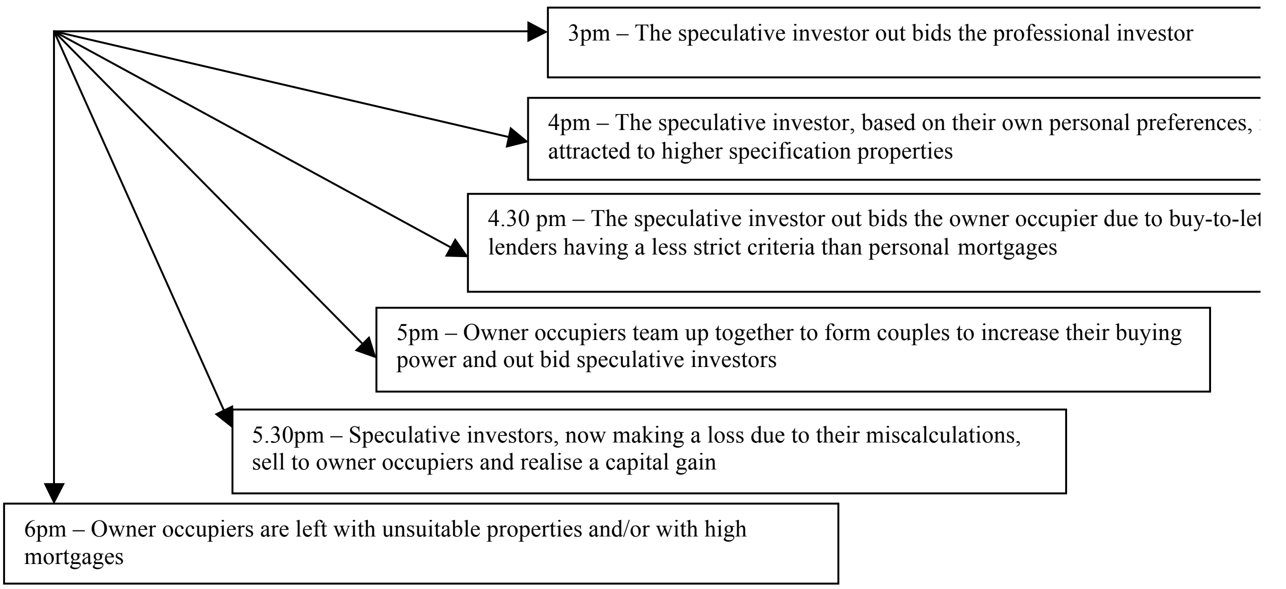
So we can see there is a point when even the speculative investor drops out and is out bid by the owner occupier accepting a lower standard property. Even speculative investors that are holding now sell out to owner-occupiers as the speculative investors are losing money on a monthly basis (due to rents not covering the mortgage and other expenses) even though they are gaining on capital growth.

If it had been an individual seeking a high income-multiple lender then his buying power could have been:

£10,000 + (4.93 x £20,000) = £108,600

4.93 times individual salary being the highest income multiple I could find in the mortgage market as of today. This still outbids the speculative investor.

Looking at it as a sweeping hand of the clock:



Strategies within a cooling spot

The professional investor has dropped out of the market at this point. So if you consider yourself as a professional then the strategy is not to buy. If you want to make money in a cooling spot then you have no option but to buy and then sell. In other words you have to property trade. Now I am no expert on property trading and there is a good reason for this – I've never done it! It's a risky game to play. I believe in the old mantra that property is a 'long term investment'. A lot of money can be made but also can be lost. If you get your figures wrong and the market turns then you can get really stung.

However, considering it is the only strategy we have within a cooling spot, we best look at it in further detail. To make a profit from buying a property and then subsequently selling the property then the property has to experience capital appreciation. Capital appreciation can be amassed by one of three ways:

1. identifying properties with foresight
2. identifying properties with potential

1.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.

2.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

<u>1. Refurbish It</u>

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.

The Buyers In a Cooling Spot

There is no point in selling when your property is currently in a hotspot. 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	Buy to Let	Due to the buy to let mortgage also operating under the current variable

Investor		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.

AWARENESS TABLE FOR CHAPTER 6

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 multiples	Check to see if lending multiples are increasing. Currently the standard is 4 but there are a growing number of lenders offering 4.25 times salary and more 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.

7. 6pm to 9pm – Cold spot

6pm…Its getting cold

So now we have owner occupiers buying properties that are too small for what they're worth and owner occupiers with high income multiple mortgages but not a speculative or professional investor in sight. The market has gone stagnant. Renters are unwilling to buy and move in to a property that is smaller than what they are renting, owner occupiers are stuck in to a property that is not growing as before, speculative investors are not interested because on the face of it there is no gain to be had and the professional investor had long gone due to it being unprofitable at 3pm. So who is left buying? – The owner occupier! The owner occupier is overstretching themselves by accepting unsuitable properties or going to high income multiple lenders (the self certified borrower who has lied about his income is also buying but this is a small percentage of the overall buyers at 6pm).

The enevietable is about to happen. Interest rates will rise. This is the only thing that can jolt the market. Now I'm not saying a few quarter point interest rate rises. I'm talking about a 2%+ rise from its lowest point. This is when it begins to hurt.

Two terms then start to rear their ugly heads (in order):

1. Negative Equity
2. Repossession

Negative Equity

This, in simple terms, is when the mortgage balance is greater than the value of the house. This in itself is not a problem over the long term as the value of the house will recover. It is a big problem for:

- **Owner Occupiers** who wish to move
- **Lenders** wishing to access their security on defaulting borrowers
- **The Economy** due to feel good factor being lost hence a reduction in spending
- **The Property Market** as less property deals are done thus estate agents, brokers and other industries surrounding the property market feel the pinch.

Repossession

This is when the lender legally enforces the sale of a property they have lent on due to the borrower defaulting on their mortgage payments. This situation occurs when:

- **Interest rates** rise making the mortgage repayments unaffordable
- **Job losses** within the household so the mortgage payments become unaffordable.

The number of repossessions occurring every month are directly related to the economy as repossessions are a function of interest rates and job losses. So if interest rates rose to 20% and/or everyone lost their job then everyone would get repossessed and lose their home. If interest rates were 0% and unemployment rates are 0% then no one would lose their home. We are somewhere in between.

6pm → 9pm

So at 6pm we only have the owner occupiers buying. The owner occupier buying unsuitable properties at inflated prices or obtaining finance from high income multiple lenders. Property prices now reach their maximum. This is due to married (or co-habiting) owner occupiers unable to buy as lending is restricted to 2.75 times joint salary or individual owner occupiers restricted to 4.93 times salary. Speculative investors unable to buy as lending is restricted to 130% of the mortgage payment. The buyers at 6pm are the last weight of buyers and are buying at the peak. As usual the private individual is the one that suffers – he buys high and is forced to sell low. These buyers have not factored in interest rate rises as well as owner occupiers that have previously bought and accessed their equity from high income-multiple lenders (greater than 4 times) and 2nd charge lenders with less strict lending criterias. They have ignored warnings that rates will rise.

Rates do begin to rise, but only modestly, to attract overseas investment in government gilts to fund the deficit being experienced as a result of over consumption. The press start to hint of negative equity to spread across thousands of households in the future due to the now upward trend of interest rates. Repossession rates are followed closely by the press to see if they are increasing month by month. If there is an increase you can be sure its front page news on some of the tabloids. A sense of fear sets in even though there has been no real change in property prices. Properties for sale remain in the windows of estate agents with none of the vendors willing to drop their prices (because they don't have to) and none of the buyers able to afford what is for sale.

TV ads for loans start to decline. Stories of how people have made a fortune in property now seem stale and also unrealistic within the current environment. Some speculative investors that were breaking even are now losing money due to the slight increase in interest rates. The speculative investor is not forced to sell (due to the loss being only small and manageable) but chooses to sell as the investment is taking money out of his pocket and he can bank a gain if he sells now. So several properties come on to the market requiring a quick sale from the speculative investors. As they already have a gain locked in the speculative investor will reduce their price for a genuine quick sale. Property prices start to reduce and creep back to affordable levels. Some speculators are lucky and sell to frustrated owner occupiers dying to get on the property ladder. Other speculative investors are not so lucky as owner occupiers get wise and think its better to wait and see if prices drop further or if a better property comes on to the market……..

Rates rise again. And again. Repossession rates have risen for the first time and its splashed over the press. Certain areas are reported to be in negative equity. The owner occupier seeking a home to buy is now smiling as he thinks property prices will drop further. Estate agents are convincing their vendors to reduce their prices to attract people through the door. Lenders are losing as a result of the repossessions as after all legal costs have been taken in to account the monies raised from the sale do not cover the amount they lent and all other costs of repossession. Lenders start to restrict lending. This further stagnates the market. Property prices fall further.

2nd charge lenders and unsecured lenders start experiencing defaults due to the borrower choosing to pay their mortgage rather than their 2nd charge and unsecured debts. Regret for the holidays and cars that were bought with this money start to set in. People start to restrict what they spend on the high street and try to liquidise some of the assets bought with their remortgaged money. Suddenly saving seems better than spending! The feel good factor has now been lost. Property prices start falling further due the lack of buyers.

