

**Investment Report**

**24, Trevor Terrace,**

**North Shields**

**Tyne and Wear**

**NE30 2DE**

**05.11.2009**



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## **Summary**

Generally our investor clients have specific questions in mind when they talk to us.

- **What will my income be if I invest in and rent out this property?**
- **What will be the growth, in real terms, of my invested capital?**

Ultimately they want to know,

- **Should I buy?**

This report aims to provide the answers to these crucial questions.

When deciding whether to buy an investment, context is important. The analysis is viewed in the light of the individual investment objectives of each client. For example, one client may consider income to be a low priority and capital appreciation high. Others may have an entirely different combination of priorities.

Therefore, whilst the results of our analysis are always objective they should be seen in the context of a client's individual needs.

Never has property investment been scrutinised to the degree it is in the current economic climate. We are currently in the midst of a credit famine and a severe recession.

No one can be certain what is going to happen in the next six to twelve months, but what we can be sure of is that the economy will recover and growth will resume, both in general economy and the property market.

Even in a falling market, property can be a sound financial investment, to maximise this there are places where, from a financial point of view, it is a good place to buy and others you should avoid.

As always when the market does recover the value of properties will not be spread evenly across the country, so this report will help guide you in your latest property investments ensuring you buy with the right knowledge at your fingertips and minimise risk.

Using the best available information our recommendations enable you to:

- 1. Avoid properties and areas where values are likely to fall excessively**
- 2. Identify places where values will be maintained in line with the general property market**
- 3. Choose properties and locations where the growth in value will be more than the average rate of growth in the property market**

Consider this report as an insurance on your property investment decisions.

## **Report Recommendations:**

Your proposed purchase of 24, Trevor Terrace, North Shields, Tyne and Wear, NE30 2DE.

Using the latest information available, combined with our skills and expertise we consider the investment performance of your prospective purchase to be such that we recommend it is

**\*\*\* A solid buy with good prospects**

Please read on and this report will explain how we have reached this recommendation

## **Introduction – how & why**

The remainder of this report will illustrate how and why we have arrived at our conclusion and the supporting data for our recommendation

### **Why invest in property?**

Traditionally putting your money into property has been regarded as a safe way to acquire and protect capital – a good investment for the future.

The reasons for this are twofold

- 1. We consider property as an enduring asset**
- 2. We believe the demand for property will remain greater than the supply**

Even before the current reduction in house building the annual number of new households exceeded the supply of new houses by 35,000 per year.

And despite the current recession, the overall trend tracked over previous years, demonstrates that as the strength of the economy increases the value of property will increase with it.

This does not mean that every house in the UK will increase in value year on year, but the long-term trend over the last sixty years has seen an average increase of approximately 6.2% that is 2.9% above inflation.

Short term falls are inevitable, but looking at property as a long term investment, the trend for growth is good.

Buying to let, is not the same as buying your own home. Being a landlord is the same as running a small business. Therefore specific criteria must be assessed, in financial terms, to ensure risk is minimised.

Traditionally the 'yield' has been taken as the measure of investment performance. In simple terms, this is the rent divided by the purchase price, expressed as a percentage.

The Yield is of limited use because it leaves out items including; the amount borrowed, cost of borrowing, buying expenses, maintenance costs, inflation, depreciation, cash flows, rates of capital appreciation etc.

Over the next few pages we'll look at all of these items and more to determine cash flows and internal rate of return over a given time.

It will enable any investor, from first timers to seasoned buyers to quickly assess show the actual and comparative financial performance of your proposed purchase.

## **How to read the report**

The following is a guide to the terms and headings used in your report and attempts to offer a brief explanation.

### **Renovations**

Renovations are included as an original input and are estimated by the clients if required.

### **Capital Growth**

Capital Growth rates are formulated using a complex model of information from the Land Registry, unemployment figures, industrial output, bank rates, business activity, property sales, office rents etc.

Overall more than one hundred factors are taken into consideration when calculating capital growth rate. However, please be aware that an absolute guarantee cannot be offered when calculating this figure.

Normally a report will predict the rate for a duration of five years, and as such it is an educated forecast. The most accurate data available is analysed to reach the conclusion, which is the most likely outcome for your property.

### **Property Value**

The property value is calculated from the initial market value, any renovations and capital growth forecast.

### **Loan Amount**

This is the amount that is outstanding through the examined period.

### **Equity**

This is the amount that your property is worth less the loan amount.

