INVESTMENT 101

Development Investing Part 1/3

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Most property investors would start their journey with basic residential assets in their home country. Moving on to commercial, industrial, land and even international assets after gaining experience. There are some, who eventually go from buying assets to building them. It can be a simple subdivision of one property into two. Or amalgamating multiple land plots for townhouse or apartment block. Or simply being a sleeping capital partner of a private fund structured for a development.

In recent days, the concept of shared economy has inspired many new possibilities. Developers are quick to jump onto the bandwagon, raising capital through crowd or collective funding structures. While that enables them to access the pockets of the common man on the street, the lack of clear regulatory control does mean the usual caveat emptor applies.

Property development is often perceived as a game for institutions with bigger war chests and appetite for risk. It demands a plethora of knowledge and experience that for most, would be a daunting undertaking. But when properly structured, such opportunities can yield attractive returns while remaining secure.

For those looking to participate in such projects, we are putting together a 3 part series that will provide you with a simple process to think through these opportunities.

The Connected Global Economy

Over the last 30 years economies have become more and more interconnected with advancing technologies. Such has a contagious effect, allowing the wows and woes of one economy to vastly and quickly impact another. In current context, global events such as trade wars, eurozone crisis and even the capital outflow restrictions in China has direct influence on economies, jobs, currency and housing markets.

It is important to understand that a negative economic situation does not necessarily imply a negative housing market. If the market is fundamentally strong, you might often find the housing market to be uncorrelated to the general economy. For example, when Australia experienced a economic slowdown during the resource market downturn, the weakening Australian dollar supported the recovery of the services and export sectors including education and tourism. Together with interest rate cuts they triggered a housing and construction boom with unsurprising strong demands from foreign investors and international migrants.

On the other hand, markets supported by a single industry such as automobile manufacturing or tourism, or a single employment entity such as a major car manufactory plant, can be easily toppled when the tide turns against them. Housing demand quickly evaporates when these industries or companies fall. For example, the collapse of oil prices brought property price woes to many oil towns in South Dakota (US) and Calgary (Canada).

If you had read the “Investing 101 - The Theory Of Property Prices” in our June issue on RS|Insider, you would have learned that the impact of macro economy

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will be more keenly felt in markets exposed to higher price levels supported by investors and foreign buyers. Developers who built to these markets will certainly be exposed to more risks than those catering to domestic demand.

The Investment Structure

For smaller projects, investors may hold the land directly as sole shareholders in a project company while the developer provide the development expertise and services. Such structures are often found among small scale migration-purposed developments or land banking structures. While that secures the monies against the land, investors must be aware that they may end up holding the land for a long time should developments fails to proceed as planned. Meticulous effort to ensure that the value of the land is properly assessed, all development costs are properly budgeted and the fees due to the developer is fair is critical.

With larger projects, often an equity (shares) or debt-driven corporate structure will be put in place to secure the investors against the land. These structures are inadvertently more complicated. While investors are often the shareholders, they are often at the mercy of the directors who have the day-to-day control of the company. It is therefore important that investors must either have director-oversight of the company or a caveat lodged on the title. Such will defend the investor against irresponsible directors. Investors who are not sure may find it helpful to seek an independent legal assessment/opinion of the structure by a trusted corporate lawyer.

Unfortunately investors often choose to blindly trust than seek professional opinions, often leading to unnecessary grief. I cannot understate the importance of understanding the structure that you choose to enter into. I am not against trust, but at least understand what you are trusting your monies for. In most delinquent cases the trusted person is a friend or relative. Sad to say, they too are seldom equipped to understand the structure, hence the blind leading the blind. In fact, I often would advise investors to be even more diligent when dealing with trusted parties. Simply because there are usually much more on the table than you might think.

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