**TBP 297 Know Your Numbers Edited\_Transcription**

[Daniel Hill] (0:05 - 25:15)

Welcome to the Blueprint Podcast. In these episodes, I'm going to share with you my life's work boiled down into simple blueprints that I used to build a 10 million pound portfolio and retire with financial independence at the age of 35. You can listen to these podcasts in any order, and I guarantee you that when you execute them in practice, you will see that success and failure are both very predictable.

Let's get into the next blueprint. Hello, hello, hello. Welcome to the next episode.

And what we're going to look at in this episode is terminology. And I want to try and help you to know your numbers better. And I often get questions around a lot of the terminology that we use in investing, because there's lots of terms, there's lots of acronyms, there's lots of things you need to know when you're doing appraisals, doing deals, and stacking up the numbers.

But a lot of people don't actually understand what the differences are. So I'm going to take you through some of these. I'm going to take you through ROI, ROCE, yield, gearing, LTV, different types of loans, SPVs, freehold leasehold, CGT, and SDLT.

So there's a whole list here, and hopefully by the end of this podcast, you will understand how the different elements work, what they mean, how they work, and how you can apply them in your own appraisals to go out there and do better deals. So starting off with ROI, so sort of financial metrics, ROI stands for return on investment. And what we're looking at here is based on the investment you're going to make, what return are you going to get?

And there's two sort of terms that you use. Return on investment is the return that you're getting on the investment you've actually made. So if you're buying it cash, that would be on the total price and funds invested.

If you were using a mortgage, it would be either the total spend, or it would be the cash element. And this is what we actually use. Rather than specifically ROI, we actually use ROCE, which is return on capital employed.

Because it depends what sort of deal you're doing, but often what you're looking at is how much return are you going to get on the money that you've put in. Now there's two different types of investment model. You've got cash flow models, and you've got capital models.

So cash flow model is when you're buying something with the intention of renting it out and creating a net surplus each month that you can draw, like an income, like a salary. Capital is more like equity. And it might be that you're buying a block or a building for a million.

And either you're going to asset manage it, or you're going to refurbish it. And then at the end, you spent 1.2, but it's worth 1.5. You've then created 300,000 pounds worth of equity. And the ROI and ROCE is more to do with the cash flow element once it's operating.

So if you're going to buy a building with a deposit, so let's say it's 100,000 pound building, and just for round numbers, you're going to put a 25% deposit down. You then put 25,000 pound into the deal. You've got fees on top of that.

So let's say that there was 5,000 pounds of stamp duty, fees, et cetera. Your capital employed is 30,000 pounds. And then if that property makes you 10,000 pound a year, you're making 10,000 pound a year income off the 30,000 pounds that you've put in.

So that's the 33% return on investment. And specifically, the capital employed, ROCE, the return on the capital employed is you've put 30,000 pound in, and it's going to give you 10,000 pound a year out of it. So that's an annual return on capital employed of 33%, 10,000 pound over the 30,000 pound you've invested.

So that's about the sort of net returns, and that's what you're going to gain. But there are other figures when we're looking at appraisals that are not necessarily to do with the net return. And two of these would be the yield.

It's understanding there's two different types of yield. So you get gross yield, and you get net yield. And if you think about what does yield actually mean, if you think about a farm or a plot of land where you harvest the corn, your farm yields a certain crop or volume or taken from that one side, that's what you've yielded from that.

It's the same with property. So if you think about you've got a million pound building, and the rent roll on it was 100,000 pound a year. 100,000 pound rent over a million pounds investment would be a yield of 10%.

So that million pound yields 10% or the yield is 10%, 100,000 pound a year. The thing to note here is understand the difference between gross and net yield, because it completely depends on what strategy you're doing. Because if you're doing a buy to let property at a sort of macro level, around the Midlands where we are, forever really, a standard buy to let property around the Midlands sort of area is about a yield of, you'd normally expect a yield of about 6%.

