UNDER DEVELOPMENT?

If you want to grab your share of the new apartment market, how should you pick a developer and what are the risks?

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New developments are popular with investors and can deliver solid returns for the astute buyer.

A couple of decades ago, an apartment was seen as a riskier investment than the good old-fashioned quarter-acre block. But times have changed: apartment living is now mainstream.

Regardless of where you live, chances are there's a new development going up somewhere nearby.

In the sprawling suburbs of the major cities, as well as in regional centres, medium-density projects are proving popular. Closer to the CBD, large apartment buildings are capitalising on smaller block sizes.

But not all new projects live up to what's depicted in the glossy brochures.

How can investors cut through the marketing spin to spot a genuine – and reliable – opportunity?

Smart Property Investment's panel of experts gives you the low-down …

1

WHAT ATTRIBUTES SHOULD INVESTORS LOOK FOR WHEN SELECTING A DEVELOPER?

GH: Look for a developer who is reputable and has done numerous projects.

Obviously, if they *have* done a number of projects, look at where those other projects are. Go and see them and most importantly, talk to someone who lives there.

Ideally, look at their last one or two projects and how they went. Speak to people who are there and ask them how they feel about it? Did they get what they thought they were going to get?

If you're looking to buy off the plan, look at the level of detail the developer has gone into and how slick the sales program is. Make sure the developer can back up what they're saying. The glossier and the pushier the sales effort, the more likely it is the developer won't deliver.

PB: Check the builder is licensed. Ask how long the developer has been in business (the longer the better). Ask what other successful developments have been undertaken (look for a strong track record and check out previous developments so you can gauge things like quality, design and curb appeal). Check out what guarantees and warranties they offer (the developer should be prepared to stand by their work), and make sure they have adequate insurance, including Builders Warranty insurance.

You should also contact your state or territory Office of Fair Trading or the consumer affairs department to check there are no claims against or investigations into the developer.

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HOW CAN AN INVESTOR FIND OUT ABOUT A DEVELOPER'S REPUTATION?

PB: Google their name or business name and see what's been written about them. Check the developer is a member of a recognised industry body like the Master Builders Association to ensure they subscribe to minimum building standards and codes of conduct. Again, visit earlier developments and speak to prior purchasers. Ask them how the developer behaved, whether they delivered on time and within budget, and whether they were satisfied with the quality of the finished product.

RJ: PIAA does a five-star rating of investment properties. It's a due diligence audit of 200 items that includes the reputation of the developer. We also ask to see feasibility studies as we want to know if the profit margin is sufficient to ensure the developer will conclude the development. Putting your deposit funds into an opportunity only to have the sunset clause evoked two years later is a lost opportunity as you weren't in the market for that period of time. This can be costly.

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SHOULD INVESTORS EXPECT STARTING PRICES TO BE OVERVALUED? IF SO, BY HOW MUCH?

GH: Generally speaking, that's the price – take it or leave it. Sometimes you can have a few extra things put in: perhaps you can get early access, or something changed that adds value, but generally speaking there's very little you can do with prices. To help, establish how quickly they're selling, who the buyers are, are they owner occupiers or investors (generally you want more owner occupiers in your building because they take a special interest in the development whereas a tenant can just say 'I'm out of here').

PB: Trying to value a new development – and therefore work out whether you're paying too much or getting a bargain – can be difficult.

There are two options to try: compare the asking price with recent sales of similar properties, and/or bring in an expert and arrange for a registered valuer to value the development.

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HOW WARY OF DEVELOPERS SHOULD INVESTORS BE? ARE THERE MANY SCAMMERS OUT THERE?

PB: There will always be good and bad developers out there. As Catherine Cashmore (of JPP Buyers Advocates) advises, it's a case of doing your homework and looking for testimonials – a strong indication of a good developer who can prove their projects are successful and financially worthwhile.

GH: There aren't many scammers. It's highly unlikely and they usually stand out by a mile. If you like them but you think they're a rogue, they normally are. Rogues always make themselves likeable. If you're going through the sales program and there are other people there, looking at the display or the brochures, talk to them. Talk to people who are also looking to buy.

RJ: Look out for any emotional selling of the property. Remember the sales agent is working for the vendor, no matter how nicely they present the information about investment.

HOW IMPORTANT IS IT TO SPEAK TO PREVIOUS/EXISTING CLIENTS? HOW CAN INVESTORS TRACK THEM DOWN?

