TIPS FOR FINANCE

Use an Experienced Finance Broker

To begin - cash up - calculate what cash you have available to put towards the purchase from cash in hand and what, if any, property you have yet to sell. Sale of property can be the subject of a whole other story, however, it boils down to this: should you retain your property, you are able to borrow against it however at only 80% of its value less any existing mortgage and you will create another debt to repay. This other debt may place a strain on your MLR income.

Should you sell your property you will gain 100% of its value less any existing mortgage and your only debt will be for the management rights purchase. That 20% difference may put you into a better quality business.

Choose a lender

Should you choose to visit each bank that has a policy in management rights ensure you are speaking with the manager who is experienced in this field. This will more than likely not be your local manager. Experienced does not mean that the person has come through the ranks and been promoted to a business banking position and had management rights added to their portfolio.

I know we all had to start somewhere but ensure you are dealing with someone who has had at least two years primarily in the industry and does the odd commercial loan on the side and not the other way around. Most banks have, however, realised that this is a specialised industry and have a designated specialist to the industry where most enquiries are directed.

It may be preferable at this time to seek the services of a specialist management rights finance broker. The same criteria should apply in that you should choose a broker who specialises in management rights and not a part timer to the industry. When utilising the services of a broker they can control much of the process (for example the bank will generally instruct the valuer and should you strike a problem and you want to change banks then you will need the bank's consent to reassign the valuation to another bank. Should the broker instruct the valuer and the need to change banks arises then this process is much simpler).

Your broker should be paid by the bank once your loan has settled and not by you. Armed with your cash contribution see your management rights finance specialist as they, using a formula, will be able to provide you with a purchase price ceiling that your cash contribution can accommodate. With this information your chosen agent will be able to show you buildings in your price range and not waste your's or anybody else's time and effort.

To assist in the process of elimination of which building to buy it may be beneficial to obtain the business summaries from your agent of the particular buildings you have narrowed your choice down to and present them to your finance broker or bank for finance scenarios or comment. The response may also narrow down your choice of lender.

How much can you borrow?

It should be mentioned that while most banks have a management rights policy some are just that, 'policies'. It does not necessarily follow that all banks will lend in every situation. Their policies do vary according to location, price, your background and many other variables. Most banks will lend up to 70% of the total purchase price subject to their own criteria. Some a little higher which brings increased criteria and often you will pay a premium in cost and rate for the privilege. The borrowing will depend on the income generated by the business together with your cash contribution in terms of repayment capacity.

This is also where, as mentioned earlier, it is preferable that you do not have any other debts affecting your repayment capacity. Most banks will not want the income from the management rights business servicing any other debts.

In determining how much you can borrow it should also be mentioned that you should allow approximately 6% of the total purchase price for setup or 'get in' costs. The industry average used to be 5%, however with increased purchase stamp duty and professional fees, we have found that 6% will cover the initial get in costs such as stamp duty, lawyers' and accountants' fees and the bank and licensing costs. This may marginally reduce at the end of the year when the government is said to be abolishing mortgage stamp duty.

Loan structure

An early visit to your accountant and lawyer will assist here. While the banks have their own format for a loan structure this will be assisted if you have your borrowing entity in order early in the process. Most accountants and lawyers will, depending on your individual circumstances, have you purchase the unit in your individual names and the business in a company and or trust entity. The bank will need to know this to give you a true costing. You will also need to have this entity in place prior to entering into a purchase contract.

Mark Harvey
PCS Finance

The structure will generally involve a retail facility for the manager's unit and a business or commercial loan for the business itself. The structure needs to take taxation considerations into account, not only income tax but capital gains is also important and your accountant can guide you in this area. Depending on the remaining terms in the management and letting agreements you should be able to secure between three to five years interest only on both the unit and business loans.

Best bank

The best bank is the one that will give you the rate, price and term you want. It may also depend on how much shopping around you are prepared to do. Should you approach a specialist finance broker then the banks will know they are not the only one being approached and will give there best price up front. This may not be the case should you approach several banks yourself. Your specialist finance broker has an intimate knowledge of the banks and their policies and will only approach those that they believe will tips for finance

The Accountant's Perspective

When new clients discuss the purchase of a management rights business with us, they have traditionally been well researched, attended a seminar or two and seen a great number of management rights complexes. While the accounting verification and the legal due diligence are always of high importance to the prospective buyer, the loan structure quite often is an afterthought. The finance requires thought and planning. Specialist bankers exist in this industry, as in other professions, and it is essential to use a management rights specialist banker or broker when buying a management rights business.

