

# Special Report

## Site Acquisition for Developers

Selecting the right site for development is a fundamental requirement for a successful development.

However, once you have identified the right site, there are a number of key issues that you should address to ensure that you maximize your chances of success and minimize your overall costs.

The suggestions that follow are based on our years of experience acting for property developers in Victoria.

### 1. Due Diligence Special Conditions

With an increasingly complex planning environment, the suitability of a site for development or what you might be able to build on a site is not always clear. At the same time you may be reluctant to expend resources on a detailed investigation into the site unless you are sure that you will be able to acquire the site.

In a perfect world, you might prefer a 12 month option over the site to allow you time to obtain a planning permit. However, the vendor may be reluctant to agree to such a long period before they have certainty as to whether you are proceeding with the transaction.

The answer is a due diligence special condition. Such conditions have been common in large commercial transactions for a long time. They are becoming increasingly common in smaller scale and residential development sites.

A 30-60 day due diligence period is often sufficient to allow you to undertake a more extensive investigation into the property. This allows time for soil and other tests, preliminary plans to be drawn, a rough budget to be calculated including estimated costs, sales values and profits and an initial meeting with the council planning department. It also allows you to get advice in relation to the costs of connecting utilities – particularly storm water and other drainage issues.

As the developer, you would commit to expending the funds required knowing that if the project passes your due diligence investigation you can advise the vendor and proceed with the transaction. If the project doesn't satisfy your criteria then you can terminate the contract and lose only the funds and time committed to the due diligence process.

To ensure that you maximise the benefit of your due diligence period, you will need access to the property (for survey and soil tests for example), authority to seek copies of documents and the authority to make applications to council. The special condition should also include a clear mechanism for termination and you need to be aware of the deadline and what you need to do to terminate the contract if required. For larger projects, you might want the right to erect a sale sign or possibly a display suite?

I suggest that a special condition along the following lines provides a reasonable starting point:

1. Due Diligence Condition
  - a. This contract is subject to a xx day due diligence period in favour of the Purchaser.
  - b. The Vendor will, on signing this Contract, provide to the Purchaser with copies of any plans, working drawings, permit applications and like documents prepared in respect of the Property in the possession or control of the Vendor.
  - c. The Vendor will allow the Purchaser (and the Purchaser's contractors) access to the Property, promptly provide copies of such documents and information as the Purchaser may reasonably require from time to time and promptly authorise such enquiries and applications (at the cost of the Purchaser) as the Purchaser may reasonably require.
  - d. Should the results of the due diligence be unacceptable to the Purchaser (in the Purchaser's absolute discretion) then the Purchaser shall be entitled, by written notice to the Vendor or the Vendor's agent within 21 days of the Date of Sale, to terminate this Contract and any deposit paid by the Purchaser shall be forthwith refunded to the Purchaser.

As always, a vendor is likely to prefer an unconditional contract. You therefore need to try to minimise the period of the due diligence period to the period that you reasonably need. In a worst case scenario, you can always ask to extend the due diligence period if necessary.

## **2. Commencing before Settlement**

A key requirement for maximising development profit is to reduce holding costs by completing the project as quickly and efficiently as possible.

One way to do this is to start the process prior to your settling the purchase of the site. Ideally you will be able to negotiate a 12 month settlement term which will allow plenty of time to prepare plans, obtain a planning permit and potentially even sign up off the plan sales. However, even if you only have a conventional 90 day settlement period there is still value in commencing the process prior to settlement.

This should be a key term of your offer to purchase the site. Even if the property is being sold at auction you should be able to seek the selling agent's agreement (recorded in writing

naturally – an email would be fine) that you will be bidding on the basis that you will have the ability to access the site and make applications prior to settlement.

Such a clause should present no serious inconvenience to the vendor. If the property is tenanted you may need to agree to only access the property with prior notice or by appointment – and in any case you might agree to minimise any inconvenience to the occupants.

You should try to ensure that such a special condition is included in the contract of sale before you sign it. Estate agents, trying to secure the sale, are much more likely to agree. If you attempt to secure this consent after settlement you are likely to have to work through the vendor's lawyer (lawyers are conservative and risk averse by nature) and there really is little incentive for the vendor to agree after the contract has been signed.

A sample special condition might read:

- “1. The Vendor will allow the Purchaser (and the Purchaser's contractors) access to the Property, promptly provide copies of such documents and information as the Purchaser may reasonably require from time to time and promptly authorise such enquiries and applications (at the cost of the Purchaser) as the Purchaser may reasonably require. “

Please take care that any nomination is completed before you start preparing a plan of subdivision or apply for a permit of any kind. If a nomination is effected afterwards you may face double stamp duty.

### **3. GST and the Margin Scheme;**

The sale of the developed property is likely to attract GST.

In simple terms, if the developer is operating a business then the developer should be registered for GST. Whilst the sale of existing residential property is input taxed, the sale of a new or substantially renovated residential property will attract GST. That is to say, the purchaser will be required to pay GST in addition to the contracted sale price. This can be a substantial additional cost for a purchaser of a residential property (who can't claim a credit for the GST paid) which is likely to reduce the price the purchaser is prepared to pay accordingly.