RJ: I think you get the best opportunity to understand their business operation and their ethics by looking at their past product and activity.

Sales contracts let developers change approximately 4% of the property between DA application and Construction Certificate. We have seen a developer plan a car park so narrow, to meet council requirements for number of car spaces, that you couldn't open your car door. This one was saved before building began, but it did require excavation for another level and the costs blew out.

PB: Feedback is one of the best ways to gauge the calibre and quality of a developer. To find previous/earlier investors you'll need to rely on the developer to put you in touch. Also, ask around to see if anyone has heard of them or invested in one of their developments. A good report provides comfort that you're dealing with a trusted and reputable organisation. Plus, you can always ask the client how their investment has performed since being purchased. This could provide you with some insight into the developer's previous build, location and pricing strategy, which in turn may help you assess the investment you're considering. Just remember that no two investments will perform in the same way and just because an earlier development performed strongly, doesn't mean the one you're considering will do likewise.

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WHAT IMPORTANT QUESTIONS SHOULD INVESTORS ASK DEVELOPERS?

PB: Questions should include: What's included in the purchase price? Will there be additional costs? When do I have to pay? Who holds my deposit and how is it protected? Are you offering any promotions? What upgrades or non-standard options do you offer? How flexible is the floor plan and design? How long will it take to build? What are my rights if the development is delayed? Can I visit the development during construction? What happens if the developer goes into liquidation?

GH: Get as many specifics as possible on what to expect. Read the fine print, read the document they offer you and most of your questions will come from there. Clarify what they mean by this or that. If they have done any developments before, where are they? Were they delivered on time? Did they have any problems with the development and if so, what did they do to overcome them? Sometimes asking those questions is like asking the person in the dress shop, Should I buy the dress? So you have to look at *how* they answer rather than *what* they give as an answer.

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WHAT GUARANTEES OR PROMISES FROM THE DEVELOPER SHOULD INVESTORS BE WARY OF?

PB: A big one is rental guarantees. The cost of these guarantees is usually factored into the selling price, meaning you could be paying more than what the development is really worth. A rental guarantee of $20,000 over two years probably means a development bought for $400,000 is really worth $380,000.

RJ: Most guarantees are not founded on a legally-binding structure, hence investors have no legal recourse should events require them to take action.

GH: Generally speaking, the prices usually drop when the rental guarantee runs out. So be very sceptical if they are offered.

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WHAT SHOULD BUYERS BE WARY OF, OR LOOK TO HAVE INCLUDED IN THE CONTRACT, BEFORE SIGNING IT?

GH: If you don't understand or you doubt any part of the contract, step back and take some advice, because you need to understand it clearly and it's usually those little things that come back to bite you.

RJ: These are the things to look for: that your unit is listed on the plans clearly and you sign its location as well as the sales contract; that your car parking space is on your title and not at the discretion of the body corporation who may rent it out to someone else; that the body corporate budget is fair and representative of what you will be paying; that the managing or caretaking agent has fair and reasonable expenses, compensation and management fees for your tenants.

PB: Always get purchase contracts reviewed and checked by conveyancers or solicitors who specialise in property developments. Contracts are often long and complicated, with severe penalties when purchasers fail to meet their obligations. Key clauses to be aware of include those covering what happens if the development fails to proceed; the circumstances under which can a party walk away (e.g. if the development is delayed); what happens when the developer makes changes to design, fixtures and fittings; and what type of warranties does the developer provide.

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WHAT ARE THE POTENTIAL CONSEQUENCES OF BUYING FROM A SHONKY DEVELOPER?

RJ: A potential consequence could be the body corporate going broke in three to four years due to the cost of managing a poorly-designed building. Things like the lights over the entrance to underground parking might be at a height that requires a ladder and on a slope that requires specialist equipment and insurance to work there. Changing a light globe could be $300 - $400; the cost of moving the lights to the side might be similar.

PB: The biggest risks include: paying too much and the property doesn't generate the expected level of capital growth; the development not being built to specifications – you're therefore not getting what you thought you'd paid for (this is why it's so important to get the contract checked by an experienced solicitor or conveyancer); the building being finished with defects and the builder goes into liquidation or disappears (this is why Builders Warranty insurance is a 'must have' and it's a statutory requirement that all builders/developers do).

If things go wrong, there's the risk of loss of deposit, incurring expensive legal costs to get your money back or having to compel the developer to meet their contractual obligations. ■