Richmond Townhouses in Melbourne by Rossetti Architects. Photography: Tim Griffith

Finance and development

Andrea Sharam looks at the "deliberative" development model and the financial barriers that can prevent it from flourishing, sharing architect-designed Australian examples spanning three decades.

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The poor design, quality and sustainability of Australian apartments reflect the fact that around 80 percent of apartments are built for investors. While luxury apartment developers will market quality design and sustainability to homeowners, would-be owner-occupiers on more modest incomes have little option but to purchase a generic product intended for the rental market.

This article looks at "deliberative" as opposed to "speculative" development – multi-unit developments undertaken by groups of friends and family without the involvement of a developer – and at the way they are affected by financing. In Germany such do-it-yourself schemes are known as Baugruppen, in France as autopromotion, in the Netherlands as group-build and in the UK as collective custom build. Deliberative developments in Europe have demonstrated consistent and significant cost savings and, unlike speculative developments, projects are tailored to suit the diversity of households involved and are able to embody other collective ambitions, such as higher environmental performance. The Australian examples here span three decades. All were architect-designed and most were architect-led.

Deliberative developers face significant financing barriers. The most serious is the high level of equity required to obtain debt financing. The purpose of an equity contribution is to reduce the risk taken by the debt financiers. Financiers expect between 35 percent and 50 percent of the funds to be supplied by the group themselves. Given the increasing difficulty many households have with saving for a 10 percent deposit to buy a house, this equity requirement is clearly nigh on impossible except for wealthy households. Such equity requirements also apply in Germany and the Baugruppe movement has been criticized for being elitist and contributing to gentrification. Our examples show, however, the extent to which the requirement for equity can shift according to general financial conditions. Our contemporary examples underscore the role of risk and demonstrate how new ways of mitigating risk can improve affordability.

Our earliest project was conceived in the early 1980s by distinguished Melbourne architect Graeme Gunn, Grazia Gunn and three friends, with a builder friend coming in early as an owner as well as the builder. Cooked up over lunch at Melbourne's famous Jimmy Watson's wine bar, the project in South Yarra involved the conversion of a five-storey former store into residences. Most of the group sold their existing homes in order to raise the equity required. They needed to borrow about 50 percent of the total cost and it was not difficult to obtain finance because of their professional credentials and track records with their lenders. The project build was delayed by difficulty obtaining building approvals. While they had significant equity, the interest rate on the debt (which rose to 19 percent) practically killed them. Some members held their apartments for many years but some, like Gunn, ended up with mortgages that were unmanageable and needed to sell.

Our second project, built ten years later, also came close to succumbing to high interest rates. Craig Rossetti purchased a site in Cremorne, Victoria, with a 10 percent deposit, only to be retrenched a week later. Unable to interest developers in the site, he convinced some friends that it was a way for them to obtain housing they would otherwise be unable to afford. The friends put in some equity but the debt was secured only when his father provided a personal guarantee to the bank. Interest rates soared and the associated financial crisis saw a number of financial institutions fail, including Rossetti's. The townhouses went on to win the Robin Boyd Award for Residential Buildings in 1995, but at least one of the members had to sell immediately because of financial stress.

The third project (we call our proponent Jane Doe because the informant wanted to remain anonymous) was also started during the early 1990s recession. None of the group partners were architects or property professionals, but they did hire a young architect starting out who has gone on to have a very successful career. The development was an inner-urban conversion of a four-storey commercial building. Like Gunn, they sold their homes to provide the equity (50 percent). However, rather than a conventional loan they were provided with an overdraft facility, which was more expensive. Interest rates again climbed distressingly high. While originally they intended to have a floor each (with a nod to the New York loft), financially they recognized they'd have to subdivide further and recoup some funds through market sales.

Moving on to contemporary examples: James Legge, a founding director of Six Degrees Architects, and two partners developed townhouses on a former council depot site in Brunswick in the late 2000s. The remediation of the site had to be self-funded and this precluded a pure deliberative development. Nevertheless, all but one property was pre-sold to friends and contacts. The global financial crisis (GFC) then saw lending for development virtually cease but the financial credibility of the partners meant that they eventually secured a loan for the building works.

Property Collectives is a firm that manages residential property syndicates and their development projects. Founder Tim Riley and a friend, architect Dan Demant (of Six Degrees), and friends decided to undertake their own development in Northcote. Having waited out the GFC, they had no difficulty obtaining debt financing but the members were required to contribute 30 percent equity and demonstrate that they had deep pockets should something go wrong. The members obtained housing that would have cost them another $200,000 each if purchased on the market.

Our final case is the Commons apartments in Brunswick and not-for-profit housing company Nightingale Housing. The multi-award-winning the Commons started with a group of friends, including Jeremy McLeod, principal of Breathe Architecture, but they were caught by the GFC and the project was sold and developed conventionally. Undeterred, McLeod's new apartment project (Nightingale 1) raised (30 percent) equity from investors who were willing to take a lower return than typical (gross market returns are in the order of 60 percent). Equity is expensive to buy.

At my suggestion McLeod modelled a shift from 70:30 debt to equity to 90:10 for Nightingale 1 and we found that would save $100,000 per apartment. But would debt lenders be willing to take such risk? Using research by myself and colleagues Lyndall Bryant and Tom Alves, we convinced social impact investors that deliberative development models have little risk of pre-sales failing to settle (i.e. settlement risk) because of proponent/buyer attachment to their future home and, with a waiting list, drop out can be remedied without detriment. Moreover, aggregating member/buyers avoids the need to run a pre-sale campaign, delivering significant cost savings.

Nightingale Housing and the social impact investors are progressing the shift to 10 percent equity contributions by members, permitting pure deliberative development to boost affordability. We anticipate, moreover, that once this is demonstrated, mainstream lenders will rethink risk and equity requirements and thus provide credit on terms that will enable deliberative development to flourish.

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The Saint George Collective in Melbourne by Property Collectives. Photography: Scottie Cameron