So for 100,000 pounds property, it would generate 6,000 pound a year as a yield. But the difference is you've got to understand the difference between gross yield and net yield. Because if your gross yield is 6%, but then out of that you've got to pay, so let's say it's 100,000 pound building, 6,000 pound a year income.

But if out of that you've got to pay your mortgage, your utility bills, your compliance, your maintenance, your agency fees, whatever it is, let's say half of that disappears. So it's not 6,000 pound a year. Actually, there's 3,000 pound a year in costs.

And you're only actually going to net off 3,000 pounds. The gross yield, which is the gross that comes in, like revenue or gross profit, the gross yield of the money that comes in would be 6%. But the net yield, which is what you actually care about, would be 3%.

And why this is important is the yields will vary. So the gross yield and the net yield will vary because of the difference. And what you'll notice with some asset classes is the gross yield and the net yield could be very similar.

So for example, on buildings, lots of our buildings and blocks are on FRI leases, which I'll come to in a moment. But an FRI lease is where the tenant essentially pays for a lot of the costs. So it's leased out for five years, so you don't have any voids.

We manage them, the block management, we have a block management company in-house. So yes, we do have costs, but we don't necessarily have an agent. The tenant pays for the maintenance and the compliance.

And there's very little costs. So what you'll get is on a single let property, you might have a gross yield of six and a net yield of three. But on a building where you've got a lease on it and you don't have many overheads, you might have a gross yield of 10 and a net yield of nine.

It's really important to understand the difference. And what will happen is when you start to get familiar with how these numbers work, you'll be able to look at a deal and just see whether it stacks up. So I'll look at blocks that we're buying, and I'll know that from a gross yield point, we really want to be able to put a lease on it and get between 12 to 15% gross over the purchase price.

Because one, that gives us a strong enough yield to be able to finance it and get a solid return. But also when we're looking at, and I'll talk about this in a moment, the leverage and the gearing, when you've got a really strong yield of say 12%, if you could actually refinance it at say 7% and say, right, I'm going to value this building based on a 7% yield, but it's actually generating a 10, what you find is that capital value goes up because the cash flow is a lot higher. So a 10 to 15% yield would be really, really strong.

You could then leverage that and say, I'm going to say this building is worth on 8% yield, what does that calculate to be? So you take the lease amount, the annual income, you divide it by eight, times it by 100, and it'll tell you then what the building would be worth on an 8% valuation. And to give you an idea, Mankore House I bought for about a million, and it was rented at 90,000 pound a year.

Over the last year or so, the team of asset managed it, and it now brings in double that, it brings in 185,000. And even on the same yield that I purchased it, because it's commercial, you use yields a lot in valuations, because even if you use the same yield that we did when I purchased it for a million, because the rent role is now double, even if you apply the same yield, six, eight, 10%, whatever you do, it depends what the market is, but at the minute, probably somewhere between eight and 10% on FRI leases, that property is then worth 2 million. We just had a valuation from a local agent who valued it at 2 million based on 185,000 pound rent role. So that's your sort of yields and understanding how they work.

And also where, for example, people get caught out is they'll buy, say, HMO property, and say it's a 13% yield or 18% yield, which sounds phenomenal. But then you've got to remember that's a gross yield, and the net yield on a HMO would be a lot lower because you've got utility bills, you've got multiple tenants, you've got agents, you've got compliance, you've probably got cleaners and all sorts in there. That's the sort of yielding side of things.

When we talk more about financing, there's a few terms that are worth knowing. So the first is gearing. And what we mean by gearing is it's the amount of debt that you take on relative to the value.

So for example, I bought Mankore House, which is an office block, for a million pounds, and we bought it cash. So we had no gearing on that building because I bought it cash. But then what I did was once it had been asset managed, I then refinanced it and I put a 50% loan-to-value, this is the next one, LTV, loan-to-value mortgage on the building, and that gave me a gearing of 50%.

