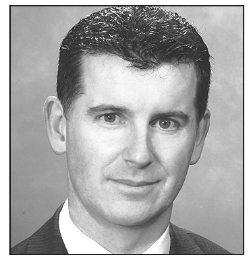
Popular investment requires careful thought and recognition of financing and risk factors

Buying a pre-sale condominium



REAL ESTATE INVESTMENT

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Real estate investors today are faced with an array of choices in the market place, which can be quite confusing and overwhelming at times. How do you know if you're making the right decision? How do you know if this is a good deal or a bad deal?

The best way to analyze an investment opportunity in terms of whether it is right for you or not is to ask yourself the following simple questions:

1) Why are you buying real estate in the first place?

2) What results are you expecting from your real estate investment?

These may seem like simple questions, but in the answers lay far more solutions than you may think.

Let's look at a few case studies:

Our first couple is new to the real estate investment game. When asked why they want to buy real estate, they say they've always known that real estate is a good investment, but they haven't had any extra money with which to invest. They have recently realized some significant equity appreciation in their principle residence and want to leverage it into a "good" investment. They're not really sure what to buy, but are concerned about losing their hard earned equity.

If I were to dig deeper with our young couple, I would find out that what they really wanted was to be able to make a simple investment that would help them increase their net worth. Increasing net worth is then further defined by a specific dollar amount within a specific time frame. For example, they would like another $100,000 within the next three years.

Another example is a sophisticated investor who has been buying and selling homes for a number of years and is now looking to take things to the next level. When asked why they are buying real estate, they are very specific. They know that they need their next real estate investment to produce a specific amount of money in a shorter time frame. They have more money to start with, and their risk tolerance is greater.

Buying pre-sale

So let's take a look at one popular investment opportunity and analyze this option based on how well it is suited to the investors' goals. The investment we are looking at is a new condominium development that can be bought at "pre-sale" price and scheduled to complete in 2009.

This is a common choice for both novice and seasoned investors, and with a little research, it can be a profitable one.

The biggest pothole an investor has to watch for is the danger of making decisions today based on advice from someone who made money a few years ago. Virtually everyone who bought a pre-sale condo from the year 2000 to the year 2005 would have experienced a healthy profit. In most cases, those individuals were able to assign (or flip) the paper before taking possession and there was no shortage of individuals willing and able to buy it off them.

My concern with the pre-sale market today is that buyers should take more caution in terms of where they buy. The market may still be strong in 2007, but if your unit is not slated to be built until 2009 or so, will the market still be there to flip it? And if you can't find a buyer right away, are you willing and able to take possession of the unit?

This is where some of the financing questions come in.

Financing

When financing a pre-sale, the developer will often offer on-site financing with as much as a two-year hold on the interest rate. In our current market with rates rising, this is a good thing. The offer will be written up either as an owner occupied purchase – in other words, you are buying this with the intention of moving in – or, it is purchased strictly as an investment property. In this case, the bank will likely require 25 per cent down by the completion date.

You should carefully research the market in which you are interested.

Most new highrise condominiums in downtown Vancouver are priced from $700 per square foot, so it may not be realistic to believe you can purchase the unit and rent it out for enough income to cover your expenses. However, there may be an opportunity for price appreciation, depending on the quality and location of the condominium.

> "If you can't find a buyer right away, are you able to take possession?"

In the Fraser Valley, new woodframe condominium prices are now nearing an average of $400 per square foot, and rental demand is growing. For novice investors more concerned with risk, this market may represent a safer option. It is up to the investor to make a decision the they are comfortable with.

Risk factors

The two things that you will need to concern yourself with when it comes time to complete the purchase are:

a) Has anything substantially changed with your financial picture from the time that you applied two years ago? An example of this can be a change of employment or the purchase of other rental properties in the meantime.

b) If you have to take possession and can't rent it out for a short period, or the rent that you get does not cover the mortgage payments and other expenses, can you afford to carry it and supplement it from your personal budget?

Assuming that you are comfortable with the answers to those two questions and you do enough homework to pick the right markets, then this third option could be an excellent investment that would allow our young investors to accomplish their goal of increasing their net worth over the next three years.

Buying resale

However, if the investor wants some cash flow to go with that capital gain, he or she may well be better off with avoiding pre-sales and going with an older property that already has positive cash flow from the current tenants.

According to the latest figures from the **Real Estate Board of Greater Vancouver**, the typical resale condominium has seen a price appreciation of 58.5 per cent over the past three years, and **Canada Mortgage and Housing Corp**. confirms that condominium rentals have less than a two per cent vacancy rate. This is fairly good evidence that buying an existing condo could be a safe investment, even in the high-priced downtown market.

When planning an investment, start with a clear understanding of who you are, which box you fit into and what results you need your real estate to produce for you, and you will find that it's not as overwhelming as you thought.

Happy investing.◆

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