



PROPERTY DEVELOPMENT
WORKSHOPS

Module 4: Site acquisition

Part 2 – Advanced Site Negotiations

You may have heard the old adage ‘You make your profit when you do the deal’. Is it true? Well basically, yes, it is absolutely ‘on the money’, if you’ll excuse the pun. So what does it *really* mean?

In Module 2, Site Acquisition Part 1, we discussed sourcing development sites based on your predetermined criteria. If you follow the prescribed funnel approach to locate your ideal site, you will probably choose one that is not for sale and therefore not advertised on the open market. The owner of the site is not even thinking about selling, let alone aware you’re coming.

There are a number of reasons why this is the best way to acquire property. For one thing, there is no competition. Provided you have not posted it on Facebook or discussed it over a beer with your mates down at the pub, no one knows you’re trying to acquire the site. At this point I do not recommend discussing it with anyone. Confidentiality is key.

To be successful at negotiating the best deal, you have to come at it from a position of strength and not fear. How do you achieve this? One of the most important things to remember is to go into it with a win/win mindset, not negotiating a deal that benefits you but screws the other person. If you have done your homework properly, you will approach the landowner confident that you are going to leave them better off than they were.

If, for instance, the owner is an elderly person, ask to speak with their adult children or their accountant or solicitor. When seeking a deal with any owner, always recommend that they obtain independent advice, particularly if it involves an option.

Before you can make an offer on a property, however, you need to determine how much you are willing to pay. So how will you determine this if the property is not for sale? Do not check with the local real estate agent – they won’t know. You are not interested in paying market price; you will need to be able to pay well above market price. But how much above?

The range will be somewhere between market price and residual land value, and residual land value is determined by your own financial feasibility analysis. Establishing this price range is also useful, for example, if you find yourself in desperate (and insane) need to buy a property at auction. It will ensure that you do not get emotionally carried away and overbid for the property.



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As I write this, I am in the throes of negotiating a mixed-use site for which my corporate client has provided me with a pre-lease agreement. This is one way to operate from a position of strength. A pre-lease agreement creates massive notional value and will ensure you will be able to obtain funding. This gives you the confidence that, provided you obtain the property at the right price, you will make a super profit. About a week ago I delivered to the landowner a deed of option with terms and conditions, a contract of sale, a letter of offer to purchase for \$24 million, a time frame within which to respond and a bank cheque for \$50,000, representing the option fee. I am awaiting his response.

Do we have to be this clinical every time we negotiate a site? Perhaps not, but it pays always to be fully prepared.

Here's the negotiation process that I use to acquire property:

Do your financial feasibility

This document will be the basis for your decision-making process and everything you do in regard to your project, including applying for funding, budgeting, your baseline for cost management, pricing, discounting for pre-sales, the level of finishes, the overall quality of your project, your risk/reward assessment (hurdle rate) and of course what you are prepared to pay for the land.

Put yourself in the owners shoes

Ask yourself whether *you* would be prepared to accept the offer you are about to make.

Arrange a meeting with the owner

Treat this as a fact-finding mission. You are not going to make an offer at this first meeting. It is an opportunity to find out the needs of the owner. Are they looking to retire and move up the coast in the next year or two? Are they downsizing because all the kids have left home? Do they want a new, maintenance-free residence while remaining in the neighbourhood close to their long-term friends or family? Are they cash flow poor and asset rich? Are there any financial issues such as Capital Gains Tax liabilities? The answers to all these questions will shape the terms and conditions of your offer and help you to provide value to the landowner.

Arrange the next meeting

This is when you will deliver your offer in writing and allow a few days for review and consideration.

Follow up with meetings and negotiations

Achieve a heads of agreement (HOA) in which you and the landowner nut out, say, ten or so dot points that summarise the essence of your agreement.

Bear in mind that an HOA is not a legal document in itself

Although there have been cases where it has been fought over in court. It makes it much easier (and cheaper) to convey to your solicitor exactly what has been agreed when he or she draws up the legal documentation. My experience is that once landowners have signed an HOA, they are psychologically committed to the deal. Often they will seek legal advice at HOA stage, therefore making the subsequent legal documentation easier and cheaper. So what is it that we're negotiating exactly? In property development the goal in the first instance is not to own property, but rather to gain control of property while investing the least amount of money possible in order to minimise risks and holding costs. The best way to do that is by entering into an option agreement with the landowner. Here I want to focus on the call option, as opposed to the call and put option, which I do not recommend for novices – or indeed for anyone.

