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Five traps to avoid when buying a condo

Adam Brind
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With signs of uncertainty in the market, it has never been more important to analyze your next real estate investment. Jumping into the unknown and hoping for the best is risky business. While this tactic may have worked over the past three years during Canada's lucrative real estate market, it is no longer the case. Real estate has never been a fool's game' and now is the time to switch strategies and become diligent for a greater chance of success.

It is also unwise to sit on the sidelines in cash. Downward market shifts are healthy for a number of reasons because it amplifies the good, the bad, and weeds out the average.

Tactical investing is the act of leveraging a strategy behind every decision. All too often, real estate investors make decisions based on past performance or success – the same type of mistakes are found in capital markets. As an investor, it is important to treat every decision independently, and perform the proper due diligence with the right set of tools.

Just because Uncle Joe bought on speculation and got lucky, doesn't mean that you have a sure bet. The only certainty in real estate is that the market can take it away as fast as it can give it. By taking a few simple steps, you will put yourself in a better position for success and maximize your working capital. Below, we examine some very relevant tools for performing your own due diligence, common traps in the market, some issues that are often overlooked, and some warning signs that the development will fail.

None of these tools are meant to make you invincible, but they will definitely help to put you in a position to take advantage of potential market changes. If you're an expert already, they are likely to reinforce your current investment strategies.

Five critical test of a good condo investment

These five core filters are the bread and butter of investing in real estate. If your next purchase does not pass at least four of the five filters below, it is likely a good time to reconsider the investment.

1. Pricing
The old proverb remains true: you make money in real estate by what you pay for it, not what you sell it for. Pricing is the easiest way to ensure that you are on the right track. If you are buying in a heated market or in a 'hot' neighbourhood, it is likely that you're buying at the fifty two-week high (or three year high in Toronto's case). Stay away from inflated prices.

2. Developer experience
The problem with heated markets is that it attracts amateurs that want to get in on the action. But, more often than not, these products lack quality and design. They may look good on paper, but the underlying issues will make you want out faster than the ink can dry. Try to buy from a local developer that has a portfolio of successful products in the neighbourhood.

3. Development logistics
Even if the price is right and the developer is great, you will still need to examine the size of the project, layouts, designer, amenities, etc. If the project is reaching for the stars, you can bet that it will feel less like a community and more like a transient bus station.

4. Location and neighbourhood
Condo investments, resale or new, hinge on their location and the neighbourhood that surrounds them. The neighbourhood makes the condo and not the other way around. This doesn't mean that the neighbourhood has to be completely gentrified; it just means that it has to have the foundation for resale and rental capacity.

5. Running the numbers
Even if you are purely a growth player, the rental numbers still have to make sense for resale value. Long-term value investors will focus directly on the cap rate of the property. Future rental capacity is critical to a strong investment and building a passive portfolio.

Traps to avoid when buying condos

Beyond examining the core filters, it is critical to understand common traps in the market. These simple mistakes can mean the difference between a great investor and an average one. Why not learn from others' mistakes?

1. Getting caught in the developer hype.
Remember, developers spend thousands of dollars on marketing and promoting the launch of a new product. So, it is incredibly easy to get lost in the vortex of developer greed. Take a step back and think about your next purchase. Don't be fooled into overpaying for a product because you are getting the 'friends and family' discount.

2. Believing you can sell it before it registers (on assignment).
If you are not in a position where you can obtain a mortgage when the project registers, stay away from buying new construction. The market is being flooded with condo assignments and many are selling below their original purchase price. This trend is likely to continue as more projects near completion and the supply increases.

3. Buying without motive / not having a plan.
Are you a passive investor? Will you manage the property yourself? Do you know about capital gains taxes? Is residential real estate the best approach? Before investing in real estate assets, it is important to hash out a very specific plan; otherwise, you run the risk of losing your capital or worse.

4. Capital appreciation vs. income approach.
Everyone can tolerate risk differently, but what is your approach? This goes back to the last point about planning. Real estate is very similar to investing in the equity market. Every investment opportunity is different, and knowing your motives will help you to place your capital in the most appropriate way.

5. Over upgrading
Over upgrading is a very common mistake made by amateurs, and one that can be costly. Developers have tried to spearhead this problem by providing palettes , but owners still make this mistake. Over upgrading to your tastes may not be reflected in the market value of the property and likely, do not appeal to the masses. By default, this decreases your buyer pool and demand for the product.

