Chapter 1

Laying the Foundations

If you want to build anything meaningful in life including a property portfolio, it has to start with a foundation. Getting the foundations right from the very beginning will help you right the way through your journey as property developer because you will always have that strong support to fall back on if you encounter difficulties.

One of the first things to consider is cash. Nobody ever became a property developer without having some cash even if it's a modest deposit. You will need cash to build or refurbish and property in any form doesn't come cheap if it's in the UK.

So how much money do you need to become a property developer?

You can't buy a property without money even if there are some organisations out there who tell you this is possible.

So if you don't have any money you have four options.

1. Get a job that pays better
2. Earn the money by setting up a business
3. Wait for a cash windfall

4. Find people who are cash rich and time poor who are willing to enter into some kind of joint venture

In my case I already had a business that provided the initial capital I needed to invest. Often, however, even if you do earn enough to consider becoming a property developer, getting hold of finance is usually the first step.

This may be in the form of a mortgage. You may have ambitious plans to buy a property you have seen that needs some attention and a location you think really couldn't be better. Then it comes to the meeting with the bank manager and the mortgage payments seem a little out of reach.

You might think that this development project will soon recoup the investment but wait a moment. Do you have any spare cash left over if anything goes wrong?

Unlike a straightforward property investment, a developer needs to take into account the cost of refurbishing and (or) building work because these two can really eat into cash, particularly if you are hiring tradespeople. If you have these skills already, then you will be at a distinct advantage over those who don't.

As a first step it is worth looking at a more modest property that falls well within your budget to protect yourself from any financial shocks on the way and, trust me, you can expect a few. Not having enough money can end up in a project stalling or worse still, it can lead to insolvency. It is far better to set a budget which will be the first and probably the most important part of your foundations at the beginning.

So now that you're ready to become a property developer let's look at the amount of money it takes to buy one.

The amount you spend on a development property depends of course on its location. You may even be considering a parcel of land on which to build on. Either way you can expect to pay at least a five figure sum.

The cheapest habitable property I have seen at the time of writing was a 2-bedroom end terraced house in Country Durham at a whisker under £20,000 which sold for nearly twice that amount back in 2004.

This should tell you all you need to know about the area in question. Property prices may rise eventually but you could be waiting a very long time in some areas of the UK thanks to the continuing legacy of the last big property market crash.

So while the price of this particular property may look tempting and it was even listed as an 'investment' you would need to be extremely careful and examine the area it is in and the reasons why it is so far below the average price of other terraced houses in the same area.

This was of course an extreme example but it highlights just how important it is to check things like price history which is readily available on websites such as Rightmove.

The ideal starter development property should be showing signs of its value increasing rather than declining over the long term. To do this it is better to look at prices over a decade rather than pay too much attention to short term fluctuations.

If you are lucky enough to find a project property in an area of rapidly rising property prices and have the means to purchase it at a knockdown price, then this can put you well on the road to success early on.

The same thing applies if you are looking to purchase land. Purchasing a parcel of land to build on is far cheaper than buying that same piece of land with a house sitting on it.

Because the value of that plot of land is less without a house built on it, you will have the opportunity to spend more time building the kind of property you want rather than do work on an existing house which may require as much labour and costs as building a property from scratch.

It all depends on any construction knowledge, any expertise you might possess in property development and the return on investment you are likely to receive for your efforts.

Where to look for financing for your development project

Most property books I have read leave this crucial bit out. They immediately launch into investing without addressing where the money is coming from. Finding out if you can get financing for your project is usually the first step before you even start making plans and looking for property or land to buy.

The money for property development usually comes from one or more of the following:

- Cash

If you have sufficient savings and, crucially, you can be confident of leaving some money in your bank account for a rainy day, then using your savings could be an option. You could also use your pension or income from other investments to fund the purchase.

If you are intending to use a large proportion of your cash, then it is worth getting some financial advice to make sure you are aware of the risks if things go wrong.

Property investment can be a risky business and using most or all of your money from the outset could leave you particularly vulnerable to unexpected costs.

- A mortgage

A simple buy-to-let mortgage is a common route into property development. Taking this option means you won't be spending all of your own money but you can expect to have to pay a sizeable deposit of typically 25% - unless you already have equity you can release in another property which we will cover in the next point.

You will also be paying a considerable amount of interest in the long term so shopping around for the best deal is essential as is making sure you are in a position to qualify. Banks are now far stricter on lending than they once were so your credit rating will need to be squeaky clean.

If you intend to use a mortgage, make sure that the monthly payments are affordable and fall well within your monthly budget. Finding a reputable mortgage broker is also very important. Check out my personal recommendations on www.nickfox.co.uk.

- Equity from your own home

It can be tempting to consider using your own home to help fund a property development project. If you have owned your own home for some time and have enough to cover 25% to 40% of the value of another property, then you could re-mortgage. If you have less than this amount in equity, then you may need to consider if re-mortgaging is worthwhile.

While it may seem like the better option, going down this route is not without risk or cost. You will of course be arranging two new mortgages which carry their own expenses in surveys, arrangement fees, solicitors' fees and so on. These can soon eat into your cash but depending on how long you have had your residential mortgage you may escape any early repayment charges.

