The best laid plans ...

Thinking of buying off the plan? Think again, writes Karina Barrymore

A CRISIS threatens the apartment and off-the-plan property markets as banks and other lenders back out of providing full settlement money.

Buyers say banks are revaluing their properties once the buildings are completed and only lending a lesser amount, leaving shortfalls of tens of thousands of dollars.

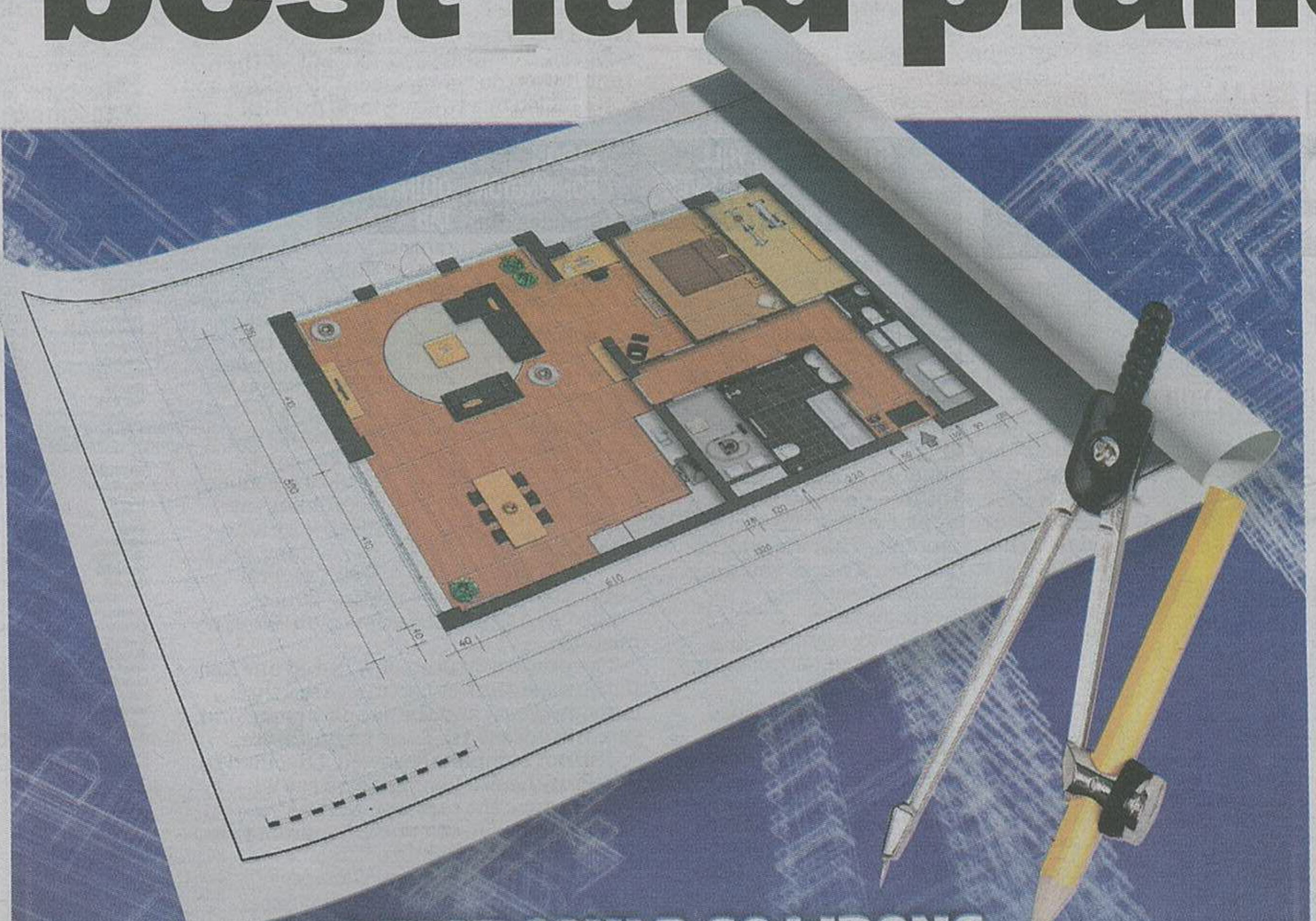
The buyers must sell assets, borrow extra money elsewhere or renege on the contracts and face legal action by the developers.

