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Commercial
Lawyers



RENT ROLL

LEGAL GUIDE TO BUYING AND SELLING A RENT ROLL

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The sale or purchase of a rent roll involves different considerations to many other types of businesses due to the nature of the assets being sold and the way rent rolls are valued.

Buying a rent roll

A good quality rent roll, which is properly managed, will provide stable management income for an agency even during challenging times. It can also be a highly saleable capital asset.

According to research by Macquarie Bank, residential property management now typically accounts for between 40% to 50% of agency revenues in Australia.

A rent roll is essential to maintain and grow a successful agency because of the income it generates, and also because of the way it 'feeds' or drives the sales business.

Whilst there are risks associated with purchasing an existing roll, the purchase of a good-quality roll can assist with rapid business growth.

Legal Guide

to buying
and selling
a rent roll

Authored by
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Principal

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POSITIVES	NEGATIVES
Increases cash flow and provides stability of income	Legacy issues (e.g. maintenance issues, pending tribunal hearing and insurance claims)
Eliminates a competitor from the local market	Lost managements on the sale of the roll
Drives opportunities for the sales department	Non-conforming managements (e.g. invalid authorities, no gas and electrical safety checks)
Turbo-charges business growth	
Increases database and marketing opportunities	

Due Diligence

If you are purchasing a rent roll, it's strongly advised that you engage an experienced team of professionals to advise you on the transaction.

This might include:-

- An accountant to advise on all financial due diligence enquiries;
- A rent roll broker who negotiates the sale or advises on the value of the rent roll;
- A property professional to assist with all relevant operational and due diligence enquiries;
- A finance broker to assist with funding; and
- A lawyer to advise on all legal aspects of the transaction (e.g. legal due diligence, and advising you in relation to the sales contract)

One of the most important considerations when purchasing a rent roll is determining whether, having regard to the purchase price and the level of investment required, the roll is profitable, or has a reasonable prospect of becoming so.

A thorough financial due diligence should be undertaken in conjunction with your business advisor and/or accountant to determine if the purchase price is justified, and to provide some analysis of the business' financial records.

The most
important
consideration:
will your
rent roll be
profitable?

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Due Diligence Questions

If you are purchasing a rent roll, the sort of questions you would be seeking answers to include:-

- What are the average rents and management fees?
- How many properties are owned by the vendor?
- Are all authorities and files up to date?
- What is the location and type of properties being managed?
- What is the ratio of landlords to properties?
- What is the current staff structure? Will they stay on? How much do they cost?
- Are there outstanding tribunal hearings or insurance claims pending?
- What is the current level of demand for rent rolls in the area?
- What property management software is used by the Vendor? Will this present integration issues?
- What percentage of properties on the roll are in arrears? Or vacant?
- Are there currently properties for sale? Will these be lost from the roll?
- Are rental bonds held for each property?
- Are there outstanding maintenance issues?

QUESTIONS
QUESTIONS
QUESTIONS!

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Valuing the Rent Roll

The value of a rent roll is usually determined by applying a multiplier to the annual management fee income. The agreed multiplier will be affected by a range of factors including:

- the average annual rent and management income of each property;
- whether properties are largely owned by single or multiple property owners (a higher proportion of multiple property owners increases the risk of loss on sale);
- the geographic spread of the properties (management of properties spread over a large area is likely to increase travel time and costs);
- whether the properties are predominantly commercial or residential (with commercial properties usually attracting a higher multiplier);
- the location and desirability of the properties; and
- the type and duration of the leasing authorities.

Depending upon the above factors, and the answers to the due diligence questions, the multiplier will typically be between 2.0 – 3.5 times the annual management fee income. However, this will also be influenced by the ordinary principles of supply and demand.

“The value of a rent roll is usually determined by applying a multiplier to the annual management fee income”

How is the
rent roll value
determined?

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Legal Documents

Confidentiality Agreement

If purchasing a roll, the broker will usually require a potential purchaser to enter into a confidentiality agreement before disclosing confidential information in relation to the rent roll.

Terms Sheet

If a sale is negotiated, the broker may require the parties to enter into a terms sheet which sets out the principal terms of the proposed sale. This is sometimes prepared as a non-binding agreement which is subject to the parties entering into a long form contract of sale.

Contract of Sale

The contract formalizes the deal and can address any issues identified in the due diligence process. It is important to ensure that you have either completed your due diligence before entering into the contract, or that a due diligence period is specifically negotiated in the heads of agreement. Your lawyer should assist with negotiating the terms of sale.

