THE NUMBERS DON'T LIE

By **Arsh Ellahi**

Hi Arsh

I am looking at a property at the moment, but I can't seem to make the numbers stack. I am not sure whether I am being too pessimistic.

How do you deal with this?

MR G – WOLVERHAMPTON

Thanks for getting in touch Mr G, and its great to hear from a fellow Midlands property professional and YPN subscriber.

As far as I am concerned, this is a very straightforward question to answer. The answer is: **THE NUMBERS DO NOT LIE**. Let me elaborate on this by giving you a few different scenarios.

I would like to start with saying: I get it. Sometimes you really want the property to work and therefore you say to yourself it will work if this figure is taken out or add a little more here. The fact is, you are trying to convince yourself that it will work.

THE GOLDEN RULE

Calculators and Spreadsheets are your friends. Do not try to massage the figures to make a deal work.

When I look at a property, I look at the worst-case scenario and work off those figures. Whether this is for a development, a potential HMO, a serviced accommodation unit or a simple buy-to-let.

My first aim is to look at the capital investment required and the breakeven point. If I find that my capital would work better on other projects, then clearly the figures will demonstrate that.

I will try and outline how I use spreadsheets daily to see how the numbers work on each type of property.

HMOs

Whether you like them or loathe them, the HMO market is still extremely strong.

When I look at a property and consider converting it in a HMO, the first thing I look at is:

- **How much is the property to purchase?**
- **Approximate cost of conversion**
- **What is the minimum the property would generate (worst case scenario)?**
- **What is the maximum the property would generate (best case scenario)?**
- **Demand. How many rooms are currently being offered within the location?**
- **Competition. The standard and how much they charge for a tenant to move in**
- **The cash flow on a worse case and best case scenario**
- **The ROI on both scenarios**
- **Breakeven points on both scenarios**

I also look at how much each room would cost me on a unit-by-unit basis.
This includes:

- **Purchase price** ie £150,000
- **Buying Costs** ie £10,000
- **Conversion Costs** ie £50,000

Using the figures above, based on a five-bed HMO, the total cost would be £210,000, equating to £42,000 per unit. I consider what else £42,000 could get me within the area and how this would compare.

In Wolverhampton, an ex-local authority one-bedroom flat could start from £50,000. Therefore, I would question whether spending £42,000 on a room is a better investment than a one-bedroom flat. There are many pros and cons for each strategy, the main con being that it's rare that a whole block of five+, one-bedroom flats is for sale at £250,000.

If you get the figures wrong and ignore the findings, you may find yourself at a breakeven, or worse, at best investment. More importantly, your funds may be tied up in the property, which could bring your growth strategy to a halt.

RENT-TO-RENT

I love this strategy. It is where you take control of someone else's asset and generate a cash flow without the need of large deposits, mortgages, solicitors and surveyors.

Although this can be a risk-free strategy, it is extremely important to understand the numbers. Do it right and you will create an abundance of cash, but if you decide to push and massage the numbers … all you will have done is take on a property where you will have guaranteed the rent to a landlord for a certain period. Have you just taken on someone else's headache?

Within the property industry, I speak to investors daily about their numbers on their potential deals. When I look at the figures, I would expect to see the very basics such as:

- **Potential income. Best case and worse case scenarios, and evidence to confirm both**
- **Rent to landlord?**
- **Utilities cost – preferably a breakdown of each cost**
- **Management costs – what do they entail? Management and tenant find costs, reference costs, etc?**
- **Broadband costs included?**
- **Cleaner costs included?**
- **Maintenance contingency included?**
- **Voids contingency included?**

From the above, it will give an indication of the cash flow for:

- **PCM**
- **Per annum**
- **Cash flow over the whole period which you are considering for the property**

Many of the investors I speak to have not considered half of these costs, and then wonder why their HMO is not making money. The brutal answer is, it was never going to make money. They failed to prepare, therefore they must now prepare to fail.

DEVELOPMENTS

Believe it or not, the principals are the same:

DUE DILIGENCE, DUE DILIGENCE, DUE DILIGENCE.

However, instead of researching room rents in a location, you may now start looking at sales values and demand.

The key to any successful development lies within a few key areas which include:

- **Buying the property/land well**
- **Maximising the space/site with the number of units**
- **Getting the right build team who will deliver on budget and on time**
- **Understanding the costs of holding/ building/finance costs**

Again I see lots of investors who use the following calculation as the basis for their appraisal:

- **GDV = £2,000,000**
- **Purchase price of building/land = £500,000**
- **Build cost = £1,000,000**
- **Profit = £500,000 = 25%**

Once you start to factor in finance costs/ holding costs/contingency costs, this could very easily eat into the margin, almost to the point of becoming unviable.

On developments, I find that investors have different types of key indicators for success. These include:

- **Percentage of GDV after all costs**
- **Monetary value ie £500,000**

Personally, I like to work on the % of the GDV as this is the true indicator. I like to work on a minimum of 20% after all costs taking into consideration a buffer for delays or increased lending costs and contingencies.

If you are refurbishing, you must add some additional costs for the unknown things that might be unearched ie additional works, wood rot, new windows etc.

TIPS FOR SUCCESS

1. **Search everywhere for evidence of room rates and sales values.**

Take the time before signing any contracts to do all your due diligence. I never just take the figures from Spareroom as evidence. Yes, it does provide a base to start from, but you have to remember that the rooms listed online are available and have not yet been rented. Why? Are they too expensive or is the demand simply not there?

Estate agents can also be your best friends. They are always happy to help by giving you info on what properties they have on the market and why they believe they have not sold. Use this information wisely and market your properties within the parameters they have suggested.

2. **Get agents on board in the area.**

To get a true indication of the market, I always advise spending an hour talking to agents in the area who manage HMOs. Get a clear idea as to what they believe a room should be let at and ask how long it usually takes to rent a room. This will allow you to build in contingencies to cover void periods and so on.

3. **Be ruthless.**

Do not be afraid to negotiate with the landlord. The last thing you want to do is take on his/her property and then try and break a contract six to 12 months later to the property being unfeasible.

What is your USP? What makes you different to all the other rent-to-rent'ers out there? Why should the landlord give you their property? How do they know that you will treat their property with respect?

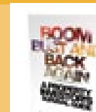
Calculate the risks and make an offer on the property on the basis that you know that you can deliver everything you promise.

The same goes with offering on a property to purchase. If you offer too much, you may find that you may withdraw from the transaction, which is not good news for the vendor or the agent you are dealing with.

There you have it, guys. I hope you have found this month's article interesting.

If you have a question you would like me to answer in next month's article, please email **arsh@arshellahi.com** and I'll aim to answer as many as I can over the following months.

Arsh Ellahi is the author of **"Boom, Bust and Back Again: A Property Investor's Survival Guide"**



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