Many investors have become wealthy through property investment, very wealthy. But the real profits in the property market are at the wholesale end - in **property development**.

In this bonus chapter of my book, I want to examine the part of the property market which has benefited me the most over the last 20 or so years – property development.

So what exactly is property development?

Let’s start with the following definition: **Property development is the continual reconfiguration of the built environment to meet society’s needs.**

New apartments, townhouses, road, sewers, houses, office buildings and shopping complexes don’t just happen. Somebody must motivate and manage the creation, the maintenance and then the eventual recreation of the spaces in which we live, work and play.

The need for development is constant because populations, technology and our tastes never stop changing.

While renovations and refurbishment are definitely a form of property development, as I have dealt with them in previously, in this chapter I am going to concentrate on the development of new dwellings – duplexes, townhouses and apartments.

To me property development is an extremely creative process and property developers are creators. They take a project from the conception of an idea in their mind through the design and approval phase, financing, construction and then eventually the leasing or sale of the project.

Successful property developers are a bit like movie producers. They assemble a highly talented team of people and skillfully lead them to develop a profitable outcome. Developers need to be proactive and make things happen. They must also be creative, flexible and adaptive to take their project through this maze.

Let’s look at some of the benefits of becoming a property developer.
THE PLAYERS IN THE PROPERTY MARKET

When we have a look at who is involved in the residential market in Australia they tend to fall into one of 3 categories:

- **Owner-occupiers** - who tend to buy properties with their heart, and will often pay a little bit more than the market price to buy the right property.

- **Investors** - who tend to buy properties with their calculators based on return, who also tend to pay full retail value, unless they have learned some of the lessons I have shown you in this book.

- **Property Developers** - who buy a property shrewdly, add value and on sell and refinance to make a profit.

In the few years a new breed of property player has come into the market. I call them “armchair developers.” These are clients of Metropole who are or want to be high net worth property investors and use Metropole Project’s development management services to allow them to become property developers.

You see…Metropole handles the whole property development process for them, from concept to completion allowing them to become property developers without getting their hands dirty.

Let’s look at the different options available if you want to get into property development.

YOUR OPTIONS AS A PROPERTY DEVELOPER

If you want to become involved in property development, there are a number of options open to you.

1. You could **renovate** a property or **refurbish** it to add value. While some developers would sell their property, I recommend you refinance your property, taking advantage of the extra equity your created.

2. You could **land bank**. This is a concept used by large property developers who buy large tracts of raw undeveloped land and keep their own ‘bank’ of land for future development.

   Beginning developers can do things on a smaller scale. You could buy an old house at close to land value. The block of land should be of sufficient size that it has future development potential. This is a great investment strategy because as you know from a previous chapter, it is the land component of your property that increases in value.
3. You could buy a property and add value by getting development approval to build new dwellings such as a duplex or units, or townhouses or apartments. By utilizing the land for highest and best use you are adding considerable value.

You then have two options. You could sell the property with development approval (DA) or plans and permits as it is called in Victoria, to a builder or developer. They will often pay you considerably more than your cost because you have now taken much of the development risk out of the project; they no longer have to be bothered with the maze of the council town planning process. Or you could proceed with the development project yourself and make the developer profit.

4. If you are prepared to pay a premium, but avoid the risk of the development approval process, you could buy land with a development approval (DA) in place and proceed with building the project.

5. If you feel uncomfortable doing it on your own, you could become a property developer using Metropole Projects Property Developer Program, where Metropole co-ordinates the whole project for you. You can find out more details at www.metropole.com.au

THE BENEFITS OF BECOMING A PROPERTY DEVELOPER.

So why would you go to the trouble and risk of becoming a property developer? You’ve probably heard that property development can be very lucrative, but you have probably also heard that many property developers go broke.

