

Introduction

Although I'm a chartered accountant with over a decade of experience in the finance industry, I'm very careful to avoid complicating my property investing.

For example, while there are almost an infinite number of variations to a deal (such as location, house type, land size, tenancy, vendors, real estate agents etc), the four essential questions that every investor ought to ask are:

1. How much **DOWN**?

How much of my own money do I need to contribute to acquire this investment?

2. How much **BACK**?

How much money, over and above my initial investment, will I receive back?

3. How much **TIME**?

How long will it take for me to realise my profit?

4. How much **RISK**?

How much risk is there that I will lose some or all of my money?

These are easy questions to ask, but coming up with meaningful answers is much more difficult. Often you will be told out and out lies, and it will be up to you to sift through the half truths and pick out the flawed assumptions that have the power to send you to the poorhouse.

Without doubt, financial loss is much better prevented than cured. While you may have powerful emotions (usually related to fear and greed) that course through your veins when first hearing about an investment, the difference between someone who speculates in property versus a sophisticated investor is the amount of time spent completing a due diligence (i.e. formal review or inspection) over the opportunity.

While there are many aspects to a thorough due diligence, going over the numbers with a fine tooth comb is definitely essential. Sadly though, many people have a fear of maths akin to being burnt alive!

In an attempt to try and ease the pain, I have blend my accounting training with my investing experience to derive a unique deal evaluation system that caters for both growth and cashflow investors.

At this point I'm assuming that you have read Chapters 14 & 15 of 'From 0 to 260+ Properties in 7 Years'. If you haven't (or it's been a while since you have) then please read them (again) before proceeding further.

When you're ready to proceed, let's make a start by taking a look at the template.

Using The Number Crunching Template

Taking a minute to review the template, you will see that it starts off by asking you to list out the purchase, closing, improvement and finance costs associated with the investment.

You will also need to estimate the current market value and expected annual growth (in dollar terms).

Next is the calculation necessary to derive the expected net annual cashflow from the investment.

Once you have input that data then you're well and truly past the hard part. The centre-middle of my template is where you calculate the 5 property investing returns (Chapter 14), while the right hand section of the template is where you complete my 3-2-1 to deal evaluation (Chapter 15).

Section A: Property, Closing, Improvement & Finance Costs

You'll notice that there are four columns in this section.

- Column I provides a description of the field.
- Column II is the portion of the total cost you'll pay in cash
- Column III is the portion of the total cost you'll borrow
- Column IV is the total of the cash and borrowed columns.

The aim here is to as accurately as possible determine the total value of the amount of the item, and then split it up between its cash component (the amount you'll pay in cash) and the borrowed component (the amount that someone else will fund).

Here is an outline for each item in Column I:

Purchase Price:

The purchase price as shown on the contract, but adjusted for any rebates, bonuses or other unusual adjustments.

Closing Costs:

Also known as purchase costs, these include stamp duty and other government charges, legal fees, finance set up costs etc. As a general rule, an allowance of 5% of the purchase cost is generally seen as sufficient.

Improvement Costs:

Improvement costs typically include renovation and development costs and encompass both consultant (architect, drafting etc.) and sub-contractor (builder, plumber etc.) expenses. Other costs would include demolition and site clean up, initial repairs, etc.

Other Costs:

This field is left open and available for you to lump in any other costs unique to your investment.

Subtotal:

As this point you will need to add down the columns to derive a subtotal of the Purchase, Closing and Improvement Costs.

Finance Costs:

The easiest way to calculate the finance costs is to multiply your total borrowings in the sub-total line by the average interest rate you expect to pay on your investment debt.

Note: If you are using a P&I loan then you will need to complete a more advanced time value of money (TVM) calculation.

Loan costs paid in cash would go in the cash column, otherwise, should the interest charges be capitalised, then place them in the borrowings column.

Total:

Add your finance costs to your sub total in each of the columns to calculate the total.

Section B: Current Market Value & Annual Growth

In Section B you simply need to estimate the current market value (CMV) of the property as well as the expected annual growth (or capital appreciation).

Current Market Value (CMV):

In most cases, the CMV will be the purchase price paid for the property (as reflected in the contract). However, in some situations where you have bought well, you may feel like the property's value is higher than what you paid.

Estimated Annual Growth:

If you expect your property to increase in value in the next 12 months then include the expected amount in this box. The growth in value could be due to the completed improvements or perhaps through rising general market values.

Section C: Cashflow

In Section Three you are required to calculate the annual expected cashflow of the investment.

Annual Rent:

I suggest you use the rent as it is now rather than another figure that the agent may feel is more reflective of what the 'market' might pay. You should also build in an allowance for vacancies where appropriate.