### **Inflation Rate**

This report measures the inflation rate by using Retail Price Index (RPI). There is a number of different ways to measure inflation; the Customer Price Index (CPI) and RPIX (excludes mortgages) and the RPIY (excludes mortgaged and direct taxes etc). For the purposes of this report RPI is the best method.

### **Gross Rent**

Estimated by the client and increased in line with inflation.

### **Principal Repayment**

A principal repayment can be paid to reduce the loan on a conventional 'principal plus interest' basis.

### **Interest Rates**

This will be the rate you have supplied. Where a variable rate loan has been used the latest and the best data has been used to forecast the future interest rates.

### **Loan Interest**

This is calculated from the loan type, the amount and term of the loan.

### **Additional Repayment**

If you decide to pay additional payments we will discuss this and add it in to the report.

### **Total Loan Repayment**

This is calculated from the loan principal, interest and additional payment.

### **Special Expenses**

This will be specified by you and added to the report if required.

### **Total Property Expenses**

From the initial yearly expenses, inflation rate and special expenses.

### **Pre-Tax Cash Flow**

The simple 'yield' does not take into account how much cash the purchaser will put into the property. The Pre-tax cash flow takes into account all of the expenses, such as maintenance, property management fees, the vacancy rate, repairs, gardening, principal repayments, mortgage application fees, appraisal fees. If all of these factors are taken into account, then we have a good snapshot of how a property will perform, at any one point.

The pre-tax cash flow and the pre-tax cash on cash return, (shown as a percentage in the appendix), is far more useful than the yield, in determining if a property is a good investment.

### **Pre-cash Cash on Cash**

The initial cash investment, additional repayments, if any, and pre- tax cash flow.

### **Depreciation – Buildings**

There is no depreciation allowed by the Inland Revenue on buildings.

### **Depreciation – Contents**

Calculated from the contents value and contents depreciation rate.

### **Total Deductions**

From the total property expenses, depreciation on contents and loan interest.

### **Tax Credit**

Calculated from standard tax rates, rental income, total deductions and marginal tax rate.

### **After-Tax Cash Flow**

From the pre-tax cash flow and the tax credit.

### **After-tax Cash on Cash**

Calculated from the initial cash investment, additional repayments and after-tax cash flow.

### **Client Income**

Using all of the input data, this is the estimated weekly income for the prospective purchaser.

### **Internal Rate of Return**

The cash on cash return is far more useful than the yield in determining if a property is a sound investment.

Nonetheless, it still is just a snapshot at one point in time. The Internal Rate of Return is an even better measure of investment performance. If the cash on cash return is a snapshot, then the IRR is the movie, or DVD.

The internal rate of return looks at how the cash flows and property values change with time. To do this it takes what the projected growth rentals will be, what the capital growth is expected to be, what the mortgage interest payments will be, if the principal is slowly being paid off, and what depreciation can be claimed each year.

The appropriate rate of inflation is used to calculate the Net Present Value of the inflows and outflows, in any one year. Another way of thinking of **the internal rate of return**, is the return a bank would have to give you if you gave the bank the initial cash investment in the prospective property, they would give you the annual net inflow from the property for each of the years over the period and at the end of the period, give you back your increased equity in the property.

IRR takes the time value of money into account. Each pound of income now is worth more than a pound in five years time and a pound of cost in five years time

is less than a pound now.

The additional feature of IRR, is that it is what is called 'dimensionless', i.e. it is just a number, expressed as a percentage.

This means we can compare the IRR to a two bedroom apartment in one location with a three bed semi in another, or a retail/commercial investment, in a third, or indeed with any other investment. This sophistication of analysis greatly helps decision making by reducing risk.

**Property Name** Trevor Terr, 24

**Location** UK



<b>Purchase Price</b> £90,000.00	<b>Market Value</b> £105,000.00
<b>Closing Costs</b> £1,570.00	<b>Cash In</b> £24,382.00
<b>Total Cost</b> £100,143.00	<b>Loan Amount</b> £76,530.00
<b>Building Value</b> £67,500.00	<b>Loan Cost</b> £769.00
<b>Contents</b> £1,800.00	<b>Annual Rent</b> £5,184.00
<b>Expenses</b> £1,071.00	<b>Management</b> £264.90

