

The One Page Guide to Strata Economics¹

Making the decision about capital works

- Separate the decision about what work you should, need or want to do from the decision about the best way to fund it – they are totally separate considerations
- Think in terms of ‘investment’ in your property not in terms of ‘expense’ – thinking of expenses inevitably constrains you to take the cheapest option. Thinking of investments encourages you to consider value and to focus on return on your investment
- Use Return on Investment (ROI) to determine which projects to undertake – you want the project with the largest ROI (measured as a percentage), not the one with the cheapest cost
- The optimum capital work is that which gives you the greatest ROI – don’t skimp by being cheap, don’t waste value by over-capitalising
- Invest most of your time considering what work to do and who should do it. The choice of investing \$200,000 versus \$400,000 will have a large impact on the ROI and the cheapest is not necessarily the best. Similarly, the choice of one contractor at \$200,000 and another at \$205,000 will have a significant effect on ROI – go with the value option, which may not necessarily be the cheapest
- Remember, it’s all about value – if you do this work, by how much will your lifestyle be improved? Your rental returns? Your capital gains?
- The interests of owner occupiers and investors are very similar – all owner-occupiers will sell at some stage and so must take an interest in the capital value of their property. Investors have to take lifestyle into account – it’s how a prospective tenant feels that determines how much rent they’ll pay and how a prospective purchaser feels that determines what they’ll offer for the property – rent and sale price are the critical issues in capital return

Making the decision about funding

- There are three choices for funding in strata – sinking funds, special levies and borrowing
- Each form of funding has its peculiarities, advantages and disadvantages
- The best form of funding (or mix of funding) for your corporation will depend on your particular situation and that of each owner – there is no universal solution
- It is not compulsory or required by law to have a regular levy to a sinking fund
- Sinking funds are usually the most expensive form of strata funding. The cost to owners of having cash sitting dormant in a sinking fund is usually between 10%pa and 15%pa². This is the most expensive form of funding in 75% of cases
- The cost of a special levy is the ‘opportunity cost’ to each owner, that is, the next best use that you can think of for the money. This is typically 11%pa to 13%pa
- Borrowing is often more efficient and effective than special levies and sinking funds and should always be considered
- The vast majority of investors will be disadvantaged by a sinking fund or special levy. An investor should always wish to keep the maximum amount of cash at the ready. Investors should also consider the after-tax cost of their funds. Borrowing by the strata corporation is usually the most effective funding for investors

¹ For copy of Lannock’s white paper, *Funding for Strata – assessing the economic and financial options for strata corporations in Australia*, please call Lannock on 1300 85 15 85, email strata@lannock.com.au or download from our website, www.lannock.com.au.

² Contact Lannock for our strata Funding Analysis tool to enable you to assess the costs for your property.