No regrets

Michael Whitehouse may not have made a huge profit on his first property development, but the 26-year-old's beachside project has given him invaluable experience and made him a more confident investor. BEN POWER

Michael Whitehouse was 24 years old and successful. He was making good money as an engineer, but there was something missing.

"All my income was going into savings and I wanted to focus on having my money work for me rather than just sitting in the bank," he says.

He decided to do his own development, with help from his girlfriend Jenny, another budding property investor.

He built a three-bedroom house in the New South Wales beachside town of Diamond Beach, which was completed in February and recently rented.

The construction was relatively smooth, but he struck significant problems with his banks, including bad advice and payment delays. He also had bad luck with the global financial crisis (GFC) hitting just as he was building, which has cut prices in sea change areas like Diamond Beach.

Michael, now 26, has no regrets, and has chalked up the development as a major experience.

"Knowing what I know now I'd probably do the same thing," he says. "I'd change aspects of the way I did it, but not the experience itself."

But after the hard work of developing a property he has decided on a completely different route for his latest property investment.

IN THE BEGINNING

Michael became interested in property investment after finishing university.

"Most young people my age tend to buy an apartment, but I was looking for something a little more challenging and different, which is what led me to a development project," he says.

He began looking for development opportunities in June 2009. Because he didn't have any residential construction experience he was looking for projects with completed designs, or something else that would provide an easier, cheaper start.

Michael was living in Neutral Bay, Sydney, but he focused on towns from Newcastle to Port Macquarie, where he grew up, and where Baby Boomers are retiring to.

"I could see value in those areas – the prices hadn't really spiked up like Sydney and there was an opportunity to take advantage of a lower market," he says.

Two options stood out immediately: they were large blocks of land in Port Macquarie with good future development opportunities in the $250,000 price range. But no work had been done yet. Michael then found a block just 150 metres from the beach at Diamond Beach, near Foster, which had certified plans. His first sight of it was an overgrown block of land with foundations already completed.

"I was attracted to the block because after running the numbers, I found it had already had about $40,000 worth of work done which wasn't reflected in the reduced land price," he says.

"I knew the value of the adjacent matching property and was confident with the proximity to the beach in a growing area. I saw it as a safe and easy first project."

The efforts of the previous developer of the block had stalled when they ran out of financing.

The seller was now stuck: because the foundations were complete, anyone who wanted to buy and build their own house couldn't modify them.

"They cut themselves out of the market completely," Michael says, "but it worked really well for me."

He viewed the foundations and plans as the opportunity for a cheaper, easier start.

"Because the groundwork had already been done it made it an easier start for me," he says. "With the foundations already laid, all the unknowns during construction had already been dealt with – ground rock and things like that."

There was another comfort: the plans were exactly the same design as the constructed house on a block in front.

"I could see what the finished product was like and also see previous sales data for that house."

It was positive. The house on the front block had sold for $490,000 in 2006. Michael conservatively figured he could get $450,000 for his completed house, and a rough calculation of $230,000 construction costs meant a $60,000 profit.

His original plan was to keep the house as his principal place of residence to secure the First Home Owner Grant, then put it on the market to sell. He bought the block on December 18, 2009, for $160,000 – a substantial reduction on the $185,000 asking price – putting up a 10 per cent deposit and borrowing the rest.


An artist's 3D impression of Michael's three-bedroom house at Diamond Beach, NSW.

AFTER SETTLEMENT

Once Michael owned the block he performed a full "due diligence" on the construction and his experience as an engineer kicked in.

"I do a lot of design costing in my day-to-day work and I tried to apply that," he says.

"My experience at work isn't specifically in the residential design area, but what my experience did help with were in areas such as modifying plans, understanding the plans and terminology, product selection and working with contracts.

"Using the Rawlinson Construction Guide, my estimates were very close and I'd recommend this technique for preliminary pricing and to drive cost discussions when negotiating contracts."

The planned house was a beachside family home of about 150 square metres internally, with three large bedrooms and a bathroom off the main bedroom, a large main bathroom and living area upstairs. Downstairs included a large modern kitchen opening up into a large combined dining/living area with internal double garage and laundry.


Under construction

To take advantage of the views and ideal climate, the house has a further 100 square metres of decking, including a balcony off the main bedroom, a large entertaining deck off the kitchen and dining area and a large two-storey deck off both the living areas taking advantage of the ocean and rural aspects.

Michael set about finding a builder, scouring the *Yellow Pages* and talking to locals. He also drove around building sites and ended up approaching eight different builders.

