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Statistically, each average participant of the financial markets, seems to know what it is the rate of return in relation to the bank deposit and exchange. Whether they know what it is the rate of return in relation to the real estate markets? Term of the rate of return (alternatively the rate of profit) is functioning from many years, mostly in the banking and trading nomenclature. However, there are more and more participants of the real estate markets who consciously or less consciously are moving this term to the real estate markets ground. Thus, every time asking our experts they are using more often the term of the rate of return in relations to the possibility of buying property chosen by them. But whether wightly?

So, let`s start from the beginning...

What is the rate of return?

The rate of return is a change expressed percentage - increase or decrease - of given investment value in the specified time.

There are simple ways to calculate the rate of return. We present them below on the listed examples with respect to all three markets taking in account the one year expiry in order to illustrate the characteristics of issue:

1. **The rate of return from the bank deposit,**
2. **The rate of return from the securities (shares),**
3. **The rate of return from the investment in the real estates.**

Ad. 1

An example from the bank deposit market:

Investor has paid 100.000 PLN to the annual bank deposit. After a year he has paid out 103.500 PLN.

RATE OF RETURN:

There is a question:

How big was the rate of return after one year?

$$\text{RoR} = [(103.500\text{PLN} / 100.000\text{PLN}) - 1] * 100 = 3,5\%$$

Answer:

In the given example the rate of return from the investment has reached a positive value and amounted +3,5% after a year, so the investor received a financial benefit in the amount of 3.500 PLN.

The basic factors affecting to the rate of return and the level of risk?

- Height of the deposit interest rates,
- Time period (estimated deposit term).

RISK:

There is need to keep term of the deposit, but the amount of interest is guaranteed. Keeping the term depends only on the investor. Of course, often the competition on the bank deposit market results providing to the clients possibility of earlier resignation from the deposit and shorten its term. Most frequently the assumed interest rate is calculated solely for the duration of the deposit and may be lower than expected

FINAL CONCLUSIONS:

The rate of return from the investment in the bank deposit is characterizes by low investment risk.

Ad. 2

An example from the stock market:

Investor has bought shares for a total value of 100.000 PLN. After a year he received a dividends in amount of 1.000 PLN and then he sold it for a total value of 95.000 PLN.

RATE OF RETURN:

There again is a question:

How high was the rate of return after a year?

$$\text{RoR} = \{[(1.000\text{PLN} + 95.000\text{PLN})/100.000\text{PLN}] - 1\} * 100 = - 4\%$$

Answer:

In the example quoted above the investor after a year received the rate of return with a negative value -4% so after a year he received a financial loss in the height of 4.000 PLN.

Basic factors affecting on the rate of return and the level of risk?

- The sum of dividends payout in the considered time period,
- Change in the market value of shares in the same time period.

RISK:

There is considerable diversity in the market value of shares and the level of diversity is affected by many factors which are completely independent from the investor.

FINAL CONCLUSIONS:

The rate of return from the investment in securities (shares) is characterized by high investment risk.

IMPORTANT:

** In both cases mentioned above, the violation of time discipline and shorten the time period under the sample year can always give a negative result and thus the rate of return from the investment can reach a negative value.*

Ad.3

An example from the real estate market:

Investor bought a property investing in the purchase 100.000 PLN. After a year he received an income from the rental in amount of 5.000 PLN, then he sold the property for 100.000 PLN.

RATE OF RETURN:

This raises the question again:

How high was the rate of return after a year?

$RoR = \left[\frac{(5.000\text{ PLN} + 100.000\text{ PLN})}{100.000\text{ PLN}} - 1 \right] * 100 = 5\%$

Answer:

In the further example quoted above the investor after a year received the rate of return with a positive value +5% so he received a financial benefit in amount of 5.000 PLN.

Basic factors affecting on the rate of return from the investment in the real estate?

- Change in the market value of the property in considered time period,
- The sum of revenue generated from the rental in the given time.

IMPORTANT:

**Using such a simple example it should be considered that it doesn't account the other costs factors, such as:*

- costs of the purchase transaction (including notary, tax),
- costs of adapting the property to rent (detail works, furnishings),
- costs of the rental income (income tax),
- costs of resale (potential income tax)).

