What to Consider When Purchasing a Management Rights Business

What Type of Business Do You Want?

This management rights industry is not for just a selected few. The Lancaster Group have seen properties purchased by public servants, salespeople, accountants, moteliers, farmers, builders and other trades people. The main criteria are that you are hard working with common sense, practical know how and have people skills, as with any other business.

Holiday

This type generally generates the highest level of income per unit due to the fact that you have multiple income streams. Firstly from the salary paid by the Body Corporate to maintain the common grounds in accordance with the schedule of duties attached to the management agreement. The average is $1000.00 per unit starting salary depending on the duties involved in Australia and $500.00 per unit in New Zealand. Other income streams are associated with the letting. An individual agreement is put in place between your company and the owner of the apartment you let. Generally the charges include a commission usually around 12% of rent collected in holiday letting. Other income is also received from linen and laundry services, repairs and maintenance to apartments, phone and PABX use, internet use and any other services agreed between the manager and owner. Holiday let properties are generally found in popular holiday areas such as Gold Coast, Sunshine Coast, Cairns, Coffs Harbour and Yamba in Australia and Queenstown, Coromandel Peninsula, Rotorua, Taupo and Bay of Island in New Zealand.

Corporate

Another good business to own is a corporate business and is generally situated in the main cities of Australia and New Zealand. Corporate business is valuable and it is repeat business. The corporate client is easier to look after than the average holiday maker, who is there to have a good time. The per-unit returns are similar to holiday let.

Student Accommodation

Student Accommodation is another excellent business. The business may have a contract to supply all beds in the complex to a university or it may be run independently. These businesses generally return good income to the owner or investor as the property runs at a very high occupancy, as the tenancies run for a minimum of 40 weeks. Once again there are multiple sources of revenue available. The rental commission rate is generally lower but is still good income due to the high occupancy. Other sources of income are supplying phone services and internet, repairs and maintenance and cleaning services. Extra people skills are necessary to run a student complex as you are dealing with young people some of whom have never lived away from home before.

Mixed Holiday and Permanent

This is a good mix and is found in both popular holiday areas and cities. It is sometimes easier in a new building to find a permanent tenant for an owner who requires income from the time of settlement on their apartment while the short term income grows. It could take six months to show a greater return than a permanent tenant. It also allows owners a choice, as in popular holiday areas the owners of the apartment often prefer short term let as it enables them to also enjoy the apartment by holidaying in it themselves.

Permanent

There is generally a lower income per apartment or house but is made up due to the fact that the businesses generally have a higher number of houses in the complex. It is not uncommon to have over 400 houses with most of them in the let pool. The Body Corporate salary is generally a little lower is housing estates and the rental income approx 7%. Other income can be derived from maintenance of properties and let fees.

The office hours are generally shorter and often permanent properties are easier to run. However, you do have to be an expert of residential tenancy legislation to ensure all the correct procedures are followed. It must also be remembered that permanent complexes run at almost 100% occupancy whereas holiday or corporate properties will generally run between 50% and 75%.

The decision on which of the 5 types of Management Rights you would like to purchase will depend on a number of factors.

Ask yourself some of these questions:

1. Are you cashed up or keeping assets you are going to use as security to purchase? If you retain property you are reducing the funds available to purchase therefore reducing the size of property and income you will receive. The larger properties often have nicer manager's accommodation and a higher income due to the multiplier. If you are purchasing at 5 times the net profit and borrowing funds from the bank at 7% you are in fact making 13% on the banks funds.

2. Do you wish to purchase a short term business or permanent let business?

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4. Do you wish to purchase a short term business or permanent let business?

5. What size do you require the manager's apartment to be? Often developers do not take into consideration the managers requirements seemingly forgetting that the manager is living full time on the complex and usually requires at least a three bedroom apartment with outside space. The average manager's apartment is approx 90m2 with two bedrooms attached to the office.

6. What level of income do you require?

7. Are there any special areas where you would like to purchase?

8. What is your age group and your condition of health? This will dictate the level of common property you are able to maintain yourself. Swimming pools, spas, saunas, gardens, gymnasiums and lifts are all common to holiday resorts. Permanent housing estates may have 10 to 20 acres of common grounds to maintain. If you cannot maintain the common property yourself, you will have to hire ground staff, reducing the income received.

9. What are your goals? Are you looking for a new building, to take the risk of starting from scratch, to build an asset and thereby maximizing your capital gain? Or would you be happy to purchase an existing property, with an established income?

