Buy to Let Secrets 2006

Double or triple your money with long term hands free investments

By Neil Lewis and Richard Davies

Part of the Property Secrets Series

www.PropertySecrets.net

Contents

1 INTRODUCTION

1.1 Scope of Buy to Let Secrets 2006

Buy to Let Secrets e-book and software will equip you with a thorough insider knowledge of property investment and the interactive property business tools to enable you (with time and effort) to identify and successfully realise long-term property investments.

Also, as a Property Secrets member, you now have access to all of our ebook titles, yours free to download and keep, in addition to unrestricted access to the Property Secrets members' only areas which contain location reports, thousands of pages of articles, software tools and discussion forums.

Please see www.PropertySecrets.net to log onto the private website.

1.2 About The Authors

Two experts have written **Buy to Let Secrets**: the property expert, Richard Davies, and the information expert, Neil Lewis.

1.2.1 Richard Davies – Investment Director, Property Secrets

Richard spent 10 years working in the estate agency business before escaping to set up a series of property investment and development businesses.

Richard was central to the growth of the short-term lets market in West London, and developing this division of Foxtons Estate Agents into one of its most profitable activities.

His background has always been in property lettings, where he gained an insider understanding of rental markets.

For the last five years, Richard has been building his own property portfolio. In this time he has developed and then sold many properties and retained many more properties on a rental basis.

Richard's advice for the would-be Landlord and Property Investor has always been:

> *"Make sure that you fully understand what you are doing before you become too deeply immersed in a property"*
>
> *"Over the years I've seen hundreds of property landlords get it wrong - and just as many get it right"*
>
> *"The old views of the Landlord as a tight-fisted scrooge are behind us. Tenants are no longer to be feared as they used to be."*
>
> *"However, there are right ways and wrong ways of managing tenants. Just as there are good and bad investment properties and locations."*

> *"Buy to Let property investment is a serious business these days. It deserves your respect, and if you dedicate time and effort to it, it will reward you handsomely"*

Richard is passionate about developing property - it's the thrill of the deal that does it for him - but the one (major) drawback is dealing with builders.

The great advantage of ***Long-term*** property investment (as opposed to ***Short-term*** property development), is that you rarely have to deal with builders.

Much of the advice contained within **Buy to Let Secrets** was developed from Richard's successful and growing property businesses.

1.2.2 Neil Lewis – Chief Executive, Property Secrets

Neil is passionate about property and delivering information in a way that allows the reader to take informed action. As the voice of Property Secrets, you will often find Neil interpreting and commenting on long-term property market trends, then translating the facts into useful advice, enabling you to profit from property.

He also has over 15 years' experience of the information publishing business, having worked on financial, music and travel publications. Most recently, Neil worked for the Economist Group in its information publications division (EIU).

Neil and his family are now living in their 3rd property together – with substantial property investments in the London market and Spain.

While he's seen property prices double and more in recent years, he also remembers the crash of 1989.

Autumn 1989 was the time when his parents - having built 3 new properties from scratch - tried to market their new houses - just as the market crashed!

His parents nearly went bust (the subsequent boom in the student rental market came to their rescue), but they nearly lost hundreds of thousands of pounds.

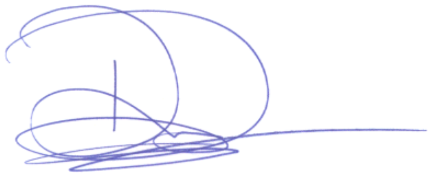
With that experience behind him, his approach to property has always been active caution mixed with a desire to understand and manage the risks involved.

He always makes sure he has a tried and tested plan 'B' should things not go as he expects them to.

Neil says:

> *"I hope that* ***Buy to Let Secrets*** *and the efforts of the many people who have contributed to it will inspire you to make wise and effective decisions in your property dealings.*
>
> *We both wish you the very best of luck".*

Neil



2 WHY A 2006 EDITION?

The first thing we need to make clear is the reason we need to update our strategy to double or treble your money through our Buy to Let Secrets 2004 and 2005 editions.

The good news is that the strategies we've already outlined in our previous editions remain sound and nothing has happened since these were devised that has given us any reason to alter them.

But, of course, how and where you apply those strategies has altered as opportunities in the property market have changed.

The purpose of the 2006 edition of the book is to bring you right up to date with the current market conditions, and show you how and where to apply the Buy to Let Secrets strategies to make money.

3 CHANGING CIRCUMSTANCES ONLY MEAN YOU MUST BE FLEXIBLE

Circumstances do change.

The secret of being a successful Buy to Let investor is to remain flexible – you need at all times to adapt a core strategy to different circumstances.

This is why we always argue that every area, every type of property, and every stage of the economic cycle present investment opportunities.

We'll look at how to exploit these opportunities in this book.

But remember, you HAVE to be able to identify the economic climate you're in, the prevailing mood of buyers and sellers, and shape your approach appropriately.

Remember also, this is a medium to long-term strategy – not a quick buck route to riches. The quick buck route will always involve very high risk. And we're all about minimising risk. So, go for very high risk, if you want, but we won't encourage you.

Interest rates rose in 2005 in a bid to cool the housing market. It worked. The overheating double-digit price rises were unsustainable and something had to be done.

Now, with consumer spending down, wage growth under control, no property crash in sight, and the Bank of England optimistic about economic growth in 2006, it is likely that interest rates have peaked and will go down, beginning a gradual descent to the 4 or even the 3.5% mark.

So, as we believed, the property market has experienced a soft landing. Now the UK will experience a period of stasis through 2006, with some modest rises in a few pockets of the market.

And that means you should be buying at real discounts to achieve locked in equity – and/or looking outside the UK for more exciting capital growth markets.

What really matters is whether the **economic fundamentals** indicate property price growth, a slowdown or a price reversal. And that applies whether or not you're in the UK or overseas market.

The economic fundamentals that drive property price growth – an expanding economy (growing GDP), along with rising employment (note: not a fall in unemployment, which is less important), and wage growth – are all on track.

These elements, though, are certainly growing more slowly in the UK than in some of the markets of the emerging new EU member states, as we shall see in this new edition.

3.1 Property is still the #1 investment

While UK capital growth figures have cooled, property will remain the number one investment because it will continue to offer the three features that are simply not all applicable to any other investment:

- Capital growth in the long term
- Income
- Gearing

Sure, in theory, you can borrow money to buy stocks and take an income (in the form of a dividend) from those shares while waiting for capital growth.

But try being cash positive (i.e. fully funding the loan repayments) by using share dividends. You can't. This route is simply not a realistic proposition if you are seeking long term growth.

The fact is that property investment is now a fundamental part of many people's investment strategy. More and more people are choosing property for long-term growth as opposed to almost any other form of investment.

And that goes, increasingly, for pensions, because millions of people are waking up to the fact that their pensions are simply not going to support the kind of lifestyle they expect.

Why property investment? Because:

- Historically it combines attractive returns based on straightforward supply and demand.
- It's tangible - you can't live in an equity portfolio or a pension plan.
- For the most part, you can invest with other people's money at a very low rate, i.e., a mortgage.

4 BUT IS NOW THE RIGHT TIME TO INVEST?

Once you've read and digested this chapter, you will be able to:

Understand the three green lights to investment:

- Green light one – see section 4.1.1
- Green light two – see section 4.1.2
- Green light three –see section 4.1.3

The UK housing market showed every sign of stabilising at the end of 2005.

The Office of the Deputy Prime Minister (ODPM) data, based on actual completions, says annual property price inflation was at 2.8% while the Land Registry put it at 3.5%.

The Royal Institution of Chartered Surveyors (RICS) reported that buyer enquiries had increased for four months (July to October 2005), the longest concerted increase for two years.

So un-sustainability in 2004 became stability in 2005. As we said, this is a good thing.

And, because you are looking for mid or long term growth, and property remains the number one asset class for the reasons we mentioned before, it is nearly always a good time to invest, so long as you are able to buy and hold. In this way an investor is able to ride out the full market cycle and any troughs along the way.

The key questions are what, how and where you invest.

And many buy to let investors will now find the 'where' is increasingly overseas, especially in the emerging property markets of the newest EU member countries, the 'EU Eight'.

The EU8 are the countries of Central and Eastern Europe that joined the EU in 2004 - Slovakia, the Czech Republic, Poland, Hungary, Slovenia, Latvia, Lithuania and Estonia.

4.1 Three Green Lights to investing Now!

4.1.1 Green light one: Predictable interest rates

The gradual rise in interest rates in 2005 was welcome because we wanted property price rises to slow in the same gradual way – calmly, gently. That's how a crash is avoided.

Thankfully, that scenario unfolded. Interest rates rose. The market cooled.

Now it is our forecast that the UK market will slowly improve or move sideways for a while – in other words, prices will remain static.

But that's fine.

Remember, we're in this for the long-term. And it's your long-term average annual rate of capital growth that is the only thing that ultimately matters.

You need to consider the average rate of capital growth and yield on your investment over the medium to long-term. The prospects for both, we believe, are excellent.

A new, stable UK property market makes us even more confident about future prospects.

4.1.2 Green light two: The UK economy

The UK economy's vital signs are still healthy. And, ultimately, it is these indicators – employment levels, wage and productivity growth and investment, along with manageable inflation – that drive prosperity and demand for all goods, including property.

The level at which interest rates are set is almost always a response to these factors. And if inflation is moderate to low, and the economy is growing at a steady and sustainable rate, there is no reason to raise rates – in fact, now there are good arguments to lower rates.

At the time of writing, the UK economy is on course to grow by 1.7% in 2005 – much below Gordon Brown's prediction of 3.5%, but it will begin to recover in 2006.

A report from Deloitte, the global accounting and business consulting organisation, states:

"Overall, we continue to expect GDP growth to slow to around 1.7% this year (2005), before showing only a modest improvement in 2006.

"Although the rise in oil prices could yet push consumer price inflation up further, there are few signs of any second-round effects.

"As such, we expect the Monetary Policy Committee to be free to cut interest rates to 3.5% by the middle of next year in order to support real economic activity, helping economic growth to recover to 2.5% by 2007."

While the number of benefit claimants rose to 2.8% of the working age population in 2005, employment has grown as new jobs are created.

The **employment** figure – and remember, this is the important figure for us as these are people with new spending power, those people in work – rose by 123,000 in the third quarter of 2005.

This means a record 30.23 million people were working in the UK in 2005.

Earnings growth throughout the country eased to 4.1% in the year to September 2005, down from 4.2% in the year to August.

Economists had expected no change in earnings growth, and the figures suggest that slightly higher inflation has not fuelled excessive wage growth.

Aside from property inflation, wage growth is also something the Bank of England is very keen to keep sustainable – so further interest rate cuts are much more likely than before.

The other key factor here is also the fall in consumer spending, which has hit high street stores so hard. A cut in interest rates would also be designed to stimulate this area.

Let's look at where the wage growth was strongest in 2005:

Industry	Salary Growth (inc bonuses)
Manufacturing	4.1%
Services	4.1%
Public sector	4.2%
Private sector	4.0%

Source: National Statistics Office.

4.1.3 Green light three: the Buy to Let Market

Buy to let investors stayed in the market in 2004 and in 2005, despite the negative headlines warning of a crash.

The numbers of new entrants dropped off in May 2005, but then stabilised again by September, according to the Royal Institution of Chartered Surveyors (RICS).

So, the many media claims of the death of the buy to let investor were exaggerated. No surprise there then!

(i) Buy to let landlords remain in the market

Data from the Council of Mortgage Lenders shows that the number of new loans decreased by 4% in the first half of 2005.

Lenders issued 93,400 loans in the first half of 2005; down from the 97,800 total recorded in the second half of 2004.

But the 4% drop was significantly lower than the 18% decrease between the first and second halves of 2004 (from 119,900 to 97,800).

Lending for buy-to-let mortgages amounted to around £9.9 billion in the first half of 2005, which was marginally higher than the second half of 2004.

And the total size of the buy-to-let sector continued to expand during the first six months of 2005, to be worth £63.5 billion.

The proportion of buy-to-let mortgages three months or more in arrears, increased in the first half of 2005 to 0.70% from 0.66% in the second half of 2004. But this figure remained lower than the 0.87% arrears rate across all mortgages.

RICS states:

> *"More buy-to-let investors are entering the market. Existing landlords are also less likely to sell when tenants' agreements expire. Landlords are exiting the market at half the rate of this time last year (2004)."*

What these figures show is that buy to let is a fully established, long-term investment phenomenon and not just the product of ultra-low interest rates and the availability of buy to let finance.

(ii) Property price falls are slowing down

The RICS November 2005 housing market report stated that:

> *"October (2005) saw the largest increase in new buyer enquiries in two years and marked the fourth consecutive month of increases. And although house prices slipped back again last month, the pace of decline was at its slowest in 15 months.*
>
> *"The number of chartered surveyors reporting price falls for October 2005 dropped significantly to 9%, down from 21% in September.*
>
> *"Buyer interest is still benefiting from August's (2005) interest rate cut, though the upturn in demand has only partially made up for previous declines.*
>
> *"Sales activity is seeing a modest increase and completed sales have risen almost 8% from their low in February, though they are still down 5% from levels one year ago."*

With sales rising and new selling instructions at a standstill, buyers still retain the balance of power, though this is beginning to shift as the recovery has been sustained.

Property Secrets believes this trend will continue and, as a result, we may see modest property price growth in 2006.

(iii) Rents strengthened in 2005

In the second quarter of 2005, residential rents picked up at their fastest pace in four years, according to RICS.

The RICS letting survey report (September 2005) states:

> *"Tenant demand for rented property continued to rise in the same quarter, having held firm during the previous quarter. Demand was strongest for flats.*
>
> *"Increasing rents continued to lift gross yields for the second consecutive quarter. However, the renewed growth in new investor instructions will increase the supply of available property and has led surveyors to dampen their outlook for growth in the sector in 2006.*
>
> *"Surveyors' expectations for rent rises have decreased across all regions other than in London and the South West. But there is little chance of short-term rent falls as tenant demand remains strong."*

(iii) 'Fly to let' and the EU in 2005

The latest analysis by the World Bank reveals how well the governments of the Eastern Eight (Slovakia, the Czech Republic, Poland, Hungary, Slovenia, Latvia, Lithuania and Estonia) - are doing in tackling the countries' biggest problems – unemployment and government spending.

Successful development in these countries is going to depend on how well governments can not only grow their economies by attracting investment, but also by how well they practice fiscal discipline and create jobs.

Just as in the UK, here the key drivers of property investment are low inflation and job creation.

This is the environment being created in the EU8 where the emergence of an aspirational middle class, alongside the introduction of rapidly growing mortgage markets, are producing exceptionally high capital growth projections.

As the buy to let market has matured, more investors have recognised the potential of these markets overseas – and are building their portfolios accordingly, using property in the EU8, as well as selected sun locations, such as Cyprus, to balance their interests in the UK.

We will explore this phenomenon later in this new edition.

Congratulations - you've finished section 4! You'll now know about the three green lights to investment ....

- Green light one – see section 4.1.1
- Green light two – see section 4.1.2
- Green light three – see section 4.1.3

5 WHY OIL PRICES WON'T SPOIL THE PARTY

Oil prices soared to $70 a barrel in 2005 and caused the highest G7 inflation rates for more than a decade.

That created headlines and scare stories.

But, as we always say, good property investors need to look behind the hype.

And, in the case of oil prices, there are strong arguments to say that although they may spike, they can also moderate growth – which is a good thing for interest rates.

This, in turn, is good for you.

Once you've read and digested this chapter, you will be able to:

Understand the links between oil prices, interest rates and inflation why oil prices can slow growth, in particular:

- A new economic landscape – see section 5.1
- Oil prices, inflation and interest rates are linked – see section 5.2
- So how do oil prices slow growth? – see section 5.3
- Why is this good news for property investors? – see **section 5.4**

5.1 A new economic landscape

A global economy means many of our old economic rules and beliefs no longer apply.

The key indicator of the new economic sphere is low interest rates. Not low interest rates per se, but low interest rates combined with huge hikes in commodity prices, especially oil.

And that should affect the way all serious investors view residential property markets.

5.2 Oil prices, inflation and interest rates are linked

The average inflation rate in the G7 economies was an estimated 3.2% in September 2005, the highest average for 13 years.

But this spike has only one cause – oil prices. That's because core inflation – minus oil and food – is actually lower in all countries.

The inflation is not caused by unsustainable salary rises, for example. And because of this, the traditional answer to raised inflation – raising interest rates – doesn't really apply when the inflation is largely the result of one commodity.

In the past, raising interest rates was used – and still is, but to a far lesser degree – to slow down overheating economies and dampen inflation in the process.

The downside of this was that high interest rates always led to unemployment and wrecked housing markets.

But now we have many booming economies, such as China's, which are driven by the export of vast quantities of packaged goods and low interest rates.

Inflation is being controlled in large parts by the availability of lower global labour costs. In short, this means the vast labour reserves of Asia and Central and Eastern Europe.

5.3 So how do oil prices slow growth?

Labour costs in the richer Western nations are held down by globalisation because workers here have far less bargaining muscle.

Instead they must compete on grounds of better productivity and high value products and services.

Globalisation has also made it almost impossible for business to pass on increased labour costs by way of prices for their goods.

So, in this new globalised environment, what does slow economies?

The answer is the price of commodities, especially oil, because ultimately its costs must be passed on to the consumer as oil is both a raw material for a great many manufactured goods, and is also needed for the transportation of goods.

Asia cannot continue to grow its exports at such a phenomenal rate without sucking in massive quantities of oil. And if oil prices go up, it makes China's exports less competitive.

That's good news, in part, because it means that oil is actually moderating the rate of growth in the world economy.

Without oil prices to slow growth, the Chinese economy would be likely to roar ahead at unsustainable levels.

5.4 Why is this good news for property investors?

Oil, then, is acting like the central banker to the world economy. Oil prices will continue to allow economic growth at historically lower interest rates than was previously necessary.

So, with lower interest rates in the long term, property markets across the world should keep moving forward steadily in developed markets.

Meanwhile, there is the possibility of spectacular growth in emerging markets like Poland, the Czech Republic and Slovakia.

Congratulations - you've finished section 5! You'll now know about the new economy, the link between oil price, inflation and interest rates, how oil prices slow growth and why this is good news for property investors....

- A new economic landscape – see section 5.1
- Oil prices, inflation and interest rates are linked – see section 5.2
- So how do oil prices slow growth? – see section 5.3
- Why is this good news for property investors? – see section 5.4

6 More Reasons Why Interest Rates won't Rise High

Once you've read and digested this chapter, you will be able to understand the six BIG reasons why interest rates won't get so high as to cause a property price crash...

- Reason one – Exports – see section 6.1
- Reason two - Debt – see section 6.2
- Reason three – Mortgages – see section 6.3
- Reason four – Inflation – see section 6.4
- Reason five – the Euro – see section 6.5
- Reason six – Politics – see section 6.6

There are six rock solid reasons why you won't get burnt by a price crash caused by interest rates.

6.1 Exports

Look at the strength of sterling compared to the currencies of the UK's major trading partners: the US and the Euro zone.

Listen carefully and you can hear the unpleasant sound of UK exporters being squeezed.

Sterling has come off 2004 highs against the dollar that approached the 1.90 mark, and in November 2005 it dropped to its lowest level in two years of $1.70.

But, remember, the pound is still at a high compared to rates over the last five to ten years. When we hit $1.70 levels in late 2003 that was a five year high!

Rates above $1.70 are hard to live with for exporters, and those corporates who make a large part of their profits in the US.

At the end of 2005, the Federal Bank in the US had put up interest rates 12 times in a row, to 4%, and the European Central Bank raised rates from 2% to 2.25% for the first time in five years to counter inflation.

The Bank of England on the other hand, simply cannot go much higher than a few quarter point rises, if it raises rates at all. And there are other good reasons why it won't raise rates, and that further cuts are actually much more likely.

6.2 Consumer Debt is £1.1 trillion pounds

Consumer debt - excluding mortgages - worries the government.

This is not mortgage money - the cheapest kind - but money borrowed expensively through overdrafts, loans and, worst of all - the most pernicious kind of debt - credit cards.

Credit cards account for around 30% of all outstanding consumer debt and around 60% of all new lending.

Total debt – including mortgages – reached the £1 trillion barrier in 2004 and, by June 2005, debt had continued rising, to £1.1 trillion.

As a nation we now owe some 125% of our GDP.

Interest rates rose in 2005 to attempt to lessen borrowing enthusiasm. And, if the slowdown in consumer spending in the high street is anything to go by, it worked.

But there is a question of balance here and with so much debt sloshing around, rates simply cannot rise too much or too fast without risking provoking a consumer debt repayment crisis.

It's a bit like the old adage - owe the bank £100 and you have a problem. Owe it £1,000,000 and the bank has a problem!

But, let's not be in any doubt about this – consumer debt of 125% of GDP is far too high and the level will have to be curbed.

Most economists would probably agree that a debt level of around 90% of GDP is acceptable.

But why?

Basically, it's all about confidence in an economy.

After all, using 90% of GDP to clear debt would be about as disastrous as still owing another 35%!

6.3 Unmanageable Mortgages

It doesn't take a mathematician to work out that over a certain rate mortgages will become unmanageable for millions of people (voters).

That rate is probably actually around 7%.

But psychology would kick in well before 7%, and panic would be the result. We guess this would happen at around 6.5%.

The last thing the Bank of England or the government want is a sharp reduction in property prices, which is what panic would cause.

Instead, they want growth and stability: a slight and gentle upward curve.

6.4 Inflation

Inflation is a bit like the Atkins Diet in reverse. What was once considered good (carbs) is now considered bad.

With inflation, it's the reverse. The old bogeyman of the seventies and eighties is now in much shorter supply but the government still wants some in the system.

Governments in all the major world economies want just a little inflation. A little in-built inflation keeps an economy active and growing.

Most importantly, it also makes it more sensible to invest through borrowing because inflation makes debt cheaper with time.

In September 2005, inflation accelerated at its fastest pace in eight years as oil prices surged by 51%.

Just one month later (in October), inflation moderated to an annual pace of 2.3% from 2.5%.

The Bank of England knows it cannot hike interest rates in response to oil price spikes.

Instead, because the Bank of England wants inflation at 2%, interest rates need to stay around the 4.5% level, or even gradually drop to 3.5% to meet their target.

6.5 The Euro

Whether the UK eventually joins the Euro zone or not, its economy will, inevitably, become increasingly integrated with countries in the Euro zone - its biggest block of trading partners.

That includes interest rates. The European Central Bank‘s rate is currently half that of the UK.

6.6 Politics

If Labour is to keep hold of the power it, like any political party, craves and the country is to be led by Gordon Brown, then economic growth needs to continue.

At the moment though the ‘prudent Chancellor’ is in danger of failing to deliver the kind of economic growth the UK has come to expect.

Right now, consumer debt and government spending are fuelling the UK’s economic growth.

And while the fundamentals are in place, that growth is more likely to be at around 1.7% (year on year) at the beginning of 2006 – than at Gordon Brown’s 3.5% prediction for year on year growth in 2005. So, this is only just above the other Euro zone countries, which are growing at around 1.5%.

Brown needs to get back on course and it looks as though interest rates might have to be cut to stimulate the kind of growth and inflation levels the Chancellor needs by 2007.

One or even two cuts of 0.25% are unlikely to rekindle a housing boom in themselves, but they will certainly stimulate the market.

Congratulations - you've finished section 6. You'll now know the reasons why interest rates will remain manageable:

- Reason one – Exports – see section 6.1
- Reason two - Debt – see section 6.2
- Reason three – Mortgages – see section 6.3
- Reason four – Inflation – see section 6.4
- Reason five – the Euro – see section 6.5
- Reason six – Politics – see section 6.6

7 Predicting Interest Rates

Once you've read and digested this chapter, you'll understand the historical reasons why interest rates peak, and at what level...

- Predicting future rates by examining past rises – **section 7.1**
- It's the difference between high and low that matters – **section 7.2**
- Applying the average to our position now – see **section 7.3**
- What happens at the peak of the cycle – see **section 7.4**

We're not going to pretend we can see into the future because no one can.

But what we can do is look back at what has happened to interest rates in the past.

7.1 Predicting future rates by examining past rises

There's nothing special about carrying out this kind of exercise. It's actually very easy – economists do it often. Headline writers, on the other hand, rarely look at the data.

If you want to check any of the following, you can easily look up the figures on the Bank of England's website www.bankofengland.co.uk (Base interest rates of selected high street banks as compiled by the Bank of England.)

While it's true that our economy these days is predominantly a service-based one, less dependent on raw materials and manufacturing; even so, the economies (and property markets), do tend to react in similar ways to similar stimuli.

Knowing – or at least being able to take an educated guess at - where interest rates are likely to peak in the medium term is clearly of vital importance to the investor.

If we look back over the years, base interest rates in the UK reached their lowest point in recent history in July 2003, when they fell to 3.5%.

The last time they hit the same low was in 1955.

In other words, before the recent rises in 2004 and 2005, rates were at near record lows (the base rate was at a post WW2 low of 2.5% in 1951).

The UK economy has journeyed through three periods of high and low interest rate cycles since it bailed out of the Exchange Rate Mechanism (ERM) following Norman Lamont's bungled attempt to buck the money markets by jacking up interest rates well into double figures.

These are periods in which rates start to rise, then hit a peak, then fall until they hit the bottom. When they start to rise again, that's a new cycle.

In each of the three periods, interest rates, at their highest, were considerably higher than their current 4.5% at the time of writing (December 2005).

But, as you'll see – it's most likely that the next move will be down. But if interest rates do move up, they won't go above 5%, we forecast.

7.2 It's the DIFFERENCE between high and low that matters

There were two economic cycles in the 90s (1994-96 and 1996-99), and then another from 1999 to 2003.

During those cycles rates peaked at 6.75%, 7.5% and 6%.

Those highs do look alarming for mortgage payers nowadays, it's true.

But rather than simply looking at the interest rate highs over these periods, it's more enlightening to examine the difference between the interest rate at the start of the cycle - when it began to rise – and the highest rate, usually somewhere in the middle.

The highest difference was in the 1996-99 cycle when the difference between start and peak was 1.75%.

The total increase in base rates from the lowest point to the highest in each period averages out at 1.4%.

7.3 Applying the average to our position now

So, let's apply that figure to our current position. The starting point of the current cycle is just before November 2003 when rates came off their low of 3.5% and rose to 3.75%.

So, add our average of 1.4% to the lowest rate (3.5%), at the start of the cycle, and we get 4.9%. An unlikely rate, obviously. So let's round it up, and we get 5%.

Of course, these are only averages, but it's fair to say that, judging by these cyclical events, rates are unlikely to rise beyond the 5 point something per cent mark – and right now, at the end of 2005, it looks like we've already passed the high point.

7.4 So what happens at the peak of the cycle?

Obviously, what you, the investor, want to know is how the property market would be affected by an interest rate of around 5% which for this cycle is a worst case scenario.

A housing market based on 5% base rates will continue to grow nicely.

This level of rates will also enable rents to move up.

Our landlord feedback is that pressure on rents is increasing and although landlords have not seen a significant jump yet, it can't be long before it comes.

The really good news is that an average of a mere 7% property price inflation a year will mean you double your money every 10 years (actually 10.24 years, to be precise). And at a paltry average 5% annual growth, it'll take you just over 14 years.

That's the beauty of compound interest!

Gear your investment by 70%, for example (which means borrowing 70% of your investment), and the return on your initial investment will be 333%!

Congratulations - you've finished section 7! You'll now know about:

- Predicting future rates by examining past rises – **section 7.1**
- It's the difference between high and low that matters – **section 7.2**
- Applying the average to our position now – see **section 7.3**
- What happens at the peak of the cycle – see **section 7.4**

8 MONEY MAKING BUY TO LET STRATEGY FOR 2006

Once you've read and digested this chapter, you will understand:

- How to make £143,000 in 15 years – see section 8.1
- Our assessment for 2006 – see section 8.2
- The essence of good property investment – see section 8.3
- How to buy with conditions – see section 8.4
- How to spot up and coming areas with capital growth potential – see section 8.4.2
- Learn to go against the grain – see section 8.5

With all the talk about buy to let being dead or on the decline, it is worth reminding ourselves of the long-term prospects for property...

... and if someone told you that you could triple your money.... even if it took eighteen years, then that'd be worthwhile, wouldn't it?

Yes, it would - but that doesn't mean you should always buy at today's prices...

...the ability to do your research and run the numbers in your Spreadsheet Software (see **section 22)** will be more important than ever, if you are going to make wise property investment decisions in this lower growth phase in the UK market.

8.1 How to make £143,000 in 15 years

The average price of a home in the UK could hit £300,000 by 2020, research from the Centre for Economics and Business Research (CEBR), suggests. That is an increase from an average house price of £157,139 in 2005 or a 91% increase over 15 years.

The economic forecaster bases its £300,000 prediction on the growing population and the snail's pace of house building. Simply the results of poor supply and high demand.

If you took out a 75% loan on your average priced property in 2005, you'd be putting down a deposit of about £40k.

So, property offers you the opportunity to turn an initial investment of around £40,000 into £182,000 in 15 years - not bad eh?

That calculation is the sale price of £300,000 minus the loan of £118,000 (75% of the value of the house when you bought it in 2005).

Another way of looking at this is as your Return on Investment (ROI), or how many times your £40,000 stake has increased against itself. In this case it is 450%!

OK, we know you've got to fund the rental - and that's where the Spreadsheet Software (see **section 22**) can help you forecast your risk/cash flow.

So, let's say you had to fund your investment by an additional £15,000 over the period, which would still leave a profit of £167,000 on a total investment of £55,000.

That is a total return of 301% in 15 years - or a mean growth of 20% per year.

That is why the prospects for capital growth, when viewed over the long-term, and when you factor in gearing, still look fantastic!

It sounds too good to be true. But when you consider that prices need to grow by an average of 4.4% year on year you can see why it is realistic.

But, of course, averages are averages - many properties will UNDER-PERFORM and many properties will OVER-PERFORM!

The trick of the successful buy to let investor is to spot those areas that will over-perform and invest there, and avoid the under-performing areas. See STEP 5 – Create your Investment Plan for more.

8.2 Our assessment for 2006

We believe interest rates peaked in 2005 – even if we're wrong and they didn't, they will not go above 5% during the next 12 months. The interest rate rises in 2005 have cooled the market. Good!

Now you can be more confident than ever that the crash, so widely predicted by the gloom merchants, will not happen. We don't think oil prices, which while high will be more stable in 2006, will impact on property prices either.

So 2006 is a benign year as far as these factors go.

But slower capital growth means you have to work harder and buy into properties at a discount, which will give you locked in equity.

It is still possible to buy off-plan and get great deals. Developers experiencing slower sales will be open to offers, but now you must be focused on whether the discount you've negotiated is a real one.

Only then can you be sure that equity is locked in. Any fool can make money in a bull market; in a slower market or even a falling one, it takes skill!

Because the hype has been taken out of the market, while costs (mortgage costs), have reached their peak, sellers are now more inclined to listen to your cheeky offers.

With long-term demographics anticipating more future demand for city centre living (especially in the North of England), 2006 could be a window of opportunity to land a bargain.

BUT - start your research now...

... because it can take six months to really get to know and identify the hot areas....

... and getting to know the really hot areas is crucial to your long-term success - see Area Research section 18.4 for more help.

... and it also means that when the opportunities start to appear then you will have everything ready to move fast - and this is very important.

Here is your checklist of what you should do now:

- Find out what properties are selling for
- Find out how many rental properties are on the market
- Find out **what those properties are achieving in rent** and how quickly they are letting
- Lastly, **read everything** you can get your hands on - so that you understand what drives the property market and you can spot a good time to buy.

We believe that Scotland, which performed extremely well in 2005, will continue to perform well – see Area Research.

Look for the medium sized towns or places on the fringes of the big cities like Glasgow and Edinburgh for returns of 7% and upwards this year.

Our money is also on London being the star performer in 2006. We expect to see the capital outperform the rest of the UK with rises of 6-8% or more and improving rental yields – especially at the higher end of the market where City bonuses will have an impact in the early part of 2006.

The optimism and impetus given to London's much awaited infrastructure improvements, due to the successful Olympic 2012 bid, will help too.

But again it is important to consider London as many micro-markets rather than one. As well as being the wealthiest place in the UK – it also contains the poorest boroughs in the country.

So pick your London areas and target rental markets carefully.

This year we're also tipping areas in the North and Midlands, and Southern seaside towns, which are improving due to regeneration and faster transport links to London

But if you want to build more exciting capital growth (with surprisingly low risk) into your portfolio then now is the time to look overseas at the Eastern Eight (the Czech Republic, Hungary, Poland, Estonia, Lithuania, Latvia, Slovenia and Slovakia).

Considerable investment has poured in to the new EU countries and they will continue to show dazzling economic growth in the next few years. Plan to get in sooner rather than later.

Again the key to this is balancing your portfolio by considering the risks against the rewards – see Area Research.

8.3 The essence of good property investment – right property at right price

We're often asked, what makes a good investment property? Well, funnily enough, that is a really easy question to answer.

It must consist of:

- positive cash flow
- in an up and coming area
- with strong - and preferably growing - rental demand

Simple, isn't it? Well, yes and no.

The rules are pretty simple; it's applying them that is the hard bit.

Nevertheless, if you test each potential property against these three rules, then you will be able to pick out the investment stars from the investment dogs.

8.4 Buy now – but buy with conditions

Our view on the property market is 'buy now – but with conditions'.

What does this mean? Well, it means that if you find a property that offers you positive cash flow, is in an up and coming area and has strong and growing rental demand, then you should buy it.

Then again, if the property you are looking at doesn't offer any one of these three criteria – then you should NOT buy it.

8.4.1 Why buy with conditions?

You are probably thinking, if I can make a return of 301% in 15 years (see **section** 8.1), then shouldn't I just jump in and buy anything before I'm too late?

Well, no. You shouldn't just buy anything.

Why? Because you might end up with a property that costs you £5,000 a year to run and fund.

In that case, it could cost you £85,000 to keep and run the property over the 15 year period – which essentially means that you would only make half as much money.

You see, the essence of good property investment is in the buying. If you buy the right property, in the right place, at the right price, you will make money.

Then again, if you get all three wrong, and buy the wrong property in the wrong place at the wrong price, you won't make money.

But then that's why you're reading this book, isn't it? Because you want to know how to do it right!

8.4.2 Up and coming location with capital growth potential

Smart investors find promising locations and find good properties within these areas.

Learning how to spot the up and coming area will show you how to really maximise your property investments.

This will be particularly true in investment hotspots, which may return as much as double the average.

See **section 15.6.1** for details on finding the up and coming areas.

8.4.3 Cash positive (or as close to cash positive as possible)

A cash positive investment is one in which annual rental income exceeds the cost of mortgage finance and maintenance costs.

Given that capital growth will be slower – or even stall for a while, even perhaps for the next two to three years - an investment with a strong (and if possible, cash positive), rental return will deliver a substantially better return over the medium term, if not the long-term.

Hence, more and more smart investors are looking for positive cash flow properties.

See section 15.2.2 Appropriate yields for a profitable investment, 15.2.3 Cash flow and time to break-even and section 22.7 for calculating your cash flow and investment returns.

8.4.4 Strong and growing rental demand for that type of property

Lastly, a region and neighbourhood with a strong and growing rental demand will ensure that your property is let with minimum void periods (see section **15.7** on **Avoiding voids**) and section 18 on STEP 1 – Find the right kind of property**.**

8.4.5 Putting it all together

Can you get all three? Yes, but this is much harder than meeting just one criterion.

In all likelihood, you will be faced with a complex mix of these three factors – and your property success will depend on your ability to give appropriate weight to the factors.

How do you do that...?

... by using the spreadsheet software included as part of this book – see **section 22.**

Investor's Tip

Use this software to turn your thoughts and ideas into hard numbers and cash flow forecasts is probably the single most important thing you can do to improve your property investments.

8.5 Learn to go against the grain

Successful property investors also have the confidence to go against the grain.

When the media are banging the drum about booming prices or falling prices, they are using data provided to them from national building societies and other organisations.

Often the data used by the media is three months out of date and gives no sense of the trend.

So, as the media looks backwards, your job is to look forwards.

The opportunity for you, the investor, is that as the media (and nearly everyone else), is looking backwards, you can use these negative price stories to negotiate a better price.

And a better price now means a greater gain in the future.

This is why a negative media creates an opportunity for the investor. Once the average house or flat seller has accepted the media story that house prices are slipping, then they will be willing to consider cheeky offers.

You might be able to offer 10%, 15% or even more, off an already reduced asking price.

However, you must read the stories in your local media to anticipate the mood of your potential sellers.

When everyone is feeling most glum about property is probably the best time to make your cheeky offers.

Remember, of course, that you may face some tough early months with your property on the rental market. So, check that you've got sufficient cash to see out any short-term hiccups.

Again, use the Spreadsheet Software to calculate your potential cash flow requirements. **See** How much money will I need? Cash flow forecasting**, Section** 22.7

8.6 Summary – Buy for the long game

It is easy to forget, in the current market hype (of both boom and bust), that property is a long-term investment strategy.

And the CEBR survey (mentioned in **section 8.1**) is a great reminder that if you are willing to hold a property for, say, 17 years, then you can realistically expect to triple your money.

Anyone playing the short-term, stack 'em high, buy on 100% loans and sell 'em off fast, might want to quit the market pretty quickly...

... which, of course, is a great buying opportunity for those willing to fund their investment properly and hang out for the medium / long-term strategy.

Congratulations! - you've finished section 8. You'll now know:

- How to make £143,000 in 15 years – see section 8.1
- Our assessment for 2006 – see section 8.2
- The essence of good property investment – see section 8.3
- How to buy with conditions – see section 8.4
- How to spot up and coming areas with capital growth potential – see section 8.4.2
- Learn to go against the grain – see section 8.5

9 Spreading Risk to Maximise Returns

The great feature of the Buy To Let Secrets strategy is that it allows for opportunities at all times of the economic and property market cycle.

By looking at the long-term – by which we mean at least ten years – we are able to ride the highs and the lows. In other words, we spread the risk.

Spreading the risk is a technique often used in equity investment. It can also be applied to property.

It's a fact that, in the long-term, an investor in stocks who buys a small amount of equity every month, regardless of the state of the market, tends to do as well, if not better, than someone who tries to buy when the market is under-valued.

How come?

Because for every time that monthly investor buys into a highly valued market, he also gets a bargain when he buys into an under-valued market. The key is to be in for the long haul.

Once you've read and digested this chapter, you will know:

- How to spread the risk with property – see **section 9.1**
- How to cash in when others are jumpy – see **section 9.2**
- How to land a bargain – see section **9.2.2**
- How to buy off-plan in a static market – see **section 9.3**

9.1 How to spread the risk with property

Spreading the risk with property is just the same as with stocks and shares.

If you adopt the Property Secrets strategy of being cash positive AND building in room for an interest rate rise or two, you needn't overly concern yourself if price growth slows or even reverses for a while.

The only property price index that matters is the average one over the life of your investment.

So, if you can stay cash positive with all your property investments when interest rates are at 5% or even 6%, you don't need to worry.

Let's take an example.

Let's say you are an especially conservative, even nervous, investor.

Say, you have £90,000 to invest in property.

Using the gearing techniques we've already talked about, you can either buy, for example, three £100,000 properties by investing £30,000 in each and borrowing £70,000 each time.

Or, you can buy one property a year by investing £30,000 each year for the next three years.

If prices continue to rise each year, you will certainly not do as well as if you had bought three properties in one go. But you obviously won't lose money either.

And if you experience, for example, 15% growth in the first year, you don't need to worry about, for example, a 5% dip in prices the next year.

Plus, in the year when prices fall, you are buying a property for a reduced price.

The success of this technique, naturally, presupposes that the long-term trend in property prices is up. And about that, we have no doubts whatsoever.

9.2 How to cash in when others are getting jumpy

The great feature of property investment is that no matter what the mood or the actual state of the market, there is always an opportunity for the smart investor to make a wise buy.

Times when the market has the jitters are no exception to this.

In 2006 we predict stasis with modest rises in some UK areas – such as London and the South East. Rents will be strong.

But there is still plenty of time to use the formidable power of the doom-mongers – the headline writers who predict a crash in prices every few weeks or so.

They've gone quiet for a while, but they'll probably be back!

9.2.1 The effect of bad news

The immediate result of the interest rate rises to the peak of 4.75% in 2005 (gradual upwards movements) was to create negative SENTIMENT – and this is always a great time to buy.

In other words, investors experience a mild panic that this particular rate rise, or piece of bad news, will lead to a big drop in prices and they are more prone to accept your cheeky offer.

When this drop fails to result, their panic subsides and prices continue to rise once again. Your window of opportunity is the short period between sentiment reaching its nadir and the point at which it starts to recover.

Remember though, what property owners are fearful of is not a slow-down or even a slight fall in prices. They have been fed on the drip, drip headline message of an almighty "CRASH"!

That's what scares them.

9.2.2 How to land a bargain - One

The louder the clamour about a crash, the more fearful sellers will be. After all, this may be their last chance to sell with maximum profits locked-in before the market implodes.

So, this is the time to go back to the properties you viewed last month, or even longer ago, and put in a revised - i.e. reduced - offer.

Offer the seller a quick sale (or at least a quick exchange), and you might well be able to agree a great price.

This is particularly true if you are looking at a refurbishment property or even a major renovation project.

You may also find that some smaller (i.e. less well-funded developers), building 20 or fewer units will be attracted by the idea of securing an early sale.

Bear in mind, though, that you need to act fast to secure a bargain in this way.

Once the scare of a crash has started to die down again (because it hasn't happened), your window of opportunity will start to close.

Property Secrets' view is that the window of opportunity is around three weeks.

So, whenever negative press headlines appear or there is a new piece of research published claiming that a big correction in property prices is on the cards, then is the time to act.

The last two years have been full of such stories, though few property commentators would admit to it now.

But it is inevitable that bad news will be back time and time again. Plus, of course, if interest rates do rise again, this will also cause negative sentiment and is therefore an excellent time to act.

9.2.3 How to land a bargain – Two

Price surveys always talk about the 'average'. In reality, there is no such thing as an average property,

In a stalled or static market you must become more choosy than ever; you need to become like a stock picker and hunt out bargains.

And, if you find the right property in the right location for the right price, you will still make money long-term.

And it is in this phase – the stalled or slightly falling prices market - that sellers will be most fearful of a crash and therefore, perhaps, most willing to talk about a lowering of price. This is where we are today.

Long- term investment is the name of the game. So long as you don't overpay in any given market climate, you will succeed long-term.

Remember – the average rate of annual price increase of your property portfolio – whether it's one buy to let property, or 200 – only needs to be AN AVERAGE of 7% for you to double your money every ten years.

That's the magic of compounding; where property price rises are calculated by adding the previous year's percentage growth to the principle sum.

Albert Einstein is credited with discovering the Rule of 72 which makes calculating the effect of compounding easy.

If you divide 72 by the percentage rate at which your investment is growing you get the number of years it will take to double in value.

So 72 divided by 7 is 10.3 years. Which means an annual price rise average of 7% will double property prices in 10 years.

9.3 Buying off-plan in a static market

Buying off-plan means literally buying a property before it is built - from the plans. From this one factor, many advantages flow.

The advantages of buying off-plan are broadly these:

- As you are exchanging contracts early, sometimes before work has even started, the developer is happy to offer a significant discount of anything from 5% to 20%.
- If you are operating as part of a syndicate of investors, the developer is effectively selling his units in bulk, which gives him another reason to offer a discount.
- You are typically paying a 10% deposit on exchange and then nothing until completion. Since this could be one or two years away, you are getting all the advantages of gearing without the monthly repayments.
- Because of this gap between exchange and completion, you're locked into the capital growth over that time, too, at no extra charge!

Contracts are generally assignable, so you can sell the unit on, or before completion, thus avoiding the stamp duty.

It's easy to buy off-plan and achieve great results in a rising market. But what about a static or slow moving market such as we predict in the UK for 2006?

Even with a slowing market new-build houses bought early in a development tend to rise faster than the national average.

And the second phase will almost certainly be priced higher than the first stage, so it pays to be in early.

If you are not a bulk buyer it is often easier to negotiate with smaller developers who will need the money more urgently for their cash-flow than the big boys.

There are still a couple of disadvantages, of course.

- The market may stagnate further or fall before you complete.
- If the development is big and all the units complete together, there may be a short-term glut that forces down prices for resale, and perhaps rentals, too.

As the UK market will be slow moving in 2006, it is more important than ever to lock in a real discount.

You should be able to do this as developers are likely to be experiencing slower sales in 2006 and will be more open to offers. But don't buy blind.

Here are some tips:

- Remember you are looking for real discounts. There are plenty of developers who market 'genuine discounts' of 10 or 15%. But ask yourself if they are genuine.
- Check real paid for prices in the area and on the development using the Land Registry. Often marketed discounts of 15% - turn out to be real discounts of 5% - or worse!
- Also be aware that guaranteed rental yields can be manipulated too. Yields of 7% guaranteed for two years sound good - but are they realistic? And what happens after two years? It pays to check real yields with agents in the area. Often a 7% guaranteed rental guarantee can be better traded off as a real discount on purchase price.
- Look at detailed plans of the site, these are available at the local planning office. The developer will have had to submit details of the scheme showing the position of the properties and the site layout to the council. Go along and ask to see it. If possible get your own copy to take away.
- Visit the site itself. Several times, at different times of the day. And drive around the periphery of the site. What is it next to? If there is open land behind, will it be built on? Check again with the council and ask to see the local area plan which will indicate its future use.
- Finally, really check out the developer offering the deal, there is no substitute for due diligence and research.

There are still deals to be had off-plan in 2006, but this is not the 'flipping' market experienced a couple of years ago.

Congratulations! You've finished chapter 9! You now know ....

- How to spread the risk with property – see **section 9.1**
- How to cash in when others are jumpy – see **section 9.2**
- How to land a bargain – see section **9.2.2**
- How to buy off-plan in a static market – see **section 9.3**

10 Property Market Crash Myths and Market Drivers in 2006

Once you've read and digested this chapter, you will be able to:

- Explode the 'property will crash' myths - see sections 10.1 ,10.2 , 10.3, 10.4 and 10.5
- Understand what makes property markets crash - see section 10.7
- Understand why property values will continue to grow - see section 10.8 and section 10.9
- Understand the link between wage inflation and increasing property prices - see section 10.10
- Understand the positive effect of government action on property prices - see section 10.12
- Appreciate the most effective investor strategy in 2006 - see section 10.13

Few would admit it today, but many property experts predicted a property crash in 2005.

Some doom-mongers – business consultants Capital Economics among them - predicted crashes of between 10% and 30%.

Compared with such predictions, 2005 ended on an upbeat note with Halifax and Nationwide both showing house prices up by 3.9% and 3.3% during the year.

During the year the headlines altered sentiment, but not the underlying fundamentals.

And this created buying opportunities in 2005 that smart investors used to drive down prices.

This year, 2006, will be more boring. There will be a welcome continued stabilisation in the UK market, with some areas of modest growth (the South East and London) and possibly some modest falls (the North).

This 'boring' period is, however, one of excellent opportunity – because the fact that it is not easily recognisable as the bottom of the market means you are at an advantage if you act during this period, while many others hang back, waiting for the crash that will not come.

We dub this period a 'long bottom'.

Even so, it is important to understand the basis of the arguments of the property bears so that you can form your own opinion of what is happening in your local market place.

After all, a property discounted by 25% is not a great buy if its value falls. So, firstly, let's deal with some common myths about the property market that you have probably heard of in various forms, so we can see the false logic.

There are several popular myths used to justify the prediction of a steep property price fall.

10.1 Myth 1 – Property price to income ratio (p/i ratio)

A favourite way (and one that is given a lot of press), of suggesting that property is over-valued (and therefore will fall), is the price to income or salaries ratio.

This ratio compares the price of property to the average income (salary) of house buyers. The Daily Telegraph was one of the first to report this myth at the back end of 2002.

The Daily Mail caught onto the same myth when it published figures supplied by Capital Economics ('economic experts') in July of 2003.

This is a quote from the Daily Mail:

"The house price to income ratio of 5.2 is higher than at any time in the last 50 years. During the previous booms of 1953, 1979 and 1989 we saw a marked correction whenever the ratio rose this high."

"The long-term average is 3.8."

10.1.1 What is wrong with the p/i argument?

Yes, the price to earnings ratio is higher - why? Because interest rates are less than half their long-term average.

I.e. It's not the <u>cost of the property</u> that matters - it is the <u>cost of the mortgage</u> that counts.

Here's an example:

Mortgage costs = purchase price x interest rates

So, £100,000 purchase price x 10% interest = £10,000 mortgage cost per year

Equally,

£200,000 purchase price x 5% interest = £10,000 mortgage cost per year.

Prices have doubled – but mortgage costs remain the same.

As you can see, if interest rates halve - then purchase price can double - and the ratio is unchanged.

Using the same logic, this suggests that if the long-term average of Property Price to Income were 3.8 – then a halving of interest rates would allow this ratio to double – to 7.6.

Given that as the ratio currently sits at 5.2 – you can see that there really isn't a problem.

The logic of this argument, (if its proponents were willing to follow it through) would also suggest that property could rise a further 50% which, we think, only goes to show what a bad argument it was in the first place!

10.1.2 Think affordability instead

That's why economists talk about 'affordability' - this is just another way of saying 'the cost of a property is NOT the price of the property - but the cost of paying the monthly mortgage costs'.

Also, you can add into this, the view that the more disposable income I have, the larger a mortgage I can afford.

Hence, the focus becomes 'increases in disposable income', rather than just income.

However, it is very hard to measure 'disposable income' as it will vary according to personal circumstances.

For instance, two people on a £50,000 per year salary would have hugely different disposable incomes if one person also had two children in public school.

OK, so what has happened to affordability in the past few years?

Well, in 2003 the Chancellor's rise in National Insurance contributions took an estimated 2.5% out of disposable income across the country.

That is estimated to have taken 2.5% off the rise in property values in 2003.

Apart from that, wages continue to grow – at around the 3% per annum mark, and as manufactured goods become cheaper, there are few signs of additional pressure on disposable income.

The gentle tightening of interest rates in 2005 that took the heat out of the market was exactly what was needed.

Investor's Tip

One of the interesting things to come out of 2003 and 2004 is that the first-time buyer stopped buying in the South of England. At the end of 2005 they are being tempted back into the market.

Why?

Often not because they can't afford the mortgage payments (or else how could they be tempted back), but because they are worried about the potential fall in property prices! I.e. **Sentiment!**

Smart investors in 2005 will have used this negative sentiment to pick up bargains and then let them back to those who fear a fall in prices.

10.2 Myth 2 – Price to Earnings Ratio (p/e ratios)

The second argument that is used to justify property's imminent demise is the Price to Earnings (or p/e ratio) argument.

Note: this ratio uses the earnings of the property (i.e. rent), rather than the income (see section 10.1), of the person who funds the property (or pays the mortgage).

This was the key argument put forward by The Economist in the summer of 2003 to justify an expected property price fall of 25% in the UK (over 4 years), in which they applied a p/e (price to earnings) ratio to property.

We believe this is wrong-headed - but it again creates buying opportunities for the property investor, especially if vendors take the dramatic advice of The Economist to sell their homes and rent instead!

p/e (Price to Earnings) ratio
p/e ratio: by dividing the price of a stock by its earnings, you get the p/e ratio. Slow growth stocks typically have a p/e ratio of about 10. Faster growing stocks (that expect future earnings to increase) have higher p/e ratios. During the dotcom boom, some telecom and technology stocks had p/e ratios in the order of 100, and many had a ratio of above 50. With hindsight, we were all a bit stupid to think this was sustainable. British Telecom's p/e ratio is currently around 10.

