



# Welcome to the Plum Property Newsletter #8

## Cash Flow Positive Property (CF+) – Explanations and Issues

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CF+ seems to mean different things to different people, sometimes with very complex approaches (whole books!). At Plum Property we have developed two relatively simple definitions:

- **“No Funds Required”** – This is an investment where you never outlay any money, and for property investment this means that the income (rent) covers the repayments on a loan which is large enough to cover all the costs (including the full purchase price, mortgage transaction costs, inspections, conveyancing, stamp duty and agent fees). A loan like this could be as high as 110% of the value of the property, and that would be very hard to get. Also, there would need to be an extremely high rent return, and the old adage applies - where the investment returns are highest the risk is greatest. For example, a property which meets this definition of CF+ might produce a good rent return but have a low purchase price because it is a shack that is ready to fall down. Again it would be hard to persuade a bank to give you a large loan with security like that.
- **“CF+ after the Initial Investment”** - The second way to look at CF+ investing is to use a more business-like definition. If you bought a business it would be CF+ if the monthly income was greater than the monthly expenses – after the initial purchase there is no ongoing drain on your funds. In the property world that means you make your initial investment, including a deposit, and from then on the rental return should cover the monthly outgoings. The rough rule of thumb for this approach is that the Yield ( $\text{Weekly Rent} \times 52 / \text{Loan Amount} \times 100$ ) should be greater than the mortgage interest rate. For example:
  - If the rent is \$400 per week, multiply by 52 = then Income is \$20,800 per year;
  - If the property price is \$280,000 and you have a \$30,000 deposit and sufficient funds to cover the other upfront transaction costs;
  - Then the simple Yield is \$20,800 divided by \$250,000 multiplied by 100 = 8.3%
  - If you can get a mortgage with an interest rate less than 8.3% then this property would be close to CF+, depending on the other monthly costs.

Even though it is still difficult to find properties to meet this definition of CF+, obviously at Plum Property we think this is the sensible way to approach CF+ investing.

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## Traps To Avoid

There is currently a great deal of interest in CF+ property, and as with many investment trends there is plenty of exaggerated hype about the pot of gold at the end of the rainbow. The illusion of easy money can turn into a disaster if you aren't careful, so here are some traps to avoid:

- **Inflated rental estimates** – Proper research can establish the appropriate market rent.
- **Rental guarantees** – you could be paying an inflated purchase price to cover a rental subsidy from a developer, and at the end of the subsidised period you may find there is no rental demand for your property.
- **Exaggerated depreciation estimates** – ensure that the Depreciation Schedules have been prepared by an independent quantity surveyor.

- **Interest Deferral Loans** – Instead of paying the interest you just add it to your debt. While there might be a place in your strategy for some capitalisation of interest, be careful that one day you don't wake up to find that your debt is a lot greater than the property is worth. On the other hand, there are some financial products that can optimise your cash flow without resorting to dubious or expensive loans.
- **High Risk properties** – Some CF+ properties may end up delivering a capital loss when the time comes to sell, and while there are no guarantees in real estate you should carefully weigh all the risks associated with the property being purchased. (Cash flow should not be the only factor.)
- **Special Commercial Arrangements** – high yield properties can be found in various commercial scenarios, such as student accommodation, retirement complexes, serviced apartments, resorts and holiday lettings. These are not always a bad thing but beware of any hidden costs, particularly for intensive property management.

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### **The Plum Property Approach to CF+ Investing**

Keeping all that in mind we still think it's a good idea to invest in property which minimises cash outflow. In fact our preferred strategy is to have a diversified portfolio, with some CF+ properties and some negatively geared in high growth markets. We can help you find, assess and purchase CF+ properties, whilst maintaining our sensible, logical and scientific approach to all our investing.

**Regards .... Bruce & Karen**

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***And please contact us if you are considering investing in property and would like an obligation-free consultation.***