BUILDING YOUR CASH EQUITY POSITION IN A FALLING MARKET

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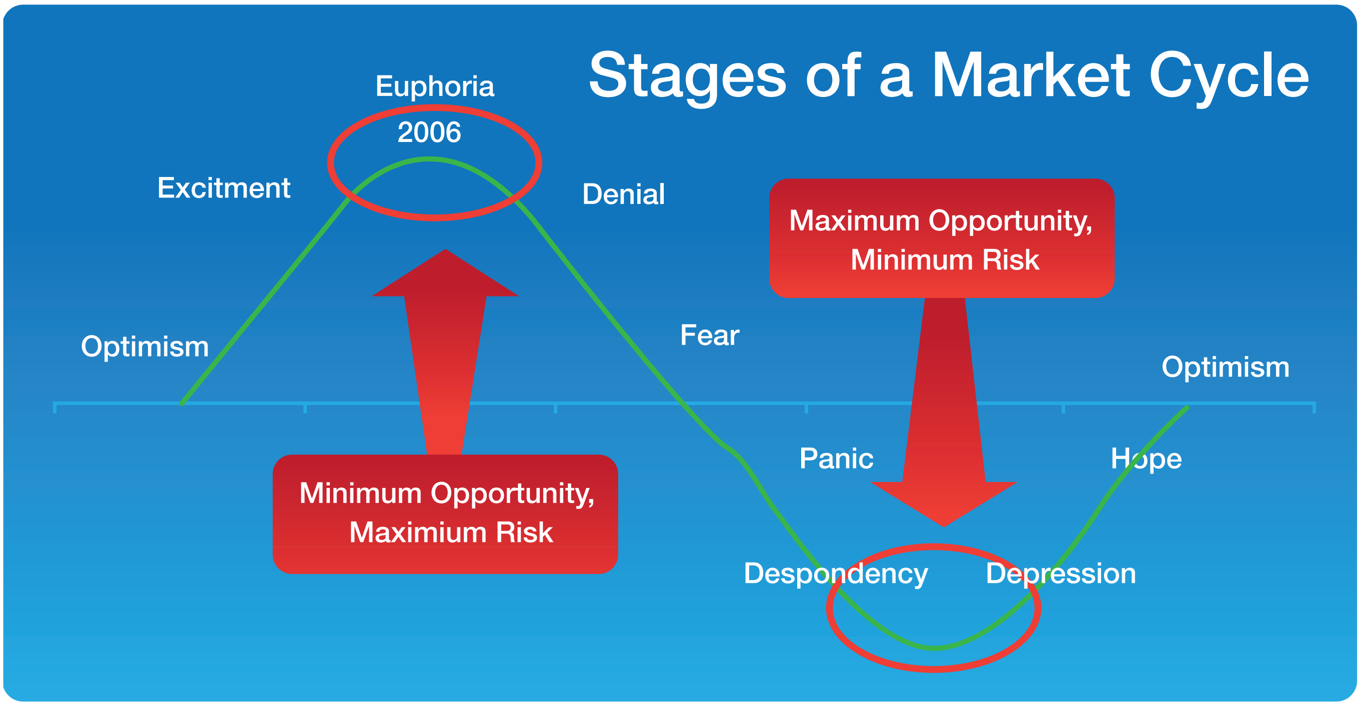
Property, like any other investment vehicle, has its most popularity in a rising market. Only a few weeks ago I heard a well known motivational coach comment that the time to be in property was 2000-2005 and then you were best to get out of the market in 2006.



Generally, in investing and business when a market is trending well it becomes popular and a 'bandwagon effect' is created which adds to the momentum. Anyone that monitors broader investment vehicles will see that trading against the Euro or holding Gold would seem sensible in the current climate, as both have trended well in respective directions over recent years. This is primarily due to the crisis in the Euro zone and the overall lack of confidence in currency as QE has been rolled out to prop various economies trading in or close to recession.

As an investor that has invested in businesses, property, commodities and regularly trades FX, I see one significant positive that property provides over others and that is the foundation of back up alternative options, giving property the ultimate safe haven status it deserves for ordinary investors. Whilst property may not consistently deliver exponential returns like a new business in a trending market, or a continuously rising stock or currency, when it becomes unpopular there are avenues and opportunities to sweat property from rental returns and broader property investment strategies that the investor can leverage, whilst continuing to trade, during the recessionary opportunistic phase of the property cycle.

Looking at the historical house price graph from Nationwide Building Society the cycle of fear, exuberance and opportunity are presented in each cycle with an upward long term price trend.

To highlight some comparables:

- **Precious Metals** – Although gold is regarded as a safe haven asset, if physical gold falls in value there is no back-up plan. You either hold the commodity hoping it will rise in value during the next recession or trade the capital loss. Whichever you choose there is no running yield for owning gold.