Protecting
the
goodwill
of the
business

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Retention

From a purchaser's perspective, to protect the goodwill of the business, it's critical to ensure that as many leasing authorities are validly transferred to it on the settlement date.

A retention sum is usually negotiated to ensure a smooth and effective transfer of the authorities to the purchaser. This will be adjusted if properties are terminated or lost at settlement, or at the end of the retention period.

The retention sum will typically be 20% of the purchase price negotiated at the time of sale, and will be held for between 3 – 6 months after settlement in the broker's trust account.

A retention sum will usually be required by the purchaser's bank if the purchaser is obtaining finance.



Adjustments to the Sale Price

The long form contract needs to have appropriate adjustment mechanisms to vary the purchase price (and the calculation of the retention sum) if:-

- any leasing authorities are terminated from the date of the terms sheet to completion, or during the retention period;
- any properties become vacant prior to the settlement date or at the end of the retention period;
- any properties are in significant arrears of rent or outgoings on the settlement date or at the end of the retention period;
- new leasing authorities are entered into between the date of the heads of agreement and the settlement date or during the retention period;
- any properties, which were vacant at the date of the heads of agreement, become tenanted by the settlement date or during the retention period.

A well-structured agreement will also ensure that the purchaser is obliged to manage the roll in accordance with best commercial practice until the end of the retention period. It will also set out circumstances that will not result in an adjustment to the sale price, including where:-

- there is a failure by the purchaser to properly manage the properties after the settlement date (and this results in a loss of management); or
- a management is lost because it is sold by the purchaser between the settlement date and the end of the retention period.

“Unfortunately, many of the rent roll agreements in the marketplace fail to deal with the above issues adequately (or at all). This can impact significantly on the financial outcome for both vendors and purchasers”

A failure to
deal with
adjustments:
what does that
mean for you?

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GST

There is some uncertainty as to whether the sale of a rent roll (rather than a sale of the agency business itself) qualifies as a sale of a GST-free going concern.

The GST legislation provides that the sale of a business as a going concern is GST-free if all of the following apply:

- everything necessary for the business's continued operation is supplied to the buyer;
- the seller carries on the business until the day it is sold (that is, until settlement);
- the buyer is registered or required to be registered for GST;
- payment is made for the sale; and
- before the sale, the buyer and seller agree in writing that the sale is of a going concern.

The issue as to what is "necessary" for the business' continued operation arises particularly in circumstances where the sale does not, for example, provide for the assignment of the office premises lease, the transfer of employees, or the business name.

In light of that, it is prudent for parties to seek their own tax/legal advice on this aspect of the transaction having regard to the specific terms of the sale.

Will the
sale be GST
free?

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Conditions Precedent

A condition precedent (CP) is merely a condition that needs to be fulfilled before performance of the contract becomes due. The following are some common CPs in rent roll agreements:-

Due Diligence

This provides a purchaser with a period in which to undertake its own legal and accounting due diligence. It will usually be for a period of between 14 to 30 days.

Finance Approval

This ensures that an offer is made subject to the purchaser's bank approving finance. As with due diligence, this will usually be for a period of between 14 to 30 days.

Following the Hayne Royal Commission, and a tightening of lending criteria, finance approvals are becoming more difficult to obtain, and the process is becoming lengthier.

Banks will generally lend up to 60% of the value of the rent roll without requiring separate security.

Franchisor Approval

If the vendor operates under a franchise, then it would be typical to include clauses which make the sale subject to (as applicable):-

- the franchisor not exercising any pre-emptive rights to purchase the rent roll from the vendor;
- the franchisor consenting to the transfer of the rent roll and the franchise agreement to the purchaser; and
- the franchisor providing all necessary releases to the vendor and its directors from the franchise agreement.

Restraint of Trade

From a purchaser's perspective, a restraint of trade clause is critical to protect the goodwill of the rent roll after the settlement date.

Most restraint of trade clauses only operate to restrict the vendor from competing with the business in terms of time (e.g. 3 years from the settlement date) and distance (e.g. 10 km from the business premises).

However, it is typical in rent roll sales to include a restraint that restricts the vendor, its directors, and related entities from soliciting, canvassing, inducing or securing the custom or patronage of any landlord's property on the rent roll for the entire restraint period.

However, it may also be necessary to structure the restraint to ensure that a vendor can continue to operate as a leasing/sales agent after the settlement date but subject, of course, to the above limitations.