<b>Investment analysis</b>	<b>YEAR 1</b>	<b>YEAR 2</b>	<b>YEAR 3</b>	<b>YEAR 4</b>	<b>YEAR 5</b>
Renovations	0.00	0.00	0.00	0.00	0.00
Capital growth	2.70%	7.40%	7.60%	7.90%	6.00%
Property value	107,835.00	115,814.79	124,616.71	134,461.43	142,529.12
Loan amount	76,530.00	76,530.00	76,530.00	76,530.00	76,530.00
Equity	31,305.00	39,284.79	48,086.71	57,931.43	65,999.12
Inflation rate	2.50%	2.50%	2.50%	2.50%	2.50%
Gross rent	5,184.00	5,313.60	5,446.44	5,582.60	5,722.17
Principal repayment	0.00	0.00	0.00	0.00	0.00
Interest rate	4.94%	4.94%	4.94%	4.94%	4.94%
Loan interest	3,780.58	3,780.58	3,780.58	3,780.58	3,780.58
Additional repayment	0.00	0.00	0.00	0.00	0.00
Total loan payment	3,780.58	3,780.58	3,780.58	3,780.58	3,780.58
Special expenses	0.00	0.00	0.00	0.00	0.00
Total property expenses	1,335.90	1,369.30	1,403.53	1,438.62	1,474.59
Pre-tax cash flow	67.52	163.72	262.33	363.40	467.00
Pre-tax cash on cash	0.28%	0.67%	1.08%	1.49%	1.92%
Depreciation-Building	0.00	0.00	0.00	0.00	0.00
Depreciation-Contents	180.00	162.00	145.80	131.22	118.09
Total deductions	6,065.48	5,311.88	5,329.91	5,350.42	5,373.26
Tax credit	0.00	0.00	0.00	0.00	0.00
After-tax cash flow	67.52	163.72	262.33	363.40	467.00
After-tax cash on cash	0.28%	0.67%	1.08%	1.49%	1.92%
Your income per week	1.30	3.15	5.04	6.99	8.98
Internal Rate of Return	28.75%	27.45%	26.03%	24.87%	22.83%