The variety of bankers and brokers in the market place makes for a very hard decision as to which bank and product to use. We recommend you seek advice from your accounting professional to assist with an evaluation of your options to achieve the greatest tax benefit moving forward. The banks have a number of differences to distinguish themselves in the market place, such as:

- Various lending percentages.
- Different loan terms.
- Varied interest only timeframes.
- Interest rate differences.
- Assorted fees and charges.
- Diversity of loan components (line of credit vs fixed vs variable).
- Financial due diligence difference.
- Various ongoing service packages.
- Credit card and merchant facilities.

Prior to signing a contract many complexes will be considered before finding the right property for you. One of the essential tasks, prior to signing the purchase contract, is to have a planning meeting with your accounting professional to ensure that you have the capacity to undertake the impending purchase. First, a budget needs to be undertaken to ensure you have the costs (approx 5% of the purchase price), the working capital (particularly for the first month) and the equity necessary to complete the transaction. Secondly, a cash flow is required and an explanation given of the various expenses such as interest, borrowings, residential unit costs, principal repayments, taxation and other expenses not included in the net profit prepared in the accountant's verification report. In addition, there may be other income streams from real estate sales commissions, leaseback profits or other income that may be included in the cash flow but not in a typical management rights net profit for sale purposes.

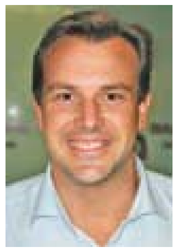
The business structure for the purchase is an important part of the deal and will depend on the personal/business circumstances of each individual. The structure should provide flexibility, asset protection, taking into account capital gains and income tax issues, and be generally tailored to the specific needs of the purchasers. It is critical to get this right prior to signing contracts on the business.

If you do not have the correct structure on the purchase contracts it may have dire consequences on the transaction in the purchase. The treatment of the sale and proceeds when disposing of the business will be dictated by the planning and structuring of the deal up front when purchasing.

Most specialist accountants provide a full range of services to their clients and as part of this process look at tax planning, wealth creation and superannuation, cash flow, budgeting and discussions on the implications of longer agreements with the body corporate. The planning and advice of an ongoing service agreement with an industry specialist accountant may change the initial cash flow calculations of your business.

Some people have cashed up in preparation for their purchase, selling everything while others have not wanted to sell the family home, the share portfolio and other assets. Being cashed up would be considered to be the ideal position of course and will generally give you the greatest leverage with the banks.

However, where people are not inclined to sell their assets but would rather use them as collateral in the transaction, the banks will consider this position as well. You may be required to leave some equity in the other assets that, in turn, may impact on your borrowing percentages. Income from other sources, businesses, government pensions and such will be taken into account by the banks when determining your ability to service the management rights debt.



Damien Moffrey
Director Baker & Affleck

The standard management rights business contract stipulates what the accounting verification should contain. The timeframe for the accountant's verification report can vary between 14 and 21 days. The banks need an additional week to undertake the financial due diligence (valuation, bank legal due diligence if required) so the contract needs to have at least 21 and 28 days for finance approval to allow for the banks to finalise their consent.

The banks look to the accountant's verification report provided to the valuers to assist with their valuation report. In addition, they look to the verification report to see whether there is a complete set of signed *PAMD* 20(a) forms with assignment clauses (these are transferable agreements between each of the unit/home owners and the manager that allows for management charges to be earned legally and explain the rights of both parties to the agreement).

There is an enormous amount of information discussed with the accountants, lawyers, bankers and agents between the signing of the contract and the settlement of the complex and the most important part of any transaction is in the planning of the impending purchase.

We can only urge you to seek professional advice to assist you in this area prior to signing your contracts to purchase. m

suite your circumstances.

Summary

The overriding tip is to use a specialist in the industry at every stage. Be it finance, sales agents, insurance brokers, accountants or lawyers they all need to have a history in the industry. The finance broker and sales agent are usually your first point of contact and they will be able to provide you with several business cards of preferred lawyers and accountants for you to choose from.

Brokers are able to provide that little extra value that the banks cannot as their partners and staff have ownership and management experience in MLRs. m

Legal Issues with

CONTRACTS: When you purchase management rights, you generally sign two contracts - one for the purchase of the management lot (that often but not always includes the management office/reception) and another for the purchase of the management rights business.

There are only a handful of real estate agents that handle the sale of management rights. These agencies all are very good at ensuring that there is adequate protection built into the contracts for the benefit of buyers.

Management rights are not a business where you can try and force a square peg into a round hole. Everything has to stack up to allow the purchase to proceed. Unlike general real estate agents, management rights agencies will not have buyers sign contracts unless they believe that there is a very good chance that the deal will proceed.

