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Off Plan Investments in Real Estate

Over the last couple of weeks, we have witnessed a number of property buyers coming to the fore claiming to have been swindled by developers over off plan real estate purchases. Specifically,

- Simple Homes – Formed in October 2015, it started operating as a developer claiming to sell houses off plan via a tenant purchase scheme, in which buyers were first required to join their cooperative and pay a Kshs 2,000 admission fee, then pay a 25% deposit for the houses in various locations including Syokimau and Kitengela. After this, they would be paying monthly instalments equivalent to their current rental rates which could be as low as Kshs 24,000 per month. The prices of the houses were fixed and no interest was charged. The buyers were to assume occupancy immediately after completion and could pay off the 75% from 5-40 years. They however did not take members to site, were not registered by any of the developer bodies, and when clients inquired on progress and requested site visits, they shut down operations as well as the online activities, which was in February 2017. Local dailies have reported that at least Kshs 500mn have been lost by investors and homebuyers in the scheme. The Directorate of Criminal Investigation has since then started investigating the matter, and,
- Gakuyo Real Estate / Ekeza Sacco – Gakuyo Real Estate / Ekeza Sacco is alleged to have collected in excess of Kshs 100mn from about 7,000 clients in deposits with each paying Kshs 10,000 with the total sum inclusive of subsequent instalments being in excess of Kshs 3bn. The deposits are supposed to accumulate to quantities large enough to purchase either houses or serviced plots in various parts on the country including Embu and Nanyuki. The company was supposed to deliver the first batch of houses in 2016 but they have not been delivered with some disgruntled clients claiming to have been asked for extra money without delivery to the initial promise. The State Department for Co-operatives through the Commissioner for Co-operative Development has hence launched investigations on the company following these allegations.

This week we seek to demystify off plan investment in real estate. We start by introducing off plan investments, the processes involved, the potential gains and risks and conclude by advising buyers what they should look out for when purchasing property off plan.

Introduction

Off plan investment refers to the purchase of property before completion, generally driven by the high price of real estate and the long time taken to deliver units. The buyer hence buys the property off the plan or design stage in the development. It has become increasingly popular as the prices of the property sold are much lower than market, and can be up to 50% less than the price of a completed house.

Processes Involved

The process of purchasing a property off plan begins with the signing of three documents, (i) the reservation form, (ii) the Letter of Offer and, (iii) the Sales Agreement, where a developer promises to deliver a parcel of land, a house or land package to a buyer at an agreed price at a future date, subject to the developer obtaining all necessary approvals in respect of the development from the relevant authorities and satisfying any conditions necessary to finalize the development. In most cases, the buyer must pay the developer a deposit upon signing the contract, with the balance of the purchase price due at the settlement date, or via a specific payment plan.

Advantages of Purchasing Real Estate Off Plan

i. Potential capital gains - Buying off plan allows you to acquire a future asset at today's price and hence in a rising or a peaking market, the buyer achieves capital gains, and on completion they have a significant margin. Developments have delivered over 50% price appreciation. For instance, The Alma in Ruaka by Cytonn Real Estate, which is at 55% price appreciation 9-months into construction,

ii. Flexible payment plans – To purchase a property off plan all one needs is a deposit, which is usually 10% to 20% of the purchase price, and the rest of the amount is either paid on completion, or in flexible periodic installments. This allows individuals without the financial muscle to purchase houses immediately to acquire homes they would otherwise not afford, and,

iii. Preference – The buyer is able to select the best location for his or her house and can also get to pick the finishes of the house and hence get a house that is in line with their preference as opposed to buying a complete house where he/she has to settle for whatever has been provided for by the developer in the locations that have been left over by early buyers.

Disadvantages/ Risks of Purchasing Property Off Plan

i. Risk of loss of capital – The buyer can lose the money invested in case the developer goes bust or if the developer was fraudulent,

ii. Poor quality of construction – Sometimes developers use very attractive brochures to advertise, but deliver substandard products hence the buyers do not get value for money unlike when buying a complete unit where one negotiates the purchase price based on tangible evidence,

iii. Delayed projects – More often than not, developers aren't able to complete the houses in the promised time frame and this can affect the buyers' financial plans, and,

iv. Lower returns – In rare cases, market conditions may change or the developer may over promise returns such as rental yields and capital appreciation and on completion the buyer achieves lower than expected returns and hence doesn't earn expected gains.

