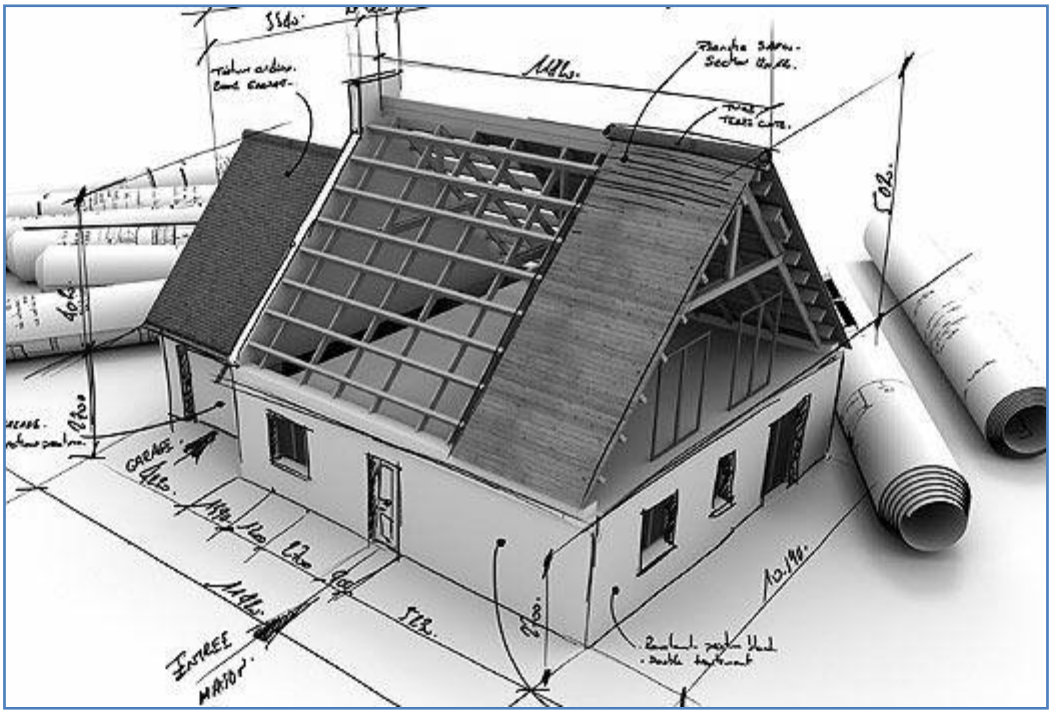

How To Renovate A Property For Profit

By Peter Jones

PROPERTY SECRETS

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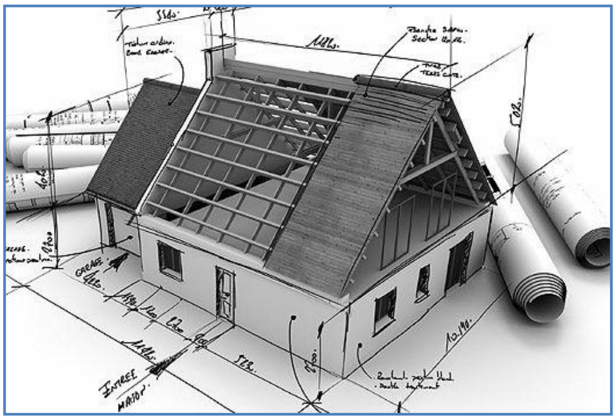
PROPERTY SECRETS

#tip Number One



Be Clear in Your Own Mind Why You Want to Renovate

PROPERTY SECRETS

There are two main reasons why we will probably want to refurbish a property.

The first is because it's a rental property for letting out.

The second reason is because it's a property we've bought to refurbish and sell on.

If it's a rental property we'll probably be trying to make sure that we:

- Make it easier to rent and so reduce our voids
- Increase the rent
- Increase the capital value so that we can refinance and pull our money back out if we want to

If we're renovating the property to sell it on, we'll need to be aware of two potential markets:

- The first is to owner occupiers
- The second is to other investors

The standard of refurbishment will be different for both of these potential buyers. If we're renovating to sell on to owner occupiers then we'll generally have to provide a higher standard of refurbishment, and conversely, a lower standard of refurbishment if we're selling on to other investors.