During the pandemic, or coming out of the pandemic, during the pandemic, we did a lot of consolidation in the portfolio, sold lots of businesses, sold a fair bit of property. And what we did was significantly paid down a lot of my mortgages. So I paid off a lot of the mortgages.

Some of the properties I actually sold to release the equity and actually pay off other mortgages. And what it meant was my portfolio ended up being geared at 18%. So if you think, for 10 million pounds worth of property, 18% gearing would be 1.8 million. Now, when you think about where you want your gearing to be, you don't want your gearing to be too high because if it's too high, you can't really weather the storm. So let's say some people will gear their portfolio up to like 100% residential value by using commercial valuations, which we've definitely done more aggressive gearing back in the day. But nowadays, we want really low gearing.

The general rule of thumb that we work with is that a good balance is probably around 50% gearing. There's other elements to that, but the main logic is if it's too low, then you're not really making the most of the equity in your portfolio. Because if you borrow money from the bank at 5.5%, or probably even less now, if you can borrow at 5.5%, most investors, we would expect to be making 15%, 20%, 30% ROI on the deals that we do because they're crazy lucrative. So actually gearing the portfolio up and doing deals and using bank leverage is a good thing in some cases. But you don't want it to be too high because if your portfolio was geared at 80% and the property market dropped 15%, 20%, which happens, what the banks can actually do is within their clauses of the mortgages, they can say that you have to maintain a bank gearing of maximum 75%, for example. And if the market dropped 20%, you would then only, your actual valuation, your gearing would be 95%.

And then what they can say is, they can demand immediate repayment. And the problem is when the market goes and prices drop, there's nobody there to buy and a lot of the lenders tend to disappear. So having too high gearing is quite dangerous.

Equally having too low gearing is probably not a good idea. And what I've done over the last few years is I've actually started to gradually increase my gearing by doing other deals. Jumping in with a request, if I could, please.

Through the last 12 months of 2024, it cost us £132,707 plus a lot of time, work, effort and energy to be able to deliver our content to you completely free of charge. Now, if you genuinely enjoy these podcasts that get delivered weekly, enjoy our daily posts on social media, all of this we aim to make maximum value for you at absolutely zero cost. And if you appreciate that, you get value from it, would you please take a moment now to rate this podcast or leave me a review, hit the subscribe, follow on whichever platform you're on, just to show us your support, enable us to increase the reach, it would be hugely, hugely appreciated.

It really will enable us to continue to invest in the channel over the year ahead to give you maximum value at zero cost through the next year of 2025. Please press pause now, do it before you forget and just show your support. We would really, really appreciate it.

Back to the podcast. So that's what gearing is and loan to value is how much you're going to borrow against the value of the property. So what I'll often do here is I'll buy a deal, let's say it's a block of apartments, I'll pay 750,000 pound for it.

What I'm trying to do is, so I'll buy it cash or with a bridge for 750,000. What I'll then do is I'll asset manage it or refurb it and aim to get the end value, which is called the GDV, the gross development value, get the GDV up to say a million. And then the logic is I bought it for 750, let's say I spent 50 on it, in for 800, let's say then it's worth a million.

If I then gear it up at 75% of its new value, a million, I can then release 750,000 pounds. So if I had spent 50K on refurb and fees, I've only then left 50,000 pound of my own money in, but I've acquired another million pound asset, which would probably then cashflow, five, 10, 15,000 pounds a month, whatever. So the blocks that we're doing at the moment, I think I paid a million pound, we bought five blocks, basically about a million pound each.

And they're leased out, each block's leased out of 10,000 pound a month. And then the end value based on the strength of that lease is say 1.3 or 1.4 million. So really I bought them all for, there's five blocks, one of them is quite a small block.

The other four are like good size ones. But I basically spent four, I'm now trying to refinance at say 6.5. And then at 75% gearing, I actually get all my money back out, plus I own the properties, plus they make a couple hundred thousand pound a year net cashflow. So that's how you sort of use gearing and loans of values.

