TIPS FOR PURCHASING MANAGEMENT RIGHTS

Selecting What Type of Business You Want

Management rights is one of the most successful businesses in Queensland. Over the past 13 years I have sold them to people from all walks of life such as teachers, farmers, trades people, accountants, bank managers, public servants, moteliers and even solicitors! The main attributes are people skills and common sense. A lot of clients are 'baby boomers' wanting a lifestyle change. So, you are interested in buying management rights? Well first, let's look at a breakdown of the options available to you.

- Holiday (a strong return business with guests staying between one night and three weeks);
- Corporate (long-term business accommodation);
- Permanent (three months or longer leases)
- Mixed (combination of holiday and permanent)
- Student (long term accommodation usually in the vicinity of a university).

Each of these five types of management rights has its own advantages but the main points of difference to be aware of are:

- A holiday or corporate complex usually obtains a higher level of income than a permanent, student or mixed property. Not only are the commissions higher (12% of rent collected) but also extra income can be made on linen, Internet and tours and such.
- Also, corporate or holiday properties thrive on repeat business. So with these two types of complexes, public relations skills are imperative!
- Permanent complexes involve less work hours and less interaction with guests or tenants.
- While the commission for permanent properties is only 5% of rent collected and a 3% management fee, it is important to remember that permanent complexes run at almost 100% occupancy as opposed to the 75% a majority of corporate and holiday properties will run at.

In management rights there are usually two types of agreements. These are: caretaking; and letting.

With a caretaking agreement it is the manager who does the work of a contractor employed to do the caretaking of the complex and attends the pool, spa, gardening, lawns, paths, foyer and the general cleanliness of the property themselves.

In a letting agreement, the manager is in an agreement with individual owners that allows the manager to be the only person onsite to conduct business.

The income generated from each agreement varies accordingly. In a caretaking agreement, the manager is paid a monthly salary but also obtains additional income from:

- Re-let fees;
- Letting commissions;
- Linen supply;
- Apartment cleaning;
- Tour sales;
- Equipment hire.

The manager's monthly salary is dependant on the size of the complex and is normally CPI linked. It is the body corporate that pays for the general complex expenses for things such as materials, pool chemicals, equipment and tradesmen.

Once you have considered the above criteria and have an idea of the type of complex desired and the letting agreement that best suits your needs, it is time to find a management rights agent who truly specialises in this field. You want an agent who only sells management rights because they are more likely to be able to give you sound advice; be up-to-date with current property valuations; and more likely to direct you to other specialists such as financiers, lawyers and accountants.

A good management rights agent will be able to match you with your perfect property. But to do this, they must understand what it is you are ideally looking for. This can be determined by answering question such as:

- Do you have a house or property to sell?
- What assets do you have to contribute to your purchase?
- Do you want a permanent or holiday rental complex?
- Are there any strong preferences for location?
- How large do you need the manager's unit to be?
- What level of income do you require?
- Do you want a low or high maintenance property (lots of lawn, pools and so on)?

Now with the type of letting agreement and specific complex requirements firmly decided, the next step is to source finance for this dream. Because of the long and successful track record of the management rights industry, most major banks are more than happy to assist with finance. But how much they will lend you depends on two things: The freehold value of the manager's unit; and the value of the management right's business itself.

The banks will view the manager's unit as the principal place of residence and therefore will provide a housing loan of 80% of the value of the apartment over 25 years. To finance the business, the banks will provide loan of 50% of the business value over 10 years at the business rate.

But this does not include acquisition expenses such as stamp duty, solicitors and accountants. These expenses often total to 5% of the purchase prices so it is important to keep this in mind and perhaps source a bank that will lend this additional 5%.

Many entering the management rights industry for the first time are probably not used to borrowing such large amounts of money so when it comes to deciding how much to borrow remember in management rights that living expenses are low, you are working from home and the cost of finance is only around 8% to 9% while the net return of the business is often 25% to 30% - meaning the difference is your's.

The other benefits of management rights – especially with today's interest rate rises – is that you aren't affected by inflationary pressure in our economy.

Liz Lavender
Liz Lavender Management Rights

With your own management rights business your caretaking income is adjusted to inflation and so is your permanent letting pool income.

Generally, when interest rates increase, a manager receives three benefits:

- Rental values increase and therefore increase a unit owner's return and, subsequently, a manager's remuneration package.
- People are less likely to buy their own homes or purchase owner occupied properties keeping tenants in the rental market and therefore increasing the size of letting pools.
- The interest the manager pays is included in their profit and loss as an expense, which therefore brings down the manager's net income and results in them paying less tax.

