Te Tohu Whakahaere Pūtea
*Certificate in Money Management*

# Wāhanga Tuatoru: Ngā Whakatupuranga Hanganga

*Module 3:*
*Property Investment*

## Programme Developers and Authors

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# Module Outline

## *Introduction*

In the first two modules of this programme we have spent time thinking about our goals. These goals have included:

- personal goals relating to our desired lifestyle,
- things we want to be able to do and things we want to own, as well as
- financial goals relating to becoming financially independent and preparing for retirement.

The problem that we have is that our personal goals often clash with our financial goals. That is, achievement of our personal goals often requires money! This diverts funds from achieving other goals. For example, if we have a personal goal to have a 3-week overseas holiday, this will take money that could otherwise be used to become debt-free or contribute towards your retirement savings. However, this is not necessarily the case – especially when it comes to purchasing property.

Home ownership is a common dream, shared by many New Zealanders. When we think about home ownership, it is often the lifestyle factors that appeal to us. For example, we think about:

- having the freedom to make changes that turn a house into a 'home'.
- the comfort of being able to relax in our homes and not be accountable to anyone else for any damages caused by our pets and children.
- the security of knowing that someone else cannot require us to move out of our home, and so on.

However, home ownership also has financial appeal. Through home ownership, we can therefore satisfy BOTH personal aspirations as well as financial goals.

In this third Module of the programme, we look at both home ownership and property investment as tools that can be used to build wealth.

The Module begins by looking at property market trends in New Zealand and understanding factors that affect property prices, before moving on to the process of buying a house. Section 3 of the Module is then devoted to a key factor in most property investments – financing. The various types of

***mortgages*** available are explained, as are the financial implications of the decisions you make when you take out a mortgage - from the amount of the ***deposit*** through to types of ***interest rates*** and the term of the loan.

The last two sections of the Module focus on property investment strategies. The ability to use '***leverage***' to build a property ***portfolio*** quickly and to multiply returns is something that attracts many people to this form of investment. Thus, ***leveraging*** is a key topic introduced in Section 4.

Finally, as the overall financial returns from property investment are dependent on how the investment is managed, Section 5 focuses on the processes involved in renting out an ***investment property*** and your responsibilities as a ***landlord***.

## *Definitions of Terms*

A lot of new words and terms are introduced throughout this Module. These terms are explained in the Module content. In addition, a glossary of terms is provided at the end of the Module.

Words and terms which are included in this glossary of terms are shown in ***bold and italics*** when first introduced in the Module. Therefore, if you see a word in bold and italics in the Module content, you will know that you can find a definition for this word in the glossary of terms.

## *Learning Outcomes*

Core Module Learning Outcomes

*By the end of this Module tauira will be able to:*

1. Demonstrate an understanding of the New Zealand property market and of the basic features of property as an investment strategy.
2. Understand and evaluate home ownership options in given situations.
3. Identify and analyse mortgage options.
4. Demonstrate an understanding of leveraging to purchase property.
5. Demonstrate an understanding of key considerations in, and components of, the process of purchasing investment properties.
6. Demonstrate an understanding of key issues involved with maintaining and selling investment properties.

Literacy and Numeracy Learning Outcomes

*By the end of this Module tauira will be able to:*

A. Demonstrate understanding of technical terms and phrases relating to property investment.
B. Locate and identify information of relevance in a case study and / or programme materials.
C. Plan and compose a comprehensible scenario which demonstrates understanding of a concept.
D. Write comprehensible sentences in response to questions.
E. Develop and perform calculations which demonstrate the use of leverage and leveraging percentages.*
F. Calculate net yields for property investments.*
G. Complete basic calculations relating to securing and paying a mortgage.*

** These are numeracy learning outcomes.*

# Section 1

# The New Zealand Property Market

# 1.0 The New Zealand Property Market

Property is one of the most popular forms of investment among New Zealanders. If you were to ask a number of people why property investment and home ownership appeals to them, it is likely that they will identify advantages such as these:

- Over the long term, house prices go up. They sometimes even go up by large amounts in a short period of time, meaning that you may be able to make money quickly.

- Everyone needs somewhere to live and the population is growing, so even in bad times there will be a demand for housing.

- A house is a physical ***asset*** and tends to keep its value better than other types of investments.

- Banks will lend you money to invest in property. This means you do not necessarily have to have much money in order to benefit from the potentially large gains available.

- If you already have a house, you may be able to buy more property without even having a cash ***deposit***!

- You can claim expenses on your rental property, which may reduce the tax you pay.

