TIPS FOR SELLING MANAGEMENT RIGHTS

Maximising the value of your business

Having all the accounting matters in order is a vital component in achieving the maximum value for a management rights business.

Before the business is listed for sale it is important to do some "housekeeping" checks and sort out any problems or contentious matters, rather than these raising their head in the sale process.

It generally costs more to fix then, is time consuming and may erode the buyer's confidence in the business which could lead to a lower sale price.

Some matters to consider are:

Agreements – body corporate & owners - Management rights businesses achieve high values because of the stable and recurring nature of the income. The right to earn income is based on two sets of agreements, caretaking and letting agreements with the body corporate and individual letting agreements with each lot owner (*PAMDA* forms). These agreements should be reviewed to ensure that they are up to date, have an adequate term and are in place with all relevant parties.

Assets to be sold - Prepare a detailed list of what assets are being sold with the business, what they are worth, have you got proof of title to these assets, are there any finance facilities attached to these assets and if so, how do you intend dealing with this.

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Accounting records - The trust account and general account accounting records should be kept up to date so that any prospective buyer can easily trace income through the system and in to the sale figures for the business. Ensure your licence is current and trust account audit reports are up to date.

Unit owner charges - Letting income comprises unit owner charges for commission and other services. These charges should be reviewed on a regular basis, generally yearly, to ensure that they are up to date, are competitive in the market place, and in line with the *PAMD* agreements and what is being charged through the trust account system.

Net profit - The value of the management rights business is based on a function of the net profit of the business times a multiplication factor. Anything that can be done to increase revenue or reduce costs will directly and positively impact on the value of the business.

Therefore it is worth reviewing if there is any scope to increase revenue, whether by increased room rates/occupancy/unit owner charges or perhaps some new revenue streams. Similarly any business expenses that can be reduced or handled in a more efficient way will also increase the bottom line profit.

David Jackson
HLB Mann Judd

Taxation issues - Lastly discuss your sale plans with your accountant as the income and capital gains tax rules surrounding sales of businesses are complex and a badly structured sale transaction may result in the manager paying more tax than necessary, thereby reducing their net proceeds.

Once you have done all your housekeeping, the next step is the preparation of sales figures for the business.

Up-to-date sales figures - All vendors should have a 'sale basis' profit & loss statement for the business prepared by an

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tips for selling management rights

Use an Expert

In previous articles for this feature in *Resort News*, I said "the best advice I can give any potential seller of their management rights is 'prepare for it well in advance'. Nothing has changed. As I said then, that might sound like something fairly simple but it is advice often overlooked, sometimes at significant cost.

But how then should you prepare for a sale?

First, check your letting appointments to see if they contain an assignment clause, as they will only be assignable to a buyer if they do contain such a clause or you obtain the consent of all owners to an assignment to the buyer. It is also an offence for you, in the case of a letting appointment without an assignment clause, to assign that appointment without the owner's consent.

Almost without exception, buyers are insisting that all appointments be properly assignable and assigned at settlement or the purchase price be reduced for non-compliant appointments. In one case I saw a purchase price reduced by $70,000 and in other cases have been terminated because the sellers did not want to, or were not able to, assign appointments.

If your appointments are not assignable, you should consider new appointments (particularly if the existing ones are a few years old as there have been many changes that should be incorporated) or amending the existing appointments to include assignment clauses. We have developed a simple one page amendment document that many of our clients (and sellers to our clients) have used with success.

Next, check your body corporate agreements.

Locate copies of all of the relevant agreements with the body corporate – copies of the caretaking and letting agreements, deeds of assignment, deeds of variation and the like. If my firm has acted for you, you would have all of these documents in the indexed binder we give our clients after settlement of their purchase.

Get the real estate agent you have selected to scan electronically and/or take photocopies of these to give to prospective buyers. You should also give your solicitor copies of these documents for two reasons. First, your solicitor can check that everything if in order - for example, that options have been properly exercised. Secondly, if the buyer's solicitor or financier raises questions about the agreements during the course of the transaction, your solicitor will be able to deal with the matter quickly and efficiently.

