

WEEKEND MONEY

& MEDIA REVIEW

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Good time to lay the foundation for a property portfolio

THE property market is not a favourite among investors at the moment, and can at best be described as challenging.

Experts say this will be the case for at least the next 18 months. But the present might just be the right time to prepare for what comes after those 18 months.

The question then is, how does one build a property portfolio? Where do you start and what strategy should be followed?

I suppose perceptions about this differ, but there are basic principles that cannot be disregarded.

Here are some points to ponder when considering a good property portfolio:

■ There are different types of properties to invest in; this should be thoroughly analysed.

Diversify the types of assets you invest in: consider residential, commercial, industrial and combinations thereof.

Also consider developing areas versus developed areas, coastal properties or student villages.

■ Invest in a property portfolio that has the potential to generate cash flow – think of a vacant stand, compared with a flat that is rented out.

The income has to be able to escalate to keep up with inflation. This means that you build annuity income, which cannot be depleted by inflation or rising costs.

■ Start with a smaller investment which has the right location and price, but which will not be a burden on the cash flow.

■ Although rate of return is a topic on its own, your property as an investment should show a return comparable to, or better than, the stock exchange and other constant, long-term investments.

According to Absa's July market report, the growth of residential properties, measured against gross internal rate of return, has exceeded that of the stock exchange, money market and the inflation rate by far with a yield of 24%.

During the past five years the growth rate was 30%.

Let's consider the principles: the first basic one is patience.

There is no short cut – an income-generating portfolio that disposes of sufficient equity is built up over a few years.

Trying to speculate with properties in the short term may not only be dangerous, but can also lead to impetuous investments.

Such a strategy might work for some, but it also holds certain risks. For example, in the current economic climate, where markets are swinging downwards in terms of sales and house prices, the market has become so illiquid that even good properties are struggling to sell.

The problem then is that a shortage of cash flow can compel you to sell your property at a very low rate of return.

This is where the second, and probably the most important, principle is applicable: location.

Location has a direct effect on the growth of your asset.

If you find yourself in a



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situation where you are forced to liquidate some of your properties, this principle is particularly important and it is most probably the first aspect that a potential investor or buyer will look at.

The third principle is: do not invest in something that you do not understand.

This is also one of Warren Buffett's major principles.

It is simple, yet it is one of the biggest mistakes investors make. How often do we get carried away by good selling techniques and panic purchases? It is sometimes difficult to control the impulse, but when it comes to investment decisions, emotions should not play a role.

Principle number four is to do the (interest) maths.

By doing simple income and

expenditure calculations, you can determine your monthly cash flow surplus or deficit.

You can also establish what bearing interest rate increases will have on this.

Do a "stress" test; determine the break-even point and forecast the growth in property values.

By doing so you can, in good time, decide your interest rate strategy – when you should fix the rates, take options and go linked.

In many cases, investors are scared to fix rates. The timing will never be perfect, but it is important to reinforce a portion of your portfolio.

The fifth principle is to position your portfolio within the correct entity. Is it a trust, a close corporation, a company or even in your personal name?

When you come to a stage where you want to run the property portfolio as an independent, income-generating entity you will have to decide in advance what structure you are going to purchase and trade the assets in.

Income and capital gains tax, estate duty, transfer costs and other factors also need to be taken into consideration.

Finally, it is important to lever your portfolio correctly, always within your cash flow potential.

Make use of expert, independent, trusted consultants to give you good advice before you make decisions. To try to cure an error afterwards can cost you dearly.

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