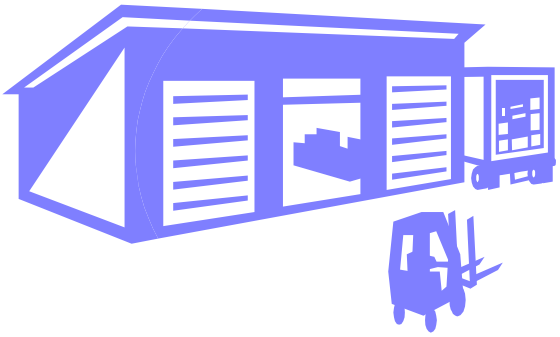
- If you rent a house, you are helping to pay off someone else's ***mortgage*** and, after a while, they will have a house that is fully paid for, but you will not!

- Buying a property is like a compulsory form of saving – you are much more likely to meet mortgage payments than save money in other ways.

Although these advantages are all true, **they are only part of the story**.

Throughout this Module we will explain each of these advantages and look at any 'flipside' to them. This first section of the Module focuses on looking at those advantages that relate to the potential returns from property investment.

Also covered within this section is a description of the various types of property investment available. Often, when we think of property investment, we only think of buying houses which people live in. This is ***residential property investment***.

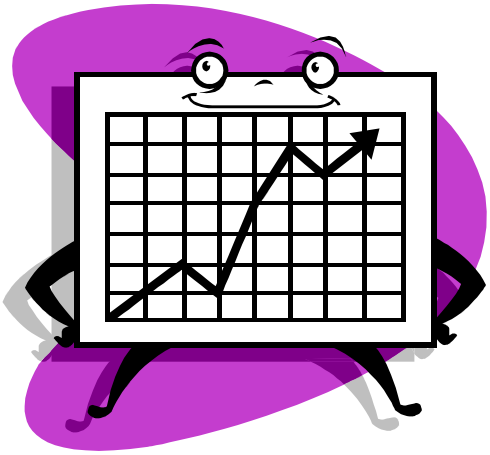


However, there is also the option of ***commercial property investment***. Although the advantages listed above generally apply to this type of investment as well, commercial property investment has its own features, advantages and disadvantages which may be different to residential property investment.

## 1.1 Trends in the New Zealand Property Market

People are often attracted to property as an investment when they compare the prices that their parents and others in their generation paid for their houses 30 years ago to current prices, or when they witness property prices in their own neighbourhood leap within a short period of time. They see property as a 'sure thing' and want to be a part of the next big boom.

Whilst it is true that property market prices have multiplied, many times over, in the past half century or so, **it hasn't been a smooth ride upwards**.



There are a number of factors that influence property prices which result in the market being somewhat ***cyclical*** in nature. That is, it has periods of strong growth, followed by periods where prices remain stable, or even fall.

Like other investments, there is risk involved and investors generally need to be prepared to take a long term view of their investment. Before getting into property investment, it helps to prepare yourself for this by gaining an understanding of how the property market works and of what drives prices.

## 1.1.1 Market Prices

Over the last 60 years, property prices have increased significantly, doubling many times over. However, for property investors, it hasn't been a smooth ride upwards, especially when looking at ***real returns*** – that is, returns that take into account the impact of ***inflation***.

Between the years 1950 and 1954, real property values increased by 66%. Over the 18 years following, there was very little increase until the early 1970s.

Then, between the years 1971 and 1974, a period in which a large number of new homes were built, real house prices jumped by 59% within just this very short period.