Speculative investors are now happy to get back what they had paid for the property as it is better to get rid of a property that is costing them every month. The gain once promised from these properties fail to materialise. Some speculative investors actually lose capital to obtain a quick sale. Property investment starts to get a bad name. Some speculative investors see some of their hard earned savings lost to free them from the bind of the poor performing investment property or properties.

Rates rise further. Repossession rates rise further. Everyone is now in negative equity that had bought at 6pm. More and more owner occupiers are struggling to pay their mortgages and they want to sell. The market gets flooded with properties for sale by desperate vendors. The problem is it is neither a buyers market nor a sellers market! Some are lucky and sell to other owner occupiers others are not so fortunate and get repossessed. All the owner occupiers that had overstretched themselves by over borrowing can no longer meet the higher repayments as a result of the interest rate rises. Supply of property is now well in excess of demand. Prices have to fall even further.

The only real saviour to this falling market with any kind of buying clought to prevent the price falling to ridiculous levels is the professional investor. At 9pm he sees that prices have fallen to a level where if he were to buy the purchase will put money in to his pocket at a rate greater than leaving the money in the bank EVEN though property prices are falling. So, the clock strikes 9pm. Welcome back the professional investor.

Looking at it as a sweeping hand of the clock:

9pm – The professional investor is attracted back to the property market due to the yield turning positive.

8.30pm – The market becomes flooded with properties. Supply exceeds demand. Property prices plummet.

8pm – The speculative investor sells and realises an overall loss while owner occupiers default on unsecured lending to meet mortgage payments. Lenders start to suffer.

7.30pm – Repossession rates rise, certain areas report negative equity and lenders restrict lending

7pm – The speculative investor sells at a lower than anticipated price to realise some gain

6pm – Owner occupiers are left with unsuitable properties and/or with high mortgages

Strategies Within A Coldspot

There is no money to be made here. Anything you buy will take away what ever you put in by way of a deposit and take money out of your pocket every month – ouch! If an area is a coldspot then simply avoid it. If you own a property in a coldspot and you can get out with a gain then do so. If you own a property in a coldspot and cannot get out with a gain then oh dear! You will be experiencing the following:

1. Having a property that is in negative equity
2. Having a property that is costing you every month to hold

Now you can sell but it will cost you capital to get out. I would not advise this as you are realising a capital loss. Property is a long term investment and prices WILL recover so there is no point in realising a loss if you able to. So the only strategy left to you is to fund the difference every month from your own pocket. This requires cash. Ways to raise cash to fund the monthly shortfall are to:

1. Liquidize assets you have now
2. Save some of your income you earn now
3. Increase your income

1. Liquidize Assets You Have Now

Here is a list of assets that you may have that have some value to someone. That is to say that you could sell, liquidize or cash in on these assets and raise cash, as there is a ready market for these type of assets. The best place to advertise these items are in the local press, internet or papers such as loot or Ad-Trader. If you cant be bothered then take the items to dealers in your area.

Asset	Justification
Cars	How important is the car you have for your day to day activities? Do you commute to work by public transport Monday to Friday, drink at the weekends and only use the car to ferry your weekly household shopping? Have you ever considered getting a taxi or shopping online? All the major supermarkets offer online shopping – some offer free delivery. If the car's not that important you can raise cash from the sale of the car plus save on the ongoing running and maintenance costs. Running a car costs anywhere from £50 to £500. This can easily rise to above £1,000 if you take in to account the HP payment if its on HP. Selling a car can have a dramatic impact on cashflow as not only does it raise cash - it saves cash. If the car is important to you then consider trading your car in for a cheaper alternative.
Jewellery	Do you have any jewellery that you no longer and never intend to wear? It is a waste to have these items. Look at these items as if they are cash. There are plenty of jewellery shops out there that have cash ready and waiting. Don't worry if all it raises is £150 – its still £150! This all goes in to the kitty. Remember, you've got to start somewhere.
Furniture, Collections & Other Household Goods	Do you own an expensive record collection that you never touch? I know I do – but I don't need the money now! When I was younger though I used to DJ. I would sell my old records (and when I say old, I mean 6 months out of date) to raise cash to buy up to date records. This kept me getting booked for gigs. Unused goods, collections, furniture or other items can just sit there and eventually end up in a boot sale, jumble sale or even worse – the rubbish bin. Are any of your goods that you no longer use that have a value now? Not only can you raise cash but you can also de-clutter you living space.
Electrical Equipment	TVs, Videos, DVD Players, Hi-Fis are easy ways to raise cash. Also

	the actual cassettes can raise you more than you think. There are many second-hand exchange type of stores, such as Cash Converters, that will pay you for these type of goods.
Obsolete Items	Look around your house and garage. Is there anything that you don't use? Now does it have value? The best way to gauge if it has value is to ask yourself – how much did I pay for this thing! If it was substantial, say over £100, and you could imagine someone else using it then its probably worth something to somebody.

2. Saving Some of Your Income You Earn Now

There are really only two core ways of saving money:

A Going without i.e. not spending!
B Cutting costs i.e. spending less!

A) Not Spending

I'm not going to bore you about how you should stop smoking, drinking, eating or just simply indulging. What you should do is when you get paid then pay out all your fixed costs first as these are non-negotiable. So the shortfall should be paid as soon as you get paid. What will happen is that you'll adjust to the new level of spending that you have at your disposal.

Always ask yourself – do I really *need* this item that I'm buying now or do I just *want* it? Is it a need or a want? If it's a luxury item then its probably a want. When I was setting up my property business I went without. Here a some of the things that I used to buy when I was at work but went without when I was starting self-employment:

- Newspapers & Magazines
- Use of a whole flat to shared accommodation
- CDs
- Designer clothes
- Meals at restaurants
- Nights out in London visiting trendy bars and nightclubs

It was easy for me to go without. In the back of my mind I knew that if I went without now I would have in the future.

B) Spending Less

There are really only five things you can spend your money on:

i) Food & Consumables
ii) Shelter
iii) Travel
iv) Entertainment & Clothing
v) Loans & Savings Plans

Here are some tips on how to cut back on spending on each of these categories:

Spending Category	Tip	Narrative

FOOD & CONSUMABLES	Eat in rather than out	Its so easy to go to down to your nearest Burger chain, Indian restaurant or Chinese take-away. There's no washing up, it tastes lovely and there is no preparation time involved. However, you do pay for this! I used to make myself sandwiches in the poor days. 2 slices of bread, a bit of lettuce and a chicken slice – total cost 20p! Compare this to an Indian take-away costing £7 at least. Now I'm not saying don't treat yourself. I treated myself to one Chicken Biryani from my local Indian once a week – but that was it. Invariably the food you will prepare at home will be healthier too. The irony is that even though I can afford to eat out every night I now choose to eat in as it is healthier. I even look forward to those chicken sandwiches now!
	Go round your Mums!	Now this may not be possible for everyone. It depends on whether she is still alive, you still see her or if you live close to her. The principle is – don't be ashamed to ask for help. My mum quite enjoyed seeing me twice a week (or sometimes more!) and likewise – there's no cooking like your mum's cooking. Do you have a brother, sister, nan, cousin or good friend that loves to see you? If you let them know what you are doing – trying to preserve your property portfolio, then you will be surprised, they are more than willing to help. Do not think you are a sponger! *Always* remember people who help you get to the top. As thanks my mum now receives an income from me that is in excess of her pension and she doesn't have do a thing!
	Try non-branded goods	If you understand how supermarkets work then you will try this. A lot of 'own brand' goods are produced by the branded good manufacturers. So sometimes the quality is the same. Now I say sometimes! I have tried some of the non-branded goods and they taste awful but there are some own-branded goods that taste as good if not better than the branded goods. So give it

		a try. The cost savings can be up to 50%.
	Buy one get one free	Every supermarket does this. They sell goods at no profit or even at a loss to get you through the door. You can use this to your advantage. If you have the time you can go to every major supermarket and capitalise on all of their deals. I have to admit, I never had the time to justify the cost savings. But if you have a family and you are willing to stock up then I would estimate that you can reduce your shopping bill by 40%.
SHELTER		
	Switch utilities suppliers	It's a competitive market out there when it comes to supplying gas, electricity and telephone. Due to deregulation you can save up to 40% on your bills simply by switching and it is an easy thing to do! Look out for new tariffs for your mobile phone. Prices have only come down since there introduction and so there will always be a new tariff being introduced that will trump your existing tariff sooner or later.
	Shop around for contents insurance	The insurance market is a competitive one. Do not accept the premiums you have to pay just because you paid it last year. Get in contact with a good insurance broker to get you the best deal. Have you ever considered not getting insurance? Sometimes you can pay a hefty premium to insure not a lot – and even then you don't get a pay out when you make a claim!
TRAVEL		
	Sell the car	Owning and running a car is not cheap. You've got HPI payments, insurance premiums, road tax duty, petrol & oil costs, Servicing Costs and Repairs. That's a lot of expenses! You could save a small fortune if you did sell the car. Do a feasibility test on the car. Work out how much you spend a month on the car and see if it is greater than if you walked, cycled, took the train or bus and took taxis. If it is - then its time to sell the car! Remember a car is a luxury item. Public transport is supposed to be getting better and providing better value for money so be

