The accountant's perspective

The purchase of a new management rights business off-the-plan can be a very financially rewarding investment; however, the rules have changed significantly over the years as the industry has matured.

While the final contract will, of course, be quite detailed, it is critical to get a sound in principal agreement up front.

In the early days, it was not uncommon for the management rights business to be sold by the developer on some arbitrary basis, for example a flat dollar amount or a multiple of just the caretaking remuneration. This has changed over the years and today, most off-the-plan management rights businesses are sold on a similar basis to established buildings, as in the price being a function of a yearly profit figure and a multiple of that profit.

The big difference though is that the profit in an established building is 'actual' profit whereas for an off-the-plan purchase, the profit is an 'estimate'. This estimate will be of the likely total income of the business incorporating both the caretaking remuneration and letting income.

This approach raises a number of inherent risks, which intending purchasers should be aware of before entering in to a purchase.

Assumptions & projections

The major accounting risk with buying off the plan is that the purchase price of the business is being based on a number of assumptions and estimates of income, not actual trading figures as applies to established buildings. The caretaking remuneration should be a finite amount that is known with certainty; however, the likely number of units in the letting pool, rental or tariff rates, occupancy levels etc., are all unknowns.

It is critical that these assumptions and estimates be carefully reviewed to see that they are reasonable and creditable.

While the developer will have adopted certain assumptions in arriving at the sale price, they are purely estimates and generally most developers will not guarantee any of their assumptions.

So how do you go about reviewing these assumptions and making an assessment of their reasonableness?

There are a few things you can do:

Consult with accountants and other advisers who specialise in the industry as they will be able to provide valuable input as to the reasonableness of the projections.

Do your own review of the building you are looking at, what is the style, size, quality, aspect and facilities offered in the units plus the overall complex facilities and building location generally and who is this most likely to appeal to – investors or owner occupiers.

Does the standard of the complex and location support the projected tariff and occupancy levels used in the financial projections?

Find out as much information as you can about other similar buildings in the area (number of units in the letting pool, tariffs, occupancy levels), as there are generally similar patterns across buildings in the same locality.

The way the complex has been marketed by the developer will also have some bearing on buyer profiles but don't rely on this too heavily; owners will make their own decisions.

If units in the complex have been sold off the plan, the selling agents may be able to provide some information on buyer intentions and their locality; overseas or interstate purchasers are more likely to place their units in the letting pool.

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Take up time

Unlike an established building, a new management rights will take some time to build up to its full income level. In permanent complexes it may only take a few months or so to have all units let and be achieving full letting income. ▶

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However, in a holiday let complex it could take a couple of years, not so much to achieve the number of units in the pool but to achieve the target tariff and occupancy rates.

You should allow for this gradual building up of income in your cash flows and financial commitments as the total income will not be there from day one.

Units in the pool & external selling agents

Developers typically appoint a number of external selling agents and allocate them a parcel of units to sell. In the past, there have been issues whereby these selling agents have, largely unbeknown to the developer, had the purchaser sign not only a contract of purchase for the unit but also a letting agreement with their own agency or an associate in the area of the complex.

You then proceed to settlement working on the basis that there may be say 50 units in the letting pool which turns out to be correct, except that you find out 30 of the units are with outside agents!

The better developers have addressed this issue by restricting these external selling agents from signing up letting agreements, but there are still developers that won't provide this assurance, so beware.

Also, most developers will not provide any guarantees as to minimum number of units in the letting pool so you need to do your own homework and be realistic with your estimates.

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Developer rental guarantees

If the developer is providing rental guarantees to unit purchasers, review carefully the terms of these agreements as to their duration, is the rental being offered realistic and on market, what basis do you get paid your letting commission; the actual rent received or the guarantee amount? If the terms of these guarantees are too generous, it may cause issues with those unit owners down the track when the guarantees expire and the owners have to face the real market.

Unit sales documents

In selling the units off-the-plan the developer will have provided intending purchasers with a comprehensive set of documents which may include the proposed caretaking and letting agreements, by laws and, in some cases, *PAMD* style forms detailing the manager's charges for example.

The incoming manager will be bound by the statements made by the developer so it is important that you review these documents and ensure they are consistent with the assumptions upon which you have estimated the likely business profit and you can work within them.

Timeframe of settlements

The manager is generally one of the first purchasers to settle when a new building opens.

It is likely the developer may not have sold all units in the building by that time and depending on the state of the real estate market at the time, it could take several months or even years for the developer to sell the remaining stock.

During this period, most developers will not allow those units to be rented as they will prefer to market them as new units.

This can create a significant lag effect on the manager's income if you had been budgeting on some of the unsold units being in the letting pool.

So, while there are risks, I have seen many clients have tremendous success with the purchase of an off-the-plan management rights business.

However, success is all about those initial assumptions of likely units in the letting pool and subsequent income, so be realistic and do your homework thoroughly. ■

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