Let’s explore a range of benefits that may be possible if you get involved in property development, but then we will balance this out with some potential risks. As I see it some of the benefits of becoming a developer include:-

1. **Savings** – rather than buying properties at retail, when you become a property developer you can acquire your investments at 15-20% below their market cost. This is because you don’t pay the developer’s margin (which is yours to keep), agent’s commission, GST, marketing and other costs usually included in the price of buying real estate.

2. **Profits** – at the right time of the property cycle you can make good profits selling your development projects.

3. **Easier finance** – once you have completed your development project you can approach lenders to re-finance your properties. They will usually lend you 80% or more of their retail value when completed. In many instances this is about what it has cost you to develop your project and you can take out your initial equity. In other words it’s a bit like borrowing 100% of the cost of the property or having “nothing down.”

All these benefits add up allowing you to grow your property portfolio faster and safer than most investors.
4. **Leverage** - Following on from the previous point you get massive leverage when you have completed your development project. Often you control a substantial property or even 2 or 3 townhouses with little of your own money in the properties as equity.

5. **Tax benefits** – owing new properties gives you all the benefits of depreciation allowances giving you a great “after tax” return.

6. **Higher rental return** – your tenants will pay the prevailing market rents. They won’t know that the cost of your property was substantially below the retail price. This means your rental yields will be higher than for someone who bought their property at market value.

7. **Security** – if undertaken correctly, property development can be very lucrative. If you buy your development site well, your investment will always be underpinned by the security of real estate in a prime position.

All these benefits add up allowing you to **grow your property portfolio faster and safer than most investors**. They allow you to be the owner of high growth properties that are cheap to own, because you get great rental returns and big tax benefits. This is of course why I use this personally to make fantastic returns.

**THE RISKS OF PROPERTY DEVELOPMENT.**

I make it sound so easy – there must be a catch and there is. Over the years I have seen many inexperienced property developers and quite a few that I thought were smarter than me go broke. So what are the types of risks involved in property development?

Some of the significant risks I have come across include:-

1. A downturn in the property market leading to lower property values or increased holding costs until the development properties are sold.

2. Interest rates rising during the development process resulting in increased holding expenses and therefore lower profits.

3. Increases in construction costs during the project. This was particularly obvious during the last property boom. I know of a number of inexperienced developers who thought that they entered into a fixed price contract yet were hit with cost variations.

4. Changes in the supply and demand ratio for real estate market as we are currently seeing in the inner city apartment market. This of course depresses property values and reduces your project profit margin.

5. Unexpected disputes with building or trade contractors or unions which can cause costly delays to a project.

6. Changes to the laws relating to property development could adversely affect the profitability and viability of your development project. Things like the laws relating to zoning and town planning restrictions on land use, environmental controls, landlord and tenancy controls, user restrictions, stamp duty, land tax, income taxation and capital gains tax.
7. Unexpected delays and increased holding costs may be encountered when town planning (DA) approval is required for a development. Councils are currently very slow in assessing development applications and they reject many development / town planning applications. Not obtaining an approval or obtaining one on unfavourable terms is a growing risk for developers. The cost of obtaining approval or fighting council’s rejection in a court of appeal is continually rising. And….

8. Some inexperienced developers find that some of the improvements they have made to their properties do not result in an increase in value. They learn the hard way that increases in value do not necessarily occur in line with expenditure on improvements.

As you can see many of these risks are outside the control of the developer. I know, because at Metropole are property developers for our own projects and we act as project managers for many clients. We are currently involved in over 90 residential development projects in Melbourne.

We are aware of the risks involved in a development project and this helps us minimise them so that our clients do not get any unpleasant surprises. Most of our projects are very successful, and over the years I have made good profits out of property development as have many of our clients.

But I have to be honest and admit that we also run into some of the above problems in some of our projects and they are not as successful as we initially hoped. We must learn from all our developments. Learn what went wrong and minimise the risks of this occurring again and learn from what went right and repeat this if possible.

So what is involved in a property development? What actually happens? Let’s look at the stages of a typical property development project.