		brave – get rid of it!
	Downsize the car	Okay, it may not be practical to get rid of the car but how about downsizing it. • Consider a smaller car with a smaller engine – this will cut fuel costs. • Consider a lower insurance grouped car. Even consider 3rd Party Only insurance. When was it the last time you had an accident? Statistically you are unlikely to have an accident that is your fault if you haven't had an accident in the last 5 years. • Maybe sell the car on HPI and buy a cheap run-around thus saving on the loan repayments. • Road Tax is reduced if by £60 per year if you drive a car less than 1.5 litre • Get the car serviced by a non-main dealer
	Try walking or get a bike!	If you don't have a car but get buses, trains and/or taxis then consider walking or cycling. You will save on the fares *and* it will keep you fit!
ENTERTAINMENT & CLOTHING	Shop in the sales, markets and charity shops	One of my good friend's dad told me that he buys his winter suits in summer and his summer suits in winter. The key is to get value for money. If you're shopping in a glitzy, air conditioned, fashionable part of town then you are paying for it! All their expensive rents, rates and décor they have to pay are ultimately paid by you because they charge you a high mark up on the goods sold. You'll be surprised how well stocked some of the market traders are now. I still get most of my designer clothes from markets and superstores – *not* New Bond Street in London W1!
	Think about if it's a need or a want	As mentioned above you need to always ask yourself if it's a need or a want? Do you really need to see the latest releases at the cinema or can you wait a year when they hit the Sky channels? Is the latest Kylie CD single with all the mixes really necessary or can you wait for her album? Do you really need the extra pair of trousers that are half price in the sale or

		are you buying them because they're cheap? If you master this thought process alone then half the battle is won.
	When you go out – don't stay out late!	I find that when I stay out later I spend more. More on drinks, food, taxis and club entrances. Go home early! I'm not saying just stay out for an hour or so but try to arrive early and go home early. You'll find out that you'll come home with some cash in your pocket rather than having to revisit the cash machines on the night out and regretting it later!
	Look out for the deals bars, clubs, cinemas and restaurants are offering	The entertainment market is a highly competitive one. Virtually every evening spot has an offer going on. Take advantage of this! Look out for flyers or leaflets available at their premises. Scan the local press for a restaurant trying to drum up a bit more business. Pay close attention to the TV ads when Pizza Hut and others are doing a promotion.
LOANS & SAVINGS PLANS	Switch credit cards and loans to obtain the best deals	0% APR for balance transfers – sounds familiar? I'm sure you've heard this so many times that it no longer means anything – but it does! It means that you can save a lot of cash as you pay no interest on your borrowing. Make sure you capitalise on these deals to save you real money. But don't just be happy with saving money – make an effort to clear these balances! You will run out of credit companies eventually so you do need to clear this type of unhealthy borrowing.
	Cash in or freeze payments to endowment policies and pension plans	Is the endowment policy you are contributing to really going to mature to its estimated value? You could cash it in, raise cash and save cash as you no longer need to contribute to it. It's the same for pension contributions. You could freeze payments which will result in an instant saving. When I used to work I was tempted to contribute to a pension. But after careful thought I realised that under no circumstances was I going to hand over any of my hard earned cash to company that would 'play' with it on the stock market, be unsure of how much I would get back and never access until I was of retirement age.

3. **Increase your income**

I can already hear you – how do I increase my income? Well this depends on you. You need to be assertive, hard working and be just that little bit cleverer than the rest! There are eight ways that I can think of that will instantly increase your income. This does assumes you have a job or a business in the first place:

- Work extra hours
- Take on another job
- Ask for a pay rise
- Change your job
- Claim all benefits due
- Exchange benefits for cash
- Switch from permanent employment to sub-contractor
- Increase profitability

See, I told you - it depends on YOU! Lets look at these ways in more detail:

	How	**Description**
1	Work extra hours	Are there possibilities to do overtime, work weekends or do nightshift work and get paid for it? You'll probably find out that you will get in excess of your normal hourly rate but even if you don't - still do it! If it means you earn more money then it all goes into funding the shortfall. As long as the opportunity of overtime exists then do it and use it for either payment or time to do things that will either make or save you money.
2	Take on another job	Do you do a 9-5 office job and have your evenings free? I know people that work in pubs and nightclubs that have an office job in the day. It's a great way to increase your social circle. It also means you have less time to spend money as you are working! If you find a job that is a bit of fun then it will not seem that you are working day and night. What about setting up another small business? If you're passionate about vintage clothes then why not start a market stall on a Saturday? If you're a DJ then go down to you're local bars and nightclubs and try and get a spot. Even if you don't get paid you'll save on the perks you get like free drinks and entrance costs.
3	Ask for a pay rise	The reason why men get paid more than women is largely due to the fact that they ask for more! If you think you are worth more then go knock on your boss' office door and ask for a pay rise. Back your request up with what you have done for the company, market rate for your type of job and the loyalty you have shown to the business.

		I employ three people and I have one guy that frequently asks me for a pay rise – and I like that! He's hungry to prove himself so I promise to increase his pay based on results. He's had two pay rises already and he's only worked for me for 8 months!
4	Change your job	This is an extreme measure but a valid one. There is no point staying in a job that's below you're perceived market rate. It breeds resentment to your employer and it drains your energy and motivation. Put your feelers out. Let your friends and family know that you're looking. Scan the newspapers for the latest advertised jobs. Write to companies who you would like to work for. Ring up the personnel department and tell them you want to work for them. So get your CV up to date and start making some moves!
5	Claim all benefits due	The government has a multitude of benefits to claim even if you are working. There is the family tax credit for starters. Families can have both adults working and still be eligible for some form of credit. There is about £1 billion worth of unclaimed benefits every year. You've seen the TV adverts – 'Its money with your name on it!'
6	Exchange benefits for cash	You may have a company car that you use. Employers offer cash alternatives instead of the car. You may find that you can run a car cheaper than the cash alternative hence an instant saving and a positive effect on your income. Do you get any benefits from your employer that offer a cash alternative and you could provide to yourself cheaper than them? Its no point having a brand new car and struggling to meet the mortgage payment.
7	Switch from permanent employment to sub-contractor	Usually this happens the other way round. If you're a subcontractor earning £70,000 pa, and good at your job, the company offer you full-time employment for £45,000 pa. For this you get job security and access to employer benefits such as their health and pension benefits. This is an expensive price to pay. In this example, which is a real example as one of my good friends did this, you lose £25,000 for not much. Okay, he'll get a redundancy payment if made redundant but you have to evaluate how likely is this. Its worth asking your employer, if it is an environment for subcontractor work, to consider you switching to subcontractor income from salaried employment. The increase in pay could be quite staggering.
8	Increase profitability	This is a book in itself! For those of you that have a

		business you should be looking always on ways to increase profitability. Some obvious ways are: • Reducing the hours worked by your staff and doing the work yourself thus saving on wages and salary costs • Pushing more sales through existing customers thus increasing turnover • Advertising for more business thus increasing turnover • Negotiating harder with your suppliers to reduce costs of sale • Switching banks who are offering lower costs of borrowings thus reducing bank and interest charges Now it all depends on your business and how practical this is. But it is worth a think. Look over all the lines of your Profit & Loss account and see if you can either increase turnover or decrease expenditure or even both!

Ensure that if you are on a repayment mortgage then you switch to an interest only mortgage as this will lower the monthly payment quite dramatically. Now knowing how long you're going to have to fund this shortfall would be nice. What you want to know is how bad this coldspot is going to be and how long is it going to last. You need to be aware of certain key variables so you can gauge the likely damage of being in the coldspot environment. The following variables in the awareness table play a key part in determining how long and how bad the coldspot will be:

AWARENESS TABLE FOR CHAPTER 7

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.

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.

8. 9pm to 12pm – Warm spot

9pm……its getting warm

So we have seen a rapid decline in property prices. Repossessions are higher than they've ever been in the last 5 years, negative equity has swamped the nation – who in the hell would want to get in to property investment? Well to be frank – not a lot of people! The only people that are, are people like me. Professional investors hate having money in the bank. There is absolute no excitement in keeping your money in the bank. The return is guaranteed of two things:

a) its certain
b) its low

Basically its certainly low! If you are a true business man you would never accept a low return on your money even if it was certain.

So amongst the carnage below that is happening within the property market the vultures, being the professional property investors, hover above waiting to swoop. The professional investor will know that it's a buyer's market rather than a seller's market. He will accelerate the fall in prices as he knows at what price will put money in his pocket. So for example if he sees a property advertised at £100,000 and knows that the property is worth buying at £85,000 then considering it's a buyer's market he will simply place a cheeky offer of anywhere between £75,000 to £85,000. If the vendor is desperate to sell he will entertain this offer so as to limit the damage of holding this property.

9pm → 12pm

Interest rates have peaked. Property has got a bad name. Property investment is now considered a stupid thing to do. People that had bought properties to then sell, banking on historic growth rates, are now left with a hot potato. For the fortunate people that have money and who want to still speculate are heading towards their nearest stock broker to play the stock market. The professional property investor however, never favouring the stock market, watches property prices on a daily basis to see when the price falls to a level that will put money in his pocket.

