Adapting and Adding Value

Property investor and chartered surveyor **John Raye** talks with the editor Richard Bowser about his experiences of investing in UK and Europe residential property in recent years

John Raye's interest in property investment stemmed from his experiences in the construction industry as he studied Quantity Surveying and then trained as a Chartered Surveyor within a multidisciplinary surveying practice in the City of London.

"I can remember seeing property developer clients putting complex land deals together and found the wider property market more interesting," says John. "So I moved towards the property development sector and got some good exposure to land deals, development and regeneration projects whilst working for a 'blue chip' property development company during the Manchester property boom of 2002-2005. It was during this period that I purchased a two bed flat and got my first experience of renting and directly managing a property.

He adds: "I continued to purchase more property and each purchase enabled me to gain more skill in finding value whether it was genuinely discounted off-plan, investing in a regeneration area or doing a simple refurbishment. I stayed away from the expensive city centre flats market and went for high yielding one and two bed flats on the fringe of the city centre for rental. I also purchased some older terraced properties typical of the North West and then went for refurbishments with a 'next to the best area' strategy. I purchased a rundown two bed half a mile north of Deansgate in Manchester for £52k, then gave it a makeover for £7k and sold it on for £85k."

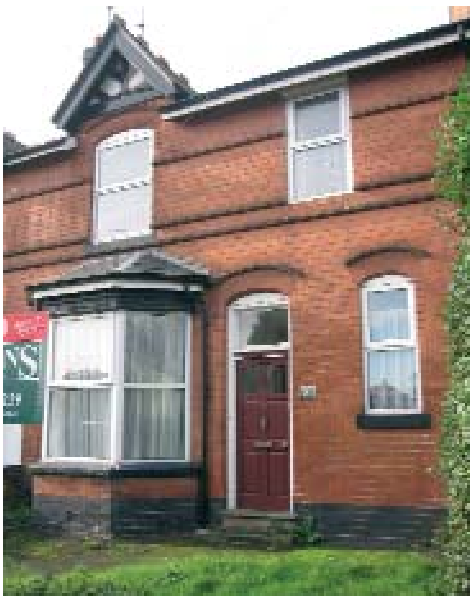
Although he was enjoying the experience of his day-job John felt that working for himself appealed to his independent nature, so he liquidated and traded all his properties on and as a result his starter capital of £5,000 in 2002 had grown to £243,000 by 2005.

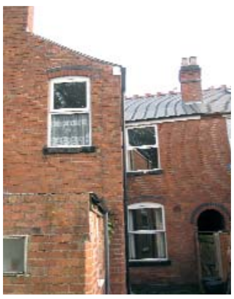
"I decided to take the steps to get into property but always felt that alternative cashflow streams were important due to the illiquid nature of property and my lack of confidence to do 'property' full-time," says John. "The switch from surveying to property investment was difficult, so I purchased equity in two other running businesses and employed management teams to run the day-to-day operations of my retail investments. The experience was great and this provided the back-up cashflow I was seeking. I also gained some great experience in marketing, recruitment and overall business and people management. I went on and set some new property goals."

Having seen his property investments in the UK realise such a good return over just three years John made a decision to look outside of the UK for his next investments in property.

"I decided to trade in new property markets that were set to produce good returns," says John. "As a subscriber to Property Investor News and as an attendee at the property shows at the time I liked both the economic and property outlook of Eastern Europe. The idea of travelling and being a property investor appealed and my plan was to buy and trade as quickly as

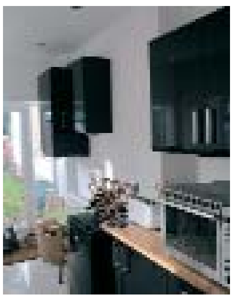
John outlines some of the projects he has been doing in the last year or so:

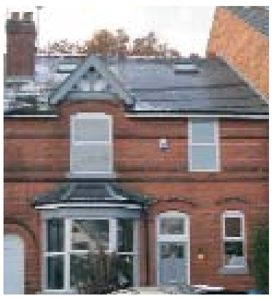




December 2010 completion
Kings Heath, Birmingham
(Permitted Development)

Purchase Price £159,000
Construction and on-costs £88,000
Sold for £330,000
Gross Profit of £83,000





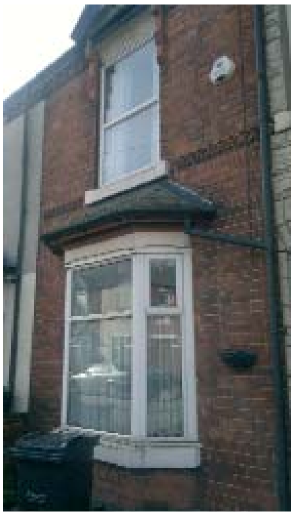
possible. I felt that Dubai had limited trade-out opportunities but seemed strategically placed for long-term growth with its links to the developing eastern economies but in 2006 the cycle there just looked 'overcooked' and highly speculative.

