Investing in Commercial Real Estate

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Introduction

There are a few things you'll need to ask yourself before taking the plunge into the world of commercial property investment in New Zealand.

What am I looking for?

How much is it worth?

How does the process work?

How long has the lease to go?

Generally commercial property investment offers investors good opportunities to make stable long term returns. Returns are generally higher than for most other forms of investment, including other property investments. Income from rental yield is strong, and commercial properties rely less on capital gain to provide value for their investors.

A factor to consider before investing in commercial property in New Zealand is the option of tax write-offs. If your company is profitable, property ownership can help reduce your taxes. You should be able to write off a part of the building's annual costs through depreciation. Another option is to purchase the building personally and rent it out to the business. This is a method that has some tax advantages.

Is commercial investing for you?

If you answer yes to any of the following questions, then this booklet provides a good start.

- ✓ Have you acquired excess capital over the years?
- ✓ Have you recently come into money?
- ✓ Are you looking for a retirement plan?
- ✓ Are all your financial eggs in one basket (the farm, family home)?
- ✓ Do you wish to help your family financially in the future?
- ✓ Are you fed up with owning residential property investments?
- ✓ Do you have an interest in commercial real estate?
- ✓ Are you a tenant paying rent?

Where to begin?

Ownership Options

Options for buying a commercial property in New Zealand include:

- Buying as an individual
- Buying as a partnership
- Buying through a company
- Buying through a trust
- Buying in a syndicate

Your professional advisors will help you decide which option or business structure is best for your circumstances.

How much deposit do I need?

Before investing in a commercial property, you'll want to learn more about the market and opportunities around New Zealand.

- Start looking on pb.co.nz, trademe.co.nz or realestate.co.nz under the commercial section or in the newspapers.
- Talk to your commercial real estate salesperson.
- Check with your Bank or Lender but generally work on the Banks lending 60% to 70% on the value of the property depending on your financial situation.

Commercial interest rates are higher than residential rates.

Types of commercial real estate

Offices

These come in all shapes and sizes, anything from a single floor to the entire building

Retail

Either a standalone building or a block of shops however there are buildings with retail on the ground floor and offices above

Light Industrial

Usually comprise showrooms with warehouse at the rear or workshops

Heavy Industrial

Situated further out of the town area and vary from warehouses to large distribution centres

Motels

Sizes vary considerably (Freehold or Leasehold)

Hotels

Variations from country pubs to inner city luxury hotels and serviced apartments

Businesses

A wide variety of business options are available

Commercial vs residential investing

Residential real estate has the three L's location, location and location.

Commercial real estate also has the three L's
Lease, Lessee and Location

This indicates how much importance is placed on the lease.

Whereas residential property has an inherent value, based on the area it is located, similar houses in that area combined with average rents in the area — the capital value of commercial property is largely dependent on its yield (or cap rate in commercial property terms).

Investing in Commercial Real Estate

- There is no brightline tax on commercial property transactions
- Commercial property does not come under the Residential Tenancies Act
- Tenants in general, pay the outgoings (rates and insurance etc.)
- Tenants are liable for most internal repairs, and often refurbish their buildings
- Tenants are less likely to default on rental payments
- In a commercial lease, what you agree on and sign, is binding
- Lease agreements are generally long term (years)
- Returns are generally higher than for most other forms of investment
- Commercial properties rely less on capital gain to provide value for their investors
- Returns are better from commercial property because the rental returns are generally net (includes outgoings).

What makes a good property investment?

Location

Look for properties close to transport and infrastructure, with parking facilities and appropriate businesses around it.

Land

How big and is there room to extend the building? How much parking and is there room for a truck to get in and out? What zoning does the land come under and which uses are permitted there?

Building

Are there opportunities to add value? Does the building have the appropriate facilities to attract and keep ideal tenants e.g. stud height, air conditioning etc.

Check your insurers approve the building, particularly if pre-1935.

Tenant

Look for tenants that are reliable, willing to sign a long term lease, present a low risk of default on rental payments and have been in business for a while. It is not recommended to buy an investment solely on the strength of the tenant alone as they come and go.

The lease

- How long is the lease term?
- Are there rights of renewals (more beneficial to the tenant than the landlord)?
- How often is there a rent review and how is it structured?
- Is there a ratchet clause or partial one? Many leases have a “hard ratchet” clause, which means that the rent can never go down, even if market rents have fallen generally. Some have a “soft ratchet” clause which requires a rent reduction if market rents fall, but prevents the rent from falling below its original level.
- Does the tenant offer a personal guarantee?
- Chattels — who owns what?


