Risk, what you really need to know. And why you should be wary of headline-grabbing capital growth figures.

Poland Property Investment Summary

Market:	Utska, Urban - Warsaw, Krakow, Wroclaw, TriCity, Poznan, Lodz. Resorts
Opportunity:	Off-plan. Mid- market
Rental Market:	Emerging rental market. Net yields, 4% to 6%
Investor Finance:	80% LTV over 20-30 years. Zloty - 6.5%; Swiss francs 3%+; €4.5%
Politics & Economy:	Politically stable. Low taxes. Export driven economy.
2006 GDP Forecast:	4.4%
Property Secrets' Verdict:	High long term capital growth. Need to cashflow in the short term. Low risk.

Article Rating : ★★★

There are actually three kinds of risk:

- risk you can't mitigate. That's simple. It's just risk, plain and simple, and it cannot be reduced. It's the unknowable, like a straight gamble.
- risk of playing ultra safe - which is essentially the risk of doing nothing with your money but sticking it into an interest-bearing account.
- risks that you can mitigate.

Obviously, there's little to say about the first kind - risk you can't mitigate. That's for gamblers - and property investment isn't - or shouldn't be - about gambling.

No, I want to focus on the other two kinds of risk - that of doing nothing and that of mitigating - or managing - risk.

And here's the first surprise: the risk of doing nothing - or taking the 'safest' investment

route - actually turns out to be the riskiest option of all!

Riskiest, that is, unless you mind being poor when you want to use your investment proceeds to fund your retirement.

Let's suppose you are 40 years old and you have a pot of £20,000. What might be the very safest (i.e. least risky), option for that money?

Put it on deposit in a bank? Inflation equals 2%, your net interest keeps up with inflation. You're okay, right?

But ask any pensioner who has an index-linked pension and they'll tell you how they feel poorer each year, even though the money they receive is keeping pace with inflation.

And it's not just perception - they really are poorer - relative to most people around them - because if your investments are only keeping pace with inflation, then you are gradually moving down the pecking order in terms of spending power.

And that's simply because wages historically outpace inflation.

It really boils down to the old adage that the greatest risk is that of not taking any risk at all.

So, for anyone who wants to increase their wealth beyond a rate that will gradually see them slip to the bottom of the spending power league, the safest option is really not an option at all.

Risk you can mitigate

So, let's turn to risk you can mitigate because this is where property investment becomes so exciting.

And it's also why, if you apply risk management rules, you can invest in property in central Europe's emerging markets, say, as easily as buying a buy to let in another part of the UK from where you live - for the same amount of risk but much greater potential returns.

The main risks of entering an overseas market are twofold - it's a foreign country in which you don't speak the language, and you don't understand the law.

If you go in blind, without researching the market, you'll be seen coming a mile off and you can guarantee you'll overpay for property....or be ripped off.

This isn't unique to overseas markets, though. In the 90s cash rich southerners paid through the nose for worthless northern investment properties.

In fact, this risk is faced by anyone whenever they step outside their local market - unless they do their research first.

And, if you do your own research, you will have to either spend thousands of pounds or spend huge amounts of your own time.

The answer is to pay someone to do the research for you, find the right property deal and legal services.

And when it comes to legalities abroad, it is so important to have on your side an English speaking lawyer who is the best in their business.

Unlike the UK, this does not need to cost a fortune - in fact in central Europe you might be talking about €100 to €150 an hour for the best, perhaps a third of the cost of London lawyers.

And when you hire affordable high quality legal advice, perceived risk turns into highly mitigated risk.

Here's another way of mitigating risk - valuations in central and eastern Europe are also considerably less expensive than in the UK and the Netherlands. - OK, they're perhaps not so rigorous, but they are still excellent guidance, and, again, amount to risk reduction.

The key then is to stop acting emotionally and see instead if, as they say, the numbers stack.

The greatest risk in property investment

The very biggest risk with property investment is acting like someone with a wad of money in your pocket who has to invest it by Tuesday!

If you enter into a property market that you don't know and without doing the research you are likely to get hammered regardless of the country.

The property investor who separates himself from hype and fashion and thinks about the basics will always double, triple, even quadruple their chances of succeeding.

And one way of considering the basics and reducing risk by the greatest amount is to look at any potential investment in reverse.

Here's what I mean.

Exit strategy is key

Start by considering not discounts, not apparent cheapness, not guaranteed rentals, etc, etc. But consider instead your exit strategy.

In essence this amounts to a simple question: If I had to sell this property tomorrow, who would buy it and who would sell it for me?

If you buy the right kind of property in the right place at the right price then it doesn't matter if that property is in London, Warsaw or Madrid.

Suddenly, you'll stop seeing Warsaw as 'riskier' than London or the North East. Instead, you'll be asking if the property in such and such a district is priced right and will appeal to the growing middle class market for subsequent rental and resale.

Interestingly, the chances of selling into a rising property market are much greater in Warsaw and other parts of Poland (Ustka) than in many other parts of the Europe.

And that makes them less risky than you might think.

If you look at city centre markets, or markets attractive to retirees/ residential tourists, you have your exit strategy AND know who your prospective tenants will be.

Think about it, though - I've heard people enthusing about off-plan deals along the coast of Poland and I've heard talk of the next big opportunities - Turkey, Morocco even Panama!

But who is going to buy these properties from you, and how? There is no credible exit strategy. And who is going to rent them and how? Are cheap flights available? Is there a developed infrastructure? If not, forget it.

By the way, the expectation that a bunch of estate agents will come along and set up shop next to the new 1,000 villa development on the desert is pure speculation.

