The block

Renovation has as much price-pushing power in apartments as it does in freestanding homes but the process requires more forward planning. We ask the experts about the pros and cons of apartment makeovers. **Anastasia Hackett**

THERE are plenty of stories of people making money turning tasteless units into art-deco trendsetters or inner-city eyesores into contemporary sky homes. Transforming the bland brick boxes of the 1960s and '70s that are the country's current apartment bread and butter into something that better suits the modern Aussie image, however, is not without its hurdles.

Before leaping into a major renovation with plans to maximise the capital growth potential of a tired old flat, it's important to avoid the very real risk of overcapitalisation.

Identifying potential

Choosing an apartment with growth potential follows the same key principles as any other property and putting location at the top of the list is a good start. However, position may be even more pertinent in the apartment market because buyers expect additional lifestyle benefits in exchange for giving up the traditional backyard. Proximity to public transport is essential and the more amenities like cafés, shops and cinemas within a few blocks of the front door, the better.

To that end, it's often preferable to buy an older apartment in a good area. In fact, author of *Smarter Property Improvement* Peter Cerexhe says older buildings often allow more scope for growth.

Before

"If you're wanting to add value you must not buy a brand new apartment that has already been styled within an inch of its life, because anything you do will just detract from the current fashion and devalue the property," he says.

Geoff Doidge of the Reno Kings, a renovator and investor with a $5 million portfolio, points out that it's best to look for an apartment in an area that has already been touched with the renovation wand, adding that it's crucial to find out exactly how much those renovations returned.

"Do a CMA (comparative market analysis) and go and see what the market is paying. If you see a unit before renovation and a similar unit after renovation and the difference in price is only $50,000 you know you can't spend that. You should spend $15,000 maximum. You want to make $3 for every $1 spent," he says.

Doidge says there are also key things to look for when sourcing units that aren't considerations when buying freehold.

"If you're buying a single unit, try to get an apartment in a smaller block because at least it has some uniqueness," he advises. "If you buy in a block of 50 apartments, at any one time there are about 7 per cent of them up for sale or rent. I've seen apartments in blocks like that in a slow market selling for up to 30 per cent below market value because everybody is competing against each other."

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Obligations to the owners corporation or the body corporate is another factor. In addition to comparing the annual fees or levies from one building to the next, purchasers must consider the likelihood of those fees increasing.

"Get into the body corporate minutes and read them," Doidge says.

"If there are structural problems, it will be in there and details about whether it has been fixed or just patched up. Look at how much money is in the sinking fund and ask a quantity surveyor what is a reasonable amount to have in the fund."

Adding value

Once the property passes initial potential tests, Doidge points to the golden rule of any renovation – focusing on the kitchen and bathroom plus a fresh coat of paint which he estimates can add up to $5 for every $1 spent.

Yet he acknowledges that superficial changes like these only add a limited amount to the sale price and warns that they must be kept strictly within budget. The issue is that interior updates may not be mirrored on the exterior and, as Doidge notes, prospective buyers or tenants have to be enticed out of the car and into the building before any return is received.

Cerexhe says this may not always be a problem.

"If you look at suburbs like Darling Point and Point Piper in Sydney and Toorak in Melbourne, many buildings have a very dated exterior but they are very fashionable areas. Buyers looking to get a foothold in nice established areas are prepared to turn a blind eye to the ugliness of the exterior," he says.

If you only have the interior to work with, Cerexhe recommends trying to create additional space, over and above the standard facelift. He says enclosing a balcony is an ideal way to add an extra room and creating a hideaway laundry in a kitchen or bathroom cupboard is a sought-after advantage in apartments that previously went without an internal laundry.

External influence

However, Cerexhe admits major capital gains often require a revamp of the entire complex.

"This is where older buildings often come into their own because they may have additional land available. Carparking is probably the number one thing to add value to a property. If you can get a car off the street it can add between $30,000 and $60,000 and if you can provide lock-up, secure garaging, it's worth more."

From a valuer's perspective, Sjouke Price of WBP Property Group agrees that an external upgrade can help push the profit margins of a renovation up as much as 40 per cent.

"You can cite examples where developers have purchased a whole block of 1960 to 1970 units and renovated inside and out – they might spend $250,000 a flat and increase the value by up to $350,000 a flat. If you can get control of a whole block and render the exterior, create outdoor areas, maybe add security gates, it will make a big difference and the exterior presentation is often what holds a block back," he says.

Cooperation from the other owners in the building is crucial as well and this can sometimes be more difficult to find. In a strata-titled apartment complex changes to a building's exterior are funded by body corporate or owners corporation levies, often held in a sinking fund until required. Unfortunately, because levies are originally set by developers immediately prior to the apartment's sale, they are often kept low in order to attract buyers.

One Australian company that prepares 10-year sinking fund plans on behalf of corporations claims more than 85 per cent of strata management sinking funds are under-capitalised and estimates a $10 billion shortfall Australia-wide.

Managing director of Strata Finance, Bill Debney, says this is a major downfall of the system.

"Sinking funds have a purpose – to provide savings for the body corporate or owners corporation and these savings can be used for capital improvements as well as repairs and maintenance," he explains. "However, levies often start at such a low base that the owners corporation is under-resourced from the very beginning."

The implications of this can be severe. Late last year a NSW Supreme Court case created a precedent for residents to sue an owners corporation for failing to provide adequate maintenance and be awarded substantial damages. It also means funds are often reserved for maintenance rather than modernisation so a bid to upgrade the communal areas of an apartment complex usually means convincing other owners to spend not only pooled funds but also put in a little extra from their own pockets.

"For repairs and maintenance you generally need approval from 50 per cent of the owners but for capital improvements, for example if you wanted to put in a swimming pool, it's usually 75 per cent," Debney says.

