



Several mass-emails and printed advertisements in the past few months have been exhorting that one can invest in properties, without fronting a hefty down payment. Scheme or scam?

Essentially, the advertisers run a paid (or sometimes free) seminar which teaches the following techniques.

### **Modus Operandi**

A speculator (the perpetrator) signs a purchase option for an investment property from a chosen development (which is often recommended by the advertiser). He or she then seeks additional investors who:

- would be convinced that the property is worth (or will soon be worth) more than the option purchase fee and
- are willing to front the 20% upfront cash payment on the property.

In return for putting up the investment of 20% of the cost of purchase, the investors are offered 20% (or slightly more, as a bait) of the ownership of the property.

The perpetrator arranges a bank loan which covers the remaining 80% of the cost of the property and services the loan via the rental income from the property. The 20% owners who put up the cash also get a proportional share of the rental income.

Thus, without putting up any of his/her own cash, the perpetrator becomes the majority co-owner of the property.

### **Necessary Conditions**{loadposition advert1}

While the scheme works in theory, there are a few necessary conditions, failing which the scheme collapses.

01 This works only in a rising property market, such that cash-rich investors could be persuaded that the property concerned would soon be worth much more than the option purchase price.

02 The exercise of the purchase option is contingent on the securing of a bank loan.

03 A lessee must be found for the property, to generate rental income.

04 The rental income has to be sufficiently high while the rate of interest paid on the property has to be sufficiently low, such that the monthly cash flow (rental income less interest expense and less distribution to the 20% investors) is positive.

05 Moreover, to sustain the scheme, additional perpetrators would be found to persuade them to invest in a particular category of property in order to provide support to property prices, if not buy the properties off the hands of the original perpetrators.

### Confluence of Factors

The scheme is indeed viable under current economic conditions, if only because of a rare (but untenable) confluence of low interest rates and buoyant property prices.

Should interest rates rise significantly or property prices (and hence rental) fall, leading to negative cash flows, the investment scheme will likely collapse like a house of cards. In the case of negative equity, when the property value plunges below the outstanding loan amount, the property becomes at risk of being repossessed by the bank.

### Conclusion

The methods described above are certainly not illegal, but capitalizes on the greed of speculators who seek a quick return. The search for greater fools (who would sustain the larger scheme and also pay seminar fees) is the real objective of the advertisers of the scheme.