

# The Prosperity Column Success, good fortune and wealth

In this regular feature Dominic Farrell ponders aspects of prosperity and wealth

Yes, it's that time of year again. After the indulgences of Christmas and the merriment of 31st December, a new year brings with it the hangovers of the past and the optimism and anticipation of a fresh start

For us property investors, it is a time to review investment strategies and modify plans according to our assumptions of current and future market conditions. Some of us will continue with what we know and understand, others will move to new markets, whilst the rest will adopt a plan somewhere in between. Our investment decisions will depend on what we are trying to achieve, for what purpose and in what timeframe. Some of the investment goals many of us will be setting ourselves are:

- To be financially independent
- To provide a pension for retirement

- To fund children at public school
- To supplement our salary

The first two goals on the list are, by a wide margin, the main objectives of many property investors. Financial freedom brings with it the autonomy to pursue the things in life which really excite and inspire us: spending more time with the children, reducing the golf handicap, building a school in Africa, contributing towards cancer research or whatever motivates you. Doing what you want when you want.

The second most popular goal is to provide a pension for retirement. This is the period in our lives when we don't want to have a care in the world and we want to be able physically and financially to pursue all the activities that we have postponed until then. Perhaps you have thought of a world cruise on the Queen Mary II, backpacking for a

month in India, voluntary work in the community or walking the dog every day. Whatever your dream, it will only become a reality if you have the cash to do it. One thing's for sure, state and company pension schemes for most people will be insufficient to go beyond the subsistence level of living in an economy with constant increases in the cost of living.

For me and for many of my friends and family, investing in property has been my chosen route to achieve these two very important goals. Positive cashflow properties held for 10 years or more will provide you with a pension that will enable you to pursue your dreams in retirement. Long-term wealth is what you are striving for when following a pension strategy and I know of no better method than investing in bricks and mortar in selected countries around the world.



“As long as you're going to be thinking anyway, think big.” - Donald Trump

### Annual Wealth Check

A key element of building a strategy commensurate with your goals and tolerance to risk is the wealth check. A wealth check, or personal balance sheet analysis, is a must before embarking on any investment plan or reviewing performance.

At this time of year many investors, whether in stock or property markets, look back over the past year and estimate their return. However, what I am interested in is the overall return on equity achieved during the period and the potential return over the coming year. If you are doing well with your investments, then the return on your equity will be falling! Ironically, this is both a good and not so good thing.

Successful property investors are continually looking at more and more innovative ways in which to increase their return on the cash or equity they have invested. Let's assume that you

invest in a property valued at £100,000 producing an annual income of £2,000 after costs and tax. If you have an 80% loan-to-value (LTV) mortgage, then you have £20,000 equity in the property.

After one year the capital value of the property increases by 10% to £110,000 and your equity now stands at £30,000.

Whereas we invested £20,000 a year earlier to produce a net income of £2,000, we are now investing £30,000 to do the same. The respective returns are 10% and 6.6%.

If after three years the property is worth £120,000 then the return (assuming other factors are constant) will fall further to 5%, which is exactly 50% less than when we started.

This very simple example, holding all other factors constant, is to illustrate the point that Alfred Marshall so succinctly encapsulates in the quote below:

“Capital is that part of wealth which is devoted to obtaining further wealth.”

- Alfred Marshall (British co-founder of the neoclassical school of economics, 1842–1924)

In a nutshell, we must make all of our equity and cash work as hard as possible to create the wealth we seek in order to achieve our goals. As our equity is working less hard as property prices increase, then we must release it in order to increase the work rate from 50% to 100% and maintain this discipline over time.

**Homework: Conduct a wealth check on your portfolio and private residence. I am guessing you will be surprised at what you find.**

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- Donald Trump