

**GETTING REAL
TIPS FOR
ASPIRING PROPERTY
DEVELOPERS
IN AUSTRALIA**

A PERSPECTIVE

Real ESTATE

Getting Real Tips for Aspiring Property Developers in Australia

It comes as no surprise that when overseas investors are devising their international asset allocation strategy, Australia is one of the top countries they consider. However, the wise property investor won't jump in too quickly.

Consider the experiences of four Chinese developers attempting to enter the Australian market, who we shall keep anonymous.

The first, a first-time developer decides to build a landmark; the tallest building in Australia. The perfect site is found, but mandatory town planning constraints mean the building can only be up to 30 storeys high.

Regardless of third party opinion, the developer proceeds to purchase the site at a record land price, assuming the government can somehow be persuaded and planning officials can be personally influenced for a favourable outcome. The site sits idle for years.

Another developer purchases a site in 2014 but fails to obtain planning approval for apartments. Two years later, council approval has still not been obtained and the developer discovers a less costly townhouse project would have been more profitable and planning approval easier to obtain. But the shareholders are now spilt on the next steps as two years have been wasted. The project comes to a standstill.

In the third case, three shareholders commence a project, obtain planning approval and complete pre-sales in record time with assistance from good architects and a strong and well-timed sales campaign.

Three months into construction, the project comes to a standstill and the builder exits the project because one of the three shareholders no longer wishes to invest. The two remaining shareholders try to sell the semi-completed project but with no success.

Finally, a first-time developer in Australia decides to fly in their hometown project managers and sales people who have little local experience or language and cultural capabilities. As a result, the consulting teams become disengaged and unmotivated, and the project still hasn't made progress after two years.

As one can start to observe, international investment is not simple.

Australia has its own unique legal system, town planning constraints, business culture and local design and construction context, all of which suggests a steep learning curve for the inexperienced investor.

Common Issues with Overseas Incumbents

Through extensive interaction and consultation with a number of Chinese organisations, from small private investors through to State Owned Enterprises, STM Developments has made the following observations of the Australia property landscape:

- There is a long decision-making process – good deals and projects come and go. Being ready to make a timely commitment to a project is important
- Project investment criteria and locations often change frequently. This may be due to the investor's failure to undertake in-depth market research in order to ascertain the best opportunities.
- Investors suffer with information overload as they tend to consider many, many different project options and consult numerous people from different parts of the industry. This makes it very difficult to decide on one or two investments in a timely fashion.
- A local person trusted to make recommendations on the best projects is lacking – very often, investors have very little local knowledge, or lack the depth of experience to make informed recommendations and decisions. In this type of situation, it's understandable that trust is difficult to build and sustain.
- A desire from the investor to undertake joint ventures, but retain full decision-making powers. This often leads to disputes and disagreement, slowing down the project and diluting investment returns. Our perception of a successful partnership of this nature is one where there is a true passive JV investor with responsibilities and decision-making powers clearly delineated (a bit like a successful marriage!). Oversight, control and supervision can occur at a committee or board level, but direct management and operational decision

making should rest with local management.

- Little regard for local professional advice, failure to assess project risks accurately and being overly optimistic about the development potential and density of a site. This often results in investors overpaying for development sites.

- An erroneous belief that connections with the Minister for Planning or the Premier will have an effect when dealing with Council.

All experienced development professionals will appreciate that property development is ultimately a high-risk game and not all can continually generate way-above average investment returns. Any amount of analysis, due diligence or opinion will have a minimal impact on improving the quality of a decision.

Ultimately, when it comes to final decision making, the investor has to rely on his or her own judgment. Having an eye for property certainly helps and this comes with experience and broad knowledge and industry exposure.

Given property development is high risk by nature, which implies many uncertainties and having to live uneasily most of the time, why would investors choose a project in an overseas, location such as Australia?

Why Go Overseas?

There are a number of reasons behind the push overseas from Chinese investors and developers. They can be categorised into two types – pull factors (where investors are naturally attracted to the overseas countries due to their fundamentals), and push factors (where the domestic situation in China has created a rush to go overseas). Both these factors have contributed to the acceleration of investment overseas, especially in the USA, UK and Australia.



