



PROPERTY DEVELOPMENT SERIES 3 CONTRACT NEGOTIATION

A PERSPECTIVE

Property Development Series 3

Contract Negotiation

So now you have successfully completed your due diligence and your feasibility and analysis appear reasonably solid. The land is still on the market and you are now ready to make your first offer for the land. In Australia, there are typically 4 ways development land is offered for sale – off market sale, private sale by negotiation, expression of interest and auction. We discuss the process and strategies a purchaser can deploy for each of these modes and also share some of our past experiences and learnings.

Negotiation is all about information gathering, perspective taking and understanding respective bottom lines and manipulating best alternatives and concessions. Although you will most likely be negotiating through a middle person, the agent, mastering negotiation tactics and taking a structured approach will always work in your favour. Remember, negotiation is not purely about going back and forth on the price until one party caves in – there are so many other factors under consideration!

Off Market

An off market property is typically offered for sale silently through certain sales channels and agents. Typically, there will be no public listing of any type online or via any form of public print medium. Sites are generally held tightly by one or several close channels and agents and are only disclosed to close clients or partners on an as-need basis. There may be confidentiality or non-disclosure agreements in place to prevent the site being broadly publicized.

To understand how to secure the best outcome from a purchaser's perspective, one must ask the following questions or seek out the following information:

1. Why is the vendor selling the property off market through a small number of agents and channels, in lieu of a more public sales campaign? Our experience with off market sites tells us there are typically several common reasons
 - a. vendor wishes to minimize sales commissions and advertising

expenses and only market the site through word of mouth or existing agent client databases. Unfortunately, word may still get out with agents listing dummy ads online, on their own website, or through social media platforms, such as LinkedIn or WeChat. At least, the vendor is not paying for these advertising costs!

- b. vendor wishes to test the market first with an ambitious price, but ultimately, they will pursue public listing or auctioning at a later date in any case. From the purchaser's perspective, it represents a short window of opportunity to acquire the site hopefully at a slight market premium, but avoiding the risk of open competition and more aggressive price bidding at an auction. It also allows a little more time to conduct due diligence and the opportunity to include certain conditions precedent such as DD, finance clauses.

- c. vendor wishes to keep the sale quiet due to personal or business relationships, or they have only recently acquired the site at below market value, and hope to nominate the sale prior to settlement for a quick profit, with or without town planning approval

2. What is the vendor's bottom line and expectations in terms of price and settlement and other special conditions? As a purchaser with no direct access to the vendor, it is important to work with your trusted agent and understand what is the true asking price and terms, allowing for any top ups or rebates etc. If a vendor will not provide a firm commitment on selling price or terms, the property is probably not worth pursuing at all, as dealing with a moving target is probably the most painful thing to go through. A firm asking price at least provides a starting point for negotiation, or even no negotiation if the price is right! Hence to vendors, set an asking price (as ambitious as one may like) and do not be endlessly greedy. Other conditions are also worth exploring, such as required settlement terms, or deposit requirements, as these will be your negotiating strings to pull when price is not the only matter for consideration. Be sure your agent conveys the correct message to you – the last thing you want is different

agents telling you a different story!

3. Does the agent you are talking to hold direct vendor relationships, or are there other master agents involved? How many are there? What demonstrates that this site is really for sale? Ask for some form of paperwork or authority form. Ask for the contract. What is the commission arrangement, and is there a top up arrangement? We have experienced many off market sites which are not really for sale, or the vendor has not fully committed to selling, and the agent has proceeded to market the site as an off market site without vendor authority. Test this site with other agents that you know. In the end, we have expended invaluable time exploring this site in great hope, but only to find out the vendor has “changed their mind”.

Private Sale by Negotiation

This operates similarly to off market sites, with the only exception being the site is most likely allocated exclusively to one agent, and there is public online and/or print advertising. The rules for private sale sites are similar – understanding bottom line asking price, timeframe and conditions. This approach is a lot more transparent than off market sales, as you can be sure that the vendor is genuine and the agent is authorized to act on behalf of the vendor.

Expression of Interest

This approach is typically adopted by larger agencies for commercial or more sought after residential and mixed use sites through a formal structured process of submitting a non-binding written offer by a fixed date. This is followed by shortlisting of several bidders to submit a legally binding offer. Normally, there is a price range provided from the agent, but ultimately, it is up to the individual purchaser to assess a fair and reasonable price for the land, together with accompanying special conditions, if applicable.

Prior to the EOI closing date, the same questions and due diligence checks apply, although there is little risk of missing out, as all parties have the opportunity to submit a price by the closing date. This is a more transparent process which may appear fairer to all parties involved. However, there is little room for more strategic negotiations and almost all of the time, only the highest price will win the day.

Auction

This is a very common method adopted by traditional homes and some development land, and is purely based on price. Other conditions such as settlement terms and deposit payment terms

are often well defined in advance and auctions are always unconditional – meaning the successful bidder must settle the land based on the highest price. In our view, having attended numerous auctions in hope for buying the perfect development site, auctions are the least favourable from a developer's perspective – one is competing with genuine home buyers who act in a more emotional rather than scientific manner, and price is the only negotiating factor, which is very sensitive to the feasibility of the project, especially for small development sites. The room for error or oversight in smaller sites is much lower.

