A Guide To Investing In Overseas Properties

What you need to know before plunging your capital into assets beyond your shores.

THE "OVERSEAS PROPERTY" FEVER IN ASIA

According to CBRE's latest report, Asian investors pumped a total of US$53.8 billion in 2018, a 36% y-o-y decline largely due to portfolio reallocation by the Chinese. Singapore remains the in source of outbound capital at US$21.6 billion, up US$0.7 billion from 2017. London remains the top destination for outbound capital and most preferred metropolitan city for first time overseas buyers.

So why are Asians so keen in overseas properties? Where are they buying and why? Are the assets performing to expectations and does an international property portfolio make sense for the average investor? In this paper, we will attempt to answer these questions and share some thoughts we have about what are some of the pitfalls, thought process and strategies that one can adopt when investors seek to invest beyond their shores.

Over the last decade, international properties have gone from being an investment option for institutions and high net worth individuals to becoming an alternative for the man on the street. From low cost assets such as Purposed Built Student Accommodation (PBSA) and shoebox studio units in Manila to high end luxury properties across London and New York, the appetite for international assets from Asian investors, especially from China is significant enough to cause concerns among many market legislators. Thus resulting in a wave of policies and controls to constrain such activities and prevent overheating of housing markets.

At RunningStream, we have been helping our clients across Asia to strategically and systematically acquire, manage and optimise their international portfolios for over a decade now. Be it residential, commercial, or even developments, we provide in-depth expertise and knowledge to help our clients succeed. We strongly believe that an international approach is essential to diversify investment risks across economies and currencies, as well as profit from different market cycles. Hence our unique advisory practice to help our clients achieve that.

In the many years that we have been in business, we have come across different clients with different investment goals. From parents who wish to acquire an asset for their children studying overseas to developers and private funds wishing to diversify their exposure to other markets. Our team has been able to consistently serve one and all.

For the purpose of this paper, we will focus our discussion on individual investors looking to invest in international properties. Whether it is to acquire just one property for their own use or looking to build a portfolio of assets for their financial plans. Here are some pointers we believe will serve you well.

FALLACIES OF INVESTING OVERSEAS

People buy into international assets for different reasons. Some for their kids' education or their retirement. Others as a holiday home, for rental returns or simply to

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diversify their portfolio. Regardless, here's to debunking some of the most common fallacies that you might have been presented in an attempt to sell you an overseas property.

Buying For Your Kid's Education

"Why throw money into rental when you can own a property and profit from it when it grows in value or rent it out for income when your kid has graduated?"

For most parents this is one of the most common value proposition. While it will not be responsible for us to speak ill of all student-based properties, it is known that student accommodation or properties near universities seldom grow in value unless its due to the growth of the entire market. The reason is simple – professionals and families (easily 90% of any residential market) would not want to stay in an area dominated by students. So it's down to either parents or savvy investors looking for yield. While the former are mostly foreigners who will likely buy new products, the latter will squeeze your price to maximise their returns. While rental can be high, so is wear and tear thus requiring higher provisions for up-keeping and reducing net returns.

You will do better buying a property in a high growth area and passing on the rental collected to your children, allowing them to rent anywhere they prefer as they study. That way you will get to enjoy your growth while your children learn to earn their keep by playing landlord. When the studying is done, you can then decide to retain the property for income or sell it for profits. Often such a strategy can also materialise future tax benefits for your children if planned properly.

Buying A Holiday/Retirement Home

"Imagine a property where you can profit from its growth or in the worst case, use it as your retirement or holiday home!"

While the pitch of a holiday or retirement home in a nice location where space and lifestyle are much more affordable and attractive can be a real draw, investors should be aware that developers and agents are often using such tactics and reasonings to disguise the fact that their products are often overpriced or inferior.

We were often asked if buying a holiday home in Bangkok makes sense. Of course it does if it is not about growth and returns. But to backstop a non-performing asset with the idea of a retirement or holiday home is not a great idea. Now if you are to put the numbers together say for a USD400,000 property, we are talking about being there 5 times a year for the next 40 years to break even (assuming USD2,000 per week per trip for lodging). And that is staying in the same place with no housekeeping or concierge service.

