ALL eyes ON COMMERCIAL

COMMERCIAL PROPERTY INVESTMENT IS RISING IN POPULARITY FOLLOWING NEW TAX RULES ON RESIDENTIAL PROPERTY INVESTMENT.

BAYLEYS' NATIONAL DIRECTOR commercial & industrial Ryan Johnson says the latest impetus has largely come from the recent changes to interest deductibility on residential investment property, the extension of the bright-line test to 10 years and the reinstatement of bank loan-to-value ratios (LVRs).

But residential investors have always been tempted by the higher rental returns from commercial investment, he says.

In recent years, residential returns or yields have been around two-to-three percent (excluding recent capital gains), while commercial returns have been about four-to-eight percent.

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Johnson says the current level of enquiry on commercial property is greater than anything he has seen in his career.

"As well as the removal of interest deductibility on residential property, commercial property has an advantage when it comes to depreciation or writing-off expenses."

Commercial owners can depreciate buildings, fixtures and fittings, but residential investors cannot.

"The other element that has changed things for residential property investors is the increased LVRs that put them more in line with commercial LVRs," Johnson says.

LVR ratios measure how much a bank lends against a mortgaged property, compared with the value of that property. The Reserve Bank's rationale is that borrowers with LVRs of more than 80 percent (less than a 20 percent deposit) are risking stretching their financial resources and are more vulnerable to an economic or financial shock, such as a recession or an increase in interest rates.

Commercial loans carry a typical maximum LVR of 65 percent, meaning borrowers usually require a 35 percent deposit.

Bayleys has a joint venture partnership with mortgage brokers, Vega, whose commercial loan specialists assist in helping buyers obtain finance on a case-by-case basis.

Johnson says there are different factors for commercial investors to consider when investing directly themselves, particularly the strength of tenants, type of building, location, land/zoning, lease terms, and fitouts.

However, commercial property investors have several choices about how they invest and the extent to which they need to carry out their own due diligence.

Methods of investing include:

- Buying shares in companies listed on the New Zealand stock exchange (NZX)
- Syndications where investors buy a proportion of the property
- Direct purchase by an individual or their company of a property
- Special partnerships
- Providing a loan in the form of a mortgage or debenture to an owner or developer.

HANDS-OFF INVESTMENT

"One of the most 'hands-off' forms of commercial property investing is buying shares of property companies listed on NZX, although of course there is brokerage to pay, and managers take fees.

"One benefit of listed companies is their diversity of assets and geographical spread. Companies like Property For Industry and Goodman Property specialise in top tier industrial properties with a strong Auckland focus. Kiwi Property and Precinct Properties have more exposure to office and retail properties in Auckland and Wellington mainly."

Another option is to invest in a fund that holds shares in listed companies, such as Forsyth Barr's Listed Property Fund.

Property syndicates are another popular form of commercial investment, often with higher returns because of the way they are structured, Johnson says.

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Syndications generally offer returns one or two percent higher than listed company shares and considerably more than current bank term deposits. Some of the most recent ones have offered returns of around five percent.

Property syndications commonly offer parcels of units or shares generally between $10,000 to $50,000 each for an ownership share in a commercial property. There are establishment fees outlined in the investment statements.

Syndication properties can vary from supermarkets to standalone retail, industrial and office properties.

There are several specialist commercial property syndication companies that have dominated the market in recent years.

They include Centuria (formerly Augusta), Oyster Property, Silverfin Capital and Erskine + Owen to name a few.

According to property researchers, syndicates accounted for roughly eight percent of market sales in 2019. Over the 10 years between 2009 to 2019, it is estimated that syndicates have accumulated $2.4 billion worth of commercial property.

The syndicator usually borrows a portion of funds for the property purchase which has the effect of lifting the yield return.

Historically, syndication units have been less “liquid” to cash up than shares, although syndicate managers often facilitate exchanges of units.

There is also a trading platform called Syndex which lists syndication units available to buyers.

The Financial Markets Authority (FMA) has a syndicate checklist for investors that advises looking at location, tenant, type of loan (length, and whether it is interest-only), and the debt.

The FMA also says it is important to find out if any of the people or firms doing work for the syndicate are related to each other in any way. For example, is the maintenance company related to the company setting up the syndicate? If so, how will their charges be calculated and will they act in your best interest or try to maximise their fees.