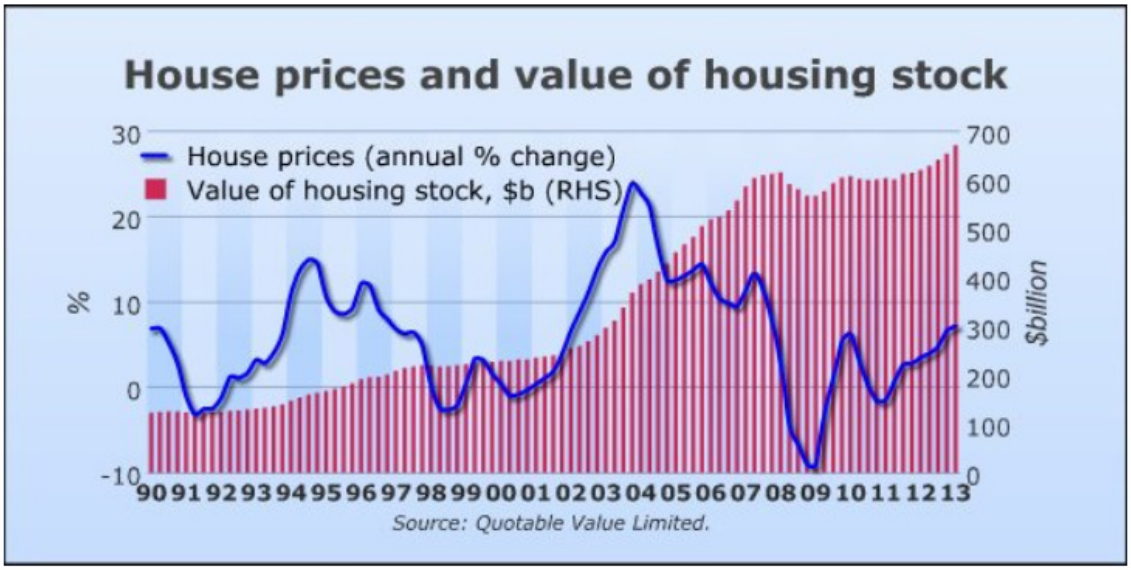
However, from 1974 to 1980, these gains were lost when *real* property values plummeted.

During this period, house prices still increased at an average rate of 6.1% a year, but given this was much lower than ***inflation*** (approximately 15% each year), the result for property investors was negative growth.

The last 60 years have shown us that, for two to six years after hitting a peak, real house prices tend to '***bottom out***'. 'Bottoming out' is a term used to describe hitting a low point. This can also be referred to as a 'crash', which is a sharp drop in prices. In the late 1970s, when values dropped, they did so by 37%. This is an example of bottoming out or crashing.

In regards to the most recent few decades, house prices have increased enormously. The ***median*** house price in 1980 was $41,240. In March 2013, the median house price reached the $400,000 mark[1] – almost 10 times what it was in 1980! This was a huge increase for investors!

However, yet again, prices did not rise consistently throughout this time. The graph below shows the annual percentage changes in house prices from 1990 through to 2013[2].




When you look at this graph, you can see that, since 1990, there have been five periods in which property values have decreased (these are the times when the main line on the graph falls below the '0'). These periods include:

- late 1990 to early 1992,
- 1998 – 1999,
- 2000,
- late 2007 – mid 2009, and
- mid 2010 – mid 2011.

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[1] Hargreaves, D. (11 April, 2013). *REINZ says median house price hit NZ$400,000 for the first time ever in March; most houses sold in a month since May 2007.* Retrieved 28 September, 2013, from http://www.interest.co.nz/property/63928/reinz-says-median-house-price-hit-nz400000-first-time-ever-march-most-houses-sold-mon

[2] Quotable Value Limited. (July 2013). *Key Graphs – House Prices and Aggregate Dwelling Values*. Retrieved 27 September, 2013, from http://www.rbnz.govt.nz/statistics/key_graphs/house_prices_values/

You can also see from the previous graph how unsteady the growth in property values has been. Annual growth has ranged from as high as over 20% in 2003-2004 to as low as -10% in 2009.

For those of us who are looking at property for home ownership purposes, the affordability of housing is of particular interest. The following graph shows weekly mortgage payments in New Zealand as a percentage of weekly take-home pay. It is based on the average income (after tax) for someone aged 30 – 34 who is buying a 'median-priced' house and has provided a 20% deposit. In other words, it shows what proportion of their pay the average home owner spends on mortgage payments.