It might seem that we are discounting growth altogether in such an example. But in reality, such properties are often under-utilised and buying it at a premium above resale market tends to render the capital growth rather anaemic in the years to come.

Again a much wiser decision would be to really build a solid investment portfolio that provides you the passive income to holiday or retire anywhere you like. The whole holiday/retirement home sales pitch can be rather misleading and in our opinion, a bad cover for selling underperforming products.

Buying For Own Stay

"The area has developed fully complete with amenities and transport options. It is a great neighbourhood that has everything you need!"

We once met a gentleman who was keen to invest in one of the most liveable city in the world. Naturally he asked for our advice on where to buy and assured me that he would send his son to have a look.

Weeks later we received a call from him, saying that his son didn't think the area we proposed was that great . There were cranes and he wouldn't want to live next to construction sites.

If you are buying for your own stay, you would look for a spot well developed and convenient with amenities. But if you are looking for growth then cranes are good news especially if they are for building infrastructural amenities. Do not confuse between investing and buying for own stay. The requirements are often different and contradicting. Compromising between them will only result in indecision at best, financial losses at worst.

Buying For Rental Income

"Build a passive income with a property that comes with a 3 years, 5% guaranteed rental and get over 15% back!"

First a reality check. Nobody ever got rich collecting rent. Just as most wealth are not made through stock dividends. Property is always about capital growth. Rental simply provides you with the ability to hold onto the properties through time for price growth. But if all you are concern about is rental guarantees and not the factors that will drive capital growth, you are almost certain to struggle. Developers will mostly price the projects above market to support the guarantees, leaving very little capital growth upside for you in the near future.

In addition, assuming that you are taking a loan to finance the asset, that loan will include the mark-up as well. Which means that you will be paying interest on 80% (assuming a 80% loan) of that premium ie. 80% of the 15%. Over a period of 20-30 years you will end up paying twice if not thrice the amount. From an investment perspective, such a deal would not make financial sense. As we like to say in RunningStream, the best form of guarantee is the one provided by the certainty of growth and rental yield by the market itself.

Buying In City Centres

"City centre apartments are the best buys for growth and yield, and their values are most resilient during market downturns."

Most marketing agencies would prefer to sell city or city-side apartments as most investors are familiar with these locations, making their job a lot easier. Such locations are often not the fastest growing nor the ones to hold their values best in a downturn. In fact, they are often quite the opposite.

Locations with high percentage of foreign ownership tends to be exposed to more risks factors. This includes forex risks, interest rate risks, capital outflow risks, policies and regulatory risks such as manpower regulations or foreigner taxes. These risks often translate into price and yield fluctuations.

So unless investors are in for a short ride to quickly flip their units, most will do better buying in locations where prices are well supported by local demand and income. Such properties will tend to provide the essential stability and growth when investing away from home.

Buying With A Low Budget

"For just USD50,000 you can own a studio in the city centre and rent it out for a good 8% yield!"

Chances are, if you are looking for lower entry points you will tend to be younger with limited resources. Apart from the points that we have already made about buying in city centres and buying for rental income, it is good for you to note that being young, your greatest resource is not money but time. You can obviously afford 10 years and perhaps even a little more hassle when managing properties in the suburban areas.

So the question is, given the same budget, which do you think will perform better over the next 10 years? A 1-bedroom studio in the heart of the CBD or a 3-bedroom house 20km out? We reckon the answer is clear.

Of course investors who are more senior might take a different strategy as wealth preservation and income is a greater concern.

Buying With Mixed Intentions

"The project is about providing housing to thousands of people living in slums and we are guaranteeing a return of 12% pa."

Ecohouse - A Brazil-based social housing development that saw Singaporeans lost over SGD65m. Now under administration and investigation, it was once touted as the best investment project by gurus and popular media agencies.

When we asked the investors why did they choose to participate in the project, many gave the same answer - Brazil was booming and it sounded like a good deal earning 12% a year while doing charity.

When an economy booms, the rich get richer, not the poor. A better and more sensible investment will be to look into developing luxury bungalows instead of social huts. While that might sound mercenary, nothing stops you from donating your profits to charity thereafter. But mixing the two intentions is a recipe for disaster. Because investments that need to wave a charity or religious flag to get your attention is waving a huge red flag in our opinion.

