PART 1

The World Property Market – A Beginner's Guide

COPYRIGHTED MATERIAL

There is no shortage of 'experts' when it comes to investing in property. Nearly everyone, everywhere, who bought property a decade ago is sitting on a unprecedented pile of 'dough'. Nominally, that is, of course, because property profit is notional until we cash in our chips. This 'success' has gone to our heads, while few of us did anything very clever to achieve this paper wealth. For the most part, we just rode the wave that swept us further and further up the profit curve. While not many people remember the last property collapse, though 2007–8 may refresh some memories many more are still nursing losses from the stock market collapse that followed the 'Dot Com' bubble burst. The 'expert' investors who rode that wave up have discovered two important facts: what goes up a long way fast can come down just as dramatically; and that they had either forgotten or never really knew the fundamentals that underpin long-term share prices.

Now, there are no absolute guarantees with any investment, except that your chances of success are improved exponentially if you understand something of the forces at work in the market – in this case, the property market. If you really are an expert and your property investments have outperformed the general trend, then skip this chapter. If not, read on.

Property – the backbone of wealth creation

Property has been a worthwhile source of wealth for generations. More private individuals have become millionaires in this way than

by any other route to wealth. Property has the added attraction that financial institutions will actually back your investment as a matter of course, rather than having to be persuaded as is necessary in order to attract funds for other wealth-creation activities. With that borrowed money, through the miracle of 'gearing', it is possible to acquire an asset 10 or even 20 times the value of the ready cash you have to hand. The property investor can then enjoy the growth in value of the whole asset for just a fractional downpayment. Research shows that most people who achieve a comfortable retirement have a large element of property, both in their home country and overseas, in their portfolio. But for most of these property millionaires their home country was the boundary of their domain. Indeed, for some, the Duke of Westminster perhaps being a prime example, their riches were the happy result of owning a few dozen acres of land in an area that became immensely desirable for reasons that had little to do with their own efforts; though it must be said that they have proved adept at enhancing the value of what serendipity provided.

The world *is* enough

The spur to the next wave of property millionaires is undoubtedly the opening up of vast new tracts of the world to the adventurous investor as brought about by the extension of capitalism, or at the very least capitalist-driven economic thinking, and its corresponding policies. Countries that until recently placed restrictions on their own citizens owning private assets (China, Vietnam and Russia, to name but a few) are now opening up their markets so that 'even' foreigners are welcomed both to own property and stay for extended periods, or indeed take up permanent residence should they so wish. For the countries of the former Eastern Europe, removing restrictions on the ownership of property and creating 'functioning market economies' has been part of the price for gaining EU membership. For countries such as Turkey, Ukraine and Albania, the mere prospect, however distant, of EU membership has knocked down barriers that hitherto re-

stricted property ownership. For Vietnam, membership of the World Trade Organization was the prize; for Russia, it was membership of the G8; for China, the Olympic Games; and for Thailand, the need for funds to fuel its tourism-dependent economy.

In a nutshell, the globalisation of financial instruments such as mortgage finance, foreign exchange and international banks, alongside cheap air fares and the richness and 'reach' in communications brought about by the Internet have created for the first time in history a world market in properties open to all. Of course, there have always been individuals and companies who owned property assets overseas, but this has until now been the domain of a very small minority of relatively sophisticated buyers. Spain, France and Portugal for the British and, to a lesser extent, the Germans; Mexico for the Americans; and the Black Sea Coast for the Russians were the first signs that a world market in private property assets was beginning to emerge.

As a consequence, for the first time ever, it is now possible for citizens of almost any country to buy property in another. Not only can they buy property, but that property is very likely to be available at prices a fraction of those currently available in their home market. Those who until now have found either getting a foot on the property ladder or building a property portfolio near impossible will now find an escalator in front of them.

CHAPTER 1

Why Buy More Property?

In this chapter:

- Understanding why property is such an attractive investment proposition.
- Seeing how demographic changes are forcing the pace of change.
- Working out how much you can ratchet up your cash.
- Monitoring enthusiasm for the market.