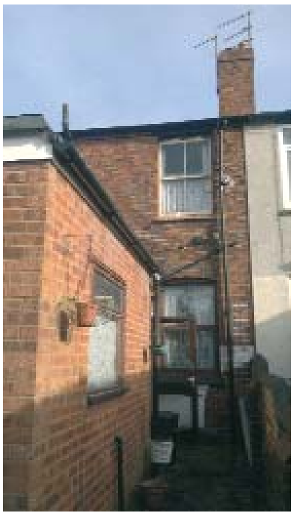
"The Spanish coasts looked overbuilt and I could see no immediate economy there to support prices and sustain growth in those locations other than from continued speculation. Emerging BRIC countries were difficult to get to and I did not feel confident going into those markets without reliable contacts. Eastern Europe was more appealing with limited costs in travel and expenses and the availability of potential finance so I researched Latvia, Bulgaria, Hungary and Poland. Eastern Europe was enjoying excellent growth in GDP and GDP per capita between 2001 and 2004.

"I felt there was still some capital growth potential but felt the market could top as there was potential affordability issues based on average local incomes to capital values. The population levels were the downside but I felt that as long as I purchased with precision, as I had done in the North West of England, I should have some decent results with a back-up plan to rent the units should the capital gains not materialise."

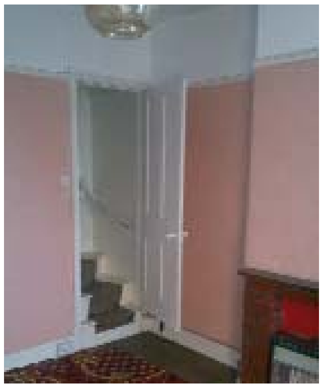
Working with a small group of investors, John purchased reasonably priced off-plans in Riga (Latvia) and sold on the contracts for all six units as soon as they had purchased them.

"We went on to purchase classical apartments 'next to the best area' in District VI in Budapest (Hungary) and then went to invest in Bulgaria," says John. "I could see that 'the crowd' were purchasing ski chalets in the resorts, Black Sea coastal flats and brand new flats in the centre of Sofia. I decided to pick up some small units on the fringe of the capital and target the resale to locals or to a smarter investor that wanted better value.





March 2012 - Oldbury:
Flipped on at Auction
Purchased at £50,000
Sold at £60,000



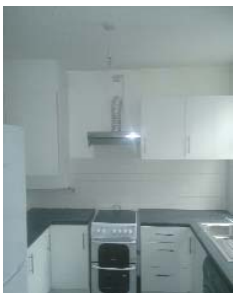
"We went to a district called Lozonets in Sofia and purchased two rundown flats with the intention of a complete refurbishment. We remodelled both apartments from one beds into two beds and fitted them out to a high specification. We made profits in all the capital locations except in Bulgaria where we broke even. Buying in a growth market or adding value is a great concept and can work exceptionally well but the lesson to be learnt was that you should be 'locking in' some equity on purchase. With growth across the board and a break even position in Bulgaria we then sold all the properties and came back to the UK and I then decided to take the steps to become a full-time property investor in 2007."

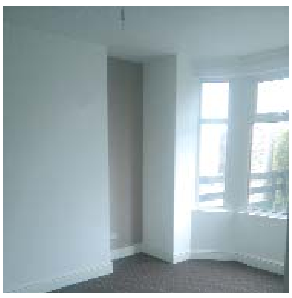
I ask John how he had adapted his approach to ensure sufficient profits were made to support himself as a full time investor-landlord.

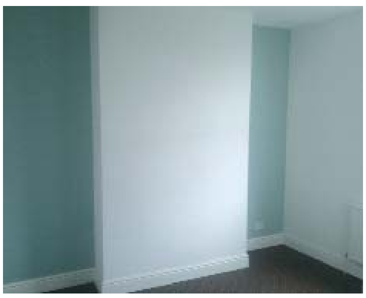
He replies: "With the turn in the market I was buying property and refurbishing to set up HMO's. I was also advertising to purchase property from distressed sellers and acting as 'the hero' to save them from repossession. Whilst it was a fulfilling experience, enabling a family to stay at their home for Xmas, the reality of dealing with court hearings and resolving debt problems meant that my role became more like a social worker than a property investor.

