The 10 best tips to consider when buying off the plan

There are a number of reasons why people want to buy management rights off-the-plan.

It is often perceived as an opportunity as there is an expectation that:

- The multiplier will be lower when buying from the developer; and
- the profit could ultimately be a lot higher than that projected by the developer (especially for short-term accommodation).

It is also important that there is no duty on the initial grant of the management rights, although there is still duty on the unit.

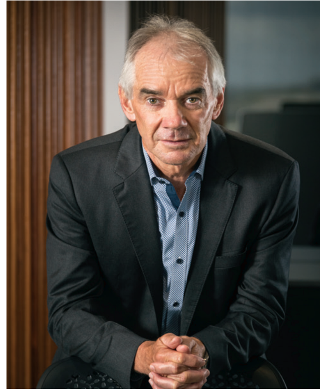
Although there is GST on an off-the-plan management rights acquisition, the GST is eventually remitted to the buyer as an input tax credit. While the legal fees and general delays can be much greater than a normal purchase, the duty-saving more than makes up for that as the duty can be over five percent of the price!

Of course, there are also risks in buying off-the-plan. But, if the items in this article are considered and acted upon, the risks can be substantially minimised.

Tip number one

Trust but verify. The agent and the developer can be an excellent source of information. But, it is critical to distinguish between information and 'blue sky'. Information can be verified, blue sky cannot.

Blue sky includes, for example, exaggerated estimates about likely rental or occupancy rates. It is important to identify, check and verify any important assumptions about the business. Do your market research to make sure that the



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projected rentals are realistic - especially in a saturated market. Get good advice from an accountant with expertise in management rights to help with the verification.

Critically, make sure that the complex will qualify for the accommodation module (and consequential 25 year agreements) if that is what has been offered. You need to be certain that at settlement a majority of owners are intended to be investors who will rent out their units.

Tip number two

Deal with competent and respected people and get good advice early. Importantly, the first person you need to check out is yourself!

Do you have the skills to bring this kind of business together? Permanent complexes are fairly straightforward. Many of my existing clients hear about a holiday building years before it is completed. Developers often approach experienced managers directly. Warning bells should ring if you have no experience and come across a major holiday or short term building six weeks before it is to be finished!

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Dealing with an experienced management rights agent is important. Remember though, they are the developer's agent. Nevertheless, experienced agents will not want to risk losing a sale or your future patronage and will usually be honest with you. But remember those agents are not solicitors or accountants! They cannot provide all of the detailed advice that you will need before the contract can go unconditional.

Tip number three

In principle, get agreement from the developer to a clawback. It is important that in principle agreement be reached on critical items such as price, clawbacks, minimum numbers of units in the letting pool to settle and any obvious due diligence issues, before a contract is signed. We have seen many transactions fall over, after a buyer has spent considerable time and money, because the basics were not agreed to at the outset. While the final contract will, of course, be quite detailed, it is critical to get a sound in principle agreement up front.

We have a comprehensive checklist that we use for working out a clawback/claw-forward arrangement. Working these out at the beginning of the matter as part of reaching in principle agreement with the developer can save time, money and angst.

Tip number four

Check out the developer and its selling agents. Ideally the developer will have a good track record, make sure you find out about the developer's other complexes and speak to the managers of those buildings.

What support will the developer offer you? This could include marketing support for websites and advertising, and assistance with identifying and rectifying building defects. Managers often need to spend significant time and money setting up the business and fitting out the office in the months leading up to settlement. Who are the agents selling units in the complex? What have they promised the buyers? Obtain copies of marketing material.

Tip number five

Obtain copies of the off-the-plan unit sale contracts and disclosure statements. The developer and its selling agents should have copies of these to provide to you. These documents should have all sorts of useful information: copies of survey plans, floor plans, budgets, lists of inclusions, caretaking and letting agreements, by laws and so on. ▶

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Tip number six

In carrying out initial financial due diligence, find out the likely settlement time frame. Is there enough time to obtain letting appointments from owners? Enough time to find tenants? Some marketing and advertising needs a long lead-in time especially in holiday buildings. Often, the developer or its selling agent will provide you with a projected profit and loss statement. That projection will usually be for the second or even the third year in a holiday complex.