"The one I ended up going with, who had done a local job in Talwood, I found through

The two-storey beachside house has decks off both living areas to take advantage of rural and ocean views.

word of mouth through the local area," he says.

Michael's hard work in finding the right builder was to pay off significantly.

DRAMAS WITH FINANCE

While Michael found a great builder, his experience with the banks was terrible, and it was to have major implications.

"The bank told me things then changed their minds, and also gave me bad advice," he says. "There were many examples where I was given the wrong information."

At the start of the project Michael's bank indicated that he could get an owner-builder loan with a loan-to-value ratio (LVR) of 90 per cent. It later dropped that to 70 per cent when he went for approval.

He had to proceed with a construction loan, which had a 90 per cent LVR but required him to enter into a building contract. That meant he lost the chance to make savings by doing more work himself, sub-letting and negotiating each part of the construction.

The bank's backflip also cost him $7000 of the available $17,000 First Home Owner Grant: as an owner-builder, under the grant's rules all he would have needed was the existing certification of the foundations to signify a start of construction. Under a construction loan he needed a signed builder's contract, but given the late change he didn't have time to have one signed before the December 2009 cut-off date.

There was another blow: the bank had originally told him he could use his First Home Owner Grant to make up the 10 per cent deposit for the house construction.

"When it got to the day, it turned out I didn't get the First Home Owner Grant till after I finished construction, so I didn't have that deposit," he says. "So I had to de-scope the builder's work to reach a 10 per cent deposit with the $17,000 cash I had available."

He took about $40,000 worth of work out of the builder's contract, including landscaping, painting and decking.

THE NUMBERS | MICHAEL WHITEHOUSE

Project	Build a 3-bed house on 600 square metres at Diamond Beach, NSW on a block with foundations complete
Date purchased	Settled on land December 2009
Occupancy	Interim occupancy February 2011, Final occupancy May 2011
Costs	
Purchase (Land $160,000)	$160,000
Purchase costs (Michael was stamp duty exempt as a first homebuyer and his conveyancer "did such a bad job that they agreed not to charge", however there were bank fees and foundation certification fees)	$4,065
Preliminary (Council Section 96 $512, engineering details $1,608, working drawings $500, all other preliminary work complete)	$2,620
Fittings (Bathroom $2,107, kitchen appliances $2,021, taps $2,551)	$6,679
Construction costs (base stage 15%, framing ground stage 15%, framing level 1 stage 15%, lock-up stage 15%, services 15%, completion 10%)	$174,000
Finishing costs (decking, landscaping, floors, driveway)	$30,913
Holding costs (bank interest)	$15,295
Council fees and rates (council, water, electricity)	$1,105
Other (water connection)	$1,608
Total costs	**$396,285**
Less First Home Owner Grant	$10,000
Total out-of-pocket costs	**$386,285**
Income	
Estimated value	Between $385,000 and $420,000
Current rental income	$370 per week
Total profit	Between -$1,285 and $33,715

Michael advises others dealing with banks to get everything in writing and not to rely on what they tell you without having a back-up plan.

Eventually the $174,000 loan was approved and building started on May 2010.

"The builder was fantastic," Michael says. "I had no problems with him."

But the bank was to become a nightmare again. "I had a loan but then there were more problems with the bank in releasing progress payments," he says. "One document got lost three times in the bank's internal mail".

Instead of 10 days, progress payments to the builder blew out to up to two months.

"The banks don't deal with many construction loans. It was something a bit different for them and the loan went straight into the too-hard pile." The builder was fine with the delays, Michael adds. "I kept him quite involved in the whole process. He knew what was going on. But at some stages he had to stop for up to two weeks because he didn't have the money to continue."

Michael's top 5 tips

1. The quality of your relationship with your builder is always the most important aspect of your building project. Don't let cost or quality disputes come between yourself and your builder; I was lucky to have this at Diamond Beach.

2. Be sure and confident of exactly what you want before your builder commences; any unnecessary changes after the contract is signed will inevitably lead to additional cost and time and is often frowned upon by the builder.

3. When it comes to making decisions, be direct and decisive, but know your limitation and when to refer to the experts. If you follow step one, then often your builder's suggested solution is the best course of action; the worst decision is no decision.

4. When dealing with banks, councils and external institutes, never rely on the advice provided as it may not always be correct. Always have a back-up plan and get all information provided to you in writing.

5. Building a house is as easy or as complicated as you make it. Don't dwell or lose sleep on the little things; keep a focus on the big picture and development goals.