The premise behind this is that the other investors will be looking to rent the property out and so a refurbishment for a sale to an investor will be identical to a refurbishment to rent the property out. In that case we'll be looking to bring the property up to a good, but not exceptional standard and use hard-wearing finishes.

If we are renovating a property to sell on to other investors their main concerns will be:

- The yield
- Buying at a discount, what we could call nowadays below market value

Of course there are always exceptions to every rule and the refurbishment will need to be in keeping with the property, in other words its size, age, character and location, regardless of whether we're renovating to rent out or to sell on.

And in some areas the appropriate market may be high-end tenants, in which case the finish for the rental market may be identical to the finish we would provide for owner occupiers or, in some cases, such as higher end corporate, higher than for owner occupiers.

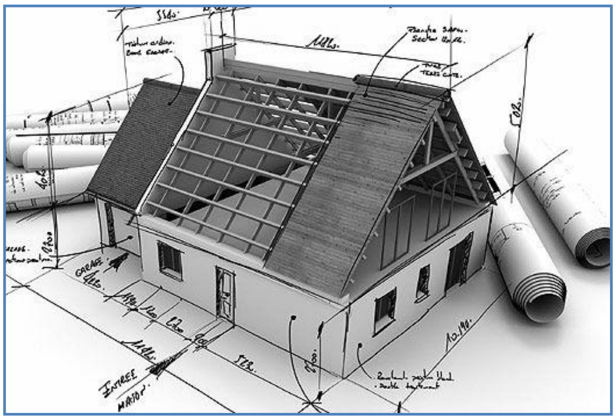
A lot of people think of renovating property to sell-on at a profit when the work is done. But don't forget that buying to do up and buying to hold and let are not mutually exclusive. In fact there are definite benefits in combining the two.

Having cut my teeth doing up a couple of properties to sell-on, but having also enjoyed the benefits of "let and hold" through buy to let, as often as I possibly can I now try to combine the two by buying to do-up and then letting and holding.

The premise behind buying to do-up is that it will result in a profit. The money you spend should be on things that will improve the property, and so the value of the property should increase by more than the amount you spend on the works.

If you buy to "do-up and sell-on" you would take this profit as a lump sum. If instead you do up and then "hold and let", this profit will translate as an increase in the equity you hold in the property. If the equity increases, this can either be seen to reduce the gearing if you have used finance or, alternatively, can be taken out by way of mortgaging, re-mortgaging or as a Further Advance, and can be used to buy or refurbish other properties, or to pay your salary as a property developer.

#tip Number Two



Know How Much Value The Works Will Add Before You Start

PROPERTY SECRETS

Before doing any works of repair, renovation, modernisation and improvement, we will want to be sure that they will add value. That is, unless there are other good reasons for doing the work, such as, we are obliged by law to undertake them, or the works will increase saleability or rentability even if they don't add value per se. So how much value do individual items of repair, renovation, modernisation and improvement add?

Remember, cost does not equal value. It is important to remember when planning to refurbish a property that the cost of the refurbishment will not always be directly reflected by increased value. Just think about the £20,000 kitchen in the £60,000 terraced house.

One of the first things I was taught as a young Surveyor was that cost does not equal value. It is therefore very likely on occasion that you could spend money on a property but not increase the value by as much as you spend, and in some instances you may even detract from the value.

Similarly, looked at the other way, this works in our favour because it also means that we can spend money on a property but disproportionately add value to the property, increasing its equity and therefore our wealth or the profit within the property.

I often get asked if there's a list anywhere, or a website, which shows how much value different works of repair, renovation, modernisation and improvement add to the value of a property.

Or if there's a formula we can use, to work out how much value is added.

Unfortunately it's not as simple as that.

The amount by which any work of repair, renovation, modernisation or improvement will add value to a property will almost always be market driven and will depend on the demand, requirements and expectations of the market in that area.

Let me illustrate this by using an extreme example. If you put central heating into a terraced house which is located in an area of extremely low demand, and where there's a glut of terraced houses on the market, you may not add any value at all. The property may be just as hard to sell with the heating as without it. Terraced houses are hard to sell, full stop. As I say, this is only an example, I'm not stating a general rule. In some areas terraced houses are very popular.

