Developers risk $100k loss on each apartment: report

Larry Schlesinger

As market conditions get tougher and tougher for high-rise developers, a new report warns they could lose more than $100,000 per apartment if a buyer defaults on their purchase.

The report, by buyer advocates Secret Agent, comes as Macquarie Bank tightened lending to high-rise apartment buyers across 120 postcodes and follows the major banks' pullback from lending to foreign buyers amid concerns of an over-supply of apartments in places such as the Melbourne CBD and Docklands.

Default rates remain relatively low, typically between 1 and 5 per cent per project, but could rise as a record number of new apartments settle over the next two years.

Using the hypothetical example of a Chinese buyer who defaults on their $714,000 off-the-plan purchase of a typical two-bedroom Melbourne CBD apartment, Secret Agent calculated the loss at over $100,000, once professional fees and commissions had been paid and after the 10 per cent deposit had been recouped.

The main reason for this loss is the lower price the developer would get in the secondary market where the apartment would have to be resold.

Secret Agent calculated that apartment values were 19 per cent lower in this market based on average sale over the past three months. "The development space in inner Melbourne and Sydney is set to be severely challenged," Secret Agent director Paul Osborne said.

"Conversations between Secret Agent and various developers over the past month have revealed their increasing anxiety about potential settlement issues.

"These developers, who have settlements due in the next 18 months, are worried that many of their apartments may not be able to settle due to the restrictions placed on foreign buyers by local banks.

"This is likely to have substantial implications."

Darkening the scenario further will be the new 7 per cent stamp duty levy imposed in Victoria on foreign buyers from July 1, adding tens of thousands of dollars to purchase prices.

But Andrew Leoncelli, head of residential projects at CBRE, called the modelling "doomsday at best".

"We have had practically no defaults from international buyers over the past 10 years.

"The international purchasers we deal with are very savvy and are targeting opportunities here for three key reasons: migration, capital preservation and education," Mr Leoncelli said.

"We would estimate that 90 per cent of the offshore buyers we deal with are well above middle-class and have significant means at their disposal."

Jamie Kay, a director at Melbourne-based project marketers Oliver Hume, said the industry needed to find ways to "reduce risk and reduce the scale of the peaks and troughs that we experience in a cyclical market".

"There should be the capacity to move deposits up and down in a wider band [above 10 per cent], as is already the case in Queensland," Mr Kay said.

Figures from market researchers CoreLogic show the number of new apartments due to settle over the next two years have hit record highs in Australia's capitals, raising the risk that some buyers will not make good on their purchases.

Risky deals

Typical loss on a two bedroom CBD apartment ($)

Contract price	714,000
Price per sq m	10,500
10% deposit paid	71,400
Current market rate per sq m	8,463
Market price	575,484
True price at settlement	-138,516
Recoup deposit	+71,400
Off the plan expenses	-21,420
Marketing fees/commissions	-11,510
Revised developer proceeds	613,954
Loss of profit	$100,046

SOURCE: SECRET AGENT

Vendors' get-out loophole in $2m withholding tax rule

Larry Schlesinger

Property developers who have bought sites using an option contract may be forced to walk away from these deals or pay more when new withholding tax rules kick in after July 1, a leading property lawyer says.

Andrew Kleiman, director at Sydney-based SME Property Lawyers, said both outcomes could arise under the new withholding tax regime, which requires buyers to withhold 10 per cent of the purchase price for property sales worth $2 million or more, unless the vendor obtains a clearance certificate from the Australian Tax Office proving they are not a foreign resident.

The new rules apply to all property with a market value (or agreed purchase price) of more than $2 million, including vacant land, buildings, residential and commercial property.

They have been enforced to ensure foreign residents meet their capital gains tax obligations.

Mr Kleiman told the *Australian Financial Review* there was an "element of retrospectivity" regarding the new tax rules in relation to option contracts, often used by property developers to grow their pipelines, obtain the necessary approvals, then pay for them at a later agreed date.

"The terms of option contracts are fixed and signed years ago, but are still caught by this change," he said.

"So, when the option is exercised, the purchaser may have a legal duty to withhold 10 per cent of the agreed purchase price and pay it to the ATO as required under tax law, but would then be in breach of the terms of the option contract."

The vendor could refuse to settle unless 100 per cent of the purchase price was paid, he said.

"This won't be an issue where the vendor wants the developer to complete the sale, but say the developer has spent $1 million getting development approval, causing the value of the property to rise," he said.

[It's] further bad news for foreign interest in Australian property.
Phil Leahy, Metro Property

"Perhaps the vendor will be motivated to terminate the contract and resell at a higher price to someone else or take advantage of the trap the developer is caught in to extract some leverage, that is, more cash from the developer," he said.

Metro Property Development head of sales and marketing Phil Leahy said the new tax regime was "further bad news for foreign interest in Australian property".

"When foreign purchasers .... sell their $2 million property in the future, 10 per cent will be withheld regardless of whether they make a capital gain or loss on the property," he said.