



Perth Apartment Market — Mitigating Settlement Risk

Market research shows there are approximately:

- 1,110 apartments currently on the resale market;
- 5,600 apartments selling off plan; and
- 3,700 apartments under construction (64% subject to pre-sale contracts) compared to just over 2,100 in early 2014.

Furthermore, loan to valuation ratios and foreign lending criteria have tightened and we understand from anecdotal evidence that in excess of 30% of all apartment resales are transacting at below the original purchase price.

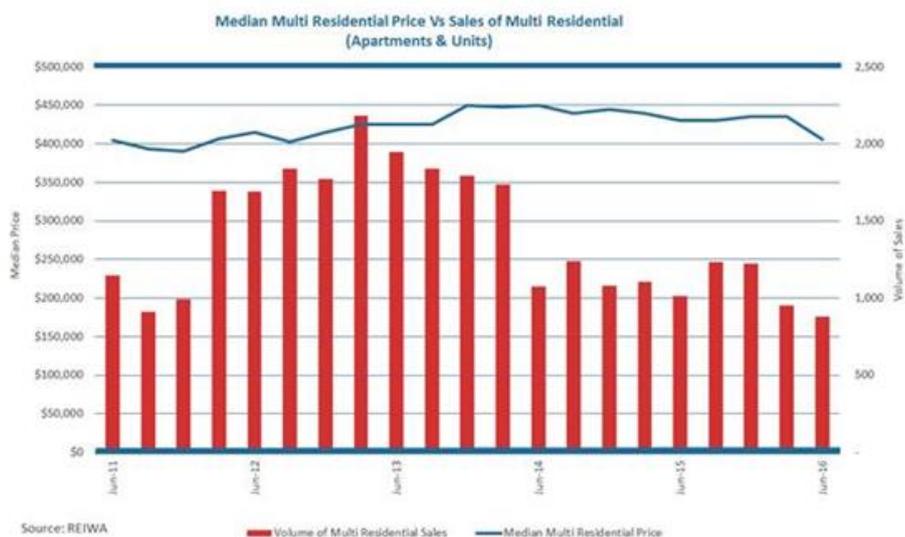
REIWA statistics below support this premise, with a steady decline in both demand/sales and median price (blue line), particularly in the June 2016 quarter.

Settlement Risk is Real for Developers

FTI Consulting believes that these circumstances may lead to settlement risk for developers caught mid-construction and who are reliant on pre-sales to maintain their financial covenants.

Many economists considered the Global Financial Crisis (GFC) the worst financial crisis since the Great Depression of the 1930s. However, several property developers weathered the GFC by:

- Employing bespoke design and construction contracts that included guaranteed maximum price conditions, restricted variation clauses and full novation of architect and sub-consultants provisions. These all helped to provide development margin protection;



- Setting sale contracts with realistic sunset clauses to minimise the ability for purchasers to exit the contracts;
- Remaining attentive to detail during construction with timely and compliant written notification to buyers of ‘change events’ to the apartments design and or size. (as failure to do so provides buyers with the ability to terminate their pre-sale contracts); and
- Proactively monitoring construction progress against project timelines and sunset dates.



Finally, and most importantly, developers were prepared to sell inventory at break-even prices to preserve equity and protect debt providers’ interests, particularly in the event that pre-sales were lost in a slow or contracting market.

They acted quickly without allowing other influences to effect the timing of that decision. Failure to act quickly and decisively meant that the developers product became ‘lost in the pack’. This resulted in slow sales which created cashflow constraints effecting the ability of that developer to secure new sites and maintain operational balance within their business. In many cases, this lead to failure of the business.

Steps to Take to Mitigate Settlement Risk

Settlement risk is an issue confronting Perth apartment developers and their financiers. In our opinion, developers should take immediate steps to mitigate and/or manage this risk. These steps may include:

1. Reviewing pre-sale registers, ensuring all deposits are present and accounted for and stress testing each contract;
2. Understanding each buyer’s personal circumstances and recording the details in the pre-settlement register;
3. Ensuring buyers are notified of all notifiable ‘change events’ to the design, or size of the apartment;
4. Maintaining a notification register, showing notification dates, delivery methods and recording of responses received within the prescribed periods;
5. Regularly monitoring sunset clauses against forecasted completion of construction. If construction completion is likely to occur after the sunset clause expiry date, seeking legal advice as to whether sale contract extensions are possible;
6. Diligently monitoring the feasibility analysis against forecast pre-sales and project break-even;
7. Being prepared, at settlement, to enforce pre-sales and/or manage financially challenged buyers into less expensive apartments (if that option exits); and
8. Being prepared for longer settlement periods and, potentially, higher legal fees to enforce pre-sale contracts.

FTI Consulting has the expertise to undertake independent reviews and successfully manage construction and development businesses and major projects through difficult economic environments. We are able to provide independent, practical advice to both developers and financiers on completed or partially completed projects. If you wish to discuss our services further, please do not hesitate to contact Greg Tomlin or Daniel Woodhouse.

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