

Location, location -but which location?

Paul Baxter offers advice on buying property overseas

I have yet to meet a buyer who did not want their overseas purchase to be a 'good investment'. However, when applied to the overseas property market, the word 'investment' has been so overused and abused by inexperienced agents that it is unlikely many buyers get balanced advice, when deciding where and what to buy.

Developers, who are risking considerable capital, research their potential market and determine very early on the type of buyer most likely to be attracted to their development; buy to let or private occupier. On some of the larger developments, for example the US golf course projects, both types may be accommodated and their location within the resort may be subtly delineated.

Many Mediterranean resorts and villages across Europe see their populations rise significantly during the summer. The islands of the Balearics, for example, see up to a fivefold increase in population in the summer months. Full time residents want shops, restaurants, bars and life in general to carry on regardless of the season – in short, to live in an 'all year round' community. The areas where they live would be suitable for investors looking for longer-term rental rather than holiday lets. Some years ago, I spent the winter in a 120 apartment development in Santa Ponsa, Mallorca and I was one of only three occupiers. It wasn't good and I couldn't wait to get out.

Capital appreciation and rate of return

All property investment types generate a combination of income and capital appreciation. Whilst capital appreciation will not be crystallized until the property is sold, it can be estimated from comparable sales, or a formal valuation can be undertaken.

To make a meaningful determination of investment performance, the two returns need to be set against time. Clearly, if one property doubles in value in 10 years and another in 12 years, where the currency is the same, then the faster you obtain your return, the better. The rate of return is the basis of all investment analysis.

However, when income, expenditure, both regular and irregular, and tax liabilities are taken into account, the result can be very different. Furthermore, currencies fluctuate, mortgage and interest rates alter, and holiday rental income can not be guaranteed. The investment performance may vary hugely from property to property. This is where good research is essential.

Interest rates

Traditionally, mortgage interest rates in any country have to reflect the national inflation rate, which erodes the interest on investments. After all, mortgages provided by banks are generally provided from funds either directly invested or obtained



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by the bank through the money markets. The availability of funds reflects a country's financial stability and banking infrastructure, and has a huge effect upon property values.

In the USA, the lack of confidence of overseas based buyers had led to mortgage loan rates being offered as high as 10% APR. This discouraging loan rate generates sellers who cannot sell, and buyers who might like to buy but cannot afford the finance. The result has been a catastrophic drop in property prices.

Conversely, in the UK, planning restrictions limiting availability and easy access to mortgages have seen property prices rising dramatically since the mid 90s, only recently tempered by 'affordability' issues.

In Turkey, where prices have seemed remarkably cheap when compared to Western Europe, mortgages scarcely exist. Unless properties are cheap, they do not sell.

Comparative interest rates and mortgage options:

| | |
|-------------|-----------|
| Cyprus | from 5.6% |
| France | from 4.4% |
| Germany | from 5.7% |
| Italy | from 5.5% |
| Portugal | from 5.2% |
| Spain | from 5.3% |
| Switzerland | from 2.5% |
| Caribbean | from 7.8% |
| Bulgaria | from 6.5% |
| UK | from 5.7% |
| USA | from 7% |

(Figures are accurate at time of going to press, UK data Nationwide)

Incentives

In the USA, oversupply has led to many developers going out of business. Incentives currently abound, including 'rental income guarantees', for up to six years in certain cases. These incentives are not limited to the USA. There are many similar offers available across Europe. The developer is effectively buying time to complete the development. Although it could be argued that some incentives are a gimmick, there are some genuine offers which should not be dismissed.

Leaseback

This type of purchase is especially popular in France, because under French law if you buy a property but give it up for rental purposes, fully furnished by the developer, you are entitled to a refund of VAT (19.6% on new property and at proportional share for refurbished property). Usually, buyers are offered some weeks usage per year, but at the expense of annual income. Typically, a 'no owner usage' offer of 5% will drop to under 4% with just two weeks usage. Standard French 'short hold' type lets (normally three year terms), attract a higher net return. The key attraction is the reliability of income with property management included. A downside is that you cannot personalise 'your' property.

Holiday rental evidence

Buyers expecting to let to holidaymakers should research their market thoroughly. It may be useful to visit some websites, such as www.vrbo.com. Be very cautious in developing markets, where a lack of data may grossly distort the results. For example, Dubai, which only permitted foreign ownership from 2002, has seen enormous rental demand for the limited property stock, raising rent levels.

These rent levels, used to support sales to investors, will come under strong downward pressure this year as tens of thousands of new properties come on to the market. Rental income information for Bulgaria's three major ski resorts has been almost non-existent. Considerable investment in infrastructure is now underway which will improve facilities and pistes but until these are all in place, returns are still conjectural.

Holiday rental or long term rental?

Put simply, second home owners who want both some personal usage and rental income will fall into the holiday rental group. It is difficult to reconcile rentals for single weeks and fortnights and



have no void periods. Off season rentals are rarer and rates are usually around 25% of peak season. For annual rentals, the income is more reliable and voids are unusual. Properties are most often rented unfurnished, with white goods only. It is important to check on the occupier's rights if you plan to take back the property. In Spain, for example, rentals are agreed on an 11 months basis, to avoid the occupier acquiring right of tenure. The UK shorthold tenancy arrangement is similar to that in France but the period of the term is longer.

Reliability of income

This is always a thorny issue. Use an established and reliable agent, ideally one personally recommended. Where the rental income is guaranteed by a developer or agent, ascertain who is providing that guarantee and what assets back it up. This may best be undertaken by an accountant.

Capital Gains Tax

Capital Gains Tax (CGT) rates vary from country to country and may also vary between resident and non-resident, as in France and Switzerland. It is essential to take qualified independent advice. The following is intended as a guide only.

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CGT (Non-primary residence, non resident)

| | |
|-------------|-------|
| Italy | 12.5% |
| France | 16% |
| Switzerland | 18% |
| Spain | 18% |
| Portugal | 25% |
| Bulgaria | 0% |
| Dubai | 0% |
| Cyprus | 20% |



Conclusion

Many buyers who have invested overseas have seen their properties grow in value considerably, whilst at the same time deriving considerable pleasure from them. The emerging markets of the last few years, such as the Cape Verde Islands, offer properties at low starting prices because the 'holiday visitor' infrastructure is still to be completed. With the recent tightening of money in the UK, buyers have shown strongest interest in the traditional favourites of Italy, Spain, France and Switzerland. In conclusion, there is no substitute for good research and independent advice.

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'Just released' leaseback developments:

Frejus, 4 star residence in south of France, return of 4.1% net with no usage. Almost immediate financial return as completion scheduled for June 2008.

Le Domaine du Chateau de Cely, south of Paris, on an 18 hole golf course. 5% net return if no usage or 3% with 3 weeks usage. Released March 2008.

Le Domaine de Yerlande, 4 star residence in Burgundy, within easy reach of Lyon and Geneva. 4.5% net return if no usage or 3.7% with 3 weeks usage. Released late February 2008.

Three examples in Mallorca:

New apartment in Calvia, with 140 m2 living, terrace, 4 bed, 2 bath, double garage, parking, storeroom, community pool and gardens. Bought for €450,000. Rented unfurnished at €2,000 per month.

New apartment in Nova Santa Ponsa, with 150 m2 living, 3 bed, 3 bath, garage, small private garden, community pool and gardens. Bought for €360,000. Rented furnished at €1,800 per month.

Holiday rental: 3 bed, 2 bath apartment in Puerto Portals. €1500-€1900 per week high summer. Current estimated value €880,000.