

Farrell's view... best of the blog

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In this regular feature, Dominic gives his forthright opinions on the news and issues that have been raised on the bewarethesharks.com blogs

“ROI is exactly what is says on the tin - the ‘profit’ from an initial investment, normally expressed in terms of a percentage”

1. Return on investment (ROI)

I received a property promotion through the post the other day that left me speechless, which some of you know is a very rare occurrence!

I wrote in the last edition of the magazine that you had to be wary and sceptical of some claims made by some agents selling you property. Return on investment is either a term not understood by some or it is a deliberate policy of the company to hype investment returns.

ROI is exactly what is says on the tin -

the ‘profit’ from an initial investment, normally expressed in terms of a percentage. So if an off-plan property is £100,000 and rises by, say, 20% in one year, the profit (before costs) is £20,000. If my initial outlay was £20,000, then my before costs ROI is 100%. This is the figure that some companies hype. It’s a meaningless investment tool – it means zip in the real world.

Now let’s take away some costs, such as:

- Finders’ fees – 5%
- Legal fees – 1%
- Transfer taxes or VAT – 5%
- Selling fees (if selling) – 4%

£20,000 minus £15,800 = £4,200 or a ROI of 21%.

That is a massive difference to the fantasyland figure of 100%, but less marketable when trying to show new clients how clever you are as a company.

Developer prices and ROI

Furthermore, if the capital appreciation figure used is down to developers and speculators competing to raise prices and not the figure found in the re-sale market, then the error is further compounded – leaving the investor not having any real world idea of the market value, which is very different from the price.

Beware!

The property industry in the UK is not regulated, which is why some companies can promote misleading and unhelpful investment returns that do not stand up to any form of scrutiny. *Fantasyland figures belong in fantasyland and those investors who rely on such figures need to book their trip today.*

2. Robert Kiyosaki

I went to a talk by Robert Kiyosaki of *Rich Dad, Poor Dad* fame in London. He gave an incredible two-hour speech expanding on elements from his Rich Dad series, but also using material from his new book, co-authored with Donald Trump called *Why We Want You to be Rich*.

He spoke very well in a relaxed but confident style, interspersing the teaching with some very funny real-life episodes. As you may know, he was a distinguished Marine pilot in the Vietnam War and holds strong views about events around the world today, but anyone who can turn being shot down three times in Vietnam into a funny story gets my vote.

I found myself agreeing with everything he said, which is not surprising as I have been following his system for many years, although I only read the book a couple of years ago. Most other investors follow his system too, although, again, not knowing it. What, then, is this system?

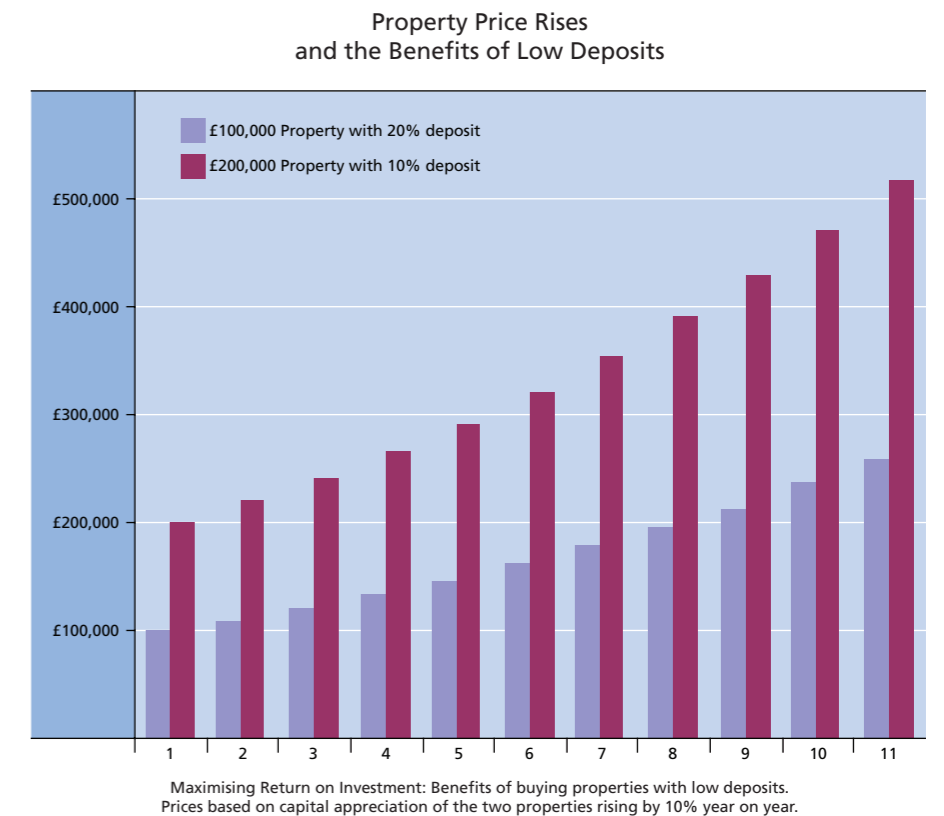
- Use debt (leverage) to purchase assets that produce an income.
- Do not borrow to buy liabilities that produce expenses.
- Cashflow your investments.
- Don’t save – invest.
- Don’t invest in paper investments – invest in property and businesses.
- Surround yourself with successful people.