**Notes:** The loan costs are included in the deductions for the first year.

Depreciation rates : Building = %

## **Who Pays the Interest Bill**

The following table shows who makes the loan interest payments

**Property Name** Trevor Terr, 24

**Location** UK

**Purchase Price** £90,000.00

**Closing Costs** £1,570.00

**Total Cost** £100,143.00

**Building Value** £67,500.00

**Contents** £1,800.00

**Expenses** £1,071.00

**Market Value** £105,000.00

**Cash In** £24,382.00

**Loan Amount** £76,530.00

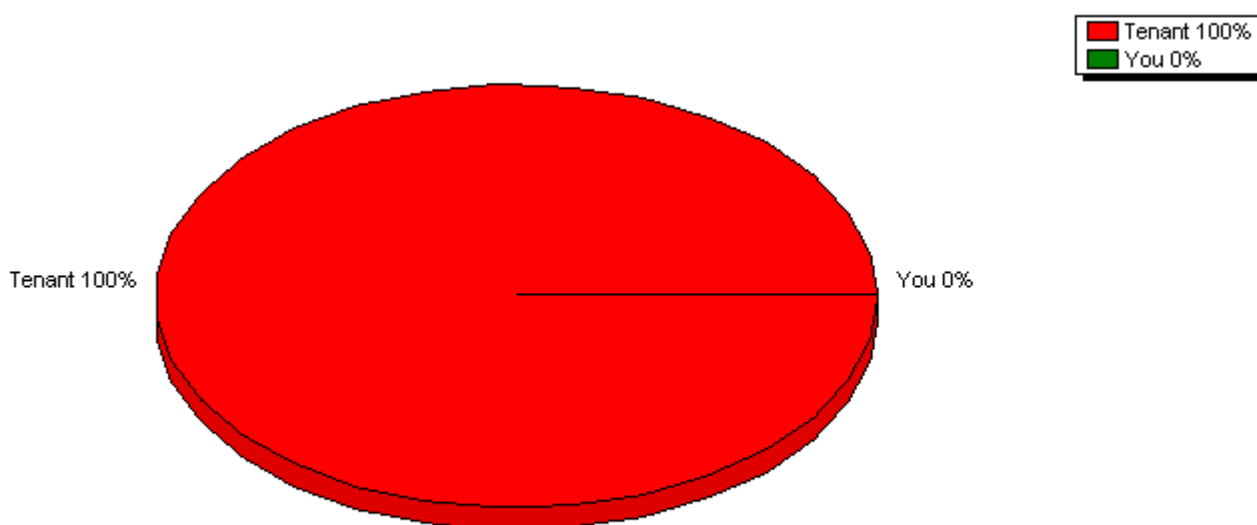
**Loan Cost** £769.00

**Annual Rent** £5,184.00

**Management** £264.90



**Who pays the interest bill?**



	<b>Interest bill</b>	<b>Rental income</b>	<b>Rental expenses</b>	<b>Net rent (Tenant)</b>	<b>Tax credit (Taxman)</b>	<b>Remainder (You)</b>
<b>Year 1</b>	3,780.58	5,184.00	1,335.90	3,848.10	0.00	-67.52
<b>Year 2</b>	3,780.58	5,313.60	1,369.30	3,944.30	0.00	-163.72
<b>Year 3</b>	3,780.58	5,446.44	1,403.53	4,042.91	0.00	-262.33
<b>Year 4</b>	3,780.58	5,582.60	1,438.62	4,143.98	0.00	-363.40
<b>Year 5</b>	3,780.58	5,722.17	1,474.59	4,247.58	0.00	-467.00

## **Property Value and Debt**

In this next table, the percentage growth rate for each of the five years is shown, as is their effect upon the value of your proposed purchase.

It shows the build up of equity in the period.

