

Wealth Creation Dynamics



Learn how to
drastically
advance
your financial
future.

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Welcome

Module 14 Renovation Magic

Welcome to module 14 of the Wealth Creation Home Dynamics Study Course - Renovation Magic

This module is number 14 of 24.

Each module is presented in the same layout and contains exercises that you can do in your own time.

The benefits of participating in this Home Study Course are:-

- You progress at your own pace.
- You can study in the privacy of your own home.
- You can ask questions regarding the course at questions@apin.com.au

We hope you enjoy the Wealth Creation Home Study Course.

Best regards,
The team at APIN

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The Strategy

It seems everybody is interested in renovating, especially with all the popular tv shows and magazines that are currently available. They can give you a massive opportunity to have a first hand look at how and what can be done. They also give you easy ideas, which are usually low cost and add immense value to personal and investment properties.

The renovation industry is a \$4 billion industry.

Some popular tv shows and magazines include:

TV Our House, Changing Rooms, D.I.Y Rescue, Backyard Blitz, Location Location Location, Ground Force, Auction Squad, The Block, Better Homes and Gardens, Hot Property.

Magazine Notebook, Better Homes & Gardens, Trends, Luxury Home Design, Home Beautiful, Renovating & Decorating, Inside Out.

With the increasing popularity of 'Foxtel' and subscriber TV, we have endless 'renovation' shows to watch and get inspired. Shows from the UK & USA include:

- Property Ladder,
- Grand Designs, How not to Decorate,
- Location Location Location,
- Relocation Relocation,
- Selling Houses,
- Street Appeal,
- Honey I Ruined the House,
- Pay off your Mortgage and This Old House.

Be aware however that some shows only indicate a value for materials only, and do not include the cost of labour or tradespeople. Many shows also use 'rental' furniture to make a room more appealing but do not add the rental fee into the total renovation cost.

Keep in mind also that some of the 'timed' shows such as Auction Squad that complete a whole house renovation in 12 hours have over 50-100 people working on various projects and that the whole renovation project took several months of planning, purchasing and preparing before the show even starts! Do not think that you can transform a whole house in just a weekend.

There are a few simple points you must consider when choosing a property for renovation:

- Buy older run down properties in established suburbs.
- Choose suburbs with shopping centres and good transport.
- Properties that are over grown with vegetation and shrubs should be your first choice.
- Pick properties with level land, avoid sloppy and steep blocks.
- Break the suburb into equal areas or zones, prices vary greatly even in the same suburb.
- What is the lowest price house in the suburb and what is the highest priced house.
- Establish your position within that area.



Some pre-purchase questions to consider include:

- How much work is involved in the renovation?
- How many days or weeks will that work take depending on weather?
- How much of the 'handy work' will you be doing yourself?
- How much of the remaining work will be outsourced to contractors/builders etc?
- Does this property fit within your budget and plan?
- Have you had an independent opinion from a builder and or architect to point out any unseen obstacles?
- Have you completed a schedule of works?
- Have any investigations been carried out with the council?

The 4 Types – of Renovation

Cosmetic Fixer

There's nothing wrong with the general structure but just looks ordinary or ugly.

These homes generally look quite good and only require minor painting and yard cleaning. Maybe a new fence, carport and patios will transform the house into a little gem.



The Rejuvenator

An older home that simply requires a new kitchen, bathroom and colour scheme.

Some older homes have period features that can be enhanced and will attract greater appeal. Some minor building changes can be added such as built in sun rooms or extended decks, older homes had small entertaining areas which can be opened up.

The Renovator

This property has a structural problem that needs to be repaired or many tiny rooms with little light.

This house will need walls removed and extensions added by professionals.

Knock Down

The house with no future at all, but a great block of land, possible dual occupancy. The money is made when you buy, so negotiation skills are the key here.



Exercise

What is the difference between a 'Cosmetic Fixer' and a 'Renovator' property? List some of things you would do to each property.

Assume you are about to purchase a property to renovate. In your current suburb, work out how much the lowest and highest priced properties are and calculate what you would be willing to pay for a property that needs work and how much do you think it would sell for once renovated?

The Steps

Step 1 - Estimate the value of the renovated property

Take photographs of other properties in the local area which you are trying to copy then take them to four local agents and get an opinion of resale value.

