# Lannock Strata Finance

## Best Practice in Strata –

## the dos and don’ts to getting the best out of your strata investment

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## Buying a strata unit for investment

People often make the mistake of thinking that the rules for buying for investment and buying to live in are different. With some small exceptions, owner-occupiers and investors are looking for the same things. However, buying a unit *is* different to buying a house and different rules do apply. See also Lannock's guide to buying a unit to live in.

| Do | Don't |
|---|---|
| 1. Focus on the most important things – ongoing rental returns and future capital gain<br>2. Consider whether your capital gains could be boosted by renovating or refurbishing:<br>a. Inside the unit (inside the front door) or<br>b. The common property (between the front gate and the front door)<br>3. Always get a pre-purchase strata inspection and check out the history and current status of the building<br>4. Be aware of future capital works that may be desirable on the common property<br>5. Assess guaranteed rental options very carefully | 1. Don't buy based on cheap levies – levies are there for a good reason, what you want is a property where levies are used well and for good purpose<br>2. If you are buying strictly for investment purposes, don't only look at properties that you would like to live in – buy the unit with the highest expected returns<br>3. Don't buy when you are on holiday (unless you had that intention before the holiday) – you are looking for solid returns, not a holiday lifestyle<br>4. Don't assume that future capital works are covered by a sinking fund<br>5. Don't assume that a sinking fund is the best means of funding future capital works (sinking funds are often the most expensive form of strata funding)<br>6. Don't forget lifestyle – although you won't be living in it, somebody else will. It's the way they feel when they walk through the gate and up to the front door that will determine how much they are prepared to pay in rent and how much they will buy it for. |

## Buying a strata unit to live in

People often make the mistake of thinking that the rules for buying for investment and buying to live in are different. With some small exceptions, owner-occupiers and investors are looking for the same things. See also Lannock's guide to buying to invest.

| Do | Don't |
|---|---|
| 1. Focus on the most important thing – your lifestyle, your appreciation and enjoyment of living in the unit<br>2. Consider whether your enjoyment of the unit could be boosted by renovating or refurbishing:<br>a. Inside the unit (inside the front door) or<br>b. The common property (between the front gate and the front door)<br>3. Always get a pre-purchase strata inspection and check out the history and current status of the building<br>4. Be aware of future capital works that may be desirable on the common property<br>5. Remember you are buying into a community – you might never see your fellow owners, or you might always be dropping in for tea, but the entire building has a say in how it operates and your enjoyment is in part determined by the decisions you make as a whole | 1. Don't buy based on cheap levies – levies are there for a good reason, what you want is a property where levies are used well and for good purpose<br>2. Don't buy when you are on holiday (unless you had that intention before the holiday)<br>3. Don't assume that future capital works are covered by a sinking fund<br>4. Don't assume that a sinking fund is the best means of funding future capital works (sinking funds are often the most expensive form of strata funding)<br>5. Don't forget capital gains – although you are purchasing and making choices about a lifestyle, it's a significant financial investment and you want to make sure you get a good capital gain when you come to sell |

## Creating value in your existing strata investment

There are many ways to create value. But the first thing to do is understand what "value" is. For both owner-occupiers and investors, it all comes down to lifestyle – how much will you (or your tenants or prospective purchasers) enjoy living there?

| Do | Don't |
|---|---|
| 1. Work out the "optimum" capital works – not the cheapest or the most expensive, but the ones that will give you the biggest bang for your buck<br>2. Measure each investment option by Return on Investment<br>3. Refurbish the common property – the part of your capital return that is located between the front gate of the property and the front door of your unit<br>4. Get involved in the decision making process | 1. Don't assume that a sinking fund is the best means of funding future capital works (sinking funds are often the most expensive form of strata funding)<br>2. Don't assume that others will make good decisions on your behalf – get involved!<br>3. Don't do it yourself. If your committee doesn't have the expertise – bring in the experts! |

## Making good funding choices

Because you have choices in funding, it's important to understand the issues and make good decisions about the right option in your situation. Making the right decision will increase the value of your unit. Getting it wrong will cost you money.

| Do | Don't |
|---|---|
| 1. Keep the decision about what work to do totally separate from the decision about how best to fund it<br>2. Work out the criteria of a funding decision that are important to you – for example:<br>a. Availability<br>b. Timing<br>c. Cost<br>d. Flexibility<br>e. Complexity<br>f. Transparency and clarity<br>g. Other criteria relevant in your particular situation<br>3. Give each of these criteria a weighting based on their importance<br>4. Get the full information on the available means of funding (read the small print!)<br>5. Evaluate each funding option against the decision criteria and give it a score<br>6. Calculate the weighted average score<br>7. Consider getting in a finance expert<br>8. Always compare apples with apples<br>9. Consider if you should get legal advice on any contract you may enter into<br>10. Wherever possible. match the term of your financial obligations with the lifespan of the asset you are "acquiring" | 1. Don't assume that one solution works for all – what worked for your neighbouring corporations may not work for you. Each funding solution is specific to the needs of the particular situation and the particular owners, there is no one size to fit all<br>2. Don't assume all funding options are the same – a qualified person should go into the small print, the devil is in the details!<br>3. Don't get upset that your sinking fund isn't sufficient to cover the required capital works – when you do all the sums and work out the costs, you'll probably be glad that you are not locked in to this expensive option<br>4. Don't assume that a sinking fund is the best means of funding future capital works (sinking funds are often the most expensive form of strata funding)<br>5. Don't ignore the timing of the funds – you need to have the funds available before signing the contract |

## About each strata funding option

Because Lannock's life and work is strata funding, we could write a book on the topic. Contact us if you would like more information or help for your particular situation.