A Call Option gives you the exclusive right, but not the obligation, to buy a property. Basically it comprises :

- a. The purchase price
- b. The option fee
- c. The time period to exercise the option.

In addition to these fundamentals, negotiate the terms and conditions. Often these are at least as important as the three primary components mentioned above. I'll now explore the relationship between these components.

The purchase price

Be sure to do your homework before negotiating price with the owner. Remember that property owners these days are very sophisticated. They generally know (or think they know) what their property is worth, and if they're aware that the property is going to be redeveloped for medium-density housing, for example, they will expect the price to reflect that.

As I have already mentioned, you determine the residual land value of the property you want to purchase based on what you think you can achieve as the highest and best use for the land. This does not mean the bulkiest development, but rather the most profitable one that will be well received by the target market and all other stakeholders. Obtain a sales report for the area that you are looking to purchase in. RealEstate.com and RP Data, for example, offer good reports of all sales made during the previous twelve months categorised into Houses and Home Units by postcode. These reports are valuable because they provide two important pieces of information: the approximate value of the house you want to purchase and (if you study unit sales) the approximate end values of your project once completed.

This will help you determine the residual value of the site once you undertake the Feasibility. Remember, the price you agree to pay wants to be somewhere between the market value at the low end and the residual land value at the high end. Once you exceed the RLV, you will of course reduce your profits and increase your risks. Conversely, the closer you are to the market value, the more the profit margin shown in your Feasibility will increase.

Option Fee

Regardless of what you may have heard, there is no standard option fee. It may be as low as a token consideration of, say, \$1.00 to make the deed of option legal; in my past agreements I have found it somewhere between 0.5% and 0.75%. Generally, I would not pay more than that as an option fee and I would always make it part of the purchase price on settlement. It is better to have a low option fee as it reduces your risk considerably. For example, if your DA is refused, you are limiting your losses, even if it means paying slightly more for the site, as long as you can justify it through your Feasibility.

Once you have offered the landowner their dream price for their property, their priority is for you to honour the purchase and exercise the option. What I have found is that if I explain to the owner that I want to keep the option fee as low as possible and spend the money instead on making sure I get the DA so I can settle, they are amenable. I have their buy-in.

Option Period

When you're negotiating an option, bear in mind that the longer the option period, the more valuable it is for a number of reasons, including the fact that the risk is reduced. The DA can be obtained before the option period runs out, therefore making the site easier to sell. It also provides, if necessary, for the time required to take a matter through the Land and Environment Court (LEC) or its equivalent, depending on where you are.

If you are going to sell the option agreement, provided you have included this in your terms and conditions, the buyer will want to have the maximum period of time to maximise their ability to add value and increase notional equity without the burden of holding costs. In turn, your 'early harvest' – the fee you will take for putting the deal together – will be maximised. Note, by the way, that you need to include the fee you intend to claim in your Feasibility as part of the land acquisition costs, so the buyer of the option does not have to take this out of their profits.

All three items – purchase price, option fee and option period – should be negotiated simultaneously to give you the best overall agreement to suit the situation. So, for example, a longer option period may mean a slightly increased purchase price; a large option fee may mean a slightly reduced purchase price; and so on.

Terms and Conditions

The terms and conditions you negotiate will depend on the property you want to acquire and the unique set of circumstances that exist between you and the landowner. However, there are a number of Ts and Cs that must be included in any option agreement where you're intending to redevelop or you risk making the option worthless.

First, the parties to the option must be identified. Always include with your entity the words 'and/or its nominee'. This is critical if you intend to change the name of your entity to your development company, for instance, so you don't pay double stamp duty. More importantly, it allows you to sell the option to someone else. Ideally you will have been following the site to order strategy outlined in this Course, and you will have a buyer ready and waiting to buy the option from you even before the ink is dry.

Second, the owner must consent to allow you, and by default your nominee, to lodge a development application with the council. The terms must also provide that you and your consultants will have access to the property for the purposes of preparing the DA application. Once you have secured the site you can move on to the next step, which is obtaining approval to develop, thereby creating additional or notional equity. **You're on your way.**