Asset 360 Report

Where we take Clubs, NFP's and broad portfolio investors behind the property market

Developing Surplus Land:

Navigating the risks and opportunities for organisational asset holders

February, 2019

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Executive Summary

The Asset 360 Report takes Clubs, Not for Profits (NFP's and broad portfolio investors behind the property market.

The February Edition, unpacks "Developing surplus land: Navigating the risks and opportunities for organisational asset holders."

Anna Porter of Suburbanite Asset Advisory explores alternate land uses for clubs developing surplus land, DIY developments versus partnering with a seasoned developer and what many developers miss in their feasibilities.

Porter is joined by Richard Batten from Campbell Advisory to unpack development finance and John Fallon from Warren Saunders Insurance Brokers to explore building and insurance.

Alternate land uses for clubs developing surplus land

Hits and Misses

When clubs and pubs have surplus land that is not generating revenue or adding to the operations of the organisation, it makes sense to look at alternate uses that will diversify revenue and compliment the operational activities of the club or pub.

We turned to Anna Porter of Suburbanite Asset Advisory to provide some hits and misses that are solid examples of what works and what doesn't, and most importantly - why!

"Some of the misses we have seen usually come back to the club or organisation not understanding or knowing their market well enough," says Mrs Porter. "When a club embarks on a development they often skip over the market research stage, or use a local real estate agent who is a friend of a board member. This is just not a robust enough process and can lead to a huge failure in how the end product performs and if it even reaches any of the goals it was set out to achieve," "All too often we see local community based organisations using one of the big tier development firms to provide advice on the project, and in many cases the market research component is self-serving to that development firm so they can land the construction job as that is their profit centre. They provide a few flashy reports on the market outlook to convince the board it is a good option, and then forge ahead with a project that just isn't the right fit for the club, the market or the community in the area. This leads to huge problems at the other end of the project," says Porter.

Some of the more well-known misses in this sector is the Sharkies unit development at Woolooware in Sydney's Sutherland Shire.

It is reported to be a $752Million development, comprising of 880 units plus retail shops, medical centre and a hotel in the last stage of this four-stage development being built by Capital Bluestone. The development has been plagued with negative media, ongoing tussles with council, poor community sentiment and financial woes for the club.

"According to the records on corelogic, there have been just 429 settled sales in the development as at Feb 2019, which reflects just under 50% of the development selling since 2012. This doesn't account for any exchanged sales yet to settle, but with finance getting tighter there is likely to be a downturn in those, as well as an inability for many purchasers to settle," continues Anna.

"The negative media surrounding this development, coupled with the arguably poor sales rates has seen the Leagues Club coming out of step with the local communities over the handling of the project. In my opinion, this is certainly seen as a miss for what could have been achieved with the right planning and development execution", says Mrs Porter.

"The other *miss* we see all too often is clubs planning to develop child care centres on their surplus land. Clubs need to consider not only the profitability of such a development, but also the purpose. How does it fit with their organisational identity, operationally and their reputation within the community. Putting children close to gambling and alcohol usually leads to community uproar and bad press for the club. Profit V's purpose can be a hard decision for the board to make and agree upon at the early stages of a development or project, but it is a critical one." Says Mrs Porter.

"It's not just the purpose and community fit that makes this type of development a *miss*, a national report by Community Early Learning Australia, (CELA) recently surveyed 463 providers across the country and found two of every three services reported more vacancies since 2015, and many services had reduced waiting lists or no waiting lists for new applications. This is stark contrast to reports of extensive waiting lists in 2015. Some facilities were even found to be offering incentives to entice new parents with $50 gift vouchers and the like," “This is a direct result of oversupply of child care facilities throughout Sydney, resulting in a downturn in revenue while expenses like insurance costs and staffing costs are increasing in the sector. This is not a venture you want to be embarking on in 2019,” warns Mrs Porter.

“The hits are often found in the retirement living sector. There have been a number of clubs looking to push into this sector and in the right market it can be a profitable move. Our research shows that many retirement living communities have waiting lists of 200-400 people ready to purchase into them as soon as something becomes available,”

“This is a stark contrast to the residential unit sector that is struggling to sell the end product in the current climate. This heightened demand for this specific product is directly linked to the large baby boomer demographic making up 20% of the overall population in Australia looking for suitable housing options that suit their lifestyle needs and a lack of that product. It does however have to be done the right way to attract this level of interest,” says Porter

Wollongong Golf Club were well ahead of the market when they pushed into aged care about a decade ago, they first identified the land surplus to their needs and, with their valuable location on the beach front decided to develop a retirement living and aged care facility, plus serviced holiday units as part of their group.

