Timing Timing Timing

By Erwin Rode
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When buying a property, location is not nearly as important as timing. This seems to fly in the face of conventional wisdom, so I better explain myself swiftly before the lynch mob gets the upper hand.

When you buy a property in a secondary location, the poor location is already reflected in the price – unless you were taken for a ride, of course. Another proviso is that this secondary location does not become a tertiary one. An example of the latter qualification would be South Africa's decaying CBDs. Buying a property in these nodes today means you could get a *hefty* discount on replacement value. However, try to sell that same property a few years on, and you could find you now have to sell at a *super-hefty* discount!

Developing – as opposed to buying – in a secondary location is, however, something completely different. The bricks and mortar now cost exactly the same as a similar development in a prime location. Yet less value is added in the secondary area because the market rental is lower and the capitalisation rate higher. (In case you are not a property pro, the capitalisation rate is the property equivalent of the forward earnings yield of shares – the higher this investment yield, the lower the market value of the asset.) And these negatives are only partially neutralised by the lower market value of the stand on which the building is erected.

A similar principle applies to houses. It is always better to erect a house with a given level of specifications in an upmarket rather than a downmarket neighbourhood. More value is added to the same bricks and mortar in the leafy suburb. This is another way of saying: beware of overcapitalisation in, especially, downmarket areas. It happens so easily: one's financial position is now better, one has another kid, and the wife wants a TV room… So often it would be better to sell – incur the friction costs – and buy elsewhere.

Next week we shall deal with the property cycle. ■