OLLY NEWLAND

CLIMBING THE PROPERTY LADDER

Tales of Profit and (mis)Adventure in the Real Estate Jungle

Best-selling author of
The Rascal's Guide® to Real Estate
and ***The Day the Bubble Bursts***

EMPOWER LEADERS™

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Olly Newland

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Introduction

Every story in this book is true. I should know — I was involved in each of them in one way or another. Only the details have been changed to save needless embarrassment to the innocent (not to mention lawsuits).

Some of the stories are about gutsy people who took risks, had their share of good (or bad) luck, and can look back and say with a clear conscience that at least they tried. There is nothing more boring than stories of 'what might have been' (or as the Americans say, 'coulda-woulda-shoulda') — the excuse many people use to gloss over their lack of progress through life.

These stories have the common threads of real estate investment and the common human failings of greed, fear, naivety, carelessness and envy. The human condition, in other words.

Some have happy endings, some do not. Many are about raw human emotion — property just happens to be involved along the way. Because most property deals involve big numbers, from hundreds of thousands of dollars to millions, it's not surprising that many people go a bit peculiar around them.

This character transformation is just one of the hazards of the game and goes to explain why real estate has been a topic of fascination since the first caveman evicted a sabre-tooth tiger from its cave.

In these pages you will read about those who started with nothing and made literally millions. You will read about the crooks, cheats and downright criminals who are attracted to big money as moths to a flame.

Then there are those who lost their nerve or had real bad luck and took a massive loss as a result. (I was one of them. Ouch!)

It takes all sorts in this world and I have met most of them. From the fellow who was an undischarged bankrupt but managed to con several real estate agents and car dealers into believing that he was capable of paying cash for one massive property after another (and got the royal treatment for weeks while it lasted), to the young couple with a baby renting a grotty one-bedroom flat who came to me for advice on how to invest in real estate. To look at them you would have thought he was a part-time school handyman and she a used clothing shop assistant. How looks can deceive. They had just inherited more than $3 million to spend as they pleased. All they wanted was a bulletproof income from real estate investment. If only every problem that crossed my desk was as easy as that!

This book covers some of the amazing adventures I've had as purchaser, landlord, or vendor in property deals or, (as is often the case) as a consultant for others.

Over the past 45 years I have owned, bought, sold or managed about $4 billion worth of residential and commercial real estate in today's values. It sounds a lot — and it is. Let me suggest with all modesty, that this experience gives me the authority to talk on the subject with some confidence — but, I hasten to add, no-one knows it all.

For those of you who really would like to get ahead, take heart from one fact I have learnt over the years: earning the first million is the hardest. After that it gets easier and easier.

In fact, I would go so far as to say that after you have two or three million under your belt, it can become a little boring. You can only eat three meals a day, sleep in one bed at a time and travel only so much before fatigue sets in.

It's all a *game*. The thrill of the chase and winning itself are the real prizes, never mind the money.

Always remember, in any activity — especially real estate — give yourself every chance.

A first step is to stop any whinging and whining. Get off your backside and give it a go. That's an order!

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Dumb deals

One of property investment's major disadvantages is the slowness of action — how long things can take at times. It can sometimes take months, if not years, to get results, and taking a long view of events is essential.

This disadvantage is also an advantage. It is rare to be forced to make quick decisions or to react quickly to moving events (with the exception of auctions, which can be a nightmare for even the strongest-willed). Often if you decide to do something with a property that you own, it is not unusual to only see the result of your labours weeks or months later — if you are lucky.

It therefore amazes me how many people make silly errors under the mistaken impression that time is against them. Here's an example: a deal I witnessed which takes the cake as the dumbest ever.

A couple of fellows I know jointly owned a building from which they ran their business. Their business had been very successful, but clearly they were making more money on the appreciation of the building's value than they ever made working like dogs seven days a week.

I told them this repeatedly, but I could see that my words went in one ear and out the other. They'd bought the property ten years previously for $100,000 and had paid off the mortgage. It was currently worth around $1 million. At that value it was appreciating, while they slept, at the rate of about $100,000 per year — about what they were drawing in wages from their business in the same period, less tax and non-stop stress.

As the market improved, it occurred to them that selling the building and leasing it back might be a good idea. It would free up capital, supposedly to put back into their business.

