This article has been reproduced from the December 2015 issue of Property Investor News™.
To subscribe go to: www.property-investor-news.com or contact us on 020 8736 0044

Property Development: Risk Assessment is Key

Editor **Richard Bowser** speaks with John Raiye

Long-term readers may recall an interview here some years ago with the West Midlands based property investor and landlord John Raiye who had created a mixed portfolio of single lets and HMO properties. I recently caught up with John who trained as a professional quantity surveyor, to learn all about his latest property venture near Walsall and it was immediately very clear when we met that he has not been at all idle since our previous meeting in 2012.

I initially sat down with John in the lounge of one of his recently sold properties which comprises of a row of seven 4-bed townhouses and a linked apartment block with 16 individual units. John started off by outlining his property investment career back to 2001.

"Over the last fourteen years I've progressed from initially doing some quite straightforward buy to lets around Manchester as a more passive investor, towards doing HMO's and then creating a lettings business in the Birmingham area. I also have been doing property trading to create profits to reinvest but in the last few years I've moved on from doing smaller refurbishments to larger scale developments like the one we are at today".

John's progression towards property development is not unusual these days but the risks of building out a site from scratch are numerous and unlike some parts of the south of England and London in particular, the local economy in the West Midlands has not been that buoyant since 2008 so developing property to sell needs strong nerves and a pretty robust business plan.

Thankfully the townhouses have now all been recently sold and are inhabited by the buyers whereas the apartments are being finished and marketed towards buyers. John explains further what occurred.

"We bought the site as a part finished development via the Receiver. The original developer, like so many during the 'Credit Crunch', had gone bust and the lender (RBS) then took control. I work with a joint venture partner and as the technical expert in our partnership had to do some fairly extensive due diligence prior to submitting our final offer to the Receiver for the site, which was for sale on the open market. There was a lot to consider including assessing the planning side and what had been implemented as well as the validity of various guarantees.

"The process, which was quite intensive, took less than two weeks and once we had our offer accepted by the Receiver we decided to proceed in two stages. The initial phase was to sell the townhouses and to ensure all the legalities were put in place so that the sales process could be done smoothly. As the pricing was very competitive at the zero stamp duty level of £125,000 they just 'flew out' as they represented great value for local owner occupiers."

John explained that one of the main reasons why the townhouses were sold first was that the build process on them was more advanced whereas the apartment block was "a shell but with a roof in place so that the building itself was watertight.

"Basically with the apartments we had a blank canvass to then finish off; doing the insulation, boarding, utility services etc and then the fitting of bathrooms, kitchens and flooring. The sales plan with the apartments is ideally to have a mix of buyers, some rented and others being owner occupied. The unit pricing for the two-bedroom units is £80-84,500 and rents will be around £500-550 per month, according to local agents. The service charge is very reasonable at £500-600 per year so gross yields for buy-to-let purchasers will be around 7-8%. The numbers are coming out similarly to when we did the original appraisal prior to purchasing the site."

I ask John how the funding for the project was arranged. "We have not needed to take on bank finance for this development but we are looking at some options for our next project. Until more recently banks were very reluctant to lend on this type of development outside of the more buoyant south east markets where overseas money has played a key part, but there is a ripple effect occurring up here in the Midlands and confidence to lend is increasing as buying activity gains momentum.

"Banks are also becoming more confident to lend up here and I say this from seeing the impact on current valuations not only on my own properties but also from the experiences of those landlords whose rental properties we manage. In Birmingham and the West Midlands I would say values are up about 10-12% this year."

The most crucial factor when appraising any property development project, irrespective of its size, is the old adage of 'location' so I asked John why they chose this particular site.

"We'd looked at a number of schemes which were then on the market and which at first seemed attractive, but with this one which we bought via the Receiver, the numbers were right and the risk profile seemed low. This is primarily entry level housing and with the values as already discussed, we felt they would be attractive to owner occupiers and that the apartments would also appeal to rental investors with a decent return very likely".

Access to transport is often a key factor for tenants in particular and John explained that the proximity of the site in Willenhall, being near to Walsall and with Wolverhampton not very far away, was a positive. "It's only two junctions down the M6 to Birmingham and we felt that from a commuting perspective given the competitive pricing the units offered a lot of positives to both end-user buyers and tenants."

John went on to give insight into some of the issues that they had to deal with after purchasing. "Initially we had to address security and although this is now a gated development there had been some vandalism on the site and the roof needed some attention.

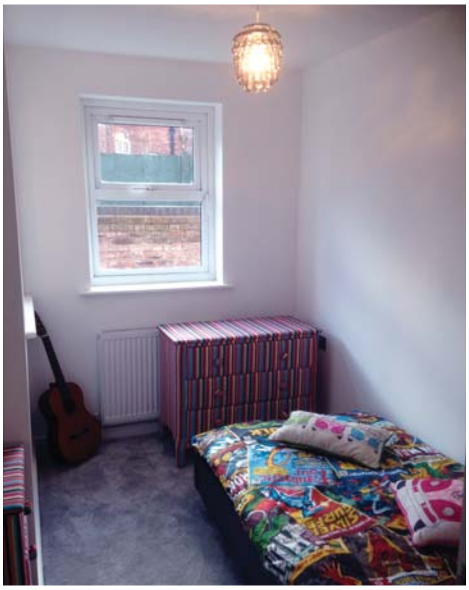
"We made a decision to work with the original architect's plan primarily because services i.e. the risers were already in place. However, we had a blank canvass to work with and put together our own interior designs. Externally we are putting up some Marley cladding on the building corners to give a design feature. In the communal areas of the apartment block we are putting in some wood panels to dress them up a bit and create a positive first impression. Kitchens and bathrooms are the key selling areas so relative to cost v sales price we have tried to give the units some individuality.