So who buys at 9pm? Well it's the professional property investor who will accept the lowest yield. In my experience the lowest yield will be a 2% loading on the current borrowing rate on the most desirable rental properties. So if the interest rate is 8% and buy to let mortgage rates are 9.5% then the lowest yield acceptable will be 11.5%, being 9.5% + 2%= 11.5%. His reasons for choosing the most desirable rental properties is because a 2% loading does not allow for too much void periods. Look at this example:

There are 2 properties for sale, with current rents and corresponding yields:

	Advertised Price	Rent	Yield
An ex-local authority studio flat	£60,000	£6,000pa	10%
A private 2 bed house	£100,000	£10,000pa	10%

Due to the yields being equal the professional investor will assess the likely voids of both properties. With the ex-local authority studio flat it will be likely that the tenant will out grow the flat quickly as it is only a studio flat. Also, being an ex-local authority flat, it will only appeal to a limited audience. A 2 bed private house will be a decent sized living space for a single person, couple or 1 child family and it will appeal to a wider audience due to it being in a private area. He will estimate that the voids will be longer with the ex-local authority studio flat compared to the 2 bed private house.

However, the yield is below his target of 11.5%. He has to buy the property at:

$$\frac{\pounds 10{,}000}{11.5\%} = \pounds 86{,}956$$

to ensure that he gets a 11.5% yield. So the professional investor will go in with a bid of around £80,000 (as professional investors are cheeky and do not care if they offer 20% below what the vendor is asking!) and will happily negotiate at a price of around £87,000.

Sometimes vendors will accept less than £87,000 as they are desperate to sell thus pushing prices down further. So in the above example an offer £80,000 might get accepted thus setting the new price levels for 2 bed private houses.

Ex-local authority studio flats need to come down even further! As this is at the undesired end of the market professional investors may require a loading of 6%. If borrowing rates are 9.5% then a yield of 9.5% + 6% = 15.5% will be needed from the most cautious of investor! This equates to:

$$\frac{£6,000}{15.5\%} = £38,710$$

So a bid of £38,710 is all that the professional investor will pay. So prices have fall further.

Now notice that I have not mentioned the owner occupier in all of this. The owner occupier does not operate to fundamentals. The owner occupier will be solely focused on the property price itself. If he sees prices falling then his worst fear is buying a property that immediately falls in value. The owner occupier will wait till prices bottom out. The problem is the owner occupier doesn't spend everyday doing this like a professional investor! The professional investor does as its his livelihood. The owner occupier has other things to do – like his job!

Property prices will continue to be bid downwards. The best rental properties being bought first with the lower end rental properties having to fall further. New entrant professional investors will enter, with higher loadings on their requirements causing the prices to fall further but the lower end of the market just simply having to fall further to attract any interest. There comes a point however, when prices at the lower end of the market catches the eye of one investor (someone like me!) who think – hang on a second, these properties are CHEAP! They start to buy where the market has bottomed out and as a result provide fantastic returns. So fantastic that other investors get wind of it and before you know it – the clock strikes 12pm!

So here we have the complete loop. As the clock strikes 12pm then we are simply back to a hotspot. Then all the principles in chapter 5 are applicable.

Looking at it as a sweeping hand of a clock:

12pm – It's a buyer's market. Properties are cheap hence yields are high.

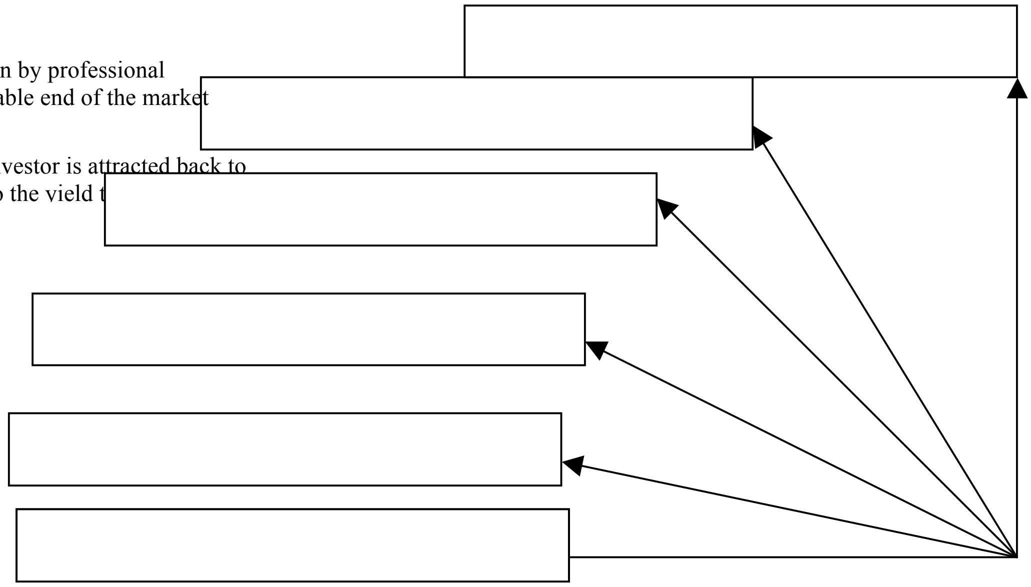
[illegible] m – [illegible] ors stumble [illegible] the market

11pm – The lack of owner occupiers willing to buy force prices down further

10.30 pm – The lower end of the market plummets due to lack on interest

10pm - Prices are bid down by professional investors at the more desirable end of the market

9pm – The professional investor is attracted back to the property market due to the yield t



Strategies Within A Warmspot

The key strategy is to bid low. Do not be scared of insulting the vendor with your offer. An offer is an offer no matter what price you bid at. Its up to them to say yes or no. At least your offer is on the table for them to consider now. It may get rejected now but accepted a few weeks down the line. Do not wait for the prices to fall to your desired level – this is apathetic! Its up to you to drive the price down. If you simply wait it is likely that another investor will get there before you.

Making Your Offer Stand Out

Now if you're going to bid low, then make sure its serious. Not seriously low but a serious offer worth considering. A vendor may accept a lower than anticipated offer if it is one of the following:

Type of offer	Description
A cash offer	This will mean that the sale, theoretically, will happen quickly as there is no mortgage to be obtained. This will mean no survey to highlight any potential problems with the property. If a vendor knows there will be no complications with regards to the finance then the vendor will favour this offer. Sometimes vendors favour a lower cash offer than a higher mortgage offer. It simply eliminates the lender from the transaction as we all know lenders can be awkward even at the best of times. To back up your cash offer show them your bank statement to prove you have the cash. This will really improve your chances of the vendor accepting your

	bid.
Backed by a Mortgage In Principle	If you do not have nice tidy sum in your bank account to make a cash offer then get a Mortgage In Principle (MIP). This is where a lender has already credit checked you and has agreed to lend subject to the property only. This will send out the message to the vendor that you have already done the preliminaries to get the finance. All that is required is that the property gets valued up to the agreed price and the property is suitable security for mortgage purposes.
A flexible offer	Sometimes if you can be flexible in your offer this helps a lot. If the vendor says that he is happy to accept your price but wants to move out in 6 months time and you are in no hurry to acquire the property then they are likely to consider your offer. Some vendors wish to take certain fixtures and fittings with them that the normal purchaser would not expect like fancy doors or fireplaces. If you allow them to do this, stipulating that they replace or make good the damage the may cause as a result of taking these fixtures and fittings then they may be more interested in your offer.

Financing

You may well find that obtaining finance in a falling market may not be that easy. This is because the banks would have got their fingers burnt due to defaulters in negative equity. Lending criterias will be stricter. They may require:

- **a larger deposit** – to lower the risk to the lender. If, for example, they restrict lending to 50% Loan To Value then the property price will have to fall by 50% before the bank starts to get worried. This will be a big problem for you as you have to come up with the other 50%!
- **Full status –** instead of the bank lending on the strength of the property to pay the mortgage they may look at the property AND your status. They may ask that you earn in excess of £50,000pa and that you can prove it. This will mean payslips, tax assessments or certified accounts.
- **A proven background –** as the banks become more cautious they may restrict lending to professional landlords only. This may be decided on how many years you have been in the business or how many properties you have got.

So to ensure that you are able to buy within a falling market you need:

- **Cash –** cash is needed for a deposit. More cash may be needed than expected. Ensure that you've remortgaged yourself to the hilt! This means that you will have the cash to put down. You do not want to be in the situation where you can get a flat for £25,000, that rents out for £500pcm (24% yield!) but you cant raise the 50% deposit (£12,500) from one of the few lenders still remain in the buy to let market. Once the market recovers you will be able to re-access the £12,500

3pm – The speculative investor out bids the professional investor

2pm – professional investors offer even higher than raised asking prices.