Cerexhe is positive it can be done.

"You may find that if everybody throws in a bit of money you can make a substantial renovation of the outdoor area. It just depends on whether you can persuade the owners corporation to agree, so it relies on negotiation skills and what sweeteners you can offer the other owners," he says

Doidge suggests joining the body corporate committee, attending meetings and, if you really want to make a difference, becoming the

INSIDE VS OUT

Like a lot of apartment owners, Julie Slifirski initially wondered whether it was worthwhile renovating the interior of her home while the exterior remained an eyesore.

She owns an apartment in a block of nine built in 1967. It's in an excellent position in Hawthorn, close to the river, transport, restaurants and shops, however the block itself is dated with poorly maintained gardens and carports, no front fence or security.

Inside, however, the apartment had a lot of potential.

"The apartment was in original condition, but structurally sound, with a good floor layout, and the potential to maximise the spectacular city views by reconfiguring a structural wall between the kitchen and living room," she says. "We consulted with agents prior to undertaking the renovations to determine what would add the most value. They said the kitchen and bathroom but not to go overboard."

Other owners in the building have made similar decisions, providing a basis to assess the worth of Julie's renovations.

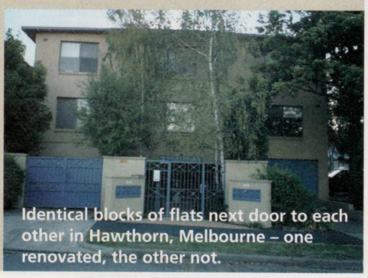
"Only one of the renovated properties has been sold. It was purchased for $311,000 and two years later sold for $435,000," she explains. "Our flat was purchased in November 2000 for $240,000. Now it would probably sell for $550,000-plus. If we're lucky we'd get $600,000."

Despite the state of the grounds, Julie estimates that a good internal renovation in a building like hers can add up to 10 per cent to the value.

"It's hard to be accurate in a rising inflated market but when the flat above was sold a year ago the feedback among the crowd at the auction was that bidders were impressed by the renovation and internal aesthetics," she says.

The next step is trying to secure owners corporation funds for exterior improvements in the hope of adding further value to the property.

"Half of the owners are keen but the other half just need convincing," Julie says. "A supportive, proactive body corporate agent and proactive committee are essential."



Identical blocks of flats next door to each other in Hawthorn, Melbourne – one renovated, the other not.

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chairperson so you can really sell the benefits. For bigger rejuvenation programs there are companies that provide loans to owners corporations or body corporates on fixed interest terms for which repayments are built into the owners' regular levies.

Owning the lot

Of course the most foolproof way to gain control of the exterior of a building is to buy the entire block. It's a recipe that has certainly worked for Geoff Doidge, who holds a near-new block of nine, an older-style six-pack and a house converted into three apartments within his portfolio. He bought his first block in 1987 for $175,000 and it's now worth $1.5 million. As he retains them as investments he can't measure the value of renovations in terms of capital gains but claims that in some cases rents have risen by as much as 70 per cent post-revamp.

Queensland builder Joe Schwarz has had a similarly positive experience with a small seaside complex which he bought four years ago. He created a dramatic transformation, taking off the roof and adding a penthouse to create a set of three luxurious ocean-view abodes (see photos above and on page 16). The renovated building is currently on the market for 55 per cent more than the purchase price. The penthouse alone is currently valued at more than Schwarz paid for the entire block originally.

Schwarz says position was a key contributor to the growth. He also ensured its profitability by building according to council's requirements for strata titling in case a purchaser chose to sell the apartments separately down the track.

Risks and warning signs

Regardless of whether the renovation is restricted to the indoors or includes the entire complex, overcapitalisation is a real risk. Price explains that the amount of value an apartment renovation adds can vary dramatically depending on the type of building and area it's in.

"If it's a basic rental in a generic building and you spend $50,000 you might not even get your money back but if you have a large, prestige owner-occupier you may be able to spend $100,000 to $200,000 and get even more in the sale price," he says.

If the building itself is unsound or has outstanding maintenance issues, special levies in addition to those advertised may arise, diverting funds from renovation projects. In NSW, for example, it's now law for an owners corporation to have a 10-year plan for the sinking fund and it would be prudent to investigate the plan to assess its adequacy and the scope it allows for aesthetic improvements.

Management needs to be as sound as the structure itself. Finding a property with plenty of room for growth will amount to very little if other owners aren't inclined toward spending money on upgrades. As a general rule, smaller complexes present a smaller pool of people to convince.

Another rule of thumb is to look for buildings with a higher owner-occupier ratio, as residents with a personal stake in enjoying the additional lifestyle benefits of a proposed renovation should be more inclined to agree with it while investors may only be concerned with how the revamp will translate into increased returns.

A major pitfall apartment renovators make is not to investigate all these factors prior to taking on the project, drawing out the process. Joe Schwarz found that he vastly underestimated the amount of time it would take to complete his apartment project.

"For instance I had to get architect visuals of what it would look like from the street, so it took me two years," he says.

Doidge notes several issues first-time apartment buyers should note prior to purchase.

"If you buy in a block of four or more the banks may treat it as a commercial property which will lower your loan-to-value ratio. Instead of borrowing 80 per cent of the value you may only be able to borrow 60 or 70 per cent. Also don't try to manage it yourself unless you have the skills. There are a lot of traps if you don't have experience."

Some of those traps include unsuitable tenants. Doidge suggests taking out landlord insurance to cover against malicious damage and also recommends purchasers check yields, the potential for rent increases and the length of leases of existing tenants to avoid getting caught with a tenant on a long-term lease at a low rate. ■