As above, make sure your own accountant verifies the projections and identifies and checks any underlying assumptions. It could take some months to fully tenant a permanent complex. My clients tell me it can easily take 18 months or more to achieve projected occupancy levels in a holiday building.

Projected profit does not equal cashflow! Depending on the size of the complex, net cashflow (before interest) could be 10 percent or more below projected net profit. Your accountant should prepare a separate cashflow forecast.

Tip number seven

Establish price calculation and related assumptions. What is the breakdown between body corporate remuneration and letting income? What expenses have been allowed for? What is the expected occupancy? What are the other income sources (electricity supply, internet services, parking fees)? Is it appropriate that those income sources be included in the projections for sale purposes?

Nobody 'buys' GST. The figures quoted for remuneration and the off-the-plan management rights price, are usually plus GST. The unit price would normally include GST. One of the things that you need to determine is how much each unit is worth in the letting pool. For example, if the projected letting income from a unit is (say) $6,000 and the multiplier on your purchase is 4.5, then that unit alone is worth $27,000 to your letting pool.

Tip number eight

Initial legal due diligence: you should make sure your lawyer has a copy of the unit contract and disclosure statement very early in the negotiations.

There will be items of critical importance that need to be resolved before the contract can be signed. Your lawyer should identify any immediately obvious issues in the agreements.

Developer's solicitors frequently use 'off-the-shelf' caretaking and letting agreements. Often, we see permanent townhouse complexes with agreements that seem drafted for a high-rise holiday building and vice versa. High risk items that might need to be considered include, for example, strict office hours, or work that is of a specialist nature.

Are the duties, office hours and remuneration appropriate? What are the rubbish removal arrangements? Is it a holiday or permanent complex? Are the courtyards accessible for maintenance? What degree of office fit out will the developer supply? Consider PABX, internet, electricity supply, car parking, furniture packages and the like.

Developers are usually highly reluctant to make any changes to the caretaking and letting agreements. That is because any changes have to be disclosed to all the other buyers. If those buyers are materially prejudiced by the changes, then they are allowed to terminate their contracts.

Developers usually don't want to risk that.

It is important for buyers of off-the-plan management rights to distinguish between their 'wish list' and 'deal breakers'. Given the understandable reluctance developers have to making amendments to the documents, be careful not to seek many amendments beyond those that are deal breakers.

Tip number nine

What are the minimum available units in letting pool at settlement? A critical question that is sometimes ignored is, "how many units do I need in the letting pool to settle?"

You can have the best clawback clause but if there are not enough sales to investors, the business might not stack up even with a major price reduction. This can be a difficult issue for all parties: you may not want to settle unless a certain percentage of units in the complex are sold to investors who have signed a POA Form 6 with you.

In a holiday complex, consider if you require a minimum number of units to be fully furnished.

Also be aware that unless a majority of units are to be rented, the accommodation module should not be adopted and if it is could be challenged in the future – reducing the term of the management rights agreements to 10 years.

Tip number 10

Clawbacks are probably the biggest single bone of contention when buying off-the-plan management rights. Some developers simply refuse to consider clawbacks or minimum numbers to complete. If that is a commercial risk that you are prepared to take, then in some ways that can be a relief. It can certainly save a lot of negotiating, legal costs and delays!

But most managers would require a clawback. Consider the example in Tip number seven. If you are expecting 50 units in the letting pool and there are only 45, the value of that discrepancy is 5x $27,000, that is, $135,000.

Ideally, other features of clawback clauses include: not paying for units retained by the developer or its associates, only paying on receipt of a signed POA Form 6 letting appointment from an owner who has completed the unit purchase, only paying for completed, furnished units (if applicable) and a credit for appointments lost (other than due to your poor performance) during the clawback period.

All of these items are negotiable. ▲

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