Pitfalls to Avoid when Choosing a Real Estate Investment Partner

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Nowadays, with so many companies leveraging the internet to inflate their presence, it is vital that real estate investors align themselves with a trusted partner. In 2012, property scams in the US were the third largest type reported to American Consumer Credit Counseling (ACCC), causing more than $10bn worth of losses. It is therefore critical to learn to spot these scams early. Here are the most common warning signs the real estate investor needs to be aware of:

YOU'RE PROMISED AN INFLATED CLASS "A" CASH RETURN: There are some Class "C" real estate investments that advertise high scheduled rental returns north of 15%, but these typically hold higher risk investment properties, with poor tenant profiles, leading to possible long vacancy periods and costly turnovers. Do not believe promises of an inflated yield on a Class "A" development if your in-depth market researched show returns to be in the ballpark of, for example, 6-8%. If it looks too good to be true, it probably is.

INFLATED BUY-BACK GUARANTEES. The investor may be tempted to think that an inflated buy back guarantee is a sign of the developers' supreme confidence in the market but really, one of two things is likely to happen. Either the market goes up and the guarantee is never needed or the market performs badly and when the investor exercises the buyback the developer cannot deliver. The company making the guarantee may not necessarily have the assets to back it up while insurance backed guarantees may not be valid. A guarantee per se isn't a sign of a deliberate scam but the investor is advised to do their due diligence and ensure that the guarantee is solid and backed by the right financials and/or insurance companies.

INFLATED RENT GUARANTEES. It is common in the industry amongst institutional investors to expect a rent guarantee period, but it is vital that the developer or agency aligns any guarantees within market expectations. If the returns offered cannot be supported by the market rent, the developer's subsidy will eventually run out and the investor is left with an asset that could potentially be cash-flow negative.

In the worst case scenario, the market may take a very long time to do so thereby degrading the quality of the investment. As an investor, always analyze the market fundamentals carefully and due your due diligence on the figures that are provided to you, checking the current market value, or appraised value of the homes that are being sold to you, and ensuring that the most conservative of market rentals for the homes aligns with the purchase, finance and other carrying costs of the asset.

BEWARE OF SELLER FINANCE OFFERS. Any project not funded through an independent third party such as a bank is subject to manipulation of value by the developer. Expectations of yield can be inflated using an in-house valuer and no-strings attached appraisals that any self-respecting bank would never approve. Sometimes, the seller finance is a teaser rate for the first year or two: the investor is led to believe that the the loan can be conventionally refinanced, only to find that when the investor tries, the property doesn't appraise for what he or she purchased it at, and the bank is unwilling to loan on the previously inflated valuation.

BEWARE OF PUSHY SALES PEOPLE. Don't you hate pushy sales people? So do we! They concentrate only on the short term gain instead of building long term relationships and repeat business. Their customer churn is high because there is no follow thorough or commitment, and the only value they bring to the table is the sale.

Pushy sales people are bad news and a one-close sale only enables the seller to sever his relationship with the investor as quickly as possible. Never deal with companies that do not place a premium on taking the time to walk you through the every aspect of the opportunity and answer every single one of your questions professionally.

OFF-PLAN PROPERTY IN UNDERDEVELOPED AREAS. Many investors fall into the trap of buying off-plan properties in 'up-and-coming' areas only to find them isolated from essential infrastructure, such as schools, transport arteries and other facilities that make an area investable. Ensure that the area in which you are investing in has ready access to essential transport hubs and facilities. Better still, where possible, make the time to try to visit the site personally to get a good feel for the area. Ensure that the homes are not too close of high tension electric cables, power stations, or other undesirable features that could affect resale value.

BE CERTAIN THE INVESTMENT IS BACKED BY REAL TITLE. You might find that sales literature insists that all steps have been taken to ensure the home is sold with marketable title to investors. However, it pays to do your own due diligence: you should always have your own attorney look over the documents and legal agreements to ensure investment is secure.

NEVER INVEST IN AN OPPORTUNITY WITHOUT AN EXIT STRATEGY. If you are investing with a 5- to 10-year time frame in mind, it is more difficult to ensure the exist strategy because of the long holding period. However, there should always be a back-up or contingency in the even the assets need to be sold before the eventual holding period is realized. Do your due diligence to ensure that the asset could, in theory, be sold in the open market at a price more favorable than your original investment.

If you would like to know more about investing in one of our Class "A" properties in any of our other hand-picked locations in the United States, please call us on 586.482.8156 or write to us on info@buildgreystone.com and one of our experienced Client Advisors will be happy to answer any of your questions.