Investors should also check the management fees and who they are paid to, can they rise, can syndicate owners change the manager and any associated fees.

Significantly, is anyone allowed to borrow money from the syndicate?

DIRECT INVESTMENT

Another form of commercial property investment is for investors to buy and own either as individuals or through an ownership company or trust set up for the purpose.

Johnson says that over the past 10 years, total returns from direct property investments have averaged 10 percent, making them attractive for retirees, superannuation funds or investors looking for an annuity style income. Investors/purchasers can range from individuals to trusts and partnerships.

A reliable tenant underpins the income streams that are typically paid monthly or quarterly, and the underlying lease terms ensure rental income is stable and locked in for a predetermined period outlined in the lease. Usually, the lease contains minimum annual increases in line with inflation, which means the property also tends to appreciate simultaneously.

“Strong demand and a stable economy have seen strong growth in commercial assets in recent years, and many direct property owners like to see the bricks and mortar they have invested in,” says Johnson.

Investors of directly-owned commercial properties tend to hold them as long-term investments of between five to 10 years, and commercial brokers such as Bayleys have the skills to market and negotiate sales.

The value of sales brokered by Bayleys during the past financial year was nearly $3 billion through its national network from Kerikeri to Invercargill, Bayleys has more than 230 specialist commercial and industrial sales and leasing brokers.

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Bayleys is the only New Zealand-owned specialist in direct commercial property investment – it has been awarded by the Real Estate Institute of New Zealand Awards for Excellence, Large Commercial and Industrial Office of the Year for 2020, 2019, 2018, 2015, 2014, 2013 and 2012.

LIMITED PARTNERSHIPS

Another form of commercial property investment is a limited partnership, which is where two or more partners jointly invest. The main advantage is that owners are typically not liable for the debts of the company. They are more complex than other forms of investment and administered with legal and accounting expertise.

New Zealand registers of limited partnerships are administered by the Ministry of Business, Innovation & Employment’s Companies Office. Every limited partnership must have a partnership agreement between partners that governs the terms and conditions of the partnership relationship.

When it comes to investing in mortgages or debentures there are a number of law firms that specialise in this area. Some financial services firms also offer funds that specialise in mortgage of debenture investments and carry out most of the management on behalf of investors.

ADVICE AND RESOURCES

Other advice and resources may be obtained from the Property Council of New Zealand representing 730 members with an estimated $50 billion investment in commercial property.

As part of an investor’s assessment, it is important to obtain a Land Information Memorandum (LIM) - a comprehensive report containing everything the local council knows about a property or section.

LIMs include information about special land features including potential erosion, avulsion, falling debris, slippage and possible hazardous substances, permitted uses of the land including zoning and council restrictions from using the building.

LIMs also have information about stormwater and sewerage drains, unpaid rates, consents, certificates, notices, orders or requisitions affecting the land or buildings, District Plan classifications, and any information supplied by network utility operators.

METHODS OF SALE

Auctions are the most popular method of buying commercial and industrial properties valued at under $10 million, Johnson says.

An auction marketing campaign usually runs for four-to-five weeks, with interested parties given relevant property information allowing them to undertake due diligence. A prospective purchaser can make an offer prior to the auction which, if the vendor accepts, will result in the auction date being brought forward.

At auction, a reserve price is set by the vendor and the property will be declared “on the market” only after this price has been met. It will then be sold to the highest bidder.

When a property is sold, the sale becomes unconditional, and a non-refundable 10 percent deposit is required to be paid. The date for settlement is generally one month from auction, unless the purchaser asks for a variation to this prior to the auction.

“Tenders are also a popular method of sale for larger, more complex properties. Prospective buyers submit confidential written offers for a property to the agent for the seller to consider. There is no reserve price and the vendor is under no obligation to accept any of the tenders made,” Johnson says.

Private treaty or sale by negotiation generally involves the sale of a property with a fixed price in mind. This is decided by the seller in discussion with the agent, after an appraisal of the property’s value.

The price will not necessarily be disclosed in marketing material if it is hard to estimate what a property is likely to sell for. Each prospective buyer will be asked to make a signed written offer. The agent will present all offers to the seller who will weigh up which, if any, they want to accept.

“One of the things about private treaty sales is that there is generally no timeframe so there’s less pressure on vendors and purchasers,” Johnson says.