Investment Risks

Contract

- Is there a suitable contract in place? This could be a form of JCT contract for the renovation works; or a loan agreement detailing the interest an investor is expected to make; or a joint venture agreement detailing roles and responsibilities of each party.
- Consult an independent solicitor to ensure the contract is robust and that there are no hidden or unfavourable clauses, which may impact the strenght of your position if something goes wrong.

Security

- If you are purchasing the asset, is there a legal charge on the asset?
- The strongest level of security is a first legal charge and is best used when buying cash.
- The next level of security is a second legal charge, which is used when you are using bridging finance to purchase an asset. This is because the bridging lender will have first legal charge

Guarantees

- As another layer of security for an investor, has the non-equity party involved in the loan agreement offered a personal guarantee (PG)?
- A PG can be in the form of company shares, assets that the individual/company owns, or purely cash.
- This further solidifies your return if something were to go wrong becuase the non-equity party has financial reserves, which can be used the provide the returns as per the loan agreement.

Compliance

- Do your own thorough due diligence on the company(s) you are investing with or buying a deal from.
- Check their compliance. Are they a member of a property ombudsman and the ICO? Are they registered with HMRC for anti-money laundering? Are they a member of NAPSA? Are they fully insured? All of these need to be confirmed.

Affordability

- Are you comfortable with the level of risk and can you afford to lose your money if the investment does not return as expected?
- Are you prepared to risk losing some (or all) of your money invested?

Rule of thumb

- All investments carry an element of risk. There are some exceptions, but generally a good rule of thumb is the higher the return on investment, the higher the risk.

Understanding

- Do you fully understand the investment? Could you explain it to someone with no property investment experience in a way that makes sense to them?

Property prices falling

- Do your own due diligence on the historic property price growth of the specific are you are investing in. This should give you a strong indication on the trajectory of growth in this area.
- But past performance does not guarantee future performance.

Mortgage rates

- Mortgage rates may increase. This is dictated by the Monetary Policy Committee (MPC), which in turn sets the rates in which banks can borrow from the Bank of England.
- Higher mortgage rates will squeeze your monthly profits if you retain the asset, meaning your returns will be lower than expected.

Bankrupcy

- Other companys financial situation may take a down-turn. The builder or your investment partner may go bankrupt for reasons out of your control.
- Ensure you have correct insurances in place and work with trusted and experienced professionals.

Delays in construction

- This can threaten your mortgage offer or (if funding through a bridging lender) cause penalties for delayed repayment, which can be severe.

Delays in sales

- When selling, the open market is affected by many factors, which potentially put off buyers.
- This can lead to the property being on the open market for longer than expected, meaning your investment is in abeyance and you cannot get your return.
- This is particularly risky when funding a project through a bridging lender for the same reasons as described above.

Property type

- The type of property can have its own risks. Does it have a low lease? Does the leashold have restrictions or clauses whereby the freeholder can incrementally increase the service charge and ground rent? Is the property Grade I or II listed? Does the building manager allow for reconfiguration within the property?
- All of these questions need to be asked and an investment decision needs to be made as to whether you go ahead with the project or not.

Property condition

- What condition is the property in? Does the roof need replacing? Are there electrical or drainage mains running under or in close proximity to the property? Is there subsidence, damp, or mould? Does the property need rewiring or a new boiler?
- Also check the energy rating of the property, which can cost you money in the long-term if the energy rating is very low.

Tenants

- Has the letting agent properly vetted the tenants?
  What kind of area is the property in? And what type of tenant will this area attract?
- If they damage your property...ultimately you will have to pay for the cost of repairs.

Market yield

- ○ What is the average yield in the area you are investing in? This is a good rule of thumb to guage whether this area is worth investing in.

Rental growth

- ○ Many factors affect rental growth in an area.
- ○ Make sure you check against existing rental units and also the local economy and regeneration, otherwise this area may be in decline.

Fees and costs

- ○ This includes, but not limited to:
    - Property acquisition costs (stamp duty)
    - Legal fees
    - Sourcing fees
    - Management fees
    - Mortgage product fees
    - Maintenance costs
    - Sale costs
    - Exit fees (for briding finance)

Liquidity

- ○ Property is notoriously illiquid. Meaning your cash is held in an asset and not necessarily quick or easy to release the equity from it. As a comparison, stocks and shares are liquid - so you can sell your stocks and shares and have the money in your bank almost immediately.
- ○ When investing in property, ensure your strategy accounts for your money being illiquid. Property is generally long-term wealth building strategy, so ensure you plan accordingly.

Taxation

- ○ Consider whether you are purchasing in your personal name, or in a limited company or as a sole trader.
- ○ There are tax implications, which may suit your current or future financial situation better or worse.