4pm – The speculative investor, based on their own personal prefere… …ra…d to higher specification properties

…0p… …s the owner-occupier even struggles to find a property the sp…ulative …est… …rrives further pushing prices up

4.30 pm – The speculative investor out bids the owner occupier due to b… …let lenders having a less strict criteria than personal mortgages

3pm – The speculative investor out bids the professional investor

5pm – Owner occupiers team up together to form couples to increase their buying power and out bid speculative investors

5.30pm – Speculative investors, now making a loss due to their miscalculations, sell to owner occupiers and realise a capital gain

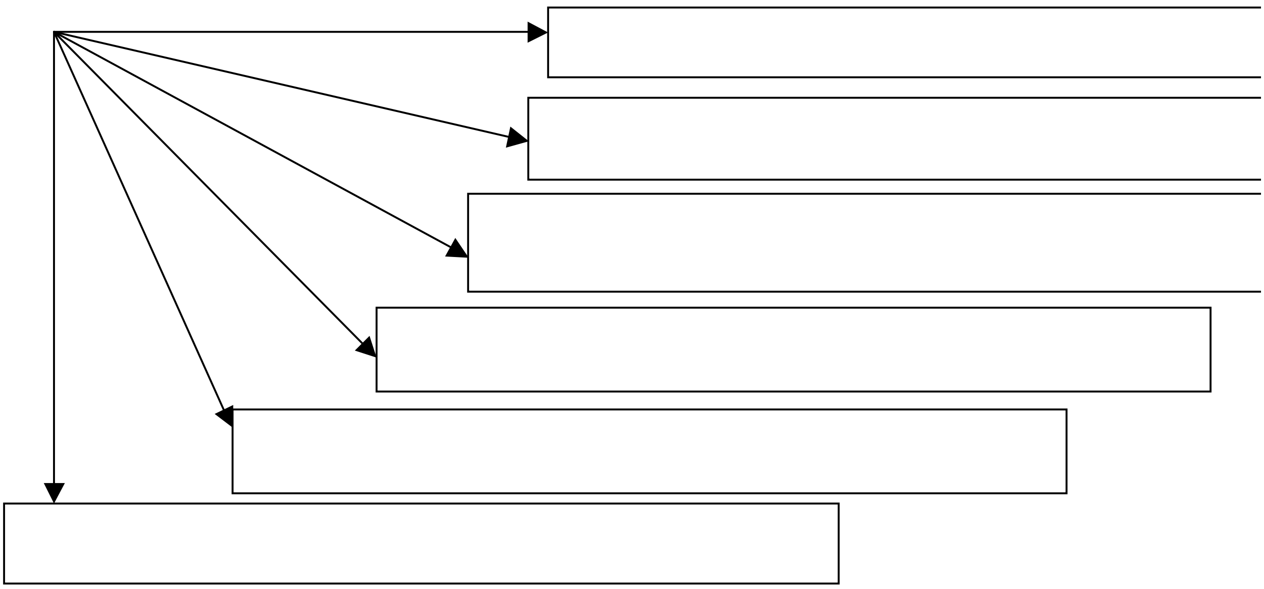
6pm – Owner occupiers are left with unsuitable properties and/or with high mortgages

(and more!) put down as lenders warm back to the idea of buy to let. Once the flat recovers to £50,000 and lenders are willing to lend 85% Loan To Value then your £12,500 put down will raise an extra £30,000 to buy further properties ((£50,000 x 85%) – (£25,000 x 50%) = £30,000).

- **Status –** Make sure you can prove your income. If you are employed then be in a good job. If you are self-employed ensure that you have been so for 3 years and you have certified accounts.
- **Experience –** make sure you've got a well performing portfolio under your belt. The threshold is usually around 5 properties and 3 years experience. This will make you stand out from the rest.

9.Strategy Summary

Since I have dissected the property cycle in to four distinct sections, let me put all four quadrants together so we all can understand it better:



9pm – The professional investor is attracted back to the property market due to the yield turning positive.

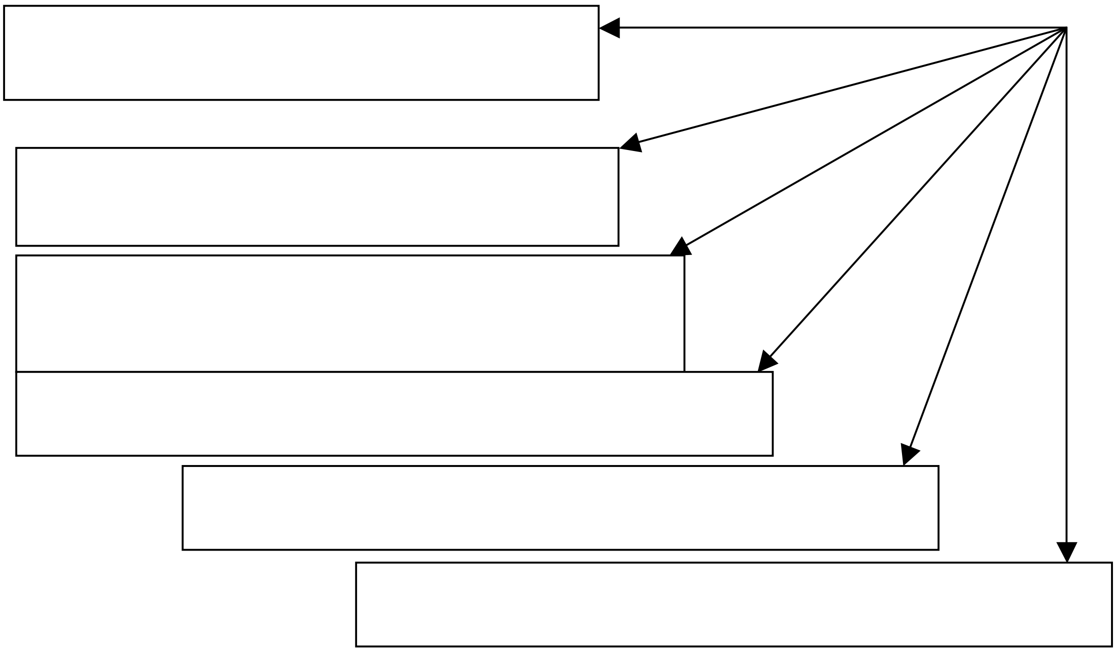
8.30pm – The market becomes flooded with properties. Supply exceeds demand. Property prices plummet

8pm – The speculative investor sells and realises an overall loss while owner occupiers default on unsecured lending to meet mortgage payments. Lenders start to suffer.

7.30pm – Repossession rates rise, certain areas report negative equity and lenders restrict lending

7pm – The speculative investor sells at a lower than anticipated price to realise some gain

6pm – Owner occupiers are left with unsuitable properties and/or with high mortgages



hence yields are high.

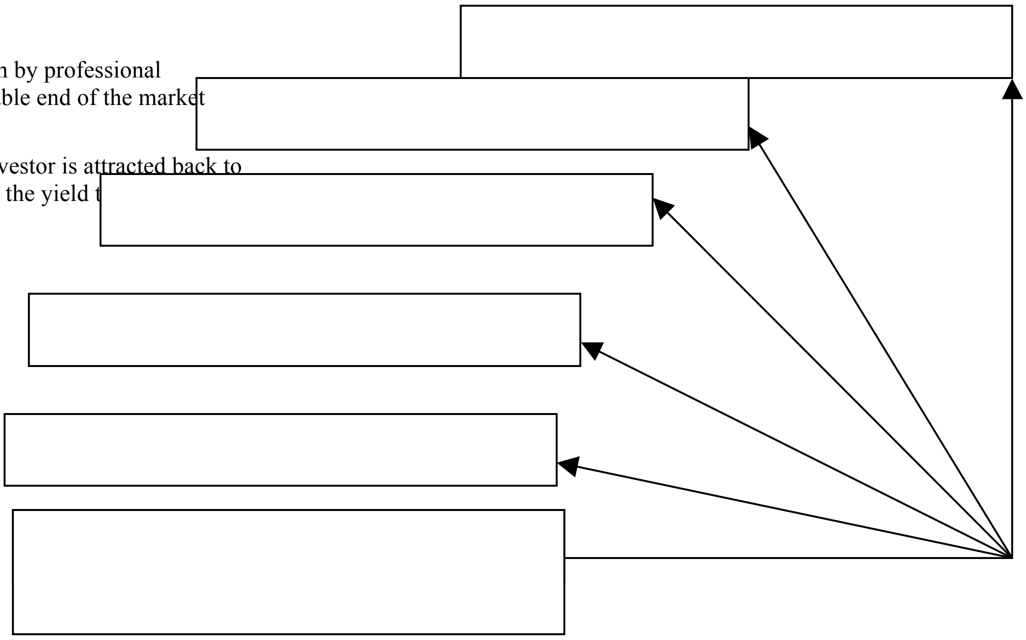
11.30pm – a few professional investors stumble across the undervalued low end of the market

11pm – The la[illegible] to force prices d[illegible]

