

Farrell's view... best of the blog

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The property investment news and comment blog is updated regularly with the latest news affecting property investors and also Farrell's view of some of these events. Known for not pulling his punches, Dominic says it as it is.

“50% of Poles aged 18 to 24 are planning to leave over the next two years”



Old 'No Trespassing' sign at border between Poland and Czech Republic. Investors are advised to tread carefully before buying property in some Eastern European countries.

1. Farrell's view on Bulgaria

As I predicted at the beginning of 2005 in the Sunday Times, the lid is coming off the Bulgarian property market and I really do feel for naïve investors who have bought on the coast, but also in the mountains where the 2014 Olympic Games was dangled like a carrot for would-be investors. Those skiers amongst us knew there was little chance of success and unsurprisingly Bulgaria did not even make the shortlist.

Investment in Bulgaria carries significant risk to capital and income. Because a country is perceived to be 'cheap' it doesn't follow that it is a good investment. Perceived value and true value are very different concepts.

There is always a danger when estate agents and developers use terms such as hotspot, hottest etc as this only adds fuel to the fire.

The hype surrounding the Bulgarian property market hasn't just appeared as a revelation in October 2006, it has been evident for a good two years, although not everyone saw it and many companies have contributed to it!

Continue to avoid Bulgaria.

2. The effect of politics and economics on Poland and its property market

In the Jet-to-Let Bible I examine the importance of political stability and the role of government and the economy in driving sustainable property markets. I have also cautioned investors to carefully consider any investment they make in emerging markets and take investment appraisals written by companies which want to sell you property for a fee with a pinch of salt.

Well, the political environment across parts of Eastern Europe is less than stable.

Roger Boyes, in an article in The Times on 29th September 2006 entitled "EU's new members are realising that sacrifices have not brought them any closer to paradise", highlights significant political problems in some of the new entrants, namely Poland, Hungary, the Czech Republic and Slovakia. So what does this mean for a property investor? A lot.

Politics and economics are inextricably linked – indeed economics is the abbreviated form of "Political Economy". Strong and stable government is synonymous with a robust and balanced economy. Weak, corrupt and polarised politics is firmly aligned to sustained economic underachievement.

Investing in countries such as Poland, for instance, would not be a wise option for some investors.

Why? The country has serious political issues. We know that the cream of their labour force has left for better prospects in the UK, Germany, France and even far-flung outposts of the EU such as Cyprus and Malta. The 'brain drain' and 'brawn drain' effect in any economy causes serious structural issues across the labour market. Polish entrepreneurs setting up businesses in the UK are depriving their own country of the employment opportunities, multiplier effects and government tax revenue that would otherwise follow. Although in some cases monies find their way back to Poland, the jobs, tax revenues and growth do not.

Poland loses 5% of workforce

Over one million Polish nationals, or 5% of the country's labour force, have emigrated since 2004 for better-paid jobs elsewhere in the European Union, according to a study by the European Citizen Action Service.

Poland, with a population of 39 million, is the largest of the ten countries that acceded to the EU in 2004 and accounts for more than 50% of the combined population of the new states. The country's unemployment rate, while still the highest in the EU, fell to a five-year low of 15.5% in August, arguably more because of emigration than the growing economy.

50% of Poles aged 18 to 24 are planning to leave over the next two years.

Poles, mainly between the ages of 25 and 34, are heading mostly to Germany and the UK. The number of migrants is set to increase, with as many as 50% of Poles aged 18 to 24 planning to leave over the next two years, the daily Gazeta Wyborcza reported earlier this month, referring to a telephone survey of 500 people.

The UK, Ireland and many other EU countries have opened their labour markets to Poles. Holland may do so later this year, while Germany and Austria plan to maintain restrictions until 2011. It takes political will to reform economies which have for so many years been operated under a communist-style planned system. As long as salaries in Poland remain only about 20% of the average in the West, then mass emigration will continue with a significant impact on the speed at which the economic system can reform and provide for the needs and aspirations of the people.

Farrell's view

Investing in Poland carries above average risk. As long as Jet-to-Let investors are aware of these risks, have positive cashflow properties and have a significant degree of 'time' on their hands for the Polish economy to reform, GDP per capita to increase and wages, salaries and rents to catch up to property prices then all will be well.

In the UK, the property industry, magazines and newspapers make much play of the house prices to earning ratio (HPE) – a measure of the overall

price/value of a national property market – I wonder what that figure would be for Poland?

3. Don't believe all you read in so-called investment appraisals

I wandered around a project site recently which I know was sold largely unseen on the internet to investors. I know the area extremely well as I have a house in the area, and for the life of me why anyone would have wanted to invest in this particular project is beyond me. You only have to stand on the site to realise that the re-sale and rental market will be very difficult as the market does not want this location. Why? Because there is nothing there:

- No infrastructure • No shops • No bars
- No supermarkets • No restaurants
- No beach, and the pool is an afterthought
- And to cap it – a dangerous road notorious in the area for accidents.