To this end, contracts for the sale of management rights are always subject to:

Financial verification – where an accountant can pour over the books and financial records of the business to ensure that the net annual income stated by the vendor is substantiated and sustainable. An experienced management rights accountant will quickly pick up on income streams that look inflated or expenses that look understated. A period of 14 to 21 days is generally allowed for the accountant to inspect the records and provide a report to the buyer.

Legal due diligence – an experienced management rights lawyer in Queensland or New South Wales will properly guide buyers through the legalities of buying management rights. The lawyer will, during this process,

Financing Management Rights

identify issues that may come back to bite a buyer if they are not identified and corrected at the time of purchase. Of particular relevance is the inspection of body corporate records undertaken by a specialist search agent and reviewed by your lawyer.

A review of these records will identify building defects or harmony issues and allow you to make a considered decision whether to proceed or not. Experienced management rights lawyers will also ensure that you understand your responsibilities once you takeover the business and help guide you through the process. Essentially, if the documentation doesn't stack up then it needs to be fixed or the buyer should not proceed. Allow 21 days for the legal due diligence to be completed.

FINANCE

Again, there are truly only a handful of banks that have a good understanding of the management rights industry and who are set up to process applications quickly and cost effectively. An experienced management rights agent, accountant, broker or solicitor can direct you to these banks. You should start talking to your proposed financier as early as possible – even when you are only thinking of purchasing management rights.

Your financier will provide you with its lending guidelines and this early knowledge should simplify the process when you eventually find a building and sign a contract. Sometimes you need banks to be flexible in relation to issues that arise during the purchasing process. Many acquisitions are not straight forward and issues arise. A bank that understands the industry can quickly make decisions that may make or break the matter proceeding.

You should ensure that the contract allows at least 21 days (if not slightly longer) for finance approval. This will allow the banks adequate time to obtain valuations and arrange for the banks' solicitors to conduct their own legal due diligence in respect to the documentation. Some banks accept a legal due diligence certification from the buyer's solicitor but will generally only do so if the solicitor is known to the bank as one who is experienced in management rights. This can result in a considerable cost saving.

When you do receive a finance approval letter, you should ensure that a copy is given to your solicitor as soon as possible to ensure that any conditions imposed by the bank can be met pursuant to the terms of the contract. Sometimes banks will impose conditions that will mean that only a conditional sign off of finance can be notified by your solicitor to the vendor's solicitor.

Body Corporate approval to the assignment of the management rights – All contracts must be subject to the body corporate approving the buyer. Some bodies corporate simply rubber stamp an incoming manager while others will vigorously investigate the background, experience and financials of an incoming manager (or associate directors/shareholders). In Queensland, there is a statutory obligation on bodies corporate to act reasonably whereas there is not a similar provision in the New South Wales legislation. You will often find a requirement for the owners' corporation to act reasonably in the agreements in New South Wales for this reason.

Col Myers
Partner Small Myers Hughes

SUMMARY

Plan, research and surround yourself with experienced industry professionals!

Talk to your proposed financier (or financiers) as early as you can so you are aware of the range of products available to you. Discuss the pros and cons of fixed rates, variable rates or a mixture of both. Discuss with your accountant what part of the loan (if any) should be attributed towards the residential unit and what against the actual business. The structure of your finance can have a significant effect on your tax at a later date.

Race ahead with... PCS Finance

- 13 years as the No.1 finance broker to the industry
- Leader in the development of innovative finance solutions
- 80% of new business is referred by current and past clients
- Reputation second to none
- Partnership and investment opportunities available

5 Management Rights Specialists at 2 Office Locations

Steve 0419 706 143 **Lisa** 0409 708 442 **Jess** 0422 870 174
Damien 0417 713 289 **Mark** 0411 327 539

New office opening soon on the Sunshine Coast

Contact the PCS Team

GOLD COAST	BRISBANE
Ph: (07) 5532 7539	Ph: (07) 3252 2219
Fax: (07) 5532 7571	Fax: (07) 3252 2812
Seabank Building 12-14 Marine Pde, Southport Q 4215 PO Box 10586, Southport Q 4215	40 Prospect St, Fortitude Valley Q 4006 PO Box 567, Stones Corner Q 4120

pcs@pcsfinance.com.au • www.pcsfinance.com.au

ACCOMMODATION • INDUSTRY • MANAGERS
PREFERRED SUPPLIER

PCS FINANCE

FBAA ACCREDITED MEMBER

the most experienced team in Management Rights funding