They initially engaged Wideform Constructions to execute the build but Wideform fell in to administration shortly after they began the project. This was unfortunate for the club but they solved the problem by partnering with Illawarra retirement trust (IRT) in a JV to complete the project and manage the operation thereafter. This was a clever move by the CEO as IRT had a stellar reputation in the area for aged care, and they also brought the knowledge and resources to manage the facility from an operational perspective into the future.

Although they had some executional risk, a common problem we see is that many clubs underestimate the risk and challenges when selecting or partnering with a builder/developer. In this case, the Golf Club overcame these issues and now have a highly sought-after facility that complements their core business operation and creates diverse revenue to the organisation.

"The structuring of these types of facilities can be done in a way that generates ongoing revenue and retains ownership through clever leasehold structures," says Anna Porter of Suburbanite Asset Advisory.

360 Degrees on the assets in a nutshell – Anna Porter, Suburbanite Asset Advisory:

1. Do thorough market research and analysis before you start the project, don't use a company that will offer self-serving reports to win the construction contract
2. Understand your profit V's purpose position & set up that framework
3. Joint Ventures (JV's) come with their own set of risks. Developer V's industry specialist will result in very different outcomes. Ensure there is an alignment of core values
4. Manage execution risk by selecting the right builder or developer with robust due diligence and no vested interest in winning other contracts for the build based on their advice

DIY developments V's partnering with a seasoned developer

What NFP's need to know

When a Not for Profit (NFP) looks to embark on a development or a major property project they often realise very quickly that they don't have the expertise to execute it themselves. NFP boards are typically made up of people who have extensive backgrounds in community focuses organisations, mental health, disability and the like; but property development – well, that is a rarity.

So, they often try to solve the problem by doing a JV with a developer as they will know the building side of things. But this comes with its own set of risks. We turned to Anna Porter, of Suburbanite Asset Advisory, for her thoughts on this approach or if it is a disaster waiting to happen.

"Developers and NFP's are usually so far apart in value alignment that they cannot effectively work together," says Mrs Porter.

> *"When you think about NFP's they are very purpose driven in everything they do, whereas developers are profit driven and all decisions are made with that at the forefront," says Mrs Porter.*

"Now that is not to say that NFP's don't need to make their property assets and project profitable, however usually they don't need (or want) to do it at the detriment of their community facing goals, whereas developers don't necessarily share the same concerns. So, it is fundamentally a relationship that has a lot of execution risk for the NFP," says Anna Porter.

"There are many other JV's that can be done that will have a much better outcome for a NFP. We have seen disability groups partner with aged care providers; show grounds partner with local businesses in the entertainment/hospitality sectors; clubs partner with serviced apartment operators and so on. These are a much better alignment for a number of reasons, even just by bringing the operational experience the NFP usually needs beyond the build phase. Then they simply go to tender and engage a quality builder for the construction phase," says Porter.

"With the right advice from the outset, finding a suitable JV partner and a builder can be a smooth process. It comes down to finding a good advisor with a lot of property experience to partner with as your strategic adviser, one that doesn't have a vested interest in winning other contracts for the build based on their advice. They need to be independent of the rest of the process," concludes Anna Porter of Suburbanite Asset Advisory.

360 Degrees on the assets in a nutshell – Anna Porter, Suburbanite Asset Advisory:

1. Consider the value alignment with any Joint Venture (JV)
2. Understand that developers are profit driven and not purpose driven
3. Acknowledge if your board doesn't have the expertise to execute a development or project and bring in the right help and partners
4. Consider who has suitable operational expertise when selecting a JV partner

Not for Profit Organisations: Fast Facts

Australian Charities Report 2014

- NFP sector employed more than 1 million Australians
- The NFP sector reported income totalling $103 billion in 2013-14
- Religious organisations accounted for 29% of all not-for-profit organisations

Knowing your numbers

What many developers miss in their feasibilities

When a more sophisticated asset holder decides to delve into a smaller or even larger development for the first time they often miss some important numbers, that can make or break the development. We asked Anna Porter of Suburbanite Asset Advisory to delve deeper into this topic for us.

> *"A feasibility study is a critical exercise to undertake, but without the correct inputs you just won't get the right output," says Anna Porter*

Anna shared her list with us of some of the critical numbers that first-time developers miss or miscalculate;

- **GST** – many people don't even realise that GST applies to a new development as they have created a new product in the market. Getting this wrong can make a project go from profitable to in the red by hundreds of thousands of dollars.

- **Underestimate interest on lending**- many first-time developers calculate the interest costs on a residential mortgage rate, but then find out that development finance is nearly always calculated at a higher percentage, often 2 or 3 percent higher, with many other complications in this type of lending.

- **Underestimate the costs to DA stage** – more often than not this is grossly underestimated by a significant amount. To give some context to this, it can cost as much as $100,000 to get a 2 or 3 lot site to Development Application (DA) and Construction Certificate (CC), and $500,000-$800,000 to get a large site to DA and CC.