The secret here is to find bargains that other people believe are too hard difficult. Remember, many people lack imagination.

Step 2 - Calculate the purchase & resale costs

Add up all the costs in both buying and selling the property. Include solicitors and agents fees as well.

Make a detailed list and write down all areas of concerns that need to be clarified.

Give a list to the owner and or Real Estate agent as this will increase your negotiating power.

Step 3 - Estimate the total cost of renovations.

Prepare a detailed analysis and as a buffer add 10%.

Step 4 - Factor in your profit margin

If you do not decide to keep the property there are two ways to calculate a profit. One is on the purchase cost and the other is on the selling price after renovating.

e.g. Purchase costs	\$250,000.00 + 10%	= \$25,000.00 nett profit
Resale cost	\$350,000.00 + 10%	= \$35,000.00 nett profit

In fact if you made somewhere between \$25,000.00 - \$35,000.00 profit you would be doing well and be pleased with your results (within 12 months)

You must consider your tax position and any movement in the market in relation to valuation increase of your property.

Identify who is going to help you

Some jobs will require tradespeople and it is important to make sure that you investigate their reputation and make sure they have the relevant licences and insurance. It is also important to get several quotes, and in some instances the cheapest quote may not be the best one to choose.

Protect yourself from arguments, disputes and poor communication.

- Define your exact requirements in writing.
- Personalise your quote format and compare all quotes, equally.

- Check and understand the terms of each contract.
- Have dispute resolution strategies in place.
- Ensure that each contractor is insured accordingly.
- Ensure that each contractor is licensed.
- Have your architect produce a schedule of events.
- Contact the department of fair trading for any forms on contractors' agreements.

Your 'success team'

Put together a group of people who have similar goals to yours, from different fields of expertise. With whom you can share and build ideas.

Do you have family or close friends who would like to be involved with you in a project. It can be a lot of fun especially if you can do most of the work yourselves.

Some people in your renovations team may be trades people which will benefit you greatly.

REMEMBER:

Since we are only interested in cosmetic renovations, the building itself must be structurally sound.

Choose a property that is close to attractive facilities and amenities for your tenants, or potential purchasers.

When buying a unit or townhouse, conduct a body corporate and strata title search. Be thorough and don't forget a building inspection report.

Look for properties that have unique features and appeal.



Renovation Returns

The purpose of renovating is to increase the value or 'return' on the sale of the property. Some renovations will add instant value whilst some items which cost a lot of money might not make any return at all. Here's a list of the best and worst renovation returns:

Best renovation return

- Painting
- Flooring
- Fixtures & Fittings
- Bathrooms
- Kitchens
- Increasing natural light
- Removing unnecessary walls
- Storage ideas



Worst renovation return

- Bathroom spa baths
- Bedrooms
- Garages
- Basements
- Swimming pools
- Excessive landscaping

Here's a few ideas to help you when renovating:

Floors

- Polished timber floors are in fashion and are best used in all living areas where possible.
- In heavy traffic areas consider using fashionable large-square tiling.
- Choose plain neutral colours for carpets with a faint pattern and use nylon wool blend.

Painting

- Choose warm colours for all the inside walls and a good quality water-based, semi-gloss paint.
- Paint ceilings in flat white to reflect more light into dark rooms.
- Think about using a 'Feature Wall' that is painted in a strong, modern and fashionable colour.
- Consider using a colour consultant from your local paint shop. They are experts and know how the colours change when they dry. And in changing light.

Effective use of colours

- The use of white will create the illusion of larger space.
- Blue can also be used to create an added impression of space.
- Red reduces the size of rooms and increases the size of objects.
- Yellow will bring impression of sunlight into a dark room.

Fittings

- When renovating replace all the light fittings and light switches.
- Upgrade all taps in the bathroom and kitchen.
- Replace all door handles and door knobs.
- These 'small changes' appeal to tenants and add to the 'designer' feel of your property.

Windows

- First choice for window coverings are timber venetians as they offer a clean, modern and finished look.
- Vertical blinds can also give a nice modern look whilst maintaining affordability and practicality.
- Modern horizontal blinds are in fashion. But check light and privacy issues room to room.
- Consider including 'designer' curtains as they can add character to your rooms on a small budget.