Finance wise, we would normally acquire with either cash, which is obvious, that's just cash, or we call a bridge. And a bridge is basically a halfway house, if you think it gets you from buying it to refinancing it. So when you've got to do something in the middle and you can't necessarily use a five-year loan, we would buy a block of apartments on a bridge, do the asset management piece or the refurb, or put a lease on it, and then go to, and we might be with them from anywhere from three months to 12 months.

And then at the end of that term, we would refinance onto a term mortgage product. So that five-year fixed or variable, but most of ours are fixed, five-year fixed rate mortgage with a lender. And then you get three sort of lenders.

One is BTL, which would be your normal houses, no end of those lenders. You've then got this sort of hybrid semi-commercial space where you get the challenger banks, and basically they'll lend on things that are not necessarily normal buy-to-let, but they're definitely not full commercial. So things like the multi-unit freehold blocks I just told you about then, things like HMOs that are sort of still residential, they're still investment properties, but they're not full-on commercial.

And then finally, you would have your commercial lenders who might lend on SPVs and residential blocks as just looking at it as a commercial investment. But in more cases, the commercial lenders will lend on things like company acquisitions or commercial buildings, office blocks, things that are proper business. And all of them have got different rates, terms, loan to values, et cetera.

ERC is another one. So when you're looking at your finance, ERC is your early redemption charge. So if you go onto a five-year fix, you'll normally find that if you say you want to have the loan for five years, the bank obviously lends you the money and then they, the bank will lend you the money and then they'll go and obviously put that in their books that you're going to have it for five years.

If you want to get out of that early and pay it off early, which is, then there's a thing called the early redemption charge, ERC. And normally that's a five-year loan. Normally in year one, it'd be 5%, year two, it'd be 4%, year three, it'd be 3%, two, one.

Over the five years, it'd be five, four, three, two, one. And obviously the longer you leave it, the less you have to pay to get out of it. And if you see the whole five years through, which most people, we normally would, then you don't have to pay the early redemption charge.

It's just a get out of jail free card if you need it. FRI, I talked about leases. FRI is a full repair and insuring lease, which basically means the tenant takes over all full responsibility under the terms of a lease for the repair of the building, the insurance, the maintenance, the compliance, and they basically take over that.

The next one is SPV. So an SPV is a special purchase vehicle and we use SPVs for all of our acquisitions. But then within them, I might have different things.

So for example, I've got an SPV, which is a limited company, special purchase vehicle, and all of my single lets go into one SPV. So I've got one limited company and all of my little single lets, one individual apartments will go in there. But then for every other deal or development or site, we actually start a new SPV.

So a new SP, all of my sites, office blocks, blocks of apartments, homeless shelter, private school, every single one of those in its own SPV. There's various reasons for that. And I won't go into that in a huge amount of detail today.

But when you're looking at ring fencing, different finance, group structure, buying, selling, moving assets, there's lots of reasons why you would use an SPV. So a special purchase vehicle is a legal entity that would own the property on your behalf. And you probably have, we've got loads of those.

You probably have one for, if they're big deals, one for each deal. If you've got a portfolio of maybe smaller deals, you might put them in another one, but that's one for your accountant. Couple other ones to finish off.

So freehold and leasehold. Freehold is basically you own the property and the land that it stands on, which is what we tend to do. I've only got one leasehold property, which is an apartment.

And I don't think I'd do it again. I don't really like leasehold. Leasehold means you don't really own it.

You sort of own the lease. And it might be that the lease is 999 years long. And it's a peppercorn rent that's due every year.

That's quite standard, but it's still, there's still gonna be a freeholder that owns it underneath you. So if you think about an office, a block of apartments, I own a one bed apartment that I bought in the pandemic in a stately home. Just a nice little, really nice apartment, really nice building.

Just got it crazy cheap. And that's in a stately home. The freeholder owns the actual building.

And then basically each of the apartments is then sold on a leasehold. So I have a leasehold on the apartment. And what that means is you have to pay a service charge.