In our hypothetical area new central heating might make the property easier to rent out, but it might not make it easier to sell.

Here's another extreme example. Adding a garage to a property in the suburbs might add a few thousand in value to a property, but if you can squeeze a garage onto a plot in central London it may add many multiples of that in value, possibly even £100,000 or more!

So a £20,000 kitchen installed in a cheap 3 bedroom terraced house in a town in northern England, and which would normally sell for £60,000, might add no extra value over and above a cheap kitchen costing £1,500, and it could even reduce the value if it's overbearing and the next owners are going to have to rip it out and start again.

I'm using this as an example because I once saw a terraced house, worth no more than £60,000, which was on at an asking price of £80,000. The reason it was on at this price? The owner had obviously spent about £20,000 on the kitchen but it was totally out of keeping. In their mind they'd added £20,000 to the value, being the cost of the kitchen (we'll look at *cost does not equal value* in a moment) but in truth, it probably hadn't added a penny to the value. It might even have reduced the value because it was so large and over-bearing.

The same £20,000 kitchen installed in a super-luxury detached house might also add no value, and might reduce the value because buyers of that type of house might expect a fully fitted kitchen costing £60,000 with all the trimmings.

So, in my experience, there are no hard and fast rules, the amount by which any work will add or reduce the value will depend upon market expectations in that area.

But having said all of that I was interested to see that the Nationwide recently published a special report in which they give advice on how much an improvement can add to the value. It's true that they have a large survey sample of properties which they can research and extrapolate their figures from but, even so, I'd be wary about relying too much upon general guidelines.

In summary, they suggest that:

- Adding a bedroom and a bathroom through an extension or loft conversion can add over 20% to a property's value.
- Extending to accommodate an extra bedroom can add over 10% to house value.
- An extra bathroom adds 5% to the value of the average home.

Specifically, Robert Gardner, their Chief Economist said:

"Having more useable space is generally thought to be consistent with better quality accommodation and people are prepared to pay for it. A 10% increase in floor space, other things equal, adds 5% to the price of a typical house, whilst adding space equivalent to the size of a typical double bedroom to a two-bedroom house can add around 11% to its value.

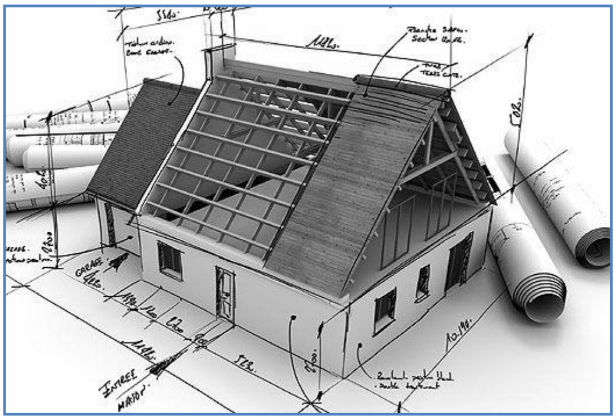
A second bathroom also remains a favourite amongst home owners and our research shows that creating an additional bathroom can add 5% to the value of the average house.

Home owners who add a loft conversion or extension incorporating a double bedroom and a bathroom can add about 20% to the value of a three bedroom, one bathroom house. Households appear happy to pay for more space and our analysis suggests that, providing the room is useable, adding an extra bedroom can be a good way to increase the value of a property".

Based on their research The Nationwide estimate the value added for different types of property by increasing floor area to accommodate an extra bedroom is as follows:

- Terraced house 2 bed to 3 bed plus 10%
- Terraced house 3 bed to 4 bed plus 9%
- Semi-detached house 2 bed to 3 bed plus 12%
- Semi-detached house 3 bed to 4 bed plus 9%
- Detached house 3 bed to 4 bed plus 9%

#tip Number Three



Be Clear on How Much The Works Will Cost Before You Start

PROPERTY SECRETS

The amount you pay will depend on where you are located, the size and quality of the property you are working on, the quality of the work you instruct, how many quotes you obtain and how hard you 'negotiate' with your contractors, and even where we are in the economic cycle; in downturns builders are more likely to be looking for work and are more likely to discount prices.