Due Diligence

Finance Approval

Franchisor Approval

Restraint of Trade

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Dispute Resolution

The risk of disputes in rent roll sales is somewhat increased as a result of the fact that a proportion of the purchase price is held back at settlement for the duration of the retention period.

A well-structured sale agreement should contain detailed clauses which outline the way that any disputes are to be resolved. This might include provisions which require:

- the parties to initially negotiate in good faith to resolve any issues; and
- refer any matter to mediation or arbitration before court proceedings are issued.

Conclusion

There are numerous legal issues which arise in the context of rent roll transactions. It's recommended that you seek the advice of a commercial lawyer and rent roll broker who have experience with these types of transactions to ensure your rights are properly protected, and the process is managed efficiently.



How will
disputes be
resolved?

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MATTHEW BAKER- JOHNSON

Principal



Matthew is an experienced commercial and corporate lawyer who advises on a broad range of business, property and private client matters.

He is the preferred lawyer for some of Melbourne's leading business brokers, and regularly acts for business owners, landlords, accountants, Owners Corporations, high net worth individuals, executors and administrators and real estate agents on their business and personal matters.

MEET THE TEAM

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Matthew has advised on a range of transactions in the hospitality and tourism sector (including the sale and purchase of cafes, restaurants, pubs, hotels, motels and leisure facilities), professional service firms (including real estate agencies, telecommunication businesses, bookkeeping firms) and on numerous deals in connection with industrial businesses (wholesale, import, B2B and manufacturing businesses).

He has advised extensively on property transactions including the sale and purchase of residential, commercial and industrial property, commercial leasing matters, and various building contracts and project management agreements. His advice work includes acting for clients on a range of dispute matters in relation to board deadlocks, shareholder disputes, commercial disputes, debt recovery, and estates litigation.

Matthew is valued by his clients for his 'no-nonsense' approach to legal issues, his excellent project management skills, and his commitment to delivering sound legal outcomes. He is a regular commentator on commercial legal issues, and enjoys working closely with clients and their advisers to ensure matters proceed smoothly.

If you wish to discuss the purchase or sale of a real estate agency or rent roll, please feel free to contact Matthew on 0438 029 433 or at email mbj@averylaw.com.au.

SUSIE MANIAS

Senior Law Clerk

Susie has over 30 years experience working as a senior law clerk in Melbourne's top legal firms.

As an experienced clerk, Susie has acted on a range of commercial, conveyancing, probate, franchising, debt recovery and litigation matters. Her current area of practice is mainly on sale of business transactions (including agency and rent sales), probate and conveyancing matters.

Susie takes enormous pride in her work, treating her clients like family and always striving to provide exceptional service. She is highly regarded by her clients and referrers alike.

If you wish to contact Susie, feel free to call her on (03) 9020 7344 or by email at susie@averylaw.com.au



Testimonials

“Without the help of Matthew and Susie, I know there are a number of my transactions that may not have had a successful outcome. Matthew recently took on an extremely difficult transaction for one of my clients and encountered issues that no one expected and few had ever seen. Matthew and Susie worked tirelessly to protect the interests our client. Though we faced many challenges, Matthew did not falter, his professionalism, honesty and integrity guided us through the entire lengthy process and provided the pathway we needed to achieve a successful outcome.

I highly recommend Avery Commercial Lawyers and will continue to engage them for all our business sales”.

Gary Lay, Senior Business Consultant, Wollermann Business Brokers

“Matthew was great to work with on a recent transaction. It was complex and testing at times, and Matthew’s advice and guidance was excellent. I would highly recommend.”

Nick Dowling, CEO, Jellis Craig Group

“I’ve worked with Matt on a number of transactions over the last few years, including the sale of my real estate business. He has a very good ability to work through complex legal issues, and is very much ‘in the trenches’ with you as you navigate legal problems. He’s become a trusted commercial advisor and I have no hesitation in recommending for commercial legal services.”

Robyn Adair, General Manager, Formerly Stockdale & Leggo (Glen Waverly)

“I have recently used the services of Matthew for the transaction of 3 separate entities. Throughout the process I found Matthew to be extremely attentive and thorough. But most of all I found that he not only protected my interests at all times he CARED about achieving the best possible outcome for ME whilst not running up the costs of his professional fees for self serving reasons.”

Troy Sheehan, Managing Director at Jellis Craig (Whitehorse)

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here
to help

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