Stretching the length
and breadth of heartland
New Zealand, our family
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Capital growth

Appreciation in the capital or market value of an investment, as opposed to income derived from the investment.

It is the difference between a higher selling price and a lower purchase price, resulting in a financial gain for the investor.

Capitalisation Rates (Cap rates) or Yield

Those who invest in real estate via income producing properties need to have a method to determine the value of a property they're considering buying.

Example:

Net rental	**$40,000 per annum plus gst**
Sale price	**$500,000**
Yield	**8% return per annum**

What yield should I aim for?

Yields will vary considerably depending on the location, town, market conditions, lease term, strength of tenant and timing.

Getting the right capital growth/yield mix is a balancing act — going for great capital growth but not tipping the scales so far that it all topples over because you can't afford to hold your properties.

As a long term investor, the goal should be to maximise capital growth. Yield is essential to the survival of the portfolio, but it is not the key to building wealth through property.

Example:

Tenant	**International Tenant - Low risk**
Location	**City, CBD, high foot traffic**
Lease term	**15 years with Rights of renewals**
Market	**Hot**
Yield	**5% return on investment**

Example:

Tenant	**Local tradesperson - High risk**
Location	**Town, secondary location, no profile**
Lease term	**2 years with Rights of renewals**
Market	**Average**
Yield	**8% return on investment**

When is the right time to buy?

Do a market analysis in the area you are looking to buy in. The old adage goes that its time in the market, not timing the market. The more time you hold your property, the more time it has to grow.

Depressed market

- Are there mortgagee sales?
- Does the retail sector have many vacant shops?
- Are the retailers having more than usual sales?
- Are retailers having 'closing down' sales?
- Are there For Lease signs on many buildings?
- Has the job market slowed down or petrol prices going up?

Hot market

- Are buildings being sold before going to the market?
- Are you missing out on buying with your offers being too low or not acting fast enough?
- Are the cap rates lower than usual?
- Are the interest rates low?
- Very few properties available for sale?

Conditional contract and due diligence

You now have a property under contract. That means you contractually have the right to buy the property, providing that you are satisfied with the conditions negotiated in the contract, namely due diligence.

Investing in commercial property really does offer some great rewards. Take care to do your research and talk to the experts first.

As a minimum we suggest the following due diligence:

- A valuation by a valuer that specialises in commercial real estate valuations
- Finance clause
- LIM – Land Information Memorandum (Issued from local Council)
- Builders and/or Engineers report
- Lease and Title – have your solicitor check the lease and title
- Check with your insurance company. Are they prepared to insure the property?
- Find out the earthquake rating of the property (NBS)

Do I need a Property Manager?

The answer depends on your personal situation. What are the benefits or downside of managing your own portfolio?

Property investment is not rocket science and you don't need a three day seminar of theory. Figure out a good safe environment to operate in, and then get going. Get advice along the way, and stay in the market long enough to see some good gains. Stay focused on the end goal.

If your time is limited or you don't feel confident - then yes, employ an experienced property manager to look after your valuable asset.

What a Property Manager can do for you?

- Negotiate rent renewals, new leases and do the paperwork
- Ensure the rent is paid and up to date
- Send tenants any accounts and ensure payment of them
- Arrange Compliance for your building
- Attend to maintenance that the tenant is not responsible for
- Look for new tenants and do reference checks
- Inspect the property regularly
- Liaise with Real Estate agents, valuers lawyers, accountants etc.

Top 7 tips for successful property investment

1. **Buy**

   Do something. Most people fail at property investment because they never take action.

2. **Buy to a plan**

   Develop a simple plan of action. Include a reason, vision and a strategy.

3. **Hold for the long term**

   The more time you hold your property, the more time it has to grow.

4. **Buy what you can afford**

   Stretch yourself but don't kill yourself.

5. **Buy at a fair price**

   Accumulate great quality properties at fair prices rather than fair properties at great prices.

6. **Buy for capital growth**

   We need yield to service the debt but yield will not generate the wealth that gives you financial independence. Focus on properties that will generate above average capital growth.

7. **Invest again when you can afford to**

Overview

You might have read this document and agree with it but be thinking – I just don't have the time or the confidence.

Property Brokers have an experienced team of Commercial Salespeople that list, sell and lease all types of commercial real estate to help you with that next step.

We also have a property management division where rental properties are managed on behalf of absentee owners.

We have a dedicated team of compliance inspectors who provide services in regard to Building Warrant of Fitness and Compliance and are IQP registered who operate in the lower North Island.

Through our NZ Realtors network we can search out investments throughout New Zealand.

If investing in Commercial Real Estate sounds like you, then please call us today to discuss how we can help you get started.

For all your commercial property needs, please call 0800 367 5263

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