RISK:

Rate of return from the real estate investment vs. investment risk.

Choosing the property as an investment object, investor already bears the risk at the stage of:

- choosing the investment location (location risk);
- deciding about the type of property (market risk);
- choosing the way of concluding the rental contracts with the potential users (tenant risk);
- considering the possibility of quick withdrawal from the investment by resale it (liquidity risk).

The potential investor who is interested in locating money in the real estate market should take into account several important elements needed to make right decision burdened with the lowest possible risk, what follows:

- people without any experience should carefully make decisions, mainly when they are related with properties bringing profits,
- attention should be given to the location which is an investment success key factor,
- when the property have to bring a rental income, there should be provided an appropriate standard for potential tenant and consider the risk of vacancy,
- when the property have to bring profits from resale, into account should be taken properties, which are original and always raises interest,
- when we want to buy from developer we should check an offer given by the secondary market (new properties are often more expensive than those from secondary market), assuming the later resale it should be deciding factor,
- knowledge of the economic cycle and situation (growth phase - stabilization - decline phase).

RENTAL GUARANTEE RISK:

Many developers are offering the property purchase with the so-called "rental guarantee" or alternatively using term "with the rate of return...".

People without any experience should be very careful with such offers, in particular, pay attention to the following aspects:

- the difference between purchase price from developer and the similar property from secondary market,
- cost of the property adaption to the needs of rental (these are often ready furniture packs),
- duration time of the rental contract (usually no longer than 2,3 to 5 years),
- never mentioned by developer risk, that is, the risk of obtaining at least similar price from resale the property.

EFFECTIVE WAYS TO MAKE MONEY FROM INVESTING IN REAL ESTATE:

Making money in real estate investing is easier than in bank deposit and stock market, but only with advices below:

1. The first way is to buy a cheap property, exactly like in the stock market, so when there is a slump and the decline in the stock prices, investors should buy and when there is a boom and high prices then it should be sell quickly to take a profit. In the real estate during the crisis which already gives away and the prices are still in the lowest level we should buying the properties and sell them when the prices will grow,
2. The best idea is to buy an occasion (at the bargain price) and wait for the stable growth of the property value. For example, the best investment are built or unbuilt lands which can generate a really high profits in the longer time period. It is more lucrative than the bank deposit and less risky than the stock market investment for the patient people,
3. Another way to achieve an income is a property rental, but again it should be taken an opportunity to buy as cheap as it is possible - to avoid a situation in which all profits achieved from the rental will be wasted by selling under the purchase price - what is very likely when we are buying the property directly from developer.

An income from the rental depends on many factors, so even without taking into account the purchase price the rental depends on inter alia:

- location,
- the distance from the sea/ocean and the beach,
- standard of an apartment/house and especially the standard of complex. Here on the top are multi star complexes with lot of facilities and signed contracts with tour operators. To illustrate the problem we would like to give an example: <https://en.ilspoland.com/real-estates/bulgaria/apartament/sale/sloneczny-brzeg/ILS6419> - in this complex each owner who has entrusted the management to the relevant company basing on appropriate agreement can get up to 3.500 EUR from the season with a two bedroom apartment (in Bulgaria season lasts from May to October) and with a one bedroom apartment: <https://en.ilspoland.com/real-estates/bulgaria/apartament/sale/sloneczny-brzeg/ILS6493> the owners earned up to 2.500 EUR.

It is worth to notice that the above exemplified purchase price is extremely occasional so at the very beginning the new owner earns money on same value, buying much cheaper than from developer and often under the current market price.

FINAL CONCLUSIONS:

Investing in real estates is characterized by higher risk level than investing capital in the bank deposit but lower than investing in stocks.

The savings located in the property are definitely good investment only if the purchase was well-judged and we made the right choice by ourself or took an advantage from professional brokers services (advisors and analytics).

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Also read:

<https://en.ilspoland.com/news/rental-guarantee-and-rental-five-facts-and-one-myth-299>

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