Rob’s extra Beyond The Bricks notes: Mat Smith

Overview

Mat is what I think of as a "cyclical investor": by buying the right properties in the right place at the right time, all he needs to do is sit back and wait for their values to go through the roof.

The first time he did it, I don't think he'd mind me referring to it as "lucky": he only started investing in Aberdeen because he was stationed there by the RAF, and he wasn't even thinking about capital growth at the time - he wanted to replace his and his wife's joint wage, and he knew that he needed to own 30 properties making £150 per month profit to do that.

The fact that the units he bought went up in value from £30,000 to £80,000 was just a happy bonus. But to Mat's complete credit, he spotted that capital growth had dramatically outstripped the income he was aiming for - and converted to being a growth-focused investor immediately. Since then, he's been in the right place at the right time for spectacular capital growth several more times around the world.

Unlike anyone else in the book, Mat "cycles" his portfolio - owning them until they've gone up in value, then selling up and taking his increased capital pot on to the next location. He doesn't add value through refurbishment or buy at "BMV" prices from motivated sellers: he just buys in the right place (before anyone else has spotted it), and waits - pocketing a decent rental return in the meantime. This is how institutional investors act, but it makes him very rare among private investors - most of whom just own a few properties, aim to pay them down, then hold onto them as their pension.

The effect is dramatic. He put £180,000 in deposits into his initial portfolio in Aberdeen (financed through his wages and the sale of a previous property), and ended up remortgaging them to pull out £1 million to take on to his next round of investments - while still owning and generating an income from all 30 properties.

The Mat Formula

1. Find an area where the achievable rental yields are historically high

In Aberdeen, Mat was seeking a gross yield of 12%. Thus his "embarrassingly simple" formula was just to knock two digits off the sale price to see if it would stack up: if a property was being sold for £60,000, it would need to rent for £600 to give him a 12% yield.

12% doesn't have to be the magic number, but the key is that it has to be **"historically high"** - because this is the signal that properties are undervalued, and at some point they will return to equilibrium. This typically means areas where **confidence is very low**: there might have just been a recession, there are no owner-occupiers in the market, and investors are sitting on paper losses rather than actively looking to acquire more.

An example of such an area now might be Leeds, although prices are going up quickly. You can still buy a repossessed luxury flat for £135,000 which was worth £220,000 at its peak, and will give you a gross yield of 8%. 8% is a long way from 12%, but it's still *historically high* - you would expect this type of unit to be bought by an owner-occupier, and not be sufficient to deliver a decent return to an investor. As it is, 8% is better than the UK average.

But look out for traps, because many areas have high yields that are *always* high - because properties just happen to be cheap. There are lots of areas in northern cities like this, where you can buy a terraced house with a yield of 12%. If that yield has historically always been around 12%, then it doesn't represent an opportunity for this model.

How do you know if yields are historically high? You can get a broad idea of historical prices for an overall postcode area (e.g. LS1) using home.co.uk, then use Rightmove's price history to get down to individual street level. You then need to map historical rental prices onto this to find out the historical yields, which aren't available online so you'll have to speak to a local agent or a resident with a long memory!

In practice, you'll probably be able to spot an investment thesis about why an area might be unloved by investors at the current time, rather than having to go across the whole UK postcode-by-postcode.

2. Set a disposal price at the point of buying

This is critical, because this isn't a buy-and-hold strategy. You need to make sure you're not tempted to hold on when you see the price rocketing up - because when you've seen the majority of the growth you're going to get, you want to liberate your cash and put it to work harder elsewhere.

Your disposal price could be:

- Simply, its value at its previous peak. Given that property prices go up over time, it's a safe bet that it will get back to at least that level. And given inflation, in real terms it would still be cheaper than it was at the previous peak

- The price at which someone buying as an investment would be getting the average historical yield. In other words, when the special window of opportunity has closed and normal service has been resumed

- A more complicated number based on income multiples of the owner-occupier you expect to be selling to

Whichever one you choose, put it in the spreadsheet and stick to it! So essentially, your spreadsheet will look exactly the same as it would for any normal buy-and-hold acquisition, but with one extra column: "target disposal price".