The p/e ratio is normally used to value stocks. And if, despite the exuberance of the technology boom, we'd reviewed our stocks according to the long-term sustainable p/e ratio back in 2001, we'd have sold everything and made a fortune!

So, having failed to predict the stock market collapse at that time, The Economist seems overly keen to avoid the same mistakes with property. Wrongly, we believe.

Here's what The Economist said in 2003:

"The p/e ratio. The price of any asset should reflect its future income stream. Just as the price of a share should equal the discounted present value of future dividends or profits, so the price of a house should reflect the future benefits of ownership - either the rental income earned by a landlord or the implicit rent saved by an owner-occupier."

"During the dotcom bubble, investors behaved as if profits no longer mattered. Likewise, people today are ignoring the link between house prices and rents."

"The p/e ratio helps to expose the fallacy that house prices are rising because of growing populations and fixed supply, because these factors should affect the rental as well as the owner-occupier markets."

"The fact that prices are rising much faster than rents suggests that homes are being bought in the expectation of capital appreciation rather than underlying fundamentals. That is the definition of a bubble."

10.2.1 What's wrong with the p/e argument?

With property, the relationship between a property's earnings (rent), and price (capital value), directly affect each other.

This is not the case with stocks and shares. If the value of property falls, more people will rent (due to fears of buying a falling asset or sentiment), and so with a sudden increase in demand for rental property then the cost of renting will jump upwards.

With stocks and shares, a fall in a company's earnings is nearly always followed by a fall in the price of its shares.

This is a crucial point and will affect how you invest in property – so let us explain in a little more detail:

10.2.2 The direct relationship between a property's value and its ability to attract rent

If more people choose to buy first-time properties than to rent, then rental demand will be weak in this sector and so rents will grow more slowly than house prices.

On the other hand, if house prices rise in the first-time buyers' market, then the demand will shift to renting.

You see, everyone has to live somewhere – it isn't an option. What is an option is whether to buy or whether to rent.

So, at any time, there will be increased pressure on either rents or on property prices.

For example, in the first-time buyer market in 2003, the first-time buyer held off buying and carried on renting; thereby increasing rental demand and leading to forecasts of increased rental income.

Hence, the use of the p/e ratio as applied to property does not 'expose the fallacy that house prices are rising because of growing populations and fixed supply'.

In fact, every time there is strong capital appreciation in house prices, rents will rise more slowly.

Likewise, in a period of slow capital appreciation rents will rise faster.

So, The Economist's analysis does not disprove the argument that says that capital values are justified on the basis of fixed supply and rising demand. **It simply demonstrates that rents are currently still fairly low and therefore are set to rise**.

The circumstances that cause a property crash (and not just a slower capital growth with faster rental increases) are different. See section **10.7.2** for an explanation.

10.2.3 An alternative conclusion - rents to rise 25%?

Let's say that you agreed with the logic of The Economist's argument, that capital values are 25% above the long-term rental income.

In this case, you might just as easily conclude that rents will have to rise by 25% (rather than capital values needing to fall). This change in rental values would bring back the balance to the p/e ratio.

In a scenario of slowly increasing capital values (which we are now entering) this is a much more likely indication of the future direction of the property market.

Investor's Tip

You can now see the key shift in the smart investor's property strategy for 2006.

Instead of looking for quick capital gain in the UK, the smart investor is now looking for a rapid increase in rents – coupled with longer-term capital gains.

We believed this was the best investment strategy for 2005 and it still is for 2006.

If you want more rapid capital gain you need to invest in the emerging economies, where many smart investors are now looking.

However, just because the Price to Income (p/i ratio) and Price to Earnings (p/e ratio) are falsely applied to property, doesn't mean there is no risk of a crash. We'll deal with what makes a property market crash and why we don't believe that a crash will occur below – see **What makes a property market crash, Section 10.7**

First, though, some more myths...

10.3 Myth 3 – First-time buyers are disappearing

This is a favourite of doom mongers. They talk about the first-time buyer having 'disappeared' from the market.

What they actually mean is that fewer first-time buyers are active in the market and more are sitting on the sidelines, renting, waiting their turn.

So why is that?

There are two reasons:

This group of property buyers seems to be THE most sensitive group to property market sentiment.

1. If a newspaper publishes a report about increased interest rates, then this group will flee the market.

   Likewise, as soon as a sense of calm returns to the market, then this group seems to charge back in trying to get a foot on the property ladder before they ‘miss out'.

2. It takes time for this group (usually younger buyers) to come to terms with where they can live and what they can afford.

   You hear that first-timers 'can't afford property', but in fact, what is really being said is that they can't afford property in the location in which they wish to buy.

10.4 Myth 4 – Disappearing jobs

Some people worry that jobs going overseas mean house prices will fall.

The worry is understandable. Essentially, if the local economy is creating more jobs, then there will be more demand for housing and people will have bigger salaries to pay for them.

Hence, property price growth.

So, when you read in the local paper that jobs are being lost to China or outsourced to India, it is a cause for concern, yes?

Well, on a local level, maybe, but on a national level it is good news.

Why? There are two key benefits to the outsourcing of jobs; and these are:

Services will become cheaper (just as happened to manufactured goods) and, therefore, global inflation will be squashed. And low global inflation means low interest rates, and low interest rates means higher property prices or at least a stable market.

When the 'low value' jobs are outsourced (most people agree that telephone answering is pretty low value) it leaves and also creates higher value jobs near the customer. These higher salaried jobs will create demand for higher priced property.

So, if a new software project is written in India, it will mean that the project needs to employ more (highly paid) systems integration people here in the UK.

And if these new 'high paid' jobs are created in the local market, then the local property market will benefit.

10.5 Myth 5 – What goes up must come down

What applies to the myth about property price to income ratio, also applies to the view that just because something rises in value it must, therefore, at some time, come down.

It might sound like homely wisdom. But anyone who stops to think for a minute will realise it's utter tosh!

Of course, any investment product will have highs and then corrections; but the trend, the average relative to time, is what matters.

There is absolutely no reason why property prices will inevitably fall in real value over the long-term or even the medium term.

So long as affluence increases (the economy grows), and the number of jobs in the economy increases, demand will continue and demand will drive prices.

The key is not the cost of an item, including property, but whether it is affordable.

Of course, if supply should meet, or even overtake demand, there will be a price correction.

But that cannot happen in the UK for many years. Why not? Have a look at **section 10.10, The demand for housing – long-term**, which is what Property Secrets has been saying all along!

10.6 'So what' for the investor?

So, what's the 'so what' element of these myths to the property investor?

It's actually very simple. If you want to be a smart investor you have got to read between the lines – and that usually means reading between the headlines.

If there is a commonly held view of the market and you can see that it's a myth then you will gain a huge advantage by using it to steer your investment decisions.

With the first-time buyers myth, for example, it's important to recognise that this group swings wildly in favour of property and then swings wildly out of favour - sometimes in the space of just a couple of months.

Hence, dismiss scare stories of 'the disappearing first-time buyer' and recognise that they are just sitting in the wings biding their time until they come back into the market.

And early signs that the first-time buyer is on the way back are a good indication that demand for property will be strong and that prices will follow too.

Equally, recognise the outsourcing of low skilled jobs from an area can have advantages to that area and NOT be a negative.

With the 'what goes up must come down' myth, if you recognise this argument for what it is (misguided), you are in a far better position to see signs of when the market is really due for a correction. And a correction spells opportunity.

10.7 What makes a property market crash

We're now going to demonstrate why property markets crash and why there was no such crash in 2005, and why there won't be one in 2006 either.

10.7.1 Unemployment or falling employment

OK, so what happened in 1989 / 90 / 91 when house prices really did crash?

If you ask the Council of Mortgage Lenders (CML), they will tell you that the key **reason people defaulted on their mortgages was because they lost their jobs** (not because property was over-valued or even because interest rates went sky high).

That is why the CML has been pushing the concept of income insurance for a mortgage ever since.

Losing your job is the number one reason for a forced property sale. And a large number of forced property sales can create a loss of confidence and negative momentum. This is called a tipping point – see **section 10.7.2**.

So, if the level of UK unemployment suddenly races up (from the current level of around 5% to over 10% as in 1990), then we grant that The Economist's scenario of falling house prices will come true.

However, there is no evidence of a big jump in unemployment. In addition, for those in employment, average annual earnings growth is steady at 2.9% (mid 2003) to 3.2% (mid 2004) and 2.8% (mid-2005), and even the UK manufacturing sector is beginning to sound positive, with manufacturing output up 0.4% at the end of 2005.

Overall, the economy grew 0.4% in the third quarter of 2005.

In fact, increasingly, investors are beginning to pay more attention to the total number of people employed – because the number of people in employment continues to grow in the UK – even if the rate of unemployment remains static. See **section 10.11.2**.

10.7.2 Tipping point – why and when emotional markets crash

Let's face facts, property crashes do occur, and the wise investor will keep an eye on this possibility.

However, the way a property crash occurs is often different from other markets. It is not a linear process based on rational behaviour; rather, we believe that the property market is an emotional market.

In an emotional market, property owners will hang on to their property in all but the direst of circumstances. And if people refuse to sell, then prices can't fall.

So, a property market will not crash until there are large numbers of people no longer able to afford their properties (i.e. can't pay the mortgage) and have no real prospect of being able to do so (i.e. lost their job and have little likelihood of finding a new one).

And, if large numbers of home owners are forced to sell, then other home owners – who might previously have hung on in hope of a recovery, will give up sooner and so the process snowballs into a crash.

The point at which large numbers of home owners give up on their properties and sell with negative equity, is called the tipping point.

It is also the point at which prices will drop almost overnight. Think of a seesaw. No matter the weight on either side of the seesaw, it will not tip until the lighter side becomes slightly heavier than the other side.

Investor's Tip

Are we going to reach a tipping point in 2006 or 2007?

Well, ask yourself, will two million jobs be lost and interest rates double in the next two years?

It will take shocks of this size to push the market over – not just the economic arguments of a few journalists.

Currently, there is no evidence to suggest that this will happen.

OK, so now you understand the circumstances in which a property market can crash, let's have a look at the many and various reasons why the property market will remain resilient and strong in 2006, and therefore a great place to invest.

10.8 Supply - why property values will grow

One of the key drivers of property price increases in the last few years has been the acute shortage of property.

This shortage is most clearly shown by the quantity of unsold properties as this represents the available stock of property at any given time.

As you can see from the graph below, average stock per surveyor/estate agent has fallen from a high of 140 properties in 1996 to around 60 at the end of 2002.

Since the beginning of 2003, stocks have risen slightly, as price growth slowed from the heights of 25% average annual growth to around 10% average annual growth. This reflects an up tick in property stocks to around 76.

Evidence to date suggests that the number of new instructions has also slowed; hence, experts believe the level of unsold stocks will remain static.

At the end of 2005, RICS announced that the stalemate between buyers and sellers has started to crumble.

The stock of unsold property has risen by 29% from a year ago, but fallen back slightly in recent months.

So sellers were moving to accept lower offers in 2005.

But overall, lack of stock is an important factor in believing that property prices will continue to move upwards long term, albeit at a much more modest rate.

10.9 Demand - why property values will grow

There are a number of factors affecting the demand side of the property equation.

10.10 The demand for housing – long-term

Longer term, there is very strong evidence that the UK housing market faces a property supply that is simply overwhelmed by demand.

Or, in plain speak – there is, and will continue to be, a shortage of homes.

Not just a slight shortage, but a truly massive one!

And that means property prices will continue to rise. There might be adjustments, sideways movements and even slight falls from time to time. But the trend of prices will be upwards.

10.10.1 The Barker Report

The Kate Barker review, commissioned by the government to look into the state of UK housing, is probably the most significant piece of evidence in recent times to influence anyone involved in property investment.

Here are some key quotes from the Barker Report that show why property prices will continue their upward trend.

"Achieving a more flexible housing market is a considerable challenge which will take time and requires determination to engage in ongoing reforms. It is not going to happen overnight."

"Real increase in UK property values was 2.4 per cent per annum over the last 30 years (increased to 2.7 per cent over the past 20 years)."

(That means that house prices have risen faster than inflation by 2.4 per cent for 30 years and compares to an EU average of 1.1 per cent, 0.0 per cent in Germany and 0.8 per cent in France.)

"Supply of new property accounts for only 1 per cent of total housing stock."

"In order to deliver a UK trend in real house prices of 1.8 per cent, an additional 70,000 houses need to be built in England each year."

"A 0.0% trend in house prices is undesirable as it would curtail house building and therefore exacerbate the lack of supply." (Therefore the government has a vested interest and will work to ensure that you profit from your property investments).

"...An additional 145,000 homes per annum would be required in the UK to lower real house price inflation to the European average of 1.1% and that an additional 240,000 houses would be needed in the UK to lower real house price inflation to zero.."

In 2001, around 175,000 houses were built in the whole of the UK.

"Social housing needs £1.2 and £1.6 billion per annum to meet additional housing needs. Currently 21,000 homes for social housing are built per year."

Currently, an extra 17,000 homes per year are needed, but an additional 9,000 properties are required to clear the backlog of demand.

So, what does this all mean to the investor?

As we said above, the UK is suffering from a severe shortage of property and this is causing prices to increase.

Addressing this imbalance will take many years, and so you, the UK property investor, can be secure in the knowledge that market fundamentals are underpinning your investment.

10.11Link between wage inflation and house price inflation

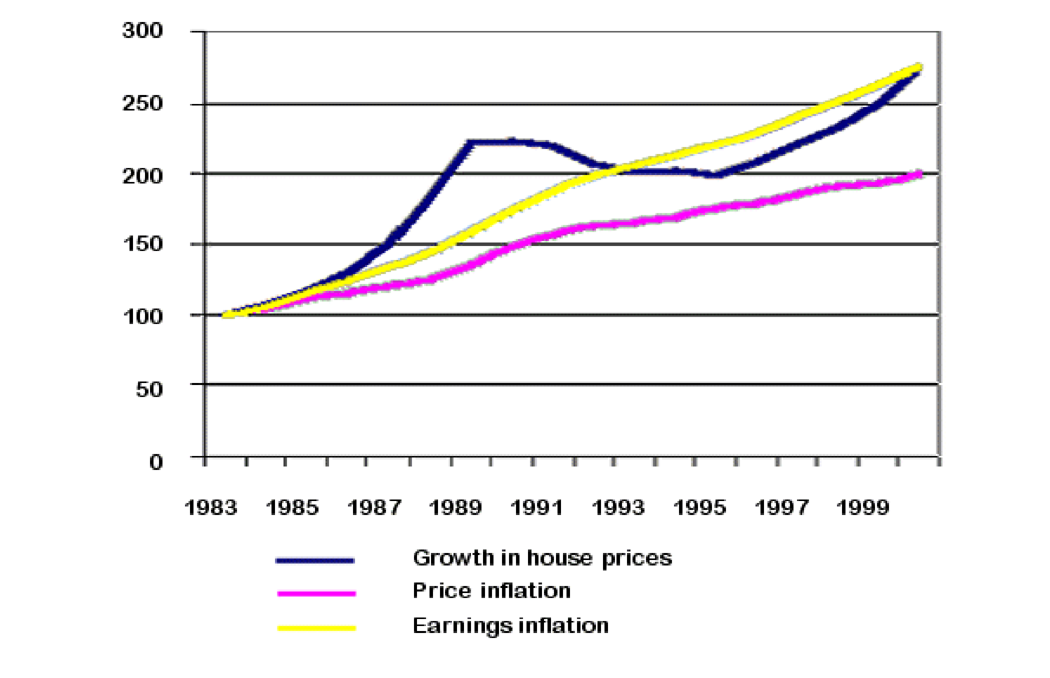
The **long-term growth in house prices is closely linked to wage inflation**. As any pensioner will tell you, wage inflation continuously outstrips the inflation index. See the graph below.

If the economic rules stay roughly the same (and there is no reason to assume they won't) then house prices will continue to beat inflation (in the long run), because wages will continue to beat inflation.

Once you add the effects of gearing - see **section 14.2.1** - your investment has the potential to deliver good to excellent returns.

In fact, there are a number of good reasons to assume that house prices might actually beat their long-term average growth of between 4% and 6% (source Nationwide Building Society).

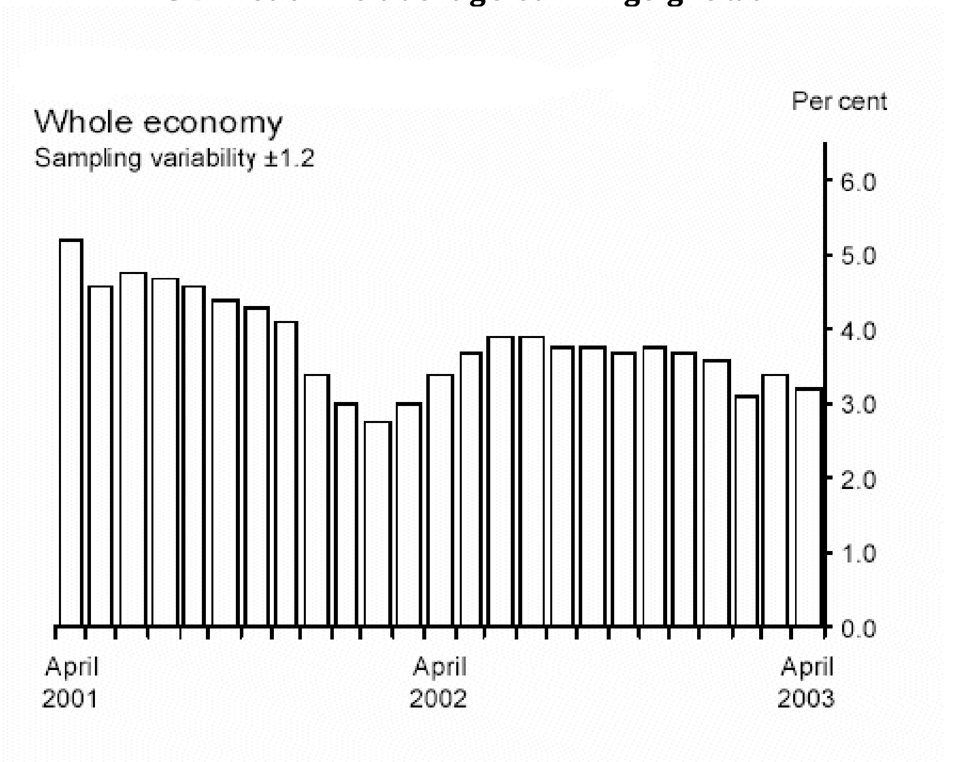
House Price Inflation is linked to Wage Inflation



So, if wage inflation is strong – expect property prices to move upwards as well.

The good news is that, as the graph below shows, UK earnings growth remains strong and is expected to remain at or around the 3% per annum growth level, thereby underpinning house price inflation.

GB Headline average earnings growth



10.11.1 Why the UK needs more houses

If the UK needs more houses, and builders fail to keep up with demand, then prices will almost certainly rise.

Here are the key reasons why the UK needs more property:

More people choosing to live alone or in smaller units due to an increase in divorce, an ageing population and so on. This is reckoned to have created demand for an additional 1,500,000 houses between 1991 and 2001 alone.

The **increasing pressure on land in desirable locations** - typically close to global economy cities - such as London, Edinburgh – and increasingly national / regional capitals too, such as Cardiff, Manchester, Newcastle and so forth.

The **desire of people to live in peaceful and secure regions** with stable economies - as other western countries, the UK is sought after by populations less fortunate from all around the world.

Increased migration to the UK, and London and South East in particular (UK population rose from 55 to 58 million between 1980 and 2000). This is increasingly driven by shortages in the NHS and teaching professions, which are bringing white-collar workers to the UK from overseas.

Note: The UK population is forecast to grow by 12% between 1991 and 2021, so these trends will continue and, therefore, so will the increased demand for property.

Key tip

Long-term capital growth of your rental properties will deliver greater investment gains than just the rental income. See **section 15.3** for an explanation on why this is so.

10.11.2 Increase in employment

It's the increase in employment – not unemployment figures – that matters!

UK unemployment is static at around 5%.

However, job creation is continuing to grow.

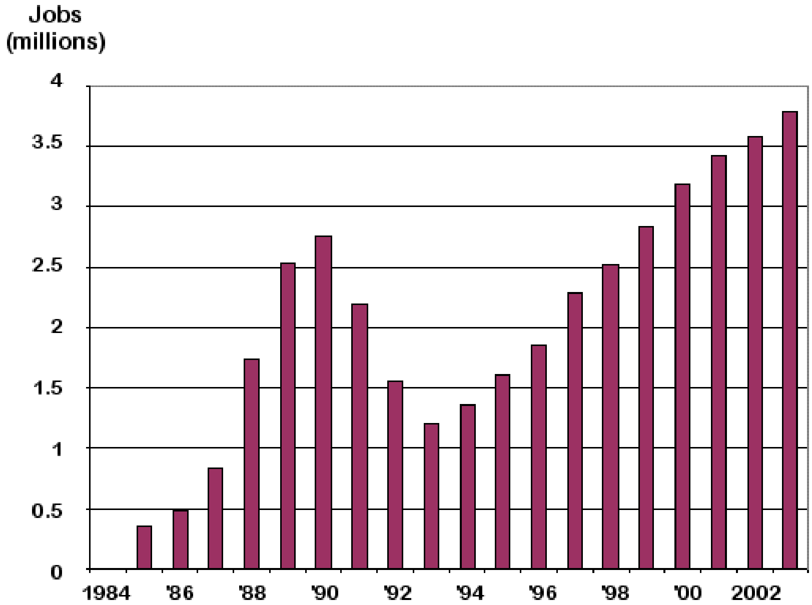
How come? Well, two factors really:

More female workers are entering the economy.

The UK population is growing.

Both of these factors will have a knock on and upward effect on the housing market.

Jobs created in the UK since 1984



Source: Property Secrets, www.statistics.gov.uk

10.12 Government action will continue to boost the property market in 2006

A major influence on the property market in 2006, as it has been in 2005 and 2004, will be the UK government.

Whether by design or by default, most of the Government's action will have a positive influence on property prices.

The key Government actions taken and predicted in 2004, 2005 and 2006 are explored on the Property Secrets members-only website. Find more information at **www.propertysecrets.net/article/1149.html**.

10.12.1 Land development tax consultation

At the end of 2005, Chancellor Gordon Brown unveiled plans to consult on the introduction of a planning gain supplement, a tax on the capital gains from the development of land.

This controversial tax plan has troubled the property industry for some time. Such a tax was first mooted just after World War II – and has been proposed four times since.

The announcement will allay industry fears that the Chancellor would impose the tax without consultation.

And the consultation means the tax, of 20% paid on the rising value of land due to the granting of planning permission, is unlikely to be introduced for several years (if at all – as industry lobbyists fight hard against it, claiming it will over-burden developers and stifle regeneration).

So, with some fears allayed for now, developers can carry on business as normal for several years, without devising ways of increasing prices to buyers to claw back tax losses on their land banks.

10.12.2 Guaranteed rents from HA and local councils

Housing Associations (HA) working in tandem with local Government, have been offering inducements to landlords to expand their stock of property.

Many areas of London and the South East are suffering a shortage of key workers and one route by which councils are addressing this shortage is to offer reduced cost housing through Housing Associations.

For the landlord, these new schemes often come with attractive rent guarantees and a guarantee that the property will be returned in good condition.

The definition of what good condition means is a moot point, but in general if the local Housing Association has a reputation for being efficiently run, then these schemes are attractive.

The schemes will also have the knock-on effect of supporting the value of these types of property and we expect more landlords to go shopping for suitable properties that can be leased back to the local council.

10.12.3 Forced rent

Forced rents allow local councils to 'force rent' property, renovate them, and then house DSS recipients or people in need.

The landlord is assured that the property will be rented at a fair price and returned in reasonable condition.

However, the biggest impact is for the landlord who has bought up northern terraced properties in a boarded up street.

If local councils are successful at bringing these properties back into use, it breathes life into the whole street with a substantial knock-on effect on local property values.

10.12.4 Houses of Multiple Occupation (HMO)

The government's new Houses of Multiple Occupation (HMO) legislation aims at standardising the rules of management of HMO across England.

The Scottish and Welsh parliaments have the right to pass their own legislation.

Largely, the English and Welsh legislation (which will follow) is aimed at removing the cowboy landlords who put tenants at risk without creating a huge additional burden on existing landlords.

An HMO is defined in the normal way – such as a house of student rooms with a shared kitchen and bathroom.

Hence, a landlord with a two-bedroom apartment let to two professional workers is very unlikely to find that they need to comply with HMO legislation.

We say very unlikely because in certain cases a local council can elect to widen the definition of HMO to include other categories of rented accommodation.

The intention is that the council should only do so when there are clear signs of a problem with that type of accommodation. Hence, the reason why it is very unlikely that a professional two-bed property would be affected.

Nevertheless, you would be wise to sound out your local council's opinions – by contacting the Housing Department – before you invest in an area.

The investment effect of this will be to remove a number of rental properties from the market and therefore reduce supply.

We expect this legislation to push rents up for HMO property.

10.12.5 Home Information packs 2007

We'll hear more about 'Home Information' packs, as the Government gears up to pass the legislation to make the information packs law by June, 2007.

A Home Information pack will include a pre-sale survey and any other comments relevant to the condition of the property. This will be paid for by the vendor and it will be law to prepare such a pack prior to marketing the property with a view to selling it.

The general view is that these packs will reduce the number of properties on the market, as they will remove the speculative sellers who will be reluctant to pay up front for a survey.

As a result, (see **section 10.8**) reduced supply almost certainly means that prices will be pushed upwards.

10.12.6 Euro: 2006/2007?

Will Sterling be swapped for the Euro in 2006 or 2007? It is extremely unlikely but, again, our conclusion is that such a move (i.e. reduction in interest rates to the Euroland level), would keep property prices moving ahead strongly.

10.12.7 Millennium Schemes and New Deal strategies

A number of the Millennium Communities and New Deal Communities (NDC) will continue to receive increased Government funding.

Regeneration activity across the country is currently very high and the smart investor will be looking to put his or her money behind the best of these schemes.

As always it is often wise to wait until the building starts work before committing to your investment.

10.13 Summary and investor strategy for 2006

- Predictions of a property market crash in 2005 were based on false logic. Instead the market cooled and the fundamentals are in place for stabilisation and some growth, albeit at a slower pace.
- So use static property market conditions and wavering sentiment to drive down prices and buy at discounted prices.
- Capital growth will be moderate in most areas in 2006, but rental growth will be stronger. Therefore, look for properties that have strong rental potential as well as good long-term capital growth prospects.
- Growth in employment in services and the public sector services (hospitals, for instance) will remain strong and continue to generate huge demand for rental property.
- Look for locations where jobs are being created by businesses (often service industries) with a strong future in the current economic climate. These areas, such as East London, given a boost by the Olympics 2012 announcement in 2005, will be the hot spots of 2006.
- Look at locations in key New Deal Communities (NDCs) (see **section 10.12.7**) and Millennium Community funding areas. In addition, you should consider the effect of government action on your investment – eg: the Olympics 2012 in East London. In nearly all cases, we forecast that this will have a positive affect.
- With UK property stable in 2006, investors might consider looking to Europe for higher returns.

Congratulations - you've finished section 10! You'll now know how to:

- Explode the property will crash myths - see sections 10.1 ,10.2 , 10.3, 10.4 and 10.5
- Understand what makes property markets crash - see section 10.7
- Understand why property values will continue to grow - see section 10.8 and section 10.9
- Understand the link between wage inflation and increasing property prices - see section 10.10
- Understand the positive effect of government action on property prices - see section 10.12
- Appreciate the most effective investor strategy in 2006 - see section 10.13

11 FORECAST AND REGIONAL VIEW FOR 2006

Once you've read and digested this chapter, you will be able to:

- See which industries are creating rental demand- see **section 11.1**
- See which regions are creating jobs - see **section 11.2**
- See that city living is an opportunity – see **section 11.3**
- See that London is tipped for 2006 – see **section 11.4.2**
- Understand regeneration and hotspots – see **section 11.5**
- Understand the rental prospects for 2006- see **section 11.7**

OK, so now you can see the close link between jobs / employment / earnings growth, and both increases in rental demand and increases in capital value of property.

The question for you and me, as investors, is where will the jobs growth and earnings growth come from in 2006?

First let's take a look at some of the macro factors happening in the economy.

11.1 Earnings growth by industry type

Not all industries or employment sectors are equal. Spotting the relative effect of local industry on your chosen property investment location will have a significant effect on your investment returns.

Sector	Average annual earnings growth	Percentage change on year
Manufacturing	4.0 per cent	+0.4 per cent
Service industry	4.1 per cent	0 per cent
Public sector	4.0 per cent	+0.1 per cent

*Source: Labour market, November 2005, **www.statistics.gov.uk***

Despite the increases in manufacturing wages, the main growth area, in terms of numbers of jobs, are in services and the public sector.

11.2 Where are all the jobs?

If you want to identify an area that is about to boom, then what better way than to look at employment growth?

The creation of new job vacancies, infrastructure spending and growing employment levels, all combine to create upward pressure on property prices.

Often, though, the simplest of the three to measure, and the sign that the other two are also present, is growth in employment levels.

11.2.1 Where is employment growth the strongest?

In Buy to Let Secrets 2004, we identified Wales, Northern Ireland, Scotland, the North West and Yorkshire and the Humber as the areas with the strongest jobs growth.

How have things changed, and where therefore can we expect the strongest property price growth as the knock-on effect of jobs growth?

Region	% Change in number of people employed
North East	1.2
North West	-0.3
Yorks & The Humber	1.1
East Mids	0.2
W Mids	0.8
East	-0.7
London	-0.3
South East	-0.1
South West	-0.5
Wales	-0.2
Scotland	0.9
UK	0.1

(Labour Force Survey, April 2005, period covered winter 2004/5)

Rates of growth have clearly slowed, but we can see that the North East is still experiencing the fastest rate of employment growth, followed by Yorks & The Humber.

These areas are worth examining as property investment possibilities for 2006 and beyond.

But, remember, at a micro level you need to examine why jobs are being created and why there are more people in work. Is the reason a sustainable one, or merely temporary? Also, what kind of jobs are they?

Looking at these local factors will help you tailor your investment to the demand of the market.

11.2.2 What kind of jobs

Probably most significant is the kind of jobs that are being created.

Industries or types of services that are expanding will create pockets of affluence within any region. And it is in these places we can identify micro economic growth and increased demand for housing.

The trend identified in Buy to Let Secrets 2004, of a switch from heavy industry, production and manufacturing to a service-based economy is a long-term one, and one that is taking place in all advanced economies.

Areas that were once concentrations of heavy industry and have been blighted by the closure of that industry can present areas for bargains for property investors.

Once investment money, either from private sources, or from the Government or EU, starts to revive the area, property prices can take off again with a vengeance.

For example, many parts of Wales, where many heavy industries were once located (coal mining for one), have been transformed by the introduction of hi-tech manufacturing and motor manufacturing.

Areas in which the local economy is based on manufacturing are areas that will need to transform themselves in the future.

The smart investor will pick those areas best equipped to do this and those areas most likely to attract the capital to make it happen.

11.2.3 The growth of the public sector

As we've seen above, one legacy of current government policy will be the creation of a vast number of new jobs in public services.

Whatever you may think about this, the spending power of this sector is highly significant for you, the buy to let investor.

Not only are there more people in public service, but they are also much better paid than they were.

The latest figures available show that public sector jobs have increased by 13.2%, between June 1998 and June 2005, compared to a total employment rise of 7.2%.

In the year to June 2005, 95,000 new jobs were created. And 113,000 new jobs were created the year before that.

New employment in health and social work accounted for the biggest rise with an increase of 300,000 between 1998 and 2005. Education is second with 224,000 jobs.

This means more nurses, teachers and ancillary staff in both sectors.

There are more people in these sectors than before and they have more spending power.

While continued growth in public service jobs is unlikely; these numbers, once established, tend to be long-term – to be blunt, it's much harder to sack people in public service than in the private sector.

Properties aimed at these groups – generally low-middle to middle income groups and mainly around big conurbations, are likely to see sound increases in price growth as they respond to demand.

11.3 City centre living 2006 and beyond

City centre living has gone from dearth to glut over the past couple of years.

But have developers been over-ambitious with their schemes – or are city centres an opportunity for investors in 2006?

From 1995 to 2005, more than 16,000 city centre apartments were built in Manchester, Liverpool, Leeds, Newcastle and Sheffield. Another 36,000 are expected to be built between now and 2015.

We believe city centres offer investors some great opportunities. For two reasons: the high number of units newly onto the market, and stasis in 2006 mean there should be discounts.

The rest is down to demographics!

For example, the population of Manchester's city centre will double in ten years, in Leeds it will have grown by 122%.

It is also estimated that £3bn of mainly private money will be invested in purely residential developments in cities in the North of England over the next 10 years, a report from estate agent Knight Frank reveals.

The key to this kind of information is to ask the question: why is this money being invested?

The answer, inevitably, is due to demand.

Knight Frank predicts nothing less than an explosion in demand for city centre living, as these areas are transformed from centres with virtually zero facilities after dark, to vibrant communities offering schools, shops and a sense of community.

By the mid 1990s, less than 1% of the population of Leeds, Liverpool, Manchester and Sheffield lived in city centres - a total of less than 20,000 people.

The biggest city centre population during this period was in Manchester, which had a population of more than 6,000; Liverpool had the smallest population, with fewer than 2,500 people.

Ten years later, the population of the same five cities has increased by almost 140% to 47,000. This trend is likely to continue.

Big population rises are also predicted for Liverpool, Newcastle and Sheffield, as more people head back to city centres to live.

11.3.1 City centre transformations

A highly significant factor in the Knight Frank report is its prediction that the character of city centre dwelling will change.

In years to come, growth will be driven not so much by young professionals moving into the city centres, but more so by retirees and families. The report's authors believe the UK's demographics make this inevitable.

There are now some 16m people in the UK aged between 20 and 30, and only about 12m people of 60 years or more. By 2025 that profile will be turned on its head - there will be some 14.5m 20 to 30-somethings and a total of 17.5m retirees.

The report predicts that both groups will be drawn back into city centres as facilities there are increasingly developed.

Where are the city centre opportunities?

Knight Frank mainly focuses on the five main Northern cities of Leeds, Manchester, Newcastle, Sheffield and Liverpool, but it also identifies other smaller conurbations that will follow the same trend during the next decade, including Barnsley, Wakefield, Hull, Bolton, Doncaster and Lancaster.

The report also includes a survey of people who currently live in the city centres and reveals that most are there because it means they are close to work and a vibrant social life.

People also stressed the low maintenance of new-build flats as well as the high security as key positives. Most people identified more green space, better health facilities and parking spaces as well as better public transport as topping their wish list.

11.3.2 The investor opportunity

Investors have generally been cool on northern cities during 2005 as the market has slowed and in city centres, the large new supply of new built apartments has kept prices down.

After zero capital growth in many places in 2005, the report predicts rising prices again by 2007, but at pedestrian rates of between 2% and 3%.

Prices in northern city centres are likely to see slower growth as new supply is brought to the market.

After several years of exceptional capital growth, prices of new homes in Manchester have dipped over the past year, with prices falling 2.7%. This compares with a decrease of 5.3% in average UK prices.

Apartments still make up the majority of new builds in Manchester, and make up more than 64% of all new builds, compared to just fewer than 16% for detached homes and 14% for semi-detached houses.

But high spec, low maintenance and highly secure apartments in city centre locations are still in demand by investors and tenants, with some developers expecting yields of up to 7%.

As capital prices slow, or even fall back, this would seem to be a window of opportunity for investors to negotiate on price, with the backing that future demand for units will be there.

11.4 Central London

London's allure for property investors is underlined by new forecasts that the capital will dominate the UK economy even further over the next decade.

And, for the property investor, the creation of tens of thousands of new jobs and huge population growth are of special interest.

Why?

Because growing populations and more employment equals increased demand for housing.

London is truly a city of extremes: an economic powerhouse, and an area with the second highest rate of unemployment in the country (just behind the North East).

London has an employment rate forecast to rise twice as fast as the UK as a whole over the next three years, and yet, of the ten most deprived local authorities in the country, five are in London.

That is partly why we believe that the Central London market is a unique market, different from the rest of the UK.

Central London also competes with other global cities such as New York, Tokyo, or Paris. Hence, it is more directly affected by global economics and trends than the rest of the UK.

11.4.1 Central London tenants

The Central London property market is largely the preserve of City workers and Americans plus other corporate re-locators.

Since the dotcom bubble burst in 2001, the number of corporate executives, financiers, or technical gurus relocating to London for 1 to 3 years, has crumbled.

In this particular market sector, the demand for property rentals is far more fluid and can expand or contract much faster than supply. Hence, this market is much more likely to overshoot in terms of prices up (and also, prices down).

But the American technology industry (especially that based in Silicon Valley) believes that London is the first overseas destination on its world expansion plans.

And now the US venture capitalists are beginning to see life in the technology sector after all, and the first overseas location that they consider is London.

Why?

It's English speaking to start with. Secondly, the form of capitalism and company ownership is much closer to the US model, and thirdly, it sits in the perfect time zone between Tokyo/Hong Kong and New York and the US West Coast.

Lastly, the price gap between towns around London and Central London is such that Central London is beginning to look cheap – some are saying that even places like Mayfair are undervalued (at £750 per sq ft compared to £900 and £1,000 in Chelsea), and hence, likely to attract more demand and gain from price rises (of around 5% most pundits reckon) in 2006.

11.4.2 Statistics that make a case for London

Here are some of the reasons why we believe London will continue to be the UK's economic torch bearer.

London's contribution to the UK's public finances was in a range with a mid point of £12.1 billion in 2003/2004.

This figure for the previous year was £2.5 billion higher, but given the rise in the UK budget deficit by over £14 billion, London's relative contribution has increased.

London's economic performance has remained robust this year, despite the terrorist attacks during the summer.

Tourism has been affected by the fear of further attacks, but, even so, it appears that 2005 will have seen an even greater number of visitors having come to London than in 2004.

The strong recovery in financial markets this year, along with generally more upbeat business surveys, suggests London's economy, specifically, its GDP growth in 2005, may be slightly faster than the UK's as a whole.

Employment in London is now 4.45 million - 15% of the UK's total workforce and 700,000 more people in work than in the early 1990s.

Employment in London is set to rise twice as fast as the UK average over the next three years.

11.4.3 London bucks the employment trend

Employment growth in the UK is predicted to be weaker in 2006 than in 2005, as the effects of the current slowdown in output growth start to affect the labour market, but London may be an exception to this, a report by the Corporation of London shows.

The capital is expected to benefit from renewed expansion in business services jobs, after three years in which the sector failed to provide the spur to jobs growth it typically has over the past 20 years.

The forecasters predict London to employ another 200,000 people by 2008, with employment growth averaging 1.4% a year over the next three years - twice the jobs growth rate of the UK as a whole.

London's productivity performance continues to out-perform the rest of the country. Gross value added was 27% higher than the national average in 2004, up from 22% five years ago.

This reflects the increasing specialisation of the London economy in a range of high productivity service sectors - financial, insurance, legal and accounting services in particular, and also in media.

London's workforce is better qualified than the UK average, with 32% of the workforce in 2004 having a degree or equivalent, compared with 265 for the UK as a whole.

London remains a big draw for inward investment in the UK, attracting 37% of all inward investment projects in 2004/5, compared to just 5% in the mid-90s.

11.4.4 A tale of two cities

The contrast is between areas of London, it will be no surprise to learn. The problem of unemployment, in particular, is most acute in the inner London boroughs. Five of the UK's most deprived boroughs are in inner London.

And yet it is precisely these areas that are likely to be increasingly gentrified, as the population and the number of employed in London continues to grow.

Indeed, one of the central problems faced by London, highlighted in the report, is the challenge of housing.

“With London's population projected by the GLA to grow by a further 810,000 by 2016, there needs to be a substantial increase in house building.

“Central London and the East - notably, the Thames Gateway - have been earmarked for the bulk of this expansion. It may be difficult, however, for the planning system and the construction sector to keep pace with expected demand.”

The report also stresses that, while there is currently high availability of office space in London, the supply will be inadequate over the next decade.

11.4.5 Olympics 2012

Against all the odds, London 2012 is a reality. The capital's sporting dream has come true and billions of pounds are set to pour in to East London.

But as we've said before, East London, where properties are already valued at around 15% under the rest of the city, was already a property investment winner - Olympics or not.

That's because many of the initiatives that will bring huge regeneration to East London are already underway.

For example, the Government is spending £800million redeveloping the Lower Lea Valley - not included in the Olympic budget.

Around £7billion is also being spent on things like the Channel Tunnel Rail Link and the extension of the East London Line.

Nevertheless London 2012 is a big boost to everything else that is already happening.

There are three main reasons for this:

- The feel-good factor will boost the economy
- Regeneration projects will now get the highest level of support; the UK's leaders are in the spotlight
- The Olympics brings focus and deadlines to current improvement plans and activities.

Broadly speaking, London 2012 brings a national and local pride that will get things done. And optimism fuels booms.

11.4.6 London – what happened in 2005

Last year brought real highs and real lows to London.

Winning the contest for London to host the Olympics in 2012 transformed a dream (many thought a pipe dream compared with Paris' chances) into reality.

But two days later London was bombed.

The terrorist attacks show at once how vulnerable the capital city is to attack, but importantly demonstrate London's resilience.

Overall, the general feeling that the capital's property market was improving didn't dampen, and London ends the year on a note of increasing optimism.

Some of the main property trends to consider in 2005 were:

- The Square Mile bounced back with an increased uptake of office space in the City - new business confidence in London is being reflected in this upturn.
- New developments were underway too - it is expected that 1 million square feet of office space will be brought to market in the next two years or so.
- The West End of London is running out of office space and requires more development and building; rents are improving.
- Investment in office buildings in London continued apace with record prices being paid for buildings. This has resulted in record low yields, but again demonstrated confidence in London's world-class economy. Huge landmark buildings were sold: Centre Point, the Trocadero, BP's Knightsbridge estate and Abbeys £1.2 billion property portfolio among them.

- Developers remain confident too with one of London's most ambitious residential towers selling out 56% on launch day. Pan Peninsular, Canary Wharf, is a luxury development by Ballymore Properties.
- Estate agents reported greater buying and selling activity, and anticipate price increases at the top of the market as good City bonuses were announced.

London-wide estate agents Hamptons showed the following snapshot at the end of 2005.

Kensington: prices have edged up to the £1,000 per square foot level and there is a shortage of flats to let at the £550 p/w level causing rent rises. There has also been more demand for houses in the £2,500-£3,500 p/w price bracket.

St John's Wood: there have been increasing instructions, although still not enough to satisfy new buyer demand. So it is becoming a seller's market.

The agency reports City workers are already looking for flats in the £1.2m bracket to buy when their bonuses land in the New Year.

Chelsea: the market is very busy, with sellers expecting bumper deals, thanks to City bonuses.

Wimbledon: price sensitivity still exists but demand is outstripping supply. Agents expect a bumper Spring 2006.

Fulham: the sales market is strong with applicants up 64% while new instructions are down 25%.

Rents are strengthening due to decreased supply.

Clapham: rents are improving.

The City: sales prices have been squeezed up by a year-on-year drop in instructions of 25% against a 55% rise in applicants looking to buy.

Tenants are mainly looking for one bedroom apartments and the price per week has edged up to £350.

Knightsbridge: the number of people looking to rent studios and one bedroom properties remains high.

Outside of these areas you may want to look at where regeneration continues apace. In East London for example, some property prices jumped 10% on the back of the Olympic 2012 announcement.

For better growth it is best to look at areas on the fringes of the Olympic activity.

Areas to consider are **Dalston** and **Haggerston**, E8, where the new East London Line should have stations in 2009/2010.

Other areas slightly outside of the key Olympic sites include **Barking**. It is undergoing regeneration and developer Urban Catalyst is capitalising on the improvements creating new living units in the town centre which is near good transport links.

There are still attractive developments around **Canary Wharf** and **Surrey Quays,** too.

But check you are getting real discounts.

For example, developer Wimpey has offered 15% off units at The Water Gardens, Surrey Quays. Our opinion is that this is a good development, but that the units are around 8% over-priced; so the offer is only a real discount of 7%.

Closer in to the centre and another area to watch is **Elephant and Castle** in Southwark.

Major regeneration plans are about to get underway here...with 53,000 new homes, leisure and retail premises planned. Its proximity to the City and West End will make this newly attractive to young professional tenants.

Despite the gloomy headlines in 2005, it is notable that despite the downturn in London property sales, London property prices continued to increase steadily.

Achieved prices in the prime London property market rose 8.7% between January and June 2005. And, according to Prime Location, rental stock was down around 8% in 2005 causing a corresponding upswing in rents.

11.4.7 'Two cities': High end hotspot and a regeneration hotspot

Here are two contrasting area opportunities in London. Peckham, south east London and Mayfair, W1.

Peckham SE15
Peckham's reputation for being a tough crime area has proved a difficult challenge to overcome.

But things are changing – and fast!

It certainly hasn't become Hampstead overnight but things are on the up. And for investors, this is an interesting area to pick up a bargain.

Southwark council's strong commitment and belief in Peckham follows hot on the heels of a new influx of artists attracted to SE15 by cheap housing and studio space, and the nearby Camberwell Art School.

The arrival of this bohemian community can only be a good thing. It has the potential to transform pockets of Peckham into vibrant and trendy places to live.

The same phenomenon has happened elsewhere in London.

It brought Chelsea to life in the Sixties, and trail-blazed the continuing regeneration in Shoreditch, Spitalfields and parts of Hackney too during the mid to late 1990s.

As the demolition of council estates continues and new developments are built here, new bars have opened and there is a well-attended and growing farmers' market.

Affordable housing means Peckham is a pull for young professional first-time buyers as well as for families who cannot afford to live nearby in East Dulwich.

Away from the sink estates of the north, south Peckham boasts quality streets of Victorian homes, the best look over Peckham Rye Common. This is where the families live.

Of course, even though the grimmer tower blocks are coming down, there are still plenty of rough spots.

But it's the 'room for improvement' element that makes Peckham attractive for investors - especially when combined with improving transport links.

Peckham Rye overground station has good links into the centre of London and there are good bus routes, too.

But what makes Peckham an even more interesting punt is the East London Line Extension.

The extension westwards could see a short section of track constructed linking the existing East London Line, from south of Surrey Quays, to the South London Line between South Bermondsey and Queens Road Peckham.

Peckham Rye and Queens Road, Peckham, could be connected to Clapham and Wandsworth to the west and north, right up to Highbury & Islington.

We say 'could' as this is planned for phase two of the East London Line extension and funding for the project still has to be agreed - probably not until later this year.

But if it gets the green light, then prices in Peckham could rocket by around 20% on top of any normal growth.

Purchase prices fell off in 2004 but have risen again in the first half of this year to an average £210,000 across all Peckham properties and £177,000 for flats, according to the Land Registry.

The rental market is strengthening too with decent one bedroom flats commanding £700-750 per calendar month and £950 for two bedrooms. Yields are similar to London as whole - around 5%.

New build, high spec apartments costing £189,000 and £200,000 are currently renting at £750 and £950 per month respectively.

There's a lot happening in Peckham and it is well worth a closer look for a bargain buy.

Mayfair - (top end corporate rentals)
Mayfair is about as upmarket as it gets - but does it represent opportunities for investors of more modest means?

Probability buffs out there will know that if you want to win Monopoly you should forget Park Lane and Mayfair and head down market.

For, although the blue squares get you the prestige, more people will land on the orange ones and have to cough up rent.

But there are some good arguments to say that residential property in Mayfair, W1, is undervalued.

Prices per square foot are normally around the £750 mark, whereas in Belgravia, Chelsea and Knightsbridge you're looking at £900 plus. Belgravia, Knightsbridge and Chelsea are where the rich set want to live because of the amenities.

In Mayfair, the swish bars and restaurants close at the weekends. And much of the property is retail or offices.

Until now.

Mayfair is getting trendier; and staying open. Browns Hotel in Dover Street re-opened at the end of 2005 alongside many other glamorous venues that have breathed new life into the otherwise stuffy area.

New residential developments have been springing up as well.

The area around Park Lane, from Marble Arch to Hyde Park Corner, has swish apartment developments now nestling in between the Aston Martin showrooms and the Grosvenor and Dorchester hotels.

That said, Mayfair is still a varied place and cannot be categorised easily - Green Street is very different to Park Street in character.

Some property is stratospherically expensive; way over the £750 per square foot mark. For example, ultra-cool interior designers Candy and Candy achieved £1,600 per square foot on a property in Curzon Street, just off Berkeley Square.

While most investors would not see value at this level, it shows that there is still a lot of scope in upward price movements from the £750 psf mark.

One thing common to Mayfair though is that freeholds are a rarity. The Grosvenor estate, aka The Duke of Westminster, owns most of it so you're nearly always buying on a lease and they tend to be around the 35 year mark.

Buying leasehold though will give you better yields and 6-7% is achievable. But expect to pay around the £500,000 mark for flats - which will mainly be let to corporate renters.

The recent spate of new developments means there could be competition, but the odd bargain to be had too.

11.4.8 Battersea and Wandsworth

Some 10 to 15 years ago, professionals in London were priced out of Chelsea and ventured into the best bits of South West London where further gentrification followed.

They discovered a bridge not too far from Kings Road and bravely crossed the river bringing young families and four-by-fours with them.

Traditionally Battersea was unattractive because it was (and still is in some places) run down, with sink estates, waste lands and main arterial roads running through it. The attractive parts are Battersea Park and Northcote Road.

Wandsworth was a bit more schizophrenic.

It has lovely detached houses around Wandsworth Common and sought-after Victorian and Edwardian streets between Wandsworth and Clapham Common.

The only downside here is the odd incongruous-looking 1950s house. Clapham Junction was targeted mercilessly by the Germans in WWII.

Not a million miles away there are noisy roads, big roundabouts and wastelands west of Clapham Junction and nearer to the river.

Transport has also been an ongoing issue. Battersea and Wandsworth have no Tube.

The problems were two-fold – transport and dereliction caused by under-investment.

Today both of these are being tackled by:

- Private investment which is transforming the riverside
- A £2bn regeneration of Wandsworth's town centre
- A new transport connection at Clapham Common.

Big flagship developments at various stages of completion now dot the riverside stretch between Battersea and Wandsworth Bridges.

These include St George's ambitious Battersea Reach mixed-use scheme, another earlier St George's scheme, Riverside West, and George Wimpey's Candlemakers development to name but a few.

These are attracting even more young people to a borough which already has one of the highest concentrations of 20-somethings in the country.

And if you can negotiate a good price on apartments with river views this could pay dividends in the future.

In London there are only ever going to be a certain number of apartments that have river views. Local authorities are clamping down on riverside planning permissions deemed to encroach on public rights of way.

But there are always going to be people who want a river view. Therefore demand is high for something that will be in limited supply.

Because of this it's important to try and get at least a view of the river (or partial view) - even if it is from a balcony.

To the west Wandsworth is undergoing a £200m town centre facelift with a new retail, leisure space and cinema planned at Southside. In total the scale of the inward investment to the borough is currently £2bn.

Finally the Mayor of London has backed the plan to continue the East London Line extension from Surrey Quays to Clapham Junction.

Although good bus and rail routes deliver fast and regular trains to Victoria and Waterloo, a new underground station at Clapham Junction is likely to have a positive impact on prices in five years or so.

But such a scale of development along the river means at some stages of the cycle, rental supply will outstrip tenant demand. This is probably the case right now.

