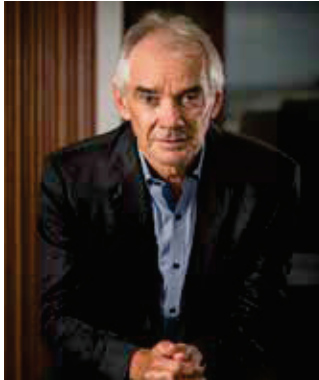


## Clawbacks:

# Where from and where to?



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**Anyone familiar with a rent roll sale or purchase will be aware that a buyer only pays for the actual letting appointments in place at settlement, and these transactions have invariably always come with a clawback mechanism.**

Typically, 20 percent or so of the sale price is held in a trust account for three months or more following settlement. At the end of that period, the buyer is paid the value of any letting appointment terminated by an owner.

Historically, there was nothing like that concept with a management rights sale. The price was based on the past year's income and bore no relevance to the number of units in the pool at settlement. The likely reasons for that are:

- Management rights and the sales of them were originally unique to the Gold Coast, where the agents and lawyers adopted an approach of Gold Coast casualness, including nothing in a contract that might complicate the deal.
- Multiples of around 3 had already factored in the risk of losing units from the pool.

- Letting pools hardly varied in number over many years.
- Losing units from the pool was not a real risk as the onsite manager was best placed to let out units and faced minimal, if any, competition from external agents.

Things changed about 10 years ago when there was a noticeable shift in the makeup of owners in many strata complexes with a trend towards owner-occupiers. Management rights buyers found that between contract signing and settlement, sometimes a six-month or more period, it was not uncommon for the letting pool to drop – sometimes substantially. With multiples at 5 and above, the impact of a lost letting appointment on the value of the business could be significant. Many buyers found that by the time they got to settlement, the letting pool – and the value of the letting component of the business – had dropped by up to 20 percent or even more.

Some buyers started asking for a clawback provision in the contract to protect them from such a situation. An industry forum held on the Gold Coast lent tacit support to the concept, and industry standard clawback provisions were incorporated into the generally used special

conditions. Despite agents and sellers' lawyers initially opposing the concept, over time it became the norm.

Unsurprisingly, the clawback concept has been limited to letting appointments lost between contract signing and settlement. Unlike a rent roll sale contract, it does not extend to any period post-settlement.

It also became common for sellers to ask for a clawforward provision so that the sale price would increase if the letting pool increased in size. That could be problematic for a buyer and a buyer's financier as if there were to be a significant increase in the purchase price, where would the additional funding come from? So buyers sought to limit the number of clawforwards, which in turn led sellers to ask for a limit on clawbacks.

Initially, clawbacks and clawforwards were limited to permanent complexes. It was perceived that as holiday and short-term letting complexes only operated at around 60 percent to 80 percent occupancy, the loss of up to 20 percent or so of units would not impact the letting income. Some complexes, though, run at much higher occupancy levels – for example, Noosa beachfront occupancy levels are close to 100

percent and produce massive letting income. So gradually, buyers in holiday complexes started asking for a clawback – and the sellers for a clawforward.

It becomes even more complicated when a complex has a mix of permanent and short-term or holiday units in the letting pool!

Unsurprisingly, in most management rights transactions, there is quite a bit of pre-contract negotiation about the clawback and clawforward provisions of the contract. Depending on the nature of the complex, the negotiations can be simple or complicated and may or may not involve lawyers and accountants. Different values might be attributed to the first, second, or third appointment lost or gained. Sellers may well point to the increase in body corporate remuneration and rents which will offset some loss of units from the pool – all part of the negotiations.

Today, the concept of clawbacks is well and truly entrenched in the industry. It will not go away anytime soon, if at all. It is something which all buyers have to consider and something which all sellers have to expect to be raised. ■