In fact the pool which is meant to service many apartments is smaller than my family pool at home! When an apartment looks cheaper, has a 'discount' or looks favourable on a comparable basis, just make sure that the sellers are comparing 'apples with apples' and not 'apples with oranges'.

It's no surprise to see lots of "For Sale" signs and little sign of anyone living or renting there. So, please do not be tempted by marketing materials and investment appraisals, urging you to "buy now before they all go..." without visiting the site first. Use your common sense and work out the target market the property will appeal to and be sure of your exit strategy.

4. Negative cash flow investing – not for the faint-hearted

There is growing concern that properties in some parts of Eastern Europe just do not stack up.

The promise of capital gains appears to deflect attention from the fact that rents do not cover costs, assuming that you can let the property in the first place. On some property internet forums investors are nine months post-completion without the whiff of a tenant and in some cases elaborate investment appraisals have overplayed rental prospects and capital growth.

The fact that an investment appraisal appears to be detailed and has many pages does not necessarily mean that it is accurate! Markets in places as diverse as Poland, Slovakia, Czech Republic and the Baltics are not living up to some of the promises made by finders or agents.

So what? Become your own 'expert' and learn about the key factors which affect property prices. Wages and salaries are not growing as fast as property prices in some Eastern European countries and therefore rentals and re-sales will not be as predicted in some of these appraisals. It is simple economics. If you are willing to hold some of these negative cash flow properties for at least ten years then you may see a decent return – but short-term gains are not to be found in some of these markets where location is the key to success. Developments off the beaten track, in the wrong district or simply sold on the "new up-and-coming concept" have left some investors in the lurch. Re-sale is a difficult option as location, oversupply and price work against you. ▶



Don't lose out – make sure you do your research before you buy



You also need to have your rental plan in place long before completion – suppliers, furniture, insurance etc. Avoid negative cashflow properties as they will burn a large hole in your pocket, regardless of the ‘promise’ of paper capital gains.

In my view, the risks of investing in these markets are not adequately explained by sellers.

Remember so-called ‘paper profits’ are very different to having to sell your property in an oversupplied market where the indigenous population cannot afford to buy, never mind rent.

In future editions we will look at the advantages of short-term lets.

Farrell's five to watch

In this section I will highlight the five countries which I think will bring solid risk-adjusted rewards for Jet-to-Let property investors, based on the available data. Some countries will be promoted and others demoted over time according to changing political, economic and financial fortunes.

There are attempts by some companies on the internet to produce indices, trackers and all sorts of ‘scientific’ means to produce a definitive picture of global property prices and

performance. Most economists would dispute the accuracy of the methodology used in order to compile these tables and therefore the validity of the findings.

In my view, the closest reliable index is: **Knight Frank Global House Price Index – Second Quarter 2006.**

Knight Frank produces probably the most reliable overseas house price index there is. Data is notoriously difficult to obtain and also one has to be careful on how that data is compiled so that countries can be compared on a like-for-like basis. Their latest report looks to hotspots for 2007, which we reproduce below:

“Our forecast is that we will see continued slowing of average global house price growth over the rest of 2006 and into 2007. However, this wider trend will mask regional hotspots and investment opportunities. Our favoured locations are:

Germany – Europe’s largest economy, and the world’s largest exporter is still underperforming and we believe will see sustained growth from 2007.

Slovenia and Slovakia – the two countries with the best potential for further growth in Eastern Europe (not yet in our index but joining from next quarter with new data sets available).

Cyprus – has potential for growth over the medium term – once the VAT changes are implemented and settle down.

Russia – effectively Moscow has the potential for more growth and will eventually rival London as the most expensive world city within five years.”

I think it is helpful to publish Knight Frank’s view as a balance to what I am proposing here. I base my view on the “Jet-to-Let Checklist” which is Chapter 10 in the Jet-to-Let Bible. For those of you who do not have access to the book then it can be bought via Amazon.co.uk, Waterstone’s in the high street and other good book outlets. In short, I consider:

- Politics
- Economy
- Property market
- Risk/Tax/Legal

Farrell's five to watch are:

1. **Cyprus (South only)**
2. **Greece (and islands)**
3. **Morocco**
4. **Germany**
5. **Slovenia**

As experienced investors are aware, there is no such thing as a national property market but a series of regional and local markets. In the countries that I have listed growth and income may be strong in a particular area and not so strong in another so due diligence, research and a rigorous adoption of the ‘top-down’ approach advocated in the book is a must.

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