Costly mistakes investors make

Next, we will take a look at some issues that are often overlooked by investors. Failing to consider these issues could be disastrous.

1. Not understanding the tax implications.
The whole point of investing is to make money, correct? Before you jump into any investment, you must understand the tax implications of buying, owning and selling that investment. Using an accountant that specializes in real estate will help you understand terms such as Recapture of Capital Cost Allowance.

2. Assuming that it will appreciate.
Over the past three years, Canada has seen some explosive growth, especially in the major cities. But appreciation is never guaranteed. Aggressive growth investors looking to buy and sell under three years of ownership could run into problems if they don't consider this fact.

3. Not double checking surrounding real estate lots.
There is nothing worse than buying real estate only to find out that your view and building will be completely obstructed by a new building. Any sign of cranes or even a zoning amendment application can be detrimental to the value of the property. Even if you are surrounded by protected heritage properties, do some research with the city.

4. Not running the numbers.
Real estate is a game of numbers. The upside is that these numbers make real estate investments predictable and controllable. Running the numbers before taking the plunge puts you in control of the situation and ensures that you maximize your capital placement.

5. Ignoring the market signs and signals.
Ignoring the market signs and signals is an amateur move that can be devastating to your bottom line. Ignore the media, read industry reports and ask the right questions.

Danger! 5 warning signs to beware of

Even after an investment has gone through copious amounts of due diligence, it is still very possible that the project is going to be a dud. Here are some clear warning signs that you should consider:

1. Trouble with the city/planning department.
If you find that a developer is having difficulties with the city's planning department, it is usually for a good reason. Even if they resolve their issues, the project timing would be extended and at the very least, your capital will be tied up and not earning money. On the more aggressive side, you could lose your entire deposit to an unfinished project.

2. Slow sales.
Ever wonder why a developer pushes Realtor commission to 5 per cent or offers a Mercedes as an incentive bonus? It is because sales are slow so they do everything in their power to attract buyers and their agents. Unfortunately, sometimes it works. But a project should sell itself. If buyers are currently staying clear, what will happen when it is built?

3. Terrible curb appeal.
Selling real estate will never change – some developers get it and some do not. It sounds simple but some developments fail because of the curb appeal.

4. Extenuating circumstances
Some developments just can't get away from extenuating circumstances **,** either by design or due to the building code. For instance, one building in Toronto was prohibited from having any operating windows on the north side of the building. This does not hurt the south facing suites, but the building now has a negative reputation. Using common sense is the best way to avoid involvement in a building that has the potential to gain negative publicity.

5. Too good to be true.
If you find a building or development that is selling far below the market and neighbourhood value, and it seems like it is too good to be true – it usually is and will likely attract the wrong investors. Every market has these developers and they usually mask their awful products with great marketing. Be cautious of below market prices.

The important point to remember is that investing in real estate can still be very risky. It is a big commitment to understand and find the right opportunities in the market place. The good news is that there are professionals that can help you with this.

Whether you decide to work alone or hire a professional, make sure that you have a solid plan; one that is dynamic and flexible enough to shift with the changing markets. The plan should have a timeline, projections, milestones and goals. It is very similar to crafting a comprehensive business plan with your ultimate goal as the underlying motivator. Your strategy and processes will most likely adapt but your goal should not.

Once the plan is in place, due diligence is only a means to an end. Running the numbers, researching and finding the right opportunity is the best part of the game and it only becomes easier after the first couple of deals are behind you.

Really savvy investors will look at hundreds of deals before they deploy their capital and that is what makes them so successful. It is also their ability to think creatively and act on instincts. This talent is developed with experience, but it is important to note that savvy investors have one distinct advantage: they can think outside the box when it comes to crafting deals.

As soon as you can understand that there are no rules, it will automatically put you at a distinct advantage compared to the general population that believes that buying and selling real estate has boundaries.

From Canadian Real Estate Wealth Magazine, *a monthly publication focused on building value through property investment, covering topics such as values and trends, mortgages, investment strategies, surveys of regional markets and general tips for buyers and sellers. Adam Brind is the Principal at Core Assets Inc. and Realtor with Remax Condos Plus Corp., Brokerage in Toronto.*