Just to give you a rough guide, here are the kind of prices I would expect to pay for my properties in the North East, although you have to bear in mind that prices will vary greatly across the country for the reasons I've just given.

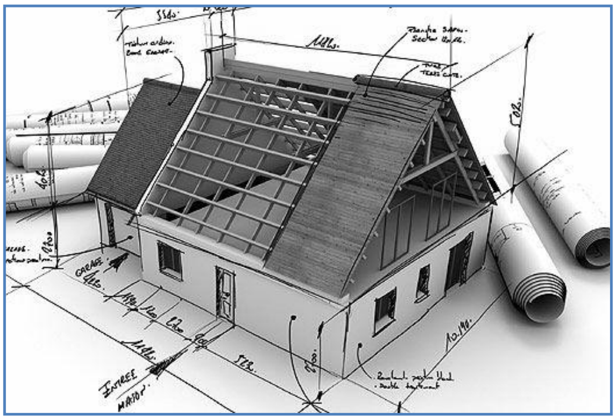
So, here's a very brief list:

- Central heating for a 2 to 3-bedroom property: £3000 - £4000
- New windows and a new front and rear door for a 2-bedroom or 3-bedroom property: £4000, unless I buy the windows direct from a manufacturer and get my builder to fit them, in which case they'd probably be nearer £2,000 to £2,500
- Rewiring a 2 bedroom flat: £2,750 to £3,000
- A new kitchen fitted by my builder: £1,500, including built-in cooker and hob
- A new bathroom fitted by my builder: £500 - £600 including new 3 piece bathroom suite
- Tiling the bathroom: £300 - £500
- Decorating a 2 or 3-bedroom property: £2,000 to £3,000
- Cheap carpets for a 2 to 3-bedroom rental property: £800 to £1,500

And don't forget to allow for a notional charge for your own time when you're calculating or estimating the cost of the works. If you don't cost out your time, you will be robbing Peter to pay Paul. Your time is a valuable resource and should be accounted for.

The same is true with interest. Even if you buy the property for cash and fund the building works with your own money, you must allow for notional interest payments, otherwise you're really cooking the books. You have to allow for the opportunity cost of using your own money. After all, if didn't use it to fund your project, it would be invested somewhere else, for example in the bank earning interest.

#tip Number Four



Search Around For The Best Finance For Renovation Projects

PROPERTY SECRETS

Lenders require a property to be habitable from day one before they will advance a buy to let loan.

Many buy to let lenders are reluctant to advance mortgages against properties which require even minor works of repair, modernisation or improvement. The rationale behind this is that in lending on the property they are taking the potential income into account, and they want to see that income coming in as soon as possible. So if the property requires repair or modernisation, there won't be an immediate stream of income, which puts the lender at risk if they ever had to repossess.

For this reason most lenders will insist that the property is in a letable condition from day one, and as a consequence of that I have seen instances where loans have been declined, based upon the valuer's comments when he has inspected the property, for what would usually be considered fairly trivial reasons.

However, the good news is that some lenders will lend on properties requiring a limited amount of renovation or refurbishment by way of a light refurbishment loan.

The definition of light refurbishment is a little vague but it essentially covers situations where the property requires a cosmetic upgrade, and perhaps minor improvements, such as a new kitchen or a new bathroom.

The way that light refurbishment loans work is that the lender will advance, say, 70%, depending upon their LTV, of the purchase price of the property, or the value, whichever is lower, and will usually also retain a sum of money equivalent to the cost of undertaking the improvement or repair works.

At the time of the initial mortgage application the valuer will be asked to provide an opinion of value of the property in its current un-refurbished condition, and also an opinion of value of the property upon completion of the works.

When the borrower informs the lender that the works have been completed, the valuer will re-inspect, and as long as the valuer is happy with the standard of the works that have been undertaken, the sum of money retained to cover the cost of the works will be released, and any extra equity.

The mortgage will be re-calculated to be 70% of the value of the property after improvement, and any extra equity resulting will be released at the same time.

There are pros and cons with using light refurbishment loans.

The first disadvantage is that only a few buy to let lenders offer a light refurbishment or limited refurbishment loan, so there's not much choice.

The main lender is Paragon, although the terms of their loan make it very limiting, but others include Shawbrook, Kent Reliance, Aldermore and the Saffron Building Society.