Tenants are already aware of this and can negotiate hard on rents.

This may be a temporary blip – but it may mean better sales offers from the developers.

11.4.9 Summary: London is 'blue-chip'

The report's summary is what is of real interest to the property investor, looking for a safe, blue-chip investment as ballast to a portfolio.

The Corporation of London's report concludes:

"Overall, our assessment is that London is well-placed to prosper over the next decade. London is uniquely competitive in the key exporting private service sectors that we expect to drive UK economic growth.

"'Coupled with expected strong population growth - fuelled by international migration - and the local demand this generates, London is expected to create an extra 650,000 jobs by 2015, accounting for 16% of UK employment and 20% of GDP."

11.5 Regeneration creates property hotspots

The government spent £3.1bn on regeneration in 2005 alone.

This money includes the New Deal for Communities programme, the housing market renewal pathfinders, the Thames Gateway, the regional development agencies, English Partnerships and the Neighbourhood Renewal Fund, which funds councils to run social regeneration schemes.

The money is bigger than the £2.4bn spent in 2003/04 and will rise to £3.3bn in 2007/08.

Here is a selection of areas that will be improved.

11.5.1 North and Midlands

Birmingham, Bristol, Leeds. Liverpool, Manchester, Nottingham, Newcastle and **Sheffield** are the 'core' cities in England (the biggest outside of London).

These cities have been earmarked as hubs of economic regeneration and development by the government.

The Northern Way Strategy, which is designed to stimulate higher growth rates in the under performing North, makes the North's five city regions the focus of its energies.

They will also benefit from the New Deal for Cities programme in 2006.

Ten thousand homes will be knocked down by March 2006 as part of the government's housing market renewal programme.

To undertake this work, nine pathfinders have been set up of which Merseyside's New Heartlands will have undertaken the most demolition work (2,700) followed by Bridging Newcastle Gateshead (2,000).

Hull is demolishing the least number of properties at 44. All the pathfinder schemes in the North and the Midlands are also in charge of major refurbishment schemes.

Other towns to watch, according to nationwide estate agents Knight Frank:

Sheffield: Its economic recovery is continuing as it catches up with Leeds and other more mature northern centres.

Doncaster: The economy has transformed from metals to distribution thanks in part to the new Doncaster/Sheffield Airport.

Newark and Grantham: London commuters are basing themselves further north than Peterborough on the East Coast Mainline now they can lose the tube commute and work next to King's Cross Station, where substantial redevelopment has created new office space.

Bradford: Large scale regeneration activity is underway in the city due to an ambitious city master plan. Bradford is also feeling the ripples from Leeds' recent economic expansion.

Hull: Despite a slowly growing economy, prices are still low, and regeneration in the pipeline promises more jobs and improved facilities.

Durham: There is strong demand from an increasingly prosperous north-east professional and business community.

Coventry: Its upturn in fortune is investment and regeneration led, especially to the north of the city centre.

11.5.2 Southern seaside towns

Many seaside towns in the south of England, which have been overlooked for decades, are now being improved and are attracting new residents.

National estate agent Knight Frank says: "as with the Northern and Midlands towns it is regeneration which is leading the shift in the fortune of these areas".

Seaside towns to watch:

Weymouth: It now has an expanding local economy which is being driven by new development due to the town hosting the 2012 Olympic sailing events.

Hastings: The artists and bohemian crowd have moved here recently bringing to life many potential restoration opportunities. This town is close to London and has become fashionable again.

Chatham (the Medway towns): New transport improvements will halve the commuting time into Central London from 2009.

Margate/Broadstairs/Ramsgate: There are big public funded improvements in all three towns and plans for rail improvements.

11.5.3 Thames Gateway

The government wants to build 120,000 new homes on the Thames Gateway, which has been dubbed Western Europe's greatest brownfield land opportunity.

This area is seen as critical to solve the housing shortfall in London and the South East.

11.5.4 Prices summary

This year is likely to be more boring then anything else, with the highest capital appreciation (around 5%) most likely, on average, to be seen in the South East and London – and in Scotland once again.

There will be none of the hysteria of 2003/04 and the subsequent 'will it, won't it crash?' headlines of 2005. The soft landing has happened. That's good for investors.

11.6 Scotland

Scotland's housing market is expected to outperform the rest of the UK in 2006, with prices rising 7% compared with the rest of the UK's 3-4%.

The Bank of Scotland, in its 2006 economic forecast, also suggested that the economy as a whole north of the border is expected to grow by 1.8%.

Average house prices in Scotland have risen by 10% in 2005, putting the market behind only Wales and Northern Ireland in the UK. But prices in Scotland are still less than in any other part of the country.

And this is shown in a lower level of house prices in relation to average earnings. The current house price/earnings ratio in Scotland is 3.9 compared with 5.5 for the UK as a whole.

The Bank of Scotland's 2006 report says:

"As a result, affordability is a significantly less powerful constraint on housing demand than elsewhere and this should remain the case in 2006, permitting prices to rise most quickly in Scotland."

Clydebank, **Renfrew**, **Airdrie** and **Wishaw** are expected to deliver the biggest price rises next year - after big price rises in the bigger cities like **Glasgow** and **Edinburgh**.

There are now only 11 towns out of the almost 500 surveyed across the UK where the average price is below £100,000 and five of these towns are in Scotland. In 2004, there were 18 Scottish towns where the average price was below £100,000.

The Bank's report adds:

"Sound economic fundamentals, and more affordable housing than elsewhere in the UK, should ensure that the Scottish housing market remains relatively strong."

There is another driver in addition to these economic factors which will boost property prices in Scotland; it's from the pattern of inheritance-driven growth - a pattern only previously noted south of the border.

There is good reason to regard the property market in Scotland as separate from that in the rest of the UK - many key factors mark out the country as different - demographics, social and political elements).

But one feature of the property market south of the border is being repeated in the north and is likely to help boost Scottish property prices - especially in the key cities - over the long term.

Studies have repeatedly shown that money inherited by offspring from the sale of their parents' property tends to be reinvested in property.

This is a key component of price growth seen in England - and now it's happening increasingly in Scotland, albeit on a modest scale as yet...which means the trend is likely to have greater impact further down the road.

The key is owner-occupation rates.

Scotland has traditionally had owner-occupation rates that were far below those in England, but now they are catching up fast - some 65% of people own their own homes compared to around 10% more people in England.

These are people then who will predominantly leave much of the wealth locked into their properties to their children who will reinvest in property.

Around £200 million will be pumped back into the market this year, a study by the Glasgow Solicitors' Property Centre shows.

The trickle-down effect will be, we believe, significant as this amount grows as does the rate of owner occupation.

GSPC estimates that the extra inherited property assets - which have grown from around £130m a year in just two years - will help to drive Scottish property prices strongly into positive growth territory, increasingly so, as home ownership continues to expand.

11.7 Prospects for the rental market in 2006

The prospects for the rental market are still excellent.

People are becoming more willing to move from city to city for work reasons.

At the same time, the number of people working on long-term contracts has expanded rapidly, such as in the technology sector.

An increasingly important rental sector is that for medical and teaching professionals who expect to move around the country in their first two or three jobs or placements, thereby remaining in the rental sector until later.

As mentioned above, the first-time buyer has moved from buying to renting and rental demand has increased as a result.

Therefore, there is a growing need for rental properties - from the corporate, individual and public sectors.

Equally, to match this demand there has been a steadily growing number of professional or investor landlords following the introduction of the buy to let mortgage a few years ago.

In some areas, there is still an oversupply of rental property.

However, the buy to let boom in areas such as London, cooled off rapidly in 2003/2004, with a number of landlords choosing to sell rather than continue to let.

In some areas, this has created shortages of rental property. Whereas, in other areas (typified by large developments sold to landlords), there is an oversupply of property for rent.

Hence, it is essential to do your research on the rental prospects before investing.

11.7.1 Prospects for the company let market

Company let describes a tenancy agreement between a landlord and a company such that the company is responsible for the individual who occupies the property.

The most common reasons for companies entering into these agreements are:

They **have staff on a short-term contract**, perhaps related to a particular project

They have staff from overseas working for a period in the UK

Therefore, the **company driven demand for rental property is mainly based in successful commercial and financial centres** such as London, but increasingly Leeds, Edinburgh and other major cities across the UK.

In addition, university towns (especially Cambridge and Oxford), and towns and cities along motorway corridors (such as Reading in the Thames Valley), are seeing significant growth in the demand for company lets.

Despite short-term difficulties due to problems with the global economy, the long-term demand for company let property is set to grow.

We believe that the main company let market, London, will see modest signs of a pick up in 2006 as the stock markets continue to recover and businesses begin to dust off their investment plans.

Generally, corporate let markets are most buoyant in areas where high-growth businesses are based, or where industries rely on a large proportion of contract staff, e.g. IT.

11.7.2 Why is the long-term company let rental market booming?

The majority share of the ***company let*** market is taken up by North Americans, European professionals and business people posted to the UK for a couple of years or more.

They are tending more than ever to choose renting rather than buying. There are three main reasons for this:

1. London and UK property prices are now very expensive in relation to their properties at home - so they would be buying a significantly smaller / less-well-situated property.
2. Most expatriates have a corporate package that covers the high costs of rents. Unfortunately, this package is often not as generous if they choose to buy.
3. It is not worth the risk and the hassle of trying to buy in a foreign market. It is a lot easier to see 20 quality rentals than to trudge around looking for the ideal home as well as avoiding the high costs of purchasing.

Case Study:

A US banker posted to the UK for two years found that the stamp duty cost (of over £20,000) alone now makes rental more attractive.

He is unsure about the length of his stay and concerned that the market may not grow sufficiently to pay back the cost of just the stamp duty.

In addition, this banker already owns a property in the US - so there is no urgency to get onto the housing ladder.

11.7.3 Prospects for the professional lettings market (long lets)

Long lets are the norm in most rental markets.

They use the short hold tenancy agreement and involve letting the property for a minimum of six months, but possibly much longer.

Typical tenants might be a young professional couple, one working in IT, the other working in the medical field, perhaps.

In the last five years, rental returns have dropped and a return of 7% (gross) is typical. Anything more would be considered a good return - especially in a location that has experienced substantial property price increases - such as Cambridge.

In some areas - particularly Central London - property prices are now so high that the rental returns have fallen back towards 4 or 5%, which would require you to fund the rental property for a number of years before the rental returns enable you to break even.

Rental returns have dropped for two reasons:

The boom in house prices - property prices have increased faster than rental prices and so the returns have diminished. As prices stabilise in 2006, rents will rise.

An increase in rental stock - as a result of the buy to let mortgage and potential landlords being drawn to the market by booming property prices.

Rental returns will continue picking up in 2006.

However, we expect that rental yields will begin to move upwards in London in 2006.

Why? Because of increased demand and due to a number of landlords having sold up, thereby reducing the number of available properties for rent.

However, successful *long-term* investment is based on spotting up and coming areas, and property in these locations offers far better rental returns - see section 18.4.1

Equally, it is possible to find areas (such as East Manchester), where the rental returns are as high as 14%.

To achieve such a high return you may have had to sacrifice long-term potential capital gains, but with the current phase of redevelopment in the North (as well as East Manchester), you may well find that these properties offer both capital and rental yield growth.

The underlying demand for rental properties is on the increase. The factors driving it are similar to those driving property prices:

- Globalisation
- Shift to contract working
- Divorce and separation and smaller family units
- Increased migration into the UK and around the UK

As long as these factors continue, and there is no reason for them not to, then the demand for rental properties should remain very positive.

However, **the potential landlord should be careful to avoid areas that have become saturated by rental properties**. Such high local supply of rental properties is bound to keep prices down until demand can catch up.

Key tip

Research your area and research your property very carefully - in some cases one street can make all the difference!

11.7.4 Prospects for the short lets market

A ***short let*** is similar to a holiday home let - people will rent a fully furnished property by the day or the week.

In Central and West London, the vast majority of short lets are to one of two types of customer:

- Tourists and visitors
- Business people

As more and more companies globalise, their work force needs to be able to move to different locations more easily and often on short (one to six month) projects. This means that rather than pay Central London hotel rates, the employer (and employee), will look for a flat (in an excellent location), to rent on a short-term basis.

Short let returns typically earn 50% more than long lets. You should expect to see a gross yield of more than 10% - although the property may be unlet more often.

Properties suitable for short lets tend to be in major global financial and commercial centres. London is the typical example, but also cities like Edinburgh and, increasingly, Leeds, Cambridge and Oxford - with vibrant and international economies offering the opportunity of short lets.

Spend some time talking to top of the range estate and letting agents to get an idea of the kinds of properties and locations that are suitable for this market. Any city's rental market will be based on the nature (and largely global nature) of its economy.

If you do your homework well - this can be a highly profitable segment of the rentals market. It is also more resilient to the national economic situation - rather it is dependent on the global commercial market.

Remember that short lets and holiday lets require much more management than a traditional let. The bedding needs to be changed and the property cleaned between lets - often within 12 hours of one tenant leaving and the next arriving.

With a higher turnaround of tenants, there are more opportunities for costly void periods as well.

11.7.5 Prospects for the student market

The numbers of students in higher education has grown substantially over the past 25 years, leading to a massive growth in the need for student accommodation.

Between 1972/73 to 1997/98, the total numbers more than doubled from 453,000 to 934,000.

The government continues to push for increased numbers of students in higher education.

The past 20 years have been a good time for student landlords as the growth in student numbers has meant high demand for rooms and houses to let.

Although the numbers of students continue to grow, more and more students are falling into debt because of the removal of maintenance grants and the increased burden of tuition fees.

Currently, English students are means-tested on tuition fees. On the other hand, Scottish students in Scottish universities have no tuition fees. However, this situation might well change and may have a knock-on effect on the student market. The result of this is that a number of student landlords have been unable to fully let their properties over the summer period.

Equally, a number of student landlords have sold property recently. As this reduces the available properties for rent, it may help this market to re-ignite.

Key tip
Check your local university accommodation office. They will be able to tell you about the levels of demand and the lack of suitable accommodation locally.

However, if you are looking for a hands-free investment - student lets are unlikely to provide you with a suitable solution.

11.7.6 Prospects for the DSS market

Letting property to DSS claimants can be even more time-consuming than student lets.

For this reason alone it would be wise for the hands-free investor to steer clear of this market unless they can strike a hands-free contract with their local Housing Association (HA).

The number of people claiming unemployment benefit and whose housing costs the local authority pay for has been falling.

In addition, the rise of the social landlord has largely taken over the role of providing accommodation to those people in need.

Private landlords tend to have a tough time with the DSS market. Generally, there are two problems:

- Ensuring that the property is cared for
- Ensuring that the rent is paid on time

Financial hardship is an every day experience for many people surviving on DSS handouts.

Although many DSS tenants are good tenants, the difficulty faced by the private landlord is that if your tenant decides to stop paying you rent, then it is time-consuming and difficult to evict your tenant because they often have no alternative accommodation to go to.

If you own just one or two properties, or have just set up your properties, a three or four month period without rents coming in could ruin your investment.

However, increasingly, smart landlords are contracting out their rental properties to Housing Associations (HA). These non-profit organisations typically work closely with the local council and, especially in the South of England, will offer landlords guaranteed rents.

In addition, the landlord is guaranteed to receive the property back in a 'good' condition.

If you are thinking of buying and renting for this market, then check out the quality of rent guarantees available through your local council. This can help to reduce the effort and headache of letting a DSS property – but remember, Housing Associations can be (but are not always) bureaucratic and slow moving.

Key tip

In general, it is wise for the private landlord to let the Social Landlords handle the DSS tenant market unless you are an experienced landlord and know what you are doing.

Congratulations - you've finished section 11! You'll now be able to:

- See which industries are creating rental demand- see **section 11.1**
- See which regions are creating jobs - see **section 11.2**
- See that city living is an opportunity – see **section 11.3**
- See that London is tipped for 2006 – see **section 11.4.2**
- Understand regeneration and hotspots – see **section 11.5**
- Understand the rental prospects for 2006- see **section 11.7**

12 BALANCING A BUY-TO-LET PORTFOLIO

When you have read this chapter you will understand:

- What a balanced portfolio is - see section 12
- How to use the RevRi to analyse risk and reward - see section 12.2
- Our view of the UK market – see section 12.3
- How to evaluate property investment in the EU8 – section 12.4
- The key opportunities in continental Europe – see section 12.4.6
- How to spread risk across your portfolio- see section 12.5

If you are serious about creating wealth then you'll be aiming to build a solid property portfolio that will deliver long-term and sustainable wealth.

You create a portfolio that will deliver long term sustainable wealth that combines rapid increase in value with good levels of security.

And this is achieved by creating a **balanced** portfolio.

By balanced we really mean understanding the different levels of risk and reward that each market offers you, so that you can spread and reduce your risk whilst at the same time maximising your potential returns.

As we've said many times, successful property investment requires a long-term view. That doesn't mean you must commit your investment decisions solely to the UK.

Especially with the much slower capital increases you'll experience in the UK over the medium term and much higher returns elsewhere in Europe.

But which city or country should you invest in? The UK? London? Warsaw? Prague? Cyprus? Riga? And when is a good time to invest there? - Now? Next year? Post 2012?

If you want to create wealth slowly, then all of the above; starting now and continuing for the next 10 years.

12.1 What does a balanced portfolio look like?

Here's an example of how a balanced property portfolio might look:

- 10-60% in 'safe' markets with steady growth (steady reward), and low risk
- 20-40% in high growth (high reward) markets, with moderate risk - but the risk is still acceptable
- 0-20% in very high growth (very high growth) markets, which may be speculative, and where the high level of risk would be justified by a high level of growth (or reward).

The decision on whether you should put 10% or 60% in a steady growth, low risk market is a personal one - but the principle of balancing your portfolio will apply to everyone.

There are always good investment opportunities to be had in even the most volatile of markets. This is a classic example of the exceptions prove the rule.

But the over-riding factor in making the 'where' and 'when' decision is always the ratio between risk and reward.

Which of the following investment markets is better?

- High rewards, low risk.
- High rewards, high risk.

In both cases the potential rewards are the same - yet the level of risk is quite different.

So, knowing when your reward is acceptable in relation to the risk is the challenge!

It's the reason why we've developed a methodology that we now can start to apply to all of our analyses and property investment deals - the Reward vs Risk (RevRi) Ratio.

In a nutshell, analysing the RevRi Ratio for a particular market gives you a clear picture of when risks are justified by the potential rewards and returns for an investment. And when they are not and the market should be avoided.

Once you can assess Reward versus Risk in a property market, you'll understand when and where is a good opportunity to invest and begin building a structured, international property portfolio.

12.2 The RevRi – Reward versus Risk

The Reward versus Risk Ratio (RevRi) is an analytical tool for determining the right time to invest in a property market (i.e. when potential returns justify the forecast risk).

To determine the RevRi Ratio, we use a long-term property price growth forecast. So we look at employment, wage and productivity growth, as well as the actions of financial institutions.

The definitions:

- By market reward we mean the annual return on your investment that you're likely to earn over a year.
- Market risk is the percentage risk that you won't get at least all of your money back in one year's time.

The RevRi Ratio is the **Reward (forecast annualised property price growth – based on a ten year view)** DIVIDED by the **Market Risk (based on a one year view).** The bottom line – RevRi shows whether the risk justifies the expected reward.

A 'High Reward' expectation in a 'High Risk' environment would be a reasonable investment market despite the high level of risk.

However, a 'Moderate Risk' for a 'Low Reward' would be a low investment, as the risk is not justified by the potential return – even if it is 'less risky' than our high risk example.

So, RevRi Ratio = Expected Reward DIVIDED by Expected Risk.

We would advise investors to be cautious of investment markets at less than 1.0 RevRi Ratio as this would mean that the potential risk outweighs the potential reward.

An acceptable but lower RevRi score (say 1.0 to 2.0) needs to be justified by higher potential returns.

And the safer (more pension-like investments) are to be found in the markets offering a RevRi score of 1.50 or more.

12.2.1 Example RevRi - The UK market

We have produced an example RevRi looking at the UK market at the end of 2005.

Each factor is scored from very low risk to very risky (0 to 4).

	Very low risk	Low risk	Some Risk	Risky	Very Risky	Comments
Likelihood of upward trend for Interest rates in next 12 months.		1	2	3	4	We believe interest rates peaked in 2005. The UK is experiencing a period of low interest rates and will continue to do so for Grodon Brown to meet his inflationary target of 2% by 2007. Rates will not go above 5%.
Likelihood of banks offering less attractive mortgage products (ie reducing loan to value % or the length of the mortgage term) in next 12 months.	0	1	2	3	4	If anything banks are likely to offer more attractive B2L mortgages in 2006, just as they have done in 2005, in a bid to meet their B2L lending targets in a market that has shown some signs of cooling - ut not dying as reported in the press!
Likelihood of local currency falling against Sterling in next 12 months.	0	1	2	3	4	Sterling remains strong against the Euro and this trend should continue in 2006.
Likelihood that property sales will become slower and take more time?	0	1	2	3	4	We predict a rather dull market in 2006 as we enter a period of much-needed stabilisation. Look to buy with discounts in areas of regeneration.
Risk of a property price bubble based on recent (last 6 months) growth)?	0	1	2	3	4	We predict overall modest growth of around 5% in UK property prices in 2006 as we enter a period of stasis after false predictions of a crash ijn 2004/5.
Risk of the rental market becoming swamped with too many landlords.	0	1	2	3	4	Some city centres (for example Manchester) experienced a glut of new developments in 2004. In these areas there may be strong competition for tenants. However with city centre living inceasing, populations growing and employment growth overall demand will outstip supply for housing in the UK for the foreseeable future.

On this basis, the UK market, assuming an annualised annual property price growth at an average of 8%, scores 1.3 (8 divided by 6). The UK market is stable – and a good long-term bet overall.

12.3 Our view of the UK market

We expect the UK market to pick up from the beginning of next year as interest rate cuts come into play, the first time buyer gets lured back into the market by the government and there is less fear of property price drops.

Rents are getting more expensive too - hence, young people will start to wonder if they should buy again.

That means a UK investor will be looking to pick up bargain property this year (2006).

There are lots out there - if you know what you are doing via auctions, searching for refurbishment property or simply by picking up the last couple of buy to let units at a big discount because the developer is ready to sell cheap.

Our forecast is that the UK market will pick up again in 2006 and grow at a secure and steady pace - we expect growth of 6-8% between June 2005 and the end of 2006.

So, you will want to keep a part of your portfolio in the stable UK market.

London is a key location - and especially Central London which has been languishing for some time.

This is always the first part of the UK property market to take off and is also the area least likely to be affected by any change in sentiment. Therefore, this is a key area that we think investors should focus on.

However, if you are looking for fast growth - and are willing to take a long term view, then your focus needs to be on Central Europe as this is the location with the greatest growth potential (and surprisingly low risk) that makes off plan investments a perfect investment in this market.

12.4 Investing outside the UK – The EU8

These are the new entrants to the EU that joined in 2004. Since then investment money has poured into the Czech Republic, Hungary, Poland, Estonia, Lithuania, Latvia, Slovenia and Slovakia.

Meanwhile the building of new properties is being encouraged (and property taxes slashed) to bring the Eight in line with the rest of the EU.

The countries that now make up the EU8 were widely ignored until recently, after a brief flurry of interest when they made headlines in the late 80s and early 90s.

They were known either simply because they gained independence from the old Soviet Union when it collapsed, or for breaking away from Russia, or splitting internally (the old Czechoslovakia is now two countries).

Since then though their economies have been transformed – and that has big consequences for anyone in search of great property investment potential.

Now is the best time to invest in property in these markets. By getting in at, or near, the basement level, you will have the potential to maximise your investment by offering properties to the burgeoning middle classes.

12.4.1 EU8 – Facts & figures

Here are a few facts and figures about the EU and the eight countries that are creating all the excitement:

- The EU grew by more than 30% geographically in May 2004 when the new members joined
- The addition of new members has made the EU the world's largest trading block - a market of 25 countries and almost 500 million people
- Joining the EU means countries have adopted the so-called acquis communautaire, which includes applying 80,000 pages of EU law, raising standards of administration and strengthening their judicial systems
- The average GDP per person in the EU8 is less than half that of the other 15 EU countries
- Joining the EU does NOT include adopting the Euro - at least not for the time being. Most experts agree it will be 2007, at least, before the eight countries join the Euro. Many of the new members have quietly put plans to join on the back burner.
- Billions of Euros are being handed out in development funds to the new members - Poland is so far the biggest recipient, with an estimated €11.4 billion coming its way in the first two years after joining
- Surveys show that Slovakians consistently feel the most European, with 68% saying they feel European to some extent as well as Slovakian
- The combined population of the Eastern Eight is 73.6 million. Poland is the biggest country (pop: 38.6m people) and Estonia the smallest (pop: 1.4m)
- The average cost of a Big Mac in the eight countries is $1.76 (£1.12)
- Total forex reserves for the eight countries amounts to $55.5 billion.

12.4.2 Two EU8 economies – Baltic and non-Baltic/Slovakia

The World Bank notes that the EU8 really divides into two groups of countries - the first being made up of the Baltic States and Slovakia, which are all growing very fast due to **domestic demand** expansion, leading, in the Baltics' case, to big external imbalances and inflationary pressures.

And in the other states, the engine of more moderate growth is net exports, which supports improvement of external positions and limits the demand pressures on inflation.

Export-driven growth dominates in t**he Czech Republic, Hungary, Poland and Slovenia (non Baltic states)**, while domestic demand is the main engine of growth in **Slovakia and the Baltic States**.

The World Bank Report for Q3 2005 states:

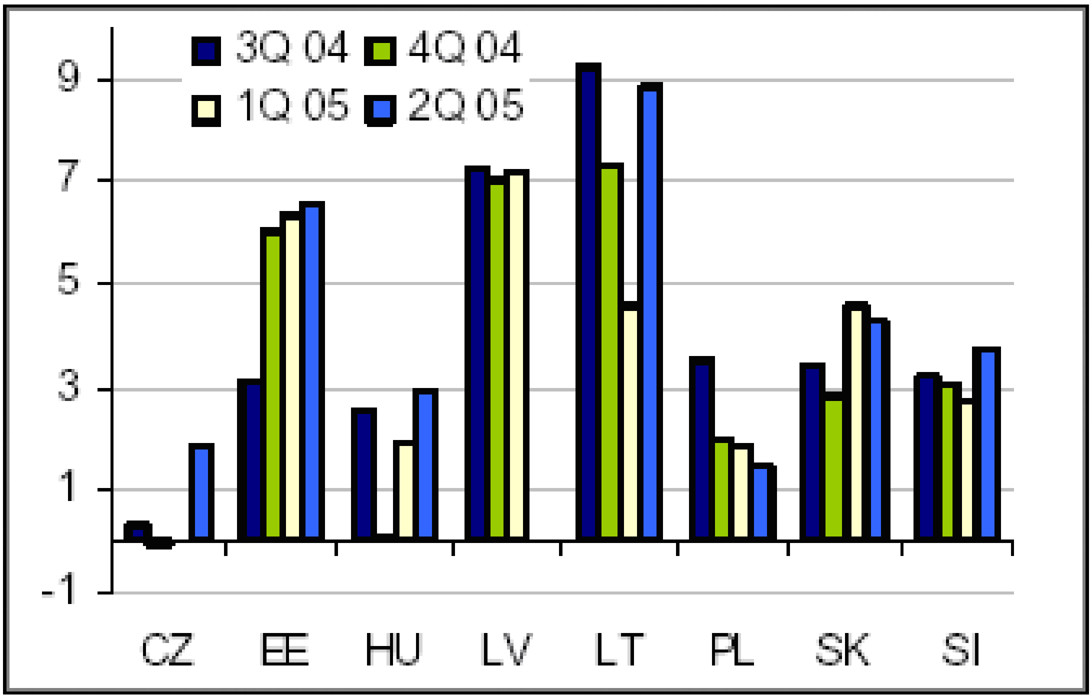
"In the largest EU8 countries, domestic demand growth remains weak, with both private consumption and fixed investment subdued especially in the Czech Republic and Poland.

"Relatively weak internal demand combined with relatively strong competitive positions support strong export expansion despite slow growth in key export markets.

In the Baltic countries and Slovakia, both consumption and investment contribute to buoyant domestic demand, with excess demand pressures most evident in Estonia and Latvia. Most countries in the region -- with Poland the notable exception -- currently appear to be growing faster than potential with any residual output gaps closing rapidly and perhaps already positive in some of the Baltic countries."

The European Commission projects potential output growth of between 3.5-4.5% per year in the non-Baltic countries, and around 6% per year in the Baltic countries and Slovakia for the period 2006-10.

Consumption real growth, % year on year



Source: National Statistics Offices and World Bank calculations

CZ: Czech, EE: Estonia, HU: Hungary, LV: Latvia, LT: Lithuania, PL: Poland, SK: Slovakia, SI: Slovenia

12.4.3 What about unemployment?

Employment and wage growth are as important factors to consider when investing in the EU8 as they are when investing in the UK.

Generally, strong economic growth is generally having the desired effect on unemployment rates in the Eastern Eight.

Here is the evidence:

- Slovakia - unemployment down to around 15% from almost 19% a year ago.
- Poland - unemployment down to around 17.5% from around 20%.
- Estonia, Latvia and Lithuania - jobless rate is well below 10% - Estonia reaching the lowest level for ten years.
- In Hungary and the Czech Republic, the jobless rate remains in the 6 - 8% range.
- Youth unemployment in particular is coming down consistently in these countries, with Hungary the only exception.

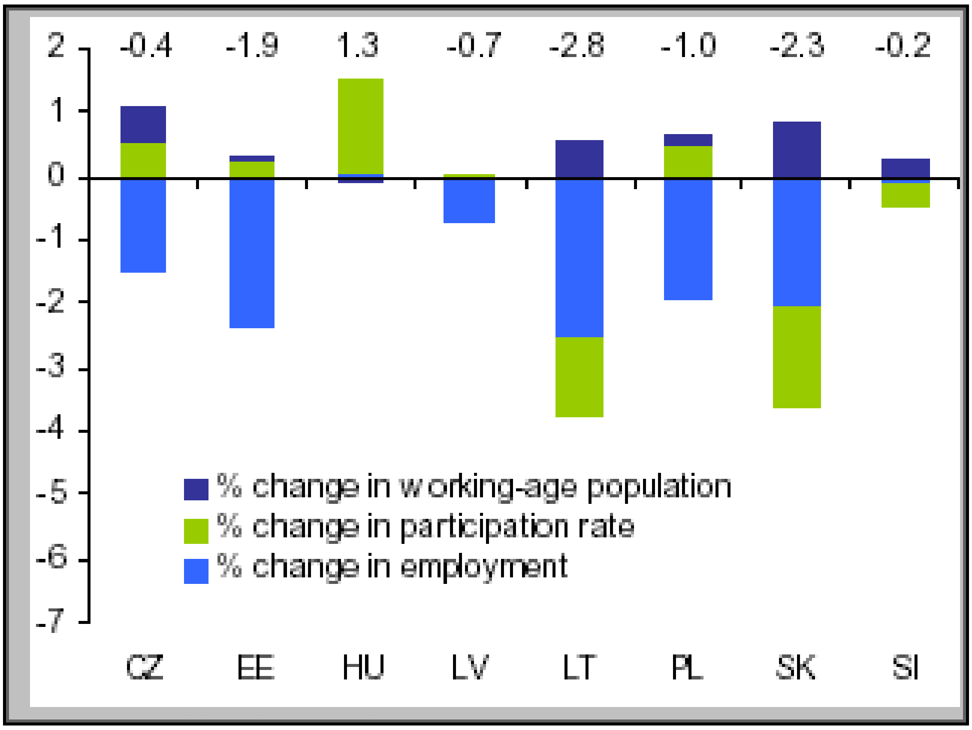
12.4.4 What about long term unemployment?

On the downside, long-term unemployment (more than a year) shows little sign of easing, and in Slovakia this category is now 70% of all unemployment (306,000 out of 429,000 people unemployed).

However, there is another way of viewing these figures.

The key is to bear in mind that, while high unemployment rates create social friction and are a fiscal burden, the jobless rates in cities is almost always considerably lower than these countrywide figures.

And it is the cities that are of interest to the property investor.



Source: World Bank

Another factor is the way unemployment rates can be broken down.

There are demographic changes (changes in the working age population), changes in the rate of participation in employment and changes in employment.

As the World Bank report points out:

> *'The main driving force behind recent labour market developments seems to be an increase in employment - in Q2 2005, up 2% year on year in Poland, Slovakia, Estonia and Lithuania.*
>
> *"The employment growth in Slovenia seems to be weaker following strong growth in Q2 to Q3 in 2004. The only exception is Hungary with a fall of employment in Q2, 2005 of 0.1% year on year.*
>
> *"In some countries the positive effect of rising employment was to some extent offset by higher participation rates. This is evidently the case in Hungary, where the increase in unemployment was entirely driven by the increase in the participation rate."*

What this means then is that not only are more jobs being created in the Eastern Eight, but also more people are coming into the employment pool, which is a positive marker of a growing economy.

12.4.5 Mortgage growth creates opportunities

It is the Baltic countries - Estonia, Latvia and Lithuania, in particular - that show the strongest mortgage growth. Here growth has been 59%, 71% and 85% respectively during Q1 2005 compared to Q1 2004. Lithuania shows the strongest mortgage market growth within the EU.

But for seven (excluding only Hungary where growth is still very strong, but severely slowed) of the Central and Eastern European states that joined the EU in 2004, the picture is the same.

The EMF says:

> *'The story in the other new member states remains one of exponential growth. These markets are still very young and are in a 'catch up' phase which is likely to last for a number of years.'*

Some key findings from the annual EMF report are:

- Mortgages outstanding in the EU's 25 countries amounted to €4.7 trillion at the end of 2004.
- This amounts to around 45% of the EU's GDP - around €10,000 for every EU citizen.
- Net lending in 2004 amounted to €412 billion - or around 4% of the EU's GDP.
- GDP growth for 2004 was 2.3% EU-wide, while the mortgage market grew by 9.7%.

- The UK has overtaken Germany to become the largest mortgage market in the EU, with €1.2 trillion in outstanding loans - almost 25% of all loans outstanding in the EU.
- The smallest mortgage market was in Lithuania, where a mere €387 million is owed - but this is the market that is expanding fastest.
- House price growth in 2004 was strongest in Malta (18.8%), France (17.6%), and Spain (17.5%). Belgium, Denmark, Ireland and the UK all experienced strong growth of around 11%.
- The Swiss have the lowest level of home ownership in Europe at 35%, with the highest in Lithuania at 98%.

For the investor, however, the really interesting indication of capital growth potential is the rate of growth of mortgage markets in countries and the current level of penetration relative to GDP, as this indicates potential to grow.

Simply put, the amount of capital borrowed will affect property prices - the more money borrowed, the more money will be chasing a limited supply of property, therefore driving prices higher.

Of course, while this is another good indicator of return, other country-specific economic circumstances also need to be taken into consideration before making investment decisions.

12.4.6 Our view of the investment opportunities

The EU8:
Prague, Czech Republic and **Warsaw, Poland**, - are the safe, solid, long term, very good growth, English speaking locations.

Brno (Czech Republic), **Krakow** (Poland) and **Bratislava** (Slovakia) are more exciting in the short term but a bit harder to deal in (mainly because there are fewer English speaking advisors) - which means more effort - but the returns look great.

Then, **Riga** in Latvia, is very high growth - but higher risks too - good for the last 10 to 20% of your property portfolio if you want to maximise returns.

Other EU8 cities waiting for their investment time to come include **Budapest**, Hungary and **Vilnius**, Lithuania.

Tallinn, in Estonia, is a great cap growth story - but without a rental market – so, for now at least, it has come and gone.

Other European destinations:
Cyprus is a different deal - because it is a sun location, so you are looking at the retired and holiday market - but it fits into the Prague / Warsaw category as a safe and solid investment (if you are on the Greek side and particularly near the regenerating area around **Paralimni**).

Romania and **Bulgaria's** time hasn't come yet by the standards with which we measure our deals, but they will. By then the Bulgarian coast will be crawling with cranes though - so the over supply risk is going to be a major consideration for new investors.

Croatia can't sort out its war crimes and therefore, there is no real prospect of EU entry - especially at the moment.

Anything else in the Balkans and the **Ukraine** is still the Wild West and you'll want to be good at handling investment data specially prepared for you by local Secret Police connections!

The **Spanish Costas** - short term risk in the Costa del Sol market is moderate to high - but the long term rewards are low to moderate - hence the risk doesn't justify the reward.

Other parts of the Spanish coast - e.g. **Valencia** have doubled in price in the past 3 years and it is hard to see why Brits will keep paying the prices when they have warmer / dryer (and more Anglo centric) options in Cyprus.

The **French** property market is discovering Anglo-Saxon house ownership and this makes it a good long term bet, but the economy is stifled by 35 hour weeks and very high unemployment.

Germany is slightly behind the French in that it is still common to rent - and there has been no house price inflation in the past 10 years worth speaking of - but political reform following the elections in 2005, and therefore economic growth seems to be just around the corner – investors are beginning to take the German market seriously.

Italy is beautiful, but the economy is a horror story – there is a potential (small) risk of the country leaving the Euro and devaluing - failing that, the economy will drag property prices. That said, it might look cheap in a few years' time.

12.5 Balancing your property portfolio – a spread suggestion

Here's a suggestion of how you could balance a UK and international portfolio starting this year.

- UK - bargain hunt in 2006 and look for special situations to form a solid base for your investment portfolio - from 20% to 50% depending on your view of risk
- Look for property in Prague and Warsaw - the core of a high return, but a low risk strategy – this could form 20% to 50% of your portfolio depending on the size of your UK interests
- Brno, Bratislava, other Polish cities should give you exciting growth. These are new markets, but they are relatively secure, so 15% to 30% of the portfolio could be earmarked for the higher growth part of your portfolio
- Riga (Latvia) – this is possibly the highest growth option, with higher (but acceptable risk). It may be good for the 10 to 15% of your portfolio that you've set aside for highest possible growth.

Congratulations - you've finished section 12! You'll now know:

- What a balanced portfolio is- see section 12
- How to use the RevRi to analyse risk and reward - see section 12.2
- Our view of the UK market – see section 12.3
- How to evaluate property investment in the EU8 – section 12.4
- The key opportunities in continental Europe – see section 12.4.6
- How to spread risk across your portfolio- see **section 12.5**

13 Tips and Trends for 2006 and Beyond

Almost all of the trends we identified in Buy to Let Secrets 2004 and 2005 are still current.

But there are one or two new pointers to best investment areas and best investment themes. There are also ways you can attempt to identify growth areas of the future.

In this chapter we'll take a look at some of these.

When you've read this chapter, you will know about:

- SIPPS – and what happened to them - see section 13.2
- REITs and what they mean for investors – see section 13.2
- How a REITs works – see section 13.2.1
- How to follow the money – see section 13.3

13.1 What happened to SIPPS and residential property investment?

From April 6 2006, dubbed A Day by the Inland Revenue, pension rules will become simpler and more flexible for individuals.

Why?

The government is trying to tackle the pension shortfall by making people take an active interest in their pensions. Drastic action is required - it's the biggest pension shake-up in 100 years.

The changes were expected to mean you could buy a wider range of investments for your pension including, for the first time ever, residential property.

This would have meant that investors could have enjoyed 40% tax breaks on direct investment in residential property though SIPPS (Self Invested Personal Pension Schemes).

BUT...

At the end of 2005, after much industry hype, the Chancellor made a spectacular eleventh hour U-turn completely scrapping the plans – despite industry experts estimating that investors had already set aside billions in anticipation of the new rules.

So SIPPS are no longer an issue as far as the residential property market is concerned.

The thousands of people who intended to use them for buy to let property, their homes or their holiday homes will not be able to.

It might still be possible to set up an unlisted company where the shares are owned by a SIPP. This would then be able to purchase property.

This would be expensive – as it requires the setting up and maintenance of two entities: a company and a SIPP. And the tax breaks would only really benefit big earners on £200K a year or more. At the time of writing, it is not clear if even this is an option.

Otherwise the only property investment vehicles will be the REITs, introduced this year (see **section 13.2**), shares in property companies and other collective schemes like unit trusts. All these are indirect, but the exposure is across a range of property – mostly commercial.

Despite the SIPPS U-turn, we always believed successful property investment is about leverage.

The more you can gear your investment, the greater your return on investment. And that, over the long-term, is what this book is about.

So, to maximise your profits, you need to take out the highest loan-to-value (LTV) mortgages available.

Under the suggested SIPPS rules, if you bought property through a SIPP, the effective LTV would have been a mere 33%.

For many investors, with new investment money, this disadvantage would have outweighed any tax advantages over the long-term.

So, we would not have recommended buying through a SIPP for new investment money – although being able to use existing pension money (otherwise dead money) to invest in property could have been advantageous.

If you were making plans to invest in property through a SIPP to fund your retirement, you may need financial advice in light of the 2005 announcement.

13.1.1 Where can I get independent advice?

You can get details of financial advisers from the trade body IFA Promotions (IFAP); their website is www.unbiased.co.uk

The organisation currently has around 9,000 member IFAs available on its database UK-wide.

IFAP has been running for over 16 years and promotes the benefits of independent financial advice to consumers and businesses.

Independent Financial Advisers (IFAs) are the only type of financial advisers who are able to select from all the products available in the marketplace - they are not tied to any particular provider.

Make sure you check their experience, not all financial advisors are suitable for giving pensions advice – so ask what their qualifications are, too.

13.2 The Coming of REITs– what are they and what they mean for the property investor

REITs (Real Estate Investment Trusts) will be introduced in the UK in the summer of 2006, Chancellor Gordon Brown announced in December 2005 after a lengthy period of consultation.

This was made in the same announcement that the SIPPS U-turn became known.

But what will REITs bring to the party?

Well, imagine a £60 billion wall of money hitting the UK property market.

It’s pretty mind-boggling, isn’t it?

Based on evidence from other countries, this is the kind of investment boost the market can expect to receive during the five years following the expected introduction of REITs.

After the disappointment the Chancellor caused those who were looking forward to investing directly in residential property through SIPPS, these are a welcome introduction.

At the end of 2005, the time of writing, the government has not disclosed its full plans, but there are very good reasons for believing REITs will have a profound effect on the UK property market, not only by pumping money into the market, but also by even more firmly establishing property (of all kinds), as a cornerstone of any investment portfolio.

REITs are already well established in the US and Australia where they have been proven to work well.

In the UK, where people are even more used to making great returns from property investment, they’re likely to be even more popular.

So where does that £60 billion figure come from?

Henderson Global Investors. They predict that a REITs investment model will be especially popular with investors either disillusioned by poor returns from the stock markets or those wanting a good hedge against stock market downturns.

And if, as is likely, the government opts to introduce a REIT along the lines of the US model, they will be extremely tax efficient and provide highly attractive incomes.

13.2.1 How A REIT Works...

Here’s a summary of what REITs are and how they work....

- REITs are companies that buy, develop, manage and sell property assets without having to pay corporation tax.
- They allow people with relatively modest resources to invest in a wide range of properties.
- REITs already operate in the US, Australia, Japan and, most recently, in France. In fact, the UK is the only G7 country in which they don’t yet operate.

- In the US REITs are required to distribute 90% of their income as dividends to investors.
- REITs are designed to invest in properties that will produce rental income and for this income to be passed to investors - what are known as pass through entities.
- REITs are designed to produce the same kind of rental yields as you'd receive if you directly owned a property.

The government hopes that REITs will bring a huge increase in private rental properties to help relieve the chronic housing shortage highlighted in the Barker Report.

But REITs will also allow investors to move into the commercial property field, buying into factories, and shopping malls, warehouses, even car parks.

They are likely to prove extremely popular with people nearing retirement who are looking for regular income.

Chris Turner, fund manager at TR Property investment trust predicts the yield will be attractive when compared to a share in a UK property company, which yields in the order of 3%. "Under REITs status we estimate that this could double," he said.

It's thought to be highly likely that the government will more or less follow the US model of REITs.

There they come in three colours:

- Equity - these simply invest in properties, own them and collect rents.
- Mortgage - these act as lenders and collect interest from loans.
- Hybrids – these, as you'd guess, do some of both.

In the US there are some 175 listed REITs with a market value of $246 billion. The companies are very often traded on the stock market and are popular with pension funds, insurance companies and mutual funds.

During the last five years of the nineties, REITs paid an average yield of 7.3% per annum. Generally, REITs show their most spectacular returns during uncertain times in the equity markets.

REITs are likely to bring a shake-up in the structure of most listed property

companies – many of which will adapt themselves to offer investors better returns – as companies or groups that meet the UK REIT eligibility criteria will not pay corporation tax on rental income or chargeable gains.

The big advantage of REITs compared to shares in property companies, is that shares are a famously inefficient way to invest in property.

The returns from a property portfolio are taxed twice before the investor feels the benefits. The company pays tax on its income and any capital gain, and the investor pays tax again on any dividends that they receive.

This is where the big advantage of REITs kicks in – no corporation tax.

13.2.2 How will REITs affect the UK property market?

Surveys carried out by market researchers MORI has shown that 47% of UK investors would be interested in REITs.

REITs would increase the importance of property as a direct contributor to the economy, which at the moment provides some 6% of GDP.

They would also mean that the cost of capital for property would be lower, which could lead either to lower rents or greater stocks of better quality property.

It is pension funds that potentially will provide a massive boost to REITs investments.

At the moment pension and insurance funds only invest around 7% of their assets in property. This is mainly because property assets are not particularly liquid, and transaction costs are high.

Research by MORI has shown that pension holders believe an average of 22% of their pension should be given over to property. When property's excellent performance as an investment was explained to those questioned, that figure rose to 37%.

The pressure will be on the pension funds to make use of REITs as an effective and tax-efficient way of investing in property.

13.2.3 What about the Buy to Let investor?

So what is likely to be the effect on the individual buy to let investor?

For one thing it is likely that may more people will be exposed to the property market, a good reason for the government to move carefully on interest rates and fiscal measures that might adversely affect the market.

And the injection of cash can only be a boost to the market and price inflation.

The effect on yields, though, may not be so good.

More residential rental must, ultimately, mean lower rents? At least in certain sectors of the residential rental market. Those other sectors will present opportunities.

It is possible that the government will impose certain restrictions on areas of investment or advantage for those companies investing in residential property.

The aim will be to direct funds to so-called affordable housing or regeneration schemes.

13.2.4 Investor Opportunity

Remember, lots of new regeneration schemes can only be advantageous to individual property investors smart enough to piggyback into an up-and-coming area.

You can basically take one of three approaches to REITs.

One - cash in and sell
If REITs cash comes to an area where you own property and its investment money drives the market upwards, it may be worthwhile cashing in by selling and moving your money to a new area ripe for development.

Piggy back on REITs
Alternatively, the amount of cash REITs may bring to an area means that area can be transformed. You can look for properties on the fringes and piggyback on the gentrification REITs cash can bring about.

Use REITs as another arm of your portfolio
Or you could simply regard REITs as another method of investing in property and use a fund as part of your property portfolio.

This might especially be true if REITs deliver the high yields which enable you to use the additional cash flow to fund your private cash negative investments.

13.3 Follow the Money – where is the big infrastructure spending?

As we've said, any predictions about precisely where to invest are best left to our private website with all the latest UK market information www.PropertySecrets.net

Having said that, there are several areas we think are worth pointing out because they will become investment hotspots – and that is still the case in 2006. Of course, the criteria we have used to determine where these places are can be used to find others.

The bottom line is that they are all areas that will see big injections of infrastructure cash.

13.3.1 Hot spot one - Ashford

In short, Ashford is the UK's Channel Tunnel gateway. It's just 12 miles from the Eurotunnel car shuttle terminal. From there it's possible to take Eurostar with direct links to Brussels in under two hours, Paris in two hours as well as travel in the other direction – London Bridge is just over an hour away.

The town is also linked to the M20 London-Folkestone motorway.

As such, it is hard to imagine a more fortunately placed location that will always experience strong demand for property.

13.3.2 Hot spot two - Arsenal

A massive London development - in the N5 and N7 postcodes - holds out the promise of big profits for investors.

Arsenal Football Club, in the north of the capital, has won permission to build a new 60,000-seater super stadium with facilities for restaurants, cafeterias and bars, function rooms, a shop, parking for 600 vehicles, a press centre/community education facility and a commercial food production business.

The ambitious project, which Arsenal hopes will be completed in time for the start of the 2006-07 season, has also proved the catalyst for a much wider regeneration scheme.

Of most interest is the redevelopment of Arsenal's old stadium. Its east stand is to be converted to residential flats and gym/health club and B1 accommodation will be provided at basement level.

This, together with the residential flats being created in the west stand, along with underground vehicle parking, a landscaped garden, play areas and a memorial garden present great buying opportunity for the investor.

The north stand and its associated buildings will be replaced with a block of residential flats with basement storage up to seven storeys high.

There will also be lower ground and basement levels, a four-storey block containing residential flats, and a three-storey block on the western side of the site containing residential flats and nursery.

Of course, opportunities will reveal themselves all around the area as regeneration cash floods in and it shrugs off its reputation as a less than salubrious place in which to live.

This is an excellent example of how regeneration cash can transform an area and create terrific investment opportunities.

13.3.3 Hot spot three – Go for Gold

Now that London is the host city there will be huge investment sums injected to ensure the promises made by the bid team are delivered – the staging costs alone are expected to be £3 billion!

The focus of the development for the Olympic stadium is the Lower Lea Valley, a wasteland in East London, where new sites in the area will also be used to create new homes, workspaces and other regeneration projects.

Prices went up 10% in July 2005 on the back of the 2012 announcement, but with all that's happening here, this is still likely to be a great investment opportunity over the long-term.

13.3.4 Hot spot four – areas due to take off

Demand for flights from regional airports in the UK is growing rapidly. This is a trend that will continue.

Budget airlines have increased the number of destinations served by UK airports and the number of people who want to travel by air.

Since 1991, the regional share of UK international scheduled services has increased from 12% to 19%, with many airports experiencing double-digit passenger growth, according to the Civil Aviation Authority.

Since 1973, international traffic at regional airports has grown at an average annual rate of 8%, outpacing London airports (5%).

And in 2002, 16 million passengers flew from the regions to London's airports, whereas 45 million boarded international flights from regional airports.

Against this background, the Civil Aviation Authority is advocating the development of regional airports.

Fourteen other airports, including Luton, London's City, Southampton and Norwich have already been identified as being ripe for expansion.

Another tip is the planned Finningley Airport – near Doncaster.

We believe development at these airports presents an excellent opportunity for buy to let investors.

Airports are increasingly a focus of economic activity, which is reflected in the rental and capital values surrounding them.

We believe that all the UK's regional airports and the area in their immediate vicinity merit close inspection as future property hotspots.

Here's where they are:

Aberdeen	East Midlands	Manchester
Belfast City	Edinburgh	Newcastle
Belfast Int.	Exeter	Newquay, Cornwall
Birmingham	Glasgow	Plymouth
Bournemouth	Humberside	Prestwick
Bristol	Inverness	Sheffield City
Cardiff Wales	Leeds Bradford	Teesside
Coventry	Liverpool	

Congratulations! You've finished section 13 and you'll now know about:

- SIPPS – and what happened to them - see section 13.2
- REITs and what they mean for investors – see section 13.2
- How a REITs works – see section 13.2.1
- How to follow the money – see section 13.3

14 PROPERTY AS AN INVESTMENT

There are many different ways to invest your money, each with particular advantages and disadvantages. If you are considering property investments for the first time, it can be helpful to compare them to stock market investments.

