# BUFFALO
LOW PRICES MEET HIGH EXPECTATIONS

CANADA'S #1 REAL ESTATE INVESTMENT MAGAZINE

# CANADIAN Real Estate Wealth

# QUIT YOUR DAY JOB
## HOW TO EARN AN EXTRA $90,000 A YEAR

- **Proven** strategies from award-winning investors
- **How to** finance multiple deals
- **Maximize** the performance of your portfolio

**3** aspects of an effective financing strategy

- How hiring a professional property manager can improve your ROI
- Curb appeal ideas that will help fill vacancies
- The Ontario Fair Housing Plan – what does it mean for investors?

Display until August 14, 2017
JULY/AUGUST 17 $7.99
08
0 55113 70148 1
KMI
canadianrealestatemagazine.ca

QUIT YOUR DAY JOB WITH ...

# A buy-fix-refinance-rent strategy

Chris Thorne

**Chris Thorne** of Spruce Properties in Winnipeg outlines his twist on a classic investment plan, turning it into what he calls 'the snowball strategy'

More often than not, people are drawn to real estate investing by the exciting house-flipping shows on television, with promises of 30-day flips, big profits and just enough drama to make it exciting.

What they don't tell you is that it you have to constantly be finding deals, or your business will sputter and die. However, there's a strategy that's gaining in popularity that is similar to a flip for the first half of the deal, but will totally change your future – if you're willing to make a small sacrifice in the short term.

That strategy? Buy-fix-refinance-rent, which I'll refer to as BFRR.

First of all, what is BFRR? Think of it as flipping, but over a long time period. Essentially, it combines the best elements of a short-term flip property with the best elements of a long-term hold property. These elements combine to create an effect similar to a snowball rolling down a hill – it starts off small and moving slowly, but as it goes down the hill, it picks up speed and exponentially increases in size.

Let's take a closer look at the different stages of a BFRR 'snowball strategy.'

## Step 1: Buy

At this stage, you should be looking to purchase properties for below market value and/or looking for ways that you can force appreciation by cost-effectively adding another suite, changing the layout of the home, or adding a bedroom, bathroom or some other unique feature that helps the property reach its highest potential.

Most of any deal's profits are made on the buy, so be prepared to look at and analyze a lot of deals before you find a great one. Before you commit to buying any property, you should already have the end in mind and have the whole plan mapped out in advance.

With the BFRR strategy, you'll also want to analyze potential rental income using post-renovation figures and the new mortgage amount once the property has been refinanced to make sure that it cash-flows. Just because a property makes a good flip doesn't mean it will be suitable for the BFRR strategy.

i Bonus tip: Your best deals will always be the ones where you're the first person to look at a property. Look where others aren't looking and be prepared to pounce quickly when the right one comes along.

## Step 2: Fix

During the second stage, it's time for the rubber to meet the road and for you to execute on your plan.

During the renovation, keep detailed records of your spending and track it against your original budget. If you notice early on that your budget is creeping upwards and you're getting overwhelmed, it's OK to stop the project for a few days. Take your time, come up with a new plan and then carry on.

With the BFRR strategy, you also have to consider that you are now catering to a different audience – you aren't selling the property to an end user, but instead 'selling' it to the bank, which will be deciding its new value. You also need to keep in mind what kind of product tenants will find desirable and renovate accordingly.

i Bonus tip: Focus on durability of materials since you will be owning the property for several years to come. You may not need to wow people with expensive finishes like granite countertops. Instead, you could install a still-durable but cheaper laminate countertop.

## Step 3: Refinance

Once your renovation is complete, it's time to 'sell' the property to the bank or lending institution, which will give you a mortgage based on the property's new increased value. The bank will likely send an appraiser, who will look at what comparable properties in the area have sold for and then give you a mortgage based on this new value.

Your goal with the refinance is to leave very little or no cash left in the deal, which allows you to take your initial money and invest it in your next BFRR project. At this point, if you've achieved your goal of having little to no money left in the project, you essentially have a property for free.

Bonus tip: Real estate appraisers are trained professionals who understand the fundamentals of real estate and aren't easily swayed by fancy staging, but they are still human. Do simple and cheap things like thoroughly cleaning the property, painting the basement floor and walls, and having a few air fresheners around the house.

## Step 4: Rent

Hopefully you've been successful up to this point, but you can't quite relax yet, as you need to find quality tenants who will protect your investment. Advertise your property by elevating it above the competition – hire a photographer to take photos, write a great ad description and be professional when dealing with prospective tenants.

When screening tenants, use a detailed application form and do a thorough background check. If there are any red flags that come up during your check, move on with confidence and wait for the right tenant to come along.

Once you have quality tenants in your property, it's up to you when you want to sell it. By using the BFRR strategy, you can take advantage of other powerful real estate profit centres like mortgage pay-down, appreciation and cash flow that aren't available when you're doing a flip.