Buying When The Currency Is Low

"GBP is at an all time low and there's no better time to buy into an UK property than now!"

We are not against buying when the currency is cheap. But we are concern that many investors are buying without much consideration other than a cheap currency.

Forex is an important consideration when buying property but it cannot and should not be the only sole reason. If you do not think that the property will grow in value, then why not just buy the weakened currency? In other words, if you were to use GBP200,000 to buy a property in UK which at the end of 5 years saw little growth, you might profit on currency when selling it, but end up with losses when fees and taxes are taken in to consideration. Buying GBP directly with the ability to exit cleanly and quickly would make much better sense.

In other words, currency upside should be a bonus and not a singular reason to get into property.

PERFORMING DUE DILIGENCE

So far we have talked about the pitfalls and fallacies of investing overseas and the need to buy for growth and not just for yield or other purposes that conflict with your investment goals. But apart from what not to do, how about what to look out for when seeking out stable and sustainable growth with overseas assets?

Well, there are a handful of factors when it comes to performing due diligence on a market regardless if it is within your home country or overseas. While you may deem it safer to invest where you live, there are exceptions and in our years of experience we have found that success rate in property investment does not necessarily correspond with familiarity or distance.

Here are some of the factors which we believe that you should always take into consideration. In fact, these are the same factors we look into when performing due diligence on a new market.

Government System

The property market is an essential and critical part of a country. On one hand it is an important component of the economy and often times it is able to act as a buffer against economic downturns. When an economy takes a dive, governments often use properties to attract foreign capital to stimulate growth and drive construction jobs. Infrastructural spending, for example, was what Australia

and Singapore used to increase economic output and jobs. Just as UK is now doing as it faces the challenges of BREXIT. It is using infrastructure developments in the north to drive economic growth and consequently, property price growth.

A liberal government for example will be more friendly towards foreign capital while a conservative one will always tend to be nationalistic, being more concern about local affordability and hence tend to constraint foreign participation that might be detrimental to the local populace. A democratic government might change tune with each election while a one party system tends to be more consistent and predictable. The former tends to be subjected to natural market forces while the latter tends to be affected mainly by policies. Australia and China are good examples of both extremes.

Legal Infrastructure

While developed countries will have mature legal infrastructure to govern the whole life cycle of property investing including property ownerships, tenancy, transfer of properties, taxes and duties etc. Investors buying in developing countries might find themselves embroiled in disputes over ambiguities of the law or worst, enforceability.

It is common to find markets in Asia for example, where law takes a backseat when it goes up against local authorities. We have seen legal systems where lawyers are unwilling to go up against more established developers simply because they are fearful that no other developers would employ their services in the future. So yes, to have the law is one thing. To have the ability to enforce is quite another.

Professional Regulations

Unlike equity investments where things can be totally transparent and electronic, property investment is a rather manual affair that requires local service providers such as property agents, rental managers, local accountants and even local handymen to help manage and maintain your assets. Professional regulatory bodies with standards and certifications will certainly go a long way to ensure that you are empowered to manage your assets effectively.

In developed markets such as Australia, professional property managers are available to manage the tenanting of your properties with clear guidelines for on-boarding tenants, regular inspection, monthly statements of accounts, guidelines for eviction and even changing of property managers.

In markets where there are no strong regulatory, investors would have to depend on the goodwill of the parties involve to manage their properties well. Note that being foreign investors from faraway lands, you will tend be the last on their priority list.

Local Culture

As Peter Drucker once said, "Culture eats strategy for breakfast". Although he was not referring to property markets, the idea is the same. When the culture of a market is not aligned with regulations you will see sidestepping instead of compliance.

Local culture affects your tenants, your agents, your service partners and even regulatory bodies and law enforcement agencies at times. To ignore local culture is to court trouble. For example, a strong sense of social responsibility in Australia means that investors are well guarded against delinquency to the extend that landlord insurances are commonplace. Developing countries, on the other hand, would have a drastically different culture that requires more effort to manage your assets as tenants might not be as considerate nor tidy.