BUILDING ISSUES

One of Michael's key principles during the building was to be flexible, particularly with the builder.

He says that even though you're trying to make things as good as they can be, don't strive for absolute perfection.

Michael also acted on suggestions from the builder. By this stage he was living in Wollongong, five hours south of Diamond Beach.

"I trusted the builder to make decisions with regards to aspects of the finer detail," he says.

For example, he originally specified a roller door to the double garage, but the detailing of the first level structure meant that it was going to sit low, so the builder suggested the alternative of a panel-lift style door, which they proceeded with.

The builder was finished by February and Michael was happy with what had been achieved given his earlier bank hurdles. But he had to finish the project himself, including landscaping, the laying of the decking (not the frames) and all the painting.

"I could have got the builder to do this work," he says, "but I enjoy doing a bit of hands on work myself."

Doing the work himself also saved around $20,000.

To make it more fun, friends came for weekends and helped out. His parents, who lived nearby in Port Macquarie, also helped.

To finish Michael worked solidly through Christmas of 2010.

"I look back at the time spent and ask myself if I had the finances available – which I do now – would I do those things myself? Maybe some of it, but not all of it."

Despite the stress of the weekends and holidays, Michael says the development strengthened his relationship with Jenny.

"I've got a lot of crazy ideas I'm always pursuing. I had to come


The deck off the kitchen is ideal for entertaining.

up quite a few weekends to stay. But it was quite enjoyable doing things together. I wouldn't say the project strained our relationship; if anything it built it in different ways."

THE END RESULT

Eventually the work was completed on February 10 this year.

Michael has recently rented the house for $370 a week, which he says is quite positive for the area.

"Hopefully that will reflect on future valuations of the property," he says.

But he's had mixed results when it comes to valuations, in part due to the impact of the GFC. Local agents valued the house at $385,000 to $420,000. His bank valued it at $350,000.

"The market in that area dropped right down because retirees held off retiring because of their super being down. It's also a small area and there are not a lot to compare it to."

But he's still confident the house is worth at least $385,000: similar places in the area are selling for $500,000, with the adjacent matching property selling five years ago for $490,000. "The bank has taken a conservative approach with $350,000 given the GFC, but this hasn't affected financing of future investments," he says.

But the lower-than-expected valuation meant Michael has had to ditch his plans of a quick sale and he now plans to hold onto it for a few years.

"I bought a lot of staging furniture to make it look nice for sale," he says.

"Now I'm renting it I realise I didn't need to do that."

He's also switched strategy for his next property investment.

At the start of this year he received some cash. "Rather than using that cash for further developments I swung completely the other way and went and bought something already completed."

On July 12 he bought a property in Wollongong, where Jenny had also bought an apartment.

It was a modern two-bedroom apartment, which cost $322,500. It rents for $360 a week.

Michael says that while the Diamond Beach and Wollongong properties aren't directly comparable, he's mindful that he spent $390,000 on the development, along with significant effort and stress, and it rents for $370; while Wollongong was cheaper, had no development hassle, and rents for just $10 less.

Even though these numbers favour the existing apartment, he hopes the capital gain in the beachside house is where it will come into its own.

PORTFOLIO | MICHAEL AND JENNY

Location	Purchase Price	Purchase Date	Weekly Rent	Current Value	Loan-to-value ratio
Diamond Beach	$392,219	Dec 2009	$370	$385,000	62%
Wollongong (PPOR)*	$335,000	Mar 2010	N/A	$365,000	69%
Wollongong	$322,500	July 2011	$360	$330,000	62%
Total	**$1,049,719**		**$730**	**$1,080,000**	**64%**

*PPOR = principal place of residence

HIS NEXT MISSION

Michael says given the state of the market, he's now looking to buy another established property.

"As the market drops the costs of constructing houses doesn't," he says.

"You get really good value in construction when the market is accelerating."

But he says when prices are falling you're better off looking at already constructed properties and focus on getting good deals.

Michael says he plans to focus on some high return investments to balance out the capital at Diamond Beach and move his loan-to-value ratio back towards 70 to 80 per cent.

Looking back on the project, despite the difficulties with the bank and the broader market, he's positive about the experience and confident about the results.

"In the current market, the development didn't look too good on paper, but with the great beachside holiday location and good rental income, I'm confident the property will support itself in the short term and have good capital growth in the long term, which will be a good mix and diversity with the rest of Jenny's and my portfolio." api