Things to Look at/Factors to Consider When Purchasing Off Plan

In order to reduce the above risks, the buyer has to conduct proper due diligence before purchasing the property off plan. The buyer should research and have background information on the developer, the proposed projects and the contracts he or she is signing.

1. **Developer Due Diligence**

   The buyer ought to establish the following facts about the developer before signing up for an off plan purchase with them

   a. Company information – The buyer should ensure that the developer is a registered company in the country of operation and it had the legal mandate to operate as a real estate developer and the location of their offices. He/she should also know who the directors of the company are, how they have delivered in previous projects and if they have any court cases with regards to the services they are currently offering. This will prevent one from investing with a brief case company run by fraudsters,

   b. Development history and testimonials – The buyer should also review previous developments done by the developer to gauge their workmanship, delivery to promise, timelines and as proof that they are actually developers,

c. Mode of operation and project financing – The buyer should then seek to understand how the developer operates, what are their day to day activities, how is information relayed to clients, and how are the payments made. In case any of the procedures, partners they deal with or operations are not above board, he or she should not work with the developer. They should also understand the nature of finance being used by the developer and hence the possibility of a project being delayed due to lack of financing

d. Developers associations – For instance, in Kenya, credible developers are members of the Kenya Property Developers Association (KPDA), which advocates for better market conditions for both the buyer and the developer

2. Project Due Diligence

For the project, the buyer ought to establish the following facts:

a. Visit the site – The buyer should visit the site to know it is an actual site that exists. This should be done prior to any investment and throughout the development period to ensure the development is running smoothly and he/she is up to date with the progress of the development, so that if any issues arise, they can follow up with the developer or consider exit options before it is too late. Those who lost money in Simple Homes made deposits without visiting the sites; you should never part with even a penny before visiting the actual site or confirming it is a legitimate site for development,

b. Confirm developer has land titles for the given site – The buyer should always insist to be given copies of the title as proof that the developer is the owner of the land and it is not a scam. He /she can also run a search on the title to ensure it has no undisclosed encumbrances and it is genuine,

c. Project plan approvals – The buyer should also seek to know if the developer has obtained the necessary approvals for the property and hence has the legal right to develop the property to prevent delays in the delivery of the project,

d. Project team and their delivery history and capability – The buyer should also know who is in the project team, their previous experience and hence gauge if they are able to deliver the given project,

e. Get regular updates from the developer on the progress – This is a must to ensure that the development is ongoing and will be delivered on time and quality. A developer who doesn't give regular updates is suspect and he/she could be hiding crucial information or is fraudulent,

f. Research on comparables around the area to gauge possibility of earning potential returns promised by the developer. That is rents, prices, yields occupancy and uptake. This also helps the buyer know if the development is overvalued and can hence look for better investment opportunities. A good developer should be able to share at least a summary of their research findings with the buyer,

g. Timelines – The buyer should understand the project timelines and milestones and hold the developer to them,

h. Project design team – Seek to understand credibility of the project design team including the architects, engineers and the main contractors.

3. Contracts Due Diligence

a. The buyer should hire a conveyancing lawyer to review all contracts signed and ensure they are all above par and he or she is not defrauded in any way or exposed to unnecessary risk

4. **Last but not least if it's too good to be true**… **there is no free lunch!**
   In the current market due to the high land and construction costs as well as interest rates, house prices are generally high. Hence if a developer offers a house at a price that is very low by market standards and not achievable under normal circumstances, and it is the only company offering such, then one should be cautious and evaluate them fully as it is probably a scam to lure unsuspecting buyers desperate to acquire a home.

Purchasing off plan is a great way of acquiring real estate and hence the buyers should not be deterred by the few cases of unethical developers as they will miss out on not only a dream home but also a lucrative investment opportunity with the highest returns of up to 25% p.a. He/she needs to understand what they are getting into, conduct a background check on the developer, consult their lawyers and invest.