Economy

Economy is a big word. It refers to a lot of things from GDP to domestic consumption, from exports and imports to key growth sectors and so on. But in essence when we refer to economy with respect to the property market, we are really just concern about employment and wage growth. Not that the other factors are not important but often by observing employment and wage growth one would be able to sufficiently ascertain the strength of a market.

By employment we do not just refer to employment rate, but also whether the industries can sustain the jobs. For example, there are markets where a single industry dominates, providing most of the employment. Should the industry be one that is consistent such as agriculture then there should be less employment volatility. But if the industry is cyclical in nature then employment volatility tends to be high. In markets with a diversified economy however, industries counteract each other's rise and fall creating a stable employment market with low volatility. Corresponding that with wage volatility and you will be able to read the house prices fairly easily.

In markets where house prices are largely driven by investments especially from foreign sources, then the scenarios can be very different. Read further to the section on The Property Price Theory to understand how so and what you will need to consider.

Liquidity

By liquidity we are referring to the availability of funds to fuel the buying and selling of properties in a market. There are basically 3 sources of liquidity - domestic capital created through employment and wages, foreign capital through foreign investors and of course bank lending.

Of the 3, domestic capital is always our preference. When wages and wealth grow, house prices are well supported by local fundamentals. However, high domestic capital can also be an indication that the cost of doing business in the city can be unsustainable which

then positions it for a possible commerce correction that will lead to loss of jobs. Balance and sustainability of growth are just as important as growth itself.

Foreign capital on the other hand can be both a blessing and a curse. In the right amount it helps to support the economy and diversify the risks. Too much and you risk domestic unhappiness creating political issues, leading to policies to curb rising prices. Singapore is a clear example where foreign participation in the market created a situation where local affordability becomes an issue leading to political complications. The government thus have to implement multiple rounds of cooling measures to dampen the market.

Bank lending certainly played a big part in the recent rise of property prices around the world. Post GFC record low interest rates, liberal lending policies and of course the infamous Quantitative Easing led the asset booms around the world. In recent years, governments recognising the ills of easy credit has started taking steps to regulate it with policies to avoid over-lending.

Taken in good measure, leveraging provides investors with the ability to safely magnify their returns. Too much and it sets the stage for a credit crisis.

Market Demand

On the surface demand and supply may seem easy. Just look at population growth and construction starts right?

Well, let's first talk about demand. Population growth is not necessary about housing demand. If we are talking about organic growth or babies, they won't be creating housing needs for a while. Migratory population growth on the other hand, is one which needs roofs over their heads immediately and would have a more direct effect on housing demand. Long term migration that is about retirement or new citizenship creates long term population whereas short term labour might spike rental demands that goes away just as quickly as it comes. Growth in families too are different compared to growth of workforce. As different as demands for 3 bedroom family homes versus studios and 1 bedroom units.

Demand is very demographically sensitive. Investors looking at a market will do well to understand where the demands are coming from instead of what they prefer or can afford. For a period of time Philippines developers were marketing heaps of tiny shoebox studios to investors not necessary because they were in strong demand nor because they make the most financial sense, but rather because the price is what foreign investors would pay. Many investors suffered thereafter, laden with units that does not meet the market's need.

Housing Supply

Many investors assume that developers build to demand. In domestically demand driven markets that would be true. But in investor driven markets, developers build to the buying demand, not the housing demand. In other words the trick is often to build what the market can afford, not what the market needs.

That is why we often find a mismatch of demand and supply in markets where investors abound.

When demand is coming from foreign investors the whole exercise can totally deviate from housing demand and degrade into a whole pricing, marketing and sales exercise instead of catering to housing needs. For example, the marketing of the Johor Iskandar region was not about housing demand, but rather relatively cheap price and proximity to Singapore. The market was about selling as quickly as possible to foreign investors with no significant effort to grow the economy or the population. That led to a record level of oversupply.

Similarly in Melbourne, the influx of foreign developers and investors into the market led to overbuilding in the city for the simple reasons that neither the foreign developers nor the foreign investors understood Melbourne suburbs and would only develop and buy in the city. The strong international migration however, cushioned the correction but not many investors made capital gains buying between 2011-2016.

