

| TOP TEN TIPS

# Passive Income Fundamentals

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## 1. The Wealth Formula. $W = (P + S + I + C) \times L$

### **W = Wealth**

It is something that is very subjective and means different things to different people. I challenge you to write down your definition of wealth and what degree of wealth you genuinely NEED and WANT, and are committed to make happen in your life.

### **P = Planning**

Planning is sometimes called goal setting, creative visualisation, budgeting, or even zero-base costing. Set your goals and work towards them. Realising your goals is what you want, after all.

### **S = Savings**

Saving, for many of us, is a dirty word – a bit like budgeting and going to the dentist. Yet, in reality it is one of the most powerful tools you can employ, especially if you can combine it with time. Save 10% of your gross income. Although it is a simple strategy, it can be the most powerful and successful strategy.

### **I = Investment**

Sometimes in the investment world you are going to make good decisions and sometimes you are going to make bad decisions. There is one constant, however, which is the higher the level of knowledge on a

particular topic, the lower your risks of making a bad decision. Spend time learning a variety of investment strategies.

### **C = Compounding**

Compounding is a product of time, i.e. the multiplying effect of gaining an investment return on your previously earned investment return. That is, interest on your interest.

### **L = Leverage**

When investing it is important to get the right mix of equity to borrowings. Gearing or borrowing can be a great friend or similarly it can also be the sword that fatally wounds you.

When considering risk factors, things such as age, income stream, taxation, attitude, other commitments, goals etc., all come into play. My philosophy is to always have a back door or a 'plan b' if circumstances go against you and things do not turn out as you planned.



## 2. The Doubling 'Rule Of 72'

This is just a quick little strategy to help you work out what things could be worth in the future. The 'rule of 72' enables you to determine how long it will take for something to double given a fixed growth rate.

If we wanted to invest \$10,000 and we knew we could get a return of 10%, how long would we have to invest that money for it to increase or double in value to \$20,000? Well, simply divide 72 by the 10% - that is 7.2. Therefore it would take 7.2 years for our \$10,000 to grow to \$20,000 given a growth rate of 10%.

## 3. The 'Rule Of Two'

When you are looking at the 'rule of two', what it refers to is:

Take the purchase price – for this example it is \$200k – divided by 1000, multiplied by two. That should give you \$400 per week.

$$\mathbf{\$200k / 1000 \times 2 = \$400.00}$$

This is the minimum weekly return or weekly yield that you are going to be looking at if you want to borrow 100% on the purchase price and still have this property looking positive for you. There are, however, three factors that influence the rule of two; borrowings, cash returns and tax deductions.

## 4. Commercial Property And The 'Rule Of Two'/'Percentage Point Split'

The 'rule of two' does not work for commercial property. With commercial property, your outgoings are normally paid by your tenant. Generally, for commercial property, you won't have a managing agent which means whatever the tenant is paying, is your cash flow coming in. The only real expense you have against the income is the interest you are paying on the mortgage. So when you take out all of those other expenses, you will find that a commercial property will be positively cash flowed a lot sooner.

When you are talking about valuations on a commercial property; the higher the rental yield is, the higher the value of the property. The difference between the income yield and cost of funds is called the 'percentage point split'. This means the difference between what your money is costing you to borrow and what that property is actually returning you.





## 5. **Cash Flow In Property**

Property is the most understood form of investment as it is tangible - you can walk through it, touch it, alter it, insure it and even demolish it.

Obviously, property is my passion and there are amazing benefits of having a swag of them in your portfolio, even if cash flow of income is not your primary goal or objective. However, it is just as important to have a balance of both properties bought for income purposes, and properties bought for growth purposes - i.e. yield and growth.

If you really want to accelerate your cash flow or growth from your property portfolio, you will want to be pro-active in the market. That doesn't just mean managing the property yourself (although it is an option if you wish). I mean being pro-active in searching for deals, talking to people, analysing your next move and knowing what type of property you need to progress.

## **6. 'Principal And Interest' Or 'Interest Only'?**

When doing investment properties as a general rule have them at 'interest only'. Sometimes a bank will not let you into a deal on that scenario, depending on your income and your debt levels for example. In which case, if the deal is a great deal and 'principal and interest' is the only way you can get it, go for it.

## **7. Multies – Multiple Income Stream Properties**

While direct cash cows can be sourced buying single residential houses, the yield or passive rental return is usually higher when you purchase multi-use or multi-dwelling premises, i.e. properties that have more than one income stream. These properties could come in the form of either residential units, commercial premises, small shopping centres or properties with the potential for income generating alterations (additional housing, storage units etc.).

In the residential market, the most common forms of multiple income streams are blocks of units, complete residential apartment buildings, or even a basic house that rents out both upstairs and downstairs.

For commercial, examples of multiple income stream properties would be a number of warehouses or strip complexes (that's a row of shops, not a strip club!) rented out to different tenants. Shopping centres, office complexes and storage sheds are also examples of multiple income stream commercial properties.



## **8. Dual Occupancies / Granny Flats / Room By Room Rentals**

An example of dual occupancy / dual income properties would be where a house would rent upstairs and downstairs separately. Strata-titling, lease options, student accommodation are all strategies that can be used to increase the income on property.

Have a look at what other options you can explore with your property to increase its income. Can you do something to that old shed at the back used for storage? Turn it into living quarters (granny flat). Can you build something on your premises? These are questions you have to ask yourself, when you are constantly on the lookout for things like this then you will know exactly what you can do when the opportunity arises.



## 9. Lease Option Purchases

Lease Option Contracts are similar to 'rent-to-buy' or 'lease purchasing' and 'instalment contracts' (wrap properties), and seem to contain the best characteristics of both.

Essentially, using a Lease Option Contract for wrap properties has the same principles as instalment contracts, except that the sale does not take place at the outset of the contract (but rather the end). Instead of making repayments, the tenant makes lease payments (even though they may work out to be exactly the same figure).

The tenant then leases the property for the duration of the agreement, as well as having the exclusive right to purchase the property at an agreed price. If, or when the tenant exercises their option or right, the purchase price reduces by the notional principal that they have paid during their contract period. This notional principle is calculated as though the lease payments were actually loan re-payments.



## 10. The 'Scatter' Technique

The 'scatter' technique is where you waltz into an area, visit every agent in town, work out the median price of your target houses on the market and then submit offers on multiple properties at 70-80 cents in the dollar of what the properties are being listed for.

You will most likely get laughed out of the real estate offices on occasions, but sometimes those offers are accepted. Investors who are after 'wrap properties' commonly use this purchasing technique as there is no emotion attached and the buyer is just after the best deal, not the house.

This technique is effective because you are not after the properties for sale, you are after the people who no longer want their property. Using this strategy, you are able to buy properties significantly under market value, do a cheap cosmetic renovation (depending on the property), work out the real market value and required profit for you, then put the property for sale on a lease option basis at the new price.

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Yours in success,



**Dymphna Boholt**

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