When I heard of their idea I warned them against it, saying a lease-back on their own premises might be a short-term solution to the shortage of cash in their business but in the long-term they were effectively selling the family silver.

It would be better, I cautioned, for them to raise a mortgage on the property — which in cash terms would do exactly the same as selling, but keep the family silver intact.

They would hear none of it and pursued the idea of selling the property with what seemed like excessive enthusiasm. I soon found out why.

A firm of commercial real estate agents had explained to them that the value of the building was determined by the rent paid under the lease. The higher the rent the higher the sale price they could achieve. Greed got the better of them. I looked on in horror as they dug a very big, very deep hole for themselves.

The building's market value of $1 million was based on an annual rental of $100,000 net (i.e. 10% yield). This was about right, and reasonable under the circumstances, but they didn't see it that way.

Motivated by greed, their illogical reasoning led them to *double* the rent they were prepared to pay to $200,000, in the belief that they could make an extra $1 million when they sold. You could almost see the juices running down their chins as they thought about the money they would pocket.

I remonstrated with them but to no avail. The real estate agents had their ear and all they could see was the money dancing before their eyes. They would listen to nothing else.

Sure enough, the building eventually went up for auction described as blue chip (which it wasn't), suitable for 'astute investors', with all the usual blandishments and over-blown hype that agents churn out so well. The annual rental quoted was $200,000.

Almost every day I get a stack of paper from various agents in town offering me this or that property for sale, so when I got the information on this particular property I read the actual terms of the lease for the first time. In most circumstances I would have laughed my head off. But I knew the people involved in this case, so it wasn't funny.

These fellows had well and truly stitched themselves up — and had done it all on their own. The lease was an exercise in do-it-yourself *hara-kiri*. It was bad enough that they were offering to lease-back the premises at an inflated $200,000 p.a., but they were prepared to also commit themselves to a long ten-year lease term with two-yearly rent reviews, personal guarantees, and paying all the outgoings. The lease even contained a tough ratchet clause, meaning a rent review could never take the rent below $200,000 or the market rate, which ever was the greater. Whoever advised them had let them down.

From an investor's point of view it was a dream even though the rental was twice the market rent for that area at the time (which would affect future rent reviews).

As auction day came closer I watched the interest build up. Breathless agents kept ringing me to suggest I should bid since so much interest was being shown.

Sorry. Not a chance in hell. It was like watching a public hanging in glorious Technicolor and in slow motion.

The property sold for $2.2 million (9.1% yield) to a group of investors. The two owners (now tenants) got $1 million each from the proceeds after expenses, but were now saddled with rent and outgoings of around $230,000 a year.

Think about it.

How would you like to wake up in the morning knowing that even before you've had your cornflakes you need to find over $5,000 a week every week, rain or shine? On top of that there were all the costs of running a business, let alone getting the groceries on the table.

I estimated that they would have to find at least $10,000 a week (not a misprint) 52 weeks of the year to make it worthwhile — and knowing their business, I knew this was impossible.

For a while they enjoyed their windfall: new cars all around, trips away, upgrading the home and all the usual things that are obtained when too much money is made too quickly by those not used to the experience.

It just *had* to come unstuck — I could see that a mile off. Within four years they had gone through all the money, but still had to find $10,000 a week whatever the circumstances.

The landlord was over the moon. By that stage, he and his colleagues had nearly half their original investment back and they still owned the building! What's more, rents and values in the area had eventually caught up with the rental paid. There was no way out for the two hapless tenants but to keep on paying and paying on a treadmill that never slowed, but ground on mercilessly.

The last I heard, both of them had sold almost everything they owned, were driving Ladas and, at the rate they were going, would soon qualify for charity food parcels.

Don't make the same mistake when you are faced with a major decision in your investment career. Chasing short-term gains at the expense of long-term benefits is not the way to get ahead. Take your time, think it through, or you may end up driving a Lada as well.

Bean counters' bloopers

You can forgive ordinary folk for making mistakes when it comes to real estate decisions. After all, most people only do a few property deals in a lifetime and can't be expected to be experts. It's an altogether different matter when it comes to big-time institutional investors who employ a small army of highly-trained graduates to advise them what to do next.

The biggest gaffes are mostly made by such investors who stare into computer screens or fondle their university degrees and declare total knowledge on all matters to do with property. For example, just look at what the banking industry did not so long ago.

