

# Management Rights

## Purchasing management rights

Management rights to strata title developments have the potential to provide a steady flow of income and are fast becoming a popular choice with people looking for an income stream and lifestyle opportunity. The purchase of management rights can cover:

- Caretaking agreement
- Letting agreement – either permanent or holiday
- Manager's unit, and
- Goodwill

The biggest challenge for operators, whether buying into a new (off the plan) complex or an established complex, is ensuring that not only are the unit owners happy and receiving a return on their own investment, but the operator too is achieving a return which relates well to the initial investment in management rights.

## The big picture - our service to you

Sound advice from the outset is critical to the return on your business investment and this is where working with a team of specialist advisors will help ensure you are maximising the potential.

As a Holmans client, you have complete access to the expertise we offer throughout the entire lifecycle of your investment:

- Due diligence
- Start-up advice
- Finance application
- Legal structure advice
- Business planning
- Management accounting
- Taxation planning
- Asset protection
- Business coaching
- Auditing services
- Valuation, and
- Ongoing wealth creation advice (through our authorised Professional Investment Services advisors)

## Types of management rights

There are 2 types of rights: permanent and holiday let. The first relates to permanent tenants of units. The role here is usually caretaker of the common property, such as pool, gardens, etc. The Body Corporate pays a salary for attending to these areas.

The chance of earning commission income with permanent management rights depends on the type of agreement. However, in most of these complexes rent is collected by other agents. Therefore, the income is less likely to fluctuate and any increase will often be related to increases in the Consumer Price Index.

Holiday let management rights usually contain both a caretaking agreement and a letting agreement. The caretaking agreement provides a salary, while the letting agreement allows for the conduct of a letting agent business.

Under the Body Corporate Community Management (BCCM) Act, a letting agent can charge an amount of up to 12% commission on the letting of a unit to holiday tenants on behalf of an owner. Depending on the agreement signed with the owner, the agent may also charge the owner for cleaning, PABX rental, security, advertising, linen hire etc. This income is in addition to the salary received as caretaker.

As the letting agent normally has exclusive access to the office within the complex, they also earn income from tours, car hire and telephone calls.

## Due diligence

When considering an investment in management rights, your first step will be to assess its viability, both as an income stream and investment potential. Holmans can provide you with a due diligence report to make sure you are paying what the business is worth, not necessarily what the current management rights owners are asking. The report will set out:

- Net operating profit
- Verification of the unit structure and inclusions
- Existing caretaking and letting agreements
- Revenue
- Expenditure; and
- Verification of records

## Valuing management rights

The valuation of management rights usually comprises 3 parts: the unit (valued by real estate agents), inventory (valued by the vendor) and goodwill (valued by an accountant). Your accountant will also advise on the total figure.

Goodwill is often calculated by multiplying the net operating profit to achieve the value of the goodwill. In general, this multiple will range between 3 and 5 although of course there have been exceptions.

The net operating profit comes from the difference between operating income and expenses. Typical income will include commission, body corporate salary, cleaning, hire, tours and PABX rentals. Typical expenses include laundry, cleaning materials, licences, credit card fees.

The valuation of management rights has resulted in many debates between accountants, real estate agents, vendors and purchasers. However, it's important to value the business on its future maintainable earnings.

## Securing finance

Financial institutions will generally consider the caretaking agreement and letting agreement as goodwill, and may lend up to 80% of the value of unit and 50% of the value of goodwill. Different financial institutions may have different criteria. Of course, the basic criteria of serviceability, character of borrower and security will apply.

As unit values increase and financial institutions change their lending policies, opportunities exist for refinancing of loans. However, care must be taken to ensure that early repayment penalties do not apply. **Holmans Lending offers a complete mortgage broking service** to assist you with your application and refinancing options.

## Legal structures

Once you've made the decision to purchase the management rights, you will need to consider:

- What is the best legal structure for your situation?
- Whose name should the manager's unit be in?
- Whose name should the business be in?
- What will be the stamp duty and Capital Gains Tax consequences?

The type of business structure you choose will depend upon a number of factors. Our tax structure specialists will be able to give you the latest information and help you set up a legal structure that best suits your individual needs.

## Keeping your records

An important aspect of any business is maintaining accurate records. You will need to operate 2 sets of books and bank accounts: trust account and a general account.

Whether you are using manual or computerised bookkeeping, it is essential to separate the various income and expense categories so that information is available for comparison and sale purposes. We are able to assist with recommending a software package to suit your needs.

## Auditing

A member of the Institute of Chartered Accountants (ICA) in Australia, or the Australian Society of Certified Practising Accountants (CPA) must audit your trust account each year.

The auditor will make 3 visits during the audit period: 2 unscheduled visits and 1 final scheduled visit. The audit report will be forwarded to the Registrar of the Office of Fair Trading. Holmans' accountants are members of both the ICA and CPA and can provide this auditing service for you.

## Working on your business

It's important that you look at your management rights as a business and investment opportunity, one that could provide you with a sound return on investment if managed well. Allocate time each week to work *on* instead of *in* your business.

Take the time to prepare management tools such as a business plan, budget and cashflow forecast and seek the advice of our specialist advisors to help ensure the success of your investment.

Once income becomes constant and efficiencies are made in relation to costs and occupancy increases, it's time to take action in respect to wealth creation and achieving financial goals.

Our financial services specialists will assist you in refining your goals and making sure you're on track.

*This information in this fact sheet is not intended to be a complete statement of fact or law relating to the issues raised. Items herein are general comments only and do not constitute or convey advice per se. Accordingly, no person should rely on this information without first obtaining specific advice from our office. Liability limited by a scheme approved under Professional Standards Legislation.*