7 WAYS TO FINANCE A PROPERTY DEAL

You don't need your own money to invest in property, you just need someone's money.

BY LAURENS BOEL

HOW TO **RAISE FINANCE**

The secret to finding the money is to destroy your limiting beliefs. The only limit you have is the limits of your creativity, as you can find money in some of the strangest places.

For instance, one student had a deal on the table and was struggling to find the money. He drafted an investor proposal and sent it to over 100 people looking for the capital, but the response was radio silence. He thought perhaps there was a spelling mistake or something on the proposal that was throwing people off. He then sent it to his receptionist to see if she could find the fault. The following day, his receptionist phoned him and asked if she could invest in the deal. She had a few hundred thousand Rand wasting away in the bank and ended up investing in his deal.

Don’t be fooled, there is a lot of money in South Africa, you just need to be patient, positive and persistent in trying to find it. Below are just some of the finance strategies available;

Bank finance

To be honest, you're most likely going to have to start here. It is possible to lend money from an investor, but the investor will want you to have some experience before lending you money. If you can do a successful deal with the bank's money, it's much easier to lend money from a private investor, because you've got credibility.

I've had the privilege to be involved with some of the discussions at ABSA bank regarding investor specific packages, and it's amazing to see how interested the banks are in funding investors.

ABSA for instance, have a few products specifically catering to investors. They have one product where they will consider future rentals of a deal and add it to your affordability. Before, banks would look at your salary to determine whether you can pay off the loan or not. That would be a limiting factor because once you've bought 3/4 properties, your affordability would run out and you wouldn't get more lending from the banks.

In South Africa, the banks look at two main criteria when giving you a loan. They look at your credit score and your affordability. Historically, they would look at your salary and assume 30% of your salary can be used for repaying a loan. Therefore, if you earned R10 000, the bank would allocate R3 000 to bond repayments and you would qualify for a loan of roughly R300 000. But now, most banks are looking at your rental income and adding it to your salary. Therefore, if your salary is R10 000 and your rental income is R8 000. They will take a portion of the R8 000 and add it to your affordability. Each bank is different, but they will take around 60% - 80% of the rental income and add it to your affordability.

To get a better understanding as to the banks offerings and what products might suit your needs, go to your banker or research online. The banks are looking to fund our deals, but we must understand their limitations and requirements to do business.

Angel finance

Angel finance, also known as Investor Finance, is getting money from a private individual. This could be your parents (if they have the means), friends, work colleagues, acquaintances, people you've met at networking sessions and a combination of them.

The investor can bring the money but can also perhaps bring networks, skills or other resources that will help move the deal forward. When targeting a private investor, you must cover 3 bases. One, you need to have a professionally designed investor proposal. Second, you need to ensure you know what partnership structure will work for this deal. And three, you need to plan for the risks and give the investor security on their money.

If you don't want to create an investor proposal from scratch, you can use the tool www.mypropertyapp.online, which is an investor app that allows you to analyse property deals with greater value, choice and confidence, and also allows you to generate a professional investor proposal with a click of a button.

Alternatively, if you prefer to create the proposal from scratch, you should have the following headings in your proposal;

- Front cover with a professional business name

Set the tone with a professional image. Like it or not, people judge books by their covers and your cover should scream professionalism. Use simple clean fonts, a picture of the property, and some high-level details of the property; the address, property type (e.g. residential) and your company name.

- Index (contents page)

It can be quite a comprehensive document, so make it easy for the investor to find the information they need to make it a decision. Without an index, the right information gets buried too deep and it's cumbersome going through the document. For easier reference, print the page number on every page and include the index title in the footer or header of the document.

- Introduction of the deal (executive summary)

An executive summary provides a summary of the actionable details. It gives a high-level overview of all the critical information required in a deal. Here is where you explain how the property was found and what the nature of the property is (distressed seller or property …)

You can briefly mention what the strategy of this deal is (is it a rental opportunity or a flip strategy), and its exit strategy (which helps protect the investors investment). Include brief details about the surrounding area explaining to your investor why this is a good area to invest in.

Provide the investor with a glimpse of the critical numbers like the ROI, deal timeline, and money required in the deal. Don't go into too much detail here but do include all the important information using bullet points and short paragraphs.

- Personal introduction

If you construct your executive summary well, it'll ease your investor into the rest of the deal and make them curious about you. Your professionalism and articulation of the deal has done some good work to put you in a positive light, now introduce yourself.