In response to this, it is common for developers to adopt the 'margin scheme'. The margin scheme means that the contract price does not need to have GST added to it – but that the developer will have to pay GST on their 'margin'. The margin is the difference between the sale price of the lot and the cost to the developer of acquiring the land. The developer will

also be able to claim input credits for GST paid by the developer in developing the lots, to offset the GST they have to pay.

The developer can apply the margin scheme when the development is sold where:

- The developer acquired the property before 1 July, 2000 (the introduction of GST); or
- If the property was acquired after 1 July, 2000 where the property was acquired:
  - From a vendor was not registered for GST or required to be registered;
  - As existing residential premises (ie not subject to GST);
  - From a vendor as a going concern or GST free farmland; or
  - From a vendor that applied the margin scheme to the sale.

There are a number of issues that commonly cause confusion:

- As a developer, you don't need to specify in your purchase contract that you intend to apply the margin scheme when you sell.
- If you pay 10% GST on your purchase you will not be able to apply the margin scheme when you sell.

Please note that the above is a short summary of some very complex provisions. You should seek advice from a professional that is familiar with your circumstances and objectives.

## **4. Financing the Acquisition of the Site**

You need to ensure that you have a good idea how you will fund the overall project before you settle the purchase of the site and before you apply for a planning permit or otherwise commence construction. Once you have settled, or even if you nominate after 'land development' (including permits) has commenced you may face liability for additional stamp duty on the transaction.

First mortgage finance or bank finance is typically the cheapest source of finance (unless you have sufficient funds of your own and ignore the cost of these funds).

Some considerations to bear in mind in applying for acquisition and / or construction finance from mainstream lenders:

- It will be easier to get acquisition finance for an investment property. That is a property that generates some income as opposed to vacant land;
- You should ensure that your financial statements and tax returns are up to date and ready to provide to a lender in support of your loan application;
- The major banks will tend to exclude from your income development profits on past projects or any other income that the banks consider unsustainable. That is you will

need to be able to service your construction loan without relying on development profits;

- As a rough rule of thumb the major banks will lend you 80% of the cost of the project or 65% of the end value. Second tier lenders can be more flexible and may be prepared to lend against the value of the completed asset without the need for income, but are likely to charge a higher interest rate;
- The major banks appear reluctant to lend even relatively small amounts to complete a development once it has been commenced. The banks may consider that they have to do all the work and take on unknown risks for a very short term loan and that this doesn't generate a sufficient return for them. It is generally easier to apply for the loan before construction begins.

It is also important to purchase the property in the right entity or structure. Most novice developers select a purchase structure entity after considering that taxation implications of different structures. However, it is perhaps more important to select the right structure to optimise your ability to raise loan funds.

In consultation with your finance broker, consider what structure, what directors or other participants and what other factors will optimise your ability to raise acquisition and / or construction funding. An individual with a solid income is likely to be helpful if added as a director while another individual with a checkered credit history may detract from a finance application.

This should be done well prior to settling the purchase as transferring title after settlement is likely to be expensive and cause unnecessary delays.

## **5. Selling the Site with Plans and Permits**

Some investors seek to on-sell the site once they have prepared plans and obtained permits.

This may be the result of the investor being dissatisfied with the permit obtained, an inability to obtain construction finance or some circumstance having changed. On other occasions it may have been a deliberate strategy on the part of the investor to generate a profit from getting a permit and to on-sell the site allowing another party to develop the site.

In Victoria, the on sale of the property will attract a second round of stamp duty – one lot of duty on the purchase by the investor and a second lot of stamp duty on the purchase by the new purchaser – even if the investor doesn't settle their own purchase.

The use of a nomination clause in the purchase contract (before settlement) or even an option is unlikely to avoid double stamp duty where a permit has been obtained.

In some cases, the use of a joint venture agreement or the sale of the purchaser company may avoid double stamp duty. However, these strategies should be implemented carefully to ensure that they do not put the vendor off side.

If your intention is to sell the site with plans and permits then you should take care to ensure that your agreements with your surveyor / town planner / architect allow you to do this without infringing their copyright or other intellectual property rights. You may also wish to ensure that you have the right to obtain electronic or even editable copies of the plans and drawings?

If you do wish to have the flexibility to on-sell the site please contact us to discuss what strategy may suit your specific needs best.

## **Lewis O'Brien & Associates**

Most developers resort to lawyers when they need a contract, a certificate signed or face a claim. We believe that this is an outdated approach that means that developers miss out on much of the value that lawyers can add.

At Lewis O'Brien & Associates we strive, using a proactive approach, to find ways to reduce your costs, speed up your project and maximise your revenue – leading to faster, more profitable projects.

A simple example of this is our fixed price contract review service. Get us to review your contract before you sign it, answer your questions and provide suggested special conditions to tailor the contract to your needs.

You can learn more about us or book a contract review from our website:

[www.Lewisobrien.com.au](http://www.Lewisobrien.com.au)

## **Disclaimer**

The information in this report is only a summary of the relevant principles and issues as they apply in the State of Victoria. It contains general information only that does not take into account the specific needs, objectives or circumstances of any person. This report is not a substitute for appropriate professional advice. The sample special conditions should not be used without first being tailored to your specific needs, circumstances and context.

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