



WHEN IS A PROPERTY DEAL, A DEAL?

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Here at The Good Property Company, we are experienced in evaluating deals having sourced 170 property deals in 4 1/2 years, at an A1 value of £32 million with a purchase price of £21 million.

TG PC THE GOOD PROPERTY COMPANY

WE ARE PROUD TO SAY THAT WE ARE VERY RARELY UNDERVALUED BY SURVEYORS OR BY A PROJECT SELLING FOR LESS THAN WE IDENTIFIED.

This is because we think and evaluate deals like an investor, building in safety in our valuations. In practical terms, that means that we intentionally value the end figure on the low side, to add extra safety in the deal.

CASE STUDY ONE

Osborne Road
Purchase Price £203,000
Refurb Cost £41,000
We said in our report, end value of £285,000
RICs valuation, 6 months later £330,000

I will go through how we evaluate deals, then show you what we look for in the analysis of a deal (information I would have loved when I was starting out). Then we'll put those figures together to ensure there is always a Plan A and a Plan B for each project, both passing my financial guidelines.

REAL LIFE DEAL EVALUATION

As a sourcing business, we do this frequently – as our run rate is over 50 deals a year we are successfully passing deals through this evaluation on a weekly basis.



PROPERTY VALUE ASSESSMENT

Essentially we are creating a Market Research brief for each property, with a number of tasks.

By using a large number of market comparables (45 pieces of research tends to pop out a statistically clear picture of value when researching any one house) we reduce the chance of getting the valuation wrong. It also helps reduce the classic property investor wishful thinking of hope over experience.

I am a sunny side up optimist myself, but in property, I want to know the downside with the lowest likely valuation for sale or for refinance, so that my world stays sunny long term. No financial rain clouds for me please!

HOW TO RESEARCH MARKET VALUE

The work in evaluating the value of a property is really a piece of market research. So if we treat it professionally, and identify the data needed and the tools to use, we get professional results.

Research Brief: To establish the current market value of a property, once renovated to good condition

Methodology: Desk Research & Telephone Interviews

Timeframe: Half a day to start with reducing to an hour once you are experienced.

I break this research into three pieces from different sources. By doing so we can triangulate the data, meaning it is more robust and more likely to be right. This reduces your risk when undertaking an expensive project. I'll briefly outline how we come to our valuation conclusions and the tools we use to do so.

CASE STUDY TWO

Albion Street
Purchase Price £120,000
Refurb Cost £15,000
We said in our report, end value of £165,000
RICs valuation, 6 months later £180,000

DESK RESEARCH TASK ONE; SOLDS

Task: Identify 20 comparable solds, within a very tight and physically, economically and socially similar area within the last 2 years.

Tool: Land Registry Sold Prices

Portal: Mouseprice or others

Method: List address, type of property, date sold and selling price into spreadsheet

Valuation: Average value of data collected

DESK RESEARCH TASK TWO: ON OFFER CURRENTLY, OR SOLD SUBJECT TO CONTRACT (SSTC)

Task: Identify 20 comparable current properties, on the market or sold STC, within a very tight and physically, economically and socially similar area within the last 2 years.

Tool: Right Move, Zoopla, others...

Method: List address, type of property, date sold and selling price into spreadsheet, with picture

Valuation: Average value of data collected

RESEARCH TASK THREE: INTERVIEW THE EXPERTS

Task: Identify market value as perceived by the experts in the market place: estate agents, of a particular property rather than an average

Tool: Telephone

Method: Call 5 local agents, who are not selling the property, ask for their 'A1' done up valuation range, (cream walls, beige carpets) and what you would get if you sold it now, done up, what market is doing

Valuation: Average value of data collected

So now, you have 45 or so pieces of information, from which to draw a conclusion.

RESEARCH CONCLUSION

Task: Identify market value from 45 pieces of information for a specific property.

Tool: Calculator!

Method: Average valuations for each category. Then take average, for overall valuation, taking into account your level of experience of a specific property area, to give valuation

Summary: Take the valuation, * 0.75, and consider builder costs. Do you have a deal? Is there a gap between the end value and all your costs? If so, is that gap worth it to you?



DEAL EVALUATION

There is now a second stage to the deal evaluation, which is around the return the deal will bring, in terms of profit, Return on Capital Employed, Payback time and Rental Yield.

These are formulas that investors use to measure the financial efficiency and profitability of a deal. It helps to be able to compare properties like for like, rather than the rather rough and ready question of 'how much cash do I get at the end of the month'.

To improve your overall delivery from your portfolio you can use these equations to evaluate and identify which properties to keep long term and which properties you may dispose of.

It also helps you analyze a property prior to purchase, so you know your likely results before you even begin.



BUY TO SELL RULES (PLAN A)

Profit Margin Rule

I always look for a 20% profit margin on a Buy to Sell project, after all costs. The obvious costs are the purchase price and the refurb. Some other costs may not spring to mind – immediately – the finance interest costs, council tax, water rates, gas, electricity, the cost of the cleaners, gardeners and other maintenance people servicing the property to keep it in tip top condition after it has been refurbished. Don't forget the estate agent commission, and if you are using furniture to stage the property, the cost of the removal people and odd job men to transport, make up and take down the furniture.

I nickname all those unseen costs 'crud and corruption', as my uncle John would say.

Ideally you would achieve a full 20% profit margin. However that profit 'rule' also helps keep you safe – if the property has a problem, say a roof needing work, rot is discovered, or it takes longer to sell than you anticipated, the large margin built in helps cushion the financial implications, and usually should still allow you to come out ahead, and in profit. So it is both profit target and safety helmet!

Return on Capital Employed

A second good measurement for your Buy to Sell projects is to measure the return on your Capital employed. This is often why developers will bring in funding from bridging companies, despite interest costs and fee rates. It is because by using leverage you use less of your own cash, and so the return on the cash used will be greater. I like to look at the ROCE and then move it to an annualized figure, so that I can compare projects with each other. Though this is an imperfect calculation, the reality is that projects do not beautifully follow each other, and there is often some down time for your money in between projects.

BUY TO KEEP RULES (PLAN B)

In analyzing Buy to Sell, you'll soon find out that though we have the same broad calculations, property investors mean different things in discussing formulas like 'Yield'.

For me, I look for 2 things.

1) ROCE of 20% or above, looking at the return on any cash left in.

2) I want a clear net yield of 10% or above, or I would not buy the property. To get to yield, I take the annual rent, minus any utility bills I need to pay for, if it is a shared house, and divide that by the cost of the house plus the refurb cost, and make it a %. Got that?! Let me put it into a visual calculation for you...

Annual rent (- bills)/(purchase price plus refurb cost * 100

Those are my formal calculations, which I can use to compare apples with apples, despite my houses being all shapes and sizes.

I hope that jaunt through a number of techniques to analyze both the value of the deal and then the performance of the property was fun – at least for the property geeks amongst us.

I wish you every success in your property journey. ☺

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