Once you've read and digested this chapter, you will be able to:

- Decide between property and equity investments - see section 14.1
- Recognise the unique advantages of property - see section 14.2
- Recognise the downside of property - see section 14.3
- Decide between hands-free property investment and hands on property development - see **section 14.4**

14.1 Property or Equity - which is the better investment route for you?

Equities can deliver a bumpy ride!

Between 1999 and 2001, the stock markets across the world, at best, delivered no growth!

Compared to the performance of residential investments delivering a 17% return in 2000 and double-digit annual capital growth since then, property would appear to be the far more attractive option.

But of course, it isn't always like this!

Throughout the 1990s, booming stock markets delivered super-charged performance that outstripped even the successful property market.

It is also true that in the long run, stock market growth outdoes property market growth.

So then, why do people invest in property rather than shares?

The main reason is that for the private investor, property is the only investment where gearing is possible. Gearing is a technical financial term, but is simple to understand and has a radical effect on the performance of your investment.

14.1.1 Gearing your investment

When you use gearing you essentially use someone else's money to finance a proportion of the investment (for a fee), but keep the capital gains yourself.

If this sounds familiar, it should be.

Gearing in the property market is achieved through taking a mortgage on a property. Essentially, you can convert a 5% capital growth on a property to a 33% capital growth on your investment (for example) - simply by taking out a larger mortgage on the property!

Don't believe us? Well here's an example:

> **Example of the Effects of Gearing:**
>
> Property of £100,000 is worth £105,000 1 year later
> **- an increase in the capital value of 5%.**
>
> However, you only need £15,000 deposit - if you take out a mortgage.
>
> Assuming the costs of the mortgage are covered by rent, then in 1 year your investment of £15,000 has become £20,000.
>
> **That's a 33% return on your investment!**

It is true that we've made some hefty assumptions - and you do need to work out your sums very carefully (e.g. take mortgage interest payments, transaction costs etc. into account) - see **section** 22 on how to open and use the **Buy to Let Secrets** spreadsheet.

However, when you compare this kind of performance return to shares and equities, you can see the true potential of property investments.

I've yet to find the bank manager who will lend you three times your current salary to help you buy shares.

See **section 14.2.1** for a more detailed explanation of the effects of mortgage gearing.

Note: Gearing is a great way to increase your returns. However, recently a lot of people have been promoting 100% loans (sometimes called 'no money down') - i.e. maximum gearing. This, in many cases, is too risky and too speculative. See **section 16.5** for more on Nothing Down / 100% loans.

14.1.2 Costs of acquiring / maintaining your portfolio

With equities, your cost is fixed at the share price.

With property, you'll need to spend money to maintain and add value to your property.

The golden rule: don't spend your money on what you like - but on what your potential tenants or buyers would like!

Typically, the biggest mistake a property investor makes is to spend too much money on refurbishment, redecoration or furnishings initially, and then fail to save for frequent refurbishments after three and six years. See **section** 21.7 for more details.

Money spent on luxury curtains and carpet is a waste, when simple and effective will do.

Money spent on a new car parking space, new kitchen, new bathroom, double-glazing and extra rooms (loft conversions or rooms above a garage), will give you the best return for your money - depending on the value of your property.

As a rule of thumb, **choose quality non-branded goods**.

But remember you need to refurbish/ improve a property in accordance with its value and location.

14.1.3 Risk profiles

Property doesn't go out of business - unlike shares and companies. It has a much more permanent feel about it. Many shares (particularly recently in the technology sectors), have offered very high returns, together with a high risk. Long-term property investment tends to be lower risk.

Even during the last property crash in 90/91, many properties that wouldn't sell became successful rental properties. Once the market recovered, the property fetched a good capital return.

That's why **people view property as a safer investment -** especially if held over a 5 to 10 year period.

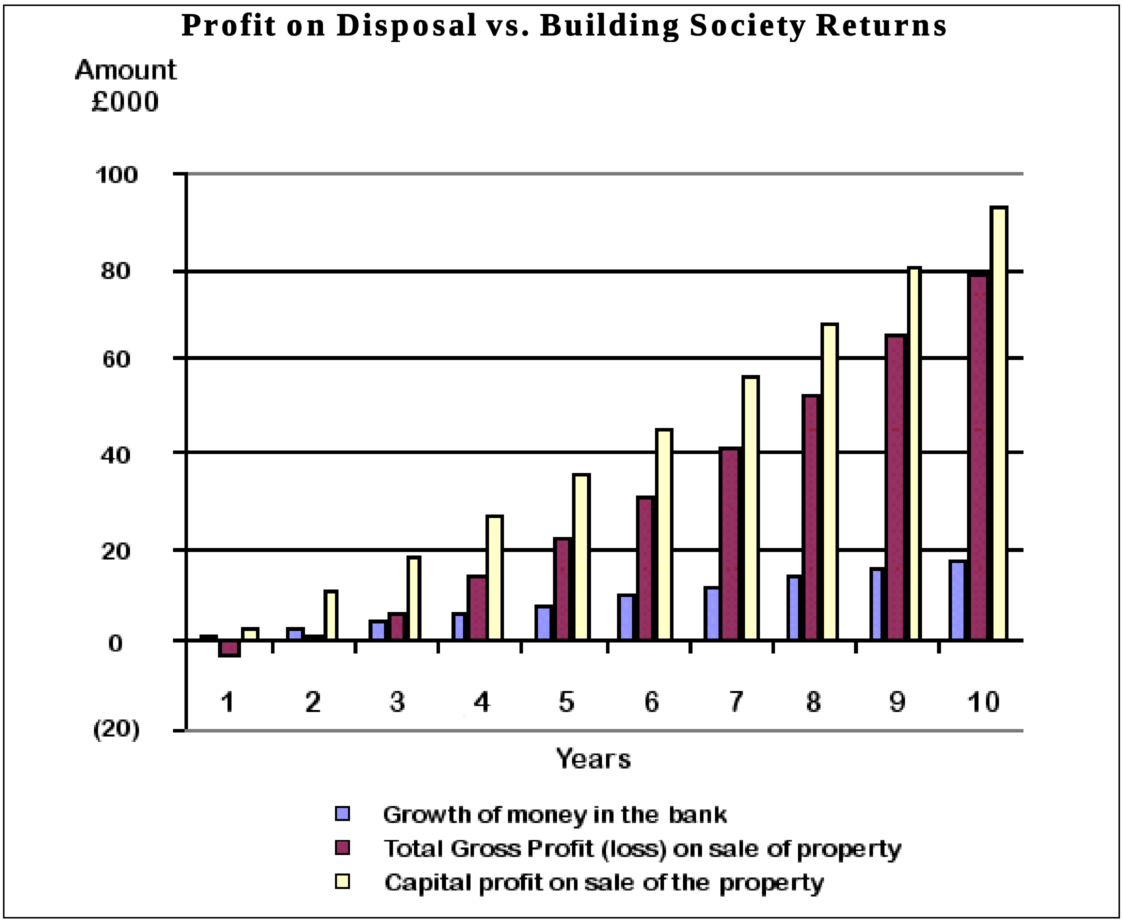
But don't forget that someone still has to pay the mortgage, fix the roof and pay for the maintenance, and this can become a drain on resources if the property is empty. See avoiding voids, **section 14.3.4**.

14.1.4 Liquidity: realising the value of your portfolio

Shares are more liquid than property; if necessary you can sell your share portfolio immediately - even if it is at a loss!

In a bad market you may be unable to sell your property. **Therefore you need to make sure that you won't need to release your property investment for a few years**.

Allow yourself at least 5 years to get your money back plus a bit, and 10 years to make a handsome return.



During year three the returns from the disposal of the property (after covering any rental losses) begin to beat the returns available from the bank. However, this assumes a smooth increase in property values.

A somewhat more bumpy growth pattern is closer to reality - so it is better to allow yourself a minimum of five years, and preferably 10 years, before you consider cashing in your asset.

However, if the market for selling property turns sour, then expect an upturn in rental yields (as per the last crash).

Golden rule: be willing to switch between property development and property letting according to the market conditions. You may not be able to sell your property - but then you will probably be able to let it out.

Using the letting income, mortgage lenders can be persuaded to advance a second mortgage for you to buy another home or property if you need to. This is often the best (and least costly) way of liquefying your property assets.

14.1.5 Up front costs and cash flow requirements

The purchase and set up costs of an investment property might be 25% of its value. Equity purchase costs are minimal in comparison.

If you buy a property for £100k, it might cost an additional £25k to pay for stamp duty, fees and refurbishment costs.

It might also take six months to complete the development, refurbishment and find a suitable tenant.

However, excellent returns are still possible without putting on your developer hat - if you are willing to hold for the long-term.

Therefore you need to ensure that you have sufficient funding to help you through the tricky set-up phase.

For more information about making money through property development, see our sister publication: Property Developer Secrets **www.propertysecrets.net/pds/**

14.1.6 Rental income and outgoings

Your rental income from property is not like a share dividend. It needs to pay for the cost of the mortgage loan, the letting agent, landlord insurance, maintenance insurance and then put away a sufficient amount to pay for ongoing maintenance charges, refurbishment costs and to cover any periods when the property is unlet.

It is unlikely that you will make a substantial rental profit in the first few years - although the value of your capital asset may be growing.

In fact, for most 8% yield properties, you'll need to dip into your own pocket to finance the letting in the early years.

Your share dividends are free of these extra expenses.

See **section** 22.6 on predicting your cash flow.

14.1.7 Ongoing management requirements

Unlike equities, part of the success of your property investment depends on your own work.

The low-risk route to property investment is to purchase a property in poor condition, and spend time and effort and/or money improving it.

This should substantially reduce your cost of purchase and ensure that you maximise your rental returns, or offer you a profit if you decide to sell.

Even if you hire a builder to do the work for you, expect to be heavily involved if the project is to complete quickly and effectively.

You need to be willing to get your hands dirty, and manage or fix any problems with the property or tenancy.

Typically, emergency property problems occur late on a rainy night, or just when you are leaving for the airport to go on holiday.

You can protect yourself from these by taking maintenance insurance, but don't assume that you won't need to get involved.

See **sections 21.7 and 21.8** on maintaining your property.

14.1.8 Income and Capital growth

The days of equities delivering a healthy income via the dividend are more or less gone.

In today's market, equity return is all about capital growth. Conversely, rental property offers an attractive mix of both income and capital growth - if held for the long-term.

Typically, in the first few years, a good rental property will break even, but as the cost of rent increases, so you can begin to draw an income from your property.

See **section** 22 on how to forecast potential returns.

14.1.9 The need for research: look before you leap

Research a potential property and property areas - just like you research equity investments.

Location is essential for property values. Some properties, in East Manchester, for instance, have fallen in value in the last 10 years and remain difficult to sell.

A mile or so away in central Manchester, property prices are booming

In this regard, properties are like shares. Finding the right property is essential.

Do all the research you can, read all the books you can, and walk the streets before you buy anything.

See **section 18.4** for more advice on how to find the right property in the right area.

14.1.10 In Conclusion

Property is a tremendous route to securing and building assets.

Long-term property investment, or buy to let, can be a relatively hands-off investment; however, in many cases you will need to invest time, effort and patience before it will reward you.

Compared to the stock market roller coaster, it is a calmer and more reliable form of investment, and one that offers excellent returns if you are willing to use the power of gearing - see **section 14.2.1** below.

Property even offers the possibility of a healthy monthly income in the years ahead.

14.2 What's so GOOD about property

14.2.1 Gearing

The beauty of property is that it offers the investor the benefits of gearing.

You put in 20% of the investment but get the capital appreciation on five times that amount. Like a hedge fund.

Gearing - we're all into it - only we don't know it!

In fact, **anyone with a mortgage is using gearing** to benefit from an increase in property prices.

You've no doubt heard of all the city whiz kids and stock market pundits talking about gearing and you probably never thought it applied to you...

... but you are probably using gearing already!

If you have or have ever purchased a property with a mortgage or loan, then you have used gearing too!

But **not everything you pay for using a loan is gearing**.

If you borrow money to purchase something that will go down in price or be valueless once you've used it; shoes, clothes, holidays, cars, for example, then that's spending - only worse!

Gearing only applies when you borrow money to fund the purchase of an investment (i.e. something that will potentially go up in value).

Companies borrow money to make investments (either in their own existing business or to purchase another business), in the belief that it will help them to grow.

The important thing about gearing is that the more borrowing you take on - the greater gain or loss you make!

Let's use an example:

Example to show the effects of gearing

Imagine two homeowners living next door to each other in the same street - Joe and Tracy.

Both houses are valued at £100,000.

Joe has a mortgage of £80,000 and Tracy has a mortgage of £60,000.

This means that Joe has invested £20,000 of his own money to purchase his property, whereas Tracy has invested £40,000.

OK, one year later the houses are revalued and they are now both worth £110,000 - an increase of 10%.

Who has made the most amount of money? Well, they both made the same amount (i.e. £10,000) - but Joe has achieved a better return.

Take a look at the table:

Effect of 'mortgage gearing' on the potential gain

	Joe	Tracy
House Value	£100,000	£100,000
Mortgage	£ 80,000	£ 60,000
Own money invested	£ 20,000	£ 40,000
Increase	£ 10,000	£ 10,000
Therefore % gain	50%	25%

You can see that **Joe achieved a return two times greater than Tracy** (50% vs. 25%), even though they both achieve the same actual gain (i.e. £10,000).

The theory is that if Joe had the same money available as Tracy (£40,000), and had invested the remaining £20,000 of his money into another house - then he would have achieved a gain of £10,000 per property - a total of £20,000 against Tracy's £10,000 gain.

Effect of mortgage gearing on the potential gain				If Joe used his money to buy one more property:
	Joe	Tracy		Joe's 2nd Property
House Value	£100,000	£100,000		£100,000
Mortgage	£ 80,000	£ 60,000		£ 80,000
Own money invested	£ 20,000	£ 40,000		£ 20,000
Increase	£ 10,000	£ 10,000		£ 10,000
Therefore % gain	50%	25%		50%

This table now shows Joe and Tracy investing £40,000 each - but Joe makes a two times greater return - thanks to gearing!

That's the power of using a mortgage to create gearing.

No other form of investment allows you to do this.

You cannot create gearing like this with shares!

That is why, even though UK house prices have increased by roughly 5% per year over the last 25 years - you can use gearing to make much more than this.

Key tip

In essence, as per the above example, you might invest 20% of the capital (price of the property), but you receive 100% of the capital increase.

Conclusion
Should you decide that you should keep your mortgage as high as possible - to maximise your return?

Yes! But with limits...

That's a strange concept - the higher your mortgage the greater your return!

Many people do take this approach - especially with property investment.

But remember if the market falls the gearing will equally work against you! And you may be faced with higher borrowing costs.

The key decision is:

What is your attitude to risk? (Higher gearing = higher risk)

Part of that question depends on your age - anyone approaching late middle age or near retirement would be unwise to take large risks - someone younger can hang on long enough for the market to recover - if things go badly wrong.

14.2.2 Growth

Average property prices have increased by 4-5% per annum across the country and 5-6% in London over the long-term (i.e. not just in the last five years).

But your return will be much higher according to your gearing. See the table below:

Property Value	Loan Amount	Your investment (deposit)	Annual Increase in value (5%)	Return on your investment %*
£100,000	£90,000 (80%)	£20,000	£5,000	25%
£100,000	£70,000 (60%)	£40,000	£5,000	16.67%
£100,000	£50,000 (40%)	£60,000	£5,000	10%
* not including finance costs etc.				

Key tip

Typical Buy to Let investments borrow about 80% of the property value. This maximises the gearing without incurring higher interest rate charges or the equivalent of Mortgage Insurance Policy (MIP) fees. See **section 16** for more information.

14.2.3 Income and capital growth

Income yield from stocks and shares has been declining over the long-term.

In contrast, returns from buy to let property investment can be a combination of both income and capital growth.

As it becomes more difficult to find investments that offer income and capital growth, property investments are becoming increasingly attractive.

This is especially true for people looking for a reliable source of retirement income coupled with capital growth.

14.3 What's so BAD about property

Before you get too deeply into property, it is worth remembering the drawbacks of property investment, including:

- need for **ongoing maintenance** of the property
- dealing with **tenants**
- dealing with letting agents
- loss of rental income in **void periods** when you are between tenants
- legal **responsibilities** and liabilities.

However, you can substantially reduce this hassle factor if you buy the right kind of properties and set them up correctly.

14.3.1 Responsibility and Maintenance

There will always be a certain amount of ongoing maintenance required for each property that you let.

In between lettings, you may need to freshen up the property.

It may just require a lick of paint or it may be something more serious like penetrating damp around window frames.

Unfortunately, not all tenants will look out for early signs of work that needs doing, possibly leading to larger bills for you later. Conversely, some tenants may constantly demand trivial work is done to a property.

In addition to this, there will always be the need for emergency repairs:

- broken taps
- broken windows
- central heating failure
- broken washing machine, etc

And for some reason this tends to happen more late at night, or when you are about to go off on holiday.......!

You can go a long way to mitigating this by careful choice of furnishings, fittings and appliances, but there will always be an irreducible flow of snags and unexpected problems.

14.3.2 Tenants

Owning property means managing and dealing with people.

Every 6 or 12 months, or couple of years, you'll suddenly be driven into a lather of activity by the need to replace your tenant.

Some people fear dealing with tenants so much that they are willing to pay a substantial proportion of their rental income to an agency to completely avoid having any contact with them. This extreme solution is more appropriate for overseas landlords who cannot have the ongoing contact with tenants.

If you are unfortunate (or unwise) you may have to deal with bad tenants, but you can reduce this risk substantially (see **section** 20.1 **-** avoiding bad tenants at all costs).

The main challenges you will have with tenants are

- how to **find** them in the first place
- how to **replace** them
- what to do about **bad tenants**

In **section** 20 we will look in more detail at finding tenants and in **section** 21 we deal with managing your tenants.

14.3.3 Agents and letting agents

Dealing with agents can either take a weight off your shoulders and a load off your mind, or just cause you more grief!

If you are going to be dealing with agents, it is vital that you **take time to find good letting agents**, and keep them focused on your needs.

We will be looking in more detail in **section** 17 on how to

- find a good letting agent
- **motivate** your letting agent

- get the most out of your letting agent

Key tip

Ask around for the agent with the best reputation - don't select on price alone - it is possibly the least important consideration!

14.3.4 Void periods

Frequent void periods can seriously damage your return.

See **section 15.7** for an illustration of what can happen to your cash flow.

Your expected pattern of void periods will obviously depend on the type of property you have and the type of tenants you are aiming for (e.g. student lets will often be empty during summer holiday periods, etc.).

It is important to **be very organised ahead of an anticipated changeover**, so you get prospective new tenants to look round the property in good time. Also, as mentioned above, the ability to do necessary repair / tidy-up work as rapidly as possible between lettings is key.

Another determinant of void periods is **the ability of your agents to locate serious potential tenants** and handle appropriate paperwork. As ever, your relationship with your letting agent is crucial.

Further on in **Buy to Let Secrets** we will give advice on identifying properties that let well in both good and bad market conditions (see **section** 18.2). If you pick a good property and make the effort to keep it in good condition, you will be a long way towards minimising void periods.

14.3.5 Legal restrictions on landlords

As a landlord you **must ensure that your property meets a number of statutory requirements**. Examples include:

- you must have regular gas appliance safety checks by a registered engineer
- all furniture must be certified fire resistant (to appropriate government standards)

These jobs are very important, but relatively minor in terms of time and money requirements.

Usually these can be safely passed on to your letting agents if you are busy (but the legal liability will remain with you).

See **section** 19.8 for more details.

14.4 Property Development (short-term) vs. Buy to Let (long-term) investment

We've looked at the pros and cons of property and seen that it has potential to deliver good to excellent long-term returns in terms of:

rent or income (i.e. the rent comes in month after month) and

capital gain (i.e. the gain is only realised once you sell the property and pay back your finance and set up costs)

There are two main ways to approach the property market:

Property Development (***short-term***) is: **buying a property, adding value to it (by renovating it) and selling it for a profit**

Buy to Let or (***long-term investment***) is: **finding properties that have long-term capital growth potential and are easy to rent out**.

Buy to let or long-term investment is a lot less time consuming than property development.

Property development is about spotting opportunities in the local housing market.

You might spot that the whole market is bouncing up or find a property that is undervalued. By improving and turning an unwanted property back into a desirable home or apartment, the developer can make rapid profits.

Property development is equivalent to an active trader on the stock market - checking the portfolio on a daily basis to measure its progress and constantly looking for new opportunities.

With a long-term buy to let investment, you are looking to find an up and coming area, and to then purchase a property that will follow the upswing of a local housing market.

Of course, if the housing market goes down, your investment goes down too.

However, if it goes up, and in the long-term it nearly always goes up, you will make money.

By holding the property over the long-term, you would make your money on the back of a rise in the capital value of the property.

The trick with long-term property investment is to buy the right kind of property so as to minimise your long-term effort.

14.4.1 How much time do Property Developments vs. Buy to Let investments require?

The amount of time you'll invest in buy to let investments is very much less than with property development.

Long-term investment would not be a full-time job, unless you already have 10 or 20 properties and are looking to add more.

Buy to let is a form of investment that working people can use to supplement their other income.

On the other hand, property development is realistically a full-time job.

To look after and manage your builders, you will need to be on site every day, so that you can make sure that the job is done right.

If you work, this will require a very understanding employer who allows you to leave the office a lot.

The buy to let investor, however, is a lot more hands off. Once the property is bought and the tenant has been found, then that is the job done for a year, bar a little bit of maintenance.

Of course, you might choose properties suitable for DSS claimants or student tenants, in which case you'll need to be much more hands on. Just be aware that these properties don't suit busy people who don't have much time.

14.4.2 Short vs. Long-term investment – which is right for you?

If you can't wait five, six, seven years or more for your properties to start delivering a return and you need a job with an income, then *short-term* property development would be right for you.

However, if you have a full-time job already and property investment is going to be part-time activity, then you might only be able to do one property development deal at a time.

But it will be tough because builders tend to work Monday to Friday and trying to get them to work outside those hours is difficult.

If you have a Monday to Friday, 9-5 job you will find it difficult to give *short-term* property development the time it deserves.

Long-term property investment can easily be done as part-time work because once you have dealt with the initial process of buying a property, then you can hand it over to the agents to find you a tenant.

Long-term investment requires some maintenance, which of course you can do over the weekends, or you can have a managing agent to do it for you, or use a local handy man.

A lot of overseas property investors have invested into the *long-term* UK market.

Case Study

Around 1996/7, there was a big influx of Hong Kong property investors who knew the UK property market was good.

They believed that it was going to become stronger and they bought a lot of properties in London and they have done very well.

As they live in Hong Kong, it just goes to show how much more hands-off *long-term* property investment can be. Equally, it is absurd to think that you could manage a property development from Hong Kong – this would be just impossible.

Key tip

Properties that are in good condition and well-built require much less maintenance time.

Key tip

There is no reason why you can't combine both property development and long-term buy to let investments. Instead of selling the property once complete, you simply move it into the rentals market.

14.4.3 Common reasons for buy to let investments

In addition to the desire to make a capital gain in buoyant property markets, many people have other specific objectives in mind when considering buy to let. In this section we look briefly at the logic behind two of the most popular buy to let aspirations:

- pension planning
- provision of accommodation for children / dependants.

Buy to let for pension planning

One of the problems with long-term pension planning is that most annuities are either flat rate (i.e. they don't increase), or they are linked to the Retail Price Index (RPI).

Many people looking to get involved in buy to let or rented property do so as an alternative pension investment. Over time you should generate a profit on your rental income (in addition to any capital growth). This income will typically rise in line with earnings, and possibly above the rate of RPI.

Long-term rented property offers the prospect of an increase in income above inflation as well as generating a substantial capital gain. But don't expect an immediate return.

Provision of Accommodation for Students / Children / Dependants
A lot of parents would like to buy a flat or house for their young child.

Instead of waiting until the child has grown up, they buy it for them now and rent it out, because they know it is going to be a lot cheaper to buy now than it will be when the child is 21.

Alternatively, when the child goes to university, the parent may choose to help fund the living expenses by purchasing a property that the child can live in and also generate an income by renting out to other students.

Either of these are good reasons to consider long-term property investment.

Congratulations - you've finished section 14!

You'll now know how to:

- Decide between property and equity investments - see section 14.1
- Recognise the unique advantages of property - see section 14.2
- Recognise the downside of property - see section 14.3
- Decide between hands-free property investment and hands on property development - see **section 14.4**

15 Key Concepts of Property Investment

Once you've read and digested this chapter, you will be able to:

- See the hidden cost of an 8% yield bargain - see section 15.2.2
- Recognise the financial rewards of a hassle-free investment - see section 15.3
- Choose between capital growth and rental yield - see section 15.4
- Get the best of both worlds - see section 15.6
- Avoid voids - see section 15.7

15.1 An investment project – not a hobby

Some people approach property investment as a hobby. This is dangerous.

A lot of people get nice ideas of buying a place because they fancy doing a bit of interior designing, but approaching any serious business proposition in this way could be ruinous.

You have to look at it in the cold light of day, do your sums and not kid yourself about what is involved.

15.1.1 Property investment compared to home buying

Don't apply the logic of buying a home to buying a property investment.

People buy a home because they buy from the heart. You fall in love with it – it's your kind of place.

That also extends to how you improve and decorate the property.

If you applied this thinking to your investment property you might end up in a lot of trouble.

For instance, you might really like Bohemian colours and want to paint the place accordingly. However, strong colours make a property very difficult to let.

Equally, you might like basement flats, but most people don't!

With investment properties, decorate them in a style that MOST people would like. You want to appeal to the MASS MARKET- and not individual taste.

Some investors do focus on particular aspects of the market - and therefore will decorate accordingly. However, you really have to understand your niche market and what appeals, otherwise you could get your fingers burnt.

For the new or newish investor, it is easier - and safer - to start off by going for the mass market.

Look for a first floor apartment with a well-proportioned living room and paint it white or neutral colours. This is what is going to appeal to the majority of the market.

See **section** 18 for more ideas on the perfect rental property.

Key tip
Apply this rule of thumb: Will it appeal to the mass market?

15.1.2 Stick to what and where you know

It is very wise to stick to an area you know, but even more so if you are considering property development simply because you need to know exactly what a property is worth in that area.

(see Property Developer Secrets **www.propertysecrets.net/pds/**)

The time it takes to get to know the local streets, notice changes and developments is considerable.

Also, you will want to read the local papers so you hear about the potential transport improvements or developments early.

See **section** 18.4 for more ideas on how to research an area.

15.2 Rental yield

Rental yield is a measure of return on your investment.

15.2.1 Gross yield update 2006

The most commonly used yield is called Gross Yield.

A gross yield simply allows you to compare the potential returns of one property vs. another property.

How to work out Gross Yield:

$$\frac{\textbf{Achievable monthly rent x 12}}{\textbf{Cost of the property}} = \textbf{the GROSS YIELD}$$

e.g.:

£1,260 per month, for 12 months per year = £15,120

property price = £150,000

gross yield =10%

The yield figure cannot tell you whether or not you'll make money from the property - only a proper analysis of the costs and income can do this.

Like any business, you have to look at your profit and loss – which is what really matters.

Key tip

Gross Yield is just a very rough guideline as to whether it is a good property that can be looked at more closely, or a bad property. It is a simple guideline - but do your sums properly for each property.

See **section** 22 on how to open and use the spreadsheet.

Typically, an estate agent uses the ***gross yield*** to demonstrate what a good bargain you are being offered.

So you should always ask the seller how they have calculated the yield, check the maths for yourself, and then work out your income and costs.

15.2.2 Appropriate yields for a profitable investment

Often when estate agents talk about a property providing an 8% gross yield, it is tempting to think that this was how much money you might make (less a bit for expenses).

This is a big mistake!

Example of why an 8% yield won't make you rich...yet:

A property generates £667 per month

Therefore, (multiplied by 12 months) = £8,004 per year

The property costs £100,000 to buy,

So gross yield = £8,004 ÷ £100,000 = 8% gross yield

Is this a good buy?

Cost of buying property is:

Cost of property	£100,000
Refurbish costs	£ 3,000
Buying costs	£ 3,000

Actual cost of property now = £106,000

Gross rent per year = £8,000 (assuming 8% gross yield)

Service and agents costs	£1,300
Future refurbish costs	£1,500
Mortgage costs	£5,600
Allowance for void periods	£ 300

Therefore, net income = (£700)

Therefore net yield = (£700) ÷ £106,000 = (0.67%)

What this tells us is that the gross yield or the gross rent (£8,000 per year or whatever) is very misleading.

The actual return that you receive will be very different from the gross yield.

Therefore, you should always calculate the actual costs and revenue accurately before you purchase your property.

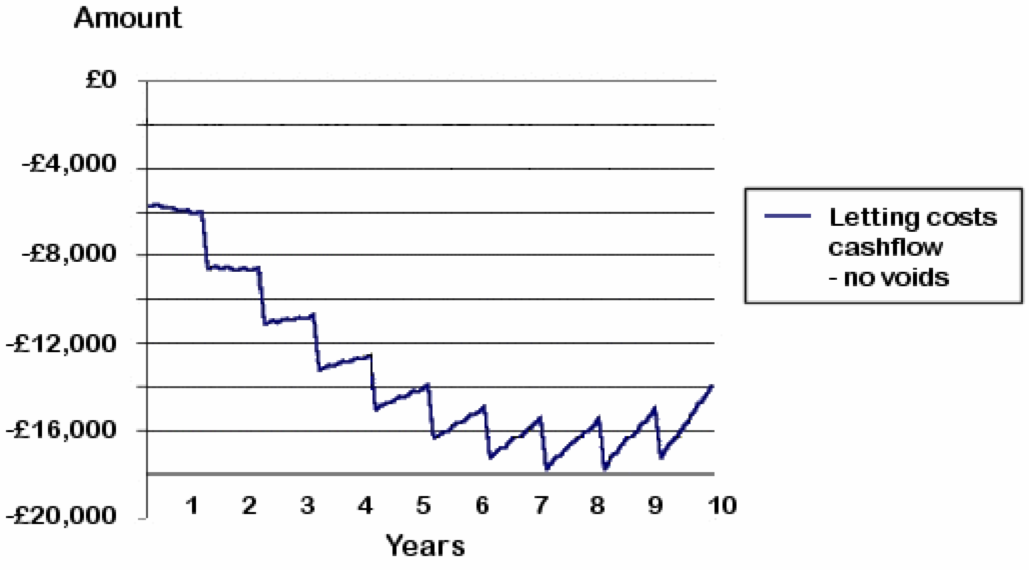
15.2.3 Cash flow and time to break-even

The gross yield should increase over time. As the amount that you borrowed stays the same, then the percentage return on your initial purchase will go up because, on average, rents go up every year.

In time, an 8% gross yield will become a 12% gross yield because rents have increased - but the amount you paid for the property remains the same.

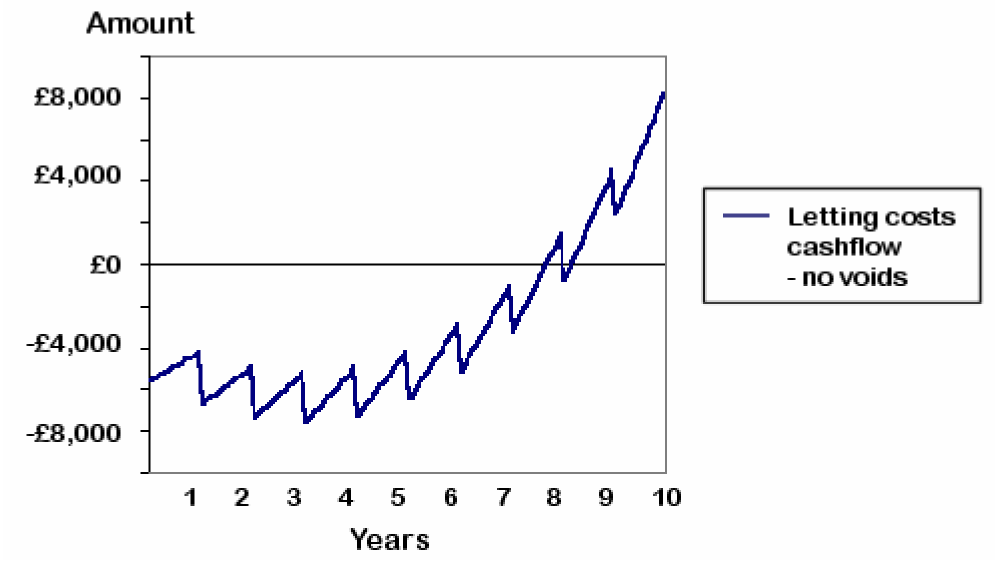
It is at this time that you will be making a profit on the rental income each month.

Cash flow forecast at 8% yield and 7% capital growth and 4% annual rent increase



Source: Property Secrets,

Cumulative Cash flow – yield 10%, capital growth 4% and annual rent increase at 4%



Source: Property Secrets,

The two graphs above show the rental cost. They assume a 4% annual growth in rent.

Both graphs start with a negative of about £5,600 - this to allow an initial investment to set up the property (your property may require less). In addition, it assumes that 2.5% of the property value is held back each year for frequent refurbishment.

You can see that the 10% yield, whilst fluctuating slightly (depending on the need to spend money on refurbishment), won't require any substantial further investment.

On the other hand, **the 8% yield property will require you to provide funds every month** to make up the gap between the net rental income and the cost of the loan and maintenance.

Look at your figures, and if you find that you are only getting an 8% gross yield, then you may need to supplement the income every month. If you don't have this extra money each month, you might have a problem.

If you want to break even from day one, you need to be looking for a gross yield of around 10%.

It is possible to get higher rent, but you will probably need to buy something that needs work initially in order to achieve that yield.

Equally, you may accept that the rental side of your investment is run at a loss for the first few years.

However, a lower rental yield now may deliver a greater profit in the end. See section 15.3 for more details.

That is why, throughout Buy to Let Secrets, we emphasise that you will make your gain on the capital growth - not the rental income - particularly if you want a 'hassle-free' investment.

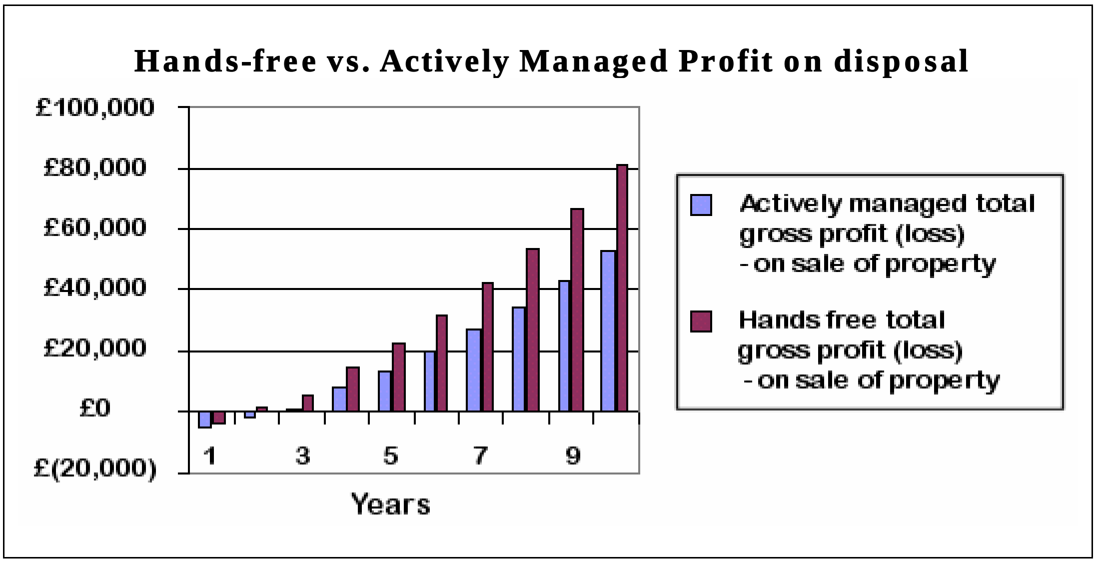
It is very important to take the time to work out your financial plan, thinking not only of long-term growth, but also of ensuring you have the necessary short-term cash flow to allow you to make ongoing repairs, service your finance etc.

15.3 Capital growth

The rental yield is only one part of the equation. Of even greater importance is the capital growth.

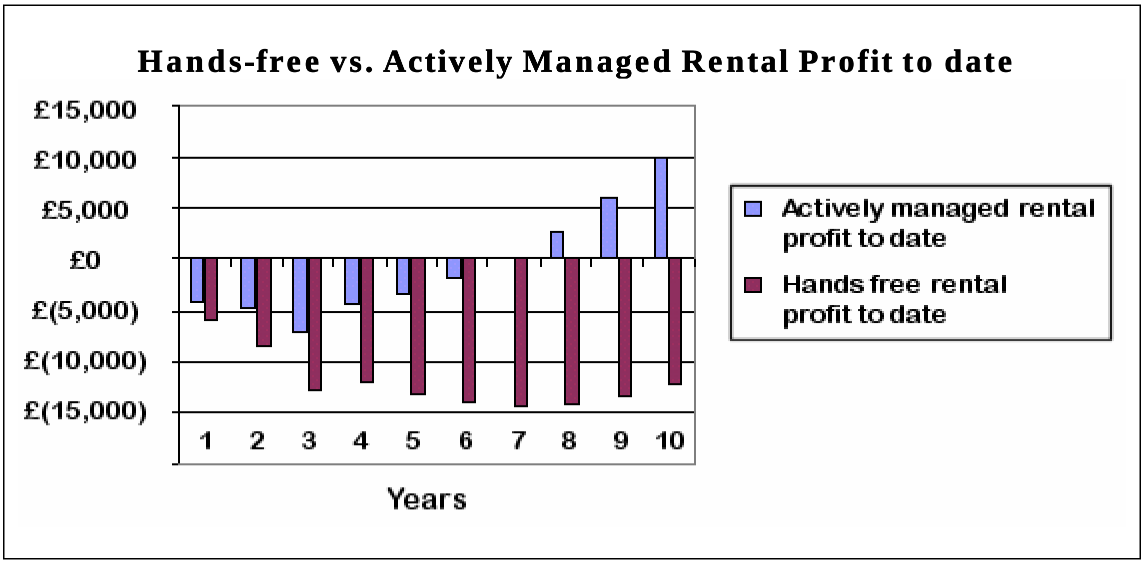
A calculation of rental yield alone will not provide the information you need to determine whether the property is a good investment. As capital growth is likely to be a major component of any profits you make, you must carefully consider the drivers of property prices.

Compare the 2 graphs below:



The hands-free property is assumed to be a professional let offering a lower rental yield (8%) vs. an actively managed let (say a student let offering 10% yield).

In addition, it is assumed that the annual increase in value of the professional property is 7% per year against a 4% per year growth for the student property.



Two things jump out from these charts:

1. The profit on disposal of the hands-free or professional let is almost 60% greater (this includes rental loses), than the higher yield property.

2. The professional or hands-free let requires much greater funding than the actively managed student let.

Add to this the fact that the higher rental yield property requires more work (time investment) and it is clear which property offers a better return.

> **A professional hands-free let will require substantial additional funding. However, if it is possible to achieve the capital growth, then this will deliver a far better return in the end.**

15.4 Maximising yield and growth returns

There are two ways to maximise your returns. Buy a property:

- in a good area that has lower rental yields but good capital growth or
- in a poorer area (lower capital growth), which offers a higher rental yield

Which is the better choice?

In the end, the higher capital growth properties will probably deliver a better return.

Although, waiting for capital growth is a higher risk investment strategy than a property that delivers a 10% rental yield and breaks even from day one.

However, your choice will partly depend on your goals and circumstances.

If you have limited funds, you may need to buy a property that can offer higher rental yields such that you can at least break even on the rental costs from day one.

There again, you may be able to consistently invest in your property over the next five to ten years, so that you can afford to purchase in a better area that has a history of delivering excellent capital gains.

During the next few years, properties will show lower capital growth, and for this reason higher yielding properties have become more attractive to investors.

Equally, recently, the Northern regions were able to post both positive capital growth and also positive rental yields, making this area one of the most attractive investment regions.

Key tip
Either way, once you have one successful property venture under your belt, you can always remortgage that property to release the capital that you can use to fund a second property purchase.

15.4.1 Rental yields and capital growth dynamics

Rental yields and capital growth move in opposite directions.

In the past whenever the property market has fallen, the demand for rental property has shot up, with the effect that rents charged rise.

If property prices do crash, then people delay buying property and rent instead. This increases the demand for rented accommodation and so pushes up the rental prices.

Unfortunately, the rise in rental prices may lag the crash in property prices, so the switch between capital growth to rental yield growth can make for difficult times and it is wise to keep some cash in reserve just in case.

However, the rise in rental values would push your project into profit earlier, and once the housing market recovers, it tends to catch up for the missed years of capital growth under-performance.

Bearing that in mind you are really looking at a minimum of 10 years. So think about what might happen to the area surrounding your property in the next 10 years.

15.5 Different properties have different growth / yield profiles

Shared housing, student and DSS accommodation tend to be in areas that are a lot cheaper, thereby offering a much greater rental return.

As property prices have soared in the past few years, more and more investors have been put off by the terrible rental yields offered by some city centre developments (in some cases as low as 4%).

As a result, more focus has been given to the higher yielding properties.

For shared accommodation, gross yields of more than 10% are common.

And a 10% yield typically signifies that you'll break even on the rental income from day one.

However, many of these properties will be in lower capital growth areas. The risk is that **you could be sacrificing long-term capital growth for higher rental income.**

Often these properties are in a nasty part of town, and it might take 20 years for them to improve.

Nevertheless, smart investors are picking up quality shared accommodation in the better parts of town.

For instance, student properties or houses let to nurses, that are within walking distance of the university or hospital are invariably easy to let and may be in an area of town that is due for gentrification or improvement.

However, remember that some companies, such as Unite, are building large student blocks, hence reducing the demand for private student rental accommodation.

In this case, you may find that the private accommodation that is a long way from the university or hospital is very hard to let out.

The risk is that what you gain on the rental income (the yield), you're actually giving up on the capital growth. And in the long-term high yield properties will require more effort from you.

Key tip

The route to a hands-free, minimum hassle property investment, is to accept a lower yield (initially), in return for greater capital growth. Keep your property in excellent condition (by re-investing your rental income) and you should, with luck, stay hassle-free and own a smart, easy to sell and valuable property by the end.

If you are willing to invest more of your time managing your property, look for shared accommodation within walking distance of universities and hospitals in areas that are improving.

15.5.1 Buy to let investment timescale

Look at a 5-10 year plan as a minimum. If you cannot see beyond five years, then fine, but you should be open to 10 years because the housing market goes up and down.

If you know you are going to need your money back in five years time, property investment might not be for you.

15.6 Getting the best of both worlds

If you are buying in a good area or one that is clearly into the stages of redevelopment, then property prices may already be high meaning that the rental yield will be low.

The only way to improve the rental yield - and so make your project break-even from day one, or at least from very early on - is to buy at discount price.

The kinds of property that are available at a discount price (in good areas), need major renovation work carried out on them.

That is why the perfect investment property is:

- **available at a low price** due to the work required
- located in a good street
- **located in an up and coming area** that will continue to improve in the next five to ten years

Buy at a low price, renovate the property, move it into the rental market and watch your capital investment grow in value as the rental income pays for the costs of running the project.

For example: - Put your property developer hat on Buy something at, say, £100,000 Spend £20,000 renovating it Turn it in to a property worth £145,000.

If you have the time and expertise to manage the property development, this offers an extra source of profit, and a level of insurance against downturns in the property market.

In our sister e-book, Property Developer Secrets, we advocate focusing on properties that offer a 20% return, as an appropriate safeguard against the risk of a downturn.
You will also then get a much higher return in an area that is up and coming, so your capital will increase above the national average because the area has improved.

See Property Developer Secrets **www.propertysecrets.net/pds/**

15.6.1 Look for the up and coming area

The secret of successful *long-term* investment is the ability to spot an up and coming area.

You are looking ideally at an area where property will increase in value at above the national average.

You are looking for an area that is undergoing improvement, through new shops, new buildings or new public transport links.

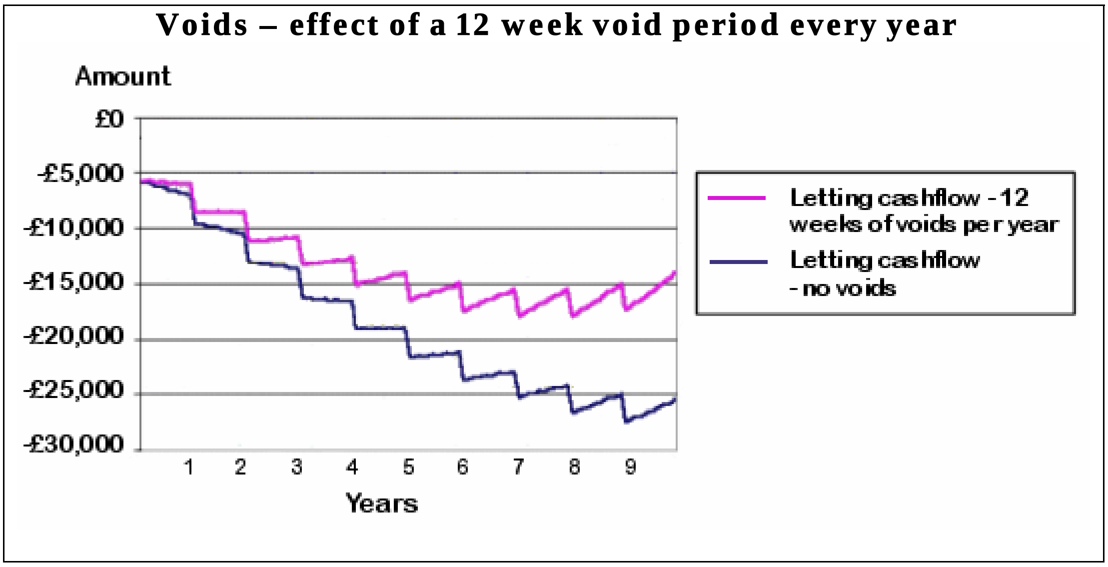
All of these factors will increase the desirability of the location and so increase local demand and prices.

Key tip
Look for an area that's up and coming so it will give you very good or above average long-term capital growth and then find a property in that area which will give you sufficient yield to enable you to fund the project. Remember that the priority is the capital growth; the rental income is initially needed primarily only to fund the project.

15.7 Avoiding voids

A void period is the time when your property is left empty, without occupants.

It also leaves you without income to cover your monthly mortgage and maintenance / apartment services costs.



The above graph, assuming an 8% gross yield and sufficient funds to keep the property in good order, shows that a persistent void period of 12 weeks per year will double the investment and cash flow required to fund your rental investment.

Of all the things that can go wrong, an extended void period will cause you the greatest problems because it can ruin your finances very quickly.

Key tip

Make the reduction of void periods a key objective

15.7.1 How to avoid voids

There are two main things you need to do to minimise void periods:

Ensure the property remains attractive to the mass (or your chosen) market.

Make sure that you are prepared to move into action quickly to get a new tenant once one leaves.

To keep the property attractive to your market, make sure that you:

- Choose and decorate an apartment or flat that will always appeal to the mass rental market (see section 19 for more information).
- Keep your property in excellent condition.

- Make your property stand out from the local competition (e.g. by offering a furnished flat in an area full of unfurnished properties).
- Keep a close eye on your tenant and deal with any payment or damage problems immediately (see **section 21.4** for more).

To get the flat out into the market quickly after the previous tenant leaves, we recommend that you:

- **Use an agent** and pay them full commission
- Ensure you can show your property to prospective tenants before the existing tenancy comes to an end
- Keep the rental price in the mid-range and avoid excessive demands
- **Complete minor repairs quickly** and at short notice, or make sure you know someone who can

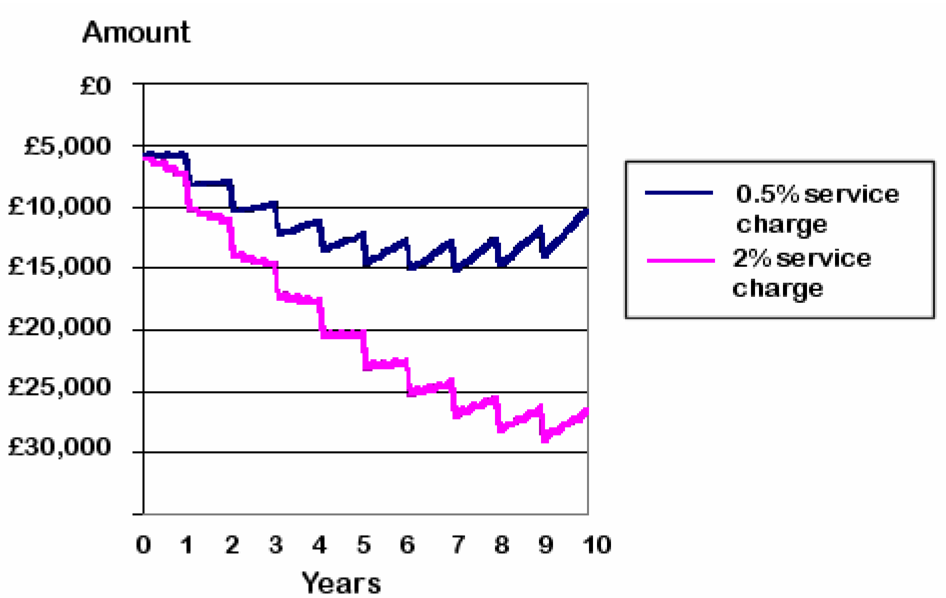
15.8 Avoid high service charges

After voids, the second biggest impact on your rental costs will be the service charges levied by an apartment - particularly in the new developments that include gyms, parking and sometimes pools and gardens.

The graph on the following page demonstrates - in this example - that the rental costs more than double for a very high service charge.

It might be possible to charge slightly more rent or even reduce void periods, but the scale of the impact means that in most cases **you are best advised to avoid properties with high service costs.**

The effect of a 0.5% vs. 2.0% service charge on rental cash flow



15.9 Letting Agents - your key source of advice

The Letting Agent will probably be your key source of advice when you are considering buy to let in a particular area. You will benefit not only from their local knowledge, but also their day-to-day experience of making lettings work.

Try to use independent people (i.e. those not involved in selling you a property), as much as you can. You can get away with asking questions to independent people by using some charm and also flattering them.

For example, talk to the head of lettings in an estate agency - not the sales manager. Flatter them that you have heard great things about them and could you please have five minutes of their time.

The head of a lettings agency is not trying to sell you a property and therefore they are much more independent.

15.9.1 Make the Letting Agent see you as a prospective client

Explain that you will give the Letting Agent your property to rent. This will motivate them to help you buy the right place because they are going to have to rent it out.

Make this very clear to them by asking the Letting Agent to come and view properties that you have seen to tell you which one they think would be best.

At this stage they will also be scared that if they give you bad advice, you will be back to remind them. As long as they know what they are talking about, they will generally give you good advice.

15.10 Your resources: time & money

15.10.1 What Money Have You Got Available to Invest?

There are three main costs that you'll need to fund:

- The deposit on the purchase of the property (typically 15% or more of the purchase price).
- Purchase costs (stamp duty, solicitor's costs, etc) and the refurbishment.
- The ongoing cost of letting the property.

Whilst the majority of the money comes from the mortgage lender, you will need to access additional funds typically from:

- Available cash in the bank
- Extending the mortgage on your current property

And in some cases (although this is more risky), you might seek an additional loan from the bank.