Management Fees:

These include letting and management fees that you'll be charged by a rental manager. The rates charged vary from 5% to 10%+

Finance Costs:

Copy the figure you included in Section A, Column II for your cash finance costs.

Body Corporate Fees:

If your property has common areas then it is almost certain that you will be subject to a body corporate. In some cases the body corporate will be run by an external party who will charge a fee for that service.

Council Rates:

Local councils charge a levy for providing local services including garbage collection, roads, public amenities such as parks etc. The amount charged is usually a function of the value of your property multiplied by a set percentage.

Utility Costs:

Electricity and water suppliers sometimes charge a service / connection fees that cannot be passed on to the tenant. Alternatively, if the services are not separately metered then you may need to pay for the entire cost and recoup it through higher rents.

Insurance:

Typical types of insurance that property investors may need to consider include home, contents, public liability, and landlord.

Taxes:

The most common tax is land tax, however you may be subject to other taxes and levies such as use of crown land.

Repairs:

Properties depreciate, so it is reasonable to expect that you will need to pay for repairs during the year.

Other:

Include any other costs not outlined above.

Annual Cashflow:

Add down the column and subtract the costs for the income to derive your net annual cashflow.

Section D: Annual Profit & Equity

Here you calculate your annual profit and your equity.

Annual Cashflow:

As derived in Section C.

Estimated Annual Growth:

As stated in Section B.

Estimated Annual Profit:

The sum of your annual cashflow and your expected annual growth.

Estimated Current Market Value:

As per Section B.

Total Borrowings:

As derived in the total line from Section A, Column III.

Equity:

Estimated CMV – Total Borrowings

Section E: Property Returns

In this section you will use the data you have previously input to calculate the five most common returns used to evaluate a property deal.

Note, there is an implied $\times 100$ to change the fraction into a percentage

Gross Rent Return:

Annual Rent:

As stated in Section C.

(Total) Purchase Price:

As stated in the purchase price line in Section A, Column IV.

Gross Rent Return:

$(\text{Annual Rent} \div \text{Purchase Price}) \times 100$

Return on Investment:

Cashflow:

As derived in Section C.

(Total) Purchase Price:

As stated in the purchase price line in Section A, Column IV.

Return on Investment:

$(\text{Cashflow} \div \text{Purchase Price}) \times 100$

Growth on Equity Return (GoER):

Estimated Annual Growth:

As stated in Section B.

Equity:

As derived in Section D

Growth on Equity Return (GoER)

$(\text{Estimated Annual Growth} \div \text{Equity}) \times 100$

Cash-on-Cash Return:

Cashflow:

As derived in Section C.

Cash Down:

Total Cash as derived in the total line in Section A, Column II.

Cash-on-Cash Return:

$(\text{Cashflow} \div \text{Cash Down}) \times 100$

Net Profit Percentage (NPP):

Estimated Annual Profit:

As derived in Section D.

Cash Down:

Total Cash as derived in the total line in Section A, Column II.

Net Profit Percentage:

$(\text{Estimated Annual Growth} \div \text{Cash Down}) \times 100$

Section F: 3-2-1 Deal Evaluation

The final Section uses the information already input and processed to ascertain whether the return might be sufficient to justify the risk.

Three Time Interest Percentage:

Current Interest Rate:

The average interest rate paid on the investment debt.

See pages 260 to 262 of 'From 0 to 260+ Properties in 7 Years' for more information.

Net Profit Percentage (NPP):

As derived from Section E.

Test Outcome:

If the NPP is more than three times the average interest rate paid then PASS, otherwise FAIL.

Two Times Interest Paid:

Finance Costs:

As derived from the total finance costs as shown in Section A, Column IV.

Estimated Annual Profit:

As derived in Section D.

Test Outcome:

If the Estimated Annual Profit is more than twice times the Finance Costs then PASS, otherwise FAIL.

Danger Money Multiple:

Estimated Annual Profit:

As derived in Section D.

Cash Down:

Total Cash as derived in the total line in Section A, Column II.

Risk Free Return %:

The percentage return your Cash Down could have earned if left in an interest bearing term deposit.

Risk Free Return:

(Cash Down × Risk Free Return %)

Cash Down:

Total Cash as derived in the total line in Section A, Column II.

Risk Free Return:

As calculated above (in dollar terms).

Danger Money Multiple (DMM):

(Cash Down ÷ Risk Free Return)

Test Outcome:

If the DMM is equal to or more than the matrix provided on page 268 of 'From 0 to 260+ Properties in 7 Years' then PASS, otherwise FAIL.

I hope this document has helped you to understand the terms. For guidance on how to interpret the numbers, please refer to Chapters 14 & 15 of 'From 0 to 260+ Properties in 7 Years'.

Further copies of the template, together with a case study demonstrating how to use the number crunching template, can be found at:

www.PropertyInvesting.com/book3