"The difference between the price paid by a property buyer and the bank valuation is often high, over 20 per cent, and the differential is spreading," Metropole Property Strategists managing director Michael Yardney says.

"Many off-the-plan purchases are made at prices significantly above true market price.

"On completion, it is not uncommon for valuations to come in at least 10 to 15 per cent below the contract price."

About 1000 new apartments are being completed every month, and the funding and valuation problem is likely to impact even more buyers.



WHAT COULD GO WRONG

THE PLAN	
Purchase price	$550,000
Deposit @ 10%	$55,000
Borrowing @ 80%	$440,000
Top-up at settlement	$55,000

THE REALITY	
Purchase price	$550,000
Deposit @ 10%	$55,000
NEW VALUATION	$440,000
Borrowing @ 80%	$352,000
Top up at settlement	$143,000

Finance shortfall

DAMIEN Roylance, director of finance and property adviser iProperty Plan, says the number of these cases is increasing.

"I've personally had five in less than two months. In every single case the valuation has come in lower and the buyer can't get all their finance," Mr Roylance says.

"I've currently got another client who pre-purchased two apartments and they have both come in at lower valuations. She came to me two weeks before settlement with a shortfall of $100,000.

"We only just managed to get her over the line on the first one, by borrowing 97 per cent (of the valuation) but she's had to settle late and had to find an extra $8000 penalty interest."

The outcome of the second property is still uncertain.

According to property advisers, the problem arises in two ways; the buyer initially pays too much and the property declines in value during construction.

"Not all off-the-plan is bad, but as a general rule off-the-plan will go down in value as soon as it's built," Mr Roylance says.

"It's like a brand new car — as soon as you drive it out of the car yard it goes down in value.

"The only thing that appreciates with property is land value. If you have a development that has squeezed as many units as possible on to a piece of land, there is not a lot of room for appreciation.

"In a $400,000 apartment, only $50,000 is the land component. That leaves $350,000 to depreciate."

Price v valuation

THE problem centres on the initial purchase price and the formal valuation when the property is completed.

In most cases the valuation, organised by the lender is well below the purchase price.

Finance contracts usually state the lender will provide a certain percentage of the property's value, which is different to the purchase price.

The shortfall between purchase prices and the valuations currently range between 10 and 20 per cent, which means on a $550,000 purchase the gap can be as high as $110,000.

In this situation the lender will still usually provide the finance but only 80 per cent of the valuation not 80 per cent of purchase price.

According to Portfolio Management Services managing director Jock Bing, this leaves the purchaser with a choice of finding the extra money or breaking the contract.

"Many of them decide to go the softer option and back out by blowing their deposit money and walking away," Mr Bing says.

"Often that used to be the end of it, but nowadays the developers are also suing the buyers.

"The 10 per cent deposit is not enough to cover the developers' losses because he probably can't sell the apartment to someone else for a 10 per cent discount; he's probably got to sell it for a 20 per cent discount.

"That means the original buyer not only loses their deposit but also gets pursued through the court for the other losses to the developer and the developer's legal costs."

> It is not uncommon for valuations to come in at least 10 to 15 per cent below the contract price
>
> Metropole Property Strategists managing director MICHAEL YARDNEY

In some cases, developers have arranged a second mortgage so the purchase can be completed. It leaves the buyer stretched by extra-large repayments.

Size matters

ANOTHER problem in the current market is the refusal by some lenders to finance apartments that are under a certain size.

Mr Roylance says: "Usually under or about 50 square metres is the 'no-go zone' for lenders these days.

"Some apartments based on just 40 square metres, typically bedsit, student-type apartments — they can't really get any finance for them at all or if they can get it, they need to have a really big deposit.

"We see it quite a bit with young people, kids. They don't have much money and they think they're doing the right thing buying a property, saving on stamp duty, but these really small apartments can't get finance."

Rental income

THE problems don't stop after the settlement.

Some buyers head straight in to a second wave of financial pressure, according to Mr Bing.

"Next comes, who are they going to get to rent their property to and how much will they earn?" he says.

"What's really putting the wind up some of these buyers now is that they can't get the income they were expecting or can't get a tenant.

"At one stage we had an estimate of up to 1000 unoccupied apartments in Melbourne.

"That's just another burden on the buyers.

"Not only have they had to borrow more than they expected, or had to sell the family home or the second car, now they can't earn the rental income they relied on."