- Risk Diversification with offshore exposure with lower funding costs and higher returns
- Mature, liquid and transparent markets – clarity of rules and regulations
- Strong macroeconomic fundamentals
- International brand building
- Personal preference driven – quality of life attraction, capital appreciation
- Slowing Domestic Economic Growth
- Excess Supply – Fierce Price Competition
- Reduced appetite for further development projects in China
- Maturing and well-funded Chinese Developers looking to develop a global footprint
- Earlier Government policy to promote foreign investment esp insurance companies

Why Australia

Let's look at some recent statistics from the Australian Bureau of Statistics Census data 2016:

- Between 2011 and 2016, the population of Australia increased by 1.7% CAGR, well above the world growth rate of 1.2% CAGR and more than double the OCED growth rate of 0.7% CAGR. This population growth is driven by the key eastern states of Queensland (1.5% growth), Victoria (2.4% growth) and New South Wales (1.5% growth).

- Victoria has the quickest growth rate of the states and Melbourne is expected to become Australia's largest city in 20 years' time. In fact, New South Wales is actually experiencing negative interstate migration, as Sydneysiders choose to relocate to the more affordable states of Queensland and Victoria.

- The population growth in Victoria is driven by both overseas and interstate migration, recording a total net migration of 81,700 people in the past year. Assuming a household size of 2.7, this equates to an additional demand for more than 30,000 new homes just to cater for overseas and interstate immigrants in the past year. This is the main driving force behind the Government's rezoning of new urban land in the outskirts of Melbourne and a cause for strong price increases in the inner suburban areas of Melbourne.

- There are now more than 500,000 people of Chinese origin residing in Australia (2.2% of the total population of Australia), 45% of which reside in Sydney, and 30% in Melbourne. This figure is expected to grow substantially in the next few years, as more students and families choose Australia as their new place of residence and education.

- Australia boasts 3 of the top 10 most liveable cities in the world, according to the Economist. (Melbourne #1, Adelaide #5, Perth #7).

Close examination of the underlying fundamentals, the demographics and supply-demand imbalance quickly lead to the contention that land owners or producers of real estate represent a long term, stable and solid industry in which to invest. Real estate is a long-term game, and despite short term economic fluctuations and ripples, the wave will be inevitable.

Specific characteristics of property development in Australia

However, as we have pointed out, it's essential for any overseas developer or investor entering the Australia market for the first time, to appreciate the nuances and local particularities of developing real

estate in Australia. While one may already be very successful in their home country, this does not necessarily equate to automatic success in another country. In our experience, Chinese real estate investors requires a completely different approach to undertaking projects in Australia.

For example, the fact that land is privately owned and freehold in Australia means that government relations become almost irrelevant with respect to land acquisition in Australia. This also implies that a developer's own resources and industry networks becomes more important in securing the best development sites.

The three layers of government (Federal, State and Local), all with different political affiliations, hold separate elections and the fact that one is not reliant on the other means that having a connection with the State Minister for Planning or Premier will have very little effect on a local Council decision-making authority (unless the project is of state significance). This is quite different from the situation in China, where power and authority is centrally controlled and governors of provinces and mayors of municipalities are all appointed by and report to the Central Government in Beijing.

In Australia, authorities only play a role in the town planning stage of a project in highly transparent processes predominantly in relation to the impact of the development on the surrounding environment. For example, they will consider access to daylight, overshadowing, wind effects, how the development will blend in with the existing urban landscape and the quality of the design and build. It is therefore prudent to adopt a professional, design-driven approach to developments. There are very few ways to "push" the boundaries for commercial purposes at the expense of the public good.

The design and construction process in Australia is outsourced to external consultants and contractors, as opposed China where key activities are undertaken in-house. This has the effect of reducing the investor's direct intervention and control over the project. Residential construction also includes internal fit-out and finishes, placing greater emphasis on design, workmanship quality and cost control. For new players, this means a higher level of professional sophistication, project and contract management expertise. Being capable of leading and managing a large and diverse team becomes crucial to success and the developer's relationships and reputation with third parties and the broader development industry becomes of primary significance.

Finally, for commercial projects, Australian labour unions

play an important role in the industry's effectiveness. Safety and worker's well-being is given a high priority. If a developer is slightly detached from the front line labour force, it may have an impact on efficiency and cost.