### Sinking Funds

1. Usually the most expensive form of funding for strata
2. Are not properly valued by intending purchasers of your unit
3. Have low investment returns (as they should, this is "widows and orphans'" money and must be carefully invested
4. Are taxed
5. Are subject to inflation – whilst you wait to save the money in a sinking fund, the cost of the works is going up and up
6. Most owners have much better things to do with their money than to have it sitting unused in a strata sinking fund
7. May expose you to legal liability if work is not done while you wait to save the money
8. May work in your situation but you are best to evaluate all the options

### Special Levies

1. They always come at an inconvenient time for owners
2. Work can't start until you have received all the money

### Borrowing

1. Make sure you are aware of the total cost, after all fees and charges have been taken into account
2. Often the cheapest funding option
3. Available immediately – no need to wait until all levies have been paid
4. May offer tax advantages to some owners

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## Getting a good sinking fund plan

Getting a plan is not just something to tick off as an agenda item at the general meeting. A good plan, intelligently used, will enhance your lifestyle and increase your wealth (but a bad plan, or a good plan used badly…..)

| Do | Don't |
|---|---|
| 1. Engage the right firm<br>a. Check that they are a member of the relevant professional association<br>b. Check if they are member of the state strata institute<br>c. Ensure that they have the appropriate qualifications<br>d. Ensure they carry the appropriate insurance<br>2. It's likely the person will need to come to the property to check things out – be wary if they don't<br>3. Recognise that this is a plan for capital works, not a budget for levies to a sinking fund – how best to fund the required and desired capital works is always a separate decision<br>4. Make sure they work on the basis of the expected efficient life of the plant and equipment – some firms juggle the dates around to make the numbers look even but this creates financial inefficiencies that cost you money | 1. Don't pay peanuts and expect a premium result<br>2. Don't engage a firm on a word of mouth recommendation – do you own investigation<br>3. Don't accept a report that appears inadequate to you – follow through and ask questions<br>4. Don't use the report as the only relevant information on levies to a sinking fund. A good sinking fund plan is only one of a number of relevant issues that you should consider when setting levies<br>5. Don't blame your body corporate manager if they won't do the assessment – they are unlikely to be the qualified, are not trained for this type of work and do not carry the right insurances |

## Doing the right capital works

Two of the most important decisions in strata are "what works should we do" and "who should we get to do them". Getting these decisions right will add thousands of dollars to your investment. Getting them wrong………..

| Do | Don't |
|---|---|
| 1. Keep the decision about what work to do totally separate from the decision about how best to fund the project<br>2. Measure each alternative project on the basis of Return on Investment<br>3. Don't get sucked into the scarcity trap – evaluate the options using ROI, not available funds or least cost<br>4. Choose a competent contractor<br>a. Do they have experience in this kind of work?<br>b. Do they comply with their OH&S obligations?<br>c. Are they covered by adequate insurance?<br>5. Remember that it's usually cheaper, better, more convenient and less painful to do all the work at the same time or within the same project | 1. Don't go for the cheapest project – this is unlikely to be the option that creates the most value<br>2. Don't necessarily choose the cheapest contractor – cheap often means nasty and costs more in the long run<br>3. Don't ignore professional advice (but make sure the professional giving the advice is appropriately briefed and qualified) |

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## Setting sinking fund levies

Remember, in NSW it's not compulsory to have levies to a sinking fund! It is important to have a plan and to take that, along with all other relevant issues when deciding what levies to raise for a sinking fund.

| Do | Don't |
|---|---|
| 1. Consider the following in deciding the relevant levies to a sinking fund:<br>a. The plan for future capital works<br>b. The amount of capital works per unit<br>c. Which of the three funding options (sinking fund, special levy or borrowing) is best in your situation<br>d. The advantages and disadvantages of all strata funding options<br>e. The "decision criteria" that are relevant to you in making a funding decision (see Lannock's guide to making strata funding decisions)<br>f. The cost to owners in having funds locked up in a sinking fund<br>g. The next best use owners have for money that would otherwise be in a sinking fund (opportunity cost)<br>2. Engage the right experts for the right things – engineering firms are expert and engineering issues, funding firms are expert at funding issues | 1. Don't assume that a sinking fund is the best means of funding future capital works (sinking funds are often the most expensive form of strata funding)<br>2. Don't ignore special levies as a valid form of funding – despite the problems many owners have with them, writing a cheque is often a simple and easy solution |

## Choosing the right pre-purchase strata inspector

Choosing the right pre-purchase strata inspection company is essential as this report will alert you to the many traps and allow you to make a good and informed decision if the building is suitable for your purpose.

This information applies to New South Wales and Queensland only.

| Do | Don't |
|---|---|
| 1. Check out their credentials<br>a. How long have they been operating?<br>b. How many strata inspections (as opposed to pest or building inspections) have they done?<br>c. Are they experienced in your area?<br>d. Do they physically inspect the strata records or just work off some database of information?<br>e. Do they do it themselves or sub-contract the report? Some companies sub-contract their reports to others – you probably don't want a pest inspector doing your strata report!<br>2. How friendly and prepared to help are their staff?<br>3. Review a sample report and compare it with others that may be available<br>4. Do they include relevant extracts from the records of the corporation? | 1. Don't go for the cheapest (unless it also happens to win on your other criteria) – you a making a substantial investment, no point scrimping a few dollars on a critical piece of information<br>2. Don't leave getting a report til the last minute<br>3. Don't treat the report as a "tick the boxes" exercise<br>4. Don't make your final decision before reviewing the report and following up on any outstanding items<br>5. Don't be put off by a "bad" building – it might be a great opportunity for you to buy in at a good price and then improve things |