



The future of investing to let

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Is South Africa's buy-to-let property market still a sure thing? Smart buyers are finding that profit may not be a foregone conclusion but good research can still yield results

So far 2016 is shaping up as the year of the financial yo-yo, with economists trailing movements by local politicians and credit rating services, and struggling to deliver solid long-term investment advice. The potential impact on the property market is slightly unnerving.

What message can you take to a potential buy-to-let (BTL) client? Are there "better, cheaper and smarter ways to make money from property investments," as Magnus Heystek, director and research head at Brenthurst Wealth Management, unequivocally suggests? And is it telling that he describes himself as the "original residential property market bull many years ago"?

Heystek's recent Moneyweb article titled '**Buy to let has become buy to regret**' elicited a vociferous response, most respondents concurring or adding their own experiences.

Said Heystek: "A perfect storm has now hit the buy-to-let market and literally tens of thousands of investors countrywide, perhaps with the exception of the Western Cape, are, according to one buy-to-let owner, 'slowly being squeezed to death by a giant financial anaconda'. Rates and taxes have been rising on average at almost double the inflation rate per annum over the past five years and more." Heystek is of the view that under current economic and political conditions in South Africa, BLT could prove to be "very costly" to your clients' personal wealth.

CONSIDER THE CURRENT MARKET

Historically in South Africa, BTL has been considered a good investment: buy a rental property with a small deposit and large mortgage. Then rent it out, the tenant pays off the mortgage and with regularly increased rentals, covers all the costs and more. A decade or two later, the bond's paid off and investors can either live off the rent or sell for a tidy profit. What's not to like?

During the 2002-2008 residential property boom BTL moved from a fringe investment vehicle to a near trend. Says Heystek: "Such was the allure of BTL that at the peak of the market in 2008, almost 25% of all South African residential property sales were in the BTL category, according to FNB."

Today he estimates that figure to be less than 6% (with commercial banks tightening on granting of bonds) and likely to reduce further in months ahead. Adds Heystek: "As properties get older, maintenance costs rise while property values themselves – both in real terms and in some cases in nominal terms – decline. Since 2008 the residential property market has declined by about 20% in real terms and is still firmly in a bear market."

PROCEED WITH CARE

When it comes investing in BTL property there are numerous variables but two factors are crucial; one controllable: the extent of prepurchase homework. The other is not: the bond rate.

Seeff Properties chairman Samuel Seeff advises caution. “While property is one of the best investments and it carries an inherent propensity to deliver capital growth, investing purely for the BTL market should be done with great care. There is no one solution that fits all and while there is usually significant demand for rental accommodation – especially during challenging economic times – not all properties or areas experience the same level of demand. The property in which [clients] are thinking about investing may not be the type that attracts tenants: too expensive, wrong area ...” he says.

Importantly, advise potential buyers to consider their options before making this type of investment. Says Seeff: “If [buyers] are looking to diversify [their] investment portfolio to add property into the mix, then it may make sense. But don’t expect stellar returns as a matter of course. With the economic decline that we are seeing right now, the rental returns (yields) are likely to dip again, not just in the non-Cape markets but even in the Cape.”



DO PROPER RESEARCH

Clearly, the more pressurised the property and financial landscape, the more thorough the homework required. Paul Stevens, CEO of Just Property, offers these pointers for your potential BTL investors: “Buy the property that is most ‘lettable’ (has the biggest tenant market). Two-bedroom houses/flats appeal to the widest range of potential tenants – avoid large family homes. Don’t restrict yourself to your immediate area but research nearby where rental yields may be markedly better. Ensure the area has a healthy market for tenants – convenience and accessibility (transport links, schools and retail) are priorities.

“Using a mortgage makes your money work harder. Whether interest-only or repayment is your decision, but a rental income high enough to cover a repayment mortgage is a good indicator that you are getting things right. Take out a fixed rate if you are uncomfortable about the chances of interest rates rising, although you will pay a premium.”

CHANGE THE FOCUS

Heystek’s unbundling of the topic provides much to think about. He references the Rental Monitor Q4 2015 report on credit bureau Tenant Profile Network’s website, the upshot of which is that 30% of tenants

typically pay late or not at all. He says this gets to the heart of the current problem: "Rental growth has been slowing for almost three years and in some parts of the country has become hugely negative. Apart from the Western Cape, property prices and rentals are not rising but costs and the hassle factors are.

"Listed property investments have been the best investment class over the past 10 years, returning almost 20% per annum year after year. The difference in net wealth over the same period between a BTL investor and JSE-listed property investor or, even better, a global fund, must be enormous today."

Myles Wakefield, CEO of Wakefields Real Estate, has a clear-cut, analytical approach to investing in BTL. "Capital growth isn't the focus, it's the bonus. The focus is on covering costs from day one. But it's also about reviewing the concept of location," he says.

Just as the country's demographics alter, so too the property market: there is a vast emerging market looking to rent or buy first homes in so-called entry-level suburbs. According to Wakefield, these are the areas experiencing the highest letting and sales interest and volumes.

While not everybody agrees on the value of BTL as a long-term investment, there is consensus that BTL is for clients who are in it for the long haul.

BTL INVESTING TIPS

From Myles Wakefield CEO, Wakefields Real Estate

- Buy only where there is a constant and keen demand. Is there a factory nearby, a college, great transport routes? There is a vast emerging market looking to rent or buy first homes in so-called entry-level suburbs.
- Be an informed rental agent. Your clients are entitled to ask about figures achieved for similar apartments in the block/area. Make sure there's a match between purchase price, achievable rentals and demand.
- Help buyers do their sums. Work out mortgage bond figures: will the rental cover their costs, with a little residue for emergencies and possible bond rate increases? Keep a record of all expenses for tax purposes.
- Be cash-flow positive from day one. Include a steady annual increase in rent and find a fully vetted tenant.
- It's all about the numbers. Your client needs to cover their costs and manage the investment well. Long term – provided the bond rate doesn't increase sharply – chances are that capital appreciation will come into play.

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