We outline below some of the specific characteristics of each stage of the development cycle to provide an initial glimpse of nature of the Australian market which may differ from that in Asia.

Stage	Nature of the Australian Market
Site Acquisition	<ul style="list-style-type: none"> • Parochial Market – Public Information widely shared • Highly Competitive, Transparent and market-driven process – Auction, Public Tender, highest price wins • 99% - acquired at or above market price
Town Planning	<ul style="list-style-type: none"> • Highly process driven and transparent • Strong element of public consultation and design consideration • Emphasis on urban design impact on neighbours
Detailed Design and Documentation	<ul style="list-style-type: none"> • High industry professionalism and self-regulation • Private building certification and documented approval • Clearly written codes and standards
Pre-Sales and Leasing	<ul style="list-style-type: none"> • Well-defined pre-sales process and rules on deposits, trust accounts, legal protection for both sides • Mature legal and banking system • Developer and Architect Profile and branding
Financing	<ul style="list-style-type: none"> • Mature and competitive financial system • Availability of alternative capital – funds, private equity • Conservative banks – qualifying pre-sales, past local experience, financial strength, relationship
Construction	<ul style="list-style-type: none"> • Turnkey Construction – Main Contractor • Lower efficiency in construction • Statutory and HSE hurdles during construction • For larger projects, union impact on projects

So, what does all this imply for aspiring overseas developers?

Our perspective is that overseas developers will need to adopt a back-to-basics approach to development, one that is reliant on professional expertise and execution capability. In essence, there are three key areas incumbents should focus their efforts:

1. Developing strong capability in project execution and delivery through disciplined project management practices, building rapport with industry counterparts and developing strong internal QA [quality assurance] processes and business systems
2. Building a competent locally based team with local expertise and industry networks that have operational and financial decision-making authority. The head office needs to be given responsibility for strategy and relationship-building
3. Investing in building the corporate brand and growing industry reputation by focusing on delivering design-driven projects which appeal the broader local market and contribute to pu-

blic urban affairs

This advice may appear common sense, but it's surprising to observe how many developers focus solely on project selection and profitability at the expense of these "softer" operational requirements. While a focus on project site selection and profit may result in short term financial success, we believe this is not a sustainable long term strategy. It is through the above measures that overseas developers can grow a truly sustainable property business, and not merely a portfolio of profitable projects.

Deploying an Asia-capable and trusted local leader is the key to executing this approach. The most successful projects enlist a stakeholder who is able to bridge the communication gap between the east and west who also has a local presence and an in-depth knowledge of how to operate an Australian business. As the Chinese proverb suggests: "The fierce tiger from a foreign land cannot fight the local worm."

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OUR CAPABILITIES



SITE ACQUISITION

Solid pre-acquisition due diligence and sourcing of the best on and off market development sites is the first step to a successful project.



PROJECT FEASIBILITY

Thorough market research, detailed risk assessment and a robust project feasibility analysis will provide comfort for a successful acquisition.



DEVELOPMENT MANAGEMENT

Leading and managing all project consultants and stakeholders and securing the best planning approval is a crucial first step in the development process.



PROJECT MANAGEMENT & FINANCING

Disciplined project management, design and documentation management and cost control within feasibility limits will ensure projects are completed on time and to budget.



INVESTOR REPRESENTATION

On larger scale joint ventures or projects, negotiating development agreements, undertake commercial and technical due diligence and representing investors throughout the project will ensure their interest and risks are managed.

ABOUT US

STM Developments is a property development & advisory business based in Melbourne, Australia.

We work alongside developers and investors, providing site acquisition, feasibility analysis and project management services for residential and commercial projects. We initiate and participate in property development joint ventures as project proponent. We also act as investors' independent representatives as their point of contact for their co-investment projects and joint ventures.

Founder and Managing Director Simon Lee has more than 17 years of professional experience in all major facets of the development industry in Australia. He has successfully designed, led and managed major commercial, retail, mixed use and residential projects in Hong Kong and Australia ranging in value from \$4 million to \$20 billion. Simon is also an occasional guest lecturer and tutor at the Faculty of Architecture University of Melbourne.

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