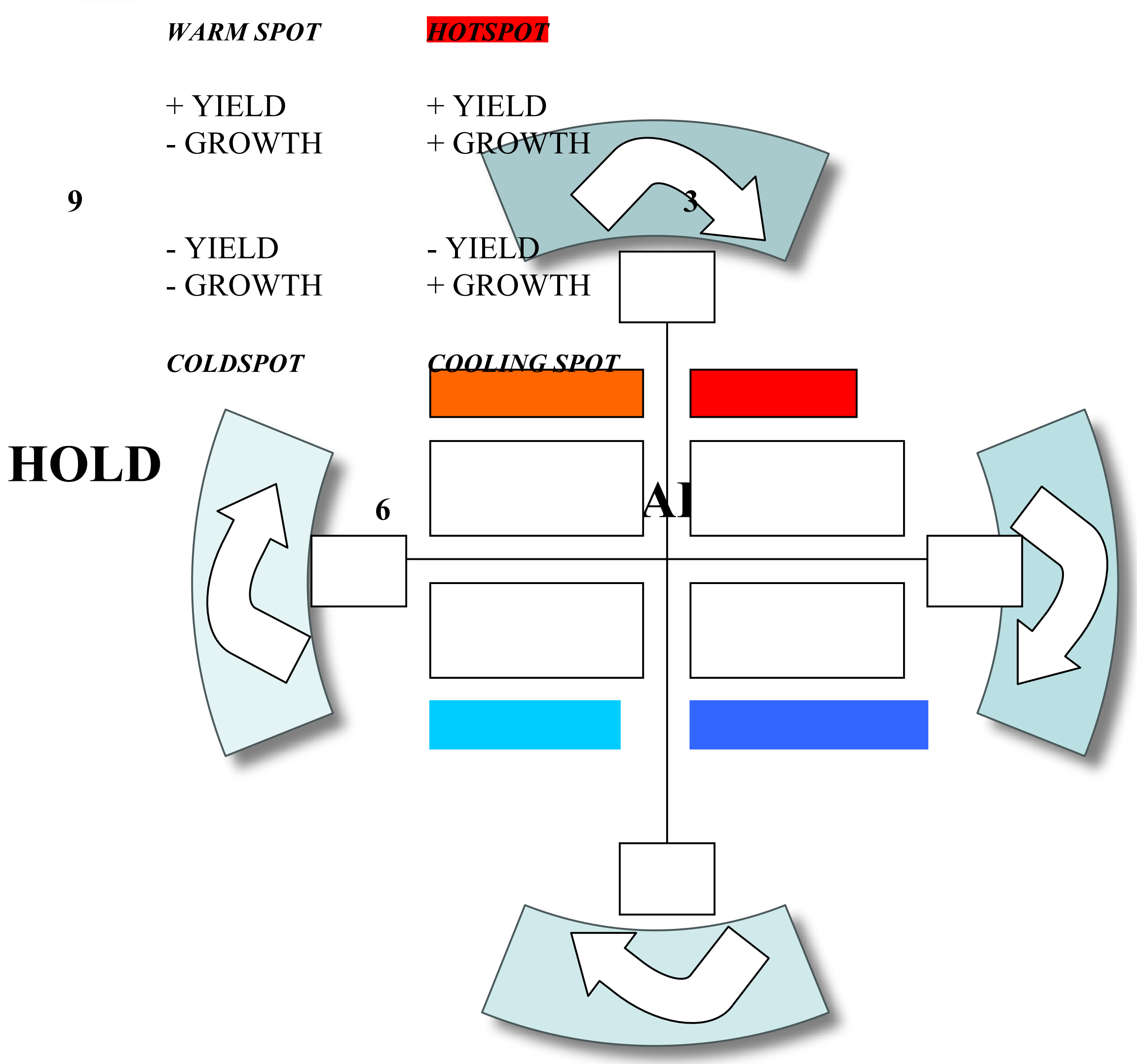
10.30 pm – The lower end of the market plummets due to lack on interest

10pm - Prices are bid down by professional investors at the more desirable end of the market

9pm – The professional investor is attracted back to the property market due to the yield t[illegible]



As a result of the actions by us and others we can simplify the strategies within each spot as:



So we can see that if you are a true professional investor you will only ever be interested in warm and hot spots. The reasons being:

- **Hotspot** – you are prompted to buy. Buying is the only true way to participating in the property market. If the strategy was to sell then it is a sure way to get out of the property market. So finding hotspot areas is key if you want to grow within the property market.
- **Cooling spot** – you are prompted to trade. Trading is buying and then selling. So in effect you dip in and out of the market. No professional investor would do this as it exposes you to massive gains as well as massive losses. Massive gains are acceptable (and well received!) but massive losses are possible and potentially bankruptable which is definitely unacceptable.
- **Coldspot** – you are prompted to hold. How exciting is that! No buying or selling is required so no real strategy is required here.
- **Warmspot** – you are prompted to buy. Again this is the only way to grow as you are prompted to buy just like a hotspot. If you can find a warm spot then it will only turn in to a hotspot so massive gains are inevitable.

So in a nutshell you should only ever be interested when an area is either a hotspot or a warmspot as it prompts you to buy. So how do you find both of these? Read on….

How to find a hot or warm spot

I have never found a warmspot in my time in property investment. I started property investment in 1996 so there has always been a hotspot to be found. The principles in finding a warmspot are the same as finding a hotspot. One should only ever seek a warmspot when there are no more hotspots. Currently there are hotspots in the UK, but there will be a time when there will be no hotspots and warmspots are the only places to invest.

The way I have found hotspots are:

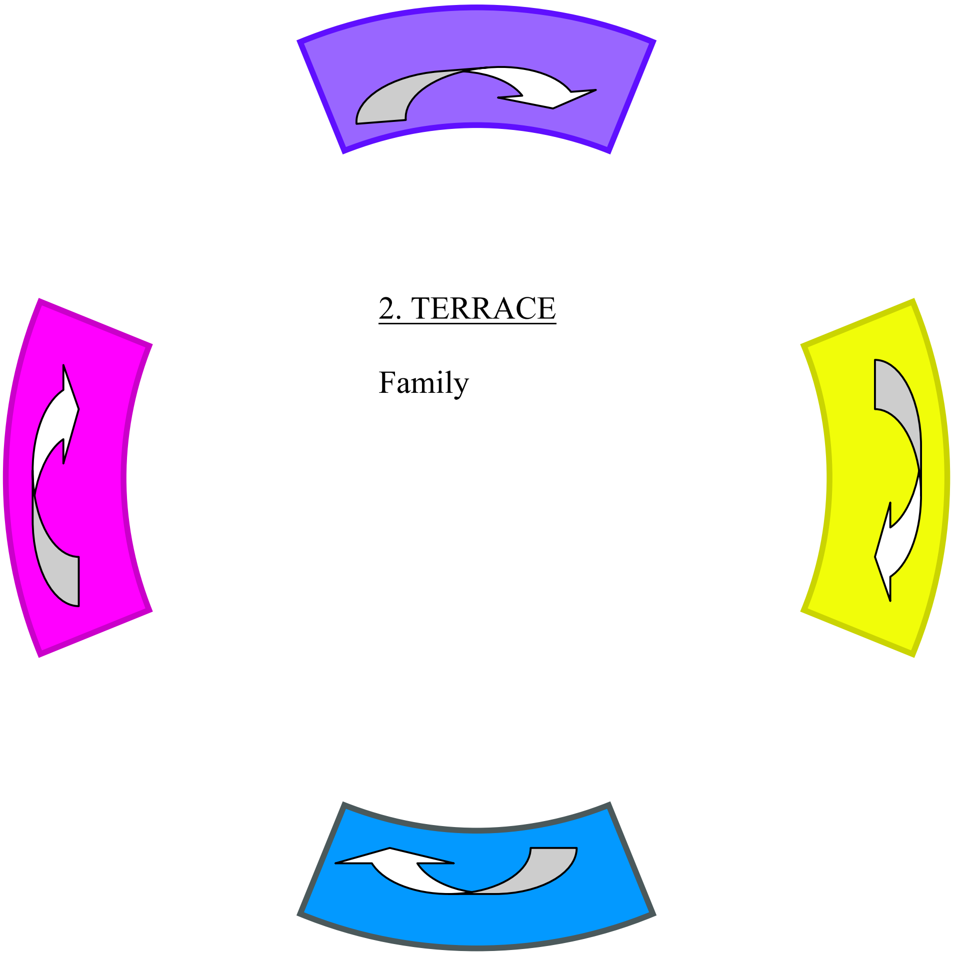
Method	Description
Internet	The easiest way to travel the world without leaving your desk! I owe a substantial amount of my success to the internet as I was able to discover areas that I had never heard of. These unknown areas now form a significant part of my portfolio! I hope you would have gathered from reading this book that you have to find cheap properties. Generally its properties under £60,000. All you do is visit these 4 sites: www.rightmove.co.uk, www.asserta.com, www.vebra.com & www.home.co.uk. Type in any town or city you can think of and search the widest radius possible. Put in maximum price £60,000 and see what comes up! If nothing has come up then the town or city you entered is not a hotspot or any town surrounding. If something comes up then check it out further. If quite a few come up then BINGO! Once you have found an area then visit www.ukpropertyshop.com. Here you have ALL the individual estate agents in that area. Check all their websites to see what they've got also. If it looks good then get in your car, drive down and buy everything you can!
Always look in agents windows	If you visit an area then ALWAYS check estate agents windows. I do this out of habit and interest. I am interested in property even if it isn't going to make me any money. Its good to get an idea of property prices of wherever you visit. You never know you may stumble across a bargain.
Get local press	Don't just stop at agent's windows. Get the local press and scan the property section. Here you can gauge the whole market in that area. You may find that there is an agent that specialises in low value properties.
Look for areas that are self	Areas with bad transport links or that are a bit isolated

sufficient	make perfect hotspots. They are sometimes valued low due to lack of demand by buyers(because unless you work there there is no point in living there) but have high tenant demand due to people wishing to rent there. One of my areas that I have a significant portfolio is Corby which meets this criteria. It has no train station, 30 miles from anywhere significant but has a large Scottish community who wish to live there.
Get out there!	Go visit places. If you haven't seen a friend because they've moved to another area then go and see them! if you've always wondered what Stoke-on-Trent is like then take your other half and visit. Look at a map of the UK, pick an area that you like the sound of and go and visit it, stopping off at all the towns on route to check out the estate agents. See it as a mini adventure – go on have some fun!

If all of that seems like hard work then visit my site, www.propertyhotspots.net, where you will find out all the hotspots that I could find and areas that are soon to be hotspots (and a hell of a lot more!).