If you are reading this book then you probably already own a property and you may even already own a second one, either as a holiday home or as a 'buy-to-let' investment. There is nothing new in second home ownership. Wealthy Romans took up residence in spacious country villas on the borders of Lake Como or the River Tiber; in the 17th and 18th centuries wealthy Amsterdam merchants huddled in the city in winter time but spent the summers in their second homes on the border of the River Vecht or in the countryside of the Gooi area. For Swedes, the second home tradition dates back to the 1930s and more than one-fifth of the population owns a second home. What is new is the rapid growth in second home ownership combined with an appetite to buy properties further from the home shores.

Around three-quarters of a million British citizens own a second home in the UK or abroad: a number that has doubled in a decade and looks set to double again over a similar future period. Three million French citizens own holiday or investment properties, putting British ownership statistics in the shade According to the National

Association of Realtors (NAR), Americans bought a record 2.82 million second homes in 2004, and by 2006/7 nearly 10 million US citizens owned another property. Until recently, buyers from the North-East of America looked for second homes in the South, while San Franciscans retreated to Lake Tahoe and Bostonians headed out of town to Cape Cod. Now they are increasingly buying in neighbouring countries such as Mexico and Brazil, and further afield in more exotic locations such as Thailand and Europe.

If you bought your property 3 or more years ago, there is every chance that you are already sitting on a sizeable profit. That in itself might be enough of a spur to look carefully at buying to one or two more. But not only is property a good investment; potentially, it is the best investment, pound for pound, that you could make. If you add in the 'fun factor', the chance to see pastures new and the fact that more people become millionaires in this way than any other, there is every reason to look carefully at adding more properties to your portfolio.

Keeping track of world interest in property

You can see to what extent other people share your excitement in buying a property overseas at any particular point by checking out these websites. Too much exuberance may be a warning sign that a bubble is building up. That may not in itself be a reason not to buy property; rather, a signal to be more careful about where and what to buy.

Office for National Statistics (ONS)

(www.statistics.gov.uk/socialtrends36/)

Social Trends, published annually by the ONS, draws together social and economic data from a wide range of government departments and other organisations to provide a comprehensive snapshot of British society today, and how it has been changing. You can download the full report or select 'Housing' where you can find statistics on the numbers of people buying overseas properties.

Survey of English Housing (SEH) carried out by Communities and Local Government (www.communities.gov.guk)

Launched in April 1993, SEH provides a wide range of information on the housing circumstances of households in England, including detailed information on those households with a second home and the numbers of people either owning or planning to buy a property overseas. The survey now comes under the umbrella of a new government department: the Department of Communities and Local Government was created on 5 May 2006. Type 'Survey of English Housging' into the search pane in the top right of the screen to access the latest data.

The Global Market Information Database (GMID) (www.euromonitor.com/GMID.aspx) **(fee payable)**

GMID, published by Euromonitor, provides key business intelligence on countries, companies, markets and consumers. Subscriptions start from £500 a year, but it is freely available for use in business libraries around the world. It includes: country-specific statistics on demographic, economic and marketing data for 205 countries from 1977 to date; market data (6-year historic market-size data for more than 330 consumer products in 52 countries); as well as 5-year forecasts; and lifestyle indicators – information and models of lifestyle indicators such as eating and drinking habits and of particular benefit data on home ownership trends and crime patterns for 71 countries worldwide. In effect, it draws on over 4,500 market reports for consumer, industrial and service sectors around the world.

Second Homes in Germany and the Netherlands (http://igitur-archive.library.uu.nl/geo/2006-0801-205705/Dijst _ 05 _ SecondhomesinGermanyandtheNetherlands.pdf)

This paper is based on two empirical studies carried out in the Netherlands and in Germany, examining why the scale of second home ownership increased enormously in the last decades and focusing on

two issues that arise from this trend: first, the impact of the residential environment of the primary dwelling on second home ownership; and, second, the impact of second homes on travel. This link is to a pdf download of a thought-provoking article by Martin Dijst, Martin Lanzendorf, Angela Barendregt and Leo Smit of the Urban and Regional Research Centre Utrecht (URU), Faculty of Geosciences, Utrecht University.

