

Property Scams and How to Avoid Them

The Nature of Property Scams

The nature of a really great property scam is that there is usually a lot of truth in the story, but never quite enough to make it work. Sales people carefully guide us to focus on the hidden secrets, the nuggets of truth, the compelling factors, and subtly convince us to leave a number of stones unturned, even though our gut instinct tells us we should investigate.

Why do we fall for it?

- We are human. We want to believe in easy street. We want to believe we have found the pot of gold. We want to think we have got a great deal.
- Sometimes the people telling the story honestly believe what they are saying . they have been lead to believe the scam themselves . and that can make the story they sell even more compelling.
- The process is not transparent and independent. During the 03-07 boom in New Zealand we saw the growth of corporate style property investment offerings. Often these schemes were elaborate and difficult for the average person to decipher. In those situations we can feel stupid for asking lots of questions because it makes it look like we are stupid . and no one wants to appear stupid.

This article is designed to highlight some of the more common scams so that you are aware of them, and then give you some tips for avoiding them.

The Scams

Inflated Values

The Scam

The best scam is to get you to believe a property is worth more than it really is. How do they do that? Tell you it is at or below market valuation. They pull out a registered valuation that states the value being say \$500,000, then show you the asking price of \$460,000 . wow \$40k under value. That's \$40k equity as soon as you buy. But . how good is that valuation and what is the reputation of the valuer who produced it. When we see something official looking on a nice letter head we are often inclined to accept it is legitimate.

The Solution

Tip One – Get Your Own Registered Valuation

Get your own registered valuation from a reputable valuer. If you don't know any . ask your bank who they would recommend. Also, make sure the valuer is an expert in the area looking at. Don't engage an individual who says he/she values city wide in a city like Auckland. It's difficult to be sharp on your values for that many suburbs.

Tip Two – Comparable Sales

Find some comparable sales in the area . how close is the asking price to these sales? Go and have a look at the properties. You can get this sales data from a number of sources:

- Ask the real estate agent to print off a list of comparable sales
- Quotable Value for the occasional user . www.qv.co.nz
- Terranet for the regular user www.terranet.co.nz

- And for the really serious/ regular investor www.quickmap.co.nz . great because they map the sales out over the streets and addresses. Expensive . but worth it if putting offers in every day

Constant Double Digit Capital Growth Rates

The Scam

History suggests that over the long term we can be fairly confident of capital growth. However it's when that truth gets twisted to be capital growth every year at a constant rate of say 10% that it becomes a scam. Before you know it you're signing a deal that you might get \$20k cheaper if you were to go out and look carefully. But who cares? We're big time developers who can read the market! Aren't we?

Positivity is great . except property markets don't always rise. Property growth tends to follow a stepped approach . a few years of rapid price increases followed by a longer period of say 5-7 years of minimal to no growth.

Solution

We're not saying don't buy in flat periods . we're saying don't buy because you think there will be continuous capital growth. For understanding more about property cycles and when and how to buy, including how to create equity in flat periods, read our free ebook *Exploiting Property Cycles for Wealth*.

If you Don't Buy Now You Will Starve in Retirement

The Scam

Fear is an amazing motivator and sales people will often use this to frighten you in to action. They'll tell you that you'll be struggling in retirement if you don't act now and sign on the dotted line and start generating some wealth. They get you so scared about not being set up for retirement they get you to act out of fear. You get more focused on the fear and forget about the detail of deal. Problem is . the devil is always in the detail.

The Solution

Yes its true, we need to plan for retirement. The pension won't give us enough to live on . less than \$20k for a couple. So even if you have your house paid off that isn't much to live off. And we think property can be a great way to help generate you a passive income in retirement.

However, we don't think you should panic and buy out of worry and anxiety. Buy to a plan. Decide how much you will need to live off and work backwards to figure out the investment that will be required.

Guaranteed Rents

The Scam

They'll tell you that the rent is guaranteed, and that makes you feel relaxed about buying. That eases the worry, and you think great, I've got nothing to worry about . a stress free investment, rent will come in every week regardless of whether the property is rented. It's pretty stressful though when you find the rental guarantee abruptly comes to an end and the market rent is \$50 less than what was guaranteed.

Ask yourself:

- How good is the guarantee? Who is the guarantor? A guarantee is only as good as the guarantor. Usually rent guarantees aren't worth the paper they are written on. The only exception to this in New Zealand are Housing New Zealand rent guarantees.
- Am I actually paying for the rental guarantee? Inevitably you'll pay for the rental guarantee in the purchase price. In fact, it's an inflated purchase price that usually leads

to the rent guarantee. You get encouraged to worry less about the purchase price because the rent is at healthy level and guaranteed.

The Solution

Basically . avoid rent guarantees, you don't need them. There is plenty of rental demand in New Zealand, and it's a growing demand. Use a property manager to find the tenant and deal with their requests. It's a lot easier than you might think.

It's All About The Numbers

The Scam

Try and get you to focus entirely on the numbers and concept of property investment and tell you not to even worry about looking at the property. They say that if the numbers compute, and you can afford it . then commit. The problem is glossy pictures often portray something to be better than it is.

The Solution

Always go on site and look at the property. If you can't do it personally then get someone independent to go on site and take photos. And of course get a registered valuation from a valuer of your choice

The Yield is Fantastic

The Scam

Sometimes a property will present a great yield . say 10%, and that alone makes the property far more affordable to hold. You'll be lead to focus on this and ignore negative aspects of the property that may seriously detract from its potential for capital growth. You'll often see this promoted with small apartments and houses in small cities and towns.

The Solution

Yield is vitally important for helping to service debt on an investment property. However, I do not believe it is the first priority. If a property has great yield, but little chance of consistently delivering capital growth, then I would ask what the point of owning it is. You are better off with your money in a term deposit. In recent years we have see growth in New Zealand in the cities as well as just about all the regions. But looking back at the median house price growth of the regions over a longer period, compared to the major cities, suggests that the regions deliver far inferior capital growth. High yielding apartments should also be treated with caution.

Tax Savings/ Negative Gearing

The Scam

They'll show you how much tax you can save . the more you buy, the less tax you pay. You get really caught up with how much tax you can save and lose sight of the quality of the deal. What they probably won't tell you is that there can be depreciation claw back.

This approach gets you really focused on the cashflow side of the deal and shows you how affordable the deal will be.

The Solution

We're not saying tax benefits don't exist and that they shouldn't be used. We're just saying we don't think tax savings should be a reason to invest. Understand tax savings and how they can help cashflow . but also understand depreciation claw back.

Buy off the Plans and Get a Significant Discount

The Scam

They lead you into believing that by buying off the plans you are going to buy significantly under valuation. The developer is letting the properties go at lower prices in order to get the development away. Sometimes the properties are at a discount to market value. But really you are paying for that discount in the form of the risk that comes with committing to something that doesn't exist. The property still has to be built and there are a lot of things that can go wrong along the way. The developer could go bust, the building might not be what the glossy brochures talk it up to be.

The Solution

We are not saying absolutely don't buy off the plans, but do be very careful. Do your home work on what the market values are and be very, very sure about the reputation of the developer.

Summary

Don't get scammed in property. Make sure you ask loads of questions even if the sales person gets irritated and you think you look stupid. Get independent advice from respected professionals. Remember that nothing in life is guaranteed (except death and taxes!) and if it all seems too good to be true