Hopefully, this article has created some insight to the intricacies of the management rights industry but we really only have touched the tip of the iceberg. m

Legal Aspects of Buying Management Rights

Most buyers of management rights are putting their life savings in their investment. Like any business, a management rights business has risks. In this article, I will look at these risks and how best to minimise or, where possible, eliminate these risks when buying management rights.

While the second part of this article contains a number of tips to guide you through the purchase process, the first part is dedicated to a couple of issues that are, in my opinion, essential to safeguard a buyer's interests but, all too often, overlooked.

General comments

In comparison to other businesses, management rights are expensive to purchase – even more so with the multiplier having reached, and seemingly maintaining, record levels.

What is it about management rights that commands these multipliers? Low risk… security… lifestyle… perceived guaranteed income? Probably all of these.

In my view, the most important factor is an expectation that the business will never come to an end. An expectation that, if you do the right thing by the body corporate, your management rights agreements will be renewed or new agreements entered into indefinitely.

As a general rule, a manager with a good relationship with the body corporate will achieve that. The attitude of a body corporate in the past is a good guide to how it will treat you as a new manager in the future and the likely relationship you will have with that body corporate. That is why, when talking to new buyers, I place so much emphasis about researching the past behaviour of the body corporate.

A buyer should, if at all suspicious that a manager's relationship with the body corporate is poor, thoroughly investigate the matter before going to contract, and always have your lawyer arrange a search of the body corporate records as part of the review of management rights documents.

Such enquiries will reveal, for example:

- Any default notices issued against the manager;
- Complaints about the manager discussed at committee or general meetings;
- Support for the manager when management rights agreements were entered into – did the manager receive overwhelming support or win by just one or two votes?
- Whether the body corporate believes the manager's salary is reasonable or excessive.

Of equal importance to this relationship issue is the income itself. From that perspective, it is important to make sure that the stated income is correct and is sustainable.

Remember that the standard contract only refers to your accountant verifying that the stated net profit of the business was achieved, usually for the previous 12-month period. That is not a guarantee that it will be sustainable in the future.

The most common reason for a subsequent drop in income is the loss of units from the letting pool.

You and your accountant should, when doing the due diligence, look at how many units have come into (or left) the letting pool over the past 12 months. Unfortunately, the case in some buildings is a trend for owner-occupiers to buy units rather than investors.

Check this out for the building you are interested in buying, Try and determine if it is a likely trend for the future.

Specific tips

Make sure you have put into place the appropriate purchasing structure before you go to contract. Your accountant is the best person to help you in this regard. Failure to do so could involve you in double stamp duty.

Use a reputable agent. Although agents act for the seller, and their commission on a sale is tens of thousands of dollars so that they have more than anyone an interest in the sale proceeding, any reputable agent will also have regard for the interests of the buyer. Speak to as many other managers as you can to find out the name of a reputable management rights agent and a reliable individual sales person.

Seek out and make contact with a recognised management rights lawyer. Again, check with other managers. Some lawyers claim to be experts in all areas of law – they are not and cannot be. Management rights is a very specialised area of law and there are only a handful of firms that truly specialise and even less that do it well. Price should not be a determining factor – you will essentially get what you pay for. Reputation, independence and quality of service should be the qualities you look for. You need a lawyer who places your interests above all else, not a lawyer who is afraid of upsetting an agent who might be a good source of referral work. An experienced lawyer will make your purchase easier. We, for example, provide a purchaser with a unique checklist setting out the things a purchaser needs to do during the course of the transaction, along with helpful tips and information.

Don't sign anything until you have at least spoken to your lawyer. You will probably be asked by the agent to sign an offer and acceptance or something similar. Generally, that is of little concern but it is still better to speak to your lawyer about it before signing. The lawyer will probably not insist on seeing it but can explain important parts of it to you and tell you what might need to be changed or added.

Speak again to your lawyer before you sign a contract. In a typical management rights sale two standard REIQ contracts would be used - one for the unit and one for the business. Most agents also use a common set of special conditions that are essential to protect the buyer's interests. These conditions cover such items as GST implications, your (and your lawyer's) approval of documents, *Managed Investment Act* implications and transfer of software. Make sure you and your lawyer are satisfied with the proposed special conditions – this can usually be achieved by a simple phone call.