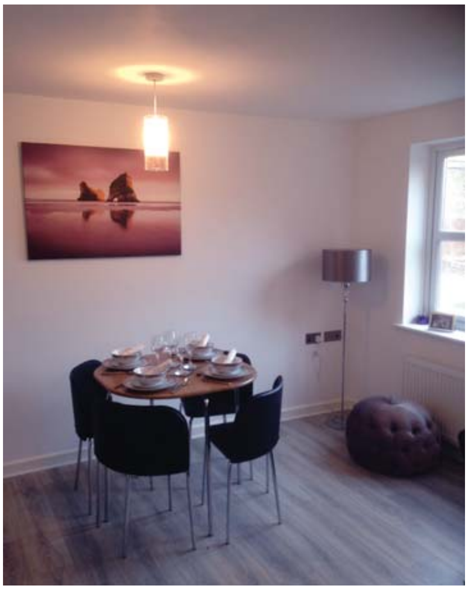
"There were external issues in the rear car park area, in particular with 'soakaway' provison' as the independent Building Regulations guy had not visited the site previously and therefore had not signed it off. We had to put two separate sections in to the ground to allow for that one in thirty year storm causing excess surface water flooding. There were a few other issues to deal with including a failed attempt to find the all-important structural engineer. As such we then had to appoint a new guy to assess and agree the building's structural integrity and approve it for occupancy which was an additional cost."

Anyone doing even a modest property refurbishment project will be aware of having a decent contingency fund and that was the case as John outlined. "You've actually got to factor in a larger contingency fund for a partially built development than if you are starting from scratch as there are potential 'unknowns' to be wary of. Given the relatively short time frame we had to assess and then bid on the site, it meant for example that the lack of a structural engineer's report had to be weighed up in our cost v benefit analysis."

I asked John as to what were some of the main lessons that he'd learnt from this project to-date and what would they do differently?

"We purchased the development site from a Receiver. Typical of the time (2009) RBS had pulled the finance from the previous developer and we purchased the site on a competitive bidding process. As already explained, I was given just over a week to do all the due diligence on the site, which was tight, given the nature of the partially completed houses with only the envelope construction of the apartment block being completed. I called around the





full design team and was fairly satisfied with the history of the site and managed to reappoint most of the team including the warranty provider Premier Guarantee. Unfortunately I was given some incorrect information from the guarantee provider at the due diligence stage on the extent of the sign off. This resulted in a completed redesign of the structural elements as Premier did not have all of the structural design signed off as previously outlined. The previous structural engineer had retired so I took the confirmation as provided by the warranty provider.

"When it came to the build phase we were handed over from the sales team to the technical department whom confirmed they did not have a complete design sign off of structural details. Given the nature of the speed that things probably progressed on site with the previous developer they would have been steaming to completion given the height of the credit crunch and the pressure on the bank to pull the loan and the pressure on the developer. These kind of mistakes are administrative but inevitably are really very important as without the sign off there is no Building Regulations approval. Without Building Regulations the site value is questionable. We had to engage a new structural engineer who did a probing exercise, a full survey and then completely redesigned the apartment block where we had this shortfall in design information.

We also had a similar problem with rainwater provision. This problem was slightly easier in that we simply dug up the ground and increased the soakaway provision. These kind of troubleshooting problems are actually quite commonplace in partially completed developments without building regulation sign off. The credit crunch did cause this kind of 'financial carnage' with some developments being worse than others."

I ask John about the team that they are using to complete the project.

"We could have put it to tender on a fixed cost basis with staged payments to a main contractor but given the partial completion we are doing it ourselves with individual trades being brought in on fixed contracts along with a few guys on day rates as they are needed. As can be the case on many projects, the overlapping of trades can lead to a few minor issues so pragmatic man-management is required.

"We have kept the design fairly simplistic and which will allow the occupier to bring in their own internal colour scheme if they see fit. The kitchens have been dressed up a bit in a modern, contemporary style," - (see the linked video clip on PIN website) - "and we've brought in some extra items to give a style twist, using more slightly more expensive doors, satin door handles, mixer taps etc. The finish will appeal to tenants looking for something up-to-date and not outdated, while also appealing to owner-occupiers, such as those in their mid-twenties, as their first home. It's just half a mile from the town centre and the motorway is a similar distance from here."

No investor interview here in PIN magazine would be complete without the all-important numbers and so John gives us a summary. "The industry typically looks for a minimum 20% gross margin and thankfully we are way ahead on that with an expectation of at least a 35% gross margin. Managing the trades ourselves and not paying a main contractor has kept costs down and increased the profit margin and not paying any bank interest payments also helps.

"We are currently on a profit margin of 34.17% which is way above the standard 20% house-builders margin but this is reflective of the risk taken when dealing with such a complicated site. The £83,000 average sales valuation on 650 sq ft giving at least £125 sq ft sales valuation on average, which reflects the outer West Midlands giving a decent yield with rental of £500pcm."

John confirmed the following financial summary:

Purchase price £900,000

Build costs: £550,000

Professional fees were £45,000

Surveying cost inc. QS, structural engineer, acoustician, architect, planning supervisor, building regulations consultancy excluding legal fees, premier guarantee inspection fee and sales agent fees were a total of £55,000.

The expected Gross Development Value is £2,000,000. PIN

Editor's note: A 30 minute on-site video interview with John Raiye will shortly be available for PIN magazine subscribers. Go to: www.property-investor-news.com and log in using your unique subscriber password.