Purchasing off the plan

The advantages of purchasing a good 'off the plan' management rights business far outweigh the disadvantages. An off the plan business is one that you purchase from the developer usually months before the complex is completed. These opportunities are usually reserved for more experienced management rights owners who have a proven good history in the industry. Sometimes the time frame from signing the purchase contracts to the time the business is paying can be close to two years so usually doesn't suit first time buyers. The due diligence is often more involved and your lender will require more protection for their loan. The best way for a first time purchaser to obtain an off the plan purchase is to enter into a partnership with an experienced operator. We cover this in the page on partnerships.

The Lancaster Group has had an association with one agent for the past 15 years dealing in mainly 'off the plan' businesses. It has been a very successful relationship.

Although the Market has slowed in Australia and New Zealand, there are still developers that have the backing and pre-sales to complete their developments. While many of the inner city large developments have been shelved, there are areas in South Brisbane, Robina on the Gold Coast and parts of Cairns in Australia, where new complexes are being built. The modern trend is to bring the experienced manager on board earlier in the development to enhance the chance of pre sales. This is a win-win situation as the developers are tending to be more negotiable on price to get the right manager.

When acquiring an established Management Rights Business, your accountant can verify the profit from the information supplied by the vendor to substantiate the purchase price. The 'off the plan' purchase has no such history as it is being sold on a projected turn-over. The only income you can rely on is the caretaking remuneration that is stated in the Caretaking Agreement. As the by-laws and the caretaking and letting agreements are included in the contracts for sale of the apartments in the complex, developers are reluctant to change these documents after sales have been recorded as the purchaser can opt out of the agreement if changes are made.

Financial institutions prefer to lend to experienced operators if they are purchasing off the plan; however, it is not compulsory in order to have finance approved. It is important to discuss the project with an experienced financier as off the plan purchases can be a complex process. For more information on using financial management rights experts, click here.

Your ability to calculate the likely profit on a new property will come down to your experience from previous businesses and in conjunction with your accountant.

The main aspects that will affect profit will be

1. The location of the building
2. The age and condition of competing buildings
3. Will it be permanent let, short term let or a mixture of both
4. The price range are the apartments
5. How many units in the complex
6. The configurations of the units
7. Whether there are any rental guarantees offered to purchasers
8. What the salary stated in the caretaking agreement is
9. Are there any proposed developments within the vicinity coming available in the near future
10. Will there be a minimum number of units in the let pool at settlement
11. Will a claw back and claw forward clause be included

Location of the Building

Is the building in a brand new area or an established area? A new area is a higher risk as there is nothing to base your calculations on. You will not know what type of cliental will stay, what the demand is and the number of units the new area can sustain.

The Lancaster Group took a large risk five years ago and purchased a 75 unit building in a brand new area that had seen no new development for years. It was anticipated that the building would be 'holiday let' with some permanent. However it turned out to be very strong 'corporate let'. The building went on in a very short time to operate at very high occupancy and was one of the most successful management rights businesses in Queensland.

The problem it has now is that the developers have seen the success and now at least half a dozen new complexes have been built. Unless growth keeps up with the number of new units available for rent our original property will find it harder to compete as the new complexes are getting bigger and better. A new building in the middle of a number of existing will be successful as it will feed from the competition. It will have the better facilities, it will look clean and fresh and guests will stay at the newest property available to them.

The Age and Condition of Competing Buildings

Have a look at the buildings around the area. Go in and enquire about staying - how friendly is the reception staff? Ask to have a look at a room - what standard is it? What is the quality of the chattels? Check the resort facilities - is the pool indoors or out? Is the pool heated? Do they have a sauna, spa, tennis courts or gymnasium? Will the building you want to purchase in have nicer facilities? Could you be friendlier than their reception staff? You have to be sure that you will have the better product if your new property is to be successful.

Permanent or Short Term Let

Short term or holiday let generally means a higher profit per unit. Permanent means lower net return but lighter work load. You should have an idea from the price the developer is asking for the business, what type of accommodation they are expecting the building to be. You will be guided by the competing buildings. It may not be wise to change the type of accommodation if the cliental will not substantiate it.

Price Range of the Apartments

This is an important factor in deciding what type of accommodation you will provide in the off the plan complex. If the sale price starts at under $300,000 and the majority of apartments are under $500,000, the building will lend itself to short term or holiday let, due to the fact that in that price range investors will be the main purchasers and you as a manager can produce a good return on the funds invested by the owner. If the apartments start at $500,000 and go over one million, there is little chance the building will be holiday let. There is a good chance these apartments will be purchased by owner occupiers, who may put the apartment in your permanent let pool while waiting to move in themselves.

The Number of Units in the Complex

The workload in a complex of fewer than 20 apartments is not a lot less than one of 100 apartments. You will have more chance of building a good let pool from a large complex which will have a range of apartments both in the number of bedrooms, size of unit and price range. The salary alone of a 100 lot complex will provide a good income without any letting. The Lancaster Group would normally purchase into buildings with over 60 apartments.