***The Roost Home Loan Affordability Index for August 2013***[3]

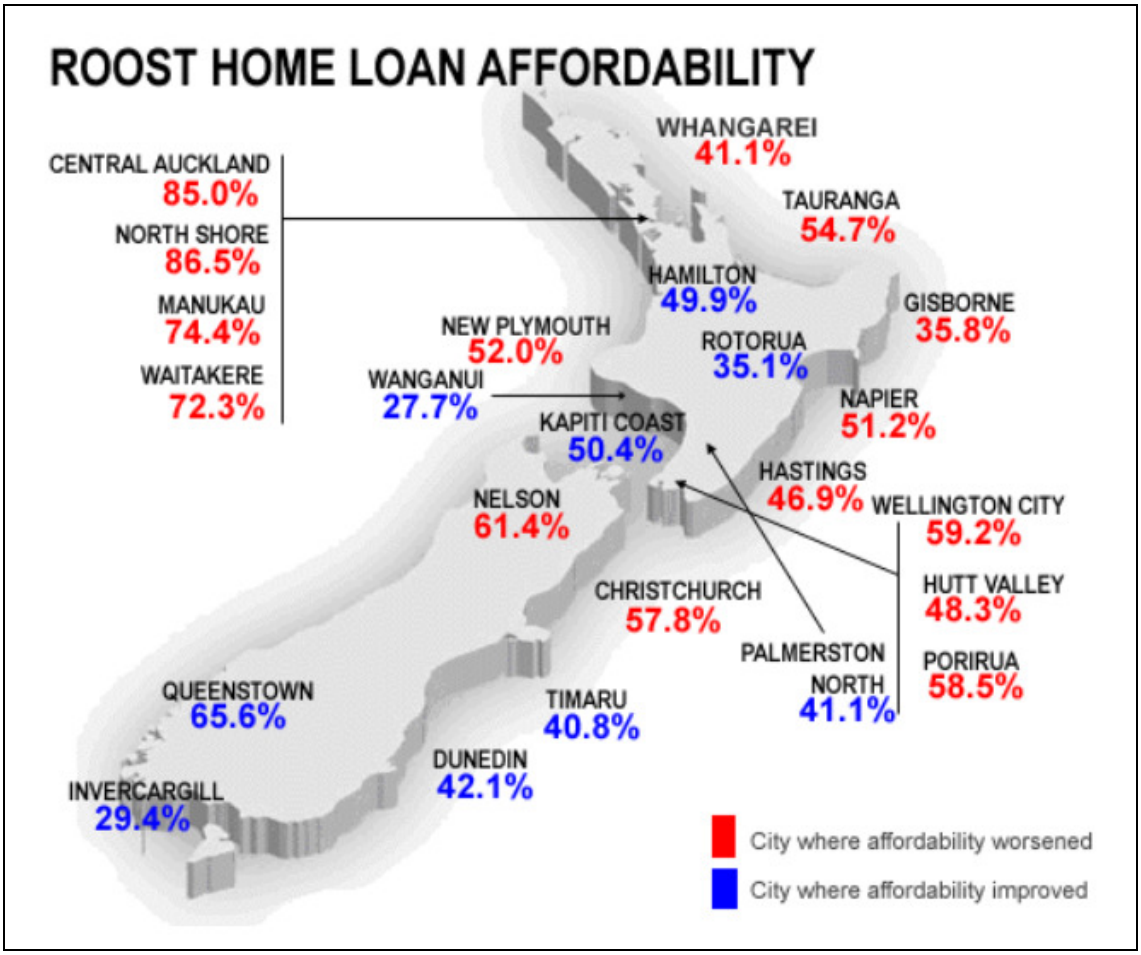
A mortgage is sometimes considered to be affordable if the mortgage payment is no more than 40% of take-home pay. As you can see from the graph above, a mortgage has not been 'affordable' since about 2001. In fact, mortgage payments peaked at over 80% of income around 2007! That means if you were to bring home $500 per week, after tax, $400 of this would go towards your mortgage payment. This would only leave $100 for power, food and other expenses!

[3] Interest.co.nz. (23 September, 2013). *The Roost Home Loan Affordability Report.* Retrieved 27 September, 2013, from http://www.interest.co.nz/property/home-loan-affordability

Statistics about house prices in New Zealand are largely affected by house prices in Auckland. Due to a shortage of housing in Auckland, mortgage payments have increased to being over 80% of average income. This is shown in the image below.

The most unaffordable region of New Zealand is the North Shore in Auckland, which has an affordability index figure of 86.5%. Remember, this means that mortgage payments are 86.5% of average income. This compares to Wanganui, where the index is only 27.7%. Christchurch, which has an index figure of 57.8%, has become less affordable in recent years due to the shortage of housing caused by the Canterbury earthquakes in 2010 and 2011.

***The Roost Home Loan Affordability Index by Town / Region in August 2013***[4]




[4] Interest.co.nz. (23 September, 2013). *The Roost Home Loan Affordability Report.* Retrieved 27 September, 2013, from http://www.interest.co.nz/property/home-loan-affordability

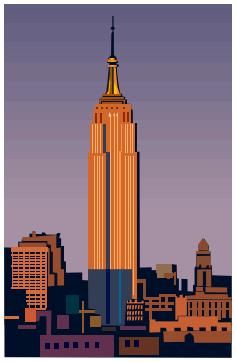
According to the results of an international study on the affordability of housing, based on data from late 2011, housing in New Zealand is considered 'severely unaffordable'[5]. This study defines an affordable house price as one that is no more than three times average annual household income.