Based on our experience, we have seen development sites sell for prices well in excess of what we would have expected. There could only be two plausible explanations – either we were overly conservative in our numbers or we underestimated the real development potential of the site, or the buyer was extremely confident of the future market conditions. Or even more unlikely, the buyer is willing to work on a 5% development margin!

STM Developments view contract negotiation as an art more than a strict science. It is important to deploy it masterfully to your advantage. Luckily over the course of our past careers and current business, we have been involved in negotiating many aspects throughout the development process – land acquisition, planning outcomes, builder selection, sales outcome and handover and defects rectification. We provide some of our insights and tips on contract negotiation in land acquisition:

1. The items for negotiating the land acquisition is numerous – price, settlement terms, deposit payment and release terms, due diligence, finance, JV arrangements or other incentives. We term this the negotiating mix. Broaden the mix as wide as possible so you have more levers to pull. Complexity sometimes will work in your favour.

2. List out these negotiating items and analyse them one by one logically. Determine what your own bottom line is and what you think the bottom line is for the vendor through asking questions and finding out through numerous conversations with agents, fellow developers, Council, architects and planners. And write it down!

3. Knowing these items is not enough - prioritise these items for you and for the vendor. Price is not always the top priority for the vendor – a vendor may need to settle on another site in 2 months, and will need a quick settlement to make this happen. If you manage to gather this vital intelligence, you are in good position to pay a reasonable price for the land, as long as

settlement is short. You also have added power to negotiate a favourable outcome because time is on your side.

4. Try and understand the manner the vendor will negotiate the transaction. Will they counter offer back and forth until the very last dollar is achieved, or will they just accept a certain minimum price and terms without hassle? This will determine your opening offer and also how much leeway you given the vendor to counteroffer. Normally, the more professional vendors will adopt the latter, as they do not wish to expose their bottom line to other bidders should this deal fall over. They also don't want purchasers to come back with a totally unrealistic offer which will waste time and effort on both sides.

5. Timing is a very powerful tool in negotiation as well. Understand timing well – how long has the property been on the market? How eager or desperate is the vendor? Has the vendor knocked back past offers? Monitor the situation on a daily basis. Make known to the agent that you will submit an offer but try and submit as late as possible. Being last in your negotiations gives you more bargaining power and also the vendor will be more eager to close the deal. Sometimes, a small buyer's agent "consulting" fee may go a long way to help you secure that perfect site.

6. Value creation - For larger and more complex sites, it may help to introduce new negotiating items into the mix such as part ownership, or transfer of a portion of the completed project or units to the vendor at completion in lieu of a full land price purchase. Even a deal on another site may assist. This can be effected via a separate agreement, but can be beneficial for both parties. The vendor has ownership of units at completion at no cost, which they can subsequently sell, mortgage or keep as an investment property. The purchaser can achieve a much better cash flow from a lower up front land price, especially when banks are lending lower LVRs now, and some banks are even avoiding land bank finance altogether. With less up front capital requirements, it enables the developer purchaser to pursue multiple concurrent projects at one time. Obviously, this approach is only workable in off market and private sale transactions and requires direct communication with the vendor.

7. Understand who you are negotiating with – harness and embrace the cultural aspects of negotiations. Asians and Westerners negotiate very differently. Respect your opponent but remain firm. Go hard with distributive negotiation when appropriate on one site but tread softly with integrative bargaining on another. Always remain flexible in approach – after all, negotiation is an art and there is no one perfect approach or solution!

A final word - If you practice Tai-Chi, an ancient Chinese Taoist form

of martial art, you will know that Tai-Chi is based on the philosophy of stillness to movement and back to stillness – the extremes of ying and yang. Ying contains Yang and Yang Contains Ying. A Tai Chi approach to negotiation implies a dynamic balance between Yin and Yang moves. This means that a negotiator has to combine in his or her behavior both Yin and Yang components: on the one hand, to be receptive, cooperative, adaptive, integrative, i.e., a soft negotiation style; but, on the other hand, to be assertive, competitive, distributive, compelling and enforcing, i.e., a firm negotiation style.

According to Tai Chi philosophy, any noncompetitive interactions contain some competitive elements, and no competition can exist without an element of cooperation. In both "integrative" and "distributive" negotiations, the negotiator can succeed only if he or she is mindful of and sensitive to the opponent, achieves a close connection with him or her, and understands and uses the other side's strengths and weaknesses. All these things require a sense of oneness with the partner/ opponent.

The above represent some of our thoughts and we consider contract negotiation as an essential first step is securing the right development site for the right price at the right time. We have experience in reviewing and securing small to large development sites and would be happy to share some further experiences.



STM Developments

YOUR TRUSTED AUSTRALIAN DEVELOPMENT PARTNER

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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