See **section** 22.6 for more on cash flow.

15.10.2 How much time can you afford?

Are you going to be available between 9-5, Monday to Friday? If not, then you'll be looking at a more hands-off approach.

If you are available during the working week, then you might want to start by developing your property first and then moving it into the lettings market. See Property Developer Secrets **www.propertysecrets.net/pds/**

Property investment, on the other hand, is much more hands-off once your property is set up.

In this case the questions to ask are:

- How much time will I need to research, find, purchase and set up my property?
- How much time will I need to manage the property?

Time investment - at the beginning
Buying your property could easily become a full-time job. You could spend all your evenings and weekends visiting properties and walking the streets.

If it is your first property investment, you are obviously going to take longer because you are covering new ground and you are very much on a learning curve.

You should expect the general research to take a great deal of time. You want to make sure that you buy in the right place.

Then you'll move into over-drive as you complete the property purchase, refurbishment and, possibly, furnish your property too. Then, on to finding your tenant - here we'd recommend that you ask a professional agent to help.

Time investment - managing the property
Once you have bought your property, then the amount of time you spend on it is minimal, as long as things go well.

Hopefully you will not have too many leaks, the central heating will not break down and you will not have any bad tenants.

Therefore, it is worth checking that everything works well initially and all your furnishings, white goods, kitchens and bathrooms are hard-wearing.

Avoid any easily breakable items when letting, because although you might be very careful with delicate appliances, the tenants might not be.

If you decide to let to students or DSS, then expect a much heavier day to day workload. See **section 21.3**

Key tip

The amount of time you spend managing a property is the function of how well it runs.

A property in good clean condition, with durable appliances and the right kind of tenant (i.e. someone who will respect your property) means that maintenance will be minimal.

Unpredictability and inconvenience

One of the major disadvantages of property investment is that **things always seem to go wrong just at the most inconvenient time**.

You are just leaving for the airport on a Friday night. The family is packed up in the car ready for your two week vacation - and guess what?

.... Yes, you guessed it!

The washing machine breaks, the kitchen floods, the downstairs flat is complaining of leaks in the ceiling and the rent cheque has just bounced!

Yes, it never rains, but pours!

Expect the worse to happen if you manage the property yourself.

You can ask someone else to manage it for you - but sometimes that just means the problems get worse before anybody does anything about them!

And when the problems do finally reach you, you still have to drop everything and rush off to deal with it.

See **section** 21 for more details.

Congratulations you've finished section 15! You'll now know how to:

- See the hidden cost of an 8% yield bargain - see section 15.2.2
- Recognise the financial rewards of a hassle-free investment - see section 15.3
- Choose between capital growth and rental yield - see section 15.4
- Get the best of both worlds - see section 15.6
- Avoid voids - see section 15.7

16 BUY TO LET FINANCE

Once you've read and digested this section, you will be able to:

- Recognise a Buy to Let mortgage - see section 16.1
- Calculate how much money you need - see section 16.2
- Refinance your Buy to Let mortgage - see section 16.6
- Answer almost any question about Buy to Let mortgages - see **section 16.11**

16.1 What is a Buy to Let mortgage

Buy to Let mortgages are a fairly recent invention. Essentially, they allow individuals to borrow money at a very keen rate of interest and use an investment property as the collateral for the loan.

In other words, if you were to leave the country with your Buy to Let mortgage unpaid, the lender would simply repossess the property, sell and pay off the loan.

Before the Buy to Let mortgage, individuals had to take out a bank loan at normal commercial rates. These were often at considerably higher rates of interest.

The Buy to Let mortgage is so competitive that nearly all property investment finance (on a scale of less than £1m anyway) has become known as Buy to Let.

16.2 How much money do I need?

Most Buy to Let mortgages work on about an 80 or 85% ***loan to value*** **(*LTV*)**, which means you will be investing at least 15 to 20% of the property purchase price.

In addition, and depending on the type of property you purchase, you will also need to fund the purchase and set up costs:

- stamp duty
- lawyers' costs
- furnishing costs
- repainting or general work. Anything from rewiring, new bathroom, new plumbing, flooring etc. or just redecoration

...and so on

Once your property is set up and ready to let, you will also need to fund void periods and any maintenance costs not covered by the rental income.

You will need to fund these additional costs yourself or borrow from the bank at a normal (i.e. higher than your Buy to Let mortgage) rate of interest.

Example of financing an older property

- purchase a property for £100,000
- receive a buy to let loan for £80,000
- then you need to invest £20,000.

However, it may cost another £15,000 to buy it, and do it up to the point where it's ready to let.

And, you may need to subsidise the maintenance of the property to the tune of £5,000.

Therefore, whilst your borrowings will fluctuate, your maximum borrowing will reach a total of £40,000.

A practical way to forecast the amount of money that you need is to work through the **Buy to Let Secrets** spreadsheet in detail. See **section** 22 on how to open and use the spreadsheet.

However, you might still be evaluating Buy to Let. In which case, follow the above example as a rule of thumb (but base your decision on your own calculations).

As a percentage of the property price you will need to find:

- 20% for the deposit
- 15% for the refurbishment
- 5% to subsidise the maintenance

That's a total of 40% of the property price.

You could borrow the additional £15,000 to get a property ready for letting, but it would be a bank loan and therefore at a higher rate of interest. This is why many people choose to borrow against their existing property - because the loan is cheaper.

Key tip

You may be able to fund the extra cost by rearranging an existing mortgage - see **section 16.3** below.

Note: The amount required to subsidise the maintenance will vary according to interest rates and the amount of rent you are able to achieve. Please refer to the cash flow spreadsheet for calculating a worst case scenario. See **section** 22 on how to open and use the spreadsheet.

16.3 Borrowing against another investment property

If you already own an investment property you could draw down some of the equity on that property to fund the extra costs.

The benefit of this approach is that you pay interest on the extra costs at your existing Buy to Let mortgage rate - and not at a bank rate - which is invariably higher. This route has the added benefit of not affecting the mortgage on your home.

16.4 100%, 80% or 60% loans? Which is right for you?

OK, so you are beginning to think - how much of a loan should I take out?

Well, the answer to that question depends on your own personal objectives. For instance, are you building a property portfolio? Are you investing in a property with a lump sum from your pension? Etc...

The larger the deposit you pay, the sooner the property will be in positive cash flow – i.e. the rental income will pay all the bills (including mortgage).

16.4.1 When is your property SAFE and when is it at RISK?

When is a property SAFE?

Once your property is in positive cash flow - you can consider it safe.

In other words, even if you lost your job or main source of income (or just retired), your property business can stand on its own - it no longer requires funding from you.

In this example, giving up your job does not mean giving up your property business.

When is a property at RISK?

A property is at risk when it requires you to fund it on a month by month basis.

In other words, if you lost your other sources of income (from your job or trade, etc), then you could also lose your property if you are unable to fund it.

However, in all likelihood, you would take over more of the maintenance and running of the property, thus reducing your costs and so bringing it into positive cash flow much sooner.

If you are able to do this, then you've got your plan 'B' should things go against you.

As a rule of thumb:

- A property yielding 10% or more of its value in rent per year is SAFE (i.e. will give you positive cash flow).
- **A property yielding 8% or more is SAFE if you take over the letting of the property** (this tends to work best with student lets - although this is not such a good idea with professional lets).

Therefore, anything below an 8% yield will be at risk because if you are unable to fund the investment in the early years, you may be forced to sell it.

Although, you can essentially manage this risk if you retain cash in reserve.

The reason that investors take on properties that yield less than 8% is in expectation of a greater capital gain.

For example, properties which have achieved some of the largest capital gains are in London, where rental yields have been substantially below 8%.

The essence of property investing is to balance the risk with the opportunity.

16.4.2 Property Investment for a Pension

Let's say you are you investing in property as an alternative to:

- A pension or
- an annuity

In this case, you have probably chosen property because it offers you better (and safer – i.e. more in your control), returns than the stock markets or annuity market.

The 100% loan scenario, being the most risky form of finance, is almost certainly too risky for you.

Many older investors, who are looking for security in their property investments might choose to take a smaller loan - perhaps 60%.

This way, the rental income will cover the cost of the mortgage much earlier, if not from day one.

Check this using the Spreadsheet Software – see section 22

And, although it is less tax efficient and offers less leverage, with the right property it still offers a great investment, and with far greater security.

In other words, the risk of having to sell the property due to a long void period (i.e. having no tenant), is very low.

So, for this reason, if you are looking at property investment as a form of pension, then you would be unwise to take a high risk, nothing down strategy, and would want to ensure that the rental income easily covers the cost of the loan.

You might choose to fix the loan (so you know your costs), and then take a 50 to 60% mortgage on your property.

That way, you will be cash positive from day one, albeit that your returns will be lower.

16.4.3 Property Investment for first-time buyers

Equally, you might be a first-time investor, looking to get a piece of the property investment action.

So, would a 100% loan or nothing down strategy be a good idea for you?

As raising a deposit can be hard work, many first-time buyers flirt with the notion of nothing down as a quick way of avoiding the effort of saving for a deposit.

Well, we get so many emails on the question of nothing down that we began asking people 'why are you looking at nothing down techniques?' - and the answer that came back again and again was:

... "because I don't have enough money for a deposit!"

So, we asked again: “but don't you own property already?”

“No,” was the frequent answer.

Well, if you do not yet own property, the best advice is to start owning your own property. There are good reasons for this:

1. **you can buy this on (almost) 100% mortgage** (using cash back, etc) in effect nothing down
2. any capital gain is free of tax (hurray!)
3. you can use the increase in value of your own property to fund your future investments

And you can do all this without spending your money on a nothing down course (in fact, the cost of the course might well be more than a 5% deposit of many a first- time property).

So, if you are looking at nothing down for your very first property - then you've already got the solution – it’s called a home buyer’s mortgage!

Of course, you will have noticed that the smaller your deposit, the more you pay for your mortgage, i.e. - Mortgage Indemnity Guarantees start to kick in from when the loan is 90% or more of the value of the property.

Also, the best mortgage deals are typically offered to lower LTV's (Loan to Value).

That means that saving the cost of a deposit will make your investment cheaper.

Lastly, if you need help to pay your home mortgage, consider letting out the rooms in your house. You can earn just over £4,000 per annum tax free.

16.4.4 Property Investment for the experienced investor?

Typically, experienced investors will take a loan of 80%.

This level of borrowing usually allows them to find competitive mortgage rates and helps to reduce their tax.

(The cost of interest on the loan can be offset against the income from the property for tax purposes - so the larger the loan the lower the tax bill).

With a loan of 80%, a property offering a 10% yield will break even after ALL costs – and, if you are more hands on, can break even with a gross yield of 8% or more.

If your yield is considerably less than this figure, and it is important to you that the investment is self-funding (i.e. you are not sure of your personal ability to fund it for the next few years), then you might want to reduce the size of your loan.

Use the **Buy to Let Secrets** Spreadsheet Software to play around with different sized loans and how they affect the point when your investment shows positive cash flow.

16.5 The problems with 100% loans or nothing down

OK, you might be asking yourself, if gearing or leverage is such an important part of property investment, then why take an 80% loan on the property, **why not just take a 100% loan?**

You might think that with a 100% loan, if a £75,000 property rises 10% in value then you've made £7,500, without any investment on your part?

What could be wrong with that?

Well, this is an inaccurate description for a number of reasons and this approach has a number of problems.

But let us start by defining what we mean by 100% loans or nothing down.

16.5.1 What is nothing down?

Nothing down is:

"How to buy property without a deposit (i.e. there is no limit to the amount of property you can buy - and therefore property profits you can make)"

- or at least that's the theory.

Anyone following the Property Secrets' Discussion board would have seen the massive interest generated by the posts about Nothing Down Techniques - or how to buy property without having to come up with the deposit.

You can access the discussion board at:

www.propertysecrets.net/forum.html

16.5.2 Nothing down techniques - what is the attraction?

Let's take an example:

100% Loans / Nothing down example
You are looking to take £100,000 of equity out of your home/ property and buy £500,000 of investment property. The £100,000 would enable you to take a mortgage (at 80% of the property value), for an additional £400,000, hence you can buy property up to £500,000. Obviously, nothing down or a 100% loan would enable you to buy not just £500,000, but perhaps £5million pounds worth of property. And, let us say, the value of property goes up 10%, then in this example you would make half a million pounds - rather than just £50,000.

You can see that what you have achieved is massive gearing! For more about gearing please see **section 14.2.1.**

16.5.3 100% loans/ Nothing down does not mean no money

However, don't be fooled, just because you achieve a 100% loan, **nothing down investment DOES NOT mean no money investments.**

You still have to fund your investments once you've let them out, and the larger the loan the more money you will need to find to fund your investment.

That is why nothing down literally means no deposit.

And, what you save at the beginning (i.e. no deposit), you'll have to pay back later (i.e. higher monthly loan costs).

Nothing down is a tool to MASSIVELY leverage your investment. 100% loans are a tool mainly for speculators who are looking to turn property around for a substantial profit.

16.5.4 80% gearing is normally enough

Normally when investors talk about gearing, they are thinking about taking a loan of 80% of the property value - as opposed to buying it outright with cash - rather than the 100% loan or nothing down option.

The gearing of an 80% loan can substantially increase the investment return. But, of course, it also increases the risk and the cost over buying the property for cash.

It is vitally important that you understand the balance of risk. So, let us explain:

The biggest risk to your property investment is a short-term fall in capital value

AND

a long-term rental void period.

If these two factors combine, then you will need to keep funding your investment from your own pocket until you can let the property OR sell the property at your original buying price.

If property prices have weakened by a few percent, then you won't want to sell, so you need to keep it in the rental market.

And, if you've run the numbers through the **Buy to Let Secrets** spreadsheet software (see **section** 22), then you'll know that in many cases the rental income is slightly less than the full costs of maintaining the property and paying for the loan.

That means that you still need to fund your investment through the early years. And, in effect, the larger the loan that you take, the more you will need to fund the property on a month by month basis.

So, nothing down or 100% loan techniques allow you to buy property with zero cash. However, you do then need to put more money into the property on a month by month basis - if you want to let it out.

This means that nothing down is not a solution for you if you have no money at all.

Here's the important point:

The effect of nothing down is simply to delay the point at which you have to put your own money in. It does not mean that you can avoid investing your own money.

Here's an example of how a speculator might use a nothing down technique:

> If you want to buy 20 properties from a brand new development pre-first phase, then nothing down might be a useful technique.
>
> It allows you to grab a much larger share earlier based on the assumption that you'll sell them quickly for a profit.
>
> However, you'll have to fund the mortgages until you can sell these properties. If you can sell all 20 within 6 months, then you will be sitting on big profits. If you have a problem selling them, then potentially you'll go bankrupt.

Key Tip

Even with nothing down or 100% loans, you still need money to fund your investment.

16.5.5 How do you get a 100% mortgage?

So, how do you get a bank or lender to give you a 100% mortgage?

A lot of companies are selling expensive courses based on this question, but the answer invariably depends on your ability to find property for sale at a discount.

Here's an example:

Find a property worth or valued at £100,000, negotiate an 80% loan on the value of property, but negotiate a discount so that you only pay £80,000.

Hence, in effect, you pay no deposit - but your mortgage is only 80% of the value of the property.

However, as anyone will tell you, it is not easy to find someone willing to sell you a property that is worth £20,000 more than you offer!

So, the real trick here is to buy property at a discount - and then take an 80% loan on the property value. This is not the same as a pure 100% loan.

Key Tip

Buying at a discount is an excellent idea - but hard to execute - see **section 16.5.6**.

100% loans on the purchase price are high risk and probably only suitable for speculators.

16.5.6 How do you buy property at a discount?

The old fashioned way of buying a property at a discount - and still the most reliable - is via property development - see our sister publication: Property Developer Secrets.

In this case you buy a property that needs doing up - or changing in someway. You might buy it for £70,000, spend £10,000 improving it, so it is then worth £100,000.

In effect, you have bought a £100,000 property for only £80,000.

And, once the project is complete, re-mortgage the property on an 80% loan, releasing £80,000 - your original investment.

Hence, you've ended up owning a property and you've got all your money back - effectively nothing down - but of course, you do need funds to finance your project in the first place.

16.5.7 Other ways of buying at a discount

Typically, you need to find either:

i) a developer willing to sell you a property at a discount (because you are buying five or more properties prior to phase one) or

ii) you find a property before it comes onto the market and manage to negotiate an excellent deal

These techniques will require you to get nosy - find properties that people need to sell fast (because they are going into an old people's home, moving in with relatives, due to a death, going abroad and need to sell quickly, etc) and make a quick and private offer.

Often, networking in your local area with solicitors willing to pass you property leads is a good way to explore this avenue.

In effect, you are trying to find something that you can offer the seller in return for the discount. These might be:

- Fast completion (valuable if death dues are payable, etc.)
- A guaranteed income (i.e. if a developer is nervous about his cash flow)

16.5.8 Here are five more ways to get 100% mortgages (i.e. nothing down)

Let's say you are still determined to buy property without a deposit.

Here are some of the ways that property investors have achieved this:

> *("Please note, I don't promote these techniques because neither myself nor my co-author Richard Davies use nothing down techniques, but forewarned is forearmed as they say." - Neil Lewis)*

1. **Take out a 100% home loan mortgage** (or 95% loan with 5% cash back), possible if you are going to live in the property and let out rooms.

2. **Find a new development property** (worth say £100,000), negotiate to pay the developer £90,000, but request a 90% bank loan based on the value of the property (i.e. £90,000), and hey presto! Nothing down.

Of course, you can see that this is dependent on your ability to negotiate with the developer and achieve a 90% loan. (Most Buy to Let mortgages will advance a maximum of 85% of the property value).

3. **Take out three or four credit cards** and run your monthly bills through these while you save your cash. When you've generated a deposit - go buy your property.

This is not such a great idea when you remember that most professional let properties need extra funding in the first few years and so you'll need to take our more credit.

Also, it may lead you into problems with the credit card companies and may not be strictly legal.

4. **Borrow some money from a relative**

5. **Use the nothing down techniques sold in seminar courses to refinance the rental income and so pay nothing down**. The only problem is you need to find the money for the course first and may face higher cash flow during the early years of the investment.

16.5.9 Extra costs of 100% loans

In the case of a home loan, the cost of a 100% loan will invariably be higher than an 80% or a 70% loan because the mortgage lender will charge you a Mortgage Indemnity Guarantee (MIG). This is an extra charge that the lender levies in order to insure themselves against the risk of you not paying back the loan.

If you look at current interest rates you'll see that the greater the percentage of the property that you borrow, the higher rate of interest (or set up costs or extra fees or MIGs) you'll pay.

16.5.10 Nothing down / 100% loans summary

"Debt is good - but too much debt is bad!"
Source: The Economist March 2002

In property terms this really means:

You still need to fund your property once you've bought it, as the rent is unlikely to cover the mortgage and all the other associated costs.

Hence, although nothing down (100% loan) offers the attraction of buying without a deposit, it does commit you to larger costs or investments on a monthly basis.

If the rental market goes against you in the short-term, then you might find your finances get swamped and that you can't cope.

This is the worst case scenario and it is well worth avoiding.

By high gearing in property terms we typically mean 80 to 85% maximum. Nothing down techniques take your debt to 100%, which we believe carries a very high risk for most people.

So, whilst it is good to have debt, it increases your return (and happens to reduce your tax bill too, see **section 14.1.1**), too much debt (e.g. a 100% loan) is generally a bad thing because it increases your risk to a dangerous level.

For a latter day case study on debt, consider the Telecoms and Technology Stocks. Do you know anyone who owns some of these? If you do - ouch! These companies are overloaded with debt and that is really hurting some fundamentally good companies.

That is why some of these stocks have fallen over 90% in value in the past couple of years.

Of course, the **right balance of debt vs. risk will vary** from person to person, and you have to make your own choices, but it is wise to remember that:

"Some debt is good - too much debt is bad!"

In other words, get the balance right - telecoms companies didn't! Unless you are an expert or speculator it is unlikely that you would want more than an 80 to 85% loan.

16.5.11 Do property experts use nothing down?

We asked a number of property investment experts if they used nothing down techniques and the answer, you might be surprised to hear, was a resounding NO!

Often, in the USA, for instance, nothing down courses are promoted as a method to explode your profits. Of course, anything that can explode your profits can also implode your profits too.

This is not to say that nothing down isn't a good idea, or that some people have made a lot of money using these techniques.

It is just to say that it is at the high / very high end of risk. Yes, the returns are magnified, but your potential losses are magnified too.

So, the question of whether you should consider this type of investment depends on why you are investing in property in the first place (**see section 16.4 - 100%, 80% or 60% loans? Which is right for you?)**

We also know some very successful property developers and investors who (investing £ millions at a time) will only buy property for cash.

Their technique is clearly opposite to the gearing route - and allows them to move very quickly, and negotiate a hard price.

Why do they do it? Well, it obviously works for them and no doubt it beats the competition.

I imagine that they later re-mortgage their properties to release cash, but it just goes to show that using cash does (sometimes) have its advantages.

The property experts we know rarely take more than an 80% loan on a property. These guys have been very successful applying the techniques that we've discussed in Property Developer and **Buy to Let Secrets**.

You could push the level of debt further (towards the 100% loan), but is it necessary? And is it wise?

UK Property holds so much promise over the next twenty years... so you've got time to get it right and build your own portfolio...

... it is great to get started in property as soon as possible and get thinking about property investments... but remember there is no rush... it might be better to take your time and get it right...

16.6 Refinancing to get your deposit back

Another way of getting your deposit back from your investment is to refinance it once it has increased in value.

This might happen in two ways:

- the value of your property increases
- you make improvements to the property (see section 15.6)

Obviously, with increasing values you may have to wait a few years before you can do this. Whereas, if you develop your property, you can get your deposit back in the time it takes to complete the improvements (see **section 15.6**)

Example of refinancing a Buy to Let investment: You purchase a property for £105,000. It increases in value to £150,000. In this case, the mortgage lender would advance you 80% of the initial purchase price (i.e. £80,000) and a few years later you could refinance the property based on its new value of £150,000. Hence, the mortgage lender would now forward you 80% of £125,000 (i.e. £120,000). Given that £120,000 is the total of your initial investment, you've now got your deposit back.

16.7 Should you fix your mortgage rate?

A fixed rate mortgage (i.e. you pay the same rate of interest over a set period of time), is **essentially an insurance policy**.

It is an insurance against interest rates rising to a level that means your mortgage payments cannot be met by your rental income.

So, the question of whether to fix your rate is a combination of:

1. do you want / need an interest rate insurance policy
2. how much does it cost?

16.7.1 Do you WANT an interest rate insurance policy?

Many people simply prefer a fixed rate of interest. It helps them to sleep soundly at night and this is an excellent reason in itself.

Once you've fixed your rate of mortgage your property costs become very predictable. Hence, it is easier to plan your investment.

If you are making your first property investment then a fixed rate mortgage is a more cautious, but perhaps more sensible, way to finance your first project.

16.7.2 Do you NEED an interest rate insurance policy?

If your finances are stretched, and you are using every spare penny to fund your investment, then you are vulnerable to a sudden increase in your costs (i.e. increase in interest rates).

In the case of an 80% loan on a property, the mortgage will be by far and away the largest single cost that you face.

Hence, an increase in rates by - say two percentage points - might add 40% to your costs.

If this increase (which on the face of it is quite small - just two percentage points) could seriously damage your finances, then you almost certainly NEED a fixed rate mortgage.

The problem with fixed rate mortgages, of course, is that they nearly always cost more money than the variable mortgages.

Hence, if your finances are very tight at the outset, it is tempting to take a cheaper variable rate mortgage.

However, in this instance, you would be well advised to take a fixed rate mortgage, although it will increase your costs at the beginning.

In effect, the cost of a fixed rate (insurance policy) mortgage is to temporarily increase your mortgage costs by about 25%.

Of course, you are then guaranteed that there will be no additional costs.

Unless you are well-funded (i.e. have got plenty of spare cash in the bank), a fixed rate mortgage is probably a wise move.

16.7.3 Should I fix my mortgage if I think interest rates might increase?

Often, when investors consider fixed rate mortgages they ask themselves this old question...

... will interest rates go up?

...as if the answer to this question will help them make the decision of fixed vs. variable rate mortgages.

In fact, predicting interest rates over a medium term - say 5 years - is a mug's game.

Hence, when you consider a fixed vs. variable mortgage, think of the fixed mortgage as an insurance policy - which carries a premium.

The aim of the fixed rate mortgage should be to protect you from the worst case scenario - just as buildings insurance would protect you from a flood or fire.

And just as you would expect you pay a premium for building insurance, think of the additional initial cost of a fixed rate mortgage as an insurance premium.

The question is - are you willing to pay the insurance premium for the security and stable financing that fixed rate mortgages offer?

16.8 Interest only vs. capital repayment mortgage?

Buy to Let finance is an interest only mortgage.

There is no allowance, with a Buy to Let mortgage, to pay off the loan bit by bit as per a repayment loan on a home mortgage.

Yet, we are often asked, why shouldn't I use a repayment mortgage on an investment property? Well, here goes with an answer:

There are two main reasons for not paying off the investment mortgage (note these don't apply to your own home):

- You will pay less tax
- You will achieve far higher leverage/ gearing

16.8.1 Pay less tax

There is no magic in owning the property without a loan - the magic is when the rental income far exceeds the mortgage.

In say, 1 to 15 years time, the rental income will have grown to cover your mortgage payments AND give you positive cash flow.

Say you take out a mortgage of £500 per month or £6,000 per year (at 6% on a £100,000 mortgage - and £120,000 property) - and let's assume the mortgage amount stays the same for 15 years.

Say you have gross rental income of 6% (£7,200) and that the rent increases by 4% each year. Then in 10 years, your rental income will be £10,657.

You can offset £6,000 against tax - giving you a gross taxable income (before other costs) of £4,657.

In 15 years your rental income will be £12,967 - giving you a gross taxable income (before other costs) of £6,966.

See how you can offset the cost of the mortgage against your tax.

If you pay off your mortgage, you might end up paying 40% of your income in later years to the taxman.

Instead, use the extra cash (that you would have used to pay off the mortgage) to buy another property and you'll end up with far more (for instance you might make twice the capital gain). Alternatively, invest it in something else - if you think that will give you a better return or want to spread your risk.

16.8.2 How paying off the loan reduces your gearing

By paying off your mortgage you are also reducing your gearing (see **section 14.2.1**).

So, let's say you began with an 80% mortgage in year one.

If by year 23 of a 25 year loan you've paid off 85% of your mortgage, then your gearing is now only 12%. Let's compare these:

Comparison of an interest only with a repayment mortgage
In year 23 of a 25 year mortgage the value of your property, £200,000, (which cost £75,000 to buy) increases by 5% (i.e. £10,000).

	Interest Only	Repayment
Increase in value of property	£10,000	£10,000
Costs of mortgage (interest rates @ 6%) per year	£3,600	£540
Net gain per year (capital gain minus mortgage cost)	£6,400	£9,460
Total amount of your money invested in the property	£15,000	£66,000
Return on investment in this year	**42.7%**	**14.3%**

Note: this scenario ignores the rental return.

The interest only option delivers a return of 43% vs. 14% for the repayment mortgage.

So, you can see how a repayment mortgage massively reduces your capital return on investment in the later years of the mortgage.

You would achieve a better return by taking the money that you would have used to pay off the mortgage and buying a second investment property or other investment.

That's why property investors don't pay off the mortgage - and why Buy to Let loans are interest only.

Of course, depending on your own circumstances you may be willing to accept different levels of gearing or mortgage finance - please see **section 16.4** for more.

Equally, if your own personal circumstances change (e.g. you retire), you may wish to reduce your gearing (from say 80% to 60%), but it is very unlikely that removing the gearing altogether will be advantageous.

16.9 Using finance to build your property portfolio

A property portfolio is a collection of investment properties. And many investors aim to build up 5, 10, 20 or more properties.

The tried and tested formula for building a Buy to Let portfolio is to leverage the capital growth of one property to purchase a second property, and then a third and so on ...

Let's look at an example of how this might work:

> First property costs £100,000 property (for which you borrow 80% deposit i.e. £80,000)
>
> Over 2 years it goes up in value, to e.g. £125,000,
>
> Now you can remortgage (again borrowing 80% of the value - i.e. £100,000)
>
> Which gives you a 'cash profit' of £25,000.
>
> Now you can take the second £25,000 and invest it in a second property.
>
> Using an 80% loan on the second property, you can now spend £112,500 on this second property.
>
> In a few years time, you refinance again to create the deposit for a third property... and so on and so forth...

However, it isn't quite a simple as that.

Remember that depending on your rental yield, each property may carry negative cash flow for up to seven years. For more on cash flow see **section** 22.6

So, while you may be able to afford the deposit for the purchase of more properties, check that you can afford to fund more properties during the first few years.

Buying too many properties too quickly could be a recipe for disaster if you suddenly hit rental void periods.

On the other hand, you may be buying cheap properties that reach positive cash flow (above 10% gross yield) much earlier (i.e. some student properties can achieve a 28% yield, so long as there is no maintenance work and no void periods).

16.10 Example of financing a newish property

If your property is newish or in almost perfect condition (except perhaps for a lick of paint) then the following example applies:

> If the property costs £100,000, then a loan for 80% of the property will be for £80,000.
>
> You will need approximately:
>
> £15,000 deposit to purchase the property
> £2,000 to cover purchase costs
> £1,500 to cover paint and furnishings
> £6,000 to cover the maintenance and loan interest while letting the property.

In total, you will need to find 24.5% or £24,500 of the property purchase price yourself. This might be through savings, equity release on your existing property or additional borrowing.

In a worst case scenario for this property – say, you only manage to receive rent for 10 months of the year - you would need to find almost 40% of the property purchase price, or £40,000.

This assumes the following, which will vary considerably depending on your property:

- 7% interest rate
- 8% gross rental yield (with some void periods)
- 5% annual increase in rents

16.11 Frequently Asked Questions

16.11.1 How much can I borrow?

Typically, a lender will allow you to borrow up to 85% of the value of the property.

Often, to achieve better rates of interest, the lender will forward as little as 70 or 75%.

16.11.2 Maximum and Minimum size of the loan

The maximum size of the loan will be between £500,000 and £1m depending on the lender.

The minimum size of the loan typically is £25,000.

16.11.3 Will the lender give me the money?

To find out how much you can borrow open the 'how much can I borrow' calculator at www.propertysecrets.net/downloads/4.html .

Typically, your rental income should cover the mortgage and then 30% on top.

So, if your potential rental income is £667 per month, then the lender would give you a loan whereby your monthly payments were a maximum of £513.

If you paid your lender £513 per month, then your maximum loan (assuming an 85% loan to value ratio) would be £103,462.

Most lenders require this, or similar, as a condition of providing a mortgage.

In effect, the mortgage company is trying to ensure that there is minimal risk to their loan. That means the lender wants to know that you'll be able to meet the cost of the loan and all other costs besides.

The extra amount is to cover the inevitable ***void periods*** (when the property is unlet), service charges, commissions to the letting agent and repair / maintenance costs.

Although it is possible, with some lenders, to take a higher mortgage (above an 85% LTV), you are betting on a significant capital growth of the property before you make any money. Risky!

In addition to this rule of thumb measure, lenders are increasingly focusing on the credit worthiness and history of the individual taking out the loan. In particular they look at:

Your overall business plan (See **section** 22 on how to open and use the spreadsheets to help create your business plan)

Your credit history - do you have outstanding debts, have you ever missed a payment for a mortgage, a credit card or other loan?

Your credit status - are you considered a good risk?

16.11.4 Do I need a minimum salary?

A minimum annual income or net profit of £20,000 for the main applicant from their normal employment is typically required.

16.11.5 Can I have more than one Buy to Let mortgage?

Yes - you can take out multiple mortgages with different lenders - but in most cases it is only possible to have one loan per property.

This is because the loan is secured on the title of the property - and each lender would want to have first claim should anything go wrong.

16.11.6 Can I buy more than one property - on a single mortgage?

Yes you can.

In fact, most lenders will allow you to buy up to four or five properties. This also means that they are willing to lend sums of the order of £500,000, or even £1m.

16.11.7 Can we get a Buy to Let mortgage in joint names?

Yes, you can.

16.11.8 Who can set up a Buy to Let mortgage – an individual or a company?

Both.

16.11.9 Can I get a Buy to Let mortgage in the name of a limited company?

Yes, although lenders often expect that the limited company is formed for the sole purpose of purchasing, owning and managing properties.

16.11.10 Can non-residents get Buy to Let mortgages?

Yes, non UK-residents can purchase property using the Buy to Let loan scheme.

If you are resident and earn an income outside the UK then a lender might treat you as a 'partial status' or 'non-status' application.

This means that the lender will not require income statements and so forth. However, they are likely to want a higher rate of interest and might only be willing to forward a smaller loan relative to the property value.

16.11.11Can I get a Buy to Let loan for property for students, DSS or sharers?

Different lenders have different criteria. The majority will say no, but some will lend.

Lenders are concerned that with a multiple occupancy tenancy the landlord may have difficulty obtaining vacant possession if it all went wrong.

Expect to pay a slightly higher rate of interest on this type of Buy to Let loan.

Check for rates at http://www.propertysecrets.net/buy_to_let_mortgages.html

16.11.12 What is the rate of interest charged on Buy to Let mortgages?

Rate of interest tends to be up to 1% above the normal mortgage rate - although competition is reducing this differential.

16.11.13 Interest only or interest and repayment?

Typically a Buy to Let loan is taken out on an interest-only basis.

16.11.14 Does my personal status matter?

In theory, a Buy to Let loan is secured on the income and capital value of the property. Therefore the income and credit status of the landlord is not relevant.

In practice your status does matter.

Generally, anyone can get a Buy to Let loan - but at a cost.

The higher the risk, the higher the interest rate.

In other words, to get the best possible finance, you should put forward the best possible case to the lender.

16.11.15 What things should I look for in a good Buy to Let mortgage?

In addition to the headline interest rate, look at the APR (this will include set up fees and costs).

Flexible payment options - can you pay off the loan early or can you stay in business if you experience a long void period?

Daily interest calculation - this can significantly reduce your borrowing costs.

Can you remortgage easily? You never know, you might want to buy another property and use the existing loan structure or your current property to gear up your borrowing

16.11.16 What's the difference between a Buy to Let and a Commercial Loan?

A Buy to Let loan is typically available at much more competitive rates than a commercial loan.

Normally a commercial loan is taken out by a business to purchase a car or other item that will decrease in value.

The key feature of a Buy to Let loan is that the loan is secured on the property. So, if you fail to pay the cost of the loan, the lender can repossess the property and get their money back.

16.12 Finance – how lenders are changing the rules

One consequence of investing now, in a more cautious market, is that you will probably find that lenders appear to be moving in two directions at once.

On the one hand they are tightening the rules on lending while on the other they're actually cutting lending rates for buy to let investors.

The consequence of this is that lenders want high quality business from you the borrower.

As property prices, especially in the south of the UK, have risen out of proportion to rents, yields have inevitably fallen. Rises in interest rates have also added to the negative effect.

In response to these factors a significant number of lenders have altered the way they assess a buy to let mortgage application.

An assessment includes such aspects as the location of the property, how much experience the loan applicant has of the buy to let market, what is the likely market rent for the property and how this measures up against the mortgage payments.

It's normal for lenders to want to be confident that rents on a property will achieve between x1.25 and x1.5 of the rent. In other words, the rent must cover the mortgage payment, plus between 25% and 50% more.

Lenders usually apply their standard variable mortgage rate (SVR) to make this calculation. But they recognise that in fact, few buy to let landlords actually pay this rate as it is higher than the fixed, discounted and various other special rates on offer.

Basically the SVR is a notional rate that has been used to work out payments when assessing an applicant's suitability for a loan.

16.12.1 Easier money – for best quality loan applicants

There is growing evidence, though, that this notional rate is being lowered so that lenders can make the calculations work – **but only for those applicants they consider good risks**.

For desirable loan applicants, competition is getting more fierce amongst lenders.

Not only will some lenders lower the notional mortgage rate, they will also allow the applicant's income to be considered as part of the equation.

These then are both ways of increasing the amount of money a suitable buy to let mortgage applicant can borrow.

On the other hand, many lenders are also being more picky about other aspects that they consider, especially how experienced the applicant is in the buy to let field.

Our insider sources tell us that previous investment experience will often carry the day even when the rent-monthly mortgage payment ratio doesn't stack up.

16.12.2 What this means for mortgage applicants

For the investors who see their property portfolio as a steady and relatively conservative investment vehicle, this is good news.

The consequences of the change in lenders' attitudes is that your credit rating is going to be even more vital than in the past.

In fact, it may well be that you, as an individual, are going to be the central focus of the lender, rather than your business plan. They are going to want to know about loan defaults in the past and any County Court Judgments you may have.

This makes it more vital than ever to guard your credit rating by making timely payments and not letting your credit score be threatened by dodgy, get-rich-quick property deals.

So, if you are struggling to get a big loan, the solution is to start with a small loan. If you can demonstrate that you can handle the loan, then next time around, you can demand more finance.

16.12.3 Why it's good news for buy to letters

Bear in mind that if you are a mortgage applicant, or a prospective applicant with a good credit history, lenders NEED you. Lending, after all, is what they do. It's their business. They're in competition.

When the market gets sluggish, the lenders will make it easier – for the right applicants!

Soft prices plus soft finance – if your credit history is good – is an excellent recipe for taking advantage of the market.

Not all lenders will apply the same criteria or give the same weighting to the same factors.

The motto then is: Shop around!

Typically, the conditions will include the fact that:

The tenancy must be an Assured Shorthold tenancy in England & Wales, a Short Assured tenancy in Scotland and an uncontrolled tenancy in Northern Ireland.

The property has to be managed by an approved letting agent such as a member of Association of Residential Letting Agents (ARLA) who has to confirm in writing the amount of the current rental income market rent where the property is to be let.

Congratulations! You've now finished section 16. You'll now know how to:

- Recognise a Buy to Let mortgage - see section 16.1
- Calculate how much money you need - see section 16.2
- Refinance your Buy to Let mortgage - see section 16.6
- Answer almost any question about Buy to Let mortgages - see **section 16.11**

17 PUTTING YOUR TEAM TOGETHER

Once you've read and digested this section, you will be able to:

- Recognise the most important member of your investment team - see **section 17.1**
- Choose a good letting agent - see **section 17.2**
- Choose a good mortgage broker - see **section 17.4**
- Find a good solicitor - see **section 17.9**

17.1 The most important member of your investment team

Question: Who is the most important advisor to a successful long-term property investment?

Answer: The letting agent.

Surprised? Yes, it is surprising, isn't it? However, the major mistake that most of us make is that we wait until we have bought and redecorated or refurbished a property before we contact the letting agent.

The ability to identify a good quality letting agent and gain their advice before you buy is crucial.

Question: After the letting agent, who is the next most important advisor?

Answer: Your mortgage broker.

An experienced mortgage broker who understands the ups and downs of property investments will not only help establish finance, but will also act as an independent advisor on the quality of your investment plan.

17.2 Choosing a Letting Agent

To choose a letting agent you should get a number of agents to visit the property and get a general feel for them – maybe go to their office.

You will probably meet a number of letting agents when looking for a property to purchase. Once you've already knocked on a few letting agents' doors then you will already have a good feel for them.

It is very important that when you are looking to buy a property and you want to work out its rental return, you seek the advice of local letting agents.

When you are looking at buying something through a particular estate agent, you can ask the rental section (or letting agent) in that company what rent the property can fetch.

However, don't rely upon just that opinion. Ask the advice of other agents too.

When you are ready to instruct the letting agent you might instruct two letting agents.

Don’t try and reduce their fees as it will be detrimental to you and it will demotivate them, and your property may let more slowly.

Key tip

Bear in mind that most letting agents are on commission. If the negotiators in the office have one property which pays 10% and another which pays only 8% or 6% commission, which one are they going to show first?

17.2.1 How do you pick a good letting agent?

Look for an agent with a good reputation.

Ask other property professionals that you meet (solicitors, surveyors, and estate agents), to recommend a quality local letting agent.

Membership of the Association of Rental Letting Agents (ARLA), or other body shows that they have actually done some training courses, but it doesn't act as a guarantee. There are good ARLA agents, and there are not so good ARLA agents.

Some of the very good agents in London aren't members of ARLA and it would be wrong to exclude these agents on that basis.

However, **ARLA**, the Royal Institution of Chartered Surveyors **(RICS**) and the National Association of Estate Agents **(NAEA**), are bonded and many carry third-party indemnity insurance.

Some agents operate within a bonded scheme for letting agents, similar to that offered in the travel industry by ATOL and AATA. In essence, this means that both the tenant and the landlord can retrieve misappropriated money if the letting agent goes bust or into liquidation.

You should look for a similar guarantee if your agent is going to handle either rent payments or a deposit.

Your agent must be bonded and have 3rd party indemnity insurance

Note: Your mortgage lender will require you to use one of these registered letting agents to provide an assessment of the likely rent. However, it isn't normally compulsory to let through a registered agent.

For a list of letting agents see:

www.arla.co.uk

www.rics.org.uk

www.naea.co.uk

Profile and success rate?
You should also choose an agent based on their profile and their success rate. Ask the following questions:

- **Who are their main tenants** - young professionals, older professionals, international executives, young people... etc. and does that fit the profile of the person your property would appeal to?
- What profile do they have in the local area?
- **How many potential tenants do they have** on their books that are looking to rent a property at an appropriate price bracket?
- **What will the agent do** (see below) and what will they charge (normally between 10-15% of the gross rental)?
- Check that the agent is bonded and has professional indemnity insurance (in case they mess up on the shorthold tenancy agreement).
- Always ask for the telephone number of some successful landlords who are happy to recommend them. Speak to these landlords and ask them if they have used this agent and how do they compare to other agents?

Remember the most important thing is to go with a good agency, and a good agency does not necessarily mean a big agency.

You are looking for someone who is reputable, after that just use your common sense. Meet the agent face to face before you instruct them; decide whether you like them; decide whether you trust them.

Key tip

Choosing a letting agent is similar to choosing an estate agent - but don't assume that someone good at selling the property will be just as good a letting it. Often, you are best to go with a specialist.

Charges
It is tempting to go for the cheapest letting agent. This often turns out to be a false economy for two reasons:

- **Many apparently cheaper agents hide their charges** (for instance, some agents will charge their % fee at the beginning of the first month - others won't charge until the end of the month).
- **Cheaper agents have less time to find good tenants**. They tend to skip key steps - like referencing the tenants and it is common to find that they will let to tenants who break the rules of the shorthold agreement (i.e. keep pets or smoke).

You should always have a minimum of two, maybe three, letting agents, because it doesn't cost you any more, but should speed up the letting process.

You can negotiate a discount for sole agency - perhaps a saving of 2% - but you will pay for it in that the agent won't be so motivated to let the property quickly. This will often cost you more money than you save.

Example

Let a £100,000 property for £667 per month, for a one year period.

One week void period = a reduction of 2% on the letting agent's fee

Weeks Void	Cost of void period	Gain (loss) by using sole agent with a 2% discount
0	0	£188
1	£154	£ 30
2	£308	(£128)
3	£462	(£285)
4	£616	(£442)

So you have to weigh up whether a sole agent, at a discounted rate, will let the property as quickly as two agents working on full commission will.

If you don't think this is likely, then it is better to work with two agents at full 10% commission.

Key tip

The table above re-emphasises that reduced void periods are more important than a saving on a letting agent's commission. Therefore, it's better to focus on swift lettings, rather than worry about commission too much.

17.3 Estate Agents

The agent you use to buy the property will be determined by the property itself.

However, in order to be offered a good deal, you will have to publicise yourself to the local agents.

Let them know that:

- you are a serious buyer
- you have your finance in place
- you are willing to make a quick decision and move fast

You may find that some smaller agents will find you good deals, because they maintain their sales by undervaluing the properties slightly, so that people will buy from them.

You just need to get to know all the local agents, large and small in your local area.

Let them know that you are serious, that you can come out and see things at the drop of a hat. Don't mess the negotiators around or waste their time.

Be very specific about what you are looking for. If they call and offer you a property you are not interested in, politely decline the offer and remind them of what you are looking for.

Key tip

Be prepared to offer on the doorstep - if you have been shown a good property. It shows that you are serious and are willing to buy property.

17.4 Choosing a Mortgage Broker

Your mortgage broker is very important to your investment success. You have to know someone you can actually trust. This will mean going to an independent financial advisor as there are a lot of stringent guidelines as to how they can behave.

For instance, a key requirement of an independent advisor is that they must show you how much money they make for recommending any product.

Look for the following:

- a reputable firm
- a broker who is readily available and easy to get hold of in an emergency
- a broker who has been in the business for at least three to five years

Don't fall for someone who has the gift of the gab and wears sharp suits. You are looking for someone who really knows their stuff and who has been successful in the past – they must look successful and have had success with the firm they are with.

Find out:

- how long they have been at their current company
- how long they have been a mortgage broker
- how long they have owned property themselves

Key tip

More then anything, be suspicious of someone who jumps from one brokerage firm to another. Look for continuity.

If you don't have a broker, look at who is probably the most successful team of Independent Financial Advisors (IFAs) in your area. Or, if it is convenient, go to a top London broker such as Charcol or Charles Cameron.

You should find out which company is the best, go in to see them and have a look around. You should be wary of a company with a lot of 25 year olds just starting out.

Key tip

Telephone the company and ask them who their most successful guy is and interview him or her. Explain that you are looking for someone who can help you long-term.

When you have made your mind up and you have decided on your broker then make it clear what you expect from them, and not just that you want them to return calls and so forth.

17.5 Getting the most out of your mortgage broker

Mortgage brokers are very busy and have limited time. The more homework and reading you can complete before you visit them, the more intelligent questions you can ask.

In addition, your broker will treat you with respect and you'll get better service.

Top four things to help your broker give you best service:

- do your homework
- come up with your own suggestion of the best mortgage
- come armed with a detailed breakdown of your business plan
- give some thought to your views about risk (for example: would you be willing to pay a little extra in return for fixed interest rates?)

17.6 Your Mortgage Lender

Your broker will advise you on your choice of mortgage lender.

It is usually best to place your business with one of the bigger mortgage firms - someone whose name you recognise.

A number of smaller mortgage companies have, in the past, 'sold their mortgage book'. This means the responsibility for the mortgage might pass onto other hands. The implication might mean higher interest rates in the future.

Often, one of the best lenders to go with is your bank.

Your bank knows you well and will probably offer more favourable terms than another lender who regards you as a higher risk.

17.7 Relocation Agents

It is common for corporate tenants to pay a relocation agent to find them a property.

Typically, this might cost £200 for the initial research, and then £150 per day for the relocation agent to accompany them on any viewings.

Often, a relocation agent will preview properties before bringing around prospective tenants.

Making sure that the relocation agent will offer your properties to their clients is crucial, so it is important to make the right impression and, if possible, be at the property to answer any questions.

It is also valuable to ask the relocation agent what they think of your property.

Often, a relocation agent will view a property that is in the middle of improvements - and this is an excellent time to ask them what they think about the paint colours you are using, the lighting, the flooring, etc.

More than anyone else, the relocation agents know what their particular clients (be they American, Australian, French, German, etc) are looking for and what they do and don't like.

17.8 Property Consultants

Property Consultants are effectively estate agents working for you.

Typically, you pay a consultant a % for finding you a property.

Example agents:

www.invest-in-property.co.uk

Invest in Property

www.kaltons.co.uk

Kaltons

www.quality-solutions.co.uk/busuk/blp.htm

Quality Solutions

www.hurford-salvi-carr.co.uk/welcome.htm

Hurford Salvi Carr Property Advisors

www.wbsandco.com

WBS & Co Property Consultants

Are they worth it? Well, in many cases, if you are short of time or new to an area, then 1 or 2% of a property's value is a small price to pay if it means you are buying a lot of local knowledge.

The key question to ask a prospective consultant is 'what properties have you located for other clients?'.

This will tell you about the market (e.g., student properties or corporate properties) and locations that they work in.

Make sure there is a good fit between what you want and what they are doing.

If, however, you are looking to buy a number of properties over the next few years, then it might be a better investment of your time to learn how to find quality properties yourself.

17.9 Solicitors

With property dealings you might use the services of two very different types of solicitor:

- a conveyancer
- a litigator (see section 21.4.2 for more information)

Find a specialist conveyancing lawyer, rather than a family lawyer you might know.

The chances are that if you have negotiated a good price on a property deal then you need to move fast to avoid the risk of another buyer gazumping you.

While it is important to find a solicitor who is both quick and efficient, there is clearly no benefit in getting a job done quickly if it is substandard.

Look for a conveyancing lawyer who:

- is diligent
- will look into everything
- will advise you accordingly
- is quick

If you suffer a problem with a tenant, then you require a litigation lawyer. This is a completely different specialism to conveyancing. This subject is covered in more detail in **section 21.4.2**.

Congratulations! You've now finished section 17.You'll now be able to:

- Recognise the most important member of your investment team - see **section 17.1**
- Choose a good letting agent - see **section 17.2**
- Choose a good mortgage broker - see **section 17.4**
- Find a good solicitor - see section 17.9

18 STEP 1 – FIND THE RIGHT KIND OF PROPERTY

Your aim is to find a property that will:

- Let quickly - by appealing to the local rental market
- Achieve above average capital growth - probably as a part of an up and coming area

Once you've read and digested this section, you will be able to:

- Decide between a wreck and a new apartment - see section 18.1
- Find a property that will let quickly and easily - see section 18.2
- Match your property to an appropriate tenant - see section 18.3
- Find a location that offers above average growth - see section 18.4
- Avoid the wrong kind of property - see section 18.5

18.1 Should you buy a wreck or a brand new apartment?

There are five main categories of property to choose from:

- an older property that needs work doing to it
- an apartment in a brand new development
- a modern conversion of a period house
- old Victorian mansion block
- ex-Local Authority apartment block

In cities such as London and Edinburgh, you will probably be looking at flats and apartments. In northern cities and smaller towns, possibly terraced housing.

Remember that in theory, apartments are easier (although not always cheaper) to maintain than houses, as the communal work (such as a new roof) is managed by the freehold landlord.

Key tip

The efficiency (or inefficiency) of your freehold landlord in making repairs will either save or create a lot of headaches. Find out about any previous problems with the landlord.

18.1.1 Older property in need of work

Gone are the days when you could put any old property on the market and find a tenant.

Tenants have become a lot more discerning, especially in London or other major business centres. A lot of rental properties in these areas are going to people from Europe or America, and they want and expect quality.

Some, but not all, landlords have realised this. If you don't offer your property in a good condition, you might find it difficult to find a tenant.

> **Example of the potential returns of a refurbishment**
>
> We know of many landlords who own property that is worth £400,000 but only earn £400 a week rent on it, because it is in bad condition.
>
> However, if they spent another £40,000 making it look really good, they could achieve £600 a week in rent.
>
> The return on the extra £40,000 is over 26% and a great deal higher than the return on the £400,000 (5.2%)

It is always worth the money, within reason, to make your property look as good as possible.

If you are going to be an investor in properties that need work, you really should download and read Property Developer Secrets, the sister e-Book to **Buy to Let Secrets,** **www.propertysecrets.net/pds/** . This book is yours free to download as part of your Property Secrets membership.

The investing principles contained in Property Developer Secrets will help make your investment more secure and deliver higher margins and greater returns.

Of course, property development does require you to get your hands dirty with complete refurbishments and renovations - even if you bring in a team of builders to do the work for you.