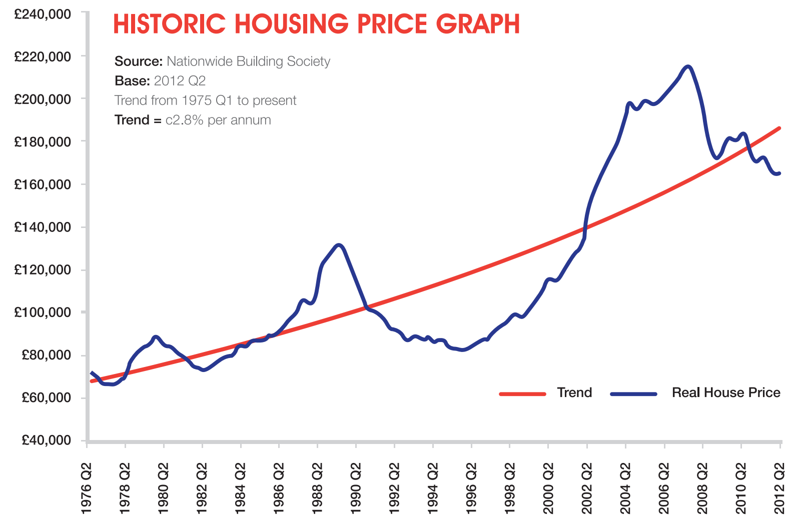
- **Currency Trade** - If the Euro rises when you've traded against it you have no alternative but to take the loss and live for the next trade. Whilst financial trading can be very profitable when 'trading with the trend', taking regular and continuous losses is part of that business.

- **Business** – When a business sector becomes saturated margins are squeezed and the options are to become more competitive through marketing or innovate with your product and tighten up on any non-revenue generating overheads. Business failure rates are still fairly high and most business concepts have a life cycle. Although the return on capital with a trending sector can be exponential and business investment can be highly lucrative it does not provide the safety barrier provided by investment into a physical asset.

- **Property** - If property falls you can rent it for the longer term or consider some alternative more creative strategies. It is obvious that prices fall and equity gets 'crushed' in a falling market but the opportunity for an investor is still there with some lateral thought and a creative mindset. The fundamental risk with property is the double edged sword of gearing and most property failures are usually based around management of debt to value ratio and cashflow.

Of the above, the backup that property delivers makes it one of the most versatile investment vehicles. So how does an investor build equity or cash position in a falling market? Can it actually be done consistently and successfully? Yes.

Strategies, hard work and investing discipline are the key to getting it right.



BUILDING YOUR EQUITY CASH BASE

Repayment Mortgage

It might not seem like an obvious one but one of the easiest and most straightforward methods of building equity in a falling market is the repayment mortgage. Switching to repayment enables you to plan the development of your equity position over the long term. I have spoken to a few investors on this very subject and quite often the response is "but I live on my income from rents and switching to repayment would damage cashflow". The simple response is "perhaps you could be more creative in generating additional cashflow". What does any business do when cashflow is damaged? Answer: Get creative and innovate! So why should property investors be any different? Your base skills are valuable and can be offered to local investors.

Property finding, maintenance, mortgage and insurance referral commissions, marketing for local business owners are just some basic ideas that the property investor can leverage. If you sit down and plan it right you will find that generating the income you have lost by switching to repayment can be created with a resourceful and proactive outlook. I recently spoke to a large West Midlands based investor, Arsh Ellahi of Ellahi Estates, who firmly considered "the interest only model to be dead". Perhaps there is a point. Will we see house prices rising again in the near future providing equity without hassle?

City Rd, Edgbaston B17

PURCHASE PRICE	£135,000
REFURBISHMENT	£23,000
	£158,000

REVALUATION	£187,500

RENTAL	4 rooms @ £69pw	£1,196 pcm
	1 room @ £55pw	£238.33 pcm
	1 room @ £75pw	£325 pcm
	TOTAL £ PER MONTH:	£1,759.33 pcm

COSTS	Maintenance/void	£100
	Water	£24
	Gas	£70
	Electric	£100
	Council Tax	£82
	Broadband	£25

MONTHLY PROFIT	£1,358.33*

*Excludes cost of finance

The Lease Option Flip

The lease option is actually a fantastic tool for controlling property and delivering cash equity in fast flip situations.

Applicable on both commercial and residential property, the lease option enables the investor to control a property, add value and trade on for some great capital gains.

Capital uplift can be achieved by securing an option on a deal with potential for adding value by way of title split, extension or loft conversion, planning gain, a cutting edge refurbishment or any other value adding strategy.

