HOTSPOTTING WITH MICHAEL FULLER

Invest for less than the bank valuation

A majority of investors follow the pack, but for those in the know, off-market opportunities can provide a healthy boost to their investment portfolio

Upon hearing about a new off-market opportunity, I received a call from an investor called Cathy, who said, "Michael, what's the catch? It seems too good to be true." I realised Cathy was sceptical, just like so many investors these days.

You see, this opportunity offered a discount of $80,000 against a bank valuation of $400,000 for a brand new townhouse in a location tipped by many to be the next Gladstone – without the reliance on mining.

With this in mind, Cathy continued, "If the bank says it's worth $400,000 and it's in a desirable location, why on earth would the developer give away $80,000?"

Before going into some detail, I first asked, "If you buy a new property (off-the-plan, for example) and you are promised an upfront cash profit of $80,000 in return for putting down a small deposit of five or 10 per cent – and the property is in a solid location – then is this too good to be true?"

We agreed nobody could offer a 200 per cent-plus cash-on-cash return – that is too good to be true! So I explained it in the same way the builder and developer who is offering the $80,000 in instant equity put it to me when I first started my investigations.

"If each investor puts in $150,000 to settle the land, I can then build four townhouses on it and still make my usual 15 per cent builder's margin," he explained. "Each investor can keep the developer's profit, save on stamp duty and save on paying the selling agent's commission. I create these benefits for the buyer for one simple reason: I can take on 10 times as many projects without having to go to the bank for money to settle on the development site, and I make myself more money in the process."

ALWAYS DO YOUR RESEARCH BEFORE JUMPING INTO 'PASSIVE' DEVELOPMENT OPPORTUNITIES

PAYING MORE FOR MARKETING HYPE

I explained to Cathy that 99 per cent of investors buy on emotion that is heightened by expensive brochures and slick salespeople in overheated markets.

Who pays for this marketing hype? The retail investor does, and the cost is buried in the purchase price.

In this scenario, the builder and developer quickly discovered that taking on 10 times more projects without the headache of dealing with the banks and looking for retail buyers was just too good to pass up.

And that's when Cathy realised that putting up $150,000 to save 20 per cent on the typical retail price by stripping out costs like stamp duty, selling agent's commission and the developer's profit is a fair and equitable exchange, rather than something that is too good to be true.

I then mentioned that two major banks approved the model and happily funded the construction and took out finance

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because for them, it's low risk. They are funding a project that is 100 per cent pre-sold to investors, the land has DA approval and is ready for construction just before they tip their funds in, and on completion they get four mortgages, as most investors choose to hold.

Best of all, these new customers have an immediate 20 per cent buffer in place (retail price less cost price) and have put 'skin in the game' ($150,000 of their own money). If the investor chooses to leave their initial investment in, the borrowings against the property drop to around 42 per cent. If they re-mortgage out their $150,000 upfront investment, they're still left with 20 per cent equity and no need for lender's mortgage insurance. They've effectively 'manufactured' the deposit and can repeat the process.

Self-managed super fund (SMSF) investors also win by knowing they have an immediate capital gain of 20 per cent in a smaller, more desirable boutique complex appealing to tenants and owner occupiers alike. These smaller complexes tend to attract better rental yields and higher resale prices.

"THEY'VE EFFECTIVELY 'MANUFACTURED' THE DEPOSIT AND CAN REPEAT THE PROCESS"

So I said to Cathy, "You can see why it's not 'too good to be true'… you need $150,000 to play this game and you need to know the right people to make it happen".

I then cautioned Cathy by saying that to make this work, the numbers need to be realistic with particular regard to the 'as if complete' valuations that form the basis of the profit margin.

NOT EVERYONE WINS…

The selling agents admittedly lose out and so does the traditional developer. Are they worried? I don't think so because most investors follow the pack – a majority of investors pay inflated retail prices after responding to the marketing hype that selling agents are paid to drum up.

There is, after all, a reason why only one per cent of property investors own multiple, positively geared properties with good capital growth upside.

That said, this strategy is not for everyone. At hotspotcentral.com.au we see these off-market opportunities all the time and recommend a select few.

Before jumping into these 'passive' development opportunities, get educated so that you can make an informed decision. You could start by viewing an online presentation detailing the mechanics of these opportunities. Visit www.hotspotcentral.com.au/whammy ■