



Taxcafe.co.uk Property Guides

# How to Profit from Off-Plan Property

By Alyssa and David Savage

## About The Authors

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Alyssa and David Savage are the co-founders of Hattan and Grand, a property investment company which sources off-plan and new-build properties for private investors.

Over the last four years they have been involved in the purchase of over £100 million of off-plan and new-build investment property.

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## How (Not) to Become a Property Millionaire!

I am sure that many of you reading this book have seen adverts saying something along the lines of: 'Become a Property Millionaire in Less than a Year'.

You may also have met people who claim to be property millionaires and you think, "Wow, if only that were me. I've got to get on the property bandwagon to financial freedom."

The funny thing is that most of these people really aren't millionaires at all.

Over the years, I have met many people who make this sort of claim. Here's how our conversation usually goes:

Investor: "I own over £1 million in property, and I did that in less than a year!"

Me: "Wow, good for you. So are you telling me that you have no mortgages on these properties?"

Investor: "No. I am planning on selling them on from plan!"

Me: "Ok, so are you telling me that they aren't built yet?"

Investor: "Yes. I just reserved four apartments valued at £250,000 each, but I bought them at £200,000 each!"

Me: "So you are saying that you haven't completed on them? You haven't sold them, and they are still being built?"

Investor: "Yes. They only cost me £2,000 in reservation fees."

Me: "So tell me, are you going to have buy-to-let mortgages in place?"

Investor: "No. I don't need any."

Me: "Ok, so you are saying that you are paying cash for each unit?"

Investor: "You have to be joking! I don't have that kind of money!"

Me: "Are you telling me that you didn't get in touch with a lender or mortgage broker before you reserved?"

Investor: "No. Because I'm selling them before I complete."

Me: "Have you had these properties surveyed?"

Investor: "Yes. The property investment company I am using told me that an estate agent valued them at £250,000, and I am getting them for £200,000! So I am going to make at least £50,000 per unit!"

Me: "I take it that you haven't even exchanged contracts yet?"

Investor: "What is that?"

Me: "Is the developer not asking for a deposit when you exchange contracts?"

Investor: "Yes. I'll use some of the profit from selling the properties for this."

Me: "Are you aware that exchange of contracts will happen approximately 28 days after you reserve? Are you aware that you will have to come up with the deposit the developer is asking for – usually 10% - plus other fees at this stage?"

Investor: "Oh, I didn't know that."

Me: "Do you have a 10% deposit plus funds for other fees available, *per property?*"

Investor: "No."

Me: "From what you are saying it sounds like you can't even afford to exchange contracts! You are looking at around £80,000 in deposits alone in less than a month."

Investor: "I can always re-mortgage my home for these funds."

Me: "Well good luck. If you haven't started that process already you will be very lucky to release funds within a month. My other concern is that you are not applying for a mortgage. What happens if you are unable to sell the properties that quickly?"

Investor: "Well, I'll just keep them until I find a buyer."

Me: "I don't think you quite understand. The developer will set a completion date for your property, at which point you must provide them with the remaining funds. If you don't have a mortgage in place the developer will charge you interest compounded daily. Or they may sue you. Remember, the property is not legally yours until you complete."

Investor: "I didn't realise that."

Me: "My other concern is rental values."

Investor: "Yes, but I'm not going to rent them out, as I keep telling you – I am going to sell them, so it doesn't really matter what the rent is."

Me: "Well, were you not told that most buy-to-let mortgages are based on rental valuations? Lenders want evidence that the potential rental income will easily cover your mortgage payments."

Investor: "I know a friendly letting agent who will say that the rental income is high enough."

Me: "It doesn't quite work like that! It will be the lender's surveyor who will decide what the rental value is – not your friendly letting agent."

Investor: "Oh."

Me: "This is a very big issue. Do you have any idea what kind of rents these apartments will generate?"

Investor: "Around £850 per month."

Me: "Ok, well let me just work that out for you, using my mortgage calculator. Based on the information you have given me, and using an interest rate of 5.69%, a lender will only loan you £143,409 per apartment. This means that you will have to pay almost £60,000 *for each apartment!* Tell me, do you have £240,000 cash available? And oh, I almost forgot! You also have to pay stamp duty on each unit."

Investor: "But as I mentioned, I am planning on selling my units before I complete."

Me: "How many units are in the whole development?"

Investor: "Around 250."

Me: "And how many units were sold to investors?"