THE PROPERTY PRICE THEORY

One of the most common reasons I have heard from clients looking to invest overseas, is that these properties are so cheap compared to where they are from. It is no surprise many of these investors are from some of the most expensive property markets like Hong Kong, China and Singapore looking to get more bang for their buck. The lures of a better lifestyle, friendlier policies, lower prices and lower cost of living are all pull factors that make these markets attractive to them.

But what is expensive or cheap? Are they relative positions or is there some way that investors can sensibly pinpoint the prices to determine the levels that they are playing to and therefore the kind of risks associated.

At RunningStream, we practice a property price theory that helps us correlate price stages to the driving factors and therefore the risks - something which many investors should and would benefit from understanding. At different price stages, investors must recognise that they are dealing with different driving factors that are controlled or influenced by different parties often beyond their control. These factors and parties bring along their different risk elements.

For example, the Australian market (particularly Melbourne and Sydney) was significantly participated by China-based investors in the recent price run. The subsequent curb on Australian banks lending to foreigners and China's restriction of capital outflow for property purchase caused quite a stir. Despite the fact that the Australian markets are well supported by strong domestic demand, it nevertheless caused significant distress to developers with products targeting foreign investors specifically.

Price Growth

Price Stages	Drivers	Details	Risks
Foreign Investor	Location push and pull factors, price points, yields and growth potential, foreign buyer friendliness	Locations with strong appeals whether as a lifestyle, economy or price point will attract foreign investors from places with significantly higher property prices to participate in the market and again push up the prices.	Government policies, foreign buyer tax and duties, foreign lending, immigration, , capital inflow/outflow regulations, foreign economies
Investors	Returns, yields, growth potential	Once the banks lend, especially at a lower interest rate and higher lending ratio, investors will be interested to leverage and pick up more properties kicking prices to yet another level.	Interest rates, rental market, investor lending volume, taxes and duties
Mortgage	Lending and mortgages.	When the banks start to provide mortgages, prices will kick to another level as it facilitates homebuyers with liquidity thus pushing up prices.	Banks, interest rates, national debt policies
Fundamentals	Jobs, incomes, population growth.	At this point, it is totally about local income, savings and jobs. Prices are all about basic demand and supply.	Domestic economics

In Singapore, heavy dependence on borrowing advocated by "investment gurus" was a key cause for the market softening when policies were put into effect to restrict debt servicing ratio (DSR). In addition, foreign investors were a key price driver and political decisions to restrict influx of foreign population resulted in a significant rental correction leading to further price deterioration.

In the table above, we have provided a reference for you to consider the price stages, drivers and therefore the risks associated. Note that it should be applied to specific locations and not markets in general. For example, to identify Melbourne as a foreign investor driven market would be ignoring the much bigger domestic market. Such can be the case for city/city-side location, or even Chinese dominated suburbs. But there are many more locations where foreign investor participation is almost absent and therefore they are in a different price stage compared to the city/city-side suburbs.

CONCLUSION

This paper is by no means a comprehensive guide to cover all the nuances and complexities of acquiring an overseas assets. Nevertheless, we hope that it does get you started in the right direction in terms of the thought process. Truth be told, many of the considerations in this paper would apply to your local markets as well.

But if all that confuses you, we would like to leave you with a even simpler parting thought process - a concept for evaluating real estate investment opportunities that we use all the time in RunningStream - the concept of OPM - Ownership, Profits and Manageability.

Ownership is about how and what are you owning in exchange for the investment and whether that ownership can be effectively enforce and controlled. The lack of clear ownership structures and control often result in conflicts and lawsuits. Whether that ownership is through titles, shares or debts, they bring different risk elements to play and each must be duly examined.

Profitability is about understanding where your profits are going to come from. Preferably not from an artificial and temporary source such as a term guarantee, but a source that is sustainable and long term such as economic progress and population growth. Not from marketing promises but market performance.

Manageability is about whether the market has the right partners and structures to support your investment. If not, you will have to be open to handling the hassles and challenges on your own. You may be surprise but manageability tends to be one of the main reasons why monies are lost in overseas markets when investors are unable to cope with the amount of work involved.

We hope that you have found this paper to be helpful in setting you on the right path as property investors. Should you need further assistance, do feel free to drop us an email at portfolio@runningstream.com and our team will be in touch with you.

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