BLOG& EMBRACE UPDATES

INVEST FOR CASHFLOW AND RETURN ON INVESTMENT

We certainly cannot stress this point enough and it is a point that all successful property and businesspeople follow diligently. Back before the last major crash in 2008, we were in a rising market where property prices were going up every year and investors were being able to buy properties and re-mortgage them straight away, in some cases the same day. This was a fantastic time to invest and property was hot in the media and on TV, with many programmes on how to profit in the rental market, and how to buy and sell for profit. Those who were seasoned, had knowledge, and were willing to act, were building large successful portfolios.

Unfortunately, though, there was the other side of the coin and some of the people that were just relying on capital growth found themselves in trouble. Because it was seemingly easy to attract finance and buy lots of properties, some investors were taking their eye off the ball with regards to cash flow and return.

This was distressing for some as they bought properties, often because they could, but did not follow the golden rules of stress testing every investment rigorously. When the crash happened, they found that they had overstretched and many of the properties just did not achieve the rental returns they needed to cash flow their business. In more extreme cases certain investors had huge void periods, and with no equity in the property they found that the profitability of their investment had gone.

This really taught us that cashflow was king, and capital growth was not to be completely relied upon. With us potentially looking at another correction in the coming months, serious business professionals want to see that the business works from a cash-flow perspective and want to know when if they invest say £50,000, they will get it back.

Property investing should be no different and it should be treated like a business. Therefore, you should always be looking at monthly cash flow, and return on investment.

WHAT DOES CASHFLOW AND RETURN ON INVESTMENT MEAN?

Cash flow from a property is calculated by taking the monthly rent and subtracting the monthly costs. These costs can include mortgage payments, insurances, service charges if applicable, management fees, and incidental funds. So, if your rent is £650 and all these costs are £400 you are then making £250 on top of this which is your cashflow all being well.

Return on investment is calculated by taking the annual cash-flow and dividing it by the total costs put into the property.

So as an example, let's say that you had to put £25,000 into a property purchase. This covered your deposit, refurbishment, and buying costs associated with purchasing the property. You then buy a property which makes you £250 per month cash-flow so £3000 for the year. You would then make a 12 % return on your investment which is calculated by dividing £3000 by £25,000. Not bad I am sure you will agree when you may only get 2 to 3% in a bank. This is certainly an achievable target in our area, and in some cases the returns are higher depending on the property strategy.

These however are the figures that a seasoned investor would want to know. They are treating each property purchase as a business entity, which is key. Now it is your job as an investor to track these properties and keep regular records of the return the property is making you. There is the theory and then there is the reality and let's say you have a couple of void months or some increased costs, then the actual return will decrease.

Therefore, it is important to put an incidental fund in there, and not be too generous on your figures. If you allow for unexpected things to happen and the return is still good, then if they do not then it is a bonus. You should still make a healthy return and by setting up your investments in this way you are preparing like a seasoned investor. Don't get us wrong: when you achieve capital growth then this is a fantastic bonus, but the investment has to work on a monthly basis for you to be able to see the capital growth in the years to come.