So if, for example, an area has a median annual household income of $80,000, house prices would need to average $240,000 or less to be affordable. Even when data was viewed on a region by region basis, New Zealand did not have any affordable markets.

The most unaffordable markets were Auckland, Christchurch, Tauranga / Western Bay of Plenty, Dunedin and Wellington. This was followed by Palmerston North, Napier / Hastings and Hamilton. In fact, the study reported that house prices in Auckland were 6.4 times more than the average household income in the area! Given that house prices have increased further since 2011, it is likely that this figure is now even higher.

The affordability of housing in Auckland was reported as being worse than the affordability of housing in Los Angeles and New York.

In Los Angeles, the median house price was 5.7 times the average household income, whereas prices were 6.2 times average household income in New York.



Housing in Auckland was, however, more affordable than in London or Hong Kong. In Hong Kong, the median house price was a whopping 12 times the average household income!

***Discussion Question:***

What do you expect will happen in regards to housing affordability over the next 10 years? Why?

[5] Wendell Cox & Hugh Pavletich. (2012). *Demographia International Housing Affordability Survey.* Retrieved 19 September, 2012, from http://www.demographia.com/dhi.pdf

## 1.1.2 Supply and Demand

***Market prices*** are determined by how much buyers are prepared to pay for properties and how little sellers are prepared to accept for their properties. It sounds straightforward, but there are many factors that affect these two variables.

These factors are called 'supply' and 'demand' factors – that is

- factors which affect the supply of property, and
- factors which affect the demand for property,
- ...which ultimately determine the prices at which property is sold.

### 1.1.2.1 The Supply and Demand Curve

To illustrate how supply and demand works, let's look briefly at the basic economics of supply and demand curves.

Some of the basic rules of economics are:

- The **higher** the price that **sellers** can receive for their goods, the **greater** the quantity that they will want to supply.

- The **higher** the price that **buyers** must pay for goods, the **lower** the quantity that they will want to buy.

Let's look at some examples of how this works in relation to property:

### *Example 1: Supply*

House prices in a town are very low. If someone is to sell their house, they can only expect to get an average of $100,000 for it.

Therefore, very few people choose to sell their homes... the only ones who put their houses on the market are those who do not really have a choice about selling (e.g. they may be forced to because they cannot afford to keep their house). Even if someone had planned on selling a property at that time, they may choose not to because the price they would receive is too low.

However, prices start to rise and more people become willing to sell their properties. As average property prices climb to $200,000, those people who want to sell because they have planned to, or would like to sell at that time (perhaps due to a desire to use the money to retire), then decide to sell their properties.

When prices rise further, people who had **not** previously considered selling their properties suddenly start thinking about it. After all, if there are buyers out there willing to pay $300,000 for a property that only cost them $100,000, they think "Yeah – let's sell!"

