

Beware the profit killers

In this edited book extract, experienced investor Patrick Bright shares his tips for finding, buying and renovating residential properties for a quick windfall



RENOVATING A HOUSE OR apartment you have bought as an investment property is a great way of building wealth quickly. It's a relatively low-risk strategy if executed correctly and will allow you to manufacture capital value and increase rental returns without relying solely on market conditions.

Back in 1999, a friend of mine wanted to sell a house his parents left him when they passed away. Since I knew a bit about real estate he asked for my help. The house had been neglected for 18 months and was in very poor condition. A few local real estate agents gave him valuations ranging between \$320,000 and \$340,000.

I did a little research and was confident my friend could get more if he tidied up the house, but he couldn't be bothered and just wanted

to sell it as it was. So we made a deal. I would fix up the house and we would split whatever profit we made, based on the average of the initial valuations less the renovation costs.

I cleared out all the junk, filling two jumbo skip bins. I had the floors sanded and polished and touched up the interior paintwork. I tidied up the gardens. I washed the outside and touched up the paintwork, replaced the cracked roof tiles, cleaned the gutters and painted them as well as the eaves. The cost was just over \$10,000 plus my labour.

Only two weeks after their initial valuations, we asked two of the original selling agents (plus another one) for fresh valuations. They valued the house between \$390,000 and \$410,000. It sold for \$395,000. So for an outlay of around \$10,000 plus one week of my labour we had increased the value by \$65,000.

In essence, I had converted a little imagi-

nation and one week of my time into \$27,500, which I used – yes, you guessed it – to buy some property to renovate.

I firmly believe that building wealth through renovating residential property is a skill that can be learnt by just about anyone. If you don't include renovating as part of your property investment strategy then you're probably not maximising your potential returns. You can use it to fast-track the growth of your portfolio, create an additional income stream, or a combination of the two.

When I refer to renovation, I'm talking about cosmetic rejuvenation. I'm not talking about buying derelict property and making it liveable again, restoring period homes or fixing major structural defects. What we're doing is taking a structurally sound but messy property, smartening it up and adding the "wow factor" on a limited budget.

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KEY POINTS

Avoid the pitfalls

- **Do the research** Take the time to cost your renovation accurately so you don't run out of money halfway.
- **Keep your self-control** If you get too excited about a particular property you run the risk of paying too much.
- **Remember the target market** Renovating for profit is all about appealing to the masses, not the few, so go for a neutral but classy look.
- **Be careful about overcapitalising** You must research the ceiling price of similar fully renovated properties to avoid wasting your money.
- **Don't believe the agent** Sales agents will always overestimate the potential price after renovation.
- **Don't try to do it yourself** Call in the experts for a quality result instead of wasting time on DIY.

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But over the years I've noticed several common traps that renovators fall into – from not conducting enough comparable market research, to thinking you have to do all the work yourself. There are numerous pitfalls that can eat into your bottom line and destroy your confidence. Here are the top six mistakes to avoid.

Do enough research

Comprehensive research is fundamental to each and every step of the process. Around 80% of the effort involved in renovating for profit is research and preparation, but so often I see people rushing in, thinking they know it all, and ending up with a disappointing result.

If you don't take the time to cost your renovation accurately, you could end up with a half-renovated property and no money to finish it. If you don't do enough comparable market research you could overestimate what the value of the property will be after the renovation and get a nasty shock when you go to sell.

Buy at a fair price

I often see people pay too much when they buy a property, and not just when they plan

to renovate it. The purchase price has a direct impact on your profit margin.

Every dollar you negotiate the purchase price below your maximum is another dollar of profit for you.

However, if you set your maximum purchase price too high (because you didn't do enough research to understand fair market value), or you exceed it (because, for example, you lost self-control bidding at an auction), your profit will suffer.

Purchasing at the right price to ensure you make a profit comes down to knowing market values and negotiating well.

All too often I see property investors taking short cuts on the research and market analysis and not bothering to hone their negotiation skills. In the end they pay too much, don't end up making a profit and don't maximise the return on their investment.

Tailor your renovation for the target market

If you're renovating your own home it's all about pleasing yourself. However, when you're renovating for profit it's about appealing to your target market: tenants and buyers. Unfortunately, many people get this wrong. They let their know-it-all attitude get in the way and decide what they like is best for everybody.

How many times have you walked into a property for sale and been appalled by the decor? I can assure you it happens to me all the time. Anyone who wants to buy such a property will reduce their offer by the amount they'll have to pay to have the place redecorated to their taste. So you can see how getting the decor wrong can easily erode a renovator's profit.

It's always safer to go for a conservative, neutral but classy decor that's appropriate to the local market and will appeal to the masses, not the few. If you're not sure how to achieve that result, get professional advice from an interior designer.

Spend appropriately on improvements

When you're renovating for profit, adding value is the name of the game. Unfortunately, you can't add unlimited value to a property because there is a limit to what the market will pay for, say, a four-bed, two-bath, double lock-up garage house. Once a home has reached its ceiling price for the accommodation it offers, buyers will not pay more. It doesn't matter how much Italian marble, state-of-the-art electronics and gold leaf on ceilings you put in it.

When you're undertaking comparable market analysis, you need to establish the ceiling price of fully renovated properties that are similar to the ones you're targeting.

To avoid overcapitalising, prioritise your expenditure on improvements that will add the most value. Be mindful of the price ceiling and resist the temptation to overspend.

It's also possible to go the other way and undercapitalise. This usually happens when you're trying to save money.

For example, you put in a cheaper kitchen with laminate benchtops but the target market prefers a much higher-quality kitchen with Caesarstone benchtops and European-branded appliances.

So they lower their offers to take into account the cost of redoing the kitchen to what it



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should be for a property of its style, position and character or they dismiss the property from consideration altogether because renovating is too much of a hassle for them. Either way, it's bad news for you.

If you don't have the budget to renovate a property to the standard the target market expects, then it's better to set your sights on a more affordable property that you can renovate properly. Otherwise wait until you've saved more money.

Take the sales agent's opinion with a pinch of salt

You can't rely on selling agents to give you an accurate estimate of the renovated value of a property. If you ask them what a property would be worth when it's renovated, they're more than likely going to give you a very optimistic estimate. Why would they do this? It's in their nature to be very bullish with sale prices. They want to paint a property they are selling in the best possible light to encourage you to make an offer on it. The other problem is, it's also an unqualified estimate, as they may interpret what you intend to do with the property as more high-end than you actually intend to do.

Hire professionals to do the work if you're not an expert

If your budget is small there's always a temptation to do some or all of the work yourself to save money, but DIY renovations can easily backfire. If the quality of workmanship is substandard, this will diminish your sale price, possibly eliminating any profit you might have made in much the same way as undercapitalising.

It's also a false economy. You might save a few bucks on the cost of the renovation, but how much is your time worth? The time it takes you to paint walls and sand floors could be better spent looking for another deal. Plus, the longer it takes you to renovate, the more you'll pay in holding costs. Why not just hire professionals to do all the work? Especially since you can still make a healthy profit without picking up a paintbrush. **M**

This is an edited extract from The Insider's Guide to Renovating for Profit (Brolga Publishing, \$29.95). A former carpenter, Patrick Bright is a real estate buyers' agent and property investor. He has written three best-selling property guides, as well as newspaper and magazine articles, and appears on TV and radio.

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To win one of 5 copies of *The Insider's Guide to Renovating for Profit* by Patrick Bright, tell us your best property renovating tip in 25 words or less. Send to Money, GPO Box 3542 Sydney NSW 2001, or email money@acpmagazines.com.au by December 6, 2011.