"I then started to source these deals for other investors through my business Ikos Investments. Whilst this was a great experience that enabled me to develop my property portfolio and develop my database of investors and contacts, I reverted back to the construction process and my preference for 'adding value'. I applied this via a Permitted Development strategy which worked well on a few properties in the West Midlands up to 2010. During the last year I have been trading property to flip in auctions and adding a few HMO's to my rental portfolio. I spent 2011 rebranding my business and set up a property management service. We also got back to property sourcing with my small team at Ikos Investments. I also decided to do JV's with private investors and offer one-to-one property coaching to property investors." ▶

2011 in Manchester: HMO Cash purchase at £60,000.
Approx. £29,000 was spent on construction and it revalued at £125,000
The gross income is £1,380pcm = £16,560pa = 18.6% gross yield.







So what are you doing now?

"The current market presents the opportunity to 'trade the pullback' as they say in financial trading. Buying into the market on the downturn will provide the basis for potential returns as the market improves over the next 5-7 years when the Quantitative Easing eventually works through the system. A high cashflow HMO strategy, property sourcing and property trading are ideal activities in this market. Buying 'smart' to then trade on at auctions, selling to passive investors and offering property management services at the 'back end' are all great strategies at present. The current market does provide an opportunity to trade stock to new investors with inflation wiping out any gains on liquid cash, so passing some equity and good cashflow onto the new investor presents an opportunity.

I ask John what he sees as the biggest challenges these days for investors.

"The market has been through a complete cycle and the current market is unusual," John replies. "Interest rates have not been at 0.5% for 400 years and this has certainly propped-up the property market as well as the economy. In my view we have passed the worst phase of the recession but I fear the stagnation will remain for a few more years. Any signs of economic growth will see bank interest rates move back to the long term average, and this will curb any potential for house price growth, although prospects in UK regions obviously vary. Perhaps the biggest challenge over the next few years will be increasing interest rates with minimum house price growth which could squeeze rental profits and equity. The full-time investor certainly needs to have liquidity at the fore.

He adds: "As a risk management exercise investors should be running sensitivity analysis on higher interest rates against an existing portfolio and purchase with an expected increase in lending rates in mind. Additional acquisitions should be made with the overall cashflow position central to the business plan. The potential position of each acquisition should also be tested upon being exposed to higher lending rates. It would also be sensible to trade for capital gains and create additional cashflow streams."

I ask John about his thoughts on how investors should approach an 'adding value' strategy in the current market given that lenders and valuers are still in risk averse mode.

> **"The yield that the property investor market wants and the price that enables the first time buyer sale is fundamental information to gain a decent trading profit margin."**

"When adding value I would recommend a methodical process," say John. "Really understand the 'patch' and the quarter mile nearby. Consider what the uplift will be when adding extra space to living rooms and extra bedrooms and bathrooms. When doing your due diligence you must see nearby properties achieving the intended target price bracket. I make detailed allowances for costs covering the purchase price, financing, construction and reselling costs. As a Chartered Surveyor myself, I take the view that a RICS valuation is only an opinion. Although it is the basis for mortgage lending, the real value is down to what the market will pay and deriving what the market will pay comes from having good local market knowledge.

"As part of the due diligence you must get to know the price uplift. For example you should really understand the uplift from a three bed to a five bed. There should also be primary evidence in recent transactions. Speak to your agents and check out the transaction and enquiry levels. The agents must become your friend and good ones will guide and advise you through the process. In sought after areas where transaction levels are high, a good estate agent likes to offer quality property to local homebuyers.

"When it comes to design I would say it is probably the most important factor to getting the sale. The ideal scenario is a buyer comment of "I saw it and just had to have it". Think about this sentence and make it the basis for your interior design. Design gives you the option to be creative. Take a blank canvass and create a theme. As with anything, detail is the key. Doors, handles, hinges, glass features, light switches, bathrooms, kitchens, feature design items, colour, floor and wall finishes and lighting design give you some great leverage.

"As for tying up less time and cash, a 'flip sale' to the investor market is the quickest opportunity as well as selling to first time buyers in locations where buying demand is still high and property transactions are fluid. Again the real market knowledge is with local auctioneers and agents and in this market they really are your leverage for knowledge. They know what is selling and what is sticking. Give them a product that they feel comfortable selling, at a price they feel is reasonable."

From the perspective of a property trader John concludes with some sound advice for readers:

"The yield that the property investor-landlord market wants and the price that enables the first time buyer sale is fundamental information to gain a decent trading profit margin." PIN

HMO purchased in 2010 at £135,000 - Refurbishment cost £23,000 - Revalued at £179,000
Gross income is £1,600pcm = £19,200pa = 12.2% gross yield.