Then you need to consider the term of your agreements. Unless you have a long-term agreement with your body corporate, you should be thinking about your sale as early as the time you buy.

You must also consider that most (if not all) buyers will want at least six to seven years to run on agreements when they purchase. Some buyers and their financiers want even longer, depending of course on the amount being borrowed – we often receive demands to extend seven to eight year agreements to 10 years.

If you buy with 10 years or so to run on your agreements, you will probably have to sell within no more than three years to avoid having to get new agreements or a new option added.

If you buy with eight years or less and plan on staying for two-three years or more, you will have to secure new agreements or add another option before you sell.

At least the transfer fee rules have been changed and you will not be penalised just because you sell within three years of getting a new agreement or adding a new option. Now it is only if you sell within one to two years of becoming manager that the transfer fee applies and the body corporate must impose a transfer fee of 3% or 2% of the business sale price.

Adding a new option to an existing agreement is technically prescriptive. Apart from getting a new agreement, this is the only way that the term can safely be extended. Because of these technical requirements, many lawyers and body corporate managers have failed in their attempts to extend the term.

Because of our involvement in the legislative changes (in fact we designed the prescribed statutory form that must accompany the motion to add the new option), we have been called upon on a number of occasions to remedy ineffective additional options ruled invalid by the body corporate commissioner's office.

You will need up-to-date financial figures. Take the time and spend the money to get up to date figures for sale purposes from your accountant. So many sellers rely upon outdated financial figures or on figures that are not really prepared for sale purposes.

I have seen a number of sellers grossly underestimate their net profit and find that the buyer's accountant has verified a net profit well in excess of that shown in the contract. With multipliers of around five and above, a difference of only $5000 will cost you more than $25,000 – enough to cover a fair component of the agent's commission.

Make sure you get the most up to date figure you can. You would expect these to show a higher figure than figures a month or two older but if they don't, you can at least decide what it is you are going to rely upon and include them in the contract.

Make sure your body corporate salary has been updated to take into account the latest CPI increases or any market review that might be permitted under your agreement.

Above all, use the experts.

You might think that you don't need an accountant or a specialist accountant to put together your net profit figures. As any honest accountant will tell you, it is a very specialised area. As a general rule, figures prepared according to normal accounting standards will show a net profit lower than the way in which it is calculated for sale contract purposes. Only a specialist accountant will be able to produce accurate figures.

You might be tempted to use a local or suburban lawyer because they offer a cheaper rate. Although as a general rule there are fewer legal issues when you are selling than when you are buying, I have seen so many sellers get themselves into trouble because they have tried to save money by using a lawyer who does not specialise in the area.

You need someone who understands management rights to be able to deal with any issues raised by the buyer or the buyer's solicitors – so often we are able to salvage a sale transaction because of our expertise and ability to convince other solicitors of our view of the legal position.

John Mahoney
Mahoney Lawyers

Perceived savings on commission might encourage you to market your business yourself rather than use an agent and sometimes you might succeed. But there are downsides. A good agent will help guide a buyer through the purchase process and often keep together a sale that might otherwise fall apart. I have seen that happen on more than one occasion.

A good agent will also pre-qualify a buyer to ensure that your time is not wasted by people who will not get finance approval.

On the other hand if you are able to find a buyer yourself, an experienced lawyer will be able to handle contract preparation and negotiation.

> **"...I have seen so many sellers get themselves into trouble because they have tried to save money by using a lawyer who does not specialise in the area..."**

accountant experienced in the management rights industry. The sale figures should be no more than three months old (as in for the 12-month period ended 30 November 2012) and the manager should be prepared to have these figures refreshed on a regular basis so they remain current.

Sales figures that are not up-to-date make everyone's job harder and even if you find a buyer who will accept such figures, they will most likely not be accepted by the banks financing the buyer.