The Configuration of the Units

The importance of this aspect is often overlooked by developers and most professionals in the industry. Permanent let will predominantly use two and three bedroom apartments and holiday or short term will use one and two bedroom units. If the building you are purchasing is in a holiday resort and consists of mainly three bedroom apartments the property will not be as successful as the return will not be high enough to satisfy the owner.

One bedroom apartments will obviously be in a lower price range and are more suited to the corporate and short term let trade and can return a net of up to 10% of the purchase price. ‘Dual locks’ (two separate units which can be joined into one) consisting of a studio and one bedroom are by far the best producers in the industry. The ideal situation for a top producing building is 30% dual locks, 20% one bedroom 30% two bedrooms and the balance three bedrooms. By building a number of dual locks and one bedroom units the developer’s profit margin will be larger than just building three bedrooms at the top end of the market. They will usually sell out of the dual locks and one bedroom in the early stages of marketing.

Rental Guarantees

It is important to know if rental guarantees are being offered on some or all of the apartments for sale. Generally it is a good thing as it tells you the apartments are being marketed to investors and the sale will also consist of a furniture package. This tells you if the apartment sells it will most likely be placed in your let pool. The only disadvantage is if the rental guarantee is high, say 8%, you may find it hard to provide the investor with the same return when the guarantee comes off. It does not affect the developer as they have already added the cost of the guarantee to the price of the apartment. It is important for you to be involved with the furniture package to ensure it is practical, comfortable and of sufficient quality to enhance the apartments you are trying to market.

The Salary

The letting side of your new business will grow slowly and could take up to one year before you have a good business. You do not want a large number of units in your let pool at settlement as you could not do justice to them as your marketing has not reached your potential guests yet. The ideal situation is to start off with 10 apartments and when you are showing a good return for those owners, canvas other owners and bring their units into your pool. However, if owners do want you to manage their investment you should not turn them away. Instead you may place some long term tenants in some apartments to provide steady income while the short term let business is growing. When you purchase an off the plan building ensure that it is of sufficient size so the Body Corporate salary will pay the bank loan. A 75 unit building should have a salary of between $75,000 and $80,000. That will cover an interest only loan of $800,000 and leave enough for your basic living requirements. You are then not under pressure to have additional funds to cover your outgoings for the first few months.

Proposed Developments

It is important to have an idea if any new developments are in the planning stages or with council for approval. A look around any large sites may show applications for consent and a trip to the local council may also be beneficial. Also ask the developer – they are obliged to tell you if they are aware of any future developments that may affect your buildings performance.

Minimum Number of Units at Settlement

You will be purchasing the business on a projected profit based on the body corporate salary and from a number of units in your let pool at settlement. The number of units will be stated but if the number falls due to a lack of sales there must be a minimum of units available to the purchaser to cover the cost of the purchase. This minimum number of units should be stated in the purchase contract. There should also be a claw back clause in conjunction with the minimum number of units.

Claw Back and Claw Forward Clauses

A claw back clause should be included for your protection. You have paid a multiplier for the business based on the Body Corporate salary and a projected number of units in your let pool at settlement. A value for each unit can be calculated and if the number falls below the expected number the purchase price will be reduced by the calculated amount for each unit. If the number of units falls below the minimum of units you have the right to cancel the contract. This clause must work both ways and if you end up with more than the calculated number the contract price will increase by the calculated amount for each extra unit.

One may be wondering why would you purchase an 'off the plan' building with all the above possible pitfalls. There certainly is more to think about. The lawyer's bill will be a few thousand dearer and the time frame will seem endless, but the possible financial rewards can be huge. You will pay a multiplier of up to five times the net profit for a good existing management rights business. You should negotiate a multiplier of between two and three for an 'off the plan' building. When that building reaches the projected profit of say $250,000 and you paid between $500,000 and $750,000 on the lower multiplier, when you come to sell it on the industry standard of five times, the business is worth $1,250,000 - that is a good capital gain. There should also be a small capital gain on the manager's apartment. The only way to create a capital gain on an existing property is to increase the turn over by injecting new ideas, building your let pool or increasing tariffs. However all these improvements will not generate the same capital gain the 'off the plan' building will.

By going to contract early on an 'off the plan' building, you will have input on aspects of it that will enhance your business. For example, the size of the office and its layout is important. Is it big enough for two work stations? What level of fit out will the developer contribute? (They have to contribute as they have sold you a business) What signage will be placed about the building? Is there parking for guests to check in? Are the storage areas adequate? Is the building wired with Cat five cables to enable a PABX and broadband to be installed? Is the building wired for satellite TV? It is amazing how many of the above are missed or not built correctly and getting in early gives you an opportunity to ensure they are in place.