Here explain that you are a professional property investor and if it's your first time buying, try leverage a coach/mentor who has the credibility you can ride on. Understand that you are an unknown and an investor might have reservations about you (it's not personal).

Mention any past deals you may have done and any content that will showcase your skills. For instance, if you did a renovation deal on time and within budget, give a summary of the deal costs as well as the targeted budget and actual budget (do likewise with timeline.) Include all the property service providers you worked with on the deal to show that you have successfully put together a team to see a deal through.

At this point the investor has a basic outline of the deal and of who you are, you can go into the granular level details of the deal.

- Give a full profile of the property.

To get an idea of how to profile a property, get inspiration from standard property listing sites like Property24. If you're sending your proposal as an electronic document, make it more interesting by including multimedia format (i.e. pictures / videos).

- Supporting documentation

Most of the numbers you're providing will be your own calculations, so you need to provide the raw data for them to do their own calculations. Tools like Lightstone and TPN provide great raw data which you can reference to justify the decisions you've made. Perhaps you've budgeted 10% for vacancies. You can show the investor a TPN suburb report which show cases the red (15%), yellow (10%) and green (5%) areas with regards to vacancies and explain why you've budgeted what you have budgeted. Instead of using your gut feeling, you're using data to make decisions.

Lightstone is another credible, independent source of data that can be used to accurately determine the resale value of an area. Providing these supporting documents will add credibility to your research because it adds a layer a transparency.

A builder's quote is another document you can add to increase your credibility. It shows the investor that you have completed a detailed due diligence. This is only applicable when a renovation is required on your property.

- Signed OTP

It is not crucial to have a signed Offer to Purchase (OTP) before approaching an investor. However, you will at least need to have a verbal confirmation from the estate agent that your offer has been accepted by the seller. If you don't have that confirmation, then you might waste the investors time and thus lose his trust when the deal falls through because your offer is too low.

- Numbers

This is where you showcase the deal from a financial point of view. You can show them whatever detail you think they want to see. Again, I use the My Property App to compile the report for me automatically, but if you choose to do it yourself, you will need to include the following numbers (at a minimum)

  - Purchase price and discount to asking price
  - Cash flow calculation (i.e. rent minus monthly expenses) – if you are doing a buy to let
  - Profit and expected Return on Investment (ROI)

On the following page is an example of the numbers section:

Cashflow Calculations	
Income	
Rental Income	20,600.00
Expenses	
Void Cost (%)	8.00%
Void Cost Amount	1,648.00
Bond Interest (%)	10.00
Bond Term (years)	20
Bond Payment	0.00
Angel Funding Payment	0.00
Total Financing Cost	0.00
BuildingInsurance	500.00
Rates and Taxes	1,046.00
Levies	0.00
Management Fee (%)	7.00%
Management Fee Amount	1,658.30
Maintenance Fee (%)	5.00%
Maintenance Fee Amount	1,030.00
Other Fees	0.00
Profit / Loss	
Monthly Cash Flow	14,717.70

- Financing requirements

Here you are going to explain to the investor what kind of capital you need for the deal and what they will get in return for the money invested. It will depend on how you have structured the deal (which will be discussed in the next section).

- Risks and mitigation plans

There is risk in property and sometimes it is unavoidable, no matter how much due diligence you do. You need to be honest with your investor and explain the risks, so that they can make an educated decision. There is always something that can go wrong in property.

For instance, if you're trying to source a flip deal, what will happen if you can't sell the property at the price you expect? That is a risk, especially with our political instability which affects the market. This is where you could advise the investor on an exit strategy. If the property doesn't sell as we expect, we can exit the deal (and recover some of our costs) by renting the property out. Or subdivide the property into multiple rooms and rent it out as a multi-let. You can change the zoning of the property and perhaps increase its resale value.

There are multiple different scenarios and exits that can be applied to any property transaction. It's important you highlight the risks of the deal and a plan to resolve that risk. Risk and mitigation include insurance, emergency funds, legal protection, processes and exit strategies.

Aside from the numeric risk and mitigation, also include processes and teams that you have in place in case things go wrong on site during a renovation. The next step in working with investors is to determine the structure of the partnership.