Mortgage Daily News (www.mortgagenewsdaily.com/10252006_Homebuying_Second_Homes.asp)

This is a publication by Brown House Media, Inc, with a broad range of articles and research studies on patterns of second home ownership. This link is to a review of a longitudinal research by the US Census Bureau Projections, entitled the Health and Retirement Study (HRS). This showed that slightly more than half of older American second home owners spend 2 weeks or less in their second homes and two-thirds spend fewer than 4 weeks. This, the study claims, perhaps indicates that most of these second homes are held for investment rather than recreation. Only 12.9% plan to make their second home their main residence in the future. The study is longitudinal, so the authors were able to conclude that, of those second home owners identified in the study in 1998, 45% owned only one home by 2004; to extrapolate from that, the typical second home belonging to older households is owned for 15 years before being sold. For the typical second home owner, equity in that home represented 13% of the household wealth.

Increased life expectancy and the demise of guaranteed pensions

The world is reeling from an astounding discovery: 'We're all living longer'. This in turn means that we have to make a better and different financial provision in order to accommodate increased longevity,

which makes it all the more important that we include and extend the role of property in our investment portfolio.

The average American citizen, just as those from Britain, France and Germany alive today, can expect to live 10 years longer than their less fortunate compatriots born 50 years ago. The really astonishing statistic is that half that gain in life expectancy came about in the past couple of decades and was 'discovered' not by the medical profession or by the drug companies who could reasonably have expected to bask in a glow of favourable publicity. Rather, it was one of the dullest professions – the actuaries – who first shed light on the growth in longevity.

Actuaries: life expectancy's bean counters

One of an actuary's responsibilities is to advise employers on how much money has to be set aside to ensure that pension liabilities can be honoured. Today, consultants at the Mortality Investigations Bureau, a working party at the UK's Worshipful Company of Actuaries, say that the average assumption for a man retiring at 60 should be that he will live until 87. In 1950, the expectation was that those retiring at 65 would be dead before their 66th birthday.

Changes in life expectancy are not confined to the UK, or even to wealthier countries: Global life expectancy at birth in 2006 was 65, and is expected to keep on rising, to reach 75 by 2050. In the more developed countries, the projected increase is from 76 today to 82 by mid-century. In the less developed countries that are nevertheless making progress, life expectancy is projected to rise to be closer to that of developed countries, from just under 66 today to 76 by mid-century.

The news is not universally good. Overall figures on life expectancy in developed countries conceal some remarkable regional differences: life expectancy in Eastern Europe since the late 1980s, particularly in the Russian Federation and the Ukraine, has actually dropped and in 2006 was 2 to 4 years lower, at 66.6 years, than it was in 1955. That fact has had some dramatic effects on local property markets as depopulation depresses demand and prices.

The impact of this increase in longevity is having a profound impact on strategies for pension provision. Few can rely on their employers to provide an adequate pension and many are closing down final salary schemes, curtailing benefits and requiring increased contributions. In 2006/7 the FTSE 100 companies – those organisations who, next to governments, are most likely to have the resources to pay pensions – are underfunded to the tune of £60 billion. The state provision of pensions, while looking generous in some countries, is also probably unsustainable. Only in Italy and the Netherlands are state pensions and benefits three-quarters or more of average earnings. In the UK, the USA and most less-developed countries, including Mexico, pensioners can expect to have their income slashed to little more than a third when they retire.

Most of us will have to invest our way to a satisfactory retirement, and property has an important part to play in that process.

Tracking life expectancy

You can check out life expectancy changes and so establish just how long you will need to finance your retirement. You can also monitor changes by country. Increases in life expectancy are usually the end result of better living conditions and improved healthcare provisions, which in themselves also make a country potentially more attractive to buy into. Look out for countries where life expectancy is declining (Zimbabwe's life expectancy has halved to around 35 years in little over a decade); this could signal serious dangers for local property markets.