Those of you who have attended one of my Bewarethesharks.com courses will be very familiar with these concepts, and in many cases these simple, but effective, ideas have changed many lives. One of

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the most important success factors, though, is altering, and in some cases fundamentally changing, our mindset.

From birth most of us are, to use a term from sociology, ‘socialised’ or ‘conditioned’ to think and behave in a



certain way. How many of us have been taught that paying off our residential mortgage is a good thing and that we must repay capital and interest ‘to be safe’? Those people who do this are, in most cases, doing it because they don’t know any better, and indeed for some people it is the only course of action given their personality traits and tolerance to risk.

However, Kiyosaki shatters this philosophy when he teaches that we should use (good) debt to invest in assets that produce an income. This income may be in the form of regular revenue or

fundamental to the process, particularly if they are more successful than you. You effectively become like the people you associate with. One of the strongest aspects of the British Army’s regimental system is the way young people from all walks of life are moulded into a cohesive group by encouraging them to interact with each other, whether in the field on exercise or in the NAAFI (pub) afterwards. Constant association from dawn to dusk sets the bar at the same height and eventually a bunch of individuals act and think as one.

Now, take this into our world, the world of property investing. If we surround ourselves with people who do not understand it, do not want to understand it, or who may put you off because they do not want to see you ‘get ahead’ for whatever reason then you are effectively running uphill with a 100lb pack on your back, stumbling over the terrain and possibly eventually running out of steam.

What if you associated with like-minded people – yes, people who even want you to do well? What if these people were having the same experiences as you? What if there

capital growth, or ideally both. In this system cashflow is king and if you can use equity sitting in a residential property effectively, you can grow your entire wealth.

The last point about surrounding yourself with successful people is



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were people in the group who had been through it themselves and were willing to help? Suddenly, rather than running uphill with a pack on your back, you are walking on a 'level playing field' and giving yourself the best possible environment in which to be a successful property investor.

Build a peer group of positive achievers, not one of negative no-hopers.

3. New build discounts – “Pull the other one, it's got bells on!”

I often come across property sales companies offering me and their clients properties at 20% or 30% or 40% and indeed 50% discount to market value.

I must admit that this sales and marketing technique, which in the main is what it is, can be very effective as psychologically we are all after a 'bargain'.

But, does any of this stand scrutiny?

Genuine discounts

You can get a genuine discount on property prior to the launch of a scheme,

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in what I term the pre-release stage. Why?

Well, the developer has a few motives, which revolve around risk.

Firstly, if he can sell 'instantly' a percentage of his scheme, he has covered some financial bases, such as cashflow, and he can also show the bank signed contracts, which make them feel warm and keen to lend money for the next project. He is also further down the road to break even, when all developers breathe a sigh of relief.

Secondly, there is the 'loyalty' effect with investors. By investing pre-release at discounted prices, the investor makes instant profit that is tangible and real. Investors who make money re-invest, and we, as a company, are benefiting greatly from this at the moment.

Thirdly, you can also get a genuine discount when a development has the last few properties remaining and the



developer wants financial closure.

However, this is not as good as getting in at the start, because in most cases prices will have risen over the period of construction.

Questionable discounts and below market value

I am assuming that most of us are aware that the standard off-plan 15% discount we see day in day out is in some cases very questionable. Often developers or agents mark up prices simply to discount them as a sales and marketing ploy. I am not saying that every company does this, but some do, so be careful.

More interesting is the 50% discount to market value claims by various companies. In the real world with hard-nosed business people, if someone really felt that he could buy something for half price, why would he tell me?

If he had the cash then why not buy it all himself and sell on, making a very hefty margin, far more than any finder's fee will provide? If he hasn't got the cash then any bank on the high street will give him a loan to fund such a fantastic business opportunity – where's the risk? Why not get friends and family onboard and form a syndicate, if for some odd reason the bank is not forthcoming?

Or do you sell to clients and in return receive a few thousand pounds per unit in finder's fees?

Well, I'll leave you to work it out!

And finally, why would any developer in the world be so out of sync with market prices in his area or region? If the market is as buoyant as is often claimed, then why does the developer need to sell a whole scheme 50% below what is claimed it is worth?

He just wouldn't, would he?