10. Lifetime Property Clock

The property clock has a typical duration of anywhere between 3 and 10 years. There are longer durations that exist, typically 40 years+, wthin our own home ownership goals. If we understand this cycle, which I call the Lifetime Property Clock, we can then have a whole understanding of the property market. This is because the property market is made up of investors following the 'Property Clock' and owner occupiers following the 'Lifetime Property Clock' who look for a home to live and bring up their family in. Look at the following diagram:



We can see that there is a definitive clock that exists within our own personal property goals over our lifetime. Looking at the detail of each stage of the clock:

1. Single Person or Young Couple – Age 20 to 30 years old

We start our working life, but more specifically receiving a pay packet and start spending what we earn on all sorts of products and services like clothes, electrical items, eating out etc. But we do all this from our parents home! There then comes a point when you want your own place as it doesnt look that cool having the latest designer gear, the porsche, but still living in your bedroom that you have done so since you were born! A 'pad' is needed to prove that you are independent. At this time the single person turns in to a first time buyer. Now there will be scenarios where a couple get together to buy for the first time and they will also fit under this category.

First time buyers (being single people and young couples) will want to preserve as much disposable income as possible. This is because it is the younger working generations that like to spend in the bars, clubs, restaurants, high streets and travel agents and they need the money to do so. So they will aim to buy a property that:

1. Is cheaper than paying rent
2. Is not surplus to their needs
3. Easy to maintain

The properties that meet this criteria will be the at the cheaper end of the market. Specifically they will be studio, 1 and 2 bed flats. Invariably these type of properties will be cheaper than the terraced, semi's and detached properties. There will be exceptions to this rule. Consider the cost of riverside luxury apartments and penthouses compared to the cost of ex-local authority houses. The riverside flats will be more expensive than the terraced and semi-detached properties but it will be likely that the buyer of these flats will not be your typical buyer. It may be a second home for a wealthy business man or a second or third time buy by a young professional moving up the corporate ladder. It could be the case that the lifetime property clock for some individuals will only ever consist of flats but these cases will be rare and can be eliminated from this clock as we are dealing with the norms. They will also be smaller than all the other property types and maintained by someone else typically the freeholder.

So first time buyers will be drawn to flats. This can be seen by the way newly constructed flats are marketed. The show flat is decorated to a modern standard as the developer knows that the typical buyer of the flats will be young so he has to make the show flat appeal to the young. Second bedrooms are dressed up as study rooms rather than baby rooms. Living rooms are larger at the expense of the kitchen as the developer knows that the young often eat out and prefer a larger living space.

So it is established that flats are typically bought by first time buyers. I have assumed that a first time buyer is NOT a young family. There may be some young families that do look to get on the property ladder but again, we are working within norms. An example of this would be Jack:

Jack has £8,000 saved and earns £18,000 per year. In his area he sees flats going for around £75,000 and houses going for £120,000 plus. His buying power is calculated as:

> BUYING POWER = (deposit you actually have) + (mortgage you're able to get)

To calculate what he can afford we just plug in the figures. The deposit is £8,000 and the mortgage he is able to get will be 4 times his salary. So buying power is calculated as:

BUYING POWER = £8,000 + (4 x £18,000)

Which equates to £80,000. So we can see he can clearly only afford a flat. So he buys a nice 1 bed flat near the town for £80,000.

So as nature follows its natural course the first time buyer:

- if it's a single person meets the love of their life and decides to have a family
- if it's a couple decide to have a family

It becomes apparent that having your children sleep in the same room as you do is not such a good idea! A bigger property is required, preferably with a garden for the child or children to play in. Therefore a house is needed………

2. *Family – Age 30 to 40 years old*

It is probable that two things would have happened to the first time buyer since moving to now:

1. **Equity Increase** – The flat that the first time buyer owns would have grown in value. This would mean that instead of the mortgage balance being around 90% of the value of the home the balance will be somewhere around 40 – 80% of the value depending on timing and how the market has performed. There may be a situation where the mortgage balance is greater than the property value (called negative equity) but if this situation had occurred the couple simply have to wait it out until prices recover so that they can move. Therefore people in this situation cannot be second time buyers as they are stuck in their homes unable to participate in the market.
2. **Salary Increase** – It is likely that the first time buyer's salary would have increased due to promotion, career progression etc. This means

that the first time buyer can borrow more to acquire his second property.

Due to both of these things happening the first time buyer can buy a better property – a house! This is because he now has a larger deposit due to an increase in equity and increased borrowing power due to an increase in salary. Using the same example above lets say Jack, 5 years down the line, meets Jill (who also owns her flat and bought at the same time), his next door neighbour, and the get married and decide to plan a family. They decide to sell both their flats, use the equity in their flats and combine their salaries to buy a nice 3 bed terrace property in the same town.

	Jack	Jill	Total
Value of flat	£100,000	£100,000	£200,000
Mortgage Balance	£72,000	£72,000	£144,000
Equity	£28,000	£28,000	£56,000
Salary	£23,000	£23,000	£46,000

So their buying power follows the same equation:

BUYING POWER = (deposit you actually have) + (mortgage you're able to get)

The deposit is £56,000 and the mortgage they will be able to get will be 2.75 times joint salary. So buying power is calculated as:

BUYING POWER = £56,000 + (2.75 x £46,000)

Which equates to £182,500. So Jack and Jill buy the nice 3 bed terrace that they had their eye on for £182,500 and start a family.

The majority of the population will stop here. The second time buy house will meet all their basic needs like a room for each child, space for a decent dining table, garden etc. The aims for the family will be to clear the mortgage by the time they hit retirement age or before. The only time a second time buyer becomes a third time buyer is when:

1. **Another Child -** The household outgrows the house due to the arrival of another child
2. **Income** - The household income increases significantly due to one or both members rising up the corporate ladder in their professional job or if one of the member's run their own business and their business does well. The household will seek a better house as they can afford it.

Inheritance - The house[illegible] receive[illegible] inheritance which is sign[illegible] enoug[illegible] invest in to their prope[illegible] increases the **deposit** and therefore their buying power

Income - The household income increases significantly due to one or both members rising up the corporate ladder in their professional job or if one of the member's run their own business and their business does well. The household will seek a better house as they can afford it. This increases their **borrowing power** as their combined salary is higher.

3. **Inheritance** - The household receives an inheritance which is significant enough to invest in to their property aspirations.

In the first instance, where the family outgrows the house, the household income would not have changed so the household can only afford a house that they currently live in. The household will move to house of the same value but it will be larger. The household may forgo such benefits of the original house such as proximity to the town centre, train station or quality of area to obtain the larger house. This type of third time buyer will buy another terraced house with simply more bedrooms for the same price like moving from a 3 bed private terrace to a 4 bed ex-local authority house. So here there is no progression in price. Its more like a sideways move within the lifetime property clock.

In the second and third instance there is a progression in price. A higher value property is sought. This is a valid third time buyer as they are moving upwards in the property market. This is what I call the aspiring family.

3. Aspiring Family – Age 35 to 55 years old

So the two scenarios where a household is able to move up the property ladder are when their buying power increases further. Looking at the buying power equation and seeing where each situation occurs are as follows:

BUYING POWER = (deposit you actually have) + (mortgage you're able to get)

So using the same example, suppose Jack & Jill were to qualify to make consultant level at their office jobs with a 80% increase of their salary then their individual pay will go from £23,000 to £41,400. Then the mortgage they are able to get increases from:

2.75 x (£23,000 + £23,000) = £126,500

to

2.75 x (£41,400 + £41,400) = £227,700

That's an increase of £227,700 - £126,500 = £ 101,200.

So now Jack & Jill can look at a house, assuming property prices have remained at the same level, for £101,200 greater than what their house is worth which equates to £182,500 + £101,200 = £283,700. This will probably buy them a nice 4 bed semi or 3 bed detached in a private area. The same house could be bought if there was no increase in salary but Jack's remaining parent leaving £101,200 on their death.

Most third time buyers will stop here. It will be a quiet and safe enough area to enjoy a happy life for them and their children. The only family left looking to move again is the Status Family……

4. Status Family – Age 40 to 60 years old

So what makes someone want to buy for the fourth time? Status! If the property they live in is meeting all their needs then the mind slowly turns 'wants' in to 'needs'. Like:

I *need* a triple garage to house my three cars as they might get stolen
I *need* a swimming pool and gym to keep fit for my health
I *need* a large garden so my children can play safely
I *need* a separate study room as it will better my ability to work

I am guilty of this! I want a house with a triple garage, swimming pool, large garden and separate office. I have convinced myself I need it but if I'm honest with myself I don't really need any of this. I am a single man and all I need is a 1 bed flat however it hasn't stopped me looking for this type of property as I believe my life will be better if I do find such a property.

The buying power will be calculated the same as above. The figures can be anything as houses at this end of the market can range from £500,000 to £100m. There are very few executive houses relative to the number of other houses and the worth of these houses will be determined by very different fundamentals. Where the value of a 3 bed terrace will be comparable to another 3 bed terrace in the same street and there will be plenty of buyers executive homes have no comparables and very few buyers. Values of executive homes will be set by holding out for a buyer to fall in love with the house.