Since the property is making you money every month, you can be strategic about when to sell and time the market - wait a few years for a hot market, sell in the spring and get maximum value or even refinance the property again in a few years and unlock some more equity - tax=free!

Bonus tip: If you're just starting out in property management, consult fellow investors and property managers for advice – they were once in your place and will be happy to help you. It's crucial to get a taste of property management and what it takes to be successful before you can outsource this part of your business.

## The BFRR plan in action

As mentioned before, the BFRR strategy is best suited for someone already making a full-time income, as it doesn't provide a lot of income in the early years. But as you'll see from the following case study, the benefits of holding onto real estate quickly compound, and eventually the BFRR strategy results in significantly larger annual returns than flipping.

This analysis doesn't consider the effect of taxation, which can have a huge impact on your profits. Everything else being equal, flipping will be taxed at the highest rate, while the BFRR strategy offers many tax advantages that allow you to delay taxation and compound your returns in the meantime. I recommend talking to an accountant, who can give you the best advice for your personal financial situation.

To fully comprehend the value of the BFRR strategy in the long term, we'll look at two people, Frank and Bob. They both make a full-time income but have the free time to flip four houses per year in their home market of Winnipeg, where a distressed property can be purchased for $100,000. Frank chooses to use the flipping strategy, while Bob elects to go with BFRR.

Here's what Frank's average deal using the flipping strategy looks like:

- Purchase price: $100,000
- Renovation: $50,000
- Buying and holding costs: $10,000
- Staging and upgraded finishes: $10,000
- Realtor: $10,000
- Selling price: $200,000
- Profit: $20,000

Doing four flips per year, Frank can make a return of $80,000 per year. Not bad for an additional source of income, but he's going to have to continue actively flipping four houses a year forever to maintain it.

Bob decides to use the BFRR strategy to acquire four houses per year for five years. Here's what his average deal looks like:

- Purchase price: $100,000
- Renovation: $50,000
- Buying and holding costs: $10,000
- Staging and upgraded finishes: $0
- Realtor: $0
- Total funds invested: $160,000
- New appraised value: $20,000
- New mortgage at 80% LTV: $160,000
- Cash in deal after refinance: $0

Here's how Bob's five years of investing goes (assuming 2% appreciation per year and mortgages at 3% interest, 80% LTV and 25-year amortizations):

| YEAR 1: FOUR PROPERTIES IN PORTFOLIO | |
|---|---|
| Total value of houses | $804,009 |
| Mortgage pay-down | $9,412 |
| Appreciation | $4,009 |
| Cash flow | $4,500 |
| NET PROFIT | $81,305 |
| **YEAR 2: 8 PROPERTIES IN PORTFOLIO** | |
| Total value of houses | $1,616,095 |
| Mortgage pay-down | $24,156 |
| Appreciation | $12,086 |
| Cash flow | $13,500 |
| YEAR 2 RETURN | $49,742 |
| **YEAR 3: 12 PROPERTIES IN PORTFOLIO** | |
| Total value of houses | $2,439,063 |
| Mortgage pay-down | $41,441 |
| Appreciation | $26,977 |
| Cash flow | $18,000 |
| YEAR 3 RETURN | $86,418 |
| **YEAR 4: 12 PROPERTIES IN PORTFOLIO** | |
| Total value of houses | $3,273,058 |
| Mortgage pay-down | $60,281 |
| Appreciation | $46,081 |
| Cash flow | $22,500 |
| YEAR 4 RETURN | $128,862 |
| **YEAR 5: 16 PROPERTIES IN PORTFOLIO** | |
| Total value of houses | $4,118,230 |
| Mortgage pay-down | $79,394 |
| Appreciation | $72,149 |
| Cash flow | $27,000 |
| YEAR 5 RETURN | $178,543 |

| BOB'S BUY-FIX-REFINANCE-RENT SUMMARY | |
|---|---|
| Year 1 return | $17,921 |
| Year 2 return | $49,742 |
| Year 3 return | $86,418 |
| Year 4 return | $128,862 |
| Year 5 return | $178,543 |
| AVERAGE RETURN PER YEAR | $92,297 |
| TOTAL RETURN OVER FIVE YEARS | $461,485 |

As you can see, Frank would have a higher return than Bob in the first three years, but in Year 4, Bob pulls past, and by Year 5, Bob has doubled Frank's return.

What's truly amazing about the buy-fix-refinance-rent strategy is that after Year 5, if Bob were to stop acquiring new properties, his total return would be more than $150,000 without ever purchasing another property. Meanwhile, Frank would still be out there having to hustle and flip properties to make that extra $80,000 of income.

When used properly, the BFRR 'snowball strategy' can be a powerful way to create long-term wealth.