Also Precise offer a bridge to let facility whereby they bridge the refurbishment and then the loan can be swapped to a more traditional buy to let type loan.

The second main disadvantage is that currently loan to value ratios are limited. Most tend to be around 70%, although Paragon offer a 75% LTV, although this comes with strings attached, Kent Reliance offer 75% LTV, and Saffron offer an 80% LTV.

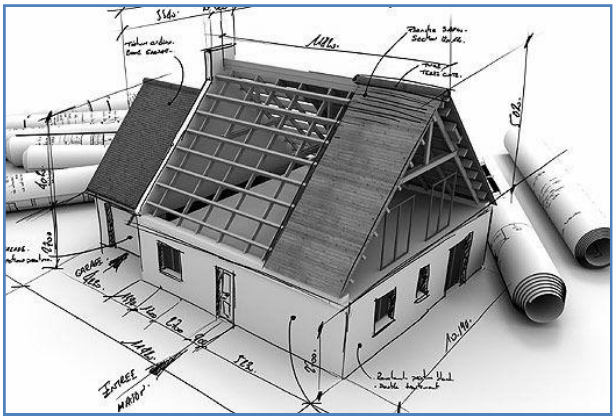
This can be compared with the best LTVs available for standard buy to let mortgages which include 85% offered by Kent Reliance, and 80% by The Mortgage Works, Mortgage Trust and Saffron.

Another potential disadvantage, depending on what you buy and where, is that most lenders have relatively high minimum valuations for their light refurbishment products. Paragon has the lowest at £75,000, and Saffron and Kent Reliance only lend on properties over £100,000, which is fairly typical.

Paragon describe their limited refurbishment scheme as being for a property that is "currently habitable but where minor works would enhance the overall appeal to the market and its potential rental income. Minor works might typically include the replacement or refurbishment of kitchens and bathrooms, renewal of services or decorative attention. The scheme is not for works that require planning permission, permitted development rights or building regulations approval, and should not involve any major structural works to the property".

That is a fair summary of how all lenders see light refurbishment.

#tip Number Five



Light Refurbishment Finance Today

PROPERTY SECRETS

In the previous chapter we looked at light refurbishment and how it works.

Let's have a look at the different light refurbishment products offered by the different lenders.

Paragon Mortgages

Here's how the Paragon limited refurbishment scheme limited works.

The minimum valuation requirement is £75,000.

Up to 75% of the purchase price or the valuation, whichever is the lower, will be advanced upon completion of the purchase.

A retention amount, being a minimum of £2,500 up to a maximum of £25,000, will be held and, once works are completed, up to 75% of the after-works value can be released.

The works must be completed within three months of the initial advance.

The maximum £25,000 retention is the maximum that will be released on refurbishment.

In other words, even if you increase the value of the property by more than £25,000, £25,000 is the maximum amount of extra equity they will release.

If you run the numbers it means that the most efficient way of using it is to buy a property for £75,000, spend £6,000 doing it up to produce an end value of £108,250. Then we'll be able to get the full £25,000 back out.

But how many properties will fit that scenario? Not many.

But it's not all bad news! There are other lenders with different products

Saffron Building Society

Saffron Building Society also offer a popular buy to let mortgage specifically for light refurbishment works. The minimum valuation of purchase price is £100,000.

They are currently advertising two buy to let light refurbishment products.

One has a 75% LTV and is on a 2 year fixed rate of 4.47%

The other, which is potentially much more interesting to us, has an 80% LTV and a five year fixed rate of 5.07%.

Their website gives the following example:

- Purchase price of property £100,000
- Initial advance £75,000
- Property value after improvements £130,000
- Total borrowing £97,500
- Further advance £22,500

Aldermore

Aldermore offer a light refurbishment product.

They will advance 65% LTV on day one on the lower of the purchase price or the valuation with a retention on the advance to take the total advance up to 70% of the completed value.

The works must be undertaken within six months from the date of drawing the original advance.

There is an arrangement fee of 2.5% with a procuration fee of 0.75% and a minimum interest margin of 5% over the base rate of 3%, with an additional loading of 1% during the refurbishment phase.