Make sure the contract allows for sufficient time for the various stages in the process. As a general rule allow:

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- 14-21 days for you and your solicitor's approval;
- 14-21 days for your accountant to verify the net profit;
- 30-35 days for finance approval;
- 60 days for settlement – the best day for settlement is the first day of the month.

Choose a specialist accountant and one that you know will look after your interests in reviewing the financial records of the seller. Some accountants scrutinise the financial data more thoroughly than others do. Make sure you see an accountant that will do the best job for you, not simply do what is necessary to substantiate the seller's claimed net profit. Your specialist lawyer will guide you as to the accountant most likely to look after your interests.

Use an experienced lender. The cheapest will not necessarily be the best. Savings of 1% on interest payments can easily be lost due to delays in settlement or higher legal costs incurred through using inexperienced lenders. Again, your specialist lawyer is one of the best advisors about lenders, as your lawyer will have dealt with various financiers and their own solicitors in previous transactions.

Get your licence application in as soon as possible and follow it through, keeping in contact with the Office of Fair Trading.

Prepare properly for your interview with the body corporate. A well-presented résumé with references included should be prepared. In holiday complexes, you should have a marketing or business plan prepared to explain to the body corporate or to answer questions about, if asked. Your lawyer should be able to give you a list of the types of questions you are likely to be asked at an interview.

These are but a few hints to help first-time buyers in one of the most important business decisions they will make in their life. y our members.

What Can You Afford?

Before you start looking for a management rights business, apart from lifestyle considerations, you will need to make a few financial decisions:

- How much do I want to pay?
- What sort of income do I want?
- Where do I want to be financially in three to five years time?

What can I afford?

How much work do I want to do?

You can obtain bank finance from 65% to 75% of the value of the management rights business. Therefore you will need a deposit of 25% to 35% plus costs.

Purchase costs will come to at least 6% (in Queensland) of the total purchase price. The majority of this in state government stamp duty.

How much should you borrow?

Are you comfortable in borrowing a large amount to purchase a business?

The following examples are for a purchaser with $400K cash available.

- Example 1: no borrowings,
- example 2: 70% bank loan,
- example 3: combination debt and equity finance.

You can see in these two examples that by borrowing money you can substantially increase your net income.

Other advantages derived from increasing your buying capacity are:

- Better managers unit may be obtained
- Better or more desirable location sought
- Better choice re: type of management rights
- Better lifestyle through increased cash flow.

Can I go bigger still?

The short answer is yes, private investor funds are available to further increase purchasing power.

You can see a large increase in the net return for the same $400K input from example one to two and two to three. What is not evident in these figures is a better chance of a larger capital gain as the size and quality of the management rights business increases.

Do I want to run the business?

What has become popular is buying a management rights business (or portion of one) for investment. Either you buy the business outright and employ a manager or go into partnership with a managing partner.

This has been an excellent investment for individuals & private super funds. The management rights has to be reasonable size so to fir passive investors to make a decent return.

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An area on concern that needs to be brought to any purchaser's attention is payment for referrals. A minority of agents involved in this industry will refer a purchaser to a bank, finance broker or other professional based on the kick back received for the introduction.

The professional agents will make a recommendation based on the expertise and professionalism of the referred party.

To protect yourself make sure a payment is not being received by the agent for the referral.

Would you be comfortable with dealing with a professional adviser who has to pay a third party for the introduction. What counts are referrals based on proven track record and sound advice.

The current market is good for buying but not so good for borrowing due to the current interest rate level. The buildings I am personally involved in keep showing increasing returns. Interest rates will come down (eventually) but the supply of quality management rights reduces with increasing numbers of large players in the industry so my advice is if your keen on entering the industry…… don't hesitate. m

Example one (no borrowings):

Purchase unit	$250,000
Purchase M/R	$130,000
Costs	$ 20,000

Total cost	$400,000
Income	$40,000
Repays	nil

Net	**$40,000**

Example two (borrowing 70%):

Purchase unit	$400,000
Purchase M/R	$700,000
Costs	$70,000

Total cost	$1,170,000
Cash available	$400,000

Loan required	$770,000
Income	$140,000
Repays	75,000

Net	**$65,000**

Example three (borrowing 70% & bringing in an equity partner):

Purchase unit	$600,000
Purchase M/R	$3,800,000
Costs	$260,000

Total cost	$4,660,000
Cash available	$ 400,000
Bank loan	$3,060,000

Private investor	$1,200,000
Income	$630,000
Bank repays	$275,000
Investor payment	$200,000

Net	**$155,000***

** Calculation based on a management fee of $80K plus 25% of profits.*

Using MR Experts is Essential

The management rights industry has grown a great deal in popularity over the last few years. If you intend to purchase a management rights business, you need to be aware of a variety of aspects in order to give yourself the best chance to succeed. We have compiled some tips to consider when contemplating entering the management rights industry. The list is by no means exhaustive but will give you some understanding of what can sometimes be a complex process.