THE STAGES OF A PROPERTY DEVELOPMENT

Developers follow a sequence of steps from the moment they first conceive a project to the time they complete the physical construction and begin ongoing asset management. While the sequence may vary slightly, usually the development is broken up into the following elements:-

- coming up with the idea
- refining it
- testing its feasibility
- negotiating contracts
- making a formal commitment
- constructing the project
- completing the project and finally
- managing the new project.

As the developer, you should have an exit strategy at all these stages; either to continue on with the project or to sell it.
I have made property development sound exciting and profitable, and it can be, but it is important for you to understand that the development process is hardly straightforward. Let’s look at the stages of the development of a new duplex, multi unit townhouse or apartment project in more detail.

1. **Pre Purchase**  Here you look for a block of land with development potential. Either to renovate the property and add value or to get a development approval / planning permit to construct multiple dwellings.

   At this stage you should already have your finance in place so that you can know your limits. You should also have a team of consultants who can advise you as to the projects viability. These should include a development manager who can coordinate the whole process or individually -a solicitor, an architect, a surveyor a town planner and estate agent (to advise honestly on end values and marketability).

2. **Concept stage**

   Once you find a potential site you must come up with a concept for it. What can you put on it? How many units? How big? What restrictions are there?

   To find out what can be built on the land you next assess the local council's policy towards development and see how many new units/townhouses can be put on the block.

   I tend to have these documents in our office, but they are generally available over the internet at the local council's web site, or in hard copy form from the counter at the town planning department.

   You must understand the local council’s requirements for minimum lot sizes for a development and their regulations regarding setbacks from the front, for private open spaces and for car parking.

   I would also do a detailed analysis of the neighbourhood character as an important consideration of town planning is keeping the neighbourhood character.

   It is important to assess what the market wants in that area and what would sell or lease well. It is important to design and build something that is marketable.

   I then put pen to paper and do some sketches allowing for setbacks, driveways, private open space (what you may call a back yard) as required by council. Ideally private open spaces should be north facing to maximise their exposure to the sun and these areas often have other restrictions on them regarding their configuration.

   I then place garages and parking spaces and leave room for turning circles to drive out in a forward motion as required by council. The amount of land that is left over after all of this will determine how many dwellings and of what size can fit on the block.

   After taking into account all the above factors, typically the footprint of the dwellings we can build would take up less than 50% of the land.
At this concept stage I would also take into account potential objections from neighbours. In some municipalities you can always count on the neighbours objecting about new development projects and if possible I steer clear of these suburbs.

After all this I finally do some number crunching in my feasibility program. I include time scales, all costs including consultants and construction costs. I include likely end sale values and the profit margin that I want and this allows me to work backwards to find out what the land is worth to me. The maximum price I could pay and still make a decent profit.

If after all this the project is still viable I would consider putting in an offer for the land.

3. **Purchase**

Now we reach the exciting part – buying the land at a price that would allow me to make a commercial profit using the figures in my feasibility study.

4. **Town planning**

I now brief my architect to draw up plans that comply with the council’s development guidelines. I usually involve a surveyor to measure up the land and a town planner to help drive the project through the development approval process. Due to the increasing complexity of the town planning process, this stage of the development can take up between 6 and 12 months before you achieve development approval.

5. **Working Drawing and documentation.**

Once the Development Approval (permit) has been achieved our architect and our engineers document the working drawings to allow us to get a building permit (also called a Construction Certificate (CC). This stage could take 3 - 4 months.

6. **Pre Construction Stage.**

At this stage we obtain quotes from builders and bank approval for the development loan.

7. **Construction**

Finally we get on site to build our project, paying the builder progressively at the completion of each stage using draw downs from our bank loan. This stage can last 6 – 12 months depending on the size of the project.

8. **Completion**

The project is leased or sold.