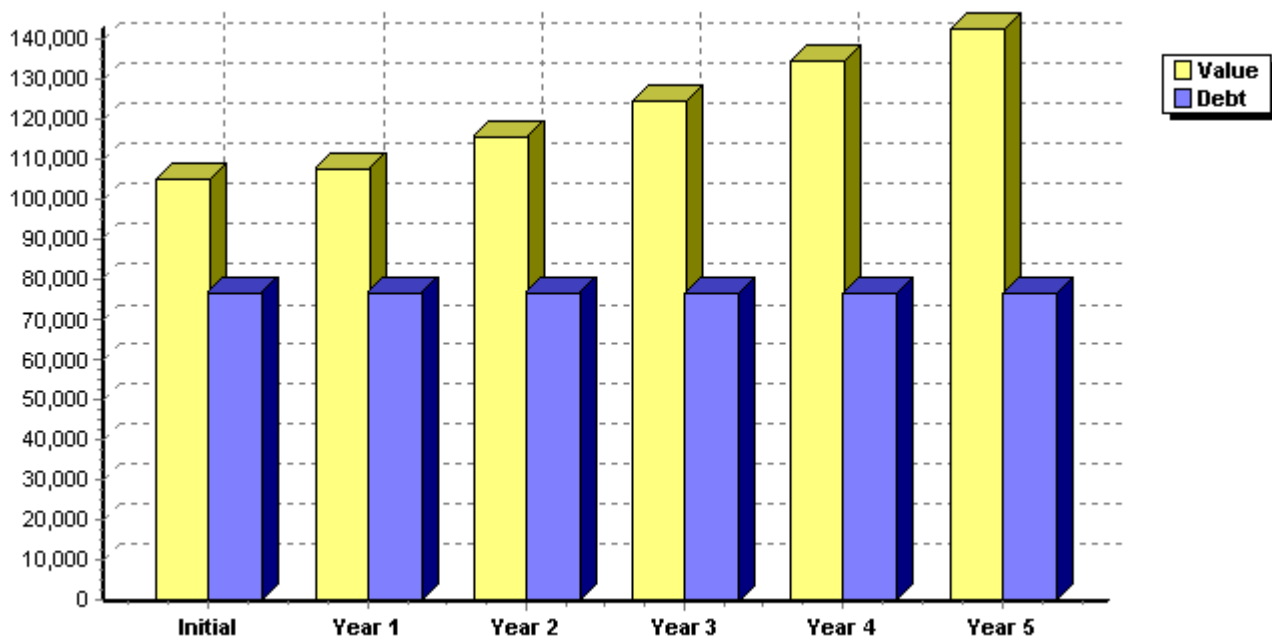
Property Name Trevor Terr, 24

Location UK

<b>Purchase Price</b> £90,000.00	<b>Market Value</b> £105,000.00
<b>Closing Costs</b> £1,570.00	<b>Cash In</b> £24,382.00
<b>Total Cost</b> £100,143.00	<b>Loan Amount</b> £76,530.00
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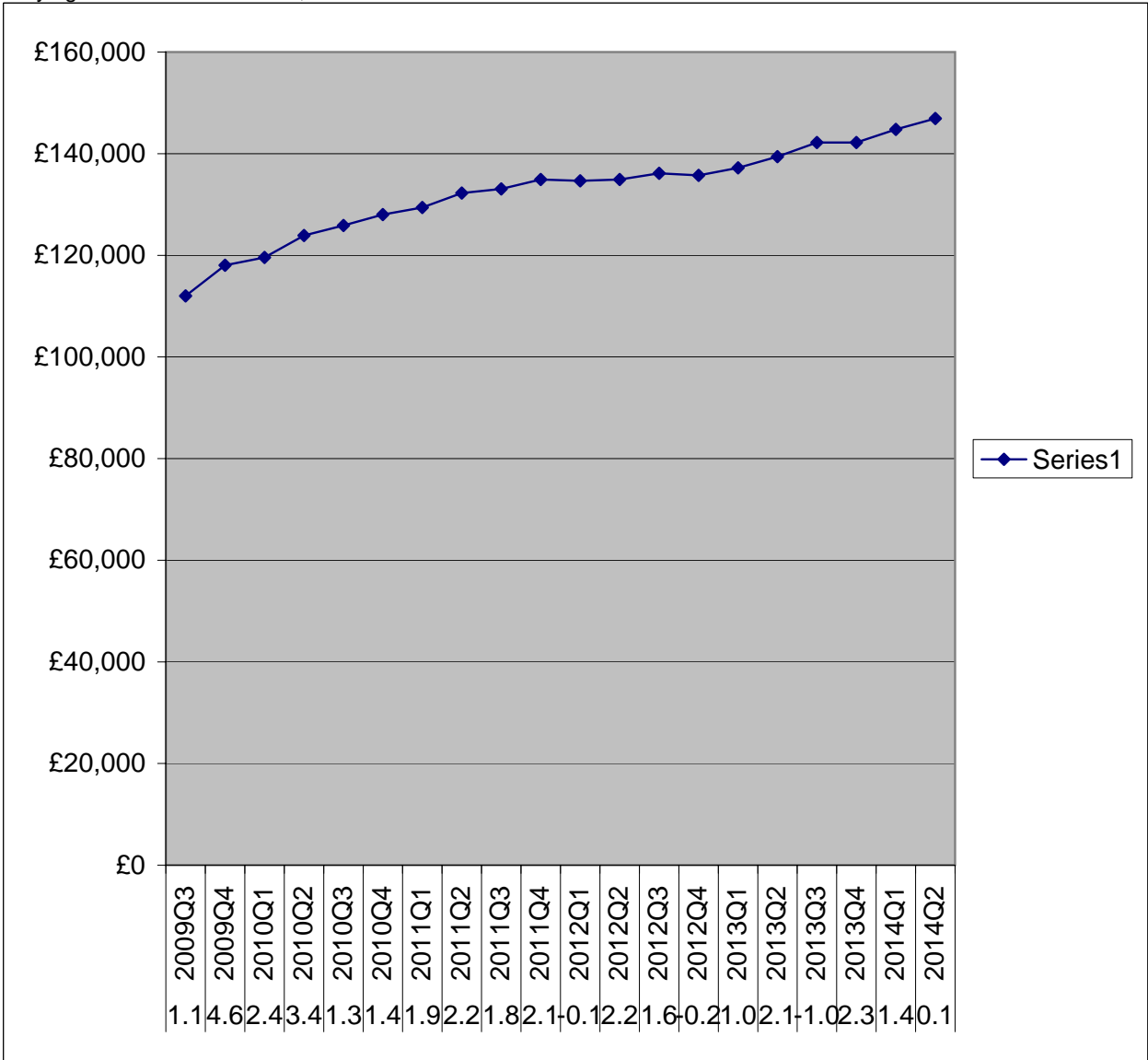
### Property value and debt



	Growth rate	Property value	Amount owing	Equity
Initial		105,000.00	76,530.00	28,470.00
Year 1	2.70%	107,835.00	76,530.00	31,305.00
Year 2	7.40%	115,814.79	76,530.00	39,284.79
Year 3	7.60%	124,616.71	76,530.00	48,086.71
Year 4	7.90%	134,461.43	76,530.00	57,931.43
Year 5	6.00%	142,529.12	76,530.00	65,999.12

Buying Price

£106,000



## **Property Cash Flow**

The following chart and table shows the pre tax and after tax cash outflows.

