

## New Properties versus Older Properties

Which investments work better and why.

A lot of people will feel personal pain with what I am about to say. For the last 5 years I've been telling people this, yet I see the same mistakes and emotional decisions which ultimately lead to financial pain, or even ruin

Pre recession I was very anti any new build. It never worked. With hindsight I think I went a little far in being negative about it but because of my experiences (and those of quite a few colleagues) of topped up prices and low yields - I couldn't see a reason to invest – other than it looked like an easy purchase without too much complication. My instincts rarely lead me to a place where easy and profitable coexist, something that this appeared to be

As we went into the decline in '08 I felt sure that I would be knocking on the door of a new build deal come the end of the year, when the prices became more realistic. The papers were talking of banks getting physical with builders as loan to value and interest cover covenants were breached as the market sank

Most of the nationals were taking a good kicking on the stock markets with Barratt dropping to around 40p and a talk of a cash crisis at Taylor Wimpey and Persimmon rarely out of the news. As they were dusting off their early 90s "what to do in a recession" manuals I felt sure that we would be able to pounce on some local stock that they needed rid of (as it would need to be round here for us)

Distress with the smaller builders was more obvious and perhaps immediate. I saw a number (and still do) going into admin with an LPA receiver being appointed with say 24 units on site, need a little finishing which are open to bids

As I negotiated, discounts emerged; it didn't take too long for 40%-50% reductions over 2007 list prices to arrive. But when most of the stock was trading for 20% below list in volume to investors pre crash this moves to a real reduction of 20% off market – which in itself is ok, but this is probably what the wider market dropped by anyway

Clearly a decision to invest is a lot more than just about cheaper stock. As people realised why 'old school been round the block' types had been banging on about yield and cashflow for so many years (strange it took events like this to remind everyone) people started to look more closely

I've been saying this for five years but people still don't get it, so let's look at the facts: the figures. 3 bed houses from a major developer in our area that would list at around £165k pre recession could be had for £105k in volume last year. A reasonable chunk off you might say. Rent would be around £600 pcm which is £7225 annually divided by £105,000 to give a gross yield of 6.9%. Say costs are about a third of the rent (as I realistically think they are) you would have net yield before finance costs of roughly 5%. If you managed to leverage this to 75% of £150k and paid 6% on a fixed rate I think you would be in negative cashflow by around 1% of the sum financed – around £1000.

Take a similar deal which I was offered (one of the best I was offered) on a 2 bed flat. Gross price pre crash would have been around £150k, if buying 5+ you could access these at around £85k. Rent is around £550 which is £6900 yearly – just over 8.1%. The main issue with these units in my opinion though is the ground rent and service charge – around £1000 a year... So £6900 x 70% minus £1000 =

$\pounds 3830 / \pounds 85000 = 4.5\%$  net yield. With  $\pounds 85k$  worth of finance at 6% fixed your cashflow would be in the red by  $\pounds 1250$  annually

I have to compare this with deals where you can buy a little terrace in the midlands for around  $\pounds 60000 + \pounds 5000$  refurb =  $\pounds 65,000$  which would rent for  $\pounds 540$  pcm or 9.9% gross yield giving net cashflow of around  $\pounds 650$  annually, an improvement of at least  $\pounds 1650$  per year –

AND there will be no new build premium, so the small terrace will likely appreciate more in the first couple of years.

I frequently get people telling me that new build is so good because of reduced maintenance costs and because of warranties. It's BS and most of the time they're just defending their mistakes or they haven't had enough experience yet. That's why I bought them in the early days: I thought they were easier and I know a lot less than I do now.

Our average maintenance cost per property per year on a 20 year old+ unit is  $\pounds 350$  (although we budget  $\pounds 500$ ). On new builds our data shows it is actually higher at more like  $\pounds 550$  as we find the boilers go wrong more (not made like they used to be), the tenants are fussier and make more maintenance calls and new build flats often have white goods which cost bucks when they go wrong!

Lots of people also repeat the "properties in nicer areas appreciate better" line. This is an emotional based comment, not one backed up with real evidence. Looking back over the past 20 years at sold prices amongst ex council stock, Victorian and new builds in East Mids, I have found that price growth has broadly been equal in percentage terms. After all, without any regeneration or structural change areas will generally remain as attractive in comparison to each other, in broad terms.

Therefore the relationship between them in price terms shouldn't change with everything else being equal. New builds bring in an added dimension – like a new car they actually depreciate when used. You may notice that ones that have been lived in are cheaper than the new ones being offered by the developer. This is because the product is now soiled, and you can't personalize the colours, curtains, kitchen and no longer has the perceived backup and marketing machine that the developer can employ.

This usually means that the new build will miss out on around 10% of any market growth as the slack is taken up from its initial drop in value.

I'm not saying new build doesn't work; you just need a real 50% discount. It works when you can drag the purchase price down far enough and the yield works, it's just more of a gap than you need when dealing with existing units.

People think that 'bulk buying' or 30% off RICS is a deal on new build – don't fall into that trap: it's marketing, and it will cost you financially and emotionally

*Rob Moore & Mark Homer, Your Property Network, Jun-2010*