Wages - The most contentious expense item in the profit & loss statement will be the level of external wages/contractors; whether that be unit cleaners, reception, gardening, maintenance, etc. Because the sale profit is calculated on the basis of including all wages "other than those of the working proprietors (two only) and any work that those two people could reasonably do themselves" it becomes a subjective analysis as to how many staff are required to effectively run the business.

In our view the best way to address this issue is for the manager to prepare an analysis of what staff/contractors are engaged at the business, their specific duties and hours of work. A similar analysis should be undertaken in respect of the managers themselves and, if the managers are not working full time, detail what other duties they could do and which staff wages would be reduced as a consequence.

Income should be recurring - In buying any business, what the purchaser will pay money for is recurring income. Accordingly one off income items will most likely be eliminated and new areas of income that have not been in existence for at least 6 - 12 months are likely to be either eliminated or discounted in the profit analysis. One way to address this issue is to have documented agreements of some form to support the sustainability of the income.

Alternatively if an income stream is still fairly new and there are some genuine concerns about the sustainability of this income, another option may be to defer the sale of the business for another 6 – 12 months, by which there will a more solid track record of earnings from this area.

These are general guidelines only and it is important any manager considering selling their business get professional advice on the accounting issues from an appropriately qualified accountant.

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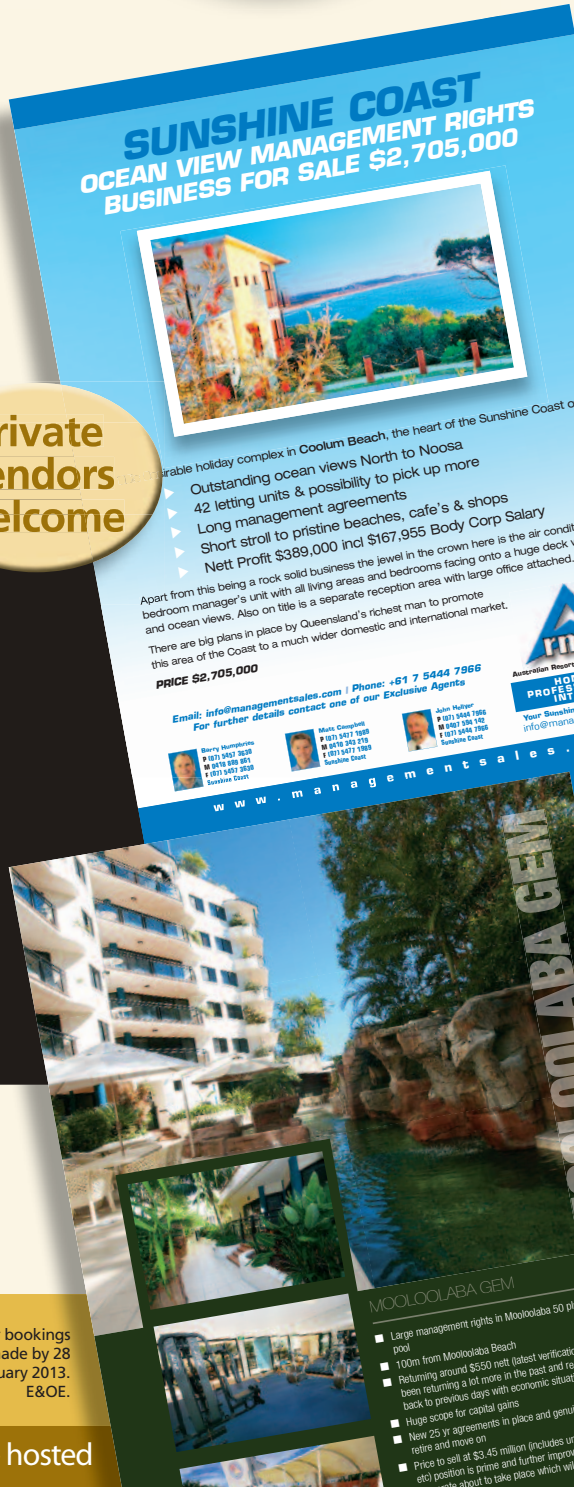

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