In the case of commercial property a refurbishment, planning gain uplift or commercial pre-let are the significant value drivers with potential for exceptional capital gains through achieving a strong covenant. Remember, if first rejected, you can incentivise your vendor with some share of equity uplift on trading the property onto the market.

As required with any flip deal you should ensure your financials and due diligence are done with precision.




Sutton Coldfield, B74

PURCHASE PRICE	£85,000
REFURBISHMENT	£28,000
PURCHASE ON COSTS	£1,500
	£114,500
RESALE	£238,000
SALE ON COSTS	£4,000
CASH BALANCE ON RESALE	£123,500

*Excludes financing costs

Vendor Finance

A commercial deal we are currently negotiating has Vendor Financing as its catalyst. The deal is a redundant commercial building owned by a client for whom we manage a portfolio of property. The vendor runs various businesses outside of property and has no time to deal with the refurbishment of the building. They attempted to sell the building on the market via an agent with a further attempt via an auction sale. When the auction route was unsuccessful they were then 'open to suggestions'. Rather than any sort of Joint Venture development I initially secured an option agreement with a 5% exchange and offered a % return on cash based on the remaining balance of the agreed value of the building in its current condition. The Vendor Financing agreement would run until we complete and refinance the property. This will enable us to refurbish the property, secure tenants and create a cashflow whilst controlling the property, making the building a more viable lending proposition for a bank. This is perhaps a slightly riskier strategy given the nature of the lending market at the moment but we have also embedded a reversion to an option of a JV should full refinancing not materialise within 12 months, enabling us to hold the property over the long term as a Joint Venture partnership, with the vendor, based on cash equity remaining in the deal following refinancing.

Vendor financing can be a great strategy against commercial property in the current climate as it is quite expensive to own commercial stock based on local rates payable. There is no rate relief for an empty building which can be an expensive carrying cost. For small business owners however, the rates relief is currently very high based on the huge incentive to kick start the economy into positive growth. With the lack of finance, commercial property presents a fantastic opportunity to create some great 'workspace', enabling investors to assist in the much needed kick start to the recessionary economy, whilst securing prices and option agreements at the very bottom of the commercial property cycle.

Agreed Valuation	**£60,000**
Refurbishment	**£100,000**
Legals	**£2,000**
TOTAL COSTS	**£162,000**

Income from six office suites @ £350pcm per suite = **£25k per annum**

Capitalised Value based on an aggressive 9% Commercial Yield = **£277,000**

Flip Trading

The current market is unusual in that we have a strong flow of investors becoming increasingly interested in property seeking strong yields and the bottom of the market.

With a combination of poor returns on cash, unpredictable stock market conditions and high levels of currency volatility, residential property is increasingly looking attractive for stable returns. Auction houses reflect the strong demand with David Sandeman eig group reporting annual increases in the percentage of lots sold via auction year on year since the downturn in 2008. With some reasonable gearing the beginner landlord can achieve a reasonable return, particularly with the back-up of perhaps one of the best rental markets for decades.

The market for purchasing and re-trading properties is strong. The most straightforward low value buy-to-lets at strong discounts to market value are the most tradable property types.

Farm Road, Oldbury

2 Bedrooms

Purchase Price	**£50,000**
Resale	**£61,750**
Profit	**£11,750**

Antrobus Road, Handsworth

Purchase Price	**£105,000**
Refurbishment	**£0**
Resale	**£112,000**
Profit	**£7,000***

Projected Revaluation post refurbishment **£170,000**

*excludes sourcing fees and oncosts

Trading with Rent to Own

Rent to own provides an innovative financing option for first time buyers but can also give the property investor a means of trading and rolling capital with the opportunity to create some equity. A typical deal example:

- **Secure a two bed flat £60k cash purchase and refurbish for £15k.**
- **Refinance after 6 months to 80k at a value of £100k covering purchase of £60k, £15k refurbishment outlay and incidental costs say 5k.**
- **Sell to a first time buyer at £110k with a 5% down payment with monthly payments of rental at £550pcm for 3 years covering the mortgage (5% interest only payable on £80k = £333pcm) + £100 of the £500 going towards the tenant buyers capital payment providing £117 per month profit for 3 years = £4212.**
- **TOTAL PROFIT = £5K LUMP SUM UP FRONT PROFIT ON EXCHANGE + £4212 PROFIT FROM RENTAL + 25K CAPITAL PROFIT BALANCE (MINUS INCIDENTAL COSTS) ON COMPLETION IN THREE YEARS.**

The most effective method of deploying this strategy is to choose an area where this strategy would work based on demographics, desirability and the profile of the potential buyer and target a number of deals per year which will complete in 3 years generating a cluster of lump sum capital gains in one calendar year, creating a healthy pot of cash equity i.e. complete on 5 deals generating 15k each in 3 years time whilst enjoying the benefit of stronger and more consistent monthly cash flow during the course of the 'Rent2Own' sale. The most essential part of the strategy is to ensure all cash is refinanced and ensure the capital gain is all created in one calendar year to enable you to plan for the cash injection to your property business.