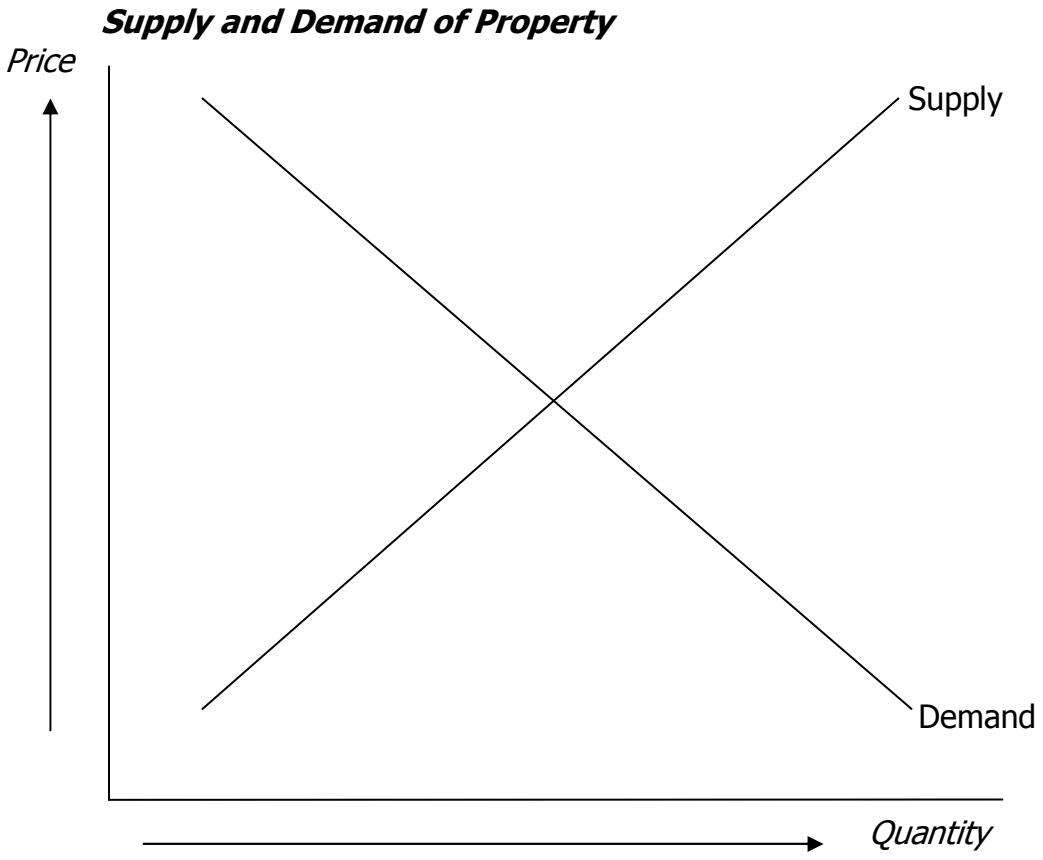
### *Example 2: Demand*

Buying a house in a particular town is quite expensive. At an average price of $400,000 for a basic house, very few people in the town can afford to buy one. Furthermore, even those who can afford to buy may choose not to – it may simply not be worth it for them. However, as prices come down, buying property becomes more attractive.

In fact, not only do more people start buying houses, but people start buying a larger quantity of houses!

When prices get as low as $100,000, those people who could afford to buy a $400,000 house but chose not to, may suddenly decide to buy four $100,000 houses because they consider they are getting a bargain!

This can be shown on a supply and demand graph:




The previous graph shows that:

As prices increase,

the quantity of property supplied increases,

BUT

the quantity of property demanded decreases.

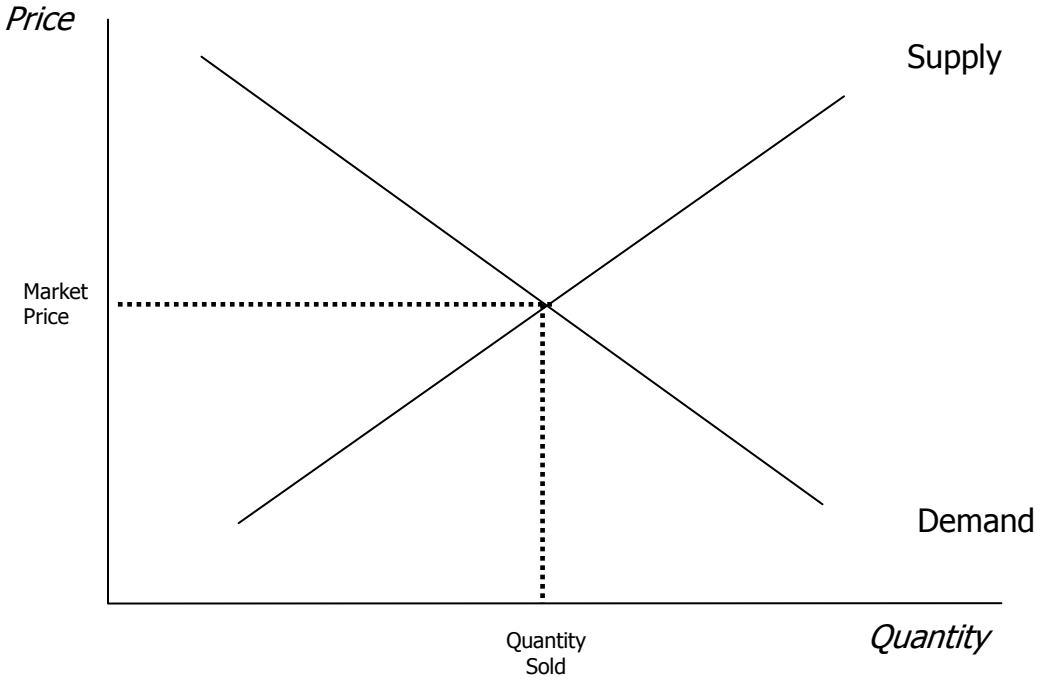
The next important point to note is that:

The **price** and **quantity** of property sold

is determined by where

**the supply curve crosses the demand curve.**

***Supply and Demand of Property***



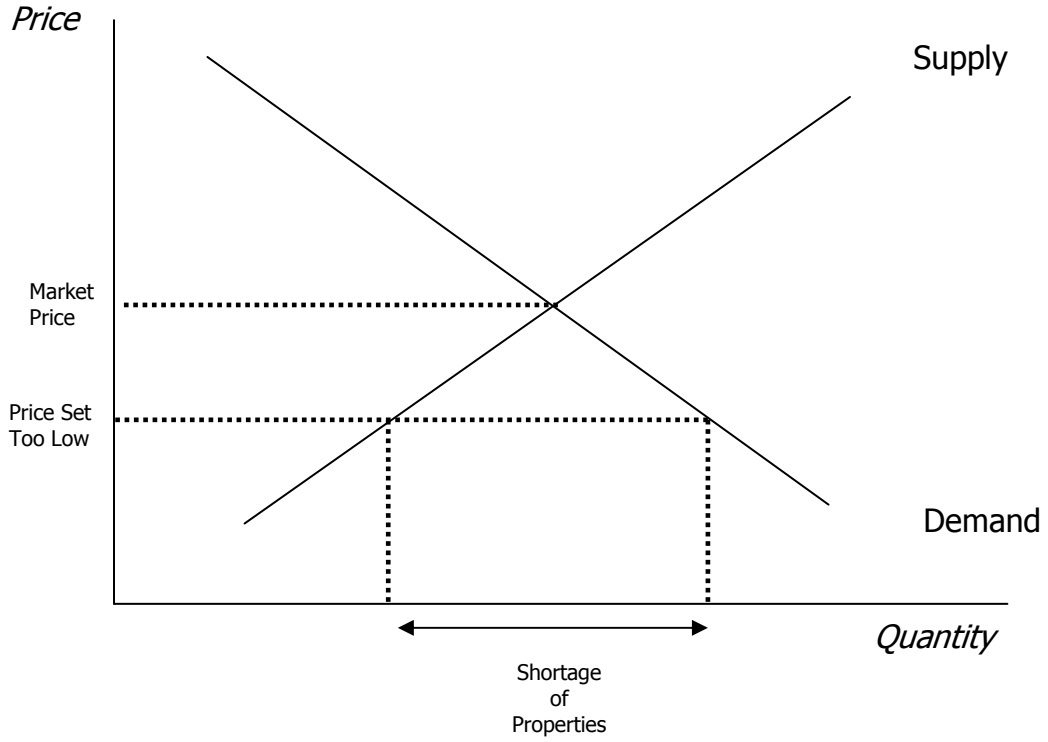

**Why is this?**

- **If the price is too low**, there are not enough properties for sale – there are more people willing to buy than there are properties available.

  Buyers therefore start to compete for the properties, with some offering to pay more just so they can get them. As buyers become willing to pay more, more property owners make their properties available for sale.

  This continues until the quantity of properties available for sale matches the quantity demanded.

***Supply and Demand of Property – Price Set too Low***




**BUT**

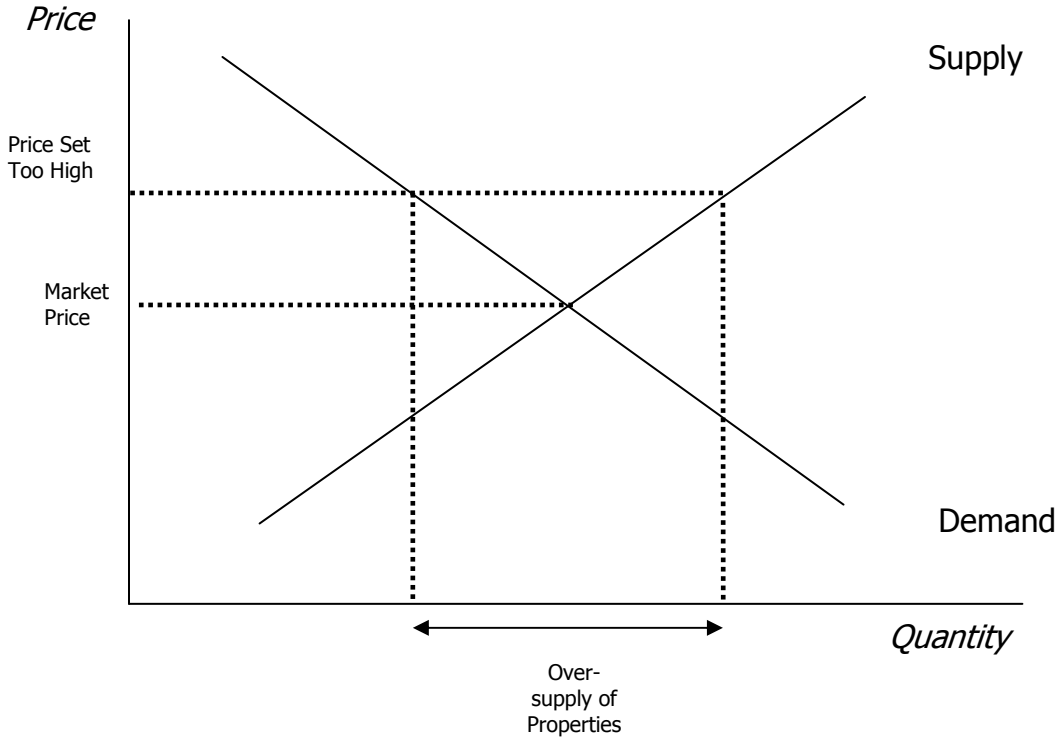
- **If the price is too high**, many more property owners want to sell their properties than there are buyers interested.