However, if you are adverse to the renovation aspects, or if you are based outside the UK and unable to focus time and effort on developments, then you will be looking for properties that are:

- brand new, or
- recent conversions, or
- part of a purpose built property, or
- older properties in good condition and requiring only a cosmetic lick of paint

18.1.2 New Developments

There are a lot of new developments that have been built by big developers. Some of them are good and some of them are bad.

Before you buy a new apartment you should consider:

- the look and feel of the development
- think about the concept behind it, and
- find out from local estate agents what people think of that particular block.

The quality of the block is not quite as important for the tenants, because they will only live there for a short period of time. However certain blocks can get a bad name, because they are either ugly or they are just badly made, and this will make flats there difficult to sell later.

Try to avoid blocks that have problems. A bad block won't have the same capital appreciation as a good block, which has a fantastic name and 20 years down the line it is still regarded as a very prestigious place to live.

Key tip

Wait until the development has sold 90% of its properties. By then, the developer will be keen to sell the few remaining units and move the sales team onto the next development. This is your opportunity to put in a cheeky offer and come away with a healthy discount.

Or

Key tip

In a booming market, you might want to buy off-plan – i.e. before the property is built. That way you can purchase at today's price for a small deposit, but you may not have to pay for it for 12 or 18 months, by which time it may have risen in value by 10 or 15%.

18.1.3 Buy from a developer with a good name.

The developer, St George, is known as a very good builder. They have built many successful apartment developments.

For example, Chelsea Harbour is still a very prestigious place to live even though it is now a 10-year old development. It was well-built, despite a few small problems initially.

Key criteria for choosing a new development are:

- it is well built
- the service charges are reasonable

The biggest problem, apart from your initial finance, is the service charges on these new blocks.

If they have swimming pools, gyms, porterage and large grounds - all things that have to be maintained - then there is a monthly maintenance cost that has to be borne by each of the flat owners.

Although these extra facilities seem attractive and they might increase the rent slightly, they probably will not increase the rent as much as the amount you are paying in service charges.

Example:

In a block with all facilities, you might pay up to 2% of the property price in annual service charges, instead of a typical 0.5%.

Therefore, you will need to achieve a 1.5% increase in your gross yield to pay for the additional services charge on the property.

Or, if using a letting agent, a 1.75% increase in gross yield.

So, compared to a similar property (without the extra services) renting for, say, £1,333 per month, you will need to achieve an extra £350 per month on the property.

Month rent without services	Monthly rent to cover extra service	+ / -
£1,333	£1683	£350

Choose a block with relatively low maintenance.

Short lets

The exception to the rule of avoiding a large service charge overhead is with ***short lets***. Here the property is let for a matter of weeks and is usually selected instead of a hotel.

For this reason it is easier to charge a high enough rate to more than cover the service charges.

See **section 20.6.1** and **section 20.6** for more information about the short-let market.

18.1.4 A recent conversion of a period house

A recent conversion of a period house is similar to purchasing a flat in a new development; however, they tend to have lower services charges (as they don't have swimming pools, etc).

This has the advantage of offering high quality accommodation (with little or no work on your part) and fairly low service charges.

Again the things to consider are:

- communal areas - how do they look and feel
- how well has the property been converted and does the entrance corridor feel too tight
- the build quality

Key tip

These properties have good potential for the investment landlord - especially if the property is attractive and has low service charges.

18.1.5 Ex-Local Authority Housing

Ex-Local Authority housing will, in big cities, consist mainly of flats in a block. In smaller towns or on the outskirts of larger towns, you may find ex-council housing estates.

In some cases, the block or estate no longer resembles council housing. It may have mature trees, properties with extensions, variations and so forth.

This kind of property tends to lag the average house price increases, so for this reason may offer better rental yields to landlords.

However, you may be sacrificing future price growth for a greater rental income now.

A number of potential buyers (when you come to sell your property), will be put off by the ex-local authority label.

If all the properties on the estate or in the block are privately owned, this negative response will be minimised.

However, even if there are only one or two properties left that are still run and let by the local council, then you may find it more difficult to sell your property.

18.1.6 Terraced Housing Investments

An increasingly common form of property investment is to buy into cheap terraced housing in cities. There is a larger stock of these kinds of properties in the northern cities, such as Burnley, East Manchester, Stoke, Bradford and parts of the West Midlands.

These properties are purchased and then may be:

- leased to housing associations on a long-term lease - perhaps five years or
- leased to a contractor working with the government to provide accommodation for asylum seekers for up to 5 years.

There may be many advantages to buying this type of property:

- the cost of the property might be less than £25,000
- in some cases the gross yields possible on this kind of investment might be in excess of 14%
- you also have a guaranteed contract - possibly running up to five years - but probably less.

However, there can be some serious drawbacks to entering this letting market:

- **your capital value may not increase** (you are buying into a low demand sector of housing) - unlike nearly all other property opportunities;
- a low demand area means **it is hard to sell;**
- you may have trouble renewing your rental lease;
- **you may be liable for additional costs** (council tax and possibly other social costs in the case of asylum seekers);
- the area may become ghettoised and a flash point for conflict.

Is this a good investment? The answer will vary according to the property amongst many other things. However, as with all buy to let opportunities, the answer will depend on what you believe to be the combined:

- rental income
- capital growth

....over the next 5 to 10 years.

We recommend you use the spreadsheet to model your potential returns over this time period if you are considering this type of investment. See **section 22** on how to open and use the spreadsheet.

Some investors believe that the potential income is so great, that even if the property is worthless after 10 years, so long as they can renew the lease, then they will make money.

Also, there are increased signs that some previously failing neighbourhoods are able, through local initiatives, to recreate a sense of community and pull the local area out of a downward property price spiral.

A good example of this is the Sandwell community (Birmingham) see

www.smbc.sandwell.gov.uk

You would be wise to look carefully at as much background information as possible if you are considering this specialised market:

Government policies in regard to social housing:

www.housing.odpm.gov.uk

For more information about Registered Social Landlords (RSL - previously known as housing associations):

www.housingcorp.gov.uk

18.2 The secrets of a good rental property

Some properties let well, others struggle. They are both in the same area, offered for the same rent. So what is the difference?

Some properties are perfect for renting - others are not. This section will give you help to spot a good property, and avoid the not so good rental properties.

18.2.1 The rooms

It is not necessarily the absolute size of the rooms that will help a property sell or rent. If the rooms are unbalanced the value of the property can be less than the square footage might suggest, e.g. if there is one very large bedroom, but very cramped living room / dining area.

Think clearly about who rents what:

- one bed flat - lets to a single person or a couple
- two bed flats - often let to two sharers

Different types of people will value space in different areas of the house, for example.

One-bed flat
Generally speaking, the bedroom and living room should be of a similar size.

If most of the space is in the bedroom, the flat can start to feel like a bedsit. If one room is considerably smaller than the other is, the smaller room may make the flat appear pokey and cramped.

Two-bed flat
With a two-bedroom apartment, the living room needs to be a bit bigger than in a one-bedroom flat, as there will typically be two sharers. A flat with a small living room and two double-bedrooms is not well proportioned.

A large difference between the size of the two bedrooms may put off sharers as the decision as to who gets the larger room could cause problems.

18.2.2 How many bedrooms?

It is better to have a good one-bedroom apartment, rather than a two-bedroom that has tiny poky rooms, because it will appeal to the market you are trying to rent to.

A very small two-bedroom flat may appeal to people who only need a one-bedroom apartment, but want an extra room as a study, or for the occasional guest. These people are unlikely to rent it because they will have a fixed budget and they don’t really need the second bedroom.

For someone who actually needs a two-bedroom apartment because, for instance, they have a child, again it will be too small for them. Rather than accept a very small flat they might decide to live further out from a good area and get something slightly bigger.

Key tip

So there's no getting away from it. Your property must have good proportions.

What do we mean by a good room size? A double bedroom is at least 100 square feet - which is 10ft by 10ft. Ideally, it will be 10 feet by 10 feet square - rather than 5 ft wide and 20ft long!

Bedrooms of 150 square feet are preferable. If the rooms have a good height this helps to give a more spacious and airy feel. This is typical of lofts apartments and older properties.

18.2.3 Which floor for an apartment?

Although the penthouse apartment offers the advantage of having fewer neighbours and a certain uniqueness, this may not be reflected in the rental rate you achieve. Also, if you own the top floor flat and there are any problems with the roof, then it is you who will have to put up with builders / incompetent freehold landlords, etc.

A ground floor apartment will usually be less attractive than other options as people tend to associate them with risk of crime. Basement apartments usually suffer from bad light.

On balance it is usually best to go for first-floor apartments as they are:

- more secure for the tenant
- easier to lock up, if left vacant
- still accessible to most people
- slightly cheaper to insure

One potential disadvantage of first-floor flats is if there is a single shared poorly-secured front door. Burglars can gain entry, then take their time to break into a first-floor property out of sight of passers by. If your apartment has shared access, security alarms could be a particularly good investment.

18.2.4 Local transport

You will obviously be looking for a property in an up and coming area, which you think is going to increase in price. One of the key factors is close links to transportation, especially in any city that has commuting problems, eg London, Cambridge, Edinburgh, Leeds, Birmingham (increasingly) and many other major city centres.

Look for something with good transport connections into the city centre. The best properties are in areas that are due for a new tube station or tram link.

Both road and rail improvements will increase the value of a property - but it is the rail links - especially those into a major commuting centre (like city centres), that deliver the greatest uplift in prices.

18.2.5 The approach to the property

The value of a property, and its attractiveness to a potential tenant, is strongly affected by the approach to the property.

Is the path clean and tidy, or do you have to walk around the back of dingy garages to get access to the property?

Is the path from the road well lit?

If part of a block, does the block look inviting or foreboding?

What do the neighbouring properties look like?

If you were a single woman walking home at night - would you feel safe?

18.2.6 Parking

A garage or off-street parking in any busy city is great, a real bonus. Of course, very few properties have one.

Most properties with parking are part of a new development with garages underneath the block. Be careful that this benefit isn't lost in the extra service charges levied.

Key tip

You can always let your parking space separately - that way you can achieve full value, as you may have one tenant for your apartment and another for taking the garage facility.

18.2.7 Light

A property with good natural light will always be easier to let and subsequently to sell. Ideally, the main living rooms - lounge and kitchen would both have good light. South-facing properties will tend to have better light than East/West facing ones. Basement flats are clearly less likely to score well on these criteria.

18.2.8 Gardens

Gardens are important to certain types of properties.

Probably the only reason why someone would rent or buy a basement flat would be if it also offered some outside space. Unless, of course, they are really going for budget accommodation.

Tenants might have a dog or a cat and they really want that outside space.

Family houses definitely need a garden.

Obviously you have to consider the ongoing cost of maintaining the garden. If your tenants are not interested in the garden, then you could find it in quite a state when you come to re-let. You would then have the extra hassle of having someone come in and sort out the garden between lets.

The benefit of a garden is dependent on the type of person who is going to be living in your property.

18.2.9 Other things to look for

You want your property to have every possible advantage in the lettings market. Here is our list of things to look for when choosing a property that is suitable for letting:

Bathrooms	Showers are essential. A bidet, a second basin, built in cupboards all help the property to let quickly. Do you still have space to move?
Kitchen	Is it large enough to eat in? Lots of cupboards, all mod cons?
Layout	Kitchen should preferably be on the same level as the dining room. The ideal arrangement has the drawing room on the same floor and a study too.
Extra rooms	TV rooms, sitting rooms, playrooms and studies all help. Often a study is preferred to a 5th or 6th bedroom at the upper end of the market.
Double Glazing	This is helpful, especially if the property suffers from road, aircraft or other noise.

See **section 19.5** for a more detailed list to consider when (and if) refurbishing.

18.3 Finding an appropriate tenant

By the time you have bought a property and done whatever work that is necessary on it, you will probably already have a pretty clear idea of what kind of tenant will be most appropriate. As discussed earlier, particular properties appeal to particular types of tenant.

The more the property or apartment can appeal to the local market, the easier and faster it will let. Remember that a quick and efficient let is what you are aiming for, rather than holding out for a minor increase in rent; it is the void periods that will really affect your cash flow.

Even if you are focusing on the long-term capital gains you might make, you don't want to be losing money from the rental side of the business.

When you are considering an area or a property, make sure that you think about what kind of people will live there. Visit the area at different times of the day to see what kind of people live in that area, and target these.

18.3.1 Ask the lettings agent first

As discussed above, a good lettings agent should be your first port of call for advice about the market. Ask your agent what type of person would live in that property in that area. If you already have a clear idea of the kind of people that you want to target, ask yourself whether the property feels right for this kind of tenant.

Start to build a profile of the kind of person you will be letting your property to. Make a check list of what is important to them.

The next section outlines one way of doing this.

18.3.2 What your tenant really wants

Look at the table below and score your property on the criteria down the left hand side. You will probably want to extend this to include other things you think might be important to your prospective tenants. Don't feel embarrassed to ask your letting agent if they think that your analysis holds water.

Score

3***	2**	1**	-
Very important	Important	Quite important	Not important

	All tenants	Young professional	Families	Your Property
Transport	***	***	**	
Commute to work (access to public transport)	***	***	***	
Access to motorways	**	**	*	
Access to airports	**	**	*	
Amenities	*	**	**	

	All tenants	Young professional	Families	Your Property
Sports clubs	*	**	-	
Bars	*	**	-	
Shops/ shopping centres	*	*	**	
Local shops	*	*	*	
Restaurants	*	**	**	
Supermarkets	*	*	**	
Children's amenities	-	-	***	
Quality Schools	*	-	***	
Medical Facilities	*	-	*	
Immediate environment	**	**	**	
Rural location	*	-	*	
City location	**	***	*	
Feeling of security	**	**	***	
Low traffic roads	*	-	**	
Parks and open space	*	*	***	
Period properties	**	**	*	
Hills & river views	**	**	*	

The next sections look at particular target tenant groups for lettings.

18.3.3 Young single professionals

Young professionals often work in city centres, and have higher than average disposable incomes. They do not spend much time at home, and are generally looking for simple, practical accommodation. They are not generally planning to remain in rented accommodation long-term.

They particularly value:

- proximity to work (i.e. speed and reliability of the link - not distance)
- city locations - flats in the centre of town.

They also value leisure facilities more highly than some other groups, so the following may all be important:

- restaurants
- bars
- health clubs & sports facilities

When renting, a single professional person will often calculate the cost of transport to work. If they can reduce their monthly travelling cost by £50 per month by living closer to the centre of town, then they may well be willing to spend that extra £50 per month on rent.

Therefore, the more centrally-located apartments, even in slightly fringe areas are in the greatest demand.

18.3.4 Families

Families have their own particular needs. As well as good transport links to work, families will value proximity to:

- shops
- parks and outside spaces, with play areas
- good local schools
- good childcare facilities (nurseries, playgroups, etc.)

Many families rent because their company has temporarily relocated the main wage earner. Well-paid professionals tend to be fussier about the accommodation they choose, particularly when the company is paying.

Features such as a good-sized garden will be particularly important to families. Family properties without gardens will be difficult to let to this lucrative market.

18.3.5 Students & DSS lettings

Letting property to students or DSS tenants can give you a good rental return. However collecting rent is much harder and they probably involve more effort.

Students are much younger than the average tenant and are enjoying their first chance of freedom. They can be unreliable and are often unlikely to care about the upkeep of the property, as they are not likely to be staying in it for more than a year or so.

It is also more difficult to credit check them as they don't tend to have a long credit history.

Dealing with DSS lettings can raise a range of other problems. For example, there is a higher probability that a DSS tenant will have a credit history problem.

Even though you are being paid directly by the DSS, rather than by the tenant, the situation is not without risk. If the tenant has been claiming benefit illegally then the DSS can demand the money back from you.

Before taking on a DSS tenant it is advisable to try and reduce your risk by finding out from your local authority if there is any way that you can check to ensure that your tenant is claiming DSS benefits legally.

Key tip

You can make money - it's just that it's a management headache and you have to be willing to work with the problems.

Key Tip

Some professional investors will buy up 10 or more student properties at once as this allows them to hire a part time property manager to deal with all the work involved in letting and managing the properties. This way, they still have the time to make other investments.

Your level of day-to-day involvement

The student and DSS lettings market is certainly a lot more hands-on than many other markets. You are more likely to have problems with your tenants and need to be able to deal with these difficulties.

If you're retired and looking for a quiet steady income, then DSS and student lets certainly wouldn't be right for you.

Equally, if you are a full time career professional, it is unlikely that you would have either the time or the inclination to resolve these tenant problems.

In which case, it is probably better to leave this market for the professional landlord.

Student lets can work out. There are high returns, although sometimes it is only payable for the nine months of the year when the student is attending college or university.

Where there is a student market in a tourist area, landlords can rent to students during the nine months of the academic year, then rent the property out short-term for holidaymakers.

This mixed method, of students during term time and holidaymakers during the summer, can deliver excellent returns. But bear in mind that holiday lets require even more hands-on involvement.

In addition to the extra workload, these tenants can impose a higher level of wear and tear on your property. So in other words, working as a student or DSS landlord can effectively become a full-time job.

You could have DSS or student tenants who cause you no trouble at all, but experience suggests that you run an increased risk of trouble if you target these markets. Remember that if you are a leaseholder, you are responsible to the freeholder to meet the conditions of the lease. If your tenants break these conditions, you will be held liable.

To manage this increased risk, you should be prepared to visit the property every couple of weeks to make sure that everything is going smoothly, and to take a more active, hands-on management role.

So DSS and student lettings are not for everyone, but if you are prepared to:

- visit the property regularly
- take a hands-on approach
- **step in and take action** when needed, bearing in mind that there is a much higher chance of that happening...

....then there are greater returns to be had, but maybe not a great deal more.

Golden Rule: Decide for yourself - "Is this a good investment of my time?"

18.4 Area Research

It is well-known that location is the key driver of property value, and clearly the immediate and surrounding area to your property will most affect the capital growth of your property.

Your ability to find properties that deliver above average *capital growth* will determine the long-term success of your investment project.

It's mostly common sense:

- if someone builds a three lane motorway across your back garden, then your property price will suffer
- likewise, if a new tube line or tram system connects your district with the city centre, then local prices will shoot up.

What you are aiming to do is spot the elusive up-and-coming areas. Spotting them is the key to achieving above average capital growth on your property. In other words, you want to find areas that are in the process of being discovered - but aren't yet too expensive.

If you purchase property in an area that hasn't yet begun to improve, you may find you need to wait 5, 10, 15 or 25 years before you see above average growth. It is generally better to wait until the area has begun to improve first, and then move in.

Often, an area will take five or more years to be discovered - so you have got time.

18.4.1 Start your search for the up and coming area

You cannot be an expert on every single area, so you should initially pick just a couple of areas. It will simplify things if these areas are close to where you live at the moment. Get to know those areas inside out. Read the local papers and figure out which streets and which districts are going to improve first.

With long-term property investment, look outside your immediate area to neighbouring areas that you think will improve.

If you want to look in your local area, try to select particular streets that you think are going to improve. Try to identify which little part of that area you should be buying in. Often you'll find a few streets will be given a local name e.g. Poets' Corner or Golden Triangle. Anything like this may make those streets slightly more desirable.

The wave of price increases usually will not hop over an area. Normally it will spread from one good area to the next neighbouring area and increase from there, as long as the facilities are there and it has the potential to become attractive.

However, if there is a massive industrial estate in the middle of any area or a major motorway running through it, then the improvements might skip that middle area and carry on beyond it.

Key tip

Always look on the fringes of the good area. Improvements tend to move out from better areas in waves. Also, look for investment in public transport or amenities. These can often act as a catalyst to private investment.

One of the best ways of spotting an up and coming area is to look at the shops. A sudden influx of trendy coffee bars is a sure sign of changes.

Also, if you start seeing some smart restaurants and bars coming into an area, for instance, it means that potential clientele is improving and that is another very good indicator.

In terms of timing, once you see the good restaurants and shops beginning to appear, that is often the time to buy property.

One of the most important influences on raising property prices in an area is new public transport links. They tend to be much more influential than new roads.

Find out whether there might be an improvement to the rail links or other transportation links, or look around for how an area is improving.

Where to find out about new transport routes:
You can find out about improvements:

- in the local papers

- by phoning the Town Hall and speak to the planning department about any new plans for extra transport links, public libraries or other amenities
- by word of mouth – talk to the estate agents in that particular area and they will tell you.

Often, the local estate agents will know the rumours first, then ask them to point you in the right direction to confirm what they are saying.

Bear in mind, though, that some areas of London have been ‘due a tube station in the next couple of years’ for almost 20 years now!

Here are some useful links:

Map of over 800 local newspapers - one of the best sources for online local news

www.fish4news.co.uk

Maps of all London transport

www.tfl.gov.uk/tfl/interactive_journey.shtml

Government department responsible for transport

www.dft.gov.uk

18.4.2 Buying in Poorer Areas

Many poor areas will remain poor - try not to get drawn into these areas unless you intend to let to the DSS and student tenants, in which case you should ensure that your rental yield is well above 10%.

Some areas will always be poor because of the lack, or poor quality, of the natural resources there – it might be near an industrial estate and the industrial estate is probably going to be there for a very long time, and that will hold back the area from improving.

As mentioned earlier in **Buy to Let Secrets**, you may be able to obtain a good rental yield in these areas but the prospects of capital growth will be low, unless you can spot a neighbourhood undergoing regeneration.

Investor’s Tip

With regeneration money driving a number of rundown areas, smart investors are learning to look for new signs. These include:
- street wardens
- cleaner streets / anti-graffiti campaigns
- new children’s play areas
In fact anything that shows that people feel safe and confident on their streets again.

Also, some parts of Britain's ex-industrial cities are in a spiral of declining property values. Once an area has got a bad name, it can be very difficult to shake it off.

For instance, in certain areas of past industrial cities, like Manchester, Newcastle or Stoke, properties have declined in capital value - against the trend of the rest of the city and country.

These properties are now caught in a spiral of negative equity and falling or stagnant prices. The properties are very hard to sell - although, as you can imagine, it is easier to achieve a good rental yield when you only pay £30,000 for a terrace house. The kind of tenant who will rent this type of accommodation will typically be DSS claimants.

Other poor areas have the opportunity to become good areas. Typically, these are areas that have become rundown - but still include lots of period housing. They might also be lacking good local transport facilities.

Thirty years ago, Islington in London fitted this model. Now areas further east, Hackney and Dalston offer this opportunity of growth. Some areas of Tower Hamlets (a very deprived area on the edge of London's financial district) could suddenly become desirable.

These are the kinds of areas that might offer you the greatest potential return for your money.

These up-and-coming areas often provide a higher rental yield at the outset, coupled with the opportunity for substantial capital growth in the medium / long-term as the area picks up and becomes fashionable and then desirable.

However, they are not without their risks, it may take 20 years not five years, for an area to reach its potential.

Key tip

Try to buy in an area that is already on an upward swing - but hasn't yet peaked.

Whatever you do, make sure you do your homework first and check out the long-term returns on the Buy to Let Spreadsheet. See **section 22** on how to open and use the spreadsheet.

18.4.3 Estate and Letting Agents - source of local advice

Estate agents are a very good source of information for everything happening in an area.

Remember that if an agent works in a particular area, they won't tell you the bad points. They do know their areas, but take their advice with a pinch of salt.

18.4.4 Student accommodation (assessing the demand)

Every university has a student accommodation office that should be able to tell you about the levels of demand for student property in your area.

List of major accommodation offices:

www.pastures-new.co.uk/student/guides/accommodationoffices.asp

The UK's top site for private student landlords

www.accommodationforstudents.com

However, be conscious that more students are suffering financial hardship and may struggle to pay bills and deposits.

It is in the university's interests to encourage you to let to students - so do question the advice that you are given.

The key factors that you might want to consider are:

- **numbers of students** and how fast this number is growing the level of demand for rented accommodation
- **rate of student drop outs** - this could pose future non-payment of rent problems
- number of mature students or students who study all year round - offering the potential for 12 month lets

Key tip

It may be possible to lease the property to the university (or sometimes hospital for student nurses), on a three or five year contract. In this case, the university or hospital is responsible for maintenance and upkeep of the property.

18.4.5 Student let voids

Typically, the student term runs from October to June.

During the summer months of July, August and September, the property may be:

- vacant
- occupied by students working locally over the summer
- let to the holiday market

In past years it was possible to let the property to students for the whole year, but students are finding it more difficult to come up with deposits in advance.

As a result, more student properties are being left vacant over the summer months. Effectively, this is a 12-week void period.

Some landlords, for instance in Brighton, Swansea and other seaside towns, are able to let their properties to holidaymakers over the summer period. However, other properties, typically in major cities like Manchester or Birmingham, are finding it more difficult.

In some cases, it is possible to find student properties in up and coming areas - if possible, this combination is ideal.

Examples in the past include the east side of Cambridge and parts of Brighton, which have benefited from the overall property boom in these respective cities.

Key Tip

If you plan to let your student property as a holiday let in the summer then plan your repaint and property improvements for the end of June, so your property looks at its best for the holiday season.

18.4.6 Interview with student landlord

One landlord from Southampton reports:

> *"I've been letting three houses to students for 12 years and for the first time this year, one student has left the house unannounced with bills unpaid."*
>
> *"It is clear that students are finding it harder to come up with the deposits required and instead of charging by the term, I have reverted to a monthly direct debit.*
>
> *"Of the three houses, I have been able to let two houses for the full year - mainly to medical students who work a longer term. However, the third house has remained unlet over the summer for the past two years.*
>
> *"Whilst this is useful for me, as it allows me to refurbish and refit the unlet house, it is a concern about the long-term potential of the market.*
>
> *"I have also noticed that a number of student landlords appear to have sold their properties in the last 12 months and this may be helping to maintain demand.*
>
> *"Currently, letting the houses requires more work than before and the market is uncertain. However, the income returns continue to be good, although it remains a lot of effort to manage the properties and leases."*

18.5 Don't buy these properties:

Regardless of their condition there are certain properties that you should always avoid.

18.5.1 Avoid properties on a busy street

Properties on busy streets are best avoided, because although you can sell them in a good market, they are very difficult to sell in a bad market.

However, a property on a busy main road may be an investment opportunity if you know that a bypass is due to be built and traffic calming measures brought into the road.

18.5.2 Avoid basements or anything above a shop

Avoid any of these:

- basement flats
- dark apartments
- potentially vulnerable ground-floor flats
- apartments above shops

Tenants will be reluctant to rent these properties and you may be faced with long void periods.

18.5.3 Avoid anything with poor transport

Poor public transport to the city centre will make the property difficult to rent.

The exception to this rule might be if you are buying in an area that anticipates new rail, tram or tube lines. Equally, as city centre property costs soar, more people are forced to compromise their desire to be close to transport.

18.5.4 Avoid properties with these features

If you are looking for a hands-off investment, then you would be best to avoid properties with any of these features:

- Old fashioned or very basic kitchen and bathrooms
- Bathrooms on half-landings
- Inadequate or electric heating
- Poor approach

.....unless, of course, you are willing to do the work of a property developer. But be aware that the economics of property development are quite different from those of a buy to let investment.

If you are willing to develop property, then you can take on the properties in the following conditions:

- tired decorations and worn carpets
- different coloured carpets in different rooms
- curtains that are too short, not adequately lined or with poor finish

- patterned wallpaper and strong wall colours

Alternatively, you may decide that you don't have the time for either refurbishment or development, in which case you would do best to avoid these sorts of property altogether. Instead, look to purchase new or newly refurbished properties see **section 18.1.2**

18.6 Researching competing properties

It is very important to find out if the local market for rental property is saturated.

You may find, for instance, that in particular streets over half the properties are let out.

This means that an oversupply of property might drive down the achievable rents.

However, try to find out if one type of accommodation (e.g., one-bed flats) is in over-supply. Often you find that other types of accommodation (e.g., two-bed flats) are in short supply.

In our experience, when a number of properties are competing for the same tenant, **it is the properties in the better condition or with slightly better quality kitchens and bathrooms that let first**.

It is difficult to find out about competing properties, but here are a couple of things that you can do:

Pick up all the 'to rent' lists from local letting agents. These often feature apartments already let and contain asking prices rather than the achieved price.

Go into an agency and tell them you are thinking about renting.

Think about what you are looking to buy, how much you can afford, and work out the rough rental costs. For example, a property costing £200,000, would cost between £250 and £375 to rent per week.

Visit a couple of agents in that area and explain that you have £375 to spend, you want a one or two-bedroom apartment and ask to look at a few places. This way you will get an idea of the standard of the competition.

18.7 How you get paid the rent

It is worth knowing how you'll be paid the rent well in advance. It might, after all, affect the kind of property that you purchase.

18.7.1 Professional lets - how you get your money

The letting agent would normally collect rent as part of the agreement.

Typically the tenant pays the rent to the agent, the agent deducts the commission and passes on the difference to you the landlord.

Normally, you would receive this money by cheque (for smaller agents) or BACS for larger agents.

It may take two weeks for you to receive your money in this way.

Other agents will take their commission in advance. So if you sign a Tenancy Agreement for one year with a company, then the agent will receive the rent until their commission has been paid, at which point the rent is paid in full to you, the landlord.

Whilst this hits your cash flow in the early months, you can set up a standing order for the tenant to pay the rent directly into your property account.

This way you will receive your money directly and faster - than when the agent deducts his commission. It also means that you get to find out about rent payment problems earlier.

Some letting agents will take their commission quarterly instead.

Check that your letting agent is fully bonded so that if the agent goes bust then your rent payments are guaranteed by the organisation running the bond (ARLA or similar).

See **section 17.2** for more details.

Key tip

Find out how your local agents work; it could affect your cash flow dramatically in the first few months.

18.7.2 Student lets - how you get your money

Typically, a student would pay a term's rent in one instalment - at the beginning of term.

Alternatively, you might break the total amount down into 4 equal amounts and debit each after 3 months.

This structure is a hangover from the days when students were paid maintenance grants at the beginning of each term.

The landlord had to ensure that the rent was paid in full for the term before the student spent all the money on beer or other such distractions.

In the current student environment, many students are supporting themselves by part-time work, loans or irregular payments from parents. As a result, more and more students prefer to pay monthly as per a normal tenancy agreement.

The disadvantage is that you are collecting rent from each individual student sharing a property. See **section 21.4.4** for more about student rent arrears.

18.7.3 DSS/ Housing benefit lets - how you get your money

In the case of a DSS tenant, the DSS will either pay the rent:

- to the landlord - if the tenant agrees or in exceptional circumstances (e.g., where the tenant is refusing to pay the landlord), or

- to the tenant if the tenant requests - in which case you need to arrange the collection of the rent from the tenant yourself

Find out the rules for letting property to DSS tenants, and find out how the local authority manages bad tenants and rent payment problems.

If you don't have the time to do the research then you are probably best advised to avoid this market.

Congratulations! You've finished section 18. You'll now be able to:

- Decide between a wreck and a new apartment - see section 18.1
- Find a property that will let quickly and easily - see section 18.2
- Match your property to an appropriate tenant - see section 18.3
- Find a location that offers above average growth - see section 18.4
- Avoid the wrong kind of property - see section 18.5

19 STEP 2 – SETTING UP YOUR PROPERTY

The condition of flats and houses to be let is often the deciding factor when potential tenants make their choice.

> *There is no doubt that a property in first class order lets more easily. The same property in a tired state might well have difficulty letting - even at a much lower rent.*

So, it is in your best interest to present the property in the best possible condition (but within your budget for the property).

Golden Rule: schedule and put money aside for regular refurbishments.

Once you've read and digested this section, you will be able to:

- Plan your refurbishment in advance - see section 19.2
- Assess how much to spend on a property - see section 19.4
- Decide between furnished and unfurnished - see section 19.6
- Meet your legal responsibilities - see section 19.8
- Take the risk out of letting - see section 19.10

19.1 When to complete

The date you complete your purchase is very important.

The stages of purchasing a property are:

- **exchange contracts** - with which you pay (typically) a 10% deposit and agree to provide the rest of the money on completion
- **completion** - the date the remainder of the money is paid and you take possession of the property

If you exchange contracts and fail to complete, you will forfeit your deposit.

However, you can negotiate the date of completion to suit you.

Golden Rule: Never release (or allow to be released) a property into the lettings market in November or December.

The lettings marketing dies in November and December and, if you release a property onto the lettings market on say, 15th November you are almost certain to have to wait until early January before you achieve a let – that's a void period of up to 8 or 9 weeks.

Also, remember that the building trade disappears for most of December as it is very difficult for tradesmen to start a project at this time of the year.

19.2 Plan your refurbishment / redecoration work in advance

You will be paying mortgage fees and losing rent during any building work, so it is very important to do the work quickly and move the property into the rental market as soon as possible.

On a £100k loan, every month's delay will cost you in the region of £583 in interest payments - with no rental income to offset against the bank charge.

If your total investment is £30,000 - then every month's delay increases your investment by almost 2%.

If your property is late reaching the rental market, then it can seriously damage your investment.

Golden Rule: Do not take the property all the way to exchange and only then start think about instructing the builders.

As soon as you have made an offer for the property, book a visit to the property with your builders.

It shows the person selling the property that you are serious - because otherwise you would not be wasting your time bringing in the builders.

Key tip

Prepare your builders so that on the point of exchange, if you have access on exchange, or alternatively on completion, the builders can start work straight away.

19.3 Gain access to the property early

If you can gain access to the property at exchange - but before completion - then you can move the finished property into the rental market much earlier. This will substantially reduce your carry cost.

Unfortunately, access to property at the point of exchange is not always possible. For example, if the seller is in a chain, they are living in it and selling it in order to buy another family home, then you won't be able to get access. They will move out on the day of completion. So you can't get access until then.

Sometimes you can get access, if it is an investment property or if someone isn't living there.

This is often the scenario if an old person was living in the property and they've either suddenly had to go into a nursing home or died, and therefore the property is now vacant.

Typically, this kind of property will require more than just slight redecoration.

If the seller agrees to provide you with access on exchange, then you would pick up keys from the selling estate agent in the morning, do the work and drop the keys back every evening to the agent during the period between exchange and completion.

The seller does not normally have a problem with this. However, it is normally offered as a goodwill gesture, so it is wise to be considerate.

Essentially the risk is on the side of the investor / developer.

You have already exchanged contracts, so it is already yours. You just haven't paid for it.

Also if you (the investor) decided for some reason that you could not complete the purchase, then the seller would keep your deposit and all the building work, which is only going to improve the value of the property.

However, the seller might refuse permission if the property is beautifully decorated and you plan to radically change it (e.g., knock down walls).

In this instance the vendor might take issue with it, because they might think that you might damage the property if the work was part-completed and then you withdrew from the purchase.

19.4 How much to spend refurbishing a property

The amount you spend on a property is common sense more than anything else.

Don't take a cheap little one-bedroom flat in a cheap area and update with limestone floors, solid granite worktops and very expensive hardwood flooring!

Although it will rent very well and it will rent very quickly, you will not get a proper return on the amount you have spent on it.

At the same time, if you have a beautiful apartment in Knightsbridge, which is extremely expensive, and you put Ikea laminate flooring down and you have Formica worktops in the kitchen and you don't refurbish it well, then it is going to be very difficult to rent.

If you are letting to students, you will prepare and furnish the property differently from a professional let.

It really is common sense.

On a £100,000 property you might spend the following amounts:

Level of work	Amount	% of Property Value
5 day repaint and quick refurbishment	£2,500	2.5%
Full renovation	£10,000 to £15,000	10 to 15%

If your property was worth £200,000, then expect to pay twice as much for a repaint or major renovation.

Key tip

You've got to look at your area and pick and set the condition of the property according to the types of tenant looking to rent in that market.

19.5 Top tips for refurbishment

Make sure that you adapt our list to your local market, but these are the essential features required by busy professionals.

Item	Notes
Walls / woodwork	Redecorating is the quickest and cheapest way to improve the 'feel' of your property and make it appeal to your prospective tenant. In the vast majority of cases, white or magnolia walls with white woodwork will best suit your property.
Bath	Don't get a plastic bath, get a proper bath (metal or steel). They don't scratch, they stay 'clean' much longer and look much more appealing

Item	Notes
Shower	Some agents believe that a quality shower can often be the deciding factor between one property and another. Select a quality shower by a quality manufacturer. Don’t get a cheap, nasty one because it will break and you'll end up buying another one. Bear in mind that buying a shower unit is only half the cost of having a shower, and the other half is fitting it. Remember that if you buy a cheap new shower, you may have to keep replacing it.
Kitchen	The key factor of a kitchen's durability is down to the person who fits it and how well they fit it. If the kitchen has been fitted badly, then it will fall apart. Avoid fashion kitchens. They look out of date very quickly. The fridge / freezer should be large. Tenants will look for a kitchen with as many cupboards as possible and all white goods - especially a washing machine. Ideally, include a separate dryer as well. For larger properties or more expensive properties, a dishwasher is essential.

Item	Notes
Furniture	Avoid chipboard. It breaks easily and quickly looks tatty. Spend a little more and get significant improvements on durability. Firm beds which are well sprung and a sofa that converts into a bed are preferred.
Carpets	Use good quality (and durable) carpets the same colour throughout. They should be a light or neutral colour. A biscuit or beige carpet is also universally acceptable.
Central Heating	Tenants look for good, reliable central heating with plenty of hot water.
Kitchen goods	Choose matching china and glasses (easily replaceable). Keep patterns to a minimum, plain white is often best and make sure that they are dishwasher proof.
Built-in wardrobes	The more the better - especially if they have well arranged interiors.

If you are buying a property and hoping to move it into the rental market quickly, then your property should already have many of these features.

If not, then you are potentially looking at a property development.

The economics of a development are very different from just a pure rental and should affect the price you pay for the property as well as your carry costs and refurbishment costs and so on.

See our sister publication, **Property Developer Secrets** for more information.

19.5.1 Brands vs. own-label

Make sure that you stick to:

- one brand of paint
- one brand of carpet
- one brand of furniture throughout.

This is doubly importantly if you let more than one property.

By using a single brand:

- repairing the items becomes much easier (and therefore cheaper)
- you can use the same repair engineer
- you can swap items from one property to another
- you don't have to keep loads of different instructions for each appliance

Also, at your expected three year minor refurbishment (see **section 21.7**) you might only need to paint one wall of a room - if you use the same paint brand, then the colour will match.

If you mix up your brands or use own label paint, then your walls won't match and you'll end up painting the whole room. Four times the work, four times as expensive.

You may find a quality brand selling goods under a different badge (eg, John Lewis often does this with furniture and white goods). These can offer good value as well as reliability.

See **section 19.6.3** for more details.

Key tip

Remember to use BRANDED paint (e.g., Dulux); and use the same paint on every property you own. That way if you need to repaint one wall of a room then the colour will match. (Own brand paints don't do this - you'll end up painting the whole room instead).

19.6 Furnished or unfurnished?

Furnished or unfurnished is always a very difficult question to answer - it depends on your tenant and what you are offering.

For instance, any of the following will require furnished properties:

- students & DSS
- short lets (especially serviced apartments)
- young professionals renting for the first-time

Properties aimed at other groups may or may not benefit from being furnished.

The stock answer used to be that a furnished property would always achieve higher rent.

There also used to be legal limitations that meant a furnished property was safer for the landlord as the tenants had fewer rights of possession compared to an unfurnished property. However, legal changes such as Assured Shorthold Tenancy have swept away these old truths.

So, if you are unsure, then the best way to decide furnished or unfurnished is to find out what matters to your key market.

Many agents will advise that for longer let properties (six months or more), adding furniture would not make a substantial difference to the rent achievable.

Even where people will pay more for furnished, it often isn't a sufficient return on investment.

Example

An empty 2 bedroom was on offer for £300 per week.

A couple said they would take it for 6 months at £320 per week if it were 'part' furnished.

However if you add up the costs of:

- beds,
- wardrobes
- sofas
- kitchen/dining table
- chests of drawers.

Then furnishing is a substantial cost for a return of only £20 a week.

Properties in the short-lets market, looking to achieve high rents need to be well-furnished, and preferably with everything down to tea towels, cutlery, corkscrew, etc.

The aim of a short let is to allow the tenant to feel that they can move in immediately with just a suitcase of clothes and start living right away.

However, often in these scenarios you might also need to provide maid service too.

Furnishing a property can work if you want to let quickly, have great taste, have the money ready up front to buy decent quality furniture and the time and energy to sort it all out and set it up.

(Do not underestimate the time that this can take or the cost of getting someone else to organise it for you).

These days many tenants have bits and pieces of their furniture they prefer to take with them. Often they would rather sleep in their own bed and be surrounded by their own taste in furnishings, so think carefully before you spend money.

Key tip

As more landlords offer unfurnished properties there can be a lack of supply of suitable furnished properties. In some local areas this could work to your advantage if you are willing to furnish.

19.6.1 Sparse furnish if you can

Sparse part-furnishing is becoming increasingly common. If you can get away without fully furnishing a property, you will save considerable effort and cost.

It has been known for a landlord to carefully furnish a flat and then find tenants would only take the flat if it were unfurnished, leaving the landlord to ship furniture out and pay for it to be stored.

In another situation the couple taking the tenancy wanted to use the rooms in a different manner than that envisaged by the landlord. This again required storage and moving everything around.

If you are keen to furnish but the property is new, it may be worth showing empty or part-furnished, and then to spend money on furniture only once tenants have been found. You can bet that if you chose a double bed for the second bedroom, the tenants will want two singles instead.

The safest route, which may save you money in the end, is to consult the agents in the area you are thinking of, and possibly visit some of your potential competitors. You will soon get a picture of what the local tenants want.

Key tip

As a rule of thumb:

Typically, one-bedroom and two-bedroom apartments, depending upon the area, need to be furnished or at least sparsely furnished'.

On the other hand, larger apartments/houses can be either furnished or unfurnished. Often, a family, if being relocated, will want to bring a lot of furnishings from with them. Especially if they have children, bringing all the toys, cots or favourite beds will be important.

19.6.2 What furnishings to provide

Keep it simple. Go for partially furnished if you can.

Bear in mind that you should keep costs to a minimum. It is very easy to over-spend in the area of furnishings.

If you need to buy furniture then your major items will be:

- beds
- sofa
- tables
- chairs
- wardrobes
- chests of drawers.

Remember to keep some money back to spend on lighting and pictures, etc.

Key tip

Add a few dried flowers to the table and throw a bed cover over bare beds. It makes all the difference and costs you next to nothing.

Anything that can give the property a homely feeling will speed the letting process.

Even better, you can always remove the decorative items once the property is let and then use them in your next property.

Try somewhere like Ikea for most furnishings.
www.ikea.co.uk

19.6.3 Electrical Goods - what should you provide?

Equipment	Long Lets (6 months minimum)	Short Lets (less than 6 months)
Washing Machine	Yes	Yes
Oven	Yes	Yes
Fridge	Yes	Yes
Dishwasher	Yes - in a good quality apartment	Yes
Dryer	Yes - in a large quality property	Yes

Equipment	Long Lets (6 months minimum)	Short Lets (less than 6 months)
TV	No	Yes
Stereo	No	Yes - in 4 or 5 star apartments
Video	No	Possibly

For the typical long let, don't supply any large electrical goods like TVs or videos, or anything that is easily broken.

Something can easily go wrong with a TV due to negligence, your tenant dropping it or spilling a drink down the back of it, etc. These items are likely to be badly treated and cause you a maintenance headache.

Key tip

If there isn't room in the kitchen for a washing machine and dryer, just supply the washing machine, not a combination washer-dryer as they are notorious for breaking down.

19.6.4 Buy economic but reliable brands

Go for economic but reliable brands. Often a manufacturer will sell their goods under another label (e.g., a John Lewis own brand). This can offer the price benefits of a cheaper brand, but without compromising the quality and durability.

A machine that breaks down will cost you a fortune in call out charges to the plumber or engineer, so avoid it!

It pays to go for the mid-range, or slightly above mid-range, manufactured by a reliable brand.

Online white goods merchants include:

www.tesco.com/electrical

www.appliance-direct.co.uk

www.applianceonline.co.uk

For good, unbiased reports on these and other appliances try Which? (www.which.net). They offer a free 30-day trial on their equipment reports.

19.6.5 Loose furnishings

A furnished property does not have to include sheets and towels. However, when you show the property everything should be complete, so make the beds!

Make it feel homely. Put up some pictures, maybe a vase of flowers. Make it feel good, so prospective tenants will walk through the door and immediately feel they could live there.

Do expect a tenant to try and imagine living there, just as someone buying a property might. The tenant is paying a premium to drop their bags and start living.

19.6.6 Fit the quality of furnishings and furniture to the quality of your property

Use common sense and look for quality workmanship and compare that against price.

Ikea kitchens are very cheap and not badly made, but obviously not as well made as those by luxury kitchen companies like Smallbone. Smallbone is very expensive, but it lasts a long time – much longer than many cheaper options.

It is worth paying a little bit extra to get something that will last, but probably not worth paying the prices for a top of the range kitchen - unless it's a £500k apartment.

19.6.7 Renting furniture

It is now possible to rent furniture, rather than buy it. The great benefit is that the furniture is delivered and removed by a specialist company; you just have to choose the package that is appropriate to the property you are renting.

You might consider renting a few items to help sell / let your property.

A nicely laid table with glasses, cutlery and crockery, chairs and so forth can make all the difference to the feel of a property.

So long as you make it clear to the potential tenants, that the property is available unfurnished, then there is no reason why you shouldn't remove these items when let.

However, it can be expensive to rent furniture. Furniture rental companies typically expect to get their money back on the furniture within a year. If you are going to need the furniture for more than a few weeks, then you should consider buying it instead.

19.7 Keys and security

It does not cost very much to make a property secure:

- Yale and Chubb lock on the front door(s)
- window locks
- perhaps a burglar alarm

It makes tenants feel good and it does not cost a lot. It is money well spent.

19.8 Landlords' legal responsibilities

As a landlord you will have certain statutory responsibilities. In particular you are responsible for the following:

Area	Responsibility
Safety of gas appliances	You must, by law, arrange an annual check of gas appliances
Safety of electrical appliances	All electrical appliances must have fixed plugs. A check of appliances is advisable but not mandatory
Fire safety requirements	You must ensure that furniture and furnishings (particularly soft furnishings) meet the requirements
Repairs	It is your responsibility to carry out repairs on the property

You may have other responsibilities according to your tenancy agreement - such as maintaining the garden.

All gas appliances (boilers, cookers and gas fires) must be maintained in good order and checked every 12 months by a CORGI registered engineer. When you come to let your property, you will need to present the tenants with a Gas Safety Certificate. This needs to be provided within 21 days of them moving in. For short lets (less than 6 weeks) you need to hand it over as they enter the property.

All furnishings must comply with safety regulations, see www.dti.gov.uk/ccp/topics1/guide/furnitureguide.pdf - essentially any furniture purchased new since 1988 should automatically comply.

In addition, it is wise to ensure that your property is fitted with

- Smoke detectors
- Carbon monoxide detectors

More information is available at

www.dti.gov.uk/homesafetynetwork/cm_intro.htm

19.9 Who pays for what - tenant or landlord?

With short lets, you, the landlord, would normally pay the:

- gas
- electricity
- council tax
- water rates
- service charges

However, with a long-term let, normally the only thing you would pay for would be the service charges. The tenant would pay for the gas, electricity, council tax and water rates.

Key tip

For both a short-let and a long-let the landlord will always pay the service charges. This is why low or moderate service charges on a rental property are so important, as the landlord always picks up the bill.

However, standard practice does vary across the UK, so you'd be advised to check with your local letting agent.

19.10 Taking the risk out of letting

The biggest concern for any new or experienced landlord is - 'what do I do if something goes wrong and/or I don't get paid the rent?' After all, you still have to pay the finance costs.

Essentially there are four main areas of concern:

- that the property doesn't let in the first place
- that the tenant doesn't pay the rent
- that something goes wrong with the property
- risk of damage to the property (e.g. fire).

19.10.1 The risk that the property doesn't let in the first place

If you have a good rental property and have accurately focused it on the local market, then so long as you employ a good agent (with a high marketing profile) the only substantial risk is that there might be a fall or crash in the rentals market.

If the rentals market does fall, then it is probably because more people are choosing to buy rather than rent - therefore look to sell your property rather than rent it.

Key tip

Don't wait until your property is ready before you start talking to rental agents. Get them involved in your project from the outset and make sure that they can start showing prospective tenants the moment it is ready (even a little bit before).

If you are concerned about the risk that your property may take a while to rent, then consider taking a buy to let mortgage which allows you to have a period when the property is vacant.

This won't save you any money, but it does mean that you'll be better able to fund any voids.

19.10.2 The risk that, once let, the tenant refuses or is unable to pay the rent

There are a number of options, of which the two most useful are:

- taking out a rent guarantee
- taking out legal costs insurance

Taking out a rent guarantee costs about 3% of the rent.

This is a guarantee that ensures that you are paid your rent in all circumstances. So if the tenant is coming to the end of their tenancy and they decide to keep the last month’s rent instead of the deposit, then the insurance would pay out.

Via www.Homelet.co.uk these policies are available on all properties (including properties let to tenants on DSS benefit, students or self-employed), so long as the tenant has been adequately credit referenced. Alternatively you can find similar insurance from www.letsure.co.uk

Ian Cooke, Partner www.charlesrussell.co.uk advises:

> *"In the case of good quality tenants (e.g. corporate lets in London) a rent guarantee may not be worth while if you have all of the above checks in place. In more marginal areas (say the East End of London) where rental yields are higher, then paying a monthly rent guarantee may make better sense as it is more likely that your tenant might have a problem paying the rent."*

Ultimately, a rent guarantee will give you peace of mind, and if you are new to property letting and development, it might be wise to cover your risk at the outset regardless of the quality of the tenant.

For about £5 per week, legal costs insurance can cover any legal costs you might incur in relation to your property up to an amount of £50,000.

So, if you need to evict or remove a tenant or have any other legal costs relating to your property, then you have the funds to take firm action and to use quality litigation lawyers to get a result on your behalf.

These types of insurance typically use a panel of specialist property lawyers. However, always check whether you can also work with a preferred solicitor. Homelet (www.homelet.co.uk), among others, offers this service.

19.10.3 The risk that something goes wrong with the property

Typical problems like a pipe bursting or a shower leaking are both annoying and urgent. These are the types of problems that if left unattended can do considerable damage to your property and also can ruin the relationship with your tenant.

For a small monthly premium (about £5 or £6 per month) your property can be covered for emergency repair work (up to £500). This means that if you are away on holiday or uncontactable, then a plumber can be called if the shower or a pipe is leaking. Often, the ability to respond quickly to an emergency means that the damage is minimised and so saves on future costs.

Areas covered by www.homelet.co.uk 's insurance includes:

- Plumbing and drainage
- Security of doors and windows
- Electricity supply
- Primary heating
- Cooking
- Roofing, downpiping and guttering
- Lost keys

A similar scheme is offered by www.letsure.co.uk

19.10.4 Buildings Insurance

If you are letting your property you'll require a specialist insurance that provides additional cover:

- if the property is vacant for more than 90 days (most domestic insurance would be invalid for longer periods)
- against public liability insurance (in case a builder or tenant injured themselves in your property and decided to sue)
- against malicious damage by the tenant

Expect to pay £1.90 per £1,000 of rebuild cost via www.homelet.co.uk or www.letsure.co.uk where the insurance includes these clauses.

Note that this kind of insurance is suitable in the example of a refurbishment - if you intend a full-scale conversion then you need to arrange bespoke building insurance.

19.10.5 Contents insurance

Standard household contents insurance will not necessarily cover you for let properties; you will need specialist cover. For example, Limited Content Cover (£5,000 cover for £5 per month) for let properties is available from a number of places. Check with an insurance broker, or look at a lettings specialist such as Homelet (www.homelet.co.uk) or Letsure (www.letsure.co.uk).