Surround yourself with professional people: In order to succeed and achieve the best possible outcome, it is important to be surrounded with people who can provide accurate advice specifically tailored to your situation. Make sure that you deal only with professionals who specialise in management rights. This includes financiers, solicitors, agents and, of course, accountants.

Know your buying capacity: When establishing your buying capacity it is important to deal only with financiers who know and understand the management rights industry. Your financier should also have a good rapport with your accountant and be able to structure your loan in the most cost and tax effective way.

After ascertaining your buying capacity, you can start looking for properties in your price range.

Gain an understanding of the businesses for sale: You should always remember that there are no 'dumb' questions when seeking to purchase a management rights business. The more questions you ask, the better understanding you have of the business that is for sale.

Consider the type of management rights business that will best suit your purposes. Choices include permanent, holiday letting or mixed letting. In holiday letting the returns are often more rewarding but the final decision comes down to personal preference and choice of lifestyle as to which one you prefer.

When inspecting a prospective purchase you should have a good look around the building including common areas and the units available for letting. Request to see a variety of units available for letting. This may avoid you being shown only the best apartments which might leave you with the impression that all apartments are in a comparable condition when in reality it could be otherwise.

Understand the factors affecting of the business: You should inspect a number of businesses available for sale to enable you to be conscious of factors affecting value. The multiple varies for a number of reasons, but some issues you should consider are:

- Location and quality of the building
- Future growth prospects
- Nature and length of management and letting agreements
- Is the office and storage area on title, do you have exclusive use of these areas or are they located on the common property
- Body corporate history and salary
- Any additional labour requirements

Obtain accountant verified figures: It is imperative that you use an experienced accountant to verify the net profit. This will ensure that figures presented by the vendor are correct. The net profit is calculated by deducting operating expenses from the gross income of the management rights business for the relevant period. The net profit excludes depreciation, borrowing costs, interest on borrowings and any labour related work that would normally be performed by a two person management team.

It is also essential that your accountant will assess the future maintainability of the business profit and discloses all factors affecting it. As you intend to make a significant investment, ensure that you protect yourself against misrepresentation by using only a specialised management rights accountant.

Set up your business structure correctly: Make sure you obtain advice from your accountant on setting up the appropriate structure in which to purchase the business before the management contract is signed. This initial action could save you considerable money in the future especially when claiming capital gains tax concession.

You can operate as sole trader, in partnership, as a company or form a trust (discretionary or unit trust). The choice of an appropriate structure will depend on individual circumstances but some factors to consider are capital gains tax, flexibility in income splitting and asset protection. These are all vital issues so make sure that you seek your accountant's advice before signing the contract.

Understand the requirements to manage and maintain the complex: You should obtain a clear understanding of any additional labour requirements that managers use for reception, garden and cleaning duties. The standard condition of sale contract generally defines net profit on the basis that a two-person management team could have undertaken the work. You should make sure that you have a clear understanding of this concept and obtain an independent opinion if necessary.

Get ready for change over: Once the contract is unconditional you should prepare yourself for the change over. Make sure that you have initial training and ongoing support in place for your trust and general account book-keeping. Your accountant can assist you with the lodgment of statutory registrations and provide you with a clear understanding of your auditing requirements.

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Archer Gowland P/L

Your accountant can also offer you ongoing support in the areas of systems and processes, budgeting and measurement to actual, together with understanding your business and adding to its bottom line.

Initial training by existing managers: The contract will generally provide a training period both before and after settlement. Make sure you use this time to obtain further information of the business and to observe the manner in which the business is conducted by the existing managers.

Start developing great relationships with unit owners and body corporate. Remember that great service and good communication is one of the key aspects to a successful business.

It can be a challenging and interesting journey to purchase management rights. By dealing only with industry specialists, you will ensure that your entry into the management rights industry goes as smoothly as possible. m