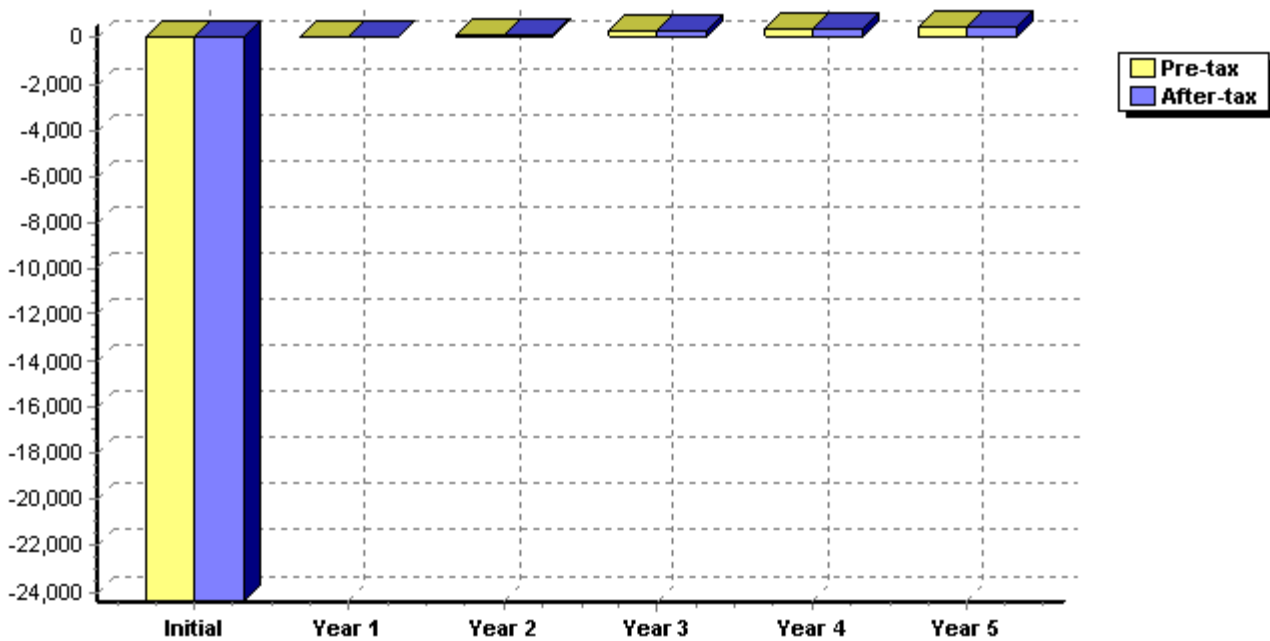
Property Name Trevor Terr, 24

Location UK

<b>Purchase Price</b> £90,000.00	<b>Market Value</b> £105,000.00
<b>Closing Costs</b> £1,570.00	<b>Cash In</b> £24,382.00
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<b>Expenses</b> £1,071.00	<b>Management</b> £264.90



### Property cash flow



	Rental income	Loan payments	Rental expenses	Pre-tax cash flow	Tax credit	After-tax cash flow
<b>Initial</b>				-24,382.00		-24,382.00
<b>Year 1</b>	5,184.00	3,780.58	1,335.90	67.52	0.00	67.52
<b>Year 2</b>	5,313.60	3,780.58	1,369.30	163.72	0.00	163.72
<b>Year 3</b>	5,446.44	3,780.58	1,403.53	262.33	0.00	262.33
<b>Year 4</b>	5,582.60	3,780.58	1,438.62	363.40	0.00	363.40
<b>Year 5</b>	5,722.17	3,780.58	1,474.59	467.00	0.00	467.00

## **Property versus Cash**

This report compares the performance of the initial cash investment in the prospective property, with an investment of the same amount of cash in the bank at a specified current rate. In both cases, the income is taxed at the appropriate rate.