Investor: "All of them."

Me: "Do you really expect to sell them before the completion date, along with all the other investors trying to do the same thing? If it were me, I'd rather take a £2,000 loss rather than have to fork out £250,000!"

“Although this deal may sound good with its discount, it simply doesn’t stack up!”

## **Summary**

Several important lessons can be learned from this discussion:

- The investor in this example had not completed the purchase of the properties and therefore didn’t own them. So stating that he is a property millionaire is very far from the truth!
- He was also under the misconception that after paying a reservation fee of £500 per unit, the properties were his and his profit would automatically be £50,000 per unit (because he bought them at a ‘discount’).
- The investor’s downfall was not understanding how buy-to-let mortgages work and why rental valuations are so important.
- He bought property that hadn’t even been valued by an independent RICS surveyor – so who knows whether or not the true value of the properties was £250,000.

Amazingly the investor in the above example had already attended an expensive course about investing in property and yet still didn’t understand the basics.

It is this lack of knowledge and incredible desire on the part of so many to get into property investment that has created cracks in the property market, specifically in the area of new-build property.

The Government has already started closing down the numerous get-rich-quick property schemes but this could cause a dangerous wobble in the market for newly built flats, many of which are bought en masse by property clubs and syndicates. In fact, in May 2005 The

*Financial Times* ran an article stating that prices of new flats had fallen by more than 17% over the preceding 12 months.

## **How to Become a Property Millionaire... Slowly**

All this doesn't mean that buying property from plan isn't a good idea! Far from it. Here are some examples of investors who did get it right and made handsome profits.

As you go through these examples, it is important to note that the discount offered was almost irrelevant to the success or failure of the investment.

A discount should only form part of your decision to buy a property – it should never be the sole reason for your purchase.

### **Case Study # 1**

In December 2002, a two-bedroom unit was purchased for £85,000 by one of our clients who we will call Jane. There was a genuine 15% discount, confirmed by a RICS (Royal Institution of Chartered Surveyors) surveyor.

We were able to negotiate this discount because the developer was fast approaching its financial year end. The company had 12 remaining units that it needed to sell quickly to meet its targets.

Therefore, we agreed to offer these units to our clients and meet the developer's strict deadline. The unit was completed in July 2003 and subsequently sold to someone else for £112,000.

Fortunately Jane had a mortgage in place because the ultimate buyer had a few problems getting his funds through in time for completion. In fact, it was two weeks after the completion date that the new buyer was in a position to complete.

In the end Jane made a gross profit of £27,000 in seven months!

Let's look take a closer look at the deal:

- Original market value: £100,000
- Price paid: £85,000
- Resale price: £112,000
- Investment company fee: £2,350
- Solicitor's fees: £1,000
- Mortgage broker's fee: £850
- Surveyor's fee: £175
- Lender's arrangement fee: £199
- Stamp duty: Stamp duty exempt area
- Estate agent's fee, including advertising: £1,370

Therefore, in just seven months, Jane had a net profit of £21,056, which she used to continue building her property portfolio.

## **Case Study # 2**

In this example the property had already been built. There were just a few units left and the developer wanted to sell them quickly.

The list price was £90,000 but the developer was offering them for £85,000.

Although this wasn't a large discount it was a genuine discount giving equity of £5,000 from day one.

More importantly, the development was in an area starting to experience steady capital growth.

The best buy-to-let mortgage available to this investor was at an interest rate of 5.85% and required 125% rental cover. The potential rental income was verified at £450 per month.

After paying the 15% deposit the investor required a mortgage of £72,250. The maximum buy-to-let mortgage he could expect to raise was £73,846, so the deal stacked up.

Let's look at the costs:

- Reservation fee: £500
- Deposit: £8,500
- Property investment company fee: £2,115
- Solicitor's fees: £1,000
- Stamp duty: Property was in an exempt area
- Mortgage broker's fee: £850
- Lender's arrangement fee: £299
- Remaining deposit required by lender: £4,250
- Survey Fee: £175

The total cost to the buyer was £17,689 plus a further £3,500 to furnish and decorate the property, bringing the total costs to £21,189.

Sounds expensive, doesn't it? But remember that the property was valued at £90,000 giving the purchaser £5,000 immediate equity.

The property rented out immediately for £500 per month, easily covering his monthly mortgage payment of £352.

On top of this, the property was in an area experiencing good capital growth and was recently revalued at £100,000.

