

Multi-phase projects

Key issues for an investor to consider before buying

By Desmond Hughes and Kris Limcharoen

A purchaser or investor in a real estate development, seeking to profit from capital appreciation of the unit and rental income by buying into an early phase of development, may not be aware that it can seek to obtain reasonable additional protections or assurances, some of which can be legally documented, and some of which involve thorough due diligence of not only the target development, but the areas surrounding it and likelihood of neighbouring development activity or use.

Below comprises a summary of key issues for an investor to consider and possibly document when buying in an 'early' development phase, such issues applying to a particular set of circumstances typically influenced by project location; strength and available funds of the developer; building restrictions and success of the first phase.

How many phases?

A buyer may wish to assess the potential benefits of buying early into an off the plan development by interpreting the rising values of re-sales of wholly built units of a comparable size, quality and location and calculating rental income less expenses, which is a very basic overview of a 'novice' or lay second-home investors approach to investment. It may be true that there will be capital appreciation and some form of rental income, but there are ways that a buyer or group of buyers may look to ensure that there potential income and return is not miscalculated by a failure to take into account the activities and development of the project.

If the first phase of a project is successful, a developer would be missing a trick if it possessed some ability to develop Phase

II, and capitalise on the success of its initial efforts. This means that Phase II is very likely, unless Phase I is landlocked. Therefore, one of the first enquiries of a buyer should be whether there are plans or even the possibility exists. Having more than one phase is not necessarily negative, but not knowing the facts can cause miscalculation and mismanagement of expectations.

Sample of effects of multiple phases on contracts

When selecting a unit as one of the first units to be sold, a buyer may be under the impression, when looking at the master plan, that after the unit is finished, full use and enjoyment may be made of it. How-

ever, it may be that unit 1 falls close to the edge of the project, is completed first but then Phase II begins therefore placing unit 1 next to a construction site. If the developer discloses that this will be the case or the buyer finds out, there is an opportunity to negotiate use of an alternative unit until peace and quiet may be had in the affected unit. This can be included in the sales documentation.

cluded a management and use of common areas agreement, then care should be taken to see how the common areas are controlled, and the mechanisms for the owners to prevent if necessary a mis-use of common areas for the exclusive benefit of Phase II.

In Phase I, if a car parking space is communal without designated parking areas, then Phase II, if insufficient car parking is provided, may result in an impact on the parking of vehicles by Phase I owners. Attention must be drawn to the rules and regulations of the estate, the lease rights in relation to designate parking for unit numbers and the enforcement provisions for breach by third par-

rect or useful benefit to Phase I owners, there may be an unfair increase in the management charges.

It is very difficult to equitably deal with the matter of potential increases of fees in a development management contract, especially when the development has yet to be completed. However, a practical way of anticipating increase in fees is to make enquiries of the developer of not only the costs in Phase I, but the probable increase of costs post Phase II. The solution then becomes a practical issue relating to due diligence and enquiries, over and above the contracts.

Summary

A buyer should not complain about the quality of an estate being lifted by the introduction of Phase II. A buyer should not complain either if Phase II is a surprise because it failed to raise the necessary enquiries prior to committing to a purchase. Possession of knowledge of Phase II means that calculations on rentability on Phase I units during construction of Phase II may be accurately made, and impact on common facilities and use can be predicted, and importantly, documented to provide protection of the owners in Phase I who will have paid for the unit expecting a minimum. The onus is really on the buyer to investigate a project thoroughly, but it may also rely upon its advisers to be familiar with the issues that arise in multi-phase developments.

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Access roads may look satisfactory to a purchaser in Phase I. However, Phase II may result in a huge increase of traffic through Phase I to Phase II especially if Phase II comprises a far greater number of units than in Phase I. If the contractual documents in-

ties of any private areas – such as parking.

The management fees in a well managed development should not be absolutely capped or fixed without room for adjustment to provide necessary facilities and to account for inflationary costs. If Phase II results in a greater number of users of the development in the manner of a resort, and this results in the 'rent-ability' of the units in Phase I increasing, then Phase I owners should not complain. However, if Phase II introduces new water features, high maintenance lifts, and a host of other 'features' that result in higher maintenance fees and charges that may not be of di-