If they haven't already arrived, you would be wise to assume that they may not arrive for another 10 or 20 years.

Hot new markets - warning!

Let me tell you what is happening in so many of the so-called hot new markets.

In the 70's and 80s, when the boom in Spanish property began, timeshare salesmen flocked to the scene and they used what are now familiar tactics to sell.

They took large groups of people to a location, basically locked them in, plied them with booze and didn't let them go until they'd signed on the dotted line.

But you know what, although we all know about these tactics - they still work, and they're being used to flog off-plan in many markets that simply don't stack up in investment terms.

And you want to know what might happen if you don't do your homework and invest recklessly in somewhere like Poland (Water Gardens, Resident Park, Grabno)?

In the Costa del Sol there is a company called Spanish Property Auctions. Basically, they sell properties for people who didn't think abut an exit strategy, and as their advertising literature says: the bulk of properties sold at auction are sold at a discount. Great, if you're buying, perhaps, but not so attractive if you're selling.

Here are some examples: nice 2 bed apartment, bank valuation €250,000, reserve price, €170,000.

Here's another: valuation, €145,000, reserve price, €120,000.

You get the picture. They're potentially being sold below bank valuation.

If you don't have an exit strategy, this could happen to you!

And, you know what, I reckon these auction guys will be setting up shop on the Polish coast in the very near future!

Forget cap growth - think ROI (return on investment).

Once we've got risk in perspective, we can start to understand some of the ways of assessing an investment.

And here's something NOT to do. Do not be blinded by headline capital growth figures.

I come across so many investors who are excited about headline capital growth figures. They read that property in Poland, say, has shot up by 28%, maybe 50% in a year.

This, they argue, is proof that this or that market is the place for be for great returns.

And yet notice that just then I said *'the place to be for great returns.'*

This is the real key - **return on investment.**

The return IS dictated by capital growth but also by **how much you need to put down to grab a piece of the action** - that's the investment part, and it's the crucial element of investing.

It is why we at Property Secrets always concentrate so heavily on what finance is available in a market.

Here are some examples showing how gearing works AND how even accelerated capital growth cannot compete with moderate growth on a highly leveraged investment.

Effect of mortgage gearing		
	Joe	Tracy
House Value	£100,000	£100,000
Mortgage	**£80,000**	**£60,000**
Own money invested	£20,000	£40,000
Increase	£10,000	£10,000
Their % gain or ROI	**50%**	**25%**

While, of course, in the example above, both investors made the same amount of money, if we assume they have the same amount to invest initially, then Joe has another £20,000 to put down on another investment and replicate the returns of the first.

Now look what happens:

Price	10%	20%	Market	Loan to Value available	Initial Investment	ROI at 10% growth	ROI at 20% growth	Order
£50,000	£5,000	£10,000	A	90%	£5,000	100%	200%	1
£50,000	£5,000	£10,000	B	75%	£12,500	40%	80%	2
£50,000	£5,000	£10,000	E	70%	£15,000	33%	67%	3
£50,000	£5,000	£10,000	C	0%	£50,000	10%	20%	4

Joe has made double what Tracey has using the same amount of investment capital.

OK, so that's gearing.

Now see how it works over a wider spread of markets or LTV scenarios:

Effect of mortgage gearing on the potential gain		
	Joe	Tracy
House Value	£100,000	£100,000
Mortgage	£80,000	£60,000
Own money invested	£20,000	£40,000
Increase	£10,000	£10,000
Therefore % gain	**50%**	**25%**

If Joe used his money to buy one more property:
Joe's 2nd Property
£100,000
£80,000
£20,000
£10,000
50%

Which means what?

Well, as the table shows, in market A, if property grows at 10% in one year, your ROI on a £50,000 property would be a very attractive 100%. To put it another way, if your investment is cash positive, you double your money in one year with just 10% growth.

In markets D and E you will need to invest £15,000 because you can only borrow up to 70% of the value of the property.

This means that with 10% growth your profit will be £5,000 or an ROI of 33%, rising to £10,000 or 66% ROI with 20% growth. Both are still way behind the figures for country A in percentage terms.

Nothing Down is best then? No!

So, the conclusion of this is that if 100% mortgages are available, you should use them, right? (This is also commonly known as Nothing Down).

Not really?

When you consider 100% mortgages - forget the idea of nothing down. It doesn't exist in reality!

When you make an investment with a 100% mortgage, you invariably are deciding to cashflow your investment.

In other words, you have a choice - you can either choose to put up the money for a deposit and therefore reduce the receipts you need each month to fund your investment.

Or you can choose to put less money down and cashflow the investment; in other words, fund the shortfall each month between rental income and loan repayment.

At the end of the day, both options amount to the same thing - the profit earned will be the same. Although, in most cases, if people have a lump of money, they will choose to use it as a deposit rather than to cashflow an investment.

This is especially true when investors buy overseas. The amount of perceived risk will probably dictate the maximum percentage of an investment a person feels happy borrowing.

So, for example, an investor will be happy to accept a higher LTV (loan to –values) when buying in Poland, simply because the central European market is less familiar and therefore the perceived risk level is higher.

The actual level of risk, though, is often in reality not higher at all.

In my experience of helping investors, I've found that the comfort level for most people in Holland is around 85% LTV, and in east Europe it's less - around 75% to 80%.

But, of course, as these markets become more familiar to investors, that comfort level will rise, available LTVs will rise too, and therefore so will ROI.

We work hard to find deals that offer maximum capital growth to our clients. And when new analysis shows that our investors are making gains that are often way beyond the market average, we consider it a job well done!

Kind regards,

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