As you can see, the £5,000 discount was not the important factor. The area itself, although not considered particularly 'desirable' proved to be an excellent investment choice as the combination of affordable prices and strong rental demand resulted in steady capital growth.

### **Case Study # 3**

Here's an example of a property deal that looked great in the beginning but eventually turned a bit sour. I personally invested in a unit in this prime city centre development in an area that was starting to achieve excellent growth due to regeneration.

The details were as follows:

- The build programme was two years
- The list price was £160,000, supported by a RICS survey
- My purchase price was £143,000
- The expected rental from the property was £750
- Reservation fee: £1,000
- Missives fee: £2,000
- Solicitor's fees: £1,000
- Mortgage broker's fee: £715
- Lender's arrangement fee: £299
- Survey fee: £175
- Stamp duty: £1,430
- Estate agent's fees: £1,500

At the time of purchase, everything was looking good. The rental was high enough to easily cover the mortgage and keep the lender happy and, because I was buying at a discount, I didn't have to pay a deposit thanks to an LTV mortgage package that was available at the time.

When the completion date arrived things weren't looking quite so rosy:

- The lender had withdrawn the buy-to-let mortgage package I wanted due to abuse from borrowers. As a result I now had to stump up a 15% deposit.
- Interest rates had risen four times since I reserved the property. As a result the rent was insufficient to provide the lender with

adequate rental cover. This meant I would personally have to stump up what they didn't!

- There was now a glut of similar properties in the area with numerous 'To Let' and 'For Sale' signs everywhere – in many cases the prices were too high for the average buyer.
- As I had already concluded missives on the unit I was legally bound to complete.

I ended up having to fund a 20% deposit in order to provide the cover required by the lender.

I completed and ended up paying the mortgage for three months before selling the property. To ensure a quick sale I had to offer to pay the buyer's stamp duty and pay for flooring.

My gross profit on this deal ended up being just £358!

Could I have done anything differently? I don't think I could have. I saw an opportunity and, at the time, it worked. That's property investment!

The area was well researched and when I reserved the property, prices were growing strongly and this was expected to continue for several years. I had the unit valued by a RICS surveyor and a letting agent – both concluding that the deal did 'stack up'.

Ultimately, I could not control the rise in interest rates or the amount of other investors wanting to get into this particular area.

This experience is a perfect example of why I'm no longer interested in glitzy new developments in major city centres which cost upwards of £150,000.

Instead, I am looking at properties under the £125,000 mark (preferably under £100,000) in outlying areas where rental yields are higher and the deal stacks easier.

I also try and avoid developments in which a lot of the buyers are fellow property investors. Many of these become 'investor ghettos'.

Instead, I look for sites that have just a handful of units left which the developer wants to sell quickly. This way I can more easily find out if the other owners are 'buy to live' homeowners rather than buy-to-let investors.

Buying one of the last remaining units in a development also allows me to accurately assess how much deposit the lender will require as I will be getting a mortgage quickly instead of in, say, two years' time when the property has been built and interest rates and rental values may have changed.

#### **Case Study # 4**

Here's an example of a property that I purchased and sold in a 'back-to-back' transaction.

Purchase price: £92,000  
Discount: None  
Reservation fee: £250  
Missives fee: £250  
Legal fees: £750  
Estate agent fees: £1,250  
Mortgage broker fees: £460  
Lender's arrangement fee: £299  
Survey fee: £175  
Build programme: 18 months

I purchased this property without getting a discount off the list price. However, I did secure a special pre-release price which was offered to attract initial buyers into a big development. Provided demand for property continued to rise I stood to make a good profit.

Several weeks prior to completion I put the property on the market through a national estate agent for £115,000. So too did many other investors.

I wanted to sell this unit as quickly as possible so that I wouldn't have to complete and stump up a 15% mortgage deposit. So I decided to drop my price to £110,000 in order to undercut the other investors and ensure a quick sale.

Within a week I had a buyer. Contracts were signed and ultimately a back-to-back transaction occurred. To be on the safe side I also had a mortgage offer in place in case the new buyer pulled out for some reason – I was fully aware that I was still 100% liable for the debt on the property and needed to complete should I not have a buyer in place.

Therefore, I incurred the cost of a survey, the lender's arrangement fees and a mortgage broker's fee. Because I purchased at a reasonable price I was also able to sell at a reasonable price and still make a good profit.

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