

# NUMBER CRUNCHER

Winning Formulas For Success founder **Ana Stankovic** dissects the key numbers needed to establish if a deal is worth pursuing

**P**erforming profitability analysis is key to knowing just how much profit there is in a potential deal. This not only helps investors compare different deals but it also makes it easier to analyse different variations within the same deal.

For example should you renovate it and resell, renovate and subdivide and then resell, knock down and develop, or renovate and develop in the back? There are many options. But it all comes down to being able to calculate the profitability of each option and look at a profit figure based on how long it takes to do that strategy.

A big renovation might not yield as much profit, but it averages at only three months of effort before it is put back on the market, instead of 18 months average with a development.

The profit figure for a project should be broken down into a per month profit figure – to truly see which strategy is best for that property. You might find that the renovation will yield a better per month return than a subdivision or development purely because it can be completed so much quicker then be sold and the investor can concentrate on repeating the process with their next deal. This means that you can complete a lot more deals within 12 months.

When using an add value strategy with property, in order for it to be profitable you must add a margin on every dollar of cost that you spend. The changes you make to the property need to add more value to the selling price than the overall costs of the project, resulting in a profit being made. →

THE PROFIT FIGURE FOR A PROJECT SHOULD BE BROKEN DOWN INTO A PER MONTH PROFIT FIGURE

Put simply, the underlying profit formula is:

**Project Profit = Selling Price – Project Costs**

The project costs are a mixture of anything that will cost the investor money for the whole duration of the project, for that particular investing deal.

The specifics of what Project Costs are comprised of include:

**Project Costs = Purchase Price + Closing Costs + Renovation Costs + Holding Costs + Selling Costs**

It sounds simple, however a large number of projects where the investor has chosen to manufacture growth rather than waiting for natural growth to happen are taken on based only on the hope of making a profit.

These projects often fall short of their profit goals and many even lose a substantial amount of money. This is mostly because those investors forget to take into account in their calculations some of the costs or use guess work where they should have worked out the exact costs.

When doing profitability analysis on a deal, the investor needs to know the 'real' profit. That is the profit that is left in their bank account after they have used the money to pay for every little thing that was required →

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Renovations average three months

Finance first

*“You shouldn’t invest in stocks unless you’ve bought Quicken first. It’s a great product: Great for the user, great for the accountant”*

– Phillip Meyer, director, investment banker, investor, philanthropist



## PROPERTY

for that particular deal – ranging from solicitor's fees to council rates, loan discharge fee or advertising and the list goes on.

The costs associated with adding value (renovation/subdivision/development) are only one part of the overall project costs of a deal. The investor needs to capture and take into account all of them to arrive at the 'end' profit.

There are a lot of elements and 'profit killing' problems and unknowns that may affect the project's end profit. Guesswork and estimation about the project costs is the most common reason why some investors find themselves not making much profit or even losing money. This is why it is important to utilise tools and techniques that will eliminate a lot of the guesswork for the investor, so they can work out exactly what they are in for with a particular deal before they have even made an offer.

Programs such as Property Analysis Tool are some of the tools that help investors capture all the costs of the project and do profitability analysis – and it takes the pressure from them having to remember each little thing and making mistakes.

Investors should know their worst-case scenario profit figures before they proceed with the purchase. If that is profitable, then they know that everything else will be icing on the cake. **W**

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Developments average 18 months

### KEY FIGURES

**SELLING PRICE** This is the most important part of the add-value process. There is no point doing a renovation, for example, if you have no idea what the finished product will sell for. Get to know your area and start tracking sales results to find out what renovated and un-renovated properties with different profiles are selling for.

**PURCHASE PRICE** It is vital to acquire properties at the right price. Every dollar saved is a dollar earned and it shows in your profits. Buying the wrong property at the wrong price limits the potential of that deal. Profitability analysis will highlight how much room there is to move with purchase price in a particular deal in order for its worst case scenario to stay profitable.

**CLOSING COSTS** When purchasing a property, you will also need to take into account all the other charges and fees that are part of the process of closing the purchase. Legal fees, mortgage application fees and stamp duty, for example, are some of the closing costs that you need to be able to finance

**ADD VALUE COSTS** This is where the costliest mistakes are made. Many people will estimate how much they think would be involved in manufacturing growth with those properties only to have a reality check after purchase.

Even the smallest items can quickly cause budget blowouts, taking thousands of dollars out of your profits. The trick is in knowing which improvements give the highest monetary returns and keeping accurate track of everything that needs to change, the type of change as well as the materials and labour required for it. You should be capturing costs right down to skirting boards, light switches and gutters.

There are a number of different software programs out there to assist you, such as Renovation Costing Template. Being able to accurately and easily work out how much an add-value strategy is going to cost you up front means that you are able to feed this information in to your profitability analysis to work out how much profit there will be left for you at the end.

**HOLDING COSTS** These are costs associated with holding on to a property from the time it settles until it is sold and settles for the new purchaser. You will have to keep paying mortgage repayments, insurance, body corporate fees (if applicable) and rates right up to the point when someone else takes possession of the property.

Professional investors understand that the longer they hold the property the more it is costing them and this slowly erodes their profits.

The shorter we can make the project cycle and closing the deal (selling or revaluing and renting), the smaller the gap will be when you are paying outgoings for the property and not earning anything from it.

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Wealth comes from knowing what others do not know. **Aristotle Onasis**

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