- **Inadequate contingency** – more often than not, things don't go to plan with a development or major renovation project and we rarely see a suitable contingency being allowed for in a feasibility. We recommend at least 5% as a minimum, or even 10% of the build costs on a more complex project.

- **Realistic time frames** – many development analysis we review neglect to incorporate realistic time frames. It will take longer to build than expected and not all sales will occur in the first few months either. Allow manageable time frames and associated costs for these to avoid a financial fall out.

- **Over estimating sale prices & missing the market** – This is the most common error we see with developers. From first timers to experienced players. So often developers miss the mark on what their market wants to buy and they build a product that doesn't perform or get accepted by buyers, resulting in price declines to achieve a sale. Or they get a local agent to provide the advice on end selling costs and they are grossly over estimated. The agent is not the right person to be asking about end selling prices for a feasibility as their advice will be based on them trying to win the listing so they will be optimistic and not conservative. This is the key element that we see turning a feasible development into a financial disaster time and time again. We strongly recommend getting an independent valuer to offer this advice instead of an agent.

360 Degrees on the assets in a nutshell – Anna Porter, Suburbanite Asset Advisory:

1. Know your numbers
2. If you aren't experienced at doing a feasibility study, engage a professional to do it for you
3. Consult your accountant on GST and capital gains taxes
4. Don't over estimate your gross realisation, get a professional to help on this who isn't too close to the project or trying to win a listing

Building & Insurance - when to speak to your insurer and why

Imagine kicking off a project for your club or organisation after months of research and analysis, meeting with consultants, back and forth with council and finally getting the building started to have your builder walk away and take the insurance cover with him. This happens all too often. You may think you have all the right cover, but complex clauses in the building contracts may negate all of this. We asked an insurance expert for their advice on this.

Builders can leave a project for a range of reasons, but you need to make sure the insurance is structured in a way that protects the organisation in this event.

> "With the right advice, you could avoid the hassle," says John Fallon of Warren Sanders Insurance Brokers.

John Fallon, General Insurance Director at Warren Saunders Insurance Brokers (WSIB) warns when it comes to the party insuring a development during construction, the construction contract is King.

"Australian Standard Building Contracts allow for various options which place the responsibility on either the builder *or* the developer to insure during construction," says Mr Fallon.

"It must never be assumed the builder is responsible."

Indemnity clauses within the building contract may negate the insurance you have in place.

"Most insurance policies have standard clauses that exclude liability purely derived out of contracts, whilst many building contracts attempt to make the other parties liable when they are not necessarily negligent," warns Fallon. Developers are urged to never assume that you are covered just because you have a policy, as the old saying goes the "devil is in the detail".

"Based on the above, it is good practice to refer any contract to your insurance broker for advice on the Insurance & Indemnity clauses within the contract," continues Fallon. "They can also advise on how these clauses will affect any insurance you have in place," he says.

"A good broker should be able to advise on who is responsible to insure the construction, which clauses will affect your coverage so that you can attempt to have them struck out or potentially arrange for your insurance to be altered so these clauses are accepted," advises Fallon.

Developers should always consider insuring the construction as a *'Principal controlled contract'* to avoid any nasty hassles down the track.

"This allows the principal to control the insurances and also provides the ability for the principal to remove a non-performing builder mid-term without affecting the insurance," says Mr Fallon.

"If the builder controls the insurance then the insurance leaves when they do,"

"This leaves the developer uninsured and in the difficult position of trying to obtain insurance on a semi-completed structure with unknown defects," foresees Mr Fallon.

Insurance Insights in a nutshell - John Fallon, Director, Warren Sanders Insurance Brokers:

1. Don’t assume the builder is responsible for insurance
2. Don’t assume that you are covered just because you have a policy
   …think details
3. Refer any contract to your insurance broker for advice on the Insurance & Indemnity clauses within the contract
   before signing it off
4. Insure the construction as a ‘Principal controlled contract”

Development finance: to leverage or not to leverage, and what the lenders will be looking for

From a finance perspective, the current environment has thrown up 3 hot points that need to be clearly dealt with when looking for Development Funding. We turned to Richard Batten from Campbell Advisory to lift the curtain and discover the finance facts Clubs, NFP's and Organisation Asset Holders need to know before they build or develop.

The first insight Richard Batten offered us is to have the end in sight from the outset.

> "1. **Exit Strategy** - When applying for Development Finance the key is to have a clear Exit Strategy…. with the major Banks this is all about Pre-sales, the quality (5% v 10% Deposit) the mix (resident V overseas) and the terms." Says Richard.