Alternative Strategies

Care Sector

Another great positive of property is that the ownership of some properties can create exceptional cashflow with an additional business investment angle and add significant realisable capital gain which can be liquidated on resale. One investor I spoke to switched from residential property investing and trading, to the heavily regulated care sector. The CQC (Commission for Quality and Care) regulate the sector and are the leading UK body for implementing compliance requirements covering everything from spatial requirements, building specifications, staffing requirements and overall quality procedure.

To address the requirements he went through the process of recruiting a consultant who eventually became a stakeholder in his care home operation to ensure the operation was in line with CQC standards.

The sector is well regulated through the life cycle of the entire care home including set-up, operation and transfer of ownership to new parties.

From a valuation perspective there is a massive advantage particularly against a falling residential market where residential values can be difficult to predict and bricks and mortar valuations are only based on comparables. The advantage of a care home is that a bank valuation is not restricted to bricks and mortar. The valuation factors in the trading operation, turnover and net profit which can significantly enhance a valuation of the property asset.

I found an example of such a difference in valuation on my local property patch here in Birmingham. e.g.

B16 Care Home valued in 2010 at £335,000

Typical B16 Valuation (pre auction) £195,000

The care home sector has minimum requirements for specification, with space planning in particular, being a key requirement which can make traditional houses quite difficult to remodel.

Looking at examples such as B16 above it does seem that there is some traditional housing stock that can offer some flexibility to remodel and meet the requirements of the care home sector. An eye for design and remodelling will be required for anyone looking to enter at the lower value end.

The sector is clearly showing signs of a strong growing trend. Earlier in the year the Office of National Statistics reported that many more people will live beyond 100 years of age. As the population ages its care needs will become more acute for a much longer period of time. It seems the UK will need more resources to cater for the care of older and vulnerable people potentially presenting an opportunity for property investors looking to broaden their horizons and obtain some capital gain from a property investment angle.

OPM and Joint Ventures

The old saying ''money makes money" is certainly relevant in property investing. Learning from experience I would state that the investor should always have a rolodex of investors that is created, developed and leveraged constantly. Investors want returns on cash and want to invest with good experienced investors.

As property people we are fortunately trading a vehicle that the everyday person understands to have some collateral value.

Private investors should be brought into deals to assist with financing cash equity. The most sensible JV structure is "I do the work and will inject some cash into the deal and you fund a larger proportion of the equity requirement."

When looking to roll cash and create equity in a falling market it would be preferable to work with investors that would not be dissatisfied to hold some equity in property for cashflow as a backup alternative. With this in mind you should be looking for JV investors to trade deals on for maximum return on cash but be in the knowledge that your investor would not be disappointed with cash equity tied into a positive cash flowing property that may not refinance fully or not sell within a pre-agreed time frame.

Remember JV's are a human relationship and managing expectation is a key factor.

The property recession is certainly a period for sharpening your skills, getting some new strategies and getting professional about property investing. Building your cash equity in this current recession is what will separate your investing skills from the crowd. A famous quote in investing:

"It is only when the tide goes out that you can see who is swimming naked."

Warren Buffet

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Hotels

Another option for the investor looking to obtain some capital gain from a business perspective is running and operating Hotels or Bed & Breakfasts.

Smaller styled bed and breakfasts are one of the most straightforward small business models.

The major considerations are location, marketing, service and meeting regulatory requirements particularly with regards to Fire safety standards. The Bed and Breakfast Association reports that good quality Bed & Breakfasts have actually weathered the recession well, partly because "cash-strapped Britons are taking more holidays in the UK and looking for alternatives to hotels".

The **Bed & Breakfast Association** provides information and support to B&B owners and it is also a good resource for would-be owners that are considering branching into hotels and the bed and breakfast sector. **www.bandbassociation.org**

An even more straightforward switch from residential investing to the hospitality sector is towards holiday cottages. I recently spoke to Lise Chesters who commented that the switch can be hardwork but saw her rental uplift go from £420 per month to £300 per week. **www.holidayinbrecon.co.uk**

The more aggressive approach would be to take on the hospitality element and go for the full hotel/bed and breakfast operation. From a capital gain perspective, similar to the care sector, there is the opportunity to enhance value from turnover and operating profit which creates a tradable property and business asset.

Traditional properties can be remodelled and styled to cater for the bed and breakfast market as demonstrated by Lise Chesters.