You basically have a landlord, even though I own it, you have a freeholder landlord. You can then actually have some liabilities for the block, whether that's the ongoing repairs and maintenance, it's the compliance, it's the roof. There are elements to consider there.

So we tend not to do leasehold. We buy freehold. And freehold is you own the land and you own the building.

Leasehold is where essentially you have a lease on the building for a fixed term, but not necessarily the land it's built on. You can also get things like flying freeholds, which is sort of in the middle of nowhere where you might have like a passageway between two houses. But the main thing is to understand the difference between the two.

I tend to only buy freehold because leaseholds, they expire. They're slightly harder to follow. There's different considerations for the finance.

You have to renew them. There's also costs. I've seen some fantastic deals over the years, or where, for example, what I've seen a bit at the moment is blocks of apartments, which are freehold, but one of the apartments has been sold off on a long-term lease.

But councils tend to do that for some reason. I've seen a few council deals recently where they've done that. And it just makes it a bit of a tin of worms.

I don't, I just, personal preference, I just tend not to do them. Last two. So CGT is capital gains tax.

That's the tax that you pay on the profit from selling an investment. So when you, you know, when you've sold something, you make your profit. If it's in your own name, if it's in SPV or company, you would pay corporation tax.

If it's in your own personal name, unless it was exempt, for example, your own residential house, you pay CGT. So it's capital gains tax on properties in your own name, shares in your own name, any profit you make in your own name, or various profits you make in your own name. And then finally, SDLT is stamp duty land tax.

That's the tax you'll pay on each property when you buy it. And it's pretty expensive now. And it does definitely get in the way of deals, especially when you're doing bigger deals.

I think my, I think we must've paid, I'd have to have a look at the exact amount, but over £200,000 last month in stamp duty on properties. Probably there or thereabouts actually, probably about £200,000. Because we're buying in a limited company, because it's an investment property, there's significant taxes, stamp duty taxes for those properties.

There are ways around it. So commercial has a lower stamp, which can make deals look quite good. You can also buy, if it's in an SPV already, you could actually buy the shares in the company.

So you don't actually buy the property, you buy the shares of the company. And also there's a, what used to be called multiple dwellings relief. It's now called non-commercial stamp duty, I believe.

And basically where we're buying say blocks of flats, if you, as long as you buy more than six in a single transaction, you can actually reduce the stamp duty using a non-commercial rate. And that can work really well. That saves us tens of thousands of pounds.

And actually you can put deals together. So we put two deals together. We bought a block of five apartments, which wasn't obviously big enough to hit the minimum rate, the minimum six units for the non-commercial rate.

So what we did was we assigned it to another transaction. We had another block, we were buying two blocks off the same landlord. What we did was we just made them, I forget what the term is, like a connected party or basically put it in the contracts that they're related deals.

And then we got the reduced stamp duty. Hopefully that helps and that will help you to know your numbers. I do appreciate there's a lot of words, acronyms, terms in the property world, but hopefully that gives you a good foundation to get started with, whether you're appraising deals, whether you're looking at your gearing, your finance and your deal structure, or it's the ownership, the tax, the structure of your group and the things I've just covered.

So hopefully you got value from that. Thank you very much for joining us for another episode. I will be on the next podcast episode on Tuesday.

And until then, thank you for the support, like, subscribe, share this with anyone you think could be of value. And I look forward to seeing you on the next podcast. I hope you enjoyed this Blueprint podcast episode.

If you're not already, subscribe, share in these. This is my lifetime's work and every Tuesday I'm giving you one Blueprint away for free. These things are unique.

They're proven. They've enabled me to build over a 10 million pound portfolio in a few short years. And over the last 20 years, start, systemize, scale and sell over 40 different companies.

If you like them, share them, subscribe, make sure you don't miss a single episode and tune in every Tuesday for a brand new episode. And then follow me daily on Instagram for free content, post twice a day, completely free of charge. Success and failure are both very predictable.

I'll see you on the next episode.