Useful addresses:

www.homelet.co.uk

Telephone: 020 8768 1616

www.letsure.co.uk

Telephone: 01628 581500

info@letsure.co.uk

Congratulations! You've finished section 19. You'll now be able to:

- Plan your refurbishment in advance - see section 19.2
- Assess how much to spend on a property - see section 19.4
- Decide between furnished and unfurnished - see section 19.6
- Meet your legal responsibilities - see section 19.8
- Take the risk out of letting - see section 19.10

20 STEP 3 – TENANTS - FINDING & SETTING THEM UP

Once you've read and digested this section, you will be able to:

- Avoid bad tenants - see section 20.1 and section 20.2
- Decide between letting direct and letting through an agent - see section 20.3
- Recognise and understand tenancy agreements - see section 20.7
- Set the rental price - see section 20.9
- Set up your tenant - see section 20.11

20.1 Avoid bad tenants - at all costs

If the agent ever says (or even vaguely suggests), that they are not quite sure about a potential tenant, then go with their instinct, even if the tenant offers full rent.

It is much better to go with a good tenant for a little bit less money than a less certain tenant who may be offering more rent.

A bad tenant can be a nightmare - avoid them at all costs.

We have experienced quite a few bad tenants – people who thought they shouldn't have to pay any rent for no good reason and thought they could get away with it.

Bad tenants can be devastating to your morale, especially if the landlord is not particularly well-off.

Don't forget there is always an emotional attachment to your property. Especially if you are still fairly new to property investment.

So choosing a good (reliable, clean) tenant is essential, and will affect rent payments as well as maintenance.

20.2 Nine Tips for a successful let

1. Find a professional agent with a good reputation **- don't go with an unknown agent**
2. Expect to pay 10% commission to the letting agent (plus VAT)
3. Choose an agent with the highest marketing profile for the type of tenant that suits your property - this usually means they have the pick of the best tenants
4. Don't try to save 3 or 4% on your agent - you will pay for it in the long run
5. Take the mid range price for your property - don't be misled by someone offering to rent your property for the highest price
6. Be realistic

7. Remember speed is more important than the end price - you want a letting office that is geared up to let your property quickly

8. Even good letting agents can have poor management departments - consider handling the management yourself

9. The agent is responsible for taking the tenant (although not guaranteed), ask them to help if a problem occurs.

For a good agent be prepared to pay the 10% commission. If they charge significantly less, then they are probably cutting corners on tenant checks and that means you may get a bad tenant after all.

A good letting agent should also be able to give you up to date advice about the conditions of the local market

20.3 Letting through an agent or letting direct?

One of the key questions to answer before you can plan your costs is to decide whether you are going to let through an agent or do it yourself.

Our advice is to use a good agent, unless you really know what you are doing with the type of people that you will attract from newspaper adverts.

Here are two very good reasons:

- agents can improve the quality of the tenant
- agents can often achieve higher rents

20.3.1 Agents can 'improve' the tenant

Why use an agent? Basically it is good to have an independent third party between you, the landlord, and the tenant.

Landlords should be discouraged from having contact with their tenants. It is much easier to go through your agent who knows what to say to the tenant and how to say it.

The biggest problem we have ever seen is with landlords who have become friendly with their tenants – worst mistake ever.

When you become too friendly, there always seem to be issues over money and disagreements, and tenants often do not always know what their responsibilities are.

If there is an argument, for example, over fair wear and tear, then the dispute will boil down to a question of what constitutes fair wear and tear.

An agent, with years of experience and hundreds of properties let, will know and will be able to give credible examples to back up the argument with the tenant.

If an agent tells a tenant that worn carpets aren't regarded as fair wear and tear and that he should pay for the damage, the tenant is much more likely to accept - given that the agent is telling him.

It is much harder to achieve a resolution if you, the landlord, have to negotiate directly with the tenant.

20.3.2 Agents can achieve higher rents

You can often achieve a higher rent by letting your property through an agent.

Yes, that's right, an agent can often charge more for your property than you can.

Agents, as a rule, if they are good agents, will achieve a sufficient additional rent so that you still end up with the same money in your pocket as if you had let the property privately.

Why? People looking for properties through newspapers tend to be looking for budget accommodation and they will be looking to save money.

It's the busy people who can afford more, and will want the agency to do all the legwork for them.

Often, if a tenant goes through an agent, then they are prepared to spend more.

This makes your choice of agent doubly important. You need to find some one with substantial experience, good reputation and most importantly someone you can trust.

See **section 17.2.1** on how to choose a letting agent.

There is of course, an exception to every rule. This usually applies when you are letting to:

- students
- DSS claimants
- possibly some other situations as well - for instance when you are letting single rooms in a house

In these instances, you need to be willing to be much more hands on and advertise the property yourself. Often it is not economic to pay an agent to do this work. Or at least, it is hard to find someone who will be as diligent as you will be, for the salary they can expect.

However, if letting to professionals, then in nearly all cases we would encourage you to let through a good quality agent.

20.3.3 Self-let or use an agent?- decision chart

If you have a buy to let scheme, the mortgage contract may already require you to let through an ARLA, NAEA or RICS approved agent. If not, use the following chart to help you decide:

	Advantages of a good letting agent	Disadvantages of Self let
Speed	Can act quickly (should have lots of applicants on their books)	May take longer to find the right tenant - meanwhile you are paying finance charges without any rental income
Company lets	Companies will use a good agent	No access to the company/ corporate letting market
Advertising	Only get paid for a successful let	May have to risk money up front on adverts (with exceptions - such as Loot and some internet sites)
Risk of a bad tenant	Reduces risk as they know how to credit reference a tenant and are familiar with good and bad tenants	If you are unfamiliar you may end up with a poor tenant who doesn't pay bills or causes a problem
Time	Take lots of work off your hands	Need to get meters read etc yourself
Contract cost	Offer contracts at a good price (normally £100ish)	Need to employ a solicitor to draw up the contract - which usually costs considerably more than allowing the agent to do the work

The major reason for landlords to go the self-let route is not to save money, but due to bad experience at the hands of a letting agent. Therefore, if you can find and work with good agents, then this is by far the best route and tends to significantly reduce the risk of something going wrong in the future.

20.3.4 What the agent does to let your property

Check with your agent, but a good agent should fulfil all the points below:

- Find the tenant
- Take up references (check whether this includes credit references)
- Prepare inventory report (optional and at extra cost)
- Arrange and get the contract signed (optional and at extra cost)
- Notify the lender
- Arrange for the utility accounts to be transferred.

A crucial function of the letting agent is taking up references. These should include a credit reference and a search to ensure that there are no county court judgements against your tenant.

Make sure that your agent has taken up references properly and that you are happy with the results.

If a problem arises, the fact that the agent chose the tenant would mean that a good agent, concerned to protect its name and reputation, would assist you in removing the problem tenants.

Equally, a good agent will have experience of similar situations and be able to provide suitable and appropriate support and help.

Most professional buy to let landlords use an agent to market and set up the tenancy for them.

Key tip

Give agents one set of keys each. This is important. If the agent doesn't have keys they will have to either phone you or another agent to arrange collection of the keys.

Lettings agents are busy people and are less likely to be bothered to show your property if it is difficult for them.

Make it easy for agents to get access to your property.

20.4 Finding Your Tenant yourself

You may decide to find the tenant yourself. Typically, this will be because there is a lack of quality letting agents in your locality or because you are letting to the student or DSS market.

20.4.1 Advertising for your Tenant

If you are promoting a student let, then contact and register with the university accommodation office.

See:

www.pastures-new.co.uk/student/guides/accommodationoffices.asp

www.accommodationforstudents.com

If you were letting a DSS property, you would normally advertise yourself. Contact your local authority housing department and ask them the best way to advertise your property.

Typically you might place an advert in:

the local paper e.g. Manchester Evening News

www.manchesteronline.co.uk

Loot (if in London - it's free to advertise)

property.loot.com

In some instances you might advertise through specialist magazines such as:

Country Life

www.countrylife.co.uk

Punch

www.punch.co.uk

The Lady

www.lady.co.uk

Think about your target market and investigate potential publications.

20.5 Corporate or private tenant?

There are two main types of tenant:

- corporate tenant
- private tenant

There is a myth that corporate tenants are better than private tenants - this is often not true.

However, if the company is well known then there may be lot of benefits such as:

- Long-term tenancy (and sometimes fixed term, e.g., for one year or more)
- Almost guaranteed rent payment
- Very low probability of a problem tenant.

If it is a small company that you have never heard of, then there is the liability if they decide not to pay their rent. Companies, especially smaller ones, can go out of business.

If a company does not pay their rent and they go bankrupt or go into liquidation, then you legally have no one to go after.

Key tip

If you are concerned about a company's financial condition then ask for a personal guarantee.

Normally if you are going to have a corporate tenant, go only with a major company whose name you recognise. Then obtain a solicitor's or accountant's reference on those companies.

Golden rule: be willing to let to either private or corporate tenants. However, don't automatically assume that a corporate tenant is good news. Do your homework first!

20.6 Short Lets or Long Lets?

You can, especially in London, let your property short-term or long-term, but most parts of the country do not have a short-term rental demand.

Short-term is less than six months and they tend to be people who are normally on work assignment or are in between buying and selling and need temporary accommodation.

Typically, if someone has been posted from abroad they might need temporary accommodation for two or three weeks before they find a property to rent long-term or a property to buy.

Increasingly, this type of rental is becoming popular in other capital cities, such as Dublin and Edinburgh, as well as regional capitals such as Leeds.

20.6.1 Why let short-term?

Typically you can charge higher rent, normally about 30% more, on short-term lettings.

There are a number of drawbacks with the short-term rental market. For example:

- Letting agents will normally charge as much as twice their normal commission.
- You will inevitably have more void periods as you will have gaps between one short let and another.
- This kind of property requires substantially more work, as you can't let and leave it for a whole year - you need to be constantly looking for new tenants.
- In some cases, the property may offer a maid service, or your tenant might reasonably request it.
- Every time a tenant comes in or departs, you'll want to run all the normal checks and inventory controls.

However, the uplift in rental incomes can make short lets lucrative if you have a centrally located apartment that appeals to this market.

20.7 Tenancy Agreements

It is wise to check your tenancy agreements with a lawyer who understands housing law.

The nature of English law is that it is set by precedent, therefore it can change at any time and a contract that you used successfully for your previous tenant may cause you problems with your next tenant.

Also, new statutes or regulations come out from time to time that will require existing tenancy agreements to be reviewed. For example, all tenancy agreements should now be reviewed in the light of the Office of Fair Trading's guidance on the Unfair Terms in Consumer Contracts Regulations 1999.

Do not use old forms of tenancy agreement. If you or your company has its own standard forms - get them checked regularly.

If you are letting to a student group, then you might contact your local Student Accommodation Office and ask for help with the contract.

It is important that you understand the different types of agreement and the various options each provides for the landlord.

20.7.1 The main types of tenancy agreements

There are several types of tenancy agreement used when letting property today; these are:

- Assured SHORTHOLD Tenancy Agreement
- Assured Tenancy Agreement
- Common law Agreement
- House and Flat Share Agreement
- Holiday Letting Agreement

The basic differences between these types of letting, is the length and protection granted to the tenant in each case:

Name of Agreement	Key Points	Length of protection for tenant	Means of gaining repossession
Assured Shorthold Tenancy Agreement ("AST")	Allows Landlord to end the tenancy, simply by serving a valid 'Section 21 notice'. This is the current 'default' form of tenancy. Note - see below for shared houses	6 months or the fixed term in the tenancy agreement (whichever is the longer).	Notice under section 21 of the Housing Act 1988 ("Section 21 notice"). Can also use the grounds in Schedule 2 of the Housing Act 1988. Landlord must get a possession order to evict
Assured Tenancy Agreement	Provides the tenant with a much higher level of assurance than the shorthold tenancy, as the landlord will not have the right to repossess the property as of right under the 'shorthold ground'. For this reason this type of tenancy is inadvisable for the private landlord who should ensure that all his tenancies are ASTs.	Indefinite (notwithstanding any fixed term in the tenancy agreement), subject to the grounds for possession in Schedule 2 of the Housing Act 1988	Can only recover the property pursuant to one of the 'grounds' in Schedule 2 of the Housing Act 1988 (the most common of which is ground 8, two months rent arrears) after service of a valid notice under Section 8 of the Act. Landlords must get a possession order to evict

Name of Agreement	Key Points	Length of protection for tenant	Means of gaining repossession
Common Law Agreement	This occurs when the statutory codes set out in the Housing Act 1988 do not apply. The most common situations are resident landlords letting a separate dwelling in the house where they live (provided this is not a purpose built block of flats), company lets, and lettings with an annual rent of more than £25,000.	The fixed term in the tenancy agreement, thereafter the notice period in the Notice to Quit - generally four weeks.	Service of a valid old style 'Notice to Quit' followed by possession proceedings.
House and Flat Share Agreement (Lodger)	Used if you are letting out a room in your own home. Offers less protection to the tenant as it is a 'license' and not a 'tenancy' – essentially four week written notice.	None - other than 4 weeks notice.	4 weeks written notice. Landlord can then evict without a court order provided there is no force or violence
House and Flat Share Agreement (no resident landlord)	Normally a room in a shared house will be let on an AST with the tenants sharing the common parts. However sometimes, for example if the landlord has regular access to the rooms, the occupants may be licensees rather than tenants, as in a hostel. Legal advice should be sought if the situation is unclear.	As for ASTs see above. Otherwise seek legal advice.	As for ASTs - see above. Otherwise seek legal advice.

Name of Agreement	Key Points	Length of protection for tenant	Means of gaining repossession
Holiday Letting Agreement	An agreement to let the premises for the purposes of holiday accommodation. This is another type of 'Common Law' tenancy.	As determined by the agreement - but typically for the duration of a holiday (i.e. one or two weeks)	At the end of the agreement period the landlord can evict without a court order provided there is no force or violence.

Note - there are still some old protected or statutory tenancies created under the Rent Act 1977 in existence, but these cannot now be created for new tenants. You will only come across them if you buy a property with a sitting tenant.

20.7.2 Assured SHORTHOLD Tenancy Agreement (AST)

An AST is actually a type of Assured Tenancy, and works in very much the same way. The main difference is that there is an additional ground for possession, the 'shorthold' ground. The AST is now generally the default tenancy when letting a whole house or flat, and landlords should be careful not to alter this when providing a written agreement, or they may lose their right to repossess the property via the 'shorthold' or 'notice only' ground.

Typically, the term will be for six months (although it can be for any period the parties wish), after which time either party may give notice as follows:

- **Tenant - one month,** the notice period to end at the end of a period of the tenancy
- **Landlord - a minimum period of two months** (ending at the end of a period of the tenancy if the notice is served after the expiry of the fixed term) - landlords should use the standard form of Section 21 notice

Note that although an AST can be created without a written tenancy agreement, this is inadvisable, as it will mean that the landlord will not be able to use the accelerated possession procedure to recover possession of the property, should this be necessary.

Never, ever, let tenants into a property until they have signed the tenancy agreement.

Assured shorthold tenancies can also be used for shared houses if the landlord wants the tenants to have individual agreements. Here the tenants will each have a separate tenancy agreement for their own room (which should be identified) and will share the common parts.

Before the Housing Act 1988 came into effect, landlords often tried to create artificial 'licenses' because under the Rent Act it was very difficult to evict a tenant but easy to evict a licensee.

It is still possible to create a valid license with tenants sharing a house each having their own agreements. However there is now little point in doing this and the law in this area is somewhat complex.

It is usually much better, if you wish to let to shared tenants individually rather than have them all sign the one agreement, to accept from the start that they will all have assured shorthold tenancies.

Key tip

As a landlord you want to minimise your void periods. Therefore, it is possible to set up a SHORTHOLD Tenancy Agreement to run for a minimum of one year - but with a break clause at six months.

20.7.3 Assured Tenancy Agreement

This is rarely used nowadays because there is no advantage to the private landlord. A number of tenancies, which were created before 28 February 1997, may be assured tenancies because the landlords failed to follow the proper procedure necessary at that time to create an AST.

20.7.4 Common Law Tenancies

If the protective codes set out in the Housing Act 1988 do not apply, then the tenancy that is created cannot be either an assured shorthold or an assured tenancy.

In those cases the Common Law will apply and these tenancies are referred to here as Common Law tenancies. There is a full list of tenancies which cannot be assured/assured shorthold tenancies in Schedule 1 of the Act.

The most common situations where a common law tenancy is created are as follows:

- properties that **rent for £25,000** per year or more
- company lets
- lettings of self-contained dwellings by landlords who live in the same building (other than in purpose built blocks of flats).

In London, at least, common law tenancies are becoming more prevalent as in today's market, a two-bedroom flat in the centre of London could easily cost £25,000 per year in rent.

A company let is excluded from protection under the Housing Act because the Act specifically provides that assured (and assured shorthold) tenancies will only be created if the property is let to an 'individual', i.e. a real person.

This agreement would typically be written with a fixed termination date (e.g. one year).

Key tip

You can sometimes ask a company for rent in advance; for instance they may pay a year in advance. Typically this only happens in London or other major financial or technological centres.

It is not often realised that a letting with a resident landlord will not be an assured or an AST. This typically happens when the owner of a large house has it divided into flats, and continues to live in one of them.

Common law tenancies can only be ended before the end of the fixed term if the tenant is in breach of the terms of the contract.

20.7.5 Fair Rents for sitting tenants

If you purchase a property with a sitting tenant then the Rent Act 1977 may apply.

If you are buying a vacant property - then you can ignore this section.

Tenancies which started before 15th January 1989 will be regulated by the Rent Act 1977 rather than the Housing Act 1988.

If a tenancy is described as a protected tenancy, a statutory tenancy or a regulated tenancy, it will probably be one which comes under the jurisdiction of this act.

These tenancies will all be referred to here as Rent Act tenancies. Two points need to be noted when buying a property with a Rent Act tenant.

- Rent Act tenants' rent is regulated and landlords can only charge a 'fair rent', which is set by the Rent Officer. Fair rents are often lower than the rent which that property could attract on the open market. They can generally only be reviewed once every two years.
- It is very difficult to evict a Rent Act tenant, even if they are in rent arrears.

Note - when deciding whether the Rent Act 1977 or the Housing Act 1988 applies to a tenancy you need to know when the tenant **first** went into the property. Do not rely on just seeing the current tenancy agreement which may be misleading.

For further information on tenancy agreements see

Landlord-Law Online - www.landlordlaw.co.uk

20.8 How long does it take to let a property?

The period of vacancy on a property will occur at the beginning and end of each tenancy. Therefore you may have a period of three to six weeks when the property is empty before letting the it continuously for the next six months to two or three years.

However, when you forecast your property investment returns, you need to allow for an average period of non-occupancy per year.

The information in the table below represents averaged-out figures over a two or three year period and is lower for one-bed flats and higher for larger properties as follows:

Size of property	Ave number of weeks let per year	Ave number of weeks vacant per year
1 bed/ studio	50	2
2 beds	49	3
3 beds	48	4
4 beds	47	5
5 beds	46	6

Key tip

One-bed/studio flats tend to let faster and quicker - this makes a difference when you are carrying finance.

20.9 How to set the rental price

Golden Rule: Speedy letting is more important than achieving an extra £20 per month!

For an average £100,000 flat, an extra £20 per month would pay for less than one week's rent on a six month tenancy.

To establish your rental price:

- **ask 3 agents** to provide you with a quote
- **take the mid price** and market the property at that level
- budget / expect to receive 90% of the market price

As with all negotiations, it is useful to pad your bid. If, for example, you need to rent at £154 per week, then ask for £165 or £170 and give yourself some room to negotiate.

20.10 Before you show your property

Showing your property in the best possible condition will save you money.

As more properties have become available through buy to let, so the tenants have become more fussy and picky.

A property in excellent condition and presented well will achieve above-average rents and let quickly (saving the expense of void periods).

Here are our top tips to put an added shine on your property. These are especially important if the property is currently unoccupied:

Type	Action
Mail	Remove all circulars and local newspapers that accumulate inside the front door.
Rubbish	Ensure the rubbish has been put away in the bins tidily and that empty milk bottles have been removed

Type	Action
Windows	Keep them clean! Extra light will be lost to dirty windows and grubby curtains. These will give a depressing, un-cared for effect.
Front Door	Clean the front door - polish any brass wear - make it shine!
Regular Cleaning	If the property is unoccupied, expect to vacuum and dust at least once per week.
Temperature	Keep the property warm in winter and cool in summer - it makes the rooms feel larger
Light	Natural light is essential. Keep the curtains drawn back. In winter turn on low level lighting during the day to brighten and 'warm' the rooms up.
Freshness	The property should smell fresh. For basement flats, keeping the property well aired will help to reduce the smell.

20.11 Setting Up Your Tenant

Once you've found a tenant and provisionally agreed a price, you should take up references swiftly.

20.11.1 Getting references

Bear in mind that personal references may not be worth the paper they are written on. Bank references, again, may not be worth the paper they are written on.

It is best to find out:

- Who does your prospective tenant work for
- How long they have been there
- What position they hold.

... then you can decide whether that offers sufficient security.

Key tip
If at all possible, obtain the name of their previous landlord, and ask whether they were a good tenant or not.

20.11.2 Credit checks

Credit checks are very good and worth the money; it is a good insurance. You can request different levels of credit checks according to your property.

If you intend to take out an insurance to guarantee your monthly rent payments, then the insurance will require credit references at the beginning of the tenancy as a prerequisite.

For online credit checks see:

www.homelet.com

Under current data protection legislation, the tenant has to apply for these references and then pass them onto you, the landlord. Most good tenants will be willing to do this.

20.11.3 Signing the tenancy agreement

The order of signing a tenancy agreement is:

1. signed
2. witnessed
3. dated
4. exchanged

When the letting agent manages the contracts, each party will sign, have the contract witnessed and pass the contract to the agent, at which point they are dated and exchanged.

If you, the landlord, are arranging the tenancy yourself, then both parties must sign in the presence of each other in front of a witness. Remember that the witness can't be a spouse.

The other tenants also need to sign and witness, if the property is shared. Then each part must be dated the same, otherwise the contract is void.

Often, a private landlord will use a solicitor to handle the contracts and act as the witness.

Key tip

Ask the tenant to sign every page. Otherwise, you may end up in dispute about the contents of the contract.

20.11.4 Deposits

Six weeks rent is typical for a deposit, although it does vary according to location.

Make sure that you, the landlord, hold the deposit and not your agent, if at all possible.

Why? Because if you, the landlord, allow the letting agent to hold the deposit, you will still be liable for refunding the money, even if the agent goes bust.

Example

The tenant gives the deposit to the letting agent.

Then the letting agent went bust and they used up all the deposit monies.

The tenant then sued the landlord for recovery of the deposit.

Although the landlord never received the deposit, he was liable because the deposit was to be held by the landlord under the terms of the agreement.

Therefore it is much better for you, the landlord, to hold onto it yourself.

But also, you may need to make deductions to the deposit in accordance with the terms and conditions of the lease.

The problem arises when the tenant requests that the agent hold the deposit. You can either turn down this request and look for another tenant or consider one of these two alternatives:

> **The deposit is held by the agent as the landlord's agent**. This means that you, the landlord, can ask for it at any time and the agent cannot withhold it, unless the agent suspects that you are going to be dishonest with it.

If at the end of the tenancy you wish to make deductions against the deposit, then the letting agent has to check with the tenant before the agent can give the landlord the money.

Alternatively,

> **The agent holds the deposit as a stakeholder** (most agents don't do this). In this case if the landlord wanted to make deductions against the deposit, then the tenant has the right to object and say that the deductions were unreasonable.
>
> The agent would then have to find a common ground and if they couldn't it would have to be referred to Landlord and Tenant arbitrators or whoever was stipulated in the contract.

Normally, the agent holds the deposit as the landlord's agent. However, you are free to object and request that you hold the deposit yourself.

Golden Rule: Do not spend the deposit. Remember that it is not your money. Place it in a separate interest-bearing account.

20.11.5 Inventories

You have two options, either:

- Complete the inventory yourself
- Hire a professional.

Bear in mind that you will be paying quite a lot of money for a fully furnished property inventory. Whereas, letting an unfurnished or partly furnished property greatly simplifies the inventory.

The costs of a professional inventory would be roughly as follows:

- one-bedroom flat £100-£120
- two-bedroom flat fully furnished £120-150
- four-bedroom fully furnished house - £350
- partly or sparsely furnished family home - £200-225

Remember you'll pay this cost each time the tenancy changes.

Keep the furnishings simple to keep the costs down.

Key tip

Try to remove books or small knick-knacks that need to be counted individually. If you are letting a fully furnished home, spend your time putting away personal effects.

There are three parts to an inventory:

- inventory make
- inventory check-in
- inventory check-out

Inventory make is where the inventory clerk walks around the property and would list say:

- carpets
- 2 single beds
- 1 loose cover
- 3 sheets
- 4 pillows with pillow cases
- map on wall

- framed photo, etc.

... and go through everything.

At this stage, the clerk wouldn't necessarily comment on the state and condition of these things.

They would count up all the books on the bookshelf or they could list each by name. It depends upon the value of the items and how much detail you want.

For the inventory check-in the clerk comments on the condition of each of the list items, so:

- carpet - good condition, slightly worn at entrance
- wallpaper - good condition
- a cracked window or if there are any scratches on the furniture and so on.

So, then you would have a list of the items in the room and the condition of them – that is the check-in.

The tenant then checks the list and makes any adjustments to the condition of the items and signs two copies - one for themselves and one for the landlord.

The check-out is the same as the check in. You check each item against the inventory and comment on its state and condition.

The tenant is liable for the difference between the inventory check-in and check-out less anything that might be considered 'fair wear and tear'.

See **section 21.6.1** for more details about 'fair wear and tear'.

20.11.6 Why are inventories so important?

Accurate inventories are essential.

For example, if you, the landlord, leave a television set at the property and it is not listed on the check-in, then there is nothing to prove that that it was there at the start. That means the tenant is free to walk off with it, if he so chooses.

If you, the landlord, deducted the cost of the television from the deposit, then a court would want to see proof that the tenant had accepted it as part of the furnishings.

Without a check-in and check-out inventory showing what had gone missing, then the landlord would be required to return the deposit.

20.11.7 DIY inventory or use a professional?

To save money, landlords could do the inventory themselves. You should then get a professional inventory clerk to do the check-in and the check-out.

You, the landlord, could complete the make yourself, i.e. list everything, and then get a professional inventory clerk recommended by the agency to do the check-in and the check-out.

Sometimes the landlord pays for the check-in and sometimes the tenant pays for the check-in. Whoever pays, the other party would then pay for the check-out.

20.11.8 Where to find a professional inventory clerk

Start by asking your letting agent for the name of two or three recommended clerks. Ask to meet them before you commission them and ask to see examples of their work.

Consider their:

- attention to detail
- **ability to record accurately** - this will be the evidence that you rely on should you need to justify a deduction from the deposit.

20.12 Tenant's Responsibilities to You

What can you, the landlord, expect from a tenant?

All the tenant's specific responsibilities will be set out in the tenancy agreement.

This includes things like a responsibility to cut the grass and so forth. See **section 20.7**.

In addition, the tenant has a responsibility to you, the landlord, to treat the property in a tenant-like manner.

This means that your tenant should be respectful to your property. However the tenant has a right to use and enjoy the property, given that that use can be regarded as reasonable.

> For example, they should refrain from having wild parties and smashing the place up, but they are allowed friends round for a drink - just not 100 people every night!

In essence a tenant's responsibility to you is to look after your property and to treat it fairly.

For disputes see **section 21.4**.

20.13 Landlord's responsibilities to the tenant

In addition to the landlord's statutory requirements (see section **19.8**) you are required to:

- allow your tenant to peacefully live in the property and
- keep it in a habitable condition

You, the landlord, cannot go round to the property every day causing trouble.

You cannot enter without reasonable notice.

While the tenancy agreement continues, the tenant has the right to exclude everyone from the property, including you.

Harassment of tenants is a criminal offence and if, for example, you continually telephone the tenant or go round (for example to complain because they have not paid the rent), you may receive an unpleasant letter from the local authority asking you to stop.

If you do not stop the harassment the local authority can bring a prosecution against you in the Magistrates Court.

The ultimate harassment of course is actually evicting the tenant, e.g. by going in and changing the locks.

This is strictly illegal and can also make you liable to the tenant for substantial damages in the civil courts. Note that tenants should only ever be evicted by obtaining a court order.

All landlords of lettings of less than seven years are also bound by the repairing covenants set out in section 11-16 of the Landlord and Tenant Act 1985.

These 'repairing covenants' provide for the landlord to keep in repair the structure and exterior of the property (including drains, gutters, and external pipes), and to keep in proper working order the installations for the supply of water, gas, and electricity, and for sanitation, and the installations for the supply of space and water heating.

These covenants are implied in all relevant tenancies - any clauses in the tenancy agreement making the tenant responsible for these repairs will be void.

Congratulations! You've now finished section 20. You'll now know how to:

- Avoid bad tenants - see section 20.1 and section 20.2
- Decide between letting direct and letting through an agent - see section 20.3
- Recognise and understand tenancy agreements - see section 20.7
- Set the rental price - see section 20.9
- Set up your tenant - see section 20.11

21 STEP 4 MANAGING YOUR RENTAL PROPERTY

Once you've read and digested this section, you will be able to:

- Decide whether to manage the property yourself - see section 21.1
- Manage a perfect handover - see section 21.2
- Manage student lets (if required) - see section 21.3
- Manage tenant problems - see section 21.4
- End a tenancy - see section 21.6
- Arrange for refurbishment - see section 21.7 and 21.8

21.1 Manage the property yourself or use a managing agent?

90% of buy to let problems occur in the management of the property.

One of the key reasons is that, for the new property landlord, it is very hard to avoid becoming emotionally involved when things go wrong.

If you have spent days decorating and improving a flat, only to find that the tenants mess up the whole place, it is very difficult to avoid the emotional disappointment.

If this is your first property for rental, or you believe that you will become emotionally attached to the treatment of your property, then you may need a 3rd party to manage the property for you.

Once you've become a little hardened to the fact that tenants don't treat your property as well as you do, then you might be ready to take over the management yourself.

Although always bear in mind this little scenario from David Humphries of www.buy-to-let.com

> **Case Study**
>
> "It's 5pm on a Friday evening and you are about to pack the car and disappear on a well-earned family holiday. Your partner and family are eagerly waiting for you.
>
> "The telephone rings - it's the next door neighbour of your property that you've just let out. They are complaining about the rubbish dumped in the front garden and the noise from last night's party.
>
> "What do you do? Go on holiday for 2 weeks and hope it sorts itself out? Or delay the holiday, go round to the property yourself and deal with the problem?
>
> "Your family will want you to go on holiday - you really ought to go to the property straight away and deal with the problem."

If you don't want to be in this scenario - then consider a managing agent.

21.1.1 Choosing a managing agent

The downside with managing agents is that, whilst there are some good firms, there are also many not so good.

As a rule, do not have the same agency that rents your property to manage it.

Most letting agents (but not all) have poor management departments.

Remember that letting agents are owned and run by sales people, and sales people are not the kind of people who enjoy looking at details and checking things.

When choosing a managing agent, look for someone who is:

- particular (it often shows in their writing)
- detailed (someone who can spot a spelling mistake)

Often, they have similar qualities to a good inventory clerk. Try to avoid managing agents whose strength is their selling skill - it won't be in their nature to check things.

Often management agents are run alongside of the estate agencies or letting agencies as a way to maximise profit and not customer service. This service can often be poorly performed and you may be better doing it yourself.

Broadly speaking, staff employed in management agents are poorly paid and poorly motivated.

If your management agent employs 20 year olds rather than more experienced staff, then you are heading towards potential trouble. Young people may be low-paid with little experience of dealing with difficult tenants.

If you intend to use a management agent check for the following:

- Managing property (not selling or letting) is the main focus of the business
- **Does the person responsible for your property own property** himself? and have they experienced problems with properties?
- Have you met, and do you trust the person responsible for your property?
- Ask yourself: 'could this person handle a bad or angry tenant?'

The best management agents will employ people who have greater personal experience of owning property.

You may be forced to use a management agent if you are living abroad or have relocated to another city. In this case, find a highly reputable management agent and stay in regular contact with them.

If you can remain unemotional about potential damage and can afford sufficient time then manage the property yourself.

Remember that you can still call on your original letting agent if you need an arbitrator over a 'fair wear and tear' dispute.

If you don't like to be on call for burst pipes and emergencies, then take out an insurance that allows your tenants to contact a certified repair person themselves. See **section 19.10.3**

21.1.2 Managing a rental yourself

Golden Rule: If a problem occurs - deal with it swiftly and firmly.

The best way to keep on top of any potential problems is to manage the tenancy yourself.

Why?...

... because you'll take swift action if someone damages your £100,000 property.

A management agent hasn't got as much at stake, and they might easily overlook important details.

If you decide to manage the tenancy yourself then start out on the right foot with your tenants. Stick to the following tips when dealing with your tenants and you shouldn't go too far wrong:

- **Be friendly but don't make friends**: keep it professional at all times so that you can be firm when you need to be (share a cup of tea - but not a pint in the pub).
- **Don't be afraid to be firm**: it's your property and you have rights too.
- **Know your tenancy agreement**: know your obligations and know the obligations of the tenant (e.g., who is responsible for the maintaining the garden?)
- **If they make a mess** - point it out there and then and follow up in writing.
- **Put it in writing** - if you need to write a legal letter or involve the courts you will need to demonstrate that you have given the tenant opportunity to clean up or repair the damage and that you have acted reasonably. You will need written evidence to do this.

As the property manager you should:

- **Arrange regular visits to the property** - once every three months is good - make sure your tenancy agreement allows this.
- Come down quickly on any problems that you find.
- Set-up an emergency repair service if you think you might be uncontactable - see **section 19.10.3** or set up an agreement with a local Mr Fixit.

Key tip

Manage your property yourself but be prepared to act quickly if a maintenance problem occurs. Speed of action often contains the problem, otherwise the tenant will get annoyed and may stop paying rent.

Key tip

Seek redress from the letting agent if the tenant turns out to be a problem. After all, they found and vetted the tenant and they have a personal stake in resolving the problems as they are paid a percentage of the rent each month.

21.1.3 Mend it yourself - or find a local Mr Fixit

If you intend to manage the property - but don't want to fix any problems you could look for someone else to help – for example, an odd job man to do the work and you would pay him for his time.

Typically, a property management agency will employ a Mr Fixit - normally very small companies or a one-man band. These people specialise in property maintenance and can fix, repair and deal with property problems - including tenants.

All you are doing is working directly with the man on the ground - rather than leaving this to the managing agent.

If you can find someone like this, then you are much better off working directly with him or her, rather than through the managing agent.

The kind of person you are looking for:

- Is reliable
- Will be able to chase the lettings agents
- Will keep a hold and perform inventory checks
- Knows where to find a set of keys
- Has good attention to detail

Obviously, they should know how to fix a burst pipe, deal with a broken window and so forth.

Key Tip

Before you hire a maintenance man, check that he does not have a fixed call out charge. If he wants to charge £30 just for looking at a problem, then you'll quickly find you run up large bills.

More and more maintenance companies are cropping up including:

London Based
0800handyman - www.0800handyman.co.uk

0800 426 396

Across UK
Linton Maintenance - www.lintonmaintenance.co.uk

0870 770 4095

21.2 Landlord's handover check list

Before you handover the property you should make sure that you have everything in order.

Here's the checklist that we use:

Issue	Check	Tick when done
Consent	Has the necessary consent (if any) been obtained from the freeholder?	☐
Insurance	Are the property and landlord's contents insured to full value? See section 19.10.4 Does the insurance company need to be informed?	☐ ☐
Inventory	Has the inventory been prepared either professionally or personally? See section 20.11.5	☐

Issue	Check	Tick when done
Management	Have you decided who will manage the property? See section 21.1 Have you taken out emergency repair insurance or instructed a local property repair man? See section 21.1.3	☐ ☐
Equipment	Are all the items of equipment in working order? Are instruction booklets available? (if not, then have clear instructions for the tenant)	☐ ☐
Keys	Do the tenants have a sufficient number of sets in relation to the size of the property?	☐
Rent	Have the appropriate standing orders been set up? See section 18.7	☐
Deposit	Has the deposit been received and cleared? See section 20.11.4	☐
Gas	Has the Gas Safety certificate been supplied to the tenant? See section 19.8	☐
References	Have all references been gathered? See section 20.11.1 Are they satisfactory?	☐ ☐
Contract	Do you have a signed copy of the contract? See section 20.11.3	☐
Clean	Has the property had one last clean?	☐
Extras	Place a bottle of wine in the fridge and flowers on the table	☐

21.2.1 Stop problems before they begin

You want your tenant to enjoy, but also take care of, your property.

The best way to ensure this is to prepare and clean your property to the highest possible level before the tenants move in.

Then keep the property in good order to avoid any sort of maintenance problems during the term of the tenancy.

Ask the tenants to let you know if there are any leaks or problems with the property as soon as possible. Put that in writing to them. Do this separately - maybe from you to them in a welcome letter. See **section 21.2.3**

It will normally be in the contract to notify the landlord immediately of any wants or repair of standard terms, but there is no harm in letting them know that you are a caring landlord.

As a rule, the better you leave the place looking, the more they will respect it. If you show respect to your property, they will respect it too.

Key tip

Leave a bottle of wine in the fridge, a welcome note with a bunch of flowers. They will appreciate it greatly and they will probably be much more careful with your property in return.

21.2.2 Your property will be returned in the same (or worse) condition that you let it in

If you leave your property slightly dirty so that when your tenant walks in they have to start cleaning up before they can live there, they will feel awful and resentful.

It is terrible if you turn up to rent a place and you have to immediately clean up someone else's mess - so don't start a new tenancy on this basis.

You can guarantee that when your tenant leaves, they will leave the property messy.

They might have a quick run around with the vacuum, but the place will be messy and your tenant is unlikely to respect it whilst they are living there.

Key tip

The most important thing is to leave the property looking really clean and very tidy for when the tenants move in to show you care.

It will make them warm to you and think this person is a nice person, rather than some landlord who is just basically taking my money.

21.2.3 Welcome letter

Write a welcome letter with your number and you can stick that on the notice board with emergency numbers for plumbers or whatever.

Leave them a little note –

> Dear
>
> Welcome to your new home.
>
> We hope you enjoy living here and feel at home.
>
> Here are my telephone numbers if you need to get hold of me.
>
> If I am uncontactable, please call Mr Jones who will be able to visit and fix any emergency problems. He has helped maintain the property in good order for a few years, so he knows his way around.
>
> Please let me know if there are any problems with the flat.
>
> Here is the managing agent's number who deals with the flat. Please give them a call so they can come round and meet you and say 'Hi' and introduce themselves.
>
> All the best
>
> John and Jane Smith

21.2.4 Maintenance

Once your tenant is in the property, find an excuse to go on regular maintenance check-ups.

Try to visit the property every month or so at the beginning. But do not make so many visits that the tenant feels that the landlord is there all the time.

Make up some excuse like checking the taps or something and ask if they mind, or the person downstairs thinks there might be a leak or a strange noise from the plumbing or something, and could you check it out.

If you have a management agent you will also want them to drop in on the property every month or so.

Ask the tenants again to let you know if there are any leaks or problems with the property as soon as possible.

If they mention a problem, deal with it swiftly. One of the biggest complaints of tenants is that it took the landlord six weeks to fix that leaking tap.

Golden Rule: Keep your tenant happy - otherwise they might start to withhold their rent.

21.2.5 Formal Inspections

Every six months or so, you should arrange a formal inspection. Again, if you employ a managing agent, they should arrange and manage this for you.

In this instance, you will need to provide your tenant with written notice of when you intend to visit.

When you arrive check the property from top to bottom. Mention anything that the tenant isn't completing. It might be just cutting the grass or something more serious.

Follow up any verbal requests in writing, stating any outstanding matters, requesting that they are put right.

Golden Rule: If you see signs of deliberate damage take action straight away. See section 21.4.

21.2.6 Cleaning

The contract will determine the cleaning responsibilities of your tenant.

Many contracts will request that the tenants clean the windows (inside and out) and maintain the garden, etc.

If you find your tenant is untidy, then remind them that the property is rented and would they treat it with care.

21.3 Managing a student let

Running a student or DSS tenancy is quite different from renting to a professional or company tenant.

The following article is taken from www.pastures-new.co.uk and offers a graphic picture of life in a student house.

It's aimed at the student - but it shows you what might have to deal with as a student landlord:

21.3.1 "Advice for students - how to lose your deposit!"

"If you would quite like your landlord to be able to keep your deposit at the end of your tenancy then we recommend the following 13 top tips for giving your landlord every justification to retain your money:

1. "Painting your walls in abstract colours, especially without getting permission to do so will ensure that you loose at least £100."

2. "Put big nails in every wall and blue tack everywhere. This goes down particularly well when you have made absolutely no effort to clean up the blue tack marks. "

3. "One of our favourites is removing the landlord's furniture into the garden shed so you can make room for your surround sound 42" screen TV system. Leave said furniture in there over the winter and come the end of your tenancy - voila, mildew - inspired!"

4. "Don't bother buying ash trays - sofas and carpets are ideal for stubbing out cigarettes (this is particularly appealing to your mates at 4 o'clock in the morning after your house warming)"

5. "Break the tasteless sculpture sitting in the corner of the sitting room. We definitely don't recommend politely asking your landlord to remove it at the start of the tenancy, as this would really remove a golden opportunity to lose a few quid."

6. "Stain the carpet with red wine. Don't try to soak up as much as possible and cover (not just sprinkle) the stain in salt as soon as it happens rather than the morning after."

7. "Let the garden grow into a natural habitat suitable for gorillas. "

8. "Break a crystal vase and replace it with a pint glass borrowed from the pub."

9. "Baking potatoes in the microwave for 45 minutes really helps the microwave to break itself."

10. "Food fights, especially when you leave that banana on the ceiling for a few days before thinking about clearing up."

11. "Forget to inform the landlord when one of his ropy chairs gives way because someone actually dared sit on it."

12. "Never defrost the fridge so the ice compartment door breaks. Putting three cases of beer in the fridge so all the shelves bend beyond the limit of elasticity isn't a bad idea either."

13. "Ensuring the place looks like a recycling plant every time the landlord comes round."

Source: www.pastures-new.co.uk

21.3.2 End of tenancy / Handover day

A student let will invariably have a fixed end date - typically the first week of July, when the students pack up and head for home or working holidays.

Often, in a shared student house, some students go home early leaving the few students left with all the cleaning work.

www.pastures-new.co.uk advises the student:

*"OK, so you are coming to the end of your tenancy and you have sensibly decided to ignore our recommendations above so your place is not looking too bad. You are moving out in two days time and all of a sudden you realise that all 5 of your flat mates have moved out...and the clean up still needs doing! Oh ****."*

"There is no way out of it. If you want your deposit back, you have got to clean the place from top to bottom. "

"It isn't just a quick Hoover and a quick wash up. It's a serious scrub of every corner, tile, work surface, skirting boards etc. It is a pain and it will be considerably more painful if you have to do it on your own."

Arrange for the final inspection to be carried out as the students move out.

Ask the students, or at least a representative, to accompany you on the inspection. This gives you the opportunity to point out any minor problems that can be fixed before you agree to handover any deposits.

If the property is in a poor condition make it clear to the student(s) that you will deduct the cost of cleaning / repair from the deposits.

Often, you will find that the remaining students will get on with the cleaning themselves and hence save you the trouble of arranging cleaners yourself.

21.3.3 Encourage your students to agree a cleaning day

If you let a student house, encourage your students to agree a day or even two shortly before the tenancy ends when all the students will be around to clean up.

If the students can't agree on a day, encourage them to make sure that those leaving early are assigned the worst jobs like:

- Cleaning out the cupboards in the kitchen
- De-greasing the pots and pans
- Beating the rugs
- Weeding the garden
- Cleaning the windows

Remind them that each person should be responsible for their own bedroom.

Sometimes a shared bank account can encourage an equal contribution from a really troublesome flat-mate.

Remind your students that it will almost always be cheaper for them to sort out any problems themselves.

Key tip

If you can, offer your students a list of your approved tradesmen should they need help (at their expense of course).

21.3.4 Arrange frequent inspections to student properties

As with all property management, the best way to deal with problems is to prevent them in the first place.

The best way to prevent your property degenerating into a hovel is to arrange frequent inspections.

Ideally, you will arrange inspections:

- End of the Christmas term
- End of the **Easter term**
- On the **handover day** at the end of the summer term

You will need to give notice to your student tenants that you intend to carry out an inspection in accordance with your tenancy agreement.

Typically you will need to give at least one week's notice, but it is a good idea to arrange it well in advance.

Write to your student tenants explaining:

- You intend to carry out an inspection
- The date and time of the inspection (if it is early on Sunday morning, i.e. before 10am - make sure that someone is awake to let you in)
- The purpose of the inspection is to ensure that they are correctly complying with the terms of the lease

After the inspection you should write to your student tenants outlining any areas in which they are failing to comply with the lease.

Remind them that if, for instance, they don't cut the grass, then the cost of returning the garden to its original condition will be deducted from their deposit.

21.3.5 Pre-handover inspection

If you live locally, you might also want to arrange a pre-hand-over inspection.

This would allow your students to clean and prepare the property before the end of term and ask you, the landlord, to identify anything that needs to be put right in order for the students to receive the full deposit.

Below is a list of the little jobs that students frequently forget and lead to deductions against the deposit – again it's from www.pastures-new.co.uk and advises students, but equally it will give you an idea of what can be expected

1. Cleaning cupboards in the kitchen.

2. Removing your own furniture - you might think next year's students would like it, but your landlord may charge you to remove it.

3. Likewise, don't leave any food in cupboards, even if it hasn't passed its sell by date.

4. Using that brush that has been sitting by your toilet all year.

5. Defrosting the fridge/freezer - make sure you leave the door open.

6. Cleaning the oven - Mr Muscle's oven cleaner works a treat.

7. Weeding the garden.

8. Failing to secure the property when you leave (window locks)

9. Returning all the keys.

10. Should you receive a visit from the electricity/gas supplier(s) DO NOT allow them to disconnect the supplies without first getting permission from your landlord/agent. You might be charged for the reconnection!

11. Check the inventory thoroughly. Replace things with items of similar quality and if they are part of a matching set, do your best to replace it with the same set. Again, the price you will pay will be much less than the landlord is likely to charge. Make sure that all items are put back into the room that they are listed as being in.

Source: www.pastures-new.co.uk

21.3.6 Guarantor

When letting to students, it is common to take a guarantee from the student's parent.

This is because students have little or no credit history and, therefore, you need a financial back-up should the property be damaged.

This would normally take the form of a Letter of Guarantee.

Check with your lawyer; however the key wording is that the guarantor agrees and signs to the following:

"I hereby guarantee all further payments on behalf of so and so for the tenancy at ....until .....date."

This should mean that the guarantor is liable for any missed payments or cost of damage to the property.

So, if the student runs out of money, or damages the property, then you can turn to the guarantor.

21.4 Managing Tenant Problems

> Please take legal advice for your particular situation. The comments below are designed to help you sort and manage through problems.
>
> Unfortunately, the law is both complex and changing, hence it is wise to seek verification from a lawyer before you take action.
>
> Nevertheless, the better an understanding you have of the situation, the cheaper will be your legal bill. You might even get a better result, too.

Your aim as a landlord is to prevent problems in the first place - see **section 21.2.1**. However, no matter what steps you take, things can and do go wrong.

Once a problem has begun, switch your focus to damage-limitation. And the golden rule of limiting your exposure is:

Take swift and firm action.

So, if the rent is late, get on the phone straight away and find out what's happening and how to put it right.

Don't be afraid to call your tenant if the rent is a day late. Be polite but firm - it shows that you are not willing to be messed about. However, be careful that you do not do anything which can be construed as harassment.

Once the rent is over two weeks past due date, treat it as a rent arrears problem and involve your lawyers straight away. Equally, if something goes wrong at the property, take swift action too. Get it fixed or arrange for a visit from a reliable repair / home maintenance person.

Your tenant will appreciate your attention to the matter, and they'll also expect that you might be equally efficient when it comes to receiving their rent.

21.4.1 Rent Arrears

Once the rent goes into arrears (usually considered to be over two weeks past due date) contact a property litigation lawyer, who will know how to deal with it.

Do not accept any nonsense from the tenant. If your tenant is in arrears, then start the litigation process from day one.

Example

If the rent is due on the 1st initially, and it is not paid, the agent should be chasing them up. If it is more than a week late, the agent should be on the phone to them asking for it.

If it is two weeks late and the tenant is fobbing the agent off or ignoring them, you know that they are seriously avoiding paying the rent.

Equally, they might have given a reasonable explanation that you can check out, which could be something like the tenant has lost their job.

If the tenant says that they have lost their job and they are trying to find somewhere cheaper and they are really sorry and they know they owe you money, then you need to decide what to do.

As a rule, I'd advise you to begin legal actions now so that the legal notices are in place in case you need to go to court in a month's time.

Try to stay calm and act professionally, as should the letting agent if they are dealing with the problem.

However, if the tenant is either not talking to you or providing lame excuses, then take swift legal action - using a litigation lawyer - see **section 21.4** (Page 251).

Golden Rule: Don't be too friendly with your tenant - it will be impossible to take the action necessary if you make friends.

Ian Cooke, Partner, www.CharlesRussell.co.uk advises all landlords to:

- Ensure the tenancy agreement fully protects the landlord's rights
- Take an adequate deposit (of six weeks' rent)
- Take credit checks and references
- Take employer references and contact numbers

"The employer references and contact numbers mean that you can still get access to your tenant in case they decide to disappear from your property."

You can always take out legal costs insurance (see **section 19.10.2**). This should ensure that you get access to quality property litigation in case of a problem.

In my experience, it is very often the case that when the landlord speaks to the tenant he decides to give them one more chance.

Don't do it - don't give your tenant another chance.

...otherwise the same conversation will happen the following month when the tenant offers to pay double, etc.

Landlords are often reluctant to get lawyers involved because of the cost and hassle. However, the problem often goes on for months before it really sinks in that this tenant is just not going to pay the due rent or abide by the terms of the lease.

Once the landlord finally gets round to taking legal action, the problem has grown from a small rent arrears to a substantial problem. And, guess what, the most reluctant litigators are often professional landlords.

My advice is that as soon as you know the tenants are not fulfilling their side of the contractual agreement then you should take legal action. I have instructed a number of lawyers before to deal with rent arrears and in most cases the results were instant."

Tessa Shepperson, Solicitor, who runs the Landlord-Law web-site (www.landlordlaw.co.uk) says:

"If someone in your property is refusing to pay rent you should arrange to serve the correct notice for possession on them as soon as possible.

"The timing of the notice and the type of notice to serve will however depend upon they type of tenancy involved. Make it clear to the tenant that if they want to stay in the property they will have to pay the rent arrears and pay promptly in future.

"If you do not want to evict the tenant for the rent arrears, or if the rent arrears are for less than two months (there needs to be at least two months' rent arrears for a possession claim to succeed under the special rent arrears ground), you can also issue proceedings for a **County Court Judgement**.

This will also be necessary if you are going to use the 'accelerated possession proceedings' (which cannot be used to recover money due).

Before proceedings for a County Court Judgement are issued it is normal to send a legal letter stating that if the sum due is not paid within a specified period (usually seven or 14 days) you will be taking the tenants to court. This letter is known as a 'letter before action.'

It is often more effective if your letter comes from a solicitors' firm.

A swift legal letter from a firm of litigation lawyers often resolves a problem and prevents it from reaching court.

