Is buy-to-let property investment on its death bed?

The once buoyant residential market is not the golden goose it was a few years back, says Rowan Alexander, director of Alexander Swart Properties, but this is a short term view for which there is little or no justification.

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“One can find weekly in the news media, data reinforcing the notion that the property market is on a decline,” he says. “Annual rental yields were recently regularly in the 7% to 10% bracket, with similarly impressive annual capital growth - but are now sometimes down to ± 4.5%. In the less developed provinces like North West and Limpopo there has actually been negative rental growth. Even in the more prosperous areas like Cape Town and Durban, rental vacancies are now close to 7% and defaulting tenants are at an all-time high. We know that incomes have deteriorated this year to the point where the average tenant has a 45.5% debt-to-income ratio.”

All markets are cyclical

Alexander states that while all this is undeniable, those now advocating an abandonment of buy-to-let investment are ignoring the very important fact that all markets, whether property-related or not, are cyclical. In the property sphere, those who hang in there for the long run have time and again shown that their patience is rewarded, with rental returns and capital growth above 15% per annum over a ten year period.

“Of course, if like so many, you have to produce revenue and show satisfactory figures within 24 or 36 months, property will not be the right investment avenue for you. For those who are able to take the long term approach and get back finance, this is still the better or safer investment asset,” says Alexander.

In the leaner times, how should a property investor go about acquiring a property? Can it still be worthwhile?

The fundamental point to realise is that the bank debt gearing available to successful bond applicants is so customer-friendly that it makes it even more possible for those with very limited means to get into this market. “Previously most investors were able to come up with a 10%, 20% or even 30% deposit. This meant that they were able to cover their mortgage bond repayments from an early stage, sometimes from day one. Now however, it is likely that the achievable rents will be smaller and to cover their bond repayments from the outset, investors might have to put down as much as 40% of the sale price.”

Recommendations

- He suggests that the investor applies for a 100% bond. If it is approved he will then have to subsidise the bond repayments, possibly for as much as six or seven years. But, says Alexander, as he is paying only ± 10% on his bank loan, this will in the long run still turn out to be a worthwhile investment.
- “Even in cases where there is a shortfall for six or seven years, the sums paid in by the investor are seldom over 15% of the total - I have never seen them exceed 20%. The cumulative sum equates to a 15% deposit, but it is a deposit that is paid off over six, seven or in a few cases even eight years.”
- On a 100% bond for R1.2m, where a gross rental at R9000pm is achieved, the cumulative shortfall payments will amount to ± 150,000 – not a great sum on a property worth over R1m and appreciating each year.
- “My message, therefore, is that if you are attracted to property investment (as you should be), right now is a great time to buy because prices are low. Many people think they cannot possibly afford such a step in today’s economy, but discussion with a good mortgage originator and/or a trusty professional estate agent will usually show that finances can be restructured and they can become property investors – and be significant beneficiaries when the market picks up.”
- Finally, Alexander comments that it is ‘illogical’ when any of the big retail stores offer wares at a significant discount people queue up to buy them, but when property is discounted people ‘run the other way’. “The principle that applies to a good roast chicken sold at a bargain price, should apply equally to property,” he says.