Investor structure

There are 3 main structures you can have with an investor, namely;

Sourcing agreement where you are "selling" the deal to the investor. You need to get the right legal advice on this structure, because if done incorrectly you can get into trouble with the Estate Agents Affairs Board (EAAB). If you are seen receiving a commission on a property, you need to be registered with the EAAB and have the right certifications. But, if you can structure the deal (with the right legal advice), you can receive a due diligence or finder's fee for the work you have done finding the deal for the investor.

Joint Venture Partnership is where you become partners. Partners share in the workload and share in the profits and the losses. You would partner with someone if you both had value to give to the other person. For instance, you might partner with someone who has the money and access to a good builder. In that sense he/she is bringing the money and a resource. You, on the other hand, might have access to cheaper materials, a good attorney and will be managing the project from beginning to end.

A partnership works when both parties are giving and receiving value from the relationship. Once you've found a partner, you need to decide on a fair profit split. 50/50 is the most common and fair way to structure the profit/loss split. But, if you are putting in all the work, bringing all the resources and your investor is just bringing the capital, then perhaps you would want to split the profits 70/30. It's a personal choice and negotiation with your partner.

Loan Agreement where the investor acts as a bank and loans you the money at a specified interest rate over a period. The most common interest rates that I've seen are around 12% - 15% (which is very high, so double check that your deal can handle that kind of interest). There are some laws in place now that you need to be registered as a Financial Services Provider (FSP) in order to lend money to people. Always ensure that you act in accordance to the law and get the right legal advice.

Seller finance

This is where the seller becomes the bank and ‘loans’ you the money. These situations are not very easy to come by, but they provide us with a potential cash cow. A typical scenario that leads to seller financing is when you find a highly distressed property that has been run down over many years. The owner will struggle to sell the property because of its current condition but doesn’t have the money to renovate.

Seller financing is about partnering with the seller. For example, you could negotiate with the seller that you will invest the money required for the renovation while they still live there, and once the property is back to market value you can sell it together and split the profits. In this scenario you have spent R0 on purchasing the property and you have only invested in the refurbishment costs. You can arrange with the seller that the profits are split 50/50 and, in this way, you have a very low entry into a deal with a potentially high profit.

This is a win-win scenario as the owner gets to sell a highly distressed property at market value and you get a nice profit for minimal capital. In these scenario’s it is incredibly important to have a solid contract in place. The seller is likely a stranger and therefore you cannot trust them yet. Also, you need to ensure that you are following the laws and regulations with lending money from someone. As mentioned, there are laws in place that require you to be registered with the FSP if you are lending money from a person directly. Speak to your attorney before moving on this strategy.

A student recently completed a successful seller finance deal. Her mom had recently passed away and her dad was forced to sell their home to cover legal costs and to downsize his lifestyle. It was a very difficult time for them, and she decided to partner with her dad. She told her dad that she would find a good buyer for him, instead of relying on estate agents.

With her understanding of property deal analysis, we structured a deal where her dad would walk away with a sizeable profit (after paying off the death costs) and she could make a profit from the sale. If he decided to work with an estate, he would’ve sold the property for around R1.1 million. With her intervention they brought the value of the property up to R1.4 million.

It wasn’t a huge amount of work. They needed to renovate the property for R100k. The house required a repainting of the rooms, retiling of the floors, renovating the kitchen and bathrooms and modernising the property in general.

She had the capital to invest in the renovations and her dad kept funding the monthly operating costs of owning the property. 3 months later they sold, and her dad made R150k more than he would’ve with an estate agent. The power of seller financing is that you can use your money to upgrade the property, instead of spending it on the purchase.

Lease options (ALA)

This is one of my favourite strategies, but they are tricky to manage and hard to find. I have never done a lease option in South Africa, where it is called an ALA (Alienation Land Act), but I have completed two successful lease options in the UK.

A lease option essentially means that you don’t own the property, but rather that you take control of the property. In the UK, for instance, we found a seller that had two properties which were in very poor condition. She didn’t have the capital to renovate the properties and they couldn’t be rented out in their current condition. In this scenario, they were bleeding money every month and became a liability to her.

My sister and I decided to draw up a contract with her, which stated that we would cover the monthly expenses on her behalf. In exchange, we wanted to rent out the house on her behalf. She agreed and signed the documents. We then renovated the properties and put tenants into the properties.

In this strategy you are not required to put large amounts of capital down, but rather become a property controller. This is incredibly powerful for us, because we were able to leverage off the lending rates of the current owner. The owner, being a UK resident, had a 2,3% interest rate on her loan, and because we are controlling the property, we get the same interest rate, which makes the deal very lucrative for us.