Shawbrook

Shawbrook offer a short term mortgage for refurbishments, with a 75% LTV and a minimum loan of £75,000, meaning a minimum valuation of £100,000. The maximum loan period is 18 months. The rate charged is 8% above 3 month Libor which means it's roughly 8.5% a year at today's rates.

So this is really a bridging facility.

But you can switch to their standard buy to let mortgage, again with a LTV of 75% and a minimum loan and value of £75,000 and £100,000 respectively, with the choice of interest only, capital repayment or partial capital repayment terms.

The maximum term for interest only is 10 years and the rates are nearer 4% at the moment.

Precise

Precise have a Bridge to Let facility. Here's a quick summary of how it works.

They offer a light refurb bridging facility with a maximum LTV of 70% for a maximum of 18 months. The minimum loan and valuation amounts are £50,000. The monthly rate is 0.95%. and there is a 2% facility fee.

Once the works are completed, within 4 months you can switch to their Bridge to let buy to let mortgage. This has an 80% LTV for loans under £500,000, with a maximum term of 30 years and with rates of around 5%.

So there's lots of different products, each with the pluses and minuses. Whether it's worth using one of these more expensive bridging type products will all depend upon the figures. You may consider it worthwhile to use a more expensive product initially if you intend to refinance down the line and then switch to a cheaper product like a normal buy to let product.

So it's worth playing with the figures and seeing which combination works best for you.

--END--

If you are interested in renovating property, either to sell-on at a profit, or so you can refinance and borrow all of your money back out to spend on your next project, you might be interested to know that I have rewritten and updated my best selling ebook ***The Successful Property Renovator's Workshop***.

This is a 'course in a book', which will take you through the whole process in detail including how to do your sums to make sure you make a profit, how to raise finance for the purchase and the project, and how to refinance when you have completed.

The good news is that I've taken all my knowledge and experience, which I have gained over the years from doing countless renovation projects, and have put it all down on 'paper' in this 'easy to read' ebook. *In it I'll show you how you can find, plan, prepare and do each project to ensure your own profitable success every time.*

And none of this is just dry theory. This is all based upon my own, personal experience of refurbishing and renovating property, which is **why I use case studies of actual properties** I've refurbished, along with photographs, to illustrate many of the points made.

I'll show you **all the things I did right**, so you can copy them, **and all the things I did wrong**, so you can avoid them. They say that 'trial and error' is one of the most effective ways of learning but I can save you the time, the grief and the cost of having to go through it all. Hopefully I can save you months, even years, of trying to work it all out for yourself!

But that's not all!

I have also rewritten and updated another best-seller of mine, ***63 Common Defects In Investment Property and How to Spot Them***. This is really a case of 'what it says on the tin', a quick reference guide to typical defects in investment property and how you can spot them.

This won't make you into a surveyor but it'll show you how to inspect property and how to spot the main defects you should be looking for.

I even outline the typical defects associated with the 8 most common forms of building construction you are likely to come across.

And I walk you through how to do a detailed inspection, and provide you with the check-lists and *pro forma* I use when I inspect a property.

All in all 63 Common Defects In Investment Property and How to Spot Them will help you make a more informed opinion about whether a property is worth buying, whether it's a property you should be buying, and will help you decide whether it's worth taking forward and so spend out on a full survey.

It'll help you to save time by helping you decide whether a property fits with what you want to do; there's no point pursuing properties that don't fit with your renovation strategy.

PROPERTY SECRETS

And it'll help you save money by helping you to establish whether you really need a survey – after all, there's no point in instructing a survey on an unsuitable property, especially if you can work out that it's unsuitable for yourself.

And, of course, by having a better idea of what's required to improve and repair the property, it'll help you make a far more accurate estimate of the costs involved BEFORE you start.

If you're serious about renovating and refurbing property these two ebooks together will give you a wealth of insider information at your fingertips.

Individually these downloadable ebooks usually cost £29.97 each but, as a special **half price offer** for readers of Property Secrets, they are available on a 'hidden' page on my website for a total investment of **only £29.97 for the two together**.

To order your half price copies please go to **ThePropertyTeacher.co.uk/PROPERTY-SECRETS-OFFER**

Here's to successful property investing

Peter Jones B.Sc FRICS

Chartered Surveyor, author and property investor

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