Property Name Trevor Terr, 24

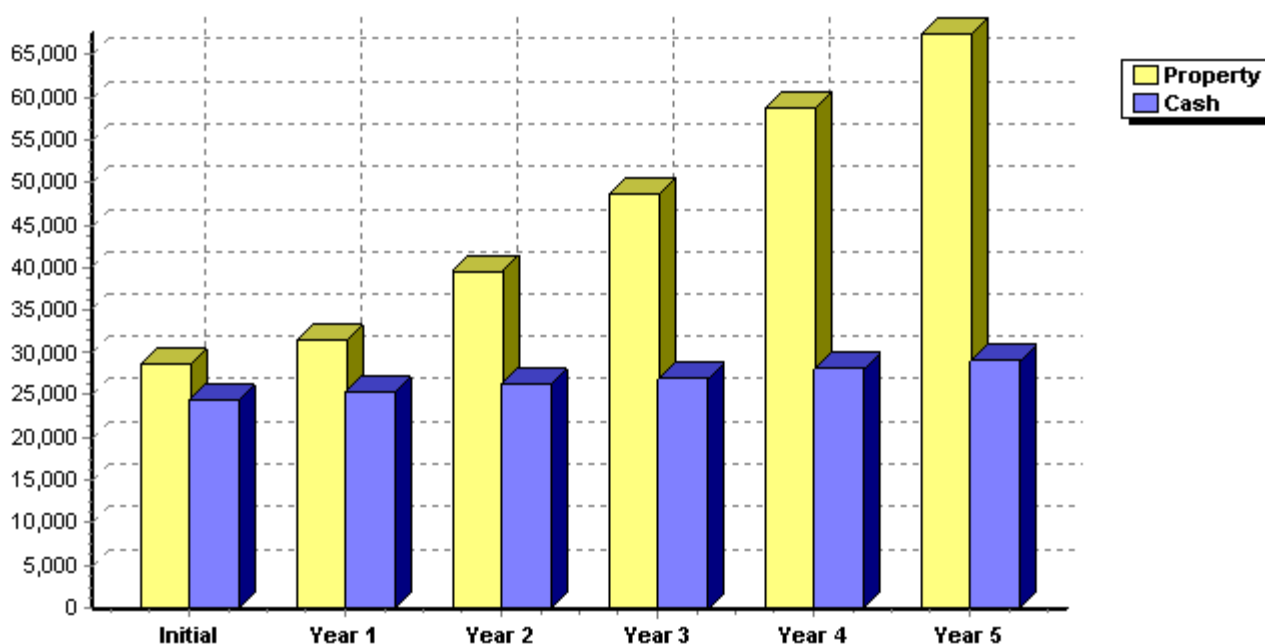
Location UK



Purchase Price	£90,000.00	Market Value	£105,000.00
Closing Costs	£1,570.00	Cash In	£24,382.00
Total Cost	£100,143.00	Loan Amount	£76,530.00
Building Value	£67,500.00	Loan Cost	£769.00
Contents	£1,800.00	Annual Rent	£5,184.00
Expenses	£1,071.00	Management	£264.90

### Property versus cash

Bank interest rate is 3.5%



	After-tax cash flow	Cash invested	Total cash + interest	Property income	Income + interest	Property equity	Equity + income
Initial	-24,382.00	24,382.00	24,382.00			28,470.00	28,470.00
Year 1	67.52	0.00	25,235.37	67.52	68.70	31,305.00	31,373.70
Year 2	163.72	0.00	26,118.61	163.72	237.69	39,284.79	39,522.48
Year 3	262.33	0.00	27,032.76	262.33	512.93	48,086.71	48,599.64
Year 4	363.40	0.00	27,977.10	363.40	900.64	57,931.43	58,832.07
Year 5	467.00	0.00	28,951.17	467.00	1,407.34	65,999.12	67,406.46

Notes: The above comparison assumes that investments made in the property are invested at the interest rate shown and the interest is taxed. Similarly, any income from the property is invested at the specified interest rate and the interest earned is also taxed.

## **Loan Analysis**

The following table shows the loans taken to acquire the property.

Details on loan amounts, principal payments, interest rates loan interests and total loan payments are illustrated

