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LAWYERS

BUYING OFF-THE-PLAN: TIPS FOR INVESTORS



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Introduction

In the last decade buying property off-the-plan has become exponentially more popular in many major Australian cities. As the eponym suggests, buying “off-the-plan” means entering into a contract to purchase a property on the basis of design drawings before it has been built. For the investor there are many reasons to consider buying off-the-plan including a lower entry price into the property market, taxation benefits and stamp duty savings as well as capital growth and a fruitful return.

The Benefits

A significant advantage to buying off-the-plan is the considerable saving you can make on stamp duty. In several Australian States stamp duty is assessed on the value of the property at the time the contract of sale is entered into. When buying off-the-plan stamp duty is assessed on the basis of the unimproved land where construction has not commenced.

As the property market continues to rise it is foreseeable that the value of your investment will increase between the period of signing the contract and taking possession. Buying off-the-plan may give you extra time to save money for future mortgage payments. It will also allow you time to sell your existing property and arrange finance. It may be possible to invest in off-the-plan property with as little as a 5% deposit or by bank guarantee.

Moreover, tax deductions may be available for investors via depreciation reducing your annual tax liability. Depreciation expenses may include the building, fittings and furniture. Ensure your contract contains a condition that the developer discloses the building costs to assist a depreciation claim. Specific advice should be sought.

The dearth of rental properties – and commensurate

increases in rents – has received substantial press exposure in the eastern states in recent months. Higher rentals may mean an investment which is ultimately positively geared.

The Risks

There are, however, a number of countervailing forces you should be aware of when considering to make an off-the-plan investment.

These include the possibilities that the market price will stagnate or fall between the time you sign the purchase agreement and take possession of the property. There are no guarantees that the purchase price will reflect the market value when the construction is complete.

Also, it can be difficult to visualise how your apartment or townhouse is going to look once it is complete as there is generally nothing a developer can show potential purchasers except a floor plan, artists conceptions and other promotional material. Some alteration during construction is likely.

If the subdivision has not been registered it will be unclear what are the proposed levies to owners. Any estimates will be just that and may increase substantially by the time the building is completed.

A practical risk is that purchasers may be tempted to buy beyond their means because of the small size of the deposit required to be paid, with the substantial balance not due for a number of years.

Tips for Investors

The following tips may assist you in deciding whether or not to purchase off-the-plan:-

- If possible, provide a deposit bond upon signing a purchase agreement rather than paying a deposit. If your deposit is released and the builder does not finish the project – for example, it may disappear or become insolvent – it will be difficult to trace back your deposit. If the developer is unwilling to accept a deposit bond try to negotiate a minimal deposit.

- Endeavour to get in early as the best lots such as penthouses and lots with private courtyards are invariably sold first. The earlier you are the wider the selection. Be aware, however, that prime lots often have higher lot liabilities which means your levies will be proportionally higher.

You may also be required to contribute to a sinking fund or maintenance fund for future repairs and maintenance required to the complex. This is seen as preferable to bodies corporate imposing large and sudden levies on lot owners when repairs or maintenance are required. Contributions are not refundable should the owner sell and move out even if the money has not yet been spent on the repair or maintenance works, though it is properly regarded as an asset of the building. A sinking fund is compulsory in New South Wales and a maintenance fund will be compulsory in Victoria after 31 December 2007¹.

- There may be lifestyle restrictions in the development of which you should be aware before entering into a purchase contract. These may include:-
 - (i) prohibition or restrictions on keeping animals
 - (ii) parking restrictions
 - (iii) noise and the behaviour of invitees
 - (iv) activities of children
 - (v) there may be a rule prohibiting washing being left to dry on balconies which would be visible from the street or adjoining buildings
 - (vi) changing the appearance of your lot
- You should insist on the inclusion of sunrise and sunset clauses in your contract. A sunrise clause requires the builder to commence work by a specified date or within a specified period. This will guard against commencement being delayed until, say, a certain percentage of pre-sales has been achieved. Equally, a sunset clause provides that the project will be completed by a specific date or within a specific period.