How to start a property development business

My experience as a business owner was incredibly useful in giving me the necessary skills to become a full time property developer and investor. Without that experience it is unlikely that I would have developed a portfolio of over 200 properties.

A property development business like any business needs a plan. This plan should include what your goals are and how you plan to achieve them.

"Good fortune is what happens when opportunity meets with planning."

Thomas Edison

Buy to let or buy to sell?

Most property investors take the buy to let route where they invest money in property and generating a consistent return on investment over time. This is usually over five years or more. If you're looking at becoming a property developer, you can make a plan based around either buy to let or buy to sell.

Buy to sell is the riskier of the two unless you can be reasonably sure that the property market will still be in as good a shape as the property you are developing. The safer route is to buy to let because there are very few areas in the country that are immune to boom and bust if you are 100% reliant on achieving a set sale price that will more than cover your efforts developing a property with plenty left over for the next project.

If your business plan is based on a buy to let investment, then you will need to research and calculate the following:

- Likely rents in the area you invest
- Rental yields
- Tenant demand
- The type of property

I say likely because none of the above comes with a guarantee but with a little research, you can soon get an idea of the likely return you can make from your property development project over time.

If your rental yield is unlikely to be more than 5% then you should consider looking at an area where property prices are relatively low and rents are high. This is often the case in less fashionable towns that are close to areas where employment prospects are good.

The type of property you choose is vital if you want to make a success of property development. As in business, you need to provide what the market needs. If you're building a 4-bedroom property in an area predominantly populated by young professionals seeking 2-bedroom apartments, then you could find yourself with lengthy voids to contend with and compromises on the rent or sale price of the property. Build that same property in a picturesque location with an outstanding school and the opposite will be true.

Buy to sell will involve a projection of how much a property is likely to be worth when the development work is complete and whether there will be a buyer come exit time. You can then work out the profit minus the associated costs. Your profit from a buy to sell project should be in the region of 30% to make it worthwhile.

As with any business the plan should include financial projections as well as profit and losses that are anticipated along the way. Having good cash flow is essential so that you have enough cash available to cover development costs.

Hanging on to a job is probably a good idea or if you are not in employment, it is worth setting some emergency funds aside.

Finding the right kind of property

This really depends on what type of property developer you are. You could be the developer of a large scale property development that is being built from scratch on a plot of land, you may be considering a major refurbishment of an existing property or you may have a large-scale HMO project in mind.

As this book is geared to those starting out, we will assume that you are in the refurbishment bracket. In this case it is crucial that the property you choose is in the right location and the price is right as it is with all types of development projects.

If you remember anything from this book, remember that you make most of your money in property or land when you are buying and it is what you later do with that asset which determines how much icing you can add to the cake afterwards.

Research the Area

You will find plenty of information online about a particular area, local sale prices and rents on websites such as Rightmove and Zoopla. The right kind of property for you will be balanced between the price you pay, the value you can get out of it and your development budget.

Your aim should be to buy a property at a price that offers the best value in a particular area and this will always be a property in need of improvement. One important point to remember is that the cost of improving this property should be more than covered by the rent you are likely to receive or the amount you intend to sell it for when it is finished.

Invest in property that suits your budget and time

As a beginner developer it is better to opt for a property that doesn't have major structural issues or is too large even if those properties are available at a knock down price.

It is important to consider time as well as your budget. Turning a church into a residential dwelling only to find that the work takes 5 years to complete is not a good strategy if you want to build a portfolio.

Property development if you are going it alone can be hard work and hiring tradespeople can be expensive. Spending too long on a development project is simply a waste of time and money when you could be starting small and generating a profit sooner.

When it comes to location, you can find plenty of opportunities around the UK. The best areas to develop property will be in areas close to good schools and areas of high employment.

Locations near top graded schools (see Ofsted, Estyn (in Wales) are in big demand amongst anxious parents keen to send their children to the best schools. In these areas, family homes will be the better investments whereas in cities where space is more constrained and populated with young professionals, HMOS and other smaller dwellings will be more in demand.

Why cash flow is so important

Cash flow is as important to a property developer as it is to a business. Having enough of it is another matter. There may be times where a business is running at a loss due to having to pay bills or buy materials and equipment and it's the same with property development. In fact, it is a particular problem in property development because you will often be waiting a long time to see a return on your investment.

Even large property developers working on multi-million pound projects are stopped in their tracks when cash flow becomes a problem. They will then look to other sources of finance to get them over this hurdle but for a person who is new to the business of property development, getting hold of enough cash to complete a project can be a nightmare.

So generating cash flow while the building work is being done is essential if you want to avoid problems.

The top five things that can impact on your cash flow as a property developer are:

- Increases in bank interest rates
- Economic downturns that result in banks being less eager to lend money
- Unexpected costs
- Missed deadlines and delays
- Inability to sell or let the property which leads to arrears in finance payments

It has to be remembered that a building is one of the least liquid assets you can invest in. This means it is not as easy to sell and this is certainly the case when development work is taking place.

You are essentially tying up money to receive a longer term return on investment. This doesn't mean however that holding lots of cash is preferable to owning a property, holding lots of cash simply means you will be missing out on some potentially great future returns.

If you can maintain a good level of cash flow while the work is being carried out, then there is no reason why your development project will not be a success. Remember, property values tend to increase over time while the value of cash erodes due to inflation.