The second insight identified by the team at Campbell Advisory, was how the lenders view a major project on the track record of the facility/organisation. This one can certainly be tricky as many Clubs or NFP's may not have taken on many major projects in their recent past as they are not developers by nature. So, positioning this appropriately is the job of a good finance partner.

2. **Demonstrated Track Record** – "Have you done this before – same size, type and market – and delivered on time and budget? If you are holding a prime site but do not have the track record to maximize its development potential a JV partner who has is likely the best option," continues Mr Batten.

The third insight Richard brought to the table is gearing. "Many organisational investors will have some decisions to make around gearing and how much exposure to lending the board is comfortable with, as compared to investing their surplus cash and the risk and lost opportunity cost of that decision," he said.

3. **Gearing** – "This includes what equity you have, or propose to have if rolling from an existing development– in the current market, valuations are not showing uplifts in 'on completion valuations' and as a result Lenders valuations are lower, which is pushing down the acceptable gearing," says Mr Batten

Mr Richard Batten continues, "the traditional banks are very conservative in their Due Diligence Requirements, LVR and geography restrictions– and there are a number of funds looking to support development funding – but at a price. The question then becomes 'do you have the margin in the development to support the higher costs of Finance?' – particularly if the time from any or all of the stages, purchase to construction to completion to settlement blow out?"

"For those sitting on land, the painful question is whether to develop with an optimistic approach, hold for better conditions or sell? This is where a trusted adviser can assist," finishes Mr Batten.

Anna Porter from Suburbanite also added that in her experience "boards of Clubs or NFP's are open to taking on debt so long as there is a clear strategy to retire the debt in a reasonable timeframe. Any significant debt held for long periods of time without an exit strategy exposes the organisation to risk and many boards just won't take that on. Echoing Richard, an exit strategy for the lender as well as the board is paramount," says Anna Porter of Suburbanite Asset Advisory.

Finance Facts in a nutshell – Richard Batten, Campbell Advisory:

1. Know your end game from the outset and work with your finance advisor to craft a suitable exit strategy
2. Consider JV's if you don't have a track record of development
3. Get the gearing right and be aware that the lenders will have restrictions on this based on a number of assessments, not just a blanket policy
4. Finance structures are getting tougher for more complex builds/development so partnering with the right finance advisor is more critical than ever so it can be positioned with the lender the right way from the outset

Suburbanite - Anna Porter

Anna Porter (Grad Dip UEM, CPV AAPI) is the principal of Suburbanite and a qualified property valuer. Dynamic, knowledgeable and ethical are three words that are often used to describe Anna.

She leads a team of highly skilled consultants to ensure her clients achieve their investment goals and avoid costly mistakes along the way.

Anna's is often sought after by media for her expert commentary and has featured in Australian Property Investor Magazine, ABC National Radio, 2UE Radio, Channel Nine's The Mornings Show, Studio 10, Sky News Real Estate, Fairfax Newspapers and many more media platforms.

Anna also has her own segment on Australia's new TV channel 'Your Money' on free-to-air channel 95.

She has shared the stage with Mark Bouris and Andrew Morello as the property expert on the 2016 and 2017 Prosperity Through Property Australian Tour. She also runs education programs for companies like Caltex, Optus, Flight Centre and Cricket NSW to name a few.

As an accomplished valuer for 10+ years, Anna worked on many institutional portfolios with thousands of assets across various property sectors. She also taught Property at Sydney Institute and was involved in helping them develop their new Degree Course in Property Valuation.

She still works with organisations and NFP's to develop their property strategies and ensure that their current assets are aligned with the outcomes of the business. But also enjoys working one on one with 'Mum and Dad' investors and first- time investors to help them start their investment journey the right way.

WARREN SAUNDERS INSURANCE BROKERS - John Fallon

Across my over 30 years in the insurance industry I have always been passionate about dealing with & solving the problems of real people and organisations. The drive for me is getting to know the individual needs of my clients and then working together to ensure they get the correct insurance protection and the service they deserve. As a broker, I get to do that every day.

At Warren Saunders Insurance Brokers, we deal with a large variety of SME clients with a specialist focus on the Aged Care, Retirement Village, Licensed Club, hospitality & construction industries.

Our purpose is to provide our clients with peace of mind by providing best in class insurance and service by utilising the skills of our Professional advisors.

CAMPBELL ADVISORY - Richard Batten

Richard has over 20 years' experience in commercial and corporate banking. During this time Richard has delivered successful outcomes through the business cycle from loan origination and management to work-out and recovery.

It is from this end to end experience across the hospitality, wholesale, finance and property sectors that Richard brings a unique skill set in understanding the financial, commercial and legal drivers in developing financing structures and assessing banking proposals.

Prior to joining Campbell Advisory, Richard worked across the relationship, credit and work-out teams at Westpac, Bank of Scotland and Lloyds Banking Group.