**Property Name** Trevor Terr, 24

**Location** UK



**Purchase Price** £90,000.00

**Market Value** £105,000.00

**Closing Costs** £1,570.00

**Cash In** £24,382.00

**Total Cost** £100,143.00

**Loan Amount** £76,530.00

**Building Value** £67,500.00

**Loan Cost** £769.00

**Contents** £1,800.00

**Annual Rent** £5,184.00

**Expenses** £1,071.00

**Management** £264.90

<b>Loan analysis</b>	<b>YEAR 1</b>	<b>YEAR 2</b>	<b>YEAR 3</b>	<b>YEAR 4</b>	<b>YEAR 5</b>
Loan amount 1	76,530.00	76,530.00	76,530.00	76,530.00	76,530.00
Loan amount 2	0.00	0.00	0.00	0.00	0.00
Loan amount 3	0.00	0.00	0.00	0.00	0.00
Loan amount 4	0.00	0.00	0.00	0.00	0.00
Principal repayment 1	0.00	0.00	0.00	0.00	0.00
Principal repayment 2	0.00	0.00	0.00	0.00	0.00
Principal repayment 3	0.00	0.00	0.00	0.00	0.00
Principal repayment 4	0.00	0.00	0.00	0.00	0.00
Interest rate 1	4.94%	4.94%	4.94%	4.94%	4.94%
Interest rate 2	0.00%	0.00%	0.00%	0.00%	0.00%
Interest rate 3	0.00%	0.00%	0.00%	0.00%	0.00%
Interest rate 4	0.00%	0.00%	0.00%	0.00%	0.00%
Loan interest 1	3,780.58	3,780.58	3,780.58	3,780.58	3,780.58
Loan interest 2	0.00	0.00	0.00	0.00	0.00
Loan interest 3	0.00	0.00	0.00	0.00	0.00
Loan interest 4	0.00	0.00	0.00	0.00	0.00
Additional repayment 1	0.00	0.00	0.00	0.00	0.00
Additional repayment 2	0.00	0.00	0.00	0.00	0.00
Additional repayment 3	0.00	0.00	0.00	0.00	0.00
Additional repayment 4	0.00	0.00	0.00	0.00	0.00
Total loan payment 1	3,780.58	3,780.58	3,780.58	3,780.58	3,780.58
Total loan payment 2	0.00	0.00	0.00	0.00	0.00
Total loan payment 3	0.00	0.00	0.00	0.00	0.00
Total loan payment 4	0.00	0.00	0.00	0.00	0.00

**Notes:** The loan costs are included in the deductions for the first year.

Depreciation rates : Building = %

## FREQUENTLY ASKED QUESTIONS

To help guide you through some of the most frequently asked questions home buyers ask before and after receiving their report, Do the Sums has prepared a list of questions and answers to help you.

*Q Given the current recession is buying property still a sensible investment?*

A. As this report has shown buying property in the right place at the right price can still be a sound investment. There are many places in the UK that are already noting increases in property values, and many that have continued to increase in value throughout the recession. Over time the market will recover. However, not every property is guaranteed to go up in value and that is why the Do The Sums Report are a sensible undertaking to help protect against taking unnecessary risks with your investment.

*Q. Why include a measure of inflation?*

A. Future earnings and costs are discounted in line with a forecast inflation rate. The value of a pound today is not the same as the value of a pound in five years time. Any accurate calculation involving amounts in the future, must reflect this change in value.

*Q. Can income tax be used?*

A. Normally there are no tax allowances on owner occupied properties. Only if the property is held as an investment, in full or in part, does it attract allowances for business expenses.

*Q. Can buildings be depreciated for tax purposes?*

A. Depreciation of buildings in the UK is not generally allowable by HM Revenue and Customs.

*Q. How about other depreciation?*

A. Depreciation of fixtures and fittings (contents) can normally be claimed if the property is used as a business.

*Q. What period can be examined in the report?*

A. In most cases the first five years is given in the report and is normally sufficient to make a purchasing decision. Other projections can be made, but obviously the further into the future the primary data is forecast i.e. interest, inflation and capital growth rates, the more problematical and less accurate the data becomes.

*Q. How do you do forecasts?*

A. Mathematical relationships are sought between past and present prices and also between a price to be forecast and other information, such as interest rates. If the relationship is strong enough to justify an attempt at forecasting, mathematical models are built to use in the forecasting process.

*Q. Can you guarantee the forecasts?*

A. The strengths and consistencies of the relationships that the forecasts rely upon vary greatly, so no individual forecast can ever be guaranteed. However, we attempt to optimise all forecasting technology to ensure that the most likely outcome, on the basis of the data history, is used.

*Q. What is a neighbourhood?*

A. A neighbourhood is defined as a postcode sector. A postcode sector is the full postcode, excluding the final two letters. So for the property postcode NE29 6XY, the postcode sector would be NE29 6. The forecast is for the UK only, at this stage.

*Q. Where can I go if I need further information about the findings of my report?*

A. Contact us if you have any difficulties interpreting your report. Please send an email to [contact details]