21.4.2 Choosing a litigation lawyer

The key thing about a litigation lawyer is that they should move quickly. We prefer lawyers that will help us sort the problem out on the telephone. We dislike receiving a bunch of letters. However, other landlords may like to have everything in writing first.

So when working with a litigation lawyer, we think the key thing is to find someone who works and thinks like you do.

Either way, they must:

- Know about property litigation (conveyancing is not the same)
- Be able to move quickly
- Be able to show success in the courts

See: www.charlesrussell.co.uk

Essentially, a property litigation lawyer is someone specialised in getting results through the courts.

Note however, that commercial property litigation lawyers may be less experienced in private residential landlord and tenant work.

Another property litigation specialist is Tessa Shepperson of TJ Shepperson Solicitors, who runs **Landlord-Law Online.**

This is a subscription site for private residential landlords. The onsite content for members includes forms for all the various possession notices with instructions for use so you can serve them yourself if you wish. Alternatively you can instruct Tessa to do this for you.

If possession proceedings are necessary, you can instruct Tessa online to do this work for you. Most standard possession work is done for fixed fees.

See: www.landlordlaw.co.uk

Key tip

As ever, the place to begin looking for a property litigation lawyer is to ask your letting agents - after all, they will have used and briefed lawyers before.

21.4.3 DSS tenant - rent arrears

If you find that your tenant is in arrears with his rent payments, then you must write explaining the breach of contract and the amount owed.

If your tenant is in arrears of rent of eight weeks or more, you can request and be successful in arranging for the local authority to pay the money directly to you, the landlord.

However, you may need to make two or three visits to your local authority housing benefit office Note that the housing benefit office will be unable to give you details of your tenant's claim unless the tenant has signed a letter of authority authorising them to do this.

This is because of the Data Protection Act. It is a good idea therefore to get housing benefit tenants to sign a letter of authority at the same time that they sign the tenancy agreement.

Before taking on a DSS or housing benefit tenant you are advised to visit your local authority housing office. Any dispute or problem is likely to be referred here first.

Find out the rules for letting property to DSS tenants, and find out how your local authority manages bad tenants and rent payment problems.

If you think you may not have the time to do this, then you are probably best advised to avoid DSS rental properties.

21.4.4 Student tenant - rent arrears

With student rent arrears you are likely to face a different situation.

Initially, try and find out what is causing the problem and if it can be resolved swiftly, i.e. within the next two or three days. Don't accept delaying tactics - like 'I have to earn some money during the vacation to pay you'.

You need to know that the student already has the money or has just arranged an advance from the bank or parent in order to pay the rent.

If you decide (and decide quickly) that the student is messing you about (not returning calls or not co-operating), then you have two possible routes of action:

- Your contract should include a guarantor - that means if the student fails to pay the bills, you should call in the guarantee as soon as possible see **section 21.4.4**. Often, it will be one student in a shared house that stops paying the rent.
- Alternatively (but most likely additionally), contact the university accommodation office to identify the problem and for any help that they may be able to offer.

Whatever you do, act reasonably, but swiftly, and put it all in writing.

If neither the guarantor nor the accommodation office is able to resolve the problem then bring in services of a litigator swiftly.

21.4.5 Damage

Damage to a property is serious – be willing to move to litigation quickly. If someone has damaged your property, then you want him or her out as quickly as possible.

You need to contact the tenant straight away to find out what happened. Explain that they have damaged the property, that you have to put it right immediately and you want them to pay for it immediately.

Explain that you are **not** going to deduct the cost from their deposit, but you want them to pay for it now.

(If you start deducting from the deposit then you are on a hiding to nothing - the damage might well continue as the tenant sits in your property and the deposit dwindles).

If your tenant is not willing to pay up front to repair the damage, then you can deduct the repairs from the deposit, but end the tenancy by serving the relevant possession notice and ask them to leave.

You cannot throw them out there and then, you have to get a court order first. Possession proceedings are not quick and this process may take some months. If the damage is very serious and ongoing, the court may agree to shorten this time. However, your litigation lawyer will advise you.

Key tip

Remember you should always get legal advice, keep calm yourself and follow up any conversation with written notes.

21.4.6 Eviction

To evict a tenant you should use a lawyer. For two key reasons:

- Getting it right
- Speed

Legally, there are different ways to win a court order, depending on the circumstances and the nature of the lease.

In all instances, you will need to go to court to evict the tenant. Once in court it is essential that all your paper work is correct and you have issued all the appropriate notices. A specialist litigation lawyer will know how to manage this - see **section 21.4.2**

The eviction process is easier and much faster than it used to be. So, don't be afraid to use it, if necessary.

It normally takes about a month to go to the court and then the court has to order them to leave.

So the fact that there is a delay in getting them to court means that you have to act straight away if you want any hope of resolving the matter in the next two months. However, this does vary from region to region.

21.4.7 How likely is a landlord to win an eviction?

Tessa Shepperson of Landlord-Law Online says:

"If you use one of the 'mandatory grounds' for possession, and your paperwork is correct, you are virtually certain to get a possession order.

“The two mandatory grounds most commonly used are the shorthold ground and the serious rent arrears ground (i.e. rent arrears of over two months). Note though that you cannot succeed on the rent arrears ground if the tenant pays the rent before the hearing date.

"If you can, you should try to evict tenants under the 'notice only' shorthold ground using the accelerated possession procedure (which can only be used for the shorthold ground).

“The accelerated possession procedure is quicker and does not normally involve a court hearing. Because of this though, it is particularly important that your paperwork is immaculate.

"There are other grounds for possession, but unless you are using a mandatory ground, there is always the danger that your tenant will try to defend the claim, and he may be able to get legal aid.

“If this happens you are at risk of losing the claim and, even worse, being ordered to pay the tenant’s legal costs (which if he has got legal aid, could be substantial).

"My advice to landlords is to always use a mandatory ground for possession if you can. A possession claim based on discretionary grounds alone should only be used in very serious cases where there are no serious rent arrears, or where it is not possible to use the shorthold ground for a long time.

"If your tenant does not have an assured shorthold tenancy, you should take legal advice before taking any action. The notices to be served will be different and the accelerated possession procedure will not be available to you.

Tessa Shepperson

www.landlordlaw.co.uk

By the time a case actually gets to court, typically, you are losing money. That is why it is so important to start the legal processes as soon as possible.

21.5 Extending a Tenancy

Extending a tenancy is done differently depending on the type of contract that you have with the tenant.

Assured and Assured Shorthold tenancies will continue to run at the end of the fixed term when they will become a 'periodic tenancy'. Alternatively a landlord can offer a tenant a new fixed term agreement. This is often a good opportunity to increase the rent.

Common law tenancies will end at the end of the fixed term. However, if the tenants stay on, a 'periodic tenancy' will generally be implied. Again, a new fixed term agreement can be given to the tenant.

21.6 Ending a Tenancy

If you do not serve the correct notice on your tenant they are entitled to stay in the property and you will not (usually) succeed in obtaining a possession order at court.

Different tenancy agreements require different types of notice.

Tenancy Type	Name of Notice	Notes	Notice Period Required
Assured Tenancy	Section 8 Notice	Tenant has security of tenure and landlords can only evict the tenant if one of the grounds set out in Schedule 2 of the Housing Act 1988 apply. The notice must be in the prescribed form.	This will be either two weeks or two months depending on the ground cited in the notice.
Assured Shorthold Tenancy	Section 21 notice or Section 8 notice.	Landlords can always recover possession after the end of the fixed term provided a proper Section 21 notice has been served. AST landlords can also use the same grounds and serve a Section 8 notice as for assured tenants above	Section 21 - must be at least two months. Notice period must not expire before the end of any fixed term and if served after the end of the fixed term, must end at the end of a period of the tenancy.
Common Law Tenancies	Notice to Quit	Must be in the prescribed form	Must be at least four weeks, and end at the end of a period of the tenancy
House & Flat Share Agreements	Section 21 notice for AST tenants, otherwise there is no standard format.	Even if a notice not formally required, it is always best practice to serve one.	For AST flat share agreements see above. Otherwise, reasonable notice is required - normally four weeks or the period by which the rent is paid.

Sources and more advice available at:

www.landlordlaw.co.uk

www.legalhelpers.co.uk/landlord/index.asp

While you may think that a letter of your own will do, this is often not the case.

Even if there is no prescribed form of notice, if you do your own letter this may not contain all the information that you are required to give the tenant, and may result in a subsequent claim for possession being thrown out by the court. If a form is prescribed, then a letter or the wrong form will not be effective, and your tenant will probably know this and ignore it.

A formal notice also shows the tenant that you are serious, whereas he may not take any notice of a letter.

Key Tip

If a tenant wants to be re-housed by the local authority, they will often refuse to vacate your property until a possession order has been made by the court.

If the tenants move out voluntarily they will lose their right to be re-housed, and they will therefore be advised (e.g. by their lawyers or the Citizens' Advice Bureau) to stay in the property until this is done.

In these circumstances you should serve notice and start possession proceedings as soon as possible; you will not be doing the tenant any favours by delaying.

21.6.1 Wear and tear

You should visit the property a couple of weeks before the tenants are due to move out so you can see what it looks like.

You'll want to know what work is required so that you can line your decorators up to move straight in at the end of the tenancy and deliver a swift turn around.

You also need to survey the property for any evidence of unreasonable wear and tear. But what counts as unreasonable?

Ah, yes, that's where the lawyers can get involved.

A typical dispute would revolve around whether the treatment of the property was reasonable or the slightly worn carpet was a result of fair wear and tear.

If the tenant has been renting the property for just a year, and the carpets look really worn then it might not have been reasonable wear and tear.

If they are good quality carpets and it wasn't reasonable use by the tenants, then you might recover a percentage of the replacement costs from their deposit.

> **Example 1**
>
> If the tenant was a smoker, and your lease allowed a tenant who smoked, then any nicotine stains would count as reasonable wear and tear.
>
> There again, if the sofa were covered in cigarette burns, then you would probably be within your rights to claim unreasonable wear and tear.

> **Example 2**
>
> If the tenants have cut into the laminate kitchen work surface, then typically, it is reasonable that you should claim a proportion of the cost of replacing it from the outgoing tenants.

Furniture should last quite a long time, as long as you have chosen well. So again, if the furniture was badly damaged after one year - that would count as unreasonable wear and tear.

In English law, precedent normally defines what counts as 'fair wear and tear'. In other words, the decision will be made on previous experience.

That's why it is best to ask your letting agent first.

Keep receipts

If you have kept good records of the furnishings that you placed in the property - when you bought them, how much they cost and the brand - then you would be well placed to argue your case.

Keep records of any dispute in writing.

For instance, if you have asked the tenant to keep the property clean and tidy on three separate occasions (and got the evidence in writing) then the law is much more likely to consider your actions reasonable if you then seek an eviction order. See **section 21.6**

> **Key tip**
>
> Remember your agents work for you – you are their client. Just like a lawyer, they work for you; they don't work for the tenant. So expect them to advise you properly.
>
> An experienced letting agent should know how much you should take from the deposit.

21.6.2 Deposit deductions and disputes

If you intend to deduct money from the deposit it is wise to write to your tenants to explain.

Typically, your letter should include:

- A list of items damaged or that require replacement
- Additional cleaning or repairs required
- Cost of replacement or repair

If you write before the end of tenancy, then you can also give the tenants the option of arranging the repairs themselves, rather than have their deposit deducted according to your, the landlord's, contractors.

If the deposit and deductions are in dispute, ask the letting agent to negotiate. In the case of a student let, bring in the university or college accommodation office.

If you have acted reasonably and are able to substantiate the damage and cost of repair with receipts, then with 3rd party assistance, the matter will rarely go any further.

Key tip
Invest in a camera - this will allow you photograph the damage or dirt and substantiate your reasons for deductions from the deposit.

21.6.3 Refurbishment at the end of a tenancy

At the end of each tenancy the carpets should be professionally cleaned, which typically the tenant will pay for (make sure it's in the contract if you can).

If the carpets look good still, then keep them. If they look really worn, then replace them.

Your property has to look fresh otherwise it is not going to achieve the same rent. Don't forget, that your business model is probably based on you being able to increase the rent annually by approximately 4-5%.

Golden Rule: Expect anything from a quick touch-up to the paintwork to fully redecorating throughout at the end of every long-term tenancy.

Key tip
Remember that a swift re-let depends on keep the property looking at its best.

21.7 Minor Refurbishment - every three years

Plan on a minor refurbishment every three years. Carpets should be replaced every three years ideally. At this time you should have a general refurbishment / redecoration.

Minor things might be:

- Replacing shower doors
- Tiling
- Re-grouting the tiles in the bathroom
- Re-carpeting
- Other minor work designed to keep the property looking fresh

You may need a new work surface in the kitchen if it has been badly damaged.

Essentially, you are looking to patch up and repair your furniture and equipment, before you replace everything after five or six years - see below.

21.8 Total refurbishment every six years

Every six years you will probably be looking at total refurbishment and updating. The reason that we plan six years, is that this is the maximum life you can realistically expect of your furnishings and decorations, washing machines and so forth.

At the end of the six year period, plan to completely renew everything - all at once. If you attempt to replace items piecemeal, then the newer items will make the older items look shabby.

Here's a sample list of works:

- Replace all major furniture, such as tables, chairs
- **Completely redecorate** (all walls and all woodwork and possibly outside masonry as well)
- Replace all the white goods
- **Consider replacing the kitchen and/or bathroom**. This, though, really depends on the quality of the bathroom and kitchen that you installed in the first place).

If it is a good quality kitchen, it should last a long time. If it is a cheap kitchen then it will look tatty and worn and the cupboards will start falling apart, normally within six years of use.

You may also need to replace furniture that is worn. To last six years you'll have to go up market a little and avoid all chipboard items, but it will save you money in the end.

Golden Rule: make sure your property investment plan puts aside sufficient money to pay for the necessary refurbishments.

Congratulations! You've now finished section 21. But before you go on, check through the key principles:

- Decide whether to manage the property yourself - see section 21.1
- Manage a perfect handover - see section 21.2
- Manage student lets (if required) - see section 21.3
- Manage tenant problems - see section 21.4
- End a tenancy - see section 21.6
- Arrange for refurbishment - see section 21.7 and 21.8

22 STEP 5 – CREATE YOUR INVESTMENT PLAN

Once you've read and digested this section, you will be able to:

- Use the **Buy to Let Secrets** Investment planning software - see below

This section is all about using and understanding the investment software spreadsheet.

Start by opening the spreadsheets supplied with this book;

Click here if you have Microsoft Excel

Click here if you have Microsoft Works

The spreadsheet contains 4 separate pages (or worksheets, for the Microsoft Works version):

1. **summary** - enter the key data here - such as projected yields, capital growth rates and rate of increase of the rent, service charge, purchase cost and size of loan
2. **purchase** - enter the appropriate stamp duty rate, solicitor's costs, estimated number of refurbishment months (if any) and other costs
3. **set up** - furnishings, refurbishment costs and tenant set up costs (inventory, contracts and references)
4. **managing** - letting agent cost, property insurance cost, estimated upkeep/ emergency repairs cost, estimated refurbishment/ repaint costs, estimated annual void period (worst case)

Once you have entered the figures for your property, then you can view the projected graphs (not available with the Microsoft Works version)

- Cash flow chart – this is the most important chart of all!
- **Profit** chart
- Total Costs chart

22.1.1 1 - Summary spreadsheet

This spreadsheet allows you to forecast year by year increases in the property value and the rental income.

Remember that when rents increase rapidly, capital values tend to grow more slowly.

Equally, when capital values are increasing at say above 10% per year, then it is typical for rents to increase by about 2 or 3% per year.

The long-term average growth rate for UK property is between 4 and 6% per annum. Hence, this is a conservative figure to use over a 20 year period.

In addition, you'll need to enter key data such as the mortgage costs.

See also

- **section 22.3** on Understanding your purchasing costs
- **section 22.4** on Understanding your renovation and refurbishment costs
- **section 22.5** on Understanding your rental income
- **section 22.6** on Understanding your Cash flow
- **section 22.7** on How much money will I need? Cash flow forecasting

22.1.2 2 – Purchase spreadsheet

	A	B		C	D	E
1	**Purchase Costs**					
2						
3	Finance Rate %		5.8%	<= See SUMMARY sheet to		
4	Stamp Duty Rate %		1.0%	<= Adjust this percentage ac		
5	Solicitors costs %		0.42%	<= Insert your solicitors cost		
6	No of months before sale or rental		2	<= See SUMMARY sheet to		
7						
8	PURCHASE ANALYSIS					
9						
10	Cost of Property £	£	105,000	<= See SUMMARY sheet to		
11	Stamp Duty £	£	1,050			
12	Solicitors Costs £	£	441			
13	Surveyor Costs £	£	450	<= Insert your surveyors cost		
14	Carry Costs (if any)	£	1,006			
15						
16	Other Costs £	£	-	<= Insert any other costs you		
17						
18	**Purchase total £**	**£**	**107,947**			
19						

This sheet will help you capture the costs related to the purchase of your investment property (such as stamp duty, etc). See **section 22.3** for these costs in detail.

22.1.3 3 – Set-up spreadsheet

	A	B	C	D
1	Setting Up			
2				
3		Item	Amount £	Explanation/ Example
4		Value of Property	£ 100,000	2 bedroom in outer London
5				
6		Square feet	800	
7				
8	Furnishings	Carpets	£ 1,000	£12 per metre
9		Curtains	£ 250	From Ikea - 6 windows to cover
10		Beds	£ 300	2 beds - from Argos
11		White goods	£ 450	Fridge, freezer, washing machine,
12		Kitchen wear, linen and towel	£ 152	Cutlery, crockery, utensils
13		Furniture	£ 653	Sofa, dining table, 4 chairs, armchair, coffee table
14				
15				
16				
17		Sub Total	£ 2,805	
18				
19	Refurbish	5 days work	£ 2,500	Repaint, retile, re carpet, replace furniture
20				
21				

Don't forget that once you've bought your property, you will probably need to spend some money setting it up. Even unfurnished properties tend to come with curtain rails, carpets / flooring and white goods.

See **section 22.4** for these costs in detail.

22.1.4 4 – Managing spreadsheet

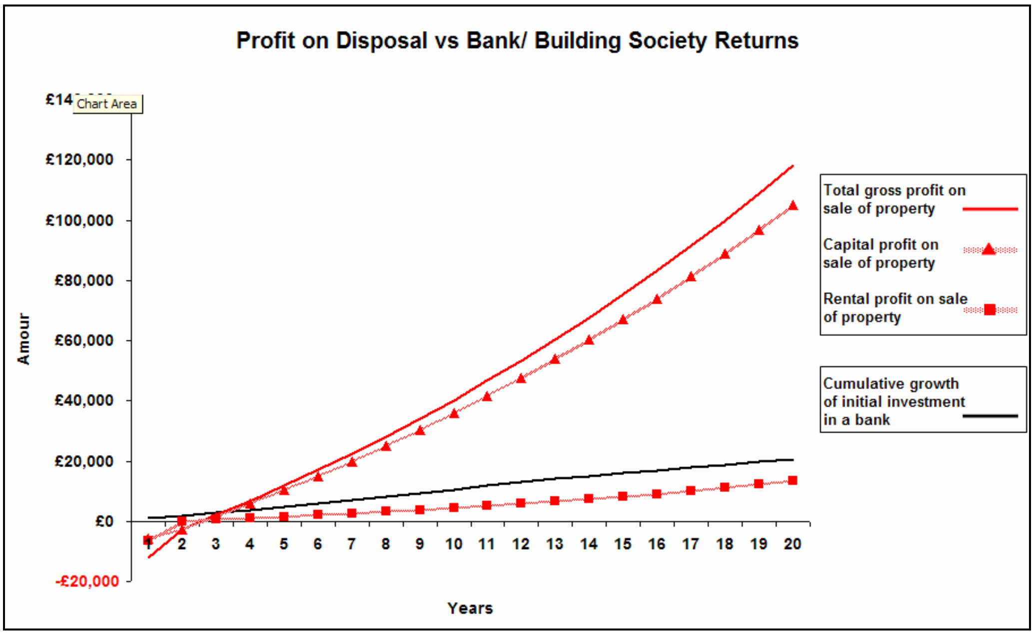
	A	B	C	D
1	Managing the rental	For Long term cash flow and income forecasts		
2				
3	Letting Agent Percentage Cost (if any)	11.75%	<= Insert your letting agent fees	
4	Property Insurance Cost %	0.21%	<= Landlords must pay for the b	
5	Upkeep/ Repairs %	0.50%	<= keep a small budget for eme	
6	Refurbishment/ Repaint costs fund (per yr)	1.50%	<= Keep a larger budget for refu	
7				
8				
9	Forecast No of weeks let per year - out of 52	48	<= To change this figure and oth	
10	Worse Case Scenario no of week let per year	44	<= Insert the worse case scena	
11	Value of Property		£ 105,000	£ 108,150 £
12				
13				
14	Results (Best guess)			
15				
16	Year		1	2
17				
18	Rent yield			
19	Potential Rent - per year		£ 9,000	£ 9,900 £

Use this spreadsheet to manage your property, including the amount you'll spend on letting agents, and the amount of money you will set aside to refurbish your property, to maintain its rental value and also to keep void periods to a minimum.

This sheet also allows you to forecast a worst case for your rental property in which you suffer an extended period of voids.

These two scenarios (best guess and worst case) will show up on your **cash flow** chart. Use this to ensure that you have sufficient funds to enable you to see out any period of voids.

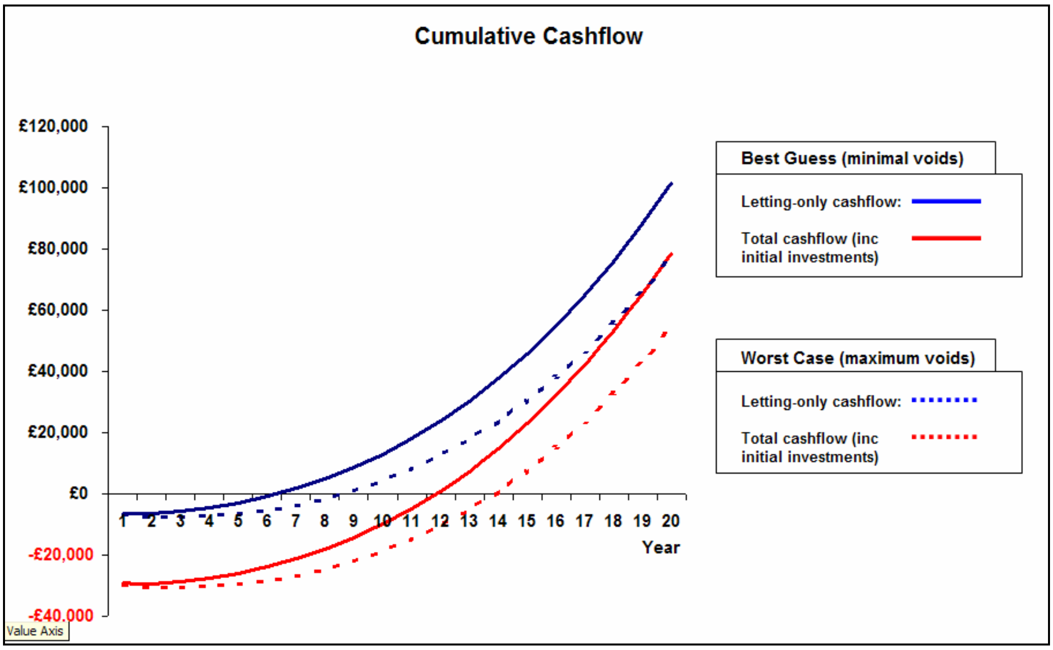
22.1.5 Profit chart



This chart illustrates the potential return of your investment against keeping your money in the bank.

It also illustrates the split of your profit between capital profit and rental profit.

22.1.6 Cash flow Chart



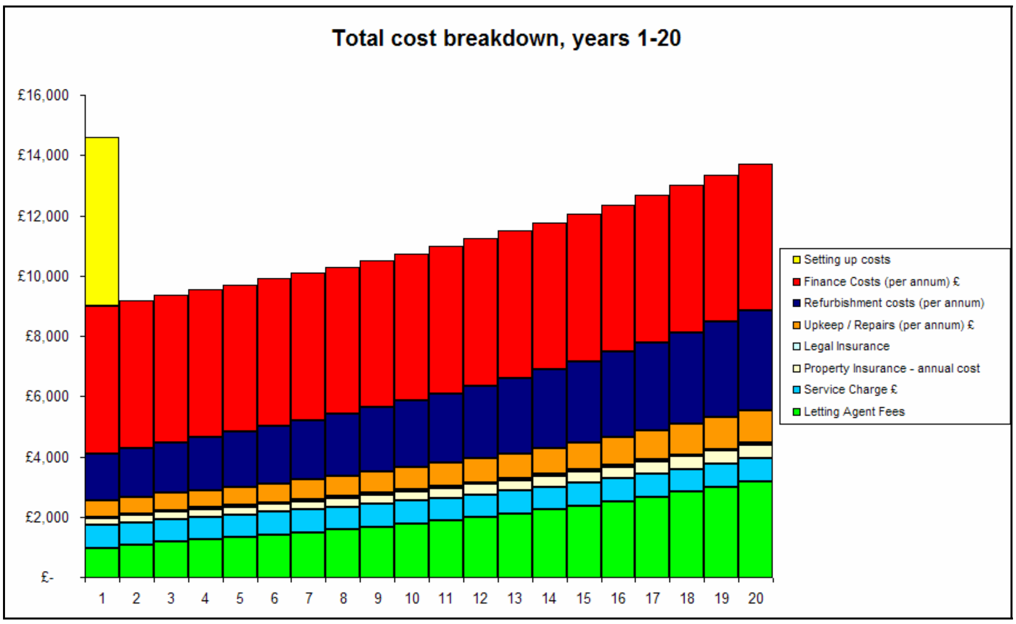
This chart shows you the total amount of funds that you will need to commit to the project should you suffer void periods.

To be sure of profits in the long-term, you should ensure that you have sufficient finance available to fund the worst case cash-flow scenario.

See **section 22.6** for more details on managing your cash flow.

Also, see **section 22.5** for details on accurately predicting your rental income.

22.1.7 Total costs chart



This chart allows you to capture all your costs – per year – into one single graph.

Use this graph to check that you have correctly forecast all your costs – so you don't get any nasty surprises.

22.2 Putting the Ideas and the reality together

The basic formulae of the Buy to Let loan are worth looking at.

A standard requirement of Buy to Let lenders is that the monthly rental income must be 130% of the monthly mortgage costs. (Remember, you are taking an interest-only mortgage).

See **section 16.11.3** for more details on whether the lender will give you the loan.

Most properties can achieve this basic requirement - but it is also a reasonable measure to ensure that you are not too exposed.

In effect, you are anticipating an extra 30% of costs on top of your mortgage. However, when it comes to planning your investment this rule of thumb really is too much of a loss.

Some properties will be much more expensive to run than others. For instance, your property might have very high service charges.

There again, you may decide to advertise and rent the property yourself, through a paper rather than through an agent. This will obviously mean a substantial reduction in your monthly costs.

It is better to consider the case for each property based on its own merits. And that's what the **Buy to Let Secrets** Investment Plan is for. See **section 22** for details on how to open and use the spreadsheet software.

22.3 Understanding your purchasing costs

In addition to the cost of the property itself, you will have to cover a wide range of other costs, including:

- Stamp duty
- Land registry fees
- Solicitor's fees
- Solicitor's indemnity insurance
- Local authority search costs
- Survey costs
- Broker's fee
- Lender's fee / mortgage indemnity policy (MIP)
- Finder's fee.

22.3.1 Stamp Duty

The purchaser pays stamp duty as follows:

Purchase Price	Stamp Duty
Up to £60,000	0%
£60,001 – £250,000	1%
£250,001 - £500,000	3%
Over £500,00	4%

The worst jump is between £250,000 and £250,001. This price increase effectively adds a £5,000 tax bill to the property.

Some properties are struggling to sell around this mark for this reason.

Most investment properties cost less than £250,000 - and the hike in tax will encourage investment below the £250k ceiling.

In some North England towns it is possible to purchase good quality housing or one-bed flats for less than £60,000.

These obviously have the benefit of being below the tax limit.

22.3.2 Land Registry fees

These charges are the cost of your legal advisor or conveyancer registering your ownership of the property with the Land Registry.

Broadly speaking, it works out at about or less than 0.1% of the property price.

At the time of writing these are the exact charges:

22.3.3 Solicitor's Fees

The solicitor's fee, depending on the type of property you are purchasing, will be around £500 and up. It is worth getting a good solicitor, but roughly £500 is a benchmark figure. Some London lawyers are a lot more expensive.

If you are not in too great a hurry, then there is no reason why you shouldn't use a lawyer based outside of London or major cities.

They are usually cheaper, and so while they take a little longer, a good lawyer will be just as efficient.

22.3.4 Solicitor's Indemnity Insurance

Solicitor's indemnity insurance is normally quite low – about £50 per transaction.

22.3.5 Local Authority Search

A Local Authority search will be another £25 or £30, or you can do a hand search, which will cost a bit more.

If you want to exchange contracts quickly (so that you don't lose a sale or purchase), then you can actually pay a legal assistant to go down to the Local Authority and pull out the relevant files themselves rather than doing it by post.

Local Authority searches can take up to six weeks sometimes, particularly in London. It is supposed to be two weeks, but it has been known to take a long time.

A hand search can be done the same day.

22.3.6 Survey

The type of survey depends on the property you are buying.

You can choose between a:

- Home Buyer's Report and a
- Full Structural Survey

Typically, **all mortgage companies will want a Home Buyer's Report** before they will loan you money.

A Home Buyer's report for a leasehold flat should be sufficient. Basically, these merely involve a surveyor looking at the property and establishing that it isn't going to fall down and is worth what you are paying for it.

Full Structural Surveys should really only be considered on a freehold house.

It is nice to know the results of a Full Structural Survey, but the important thing really is to make sure the house insurance is in place to cover any major problems that come up on the survey.

Full Structural Surveys can be a waste of money sometimes, especially if the surveyor is unable to get access to the roof space (e.g., if you are a first floor flat) or access to the other parts of the property.

22.3.7 Broker's Fee

The mortgage lender typically pays mortgage broker's fees. However, some brokers do offer a fee-based service.

And in some more complicated cases the broker may charge you.

22.3.8 Lender’s Fee or Mortgage Indemnity Policy

A lender may include a fee called M**ortgage Indemnity Policy (MIP)**. This is typically added to your mortgage and is an extra charge made by the mortgage company to cover what it considers a high risk loan.

The higher *loan to value* ratio, the higher is the lender's risk and so the more you'll be asked to pay.

Normally, if your loan is less than 80% of the value of the property, then you won't be charged a Mortgage Indemnity Policy fee.

If, however, you request a loan for 81% to 95% of the value of the property, then the cost can be high.

22.3.9 Finder’s Fee

Some investors will use the services of a 'finder' to locate good investment properties.

The standard finder’s fee is 1% of the purchase price. Sometimes you might pay more if someone calls you speculatively with a very good deal.

These charges are the cost of your legal advisor or conveyancer registering your ownership of the property with the Land Registry.

Broadly speaking it works out at about or less than 0.1% of the property price.

Lawyers are a lot more expensive than that.

22.4 Understanding your renovation and refurbishment costs

The most important thing to take into consideration when considering renovation and furnishing is that **the extent depends on the property and the area**.

If you are buying the property in Knightsbridge, London, you have to refurbish according to the value of the property. If you are buying a small terrace cottage in an ex-industrial district, you will want to spend much, much less.

As a rule of thumb, look to spend a maximum of 15% of the property value for a complete refurbishment.

The point is that if you had a beautiful house in Knightsbridge or something worth a couple of million, you would not do a cheap job on the construction or the renovation or redecorating or the furnishing. You would make it top notch.

If you are on a tight budget, make sure that your renovation and decoration are right - don't try to cut too many corners.

Key tip

Often, it would be better to save your money by offering the property in excellent condition - but unfurnished – rather than cut the renovation or decoration budget.

22.4.1 Construction

Construction costs are very difficult to figure out as a percentage of the property's value.

Construction could include:

- Building an extension
- Underpinning
- Moving load-bearing walls
- Adding a mansard

This kind of work is beyond the interest of the Buy to Let investor - see Property Developer Secrets **www.propertysecrets.net/pds/**

22.4.2 Renovation

Renovation would include replacing:

- Kitchens
- Bathrooms
- Wiring and plumbing
- Lighting

Again, this level of work is typically beyond the Buy to Let investor as it requires a more substantial investment of time and focus.

But purchasing a run-down property that needs renovation is a very good way of increasing your yield and return.

The sister book to **Buy to Let Secrets, Property Developer Secrets** recommends a maximum spend on the refurbishment of 10 to 15%. Without going into work that requires builders, you might, as a Buy to Let investor, consider spending up to 5% of the property value.

If you are considering a more substantial project – then see Renovation Secrets www.propertysecrets.net/renovation/ for advice on running or managing a renovation project for maximum profit.

22.4.3 Decoration

Decoration work would cover the carpeting, painting and decorating, fixtures and fittings. As a Buy to Let investor, you might well spend time and money on these aspects of the property. A clean and smart property lets faster and will be treated better by the tenant – usually.

Expect to paint all walls and all woodwork and replace fixtures, fittings and carpets before letting the property.

Typically, to paint and carpet a £100,000, two-bedroom flat might cost £2,000 - £3,000.

This might include replacing and improving some fittings, perhaps the kitchen work top and so on. After each letting you should consider a partial repaint.

See **section 19.4** for more details.

22.4.4 Furnished or unfurnished?

Be led by the letting agent regarding furnished vs. unfurnished.

As long as the property is in an area that is known to be a family area, it is more likely for people to have their own furniture, or be prepared to go out and buy furniture.

One and two-bedroom apartment tenants tend to want furnished properties because they tend to be young people who do not have the money to go out and buy furniture.

These young professionals do not want to be thinking about having to save up to buy a £2,000 sofa or other furniture.

In these cases it is much better that the property is furnished, or at least part furnished anyway. You should have the major items in there like the bed and the sofa and the coffee table and a few paintings.

Student and DSS lets will require furnishings too - although these might be of a lower quality.

22.4.5 Carry Costs

Carry costs depend on the amount of work that you need to perform on the property before you can release it into the lettings market.

From the day of completion, allow the following time:

Activity	Time Allowance
Renovation	4 to 6 weeks
Simple redecoration	2 or 3 weeks
Letting time	2 or 3 weeks

If you are simply redecorating the property, allow a total 2 to 3 weeks for painting and a further 2 to 3 weeks to let.

If you are renovating as well then you might need to add an extra 4 to 6 weeks onto this total.

In the case of construction, you might spend up to 3 months and then another 6 weeks, so you will be looking at maybe 18-20 weeks of carry costs before your property is let.

The other factors that will affect the level of carry costs are:

- The time of year that the property comes onto the market - as mentioned earlier in **Buy to Let Secrets**, see **section 19.1**, this can have a very strong influence on the difficulty of letting.
- **The size of the property** - the above times are a guide for a two-bedroom apartment. Obviously, a larger property may take longer.
- **Professional vs. own work** - if you bring in the professionals, then the work should complete much faster than if you attempt to do all the work yourself in the evenings and weekends.
- If possible, **see if the vendor will allow you early access** to the property. In other words, they might allow you to begin redecoration or refurbishment on exchange of contracts (but before completion). See **section 19.3** for details.

22.5 Understanding your rental income

Achievable rental income, void weeks and refurbishment weeks are all variable. If you have done your job right, you have bought the right type of property and you have also done it up well, and your timing is right during the year, then you should keep these down to a minimum.

22.5.1 Achievable Rental Income

Be guided by your letting agent on what is an achievable rent.

The main reason why good properties don't let instantly (in a normal or good market) is because the asking rent is too high.

Hence, it is essential to use a realistic rental income in your forecasts.

22.5.2 Void Weeks

Again, your letting agent will be best to advise on the likelihood and frequency of void periods.

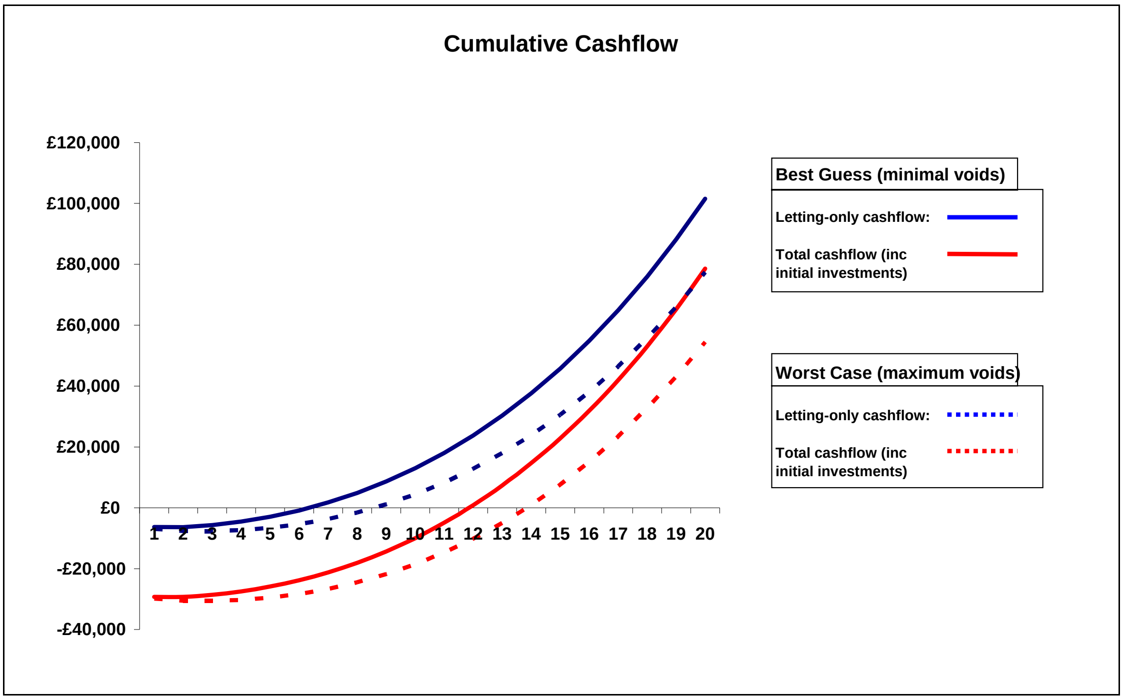
A void is one variable that is difficult to predict. If there is a market crash or if your street is suddenly full of competing properties, then you may suffer more voids than expected.

Use the worst case number of weeks let per year to account for these risks. You can then view this impact on your cash flow chart.

22.5.3 Refurbishment Weeks

Don't expect a 100% occupancy rate - at best assume a 2 week void each year, even if it is just to maintain the property or carry out minor refurbishments.

22.6 Understanding your Cash flow



The first priority, assuming the property is potentially profitable, is to ensure that you can fund the project in the worst case scenarios.

Try the following:

- Increase the interest rates
- Assume a void period of eight weeks per year

Can you still fund the project? Albeit that a crisis is likely to last one or two years - and not the full 10 years of the graph.

22.6.1 Up-front cash flow

Your cash flow initially, bearing in mind that you have just paid out thousands and thousands of pounds in terms of deposit, is very poor, because you've paid all this money and it is going to take years for you to get that back.

In addition, you need to sink a certain amount of money into your purchase to fund things like stamp duty, solicitor's costs, refurbishment, etc. See the purchase and set-up sheets.

Remember that you will only recoup this money when you sell the property.

22.6.2 Cash flow for rent - the forgotten cost!

In addition, you may have to invest money on a monthly or annual basis into your property if the rental income doesn't cover all your costs, such as:

- Mortgage payments
- Insurance
- Service charges
- Maintenance and periodic refurbishment

And so on. See **section** 15 for more details.

Preferably, you don't want to be in a situation where you have to constantly put your hand in your pocket every month.

However, in most situations of an 8% yield, this will be hard to avoid. (The best way to avoid it is to purchase a run-down property and do it up - see **section** 15.6**)**

That is fine so long as you have actually budgeted for it.

The problem usually arises when investors don't consider this cost – which is why it's called the 'forgotten cost'.

As a rule, for cash flow during the first couple of years, you will be lucky if your rent pays for all your costs. Bear in mind, however, that the amount you have borrowed stays the same, and rents will go up, and cash flow will catch up with costs in the second or third year.

The cash flow will sort itself out eventually - so long as you can put up the rents every year.

And a frequent rent increase will mean that you need to keep your property in good condition (i.e. you need to spend reasonable sums maintaining it) over the years.

22.6.3 Can you put up the rent up every year?

It is normally stated in a letting contract that the rent will go up with the Retail Price Inflation (RPI) if you are doing a lease extension.

However, some years it can go up a great deal more than that. Some years it can go up 10-15%. Other years it might not increase at all.

The biggest influence on rent increases is supply of available property for rent. If lots of new properties to rent have just appeared next to yours, then increasing rates will be difficult.

Conversely, when the cost of buying property increases too sharply, more people stay renting and so the extra demand often feeds through into higher rents being achieved.

For the purpose of your cash flow projection it would be reasonable to look at a 4% increase in the annual rent.

However, bear in mind that the increase will be uneven. It is also easier to make larger increases when you change tenant.

22.7 How much money will I need? Cash flow forecasting

OK, let's now project your cash flow. This will show you how much money you really need. Not just the initial investment, but to keep the project running.

Golden Rule: You'll need much more than the price of the property or just the deposit.

As discussed above, there are two main types of costs that you'll incur:

- Purchase, purchase costs and set up
- Maintaining the monthly interest payments and maintenance costs (less rental income)

These costs are relatively easy to predict and measure – but, even so, many property investment plans forget key items.

Also, as with all budgeting, it is best to remember that there will always be something that you forgot! Therefore, leave yourself a margin of error.

It is a good idea to estimate your costs from a best case, worst case and mid-case scenario. The 'mid case scenario' is what you think will actually happen.

The worst case scenario demonstrates the cash flow you'd need to have available if everything went against you.

It is best to ensure that your property investment plan could stand the shock of a 'worst case... '

The absolute worst case would be that your cash flow got out of hand and you had to sell the property at a loss. Thus losing your investment and failing to recoup any of the money that you subsequently put into it.

For a £100,000 property, you might easily invest £50,000 of your own money - so it could be a very expensive mistake to make.

Please use the spreadsheet to predict your cash flow. See **section 22** on how to open and use the spreadsheet.

22.8 Managing your Accounts

Set up a separate business bank account.

Pay the rent into your business account and all payments should come out of the same account.

If there is a shortfall, you top it up from your personal account. That way you can keep track of your true costs.

This will help you:

- Accurately measure your return
- Simplify your accountancy

Keep deposits held in a separate interest bearing account.

Congratulations you've finished section 22! But before you go on, check that you're familiar with the key concepts of this section.

23 Deal Barometer - How to tell a great deal from a Dog!

Ever wondered how pros approach a property deal? How they measure its potential and decide whether they want to go 'in' or 'walk away'?

Well, Property Secrets has come up with its own unique formula for assessing deals and it's a tool you can also use.

It is, quite simply, a great way of approaching any deal you may be interested in.

Of course, though, be aware that any method of appraising a property deal for investment potential is, at the end of the day, predicting the future.

And we all know how hard that can be!

In other words, the Dealometer is a model to employ, but it is a model that contains a measure of subjectivity. It has to.

23.1 How the Dealometer works

Our Dealometer formula consists of four factors. These are, in order of priority:

- Honesty/integrity of the developer and agents
- Capital growth potential
- Cash flow/rental yield
- Discount

Here's how we weigh each of the four factors and why.

23.1.1 Honesty/integrity of the developer and agents

For the Property Secrets team, this one is dead easy. It's a straight Yes or No.

If it's a No then the deal is off no matter how attractive the terms appear.

There is just no point working with dodgy dealers!

23.1.2 Capital growth potential

This time the score is out of 20, as this is the most important factor affecting potential returns.

We keep in mind that even an over-priced property with poor rental returns will provide a good return if it delivers exceptional capital growth.

So, this category scores double, both cash flow/rental yield and discount.

23.1.3 Cash flow / rental yield

This is scored out of 10 as it's a key factor in being able to hold your property while the capital value increases. We use the likely cash flow based on the rental yield, mortgage costs, likely void periods and other costs of the property.

A mildly positive cash flow property will score 6 or more. A neutral cash flow will score 5, and a mildly negative cash flow will score 4 or less.

23.1.4 Discount

This is scored out of 10, as it is another key factor but not the over riding factor that some syndicates claim.

But in any assessment of the discount on offer, we try to decide whether and to what extent the discount is a real one, not just a headline-grabbing figure.

Plus, we take a look at the payment terms and the level of deposit required.

Generally, the larger the deposit, the greater the discount and, equally, the smaller the deposit, the smaller the discount.

23.1.5 The Dealometer in action

Let's take a look at how a recent Property Secrets deal stacked up - the Drill Hall in Bristol.

The Drill Hall scored a big Yes on Honesty/Integrity. After that, it scored 25 out of a possible 40, or 62.5%.

In our estimation, any deal scoring 50% or more is good.

Here's an example of how we arrived at our scores:

HONESTY/INTEGRITY - Yes

Planning permission had been passed and contracts were being drawn up. Also, the builder has an excellent reputation as a good negotiator, but is a fair and honest man.

So, while there was no big discount sweetener, investors were getting a good, solid deal that should make profits.

CAPITAL GROWTH - 18 out of 20

We believe this specific area is about to boom.

Essentially, this is for the following reasons:

- Big inward investment by businesses in the area.
- Vicinity of Temple Meads train station - this area has become the new commercial heart of the city.
- Vicinity of much-needed office space development, bringing around 6,000 workers into the area.

- Severe shortage of good quality apartments for these workers.
- Highly attractive development of a beautiful old building with character.

RENTAL - 4 out of 10

This was based on a 4.7% yield if the development went on the market at the time of assessment, but a realistic 5.6% when it is completed.

Therefore, cash flow should be more or less neutral, but this was based on a projection and not current facts so we marked it down from 5 to 4.

DISCOUNT AND TERMS - 3 out of 10

There was no discount on units in this development. But the apartments were well priced and could be expected to make good, and quick, capital growth.

We also believed the asking prices were honest prices. They had not been inflated to create a false discount.

You simply could not buy these apartments on the open market.

So, when they do come on the market, a higher selling price can reasonably be expected.

Plus, these flats were free of stamp duty.

In addition, an exchange of contracts could be completed with only 5% of the property price and the rest on completion. This means that by the time you took possession, you should have one year's capital growth already built into your investment.

* Discount the discount

In general, we don't like discount sweeteners, and, in general, we say discount the discount!

There are plenty of discounts out there. But the question is: do you want to **feel** like you're getting a good deal or do you want to **actually get** a good deal? Something that makes you feel good, or something that makes you cash?

23.1.6 Using the Dealometer

Of course, many aspects of the Dealometer are subjective - that's obvious and inevitable. But, at the same time, it certainly helps focus on the elements that really matter.

Now if someone offers you a huge discount you've got some means of assessing the real value of the deal and not just allow your judgment to be swayed by big marketing headlines.

And, of course, anyone can apply it to their own investment assessments. We regard it as like a second opinion on a deal.

24 TAX ISSUES

Tax law is subject to change, therefore, please check any advice with a professional tax advisor or accountant.

Also, tax law can be a grey area and one court judgement can change the way in which the rules are applied.

Once you've read and digested this section, you will be able to:

- Begin to decide between individual tax status and a company status – see **section 24.1**
- Begin to assess which of your refurbishment costs are tax deductible - see **section 24.1.2**
- Maximise your tax advantage with a large mortgage - see section 24.1.3

24.1 Tax Planning

As an individual, you pay tax on:

- your income
- your capital gains

... albeit that you can offset a certain amount of both taxes against your personal allowance.

With a business, you may be eligible for capital gains taper relief. This effectively reduces the amount of capital gains that is payable according to the nature and the length of time that you held the asset.

The benefit of taper relief can be substantial - but as the rules are in a state of flux at the time of writing, please talk this though with your accountant or check the Inland Revenue's web site at: www.hmrc.gov.uk

Most big property investors will run their business as a limited company. If you don't run it as a limited company and you are relatively small, you will be charged capital gains tax as an individual.

However, if you can prove that you are an actual property investor/ developer, you can treat the profit as a trading profit, whether or not you have set up a partnership or limited company.

For instance, if you have a very good year as a property investor and you are taxed as a private sole trader, you could end up paying a very large capital gains tax bill.

Whatever you do, the tax implication of a successful property investment will be substantial and you should check with your accountant before you begin.

24.1.1 Are refurbishment costs tax deductible?

Yes - so long as they are not of a 'capital nature'.

'Capital nature' describes things like - the cost of land or the buildings on it. So you cannot offset the purchase price of the property against tax - but you can offset the monthly cost of the mortgage (see **section 24.1.3**).

Generally speaking costs such as:

- repairs
- painting and decorating
- damp and rot treatment
- mending broken windows, doors, furniture and machines (such as cookers and lifts)
- replacing roof slates, flashing and gutters
- replacing pipes

...ARE tax deductible expenses.

Where the repairs are very substantial, there may be a view that the expense adds to the capital value - and therefore might not be suitable for tax deduction - although other reliefs may be available.

Anything that is getting it in a condition to rent out (non-capital items) painting & decorating, carpeting, plugs, sockets can usually be treated as tax deductible.

A new kitchen is a debatable item. If it was to replace the existing kitchen, unless it included an extension or similar, then you may be able to offset the cost against tax.

These costs are normally tax-deductible in the first year.

The first year means the first year that you trade on this property. It will be your first year's costs – a little bit like setting up a business.

The major costs of setting up your business will largely be in the first year so, as a rule, you will not make a major profit in the first year. The same applies to this property.

24.1.2 Are furnishings tax deductible?

With furnishings you are allowed to either,

- deduct a one-off payment - so if you spend £5,000 on furnishing then you are allowed to deduct that £5,000 in the first year, or
- you are allowed to deduct 10% off the rent - so, if the rent is £15,000 a year, you are allowed to deduct 10% of that, i.e. £1,500 against your tax.

Your may choose whichever method suits you best.

24.1.3 Is the mortgage tax deductible?

The interest-only part of your mortgage is tax-deductible. If you have a repayment mortgage (if you are letting your own property for instance), the repayment part is not tax-deductible, neither is any endowment policy that you may have.

What is very, very important for tax purposes, which people often get wrong, is that...

...any money that you borrow subsequently against the property for refinancing is not tax-deductible.

It is only the mortgage that was used to buy the property initially that is tax-deductible. Therefore, if you place a large initial deposit (say 50% of the property value) then even if you refinance later to reduce your deposit to 20%, you can only offset the initial cost of the loan against tax.

If you need to refinance the property later, you will end up paying more in tax than you needed too.

Golden Rule: Keep your initial deposit as small as possible - to maximise your tax advantages.

24.1.4 Other costs

Many other costs of running your property business will be tax-deductible, including:

- insurance costs
- maintenance costs
- letting agent's fees
- wear and tear, redecoration, replacement costs
- petrol to go to and from the property
- your solicitor's costs
- accountant's costs

In short, everything that you can put down that is used to further your business, or in the course of your business is tax-deductible - just like in any business.

For more advice in this area, either speak to an accountant or consider Property Tax Secrets - this is a sister publication to Buy to Let Secrets.

Congratulations!

You've not only finished the chapter on tax - see section 24 - but you've finished Buy to Let Secrets.

All that is left to do now is to put it all into practice.

Good luck and best wishes

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