More ways to convince yourself to buy property

Government Actuaries Department (GAD) (www.gad.gov.uk)
GAD provides advice that affects the pension entitlements of over 3 million public-sector workers in the UK and, in addition, advises the governments of many other countries on similar topics. It is not just governments that rely on their data; the pensions advisers in private

companies often use this service as a default source of information upon which to base their own calculations. Select 'Life tables' from 'Demography'. There you will be able to extract an Excel spreadsheet and a chart showing the life expectancy for males and females over the period from 1981 to 2051. The statistics show that life expectancy increased by an average of around 5 years for the period to 2006 and is expected to increase by 10 years by 2051.

United Nations Population Fund (UNFPA) (www.unfpa.org)
UNFPA is an international development agency that promotes the right of everyone to enjoy a life of health and equal opportunity. Their research studies help countries in using population data for policies and programmes to reduce poverty. Their latest study 'The State of World Population' can be down loaded in PDF form by selecting the icon with that heading from the top of the home page. The data makes for startling reading. From the report you can find the life expectancy statistics for all countries individually and by continent and state of development.

Organisation for Economic Co-operation and Development (OECD) (www.oecd.org)
The OECD was founded in 1961 as the successor to the Marshall Plan-inspired Organisation for European Economic Co-operation (OEEC). Today, it has moved beyond a focus on its own 30 member countries and is setting its analytical sights on a further 70 or so countries, between them accounting for over 90% of the world's market economies. The Organisation is, for example, putting the benefit of its accumulated experience to the service of emerging market economies, particularly in the countries making their transition from centrally planned to capitalist systems. It is also working increasingly with dynamic economies in Asia and Latin America.

Select 'Browse by topic' from the left-hand vertical menu, followed by 'Aging society' from the central menu. Once in that area, click on 'Pension systems' in the left-hand vertical menu box. From here, you

can search statistics, publications and documents and information by country.

Property as an investment

A sound investment should meet four criteria. It should:

- have the capacity for being profitable
- be reasonably secure
- have a ready re-sale market
- produce cash flow during its life.

Capacity for being profitable

This doesn't mean that the investment has to be profitable – anything to do with making money involves a risk that events won't pan out as expected – just that it could be. Perhaps the most vivid example of this is what happens to your money when you buy a new car. The day it leaves the showroom, its value drop by up to 20% and within a year it could be worth as little as half its cost. That fact doesn't seem to deter nearly 2.5 million people a year from buying new cars in the UK.

Reasonably secure

In other words, money should be put into assets that generate value for customers and markets. Pyramid sales schemes are a good example of 'investments' that fail this test, as most of the money potentially to be made comes from recruiting more salespeople rather than selling any real product.

Ready re-sale market

You need to be able to get out of as well as get into investments, as you may need your money for some other purpose or have spotted an even better investment.

Produce cash flow during its life

Wine, art and jewellery don't meet the last of my tests, but that's not to say that you shouldn't buy them, just as it isn't 'wrong' to buy a new car, if that is what you want. Stocks and shares, bonds (loans to companies and governments), bank deposits and property meet all these criteria.

Property around the developed world has appreciated in value by an average of 85% in the 8 years to 2007, according to *The Economist* magazine's Global House Price Index. Since records began in 1973, UK property prices have risen 16-fold while returning an average of around 6% in rent to landlords. (See Part 2 on evaluating economies for more on tracking property prices.) Over 2.2 million people buy a property each year in the UK, taking 10 weeks on average to find a property and have an offer accepted. It takes a further 20 weeks to complete the legal processes, according to statistics from the Office of the Deputy Prime Minister (www.odpm.gov.uk).

> So, from this information you can see that, by any standards, property looks like a sound investment proposition and one that Senior People Enjoying Affluent Retirements (so-called 'SPEARS') have latched onto. According to research carried out by Brewin Dolphin Securities (www.brewindolphin.co.uk), the largest independent private client portfolio manager and stockbroker in the UK, property at home and abroad is where they keep the bulk of their investments (over £80 billion is held in property, compared with just £70 billion in shares, bonds and unit trusts) and so they can fund that affluent retirement.

Understanding the gearing effect

Gears ratchet a small wheel to a larger one to make something (a car, usually) go faster. The larger the relative difference between the size of the wheels, the faster the speed. Financial gearing used to buy assets such as property has much the same effect. In this case the small wheel

is analogous to your cash and the large wheel to any money you borrow. The more you borrow, the faster you can make your money work.