Back-to-Back

As mentioned already, with this strategy you are playing the middle man between a distressed seller and a hungry buyer. Let's imagine that you have a seller who is motivated to sell. You also have a family who wants to buy that exact property and willing to buy it at the market price. In this scenario you would sign an OTP (Offer to Purchase) with the distressed seller, with a suspensive clause that you need x months to find the money.

You will then sign another OTP with the new buyer within the x period for the second offer. The new buyer will then use his loan capability to buy the property.

A good friend of mine once completed a successful back-to-back. He found a distressed seller who wanted to relocate. Her house was worth R800k in its current condition. He was able to secure the deal for R550k. He secured the deal with a signed OTP, with a suspensive clause giving him 3 months to find the capital. He then marketed the property on Facebook and a family signed an OTP with him for R750k a couple of weeks later.

The money from the family was transferred into my friend's attorney's account, and then into the distressed sellers account. The attorney took his fees from the sale and my friend made R150k profit without any of his own money in the deal.

This is an advanced strategy and requires you to work closely with a coach (someone who has done this successful in the past) or to consult a specialist attorney. You need to make sure that everything you are doing in property is legal. There is no excuse for paying a good attorney, because the profits are great.

Equity release

Equity is a grey concept for most people. Equity is the excess money you have in a deal. Below is the calculation for determining the equity of a property.

Equity = Resale Value – Outstanding Debt – Selling Costs

The property I live in currently is a great source of equity. I bought the property in 2015 for R800k. I got a bond on the property for R500k. At the beginning of 2019 the property value was R1.2 million, and I had paid off R120k of my loan principle amount. Therefore, my equity on this deal is;

Equity = R1.2 million – R380k – R80k (estate agent fees + tax)

Equity = R740k

If I were to sell the property, I would walk away with R740k. Or, I could approach a bank and prove that the value of the property is R1.2 million. Depending on my affordability, they could increase my loan facility from R500k to R1 million (based off a fair LTV).

This means I can realise the equity from the deal without selling the property. I can access est. R500k (depending on LTV) worth of debt from the bank, using my property as collateral. This is a powerful finance strategy and can be applied to other collateral items other than a property.

Perhaps you have a car that is paid off, you can get a loan against the equity in the car. For instance, my car is 9 years old but has a book value of R150k. If I can prove my affordability and the value of the car, I can raise a loan against the car and use that to invest in property.

Please make sure that when you access debt you purchase assets only. Don't release equity from your home or car to go on a lavish holiday. Most people get stuck with bad debt because they buy things they don't need, to impress people they don't even like.

Stokvel / Crowd funding

Crowd funding is a simple principle, use multiple people to purchase a property. If you need to raise R1 million for a deal, you can either loan the money from one very wealthy individual or loan R100k from 10 friends. You could even loan R10k from 100 friends.

It's all about reducing the buy-in figure (and the risk) by including more people into the deal. This is commonly known as a stokvel in South Africa. Many communities, friends and colleagues use the stokvel concept to raise money for property.

With a stokvel, the community of people regularly contribute an agreed amount on a monthly basis. Once the money saved is large enough, responsible parties in the group make an investment decision.

One of my friends is in a stokvel. On a monthly basis he contributes R5k per month. He, along with 19 other people, contribute monthly to their capital pot. Every month, the 20 people within the stokvel save R100k. There plan is to buy a property every 3-6 months with the cash they have saved.

Currently, they are looking at purchasing flats in Berea, where you can buy a 2-bed for R300k. If their community is regular in contributing, they should be able to fund a R300k property every 3 months. This means that they can build a portfolio of 4 properties per year.

When you start including multiple people into your deals, structure becomes very important. You need to ensure that you are following the rules and regulations, especially when loaning money is involved. Be sure to speak to a financial advisor and a legal representative to ensure you have dotted the i's and crossed the t's.

You don't have to have a lot of money; you do have to be creative in the way in which you fund your deals. The money is out there, but it's not begging to be found. You need to get out of your comfort zone and hunt for it.

In every asset class, there are different strategies and finance possibilities. Please don't invest in something that you haven't researched and understood. It doesn't matter which asset class you are interested in, attend as many seminars and online programmes that can you can. Look for a coach/mentor who has had success in the past and get guidance from them. There is a lot of money to be made, but a lot of money to be lost for those who are ignorant.