3. Wait

If you have your property managed, at this point you spend a few years merrily cashing rent cheques without having to do any work.

4. Sell, and repeat

Yes, you're sad to be selling and lose your stream of income, and you think that prices are just going to go up and up forever. But by now, normal service has been resumed and you've had the best of the gains - so **pull that cash out, and repeat the process elsewhere**.

Why does it work?

The essential idea underpinning this model is **the 18 year property cycle** - which we talked about at length on the podcast (theproperty hub.net/cycle), and which I'll write about at even greater length soon! I won't go into detail here, but when you read/listen about the cycle it will become clear that Mat is buying in the "stealth phase" and selling off as "mania" approaches.

The added ingredient is the idea of "**yield compression",** which gives you more precise buying and selling signals than just trying to take the temperature of the overall market - and explains why the whole thing works.

Essentially, if yields are unusually high it's because prices are unusually low - which is your indication that the location is irrationally unloved and it's time to stock up. As confidence returns, investors will return to the market, pushing prices up and therefore yields down - but as long as yields still give them a decent return, they'll continue to invest and push the prices up further. At some point, owner occupiers will have the confidence to buy too - and they're not investing for yield, so they'll continue to bid prices up and up.

Once prices hit a certain level, buyers start to irrationally believe that they need to buy of they'll be "left behind", which is where mania kicks in. At some point the bubble bursts, prices drop, and the whole cycle starts again. Throughout, the extension and compression of the yield is your signal about whether to get in, hold, or get out.

A note about property types

According to Mat, the approach works with all types of property - but works best with prime "A-grade" units. Mat believes that these go up in price first, and they go up furthest - so you can make more money more quickly. They also make for an easier holding period (in general), because you have your pick of the highest-end tenants.

Character traits needed

Analytical ability. You need to be able to plot the historical data and "read" potential markets very effectively so you pick the right one to enter.

Self-confidence. If you're doing it right and buying in the "stealth phase", you'll find yourself completely alone in the market - meaning you're either a genius or completely mad. It takes confidence not to follow the crowd and buy when a market is in the doldrums.

Discipline. It takes discipline to sell when prices are shooting up and everyone is caught up in the boom. But if you fail to get out at the right time, you could see all your gains given up when the next crash comes.

A willingness not to tinker. Mat buys, then leaves well alone. If you enjoy refurbing - or even constantly buying regardless of market conditions - this model won't be for you.

Risks

Not many - the idea is that you're buying in areas that are irrationally cheap and that have high rental demand with good yields. So all that could really go wrong is that you don't get the growth you were hoping for, and your funds are tied up. You're still getting a monthly income, but you might choose to sell at at lower price than your original “target disposal price” so you can have another go somewhere else.

Who is it right for?

Someone who wants to be very hands-on with the research, and very hands-off once the property has been acquired.

It’s also for someone with a decent sized pot of cash - or who is able to add a lot of money from their own salary to grow the portfolio - because each property won't make vast amounts of money in itself. Mat bought 30 properties in 18 months, but he was piling in a lot of cash from his salary and working exceptionally hard. If that's the position you're in, then find that goldmine and dig like crazy.

Alternatively if you have a fixed, decently large amount of money and you're more concerned about making gains in the future rather than income now, you can just put your money into a couple of properties now and forget about them. At some point in the next 14 years, according to the cycle, you'll be able to cash out and take a big profit.

But if you have a fixed, relatively small amount of money to invest, you probably want to be looking at a strategy that will allow you to grow your cash pot more quickly - by adding value and refinancing, or maybe by flipping. Or, if your main motivation is income now, you could look to put that money into a higher yielding property like an HMO.