- Contracts will invariably allow the developer to vary the total unit area from the original floor plan. Whilst a nominal variance is acceptable the contract should contain a condition that the variance will not exceed a prescribed maximum.
- Always read the schedule of fittings and fixtures in detail to ensure that you are satisfied with the quality and type of fittings and fixtures. These include appliances, lighting, door furniture, floor coverings, paint and the like. The contract must exhaustively set out all such items.
- Only after construction is 100% complete and you are satisfied after a final inspection of the work that you should pay the balance of purchase price should you do so. If there are outstanding issues these should be communicated to the builder via your solicitor in order that the issues may be rectified prior to settlement. In my view, an independent building consultant should be engaged to conduct the inspection and certify that the work undertaken is satisfactory.
- Ascertain whether there is a penalty for withdrawing from the contract. Also, if construction finishes ahead of time ensure that your finance will be available.
- Check whether there is scope to customise your apartment design and whether you can change the fittings and fixtures. If so, inquire how the contract price will be affected.
- GST will be payable on the sale price and should be paid by the developer. Ensure that your contract contains a term to this effect or GST liability may be passed on to you.
- When purchasing you may not know what contractual arrangements have been made by the developer for management, caretaking and the like. Full inquiries should be made.
- Finally, previous examples of the builder's work should be inspected. Testimonials of people who have employed the builder and/or purchased from the developer should be sought.

¹ The Owners Corporation Act (Vic) 2006 comes into operation on 31 December 2007 unless proclaimed earlier

The Victorian Position

In June 2004 the Victorian Legislature passed the *Domestic Building Contracts (Amendment) Act 2004* to clarify the extent to which the *Domestic Building Contracts Act 1995* applies to the construction of homes that are sold off-the-plan.

In March 2004 the Victorian Civil and Administrative Tribunal held that a contract of sale which contemplated the construction of a penthouse apartment in a residential development in the Docklands constituted a domestic building contract and so came within the ambit of the *Domestic Building Contracts Act* ("DBC Act"). It followed from the Tribunal's decision that purchasers under off-the-plan contracts were able to avoid their contracts where the contracts offended the DBC Act². Within a matter of days the State Government published a press release advising of its intention to retrospectively amend the DBC Act as it was not intended to apply to off-the-plan contracts of sale. The hysteria the Philp decision generated in the development sector played no small part in effecting this legislative re-think.

Section 3 of the DBC Act provides as follows:-

A contract for the sale of land on which a home is being constructed or is to be constructed that provides or contemplates that the construction of the home will be completed before the completion of the contract is not...a domestic building contract within the meaning of the (DBC Act) if;

- (a) *the home is being constructed under a separate contract that is a major domestic building contract; or*
- (b) *the contract of sale provides that the home is to be constructed under a separate contract that is a major domestic building contract.*

Thus where developers engage or intend to engage a builder to construct the dwelling provided for in the contract of sale, the sale contract is not a "domestic building contract" as that term is meant and understood in the DBC Act. Accordingly, purchasers who enter into off-the-plan contracts do not benefit from the consumer protections set out in the DBC Act³ so far as the developer is concerned.

That is not to say that a purchaser will not have the ability to pursue the builder for defective workmanship and/or materials. Section 9 of the DBC Act provides that an owner can pursue the builder for faulty workmanship or materials as if the owner was a

party to the original building contract. Claims may be brought for up to 10 years from the date of the Occupancy Permit⁴.

In circumstances where the builder has died, disappeared or is insolvent a claim may be submitted to the builder's warranty insurer for up to two years for non-structural defects and six years for structural defects from the date of the Occupancy Permit⁵.

Conclusion

The location and aspect of many apartment buildings is congruous with the vibrant lifestyle enjoyed by many people. For reasons as diverse as proximity to your workplace, shopping facilities, cafés, theatres, beaches and parks more and more people are relocating into urban and inner suburban areas. Provided that you exercise some due diligence in selecting your apartment the prospects of procuring an investment as dynamic as your lifestyle are maximised.

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² Philp v Mirvac [2004] VCAT 367 (10 March 2004)

³ See, for example, Sections 8, 31-33

⁴ See Thurston v Campbell [2007] VCAT 340

⁵ s.135 Building Act (Vic) 1993; Domestic Building Insurance Ministerial Order No. 598, Friday 23 May 2003