As you can see the development process for a new multi unit project is a long one – it can easily take 2 years from beginning to end.
COMMON REASONS WHY DEVELOPERS FAIL

Unfortunately the development process is complicated and I have seen many smart investors turn their hands to property development and lose money. The common reasons this occurs:

1. They paid too much money for the property.
2. They haven’t done an accurate feasibility study before purchasing the property.
3. They became over confident after doing one or two successful development and were prepared to accept too low a profit margin.
4. They timed their property development poorly with regards to the property cycle. Completing a development in the depth of a slump can be disastrous on the end result. As a property developer you have to be one step ahead of the property cycle recognizing that your development project could take up to two years.
5. Some property investors move into the realm of property development not understanding the rules of the game are very different. They don’t know what they don’t know and they get caught.

CASE STUDY – JOHN AND KAREN

John is a project manager and Karen is a teacher. They knew they wanted to grow their wealth and decided to get involved in property development.

In 2003 they bought an old run down house on a good block of land in Mt Waverley, an eastern suburb of Melbourne. Over the next two years, with the help of their development manager (Metropole Projects - www.metropoleprojects.com.au) they gained development approval for a 2 townhouse project.

Their property was tenanted for the first 12 months of the project before building commenced. Their development manager then organized working drawing, building quotes and helped them sign a “fixed time, fixed price” building contract. They recently completed their two townhouse project which was quickly leased and they are now keeping them as a long term investment.

Here’s how the figures stacked up:
- Purchase site in 2003 Cost: $400,000
- Purchase costs – stamp duty etc Cost: $20,000
- Obtained development approvals Cost: $17,000
- Demolished existing house and build 2 new ones Cost: $400,000
- Holding costs after rental for the first year, including interest Cost: $50,000
- Valuation on completion Cost: $1,100,000

**Capital gains:** $213,000

In short by becoming property developers John and Karen are able to capture equity in their property much faster then if they would have purchased their properties retail.
CASE STUDY - DANIEL

Daniel is a psychologist who lives in Bryon Bay and bought an old run down house on a large block of land with development potential in an eastern Melbourne suburb. He used the services of Metropole Projects to source the site and do a pre purchase development feasibility analysis. This detailed feasibility study showed the potential to develop a 3 unit project on the land. Daniel purchased the property in May 2005 and by December 2005 he obtained Development Approval from the local council for 3 townhouses.

Let’s look at how the figures stack up:

- Purchase site in 2005: Cost $470,000
- Obtained development approval: Cost: $21,000
- Market value on obtaining market development approval: Cost: $570,000
- Approximate net costs of ownership to date interest minus rent: Cost: $5,000
- Acquisition costs: Cost: $25,000

**Capital gains:** $49,000

At the time of writing, Daniel was refinancing his property against his increased equity and so he can continue on with the development of his units.

THE KEYS TO BUILDING A SUBSTANTIAL PROPERTY PORTFOLIO

I have detailed my strategy for building a Multi Million Dollar Property Portfolio throughout the various chapters of my book. You know you want to build a substantial property portfolio and you want to get set to take advantage of the next property boom. This last chapter on property development just accelerates all that you have learned in previous chapters.

The basic steps to creating your own substantial portfolio that will one day lead to your financial independence are:-

1. Buy a well located property at **below market value** and take out a loan for 80 - 90% loan to value ratio (LVR)
2. **Add value** to your property through renovations or refurbishment or redevelopment.
3. **Lease your property** – this should be at a better rent now that you have improved your property through refurbishment. If you have constructed a new townhouse as part of a development project, you should have a flood of potential tenants.
4. **Refinance** your property taking advantage of its increased value because you have bought well and added value.
5. **Extract your deposit** and do it all again!
6. **Never sell!**
You will speed up this whole process if you think like a developer. I’m talking about having a developer’s “mindset.”

Now, just to be clear, this does not necessarily mean literally being a developer, because that just doesn’t suit everyone. What I mean is to constantly think like a developer and always look for ways to add or “create” value, in order to maximise the return on your investment.