If you were a high-flying sales executive who had pocketed a £20,000 bonus in 2004 and put it in the stock market across a spread of shares to track the market average, you would have made a whopping 74.5% return over the 3 years to 2005. Realising your investment would see you with a cash pile of £34,900.

According to the Nationwide Building Society, over the same period, had our executive invested in property he would have made just 36.92%. Looks like the stock market would have been a better investment, at least over that period. In fact, if you go back as far as 1973, stock market returns averaged 11% while property delivered 9%. No contest: stocks and shares deliver better returns.True: if you had picked Wales or Latvia to buy your property in, you could have made a 56% return, but then you might have gone for London where prices have risen by just 18% over that period.

But before you toss this book aside and back out of the property market, let's see how the deals work out in reality. In 2004 there were no properties on the market for £20,000 and the average house price was around £180,000. What would have happened had we bought a bargain property costing £150,000, using the £20,000 as a deposit and getting a loan or mortgage for the balance of £130,000? Incidentally, property is the only type of investment that you can borrow to buy without offering any other collateral. According to the Nationwide records, our house costing £150,000 in 2004 would be worth £205,380 in 2007. We would have paid out £7,800 a year in interest at 6% to whoever lent you the £130,000: a total of £23,400. So, you are a net £181,984 (£205,380 minus £23,400) better off than back in 2004. You are also more than 5 times better off in buying a property (£181,984 divided by £34,900) than you would have been had you gone into the stock market.

The magic that has turned a seemingly lower total return over 3 years (properties at 36.92% versus the stockmarkets at 74.5%) into a much higher return of 108.77 % per year is known as 'gearing'. When you buy

a property using borrowed money, you enjoy all the increase in value but only have to put a fraction of the cost down at the outset. Simply put, over this period the property investor has got a return of 36.92% on money thatcost only 6% (the average mortgage rate over the 3 years). This works in much the same way as the gears on a car. Changing up gears enables you to go faster for any given amount of power.

Checking out gearing and profit returns

The following websites will explain the thinking behind financial gearing and provide tools to measure the profit returns you can expect for various levels of personal investment compared with amounts borrowed.

1278 Software Systems (www.1728.com/compint.htm)

On this site you will find a range of calculators. This link is to the compound interest calculators where you can work out the return for any other property value, time period or interest rate.

Business Balls (www.businessballs.com/finance.htm)

Businessballs (launched as Businessballs.com at the end of 1999) is a free, slightly quirky learning and development resource for people and organisations: on it, you will find a fuller explanation of financial gearing.

Standard Chartered (www.standardchartered.com.sg/cb/pb/financialtools.html)

Standard Chartered first opened for business in Singapore in 1859 and today operates the largest branch network (20) among international banks in the Republic. This link is to a number of financial calculators including the Standard Chartered Gearing Calculator that provides a

framework to measure how much financial risk and exposure your current, as well as future, borrowings are against your current assets and reserves.

FIDO (www.asic.gov.au/fido/fido.nsf/byheadline/Reverse+mortgage+calculator?openDocument)

This calculator lets you test how your choices about borrowing money to finance an investment in property will affect the returns you can expect to make over the longer term. The key word here is 'expect': the calculator cannot predict how your personal situation will actually work out – it will just show you what will happen if your assumptions pan out. But by trying out a range of assumptions, you can spot danger points. For example if your investment decision only delivers the profit returns you want if the interest rate on borrowings doesn't exceed 6%, then you have to assess what the chances are of that event occurring are.

The FIDO reverse mortgage calculator on this website shows the effect of decisions you may make about:

- how much you borrow
- whether you take an initial lump sum, or arrange regular income payments or a combination of both
- how long you borrow for
- interest rates and various fees.

It also shows how your home equity may be affected by future changes in the value of your home. You can:

- select a low, medium or high rate of increase in value (these rates are based on advice from actuaries), or
- choose your own rate.

Of course, you must consider your own circumstances carefully when using this calculator, and you may need expert advice.