Some bean counters at head office somewhere decided that banks should divest themselves of their premises as banking would soon be a mere squiggle of a cursor on a computer screen, or transacted through a hole-in-the-wall cash dispenser. A deluge of bank premises hit the market from one end of the country to the other. They ranged from small outlets in country towns to major branches in the heart of the main centres.

The banks wrote themselves decent new leases (six-year terms generally) hoping buyers would cough up lots of nice cash and buy the investments.

How stupid can you get?

The bank properties sold for excellent prices, in many cases to investors far more savvy than the dolts who dreamt the idea up in the first place.

The investors instinctively knew what the banks forgot: people would still require real banks with real tellers at real counters — and so it has proved to be.

While a few bank branches have closed, the bulk of these leased-back bank premises are still let, earning higher and higher rents while the new owners are laughing all the way to the, um, bank.

I had just such an experience when I purchased a National Bank branch in Hamilton from an investor who had a bit of bother and sold it on to me for a good price, representing a 14% yield.

Far from closing down, the bank has renewed its lease like clockwork over and over again. And no wonder. Every time I visited the premises, customers were lined up in this busy branch.

By now the rent paid by the bank has recouped every cent I paid for the building in the first place — it's also worth twice as much, since investors are accepting yields around 7% or less for this type of building and lease.

The bigger they are ...

On a larger scale, another deal in which I was involved resulted in one of the bigger booboos ever perpetrated by an institution. They relied on pointy heads and not experience. They should have known better.

It was 1985 and I was the managing director of the fledgling public company, Landmark. Commercial property was still relatively easy to buy, and using common sense and quick thinking I had secured for the company a large building then known as Victoria House on the corner of Lorne and Victoria

Streets. The price paid was a laughable $1.7 million. It was intended to be a long-term hold, but this was not to be.

A short time later, the ANZ Bank Pension Fund decided that it wanted the same building and made me an offer to buy it that was simply too good to refuse.

The offer came in two parts. First, a payment of $5 million for Victoria House — immediately realising a cash profit of $3.3 million, which isn't bad for a few days' work. The second part was the cream on the cake. To soften their cash outlay, the managers of the pension fund asked me to buy another building from them. This was the ultra-modern 16-storey ANZ building on the corner of Queen and Victoria Streets occupied by the ANZ head office.

The asking price for that property was a piffling $2.4 million but it did have one drawback: the ANZ Bank had written itself a head lease for 30 years(!) at a fixed rent of $220,000 p.a. net.

The pointy heads in the bank had simply taken the net rent of $220,000, multiplied by a yield of 9.1% and came up with the asking price.

It didn't take me more than 60 seconds to calculate that the market rent should have been around $1 million a year, giving the property a value of around $12 million. (This was subsequently confirmed by our valuers.)

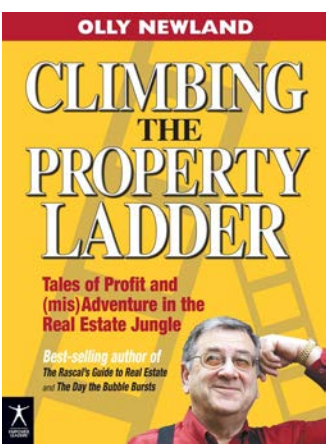
The deal was concluded with almost unseemly haste, the profit banked and the new building popped into the portfolio.

You may well ask, was I worried about the 30-year fixed lease? Answer: no, not in the slightest.

My experience as a landlord had taught me that leases rarely go the distance. Every once in a while the tenant will require something, or need a favour, or want to change something — which gives you the opportunity to play hardball, agreeing only if the terms of the lease are changed (in your favour, of course). I knew that sooner or later the ANZ would want something. Breaking the lease would be easy at that point.

A few years later that's exactly what happened, when they wanted to sub lease parts of the building and renovate other parts. I agreed so long as they re-wrote the lease — which they did. Consequently, the value of the building rocketed upwards. A very satisfactory result all round.

When looking at an investment, don't get bogged down in the facts and figures. Stand back and take a wide view. Facts and figures are only a part of the equation. Always look for the angle or 'twist' that can turn an ugly-duckling property into the deal of a lifetime.



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by Olly Newland

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