As you have learned from this chapter thinking like a developer, or becoming a developer, is a great way to quickly increase the value of your investments and allows you to build your property portfolio more quickly than the average investor. It gives you the opportunity to refinance more quickly as you are creating your own capital growth - a great strategy today when there is generally poor capital growth in most of our major markets.

But there is one tactic I would you to use that most developers ignore and that relates to refinancing.

Most developers I come across have the wrong mindset – they like to trade their properties. They buy, add value and sell. But then they “kill the goose that lays the golden egg.” Someone else now owns the property and gets all the benefit of the long term capital gain.

My suggested strategy is to buy, add value and refinance.

Let’s say, for example, that you release $80,000 of equity from your home and buy an investment property for $300,000. You use $45,000 as a deposit, and get an 85% mortgage (for $255,000) and then spend your remaining $35,000 of your funds on purchase costs, stamp duty and on a full renovation including a new kitchen and bathroom.

If you have done a substantial renovation, and done it well, this could easily increase your properties value to $360,000 and should considerably increase its rental return.

Down the track you could refinance your newly refurbished property, again to 85% of its value which gives you $306,000. You pay off your original loan of $255,000, leaving you with around $45- $50,000 after financing costs to go and do it all over again.

By extracting your deposit and possibly some or all of your refurbishment costs through smart refinancing, you are effectively using the same money, over and over again, to buy and develop a series of properties.

And the great thing is you don’t need to sell the properties at the end. They remain as part of your Multi Million Dollar Property Portfolio growing in value over the years. If you get involved in development of new properties, duplexes, townhouses or apartments, the profits are even greater.

One of the major limitations of this strategy is your ability to make repayments on the mortgage of your property.
But because your properties will be refurbished or new properties that you develop, they easily attract tenants, achieve high rents, have good depreciation allowances and therefore have a low net cost of ownership.

In other words, what you have done is to realise the value you've locked in through buying below market value, adding further value (through refurbishment or redevelopment) and renting the property out at a top rent; by refinancing, taking your investment back out, and using it to finance the next property.

Your first development property allows you to raise the deposit for your second one and you then go and do it all over again. You buy a property with development potential below market value, adding value through redevelopment or refurbishment, let it to tenants at a top rent and refinance your second property against its new higher value and raise money for your third property.

As I said, this is really no different to the strategy I explained in earlier chapters of my book, it is just greatly accelerated by you thinking like a property developer and adding value. **It's a great way to grow your own Multi Million Dollar Property portfolio.**

**SOME FINAL THOUGHTS**

It is important that you realise that by becoming a property developer you have created some equity out of thin air.

2 plus 2 = 5

If you undertake your development project correctly, the end value of your project will be considerably more than the sum of the all the costs of the project. This extra equity is yours and you don’t pay tax on it – unless you sell the property. That’s one of the reasons I strongly advocate never selling.

Rather than selling, but by retaining your property and leaving equity in your property, you are effectively saving it, and you don’t pay tax. But just leaving your money in the property is probably not the most efficient use of your funds. By extracting your equity though refinancing and using the funds to finance your next purchase, you are not really spending your equity. You are just making your money work harder and more efficiently for you.

Consider this carefully because it is an advanced finance concept. Extracted equity used to finance further purchases is effectively using your equity to create further equity!

By using the released equity as a deposit for your next property and having a mortgage for the remainder of a new purchase price, it means **you are using none of your own money.** So the investment return on your funds, the cash-on-cash return is infinite!

It is often said that **money attracts money.**

Well, that’s the end of this chapter and the end of this book, but let’s not makes it the end of our relationship. Please subscribe to my free e-magazine at [www.PropertyUpdate.com.au](http://www.PropertyUpdate.com.au) so I can keep in touch with all the latest in property investment. You will also get advice from some of Australia’s top property experts.