Bathrooms

- Bathrooms are critically important to tenants and a little money spent here can totally transform just about any old and run down bathroom into a delight.
- Where possible avoid plumbing works.
- Old bathtubs can be resurfaced.
- Re-tile only if absolutely necessary. If retiling use white or cream tiles, floor to ceiling and no borders.

Kitchens

- The kitchen is another area where you can add a tremendous amount of value with a little money.
- Replace the kitchen top with granite and new appliances.
- If you need to replace the kitchen, buy wholesale.
- Decide on the quality of appliances to suit your market.
- Avoid cheap looking colour laminates.

Landscaping

- Keep landscaping simple so as to avoid unnecessary maintenance.
- Use Australian natives and fill garden beds with bark or pebbles.
- Consider stencil-concrete instead of expensive pavers on driveways and walkways.
- Powder coated concrete is another popular choice.
- Keep trees and tall shrubs away from the house, remember that one day they will get bigger.

Other considerations

- Consider bag rendering a brick home to give an up dated and modern look.
- Your rental properties should have a built-in wardrobe in each bedroom.
- Avoid renting your properties (houses) furnished unless the tenant enters into a payment system to purchase the package. Tenants with their own furniture tend to be better tenants and stay longer.
- “Pets Welcome” – tenants will pay more rent to have pets. Be sure to have the property cleaned and fumigated and get the tenants to pay for it – condition of contract.

Bright ideas

- Increase your education by reading magazines such as Better Homes & Gardens, Home Beautiful and Trends.
- Establish your own standard set of colours, brands, decorations, suppliers and trades people.
- At times a good clean is all that is needed and the best all purpose cleaner is Sugar Soap.
- It is absolutely vital to plan your renovations prior to settlement as the longer it takes you to renovate the more it costs you.
- Remember that best return on investment is when you get the best cosmetic appeal for the least amount of money.



Exercise

Why do you think Swimming Pools and Excessive Landscaping would be considered 'Worst Renovation Returns'?

List some questions you would ask a potential 'tradesperson' who was quoting on work on you renovation property?

The Benefits

Higher rental returns

Your rental increases considerably after a good renovation.

Increase property value

This increased equity is used to help you buy more properties.

Greater tax advantage

All repairs and items = \$300 are 100% tax deductible, whilst improvements can be written off over 5 years.

Claiming depreciation

- Upon completion, organise for a Quantity Surveyor to value the cost of your renovations and to prepare a Depreciation Schedule so that all items may be claimed.
- A depreciation document is tax deductible and is a vital aid for your accountant.
- Finally when all is finished appoint a qualified valuer or invite three or four Real Estate agents for an opinion.
- You can only claim for receipted items and not on estimated values.

Case Study

Irrespective of whether you're planning a minor repaint, or something more ambitious like a new second story, the intended outcome of a renovating investment is the same: buy, improve the value through upgrades or renovating improvements and then sell or refinance to access the additional equity and profits.

An example...

Bob & Emily buy a property in Brisbane on the 5th November 2001 (on a 30 day settlement) for \$172,800 from Mrs. Brown, a retired widow.

The property is a classic old-style Queenslander weatherboard, in a good location but quite dated and generally looking tired.

Mrs. Brown's property needs some immediate repairs: repainting (inside and out), the shocking 1970s orange style carpet ripped up and also a few rotten floorboards replaced.

Bob and Emily have visions of polished floorboards, a new kitchen installed and a lovely picket fence.

They secured 95% finance at a variable interest rate of 6.5% per annum with no early payment penalties.

With the exception of the external painting, Bob and Emily will do all the work part-time on weekends and after work. They estimate that it will take about six months to complete and no more than \$20,000.

Lets look and see:-

Outside repaint	\$7,000
Internal repaint	\$1,200
Floorboards	\$2,000
New kitchen (<i>with</i> appliances)	\$9,000
Front fence	\$800
Tip fees	\$1,300
Landscaping	\$1,000
General materials, etc.	\$850
Total	\$23,150

Although Bob and Emily negotiated early access to the property to begin renovating, the project took longer to complete than was planned. It was on the 1st June 2002 that the property went up for auction.

White a lot of people looked through the renovated property and there was strong interest, on the day of the auction the bidding was dominated by two young families. When the auctioneer's hammer fell, one family was overjoyed having secured their family home for \$229,550 with a 30 day settlement.

So how did they end up with?