Take for example an executive home on the market for £1m. How many buyers do you think there are able to buy this home? Very few – that's for sure! The potential buyer will have to love the area, layout, space, style and much more if he is going to part with a large sum of money like a million pounds. So the vendor simply has to wait. If the vendor is in a hurry to sell he has to either drop his price to attract more potential buyers or improve the property's finish but you find at the top end there are few vendors that require a quick sale.

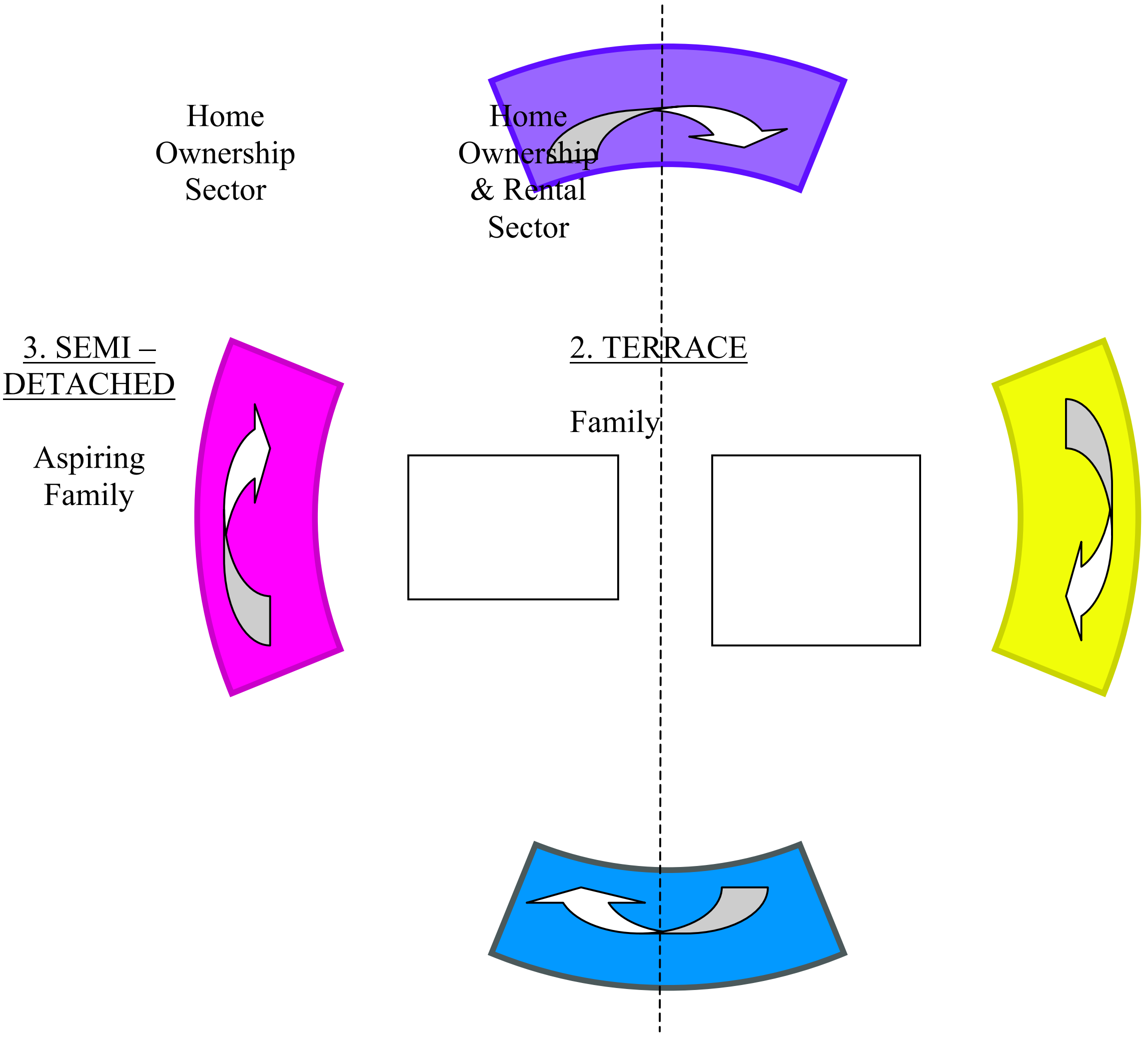
It can be assumed that once someone is over 60 years of age they will be unlikely to want to move upwards in the property market. If anything, once a spouse dies, the remaining spouse leaves the home to move into a serviced retirement flat. So in effect moves round to position 1 again being the single person.

Forced Moves

I have ignored forced moves. That is to say moving house due job relocation, divorce or sizing down. This is to keep the model simple. All these forced moves have an impact to the market but it is safe to say that people strive to move round the lifetime property clock in a clockwise fashion.

11. Interaction Between The Property Clock and The Lifetime Property Clock

Since we are interested in property investment we must see how the property clock is relevant to the lifetime property clock. Its quite safe to say that the home ownership and rental sector will be made of properties in stages 1 & 2 and the home ownership sector only will be made up of properties in stages 3 & 4. Looking at it diagrammatically:



Just check out the rental lists of letting agents. They will predominately be for flats and terraced houses. There will be a few semis and detached houses available for rent but 90% or more will be the standard properties such as flats or terraced housing. There are two reasons for this:

1. Semis and detached houses are sold at a premium compared to a terraced property with the same number of bedrooms. However the rent achievable for a semi or detached house will not compensate for the premium paid. This lowers the overall yield of the property hence making it unprofitable. Professional investors will shy away from such investments.
2. The only people able to afford such homes are people on their third time buy. The price of semis and detached houses will be set by the gains made on their original property ladder climb so it will price out a lot of speculative investors also. Speculative investors would like to buy these properties as they will let out easily and is a property they feel comfortable with but it will be out of their reach due to the high price these properties command.

Direct Interaction

Since investors can only enter in to stages 1 & 2 we can say that property investment *directly interacts* with stages 1&2. Stages 1 & 2 involve the:

- Young single person
- Young couple
- Young family

i.e. first time buyers.

Property investment used to meet the need of people who had no interest in buying and hence would rent the properties bought by property investors quite happily. In other words we were in equilibrium between first time buyers and investors. First time buyers were able to buy as well as investors. Now what is happening is that investors are buying properties that are suitable for first time buyers at a faster rate than first time buyers thus forcing them to rent their properties rather than to buy the properties. What then happens is that the rental sector grows and the home ownership sector shrinks within stages 1 & 2. If the home ownership sector shrinks too small it will effect stages 3 & 4 as there will be fewer buyers moving round the lifetime property clock. This will be the indirect interaction.

Indirect Interaction

The best way to understand this is to look at extremes. So in the extreme, if stages 1 & 2 was at a ratio of 100% rental and 0% home ownership then the prices of semis and detached would have to fall as no one would have a gain on their previous property to put down as a deposit. This will slowly drive the prices of executive homes down as there will be no one to buy them. the prices will fall to a level just above the undifferentiated terraced properties.

So the mix of investors to first time buyers is critical to sustain the prices of stages 3 & 4. It is NOT, however, critical to prevent a crash in housing. You may read a lot about the lack of first time buyers entering the market and somehow its going to trigger a crash but this is a red herring. It will only cause ridiculously priced houses at the top end of the market to come back down to a sensible level.

Strategies

I love to go where no one else goes! This is the way you make serious money. So as everyone talks about the lack of first time buyers and how they are priced out of the entry level of the market - you're looking at the other end! Check out how fast the semis and detached end is falling. At the minute I have found nothing but that doesn't mean there isn't anything out there. 'He who seeks will find'. One of my long term plans is to cash in my whole lower end portfolio and buy fewer top end properties as a nice pension policy. Now I say long term but if the semis and detached end starts yielding gross at 8 or 9% in a few years then this could be the way to go.

Look at this example, which is actually my real case:

Number of properties:	100
Property value:	£6m
Debt Value:	£3.5m
Annual Rent:	£420,000

Annual Profit Before Tax: £180,000

Lets say I sell my whole portfolio I would net:

£6m - £3.5m = £2.5m

being the property value – debt value = net proceeds

Now if I could get 9% on this £2.5m from buying ten £250,000 higher end properties then my profit and loss account would look like:

Rent (9% x £250,000)	£225,000
Mortgage Cost (no borrowings)	£nil
Other costs (management, voids etc)	£45,000
Annual Profit Before Tax:	£180,000

Spot the difference? Well there is none! I would earn exactly the same as I would before. However, it would be a manageable portfolio since being only ten properties, a better class of tenant since its higher end properties hence less bad debt and lower maintenance due to being simply a smaller portfolio (less gas safety checks, actual floor space are etc).

There are two problems currently in achieving this:

1. I cannot find any 9% yielding higher end properties.
2. I would get clobbered with a large capital gains tax bill which is difficult to shelter.

These problems can be overcome. Firstly 9% yielding higher end properties will be available in times to come so its just simply a waiting game. Secondly the large tax bill can be treated as an expense and factored in so that you adjust the selling price to cover this cost. I am sure I will find a landlord that will buy my portfolio at my price when this time comes.

Good Luck

Property is essentially a simple game if you understand a few fundamentals. The key is to buy when it puts money in your pocket and if possible increases your wealth. I know you've heard this time and time again but property is a long term investment. If you treat it as such then you are on the long term path to property millionariedom. I wish you luck with all your future property purchases and I hope you bear in mind the property clock.

[signature]

Ajay Ahuja