

THE **PROPERTY INVESTING** **FORMULA**



Millionaire Property
Strategies for the Everyday Investor



Jennie Brown & Nhan Nguyen

PROPERTY EXPERTS

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Disclaimer

All the information, techniques, skills and concepts contained within this publication are of the nature of general comment only and are not in any way recommended as individual advice. The intent is to offer a variety of information to provide a wider range of choices now and in the future, recognising that we all have widely diverse circumstances and viewpoints.

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First Edition 2014

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National Library of Australia Cataloguing-in-Publication entry

Author: Brown, Jennie.

Title: The Property Investing Formula : Millionaire Property Strategies for the Everyday Investor / Jennie Brown and Nhan Nguyen.

ISBN: 9780992484132 (paperback)

Subjects:

Real estate investment – Australia.

Wealth – Australia.

Finance, Personal – Australia.

Other Authors/Contributors: Nguyen, Nhan, author.

Dewey Number: 332.63240994

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CHAPTER 7

Renovation

We call renovation a strategy that beginners often use because they think they have to start with a renovation to become experienced. But for us, experience is not worth it if you are losing money.

This is a great strategy, especially in a market that is climbing. Aim to buy cheap properties that have the potential for renovating. Be on the lookout for properties that have had a partial renovation though, because it is likely that the previous owner either ran out of money or planned an over-ambitious project, only to later discover that he or she had over-capitalised and would be unlikely to recover costs in that market. Could this be why the asking price is so low?

You need to do your research well when chasing a renovation deal because ultimately the profit you make will depend largely upon the price you pay for the property in the first place. You need to ensure that you buy well for this strategy to really produce results.

When it comes to planning your renovation, remember to remain realistic or you run the risk of blowing your budget - and along with it your profit expectations. Understand that

you are not the one going to live there, so don't use your standards for the renovation. Keep things in perspective. Sure granite bench tops would be nice in the kitchen, but in all honesty, unless the property is in an up-market suburb, any tenant will be delighted with a new laminate one.

Make sure you factor into your budget the purchase costs such as stamp duty (allow 3-5%, as this varies from state to state), legal fees (allow approximately \$1,000) and inspection fees (up to \$1000). In addition, selling costs need to be factored in as well. A lot of people think if they buy a property for \$200,000, complete \$20,000 worth of renovations, and sell for \$250,000, then it's a good deal. In actual fact, after factoring in purchase and selling costs, it's highly likely this would not break even.

Also remember that renovations inevitably cost more than you budget for. A lot of unexpected expenses arise when you start knocking out walls, or review your plumbing or electrical wiring. Make sure you have a decent contingency amount factored in.

Last but not least, is it really worth it? If you are the type of person who is completing the renovation yourself to 'save' money by not hiring in experts, will that ultimately cost you in the long run? Work out how many hours you think it will take, add in a few more for good measure and emergencies, and divide your estimated profit by that figure. What is your hourly rate? Can you earn more by going to work? Or by putting your money into the bank?

Advantages

One of the main reasons we favour renovation as an investment avenue is because it is relatively easy to add value to a property. All you really have to do to achieve a higher valuation than when you bought it is to tidy up the garden, give the place a quick lick of paint, add a carport or shed, erect a fence around the property, replace the lounge-room carpet and upgrade the stove and dishwasher. You could go further and put in a new kitchen and bathroom.

If you make the decision to rent out the property after renovation, bear in mind that for every extra dollar your property manager can get for the property in rent will positively influence its valuation, which in turn affects what you can sell it for or borrow against it by way of refinancing. This amounts to using leverage to help pay it off quicker without you having to have additional funds tied up in the property in the long term. The added valuation allows you to recover the amount spent on the upgrade plus more, while the additional rent helps pay off the mortgage quicker.

Disadvantages

Renovation is something that carries its own set of risks. You could run the risk of over-capitalising. If your aim is to rent the property out, this could force you into a negative cashflow deal.

Regardless of the purchase price of the property, essential expenses such as purchase, holding and selling costs alone can run up to huge amounts. Then there are the renovation costs, and most likely the unexpected budget blowouts.

Be aware that the market can turn at any time, and small profit margins can turn into huge losses very quickly. If you don't think it could happen to you, talk to the myriad of investors who got caught by the market downturn in 2008.

In a market where properties are generally losing value, it's hard to make money on a renovation. This is because whilst you're hoping to add value to the property, you could in turn lose any value that you've added while you were actually doing the project, bringing you back to a negative (or a neutral) position.

Another disadvantage of renovation is that it is time consuming, and usually needs to be micro-managed. To really do well, you need to be organised and have access to great tradesmen who turn up on time and do a great job.

Our Comments

We have learnt over the years that it is important to pick the right time of the market, the right area, and to be extremely organised.

We have both seen people take months to complete a renovation. The strain on their finances with holding costs, and the emotional and physical strain are, as far as we're concerned, is not worth it. We have seen families torn apart because the parent or parents spend all their spare time working on the renovation (do-it-yourself people) instead of being with their family. We have seen arguments, frustration, anger and emotions boil over when trades people don't turn up, or the do-it-yourselfers are out of their depth.