Purchase price	\$172,800
Closing costs	\$8,500
Renovation costs	\$23,150
Loan Payments from 5th December 2001 to 1st July 2002	\$7,913
Auctioneers Fees and sale costs	\$7,000

The profit (ignoring tax) that Bob and Emily would have made is:

Sales Price	229,550
Sale Costs	- 7,000
Loan Payout	- <u>162,579</u>
	= \$59,971

Deposit	\$ 8,640
Closing costs	+ 8,500
Renovation	+ 23,450
Loan repayments	+ <u>7,913</u>
	= \$48,503

PROFIT \$ 11,468

(Note: An alternative option to selling the property would have been to retain it, have it revalued and then looked to redraw or refinance so to get access to the equity).

What are the critical success factors?

Finding a renovation diamond

The key is to find a property that is undervalued because it is cosmetically rather than structurally challenged.

So unless you're a builder, it is essential to get some specific advice to make sure that your target property isn't about to fall down around you when someone starts banging nails into walls.

Renovate and rent out

If Bob and Emily had kept the property they may have attracted a high rental return in the order of say \$300 and per week which could make the property a positive cash flow scenario.

When buying a property that you plan to use under a renovation strategy it's a good idea to seek a long settlement period and then negotiate early access. This will allow you to begin renovating without having to pay the interest costs. You will need to provide some undertakings to the vendor though such as taking responsibility for insurance.

Be very careful not to get caught up in the greed about the money you might make. Be sure to complete market research on what similarly renovated properties in the same area would sell **before you buy**.

The more you leave to chance, the more uncertain your outcome will be.

Having a renovation system that keeps control of time and cost is important.

The profit on many a renovation project has been sunk by project delays and cost blow-outs.

A great way to ensure this doesn't happen to you is to create a system for controlling the amount of time and money that you are going to invest.

This means having a cost budget, which has been preferably reviewed by someone who knows what they're doing, with components that will comprise your renovation, supported by written quotes.

Controlling your time can be done by mapping out all the phases of the renovation and then making sure that you have minimal rework or down time while you're waiting for tradespeople or sub contractors.

Leverage your time and money.

Ideally you'll avoid using your own time and money wherever possible. At first glance this might appear to bring down the returns, but having other people doing the work will allow you to complete multiple projects at once and make profits on many projects running at the same time.

Superior valuation system

- Prior to settlement, perform extensive market due diligence.
- Search for properties which are similar to yours in quality and position, but are priced significantly higher because:
 - a. Developer's construction costs are higher.
 - b. Land costs are higher.
 - c. Developer wants more profits.
 - d. Developer purchased the land recently and is still selling off-the-plan at high prices.
 - e. Finishes are similar to yours but more expensive ie: granite vs laminated.
- Research both the sale and rental price obtained for similar properties.

- Create a Research Journal.
- Keep all brochures and clippings.
- Have the property re-valued using a widely used valuer.
- Show the valuer the relevant market research you have obtained, and provide your opinion on what the property could be worth.
- Make the valuer's job "easy" by performing your own market research to 'backup' your estimated market value.
- Make sure that you spend enough time with the valuer. Explain your point of view and show ample proof.
- If your property is worth 15% more at settlement than the original retail price, it will make a huge difference to your finance and equity requirement when settling the property.
- Select the best locations.
- Try not to use your own money.
- Choose suburbs where there is less new development around.
- Select properties within 'tightly held' suburbs and streets (where no more land is available).
- If there are limited sellers and many buyers, your results will increase.
- Less competition for tenants and sales.
- Property values increase at a greater rate over longer periods of time in established areas.
- Limited sellers often means that the area is in demand, people want to live there.
- Some of the best properties to purchase for refurbishment, are large apartments, with high ceilings (2.7m +), in the best blue-chip areas and with brand new, more expensive developments in close proximity.
- The price of an established property could be dictated by the difference between a 'second hand property' and similar (size and position) brand new property.
- Boutique low rise is a perfect choice when buying.
- We want to buy second hand at 40% of the equivalent new price.

Exercise

Why would you renovate a property and then rent it out?

What could you do to assist a valuer who is doing a valuation on your renovated property?

final reflections

What key points have you learnt from this module?

Look around the current home you live in. Do you think you could increase its value by doing some Renovation Magic? List some simple renovations you could do.



You are ready for the next module.