  Buyers suddenly have a lot of power and are able to negotiate lower prices – after all, if a property owner really wants to sell a property, they need to be prepared to accept a lower price.

  Think of it like a business: the various sellers are competing for a limited number of buyers – in order to secure a buyer they need to offer the best deal!

  As prices fall, some property owners decide to take their property off the market and not sell. At the same time, more people become interested in buying properties. This trend continues until the quantity of properties demanded matches the quantity of properties on the market.

***Supply and Demand of Property – Price Set too High***




**So how do property market prices change?**

Property market prices change when either, or both, the demand curve or the supply curve changes.

In short, the greater the supply of properties, the lower the prices, and the greater the demand for properties, the higher the prices! This is demonstrated in the following sub-sections.

### 1.1.2.2 Supply of Properties

As you will know, different people are motivated to sell their properties at different times for various reasons. Consider the following reasons – perhaps:

- Interest rates have increased and they cannot afford to meet their mortgage payments anymore.
- Their income has decreased and they cannot afford to meet their mortgage payments.
- They are moving out of the area and need to sell their house.
- There are a lot of people looking to buy property at that time and thus the seller can get a good price for it if sold then.
- The bank is selling their house because they have missed the required loan repayments.
- They want (or need) to 'cash up' and use the money for other purposes.

- They have invested in the development of an apartment complex, or even the building of a single new house, specifically with the intention of selling it as soon as it is finished in order to make a profit.
- They have found another house that they would rather own.
- They had always planned to sell the property at that specific time.

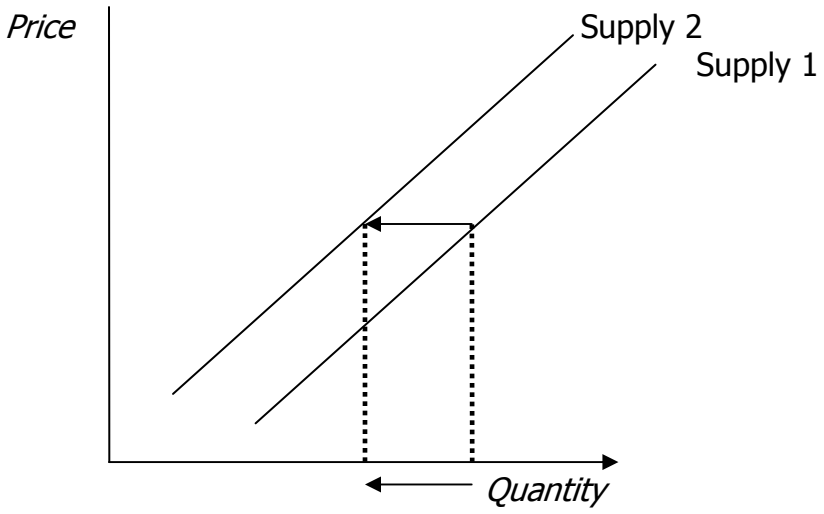
Some of these reasons affect where the supply curve of properties is currently and others influence the supply curve to change.

Let's look at the factors that influence the supply curve to change to see how this impacts on market prices. The supply curve can either move inwards (left) or outwards (right).

## Factors which move the Supply Curve Inwards

If the supply curve of property moves inwards, this means that, for any given price, fewer people are prepared to sell their properties.

***A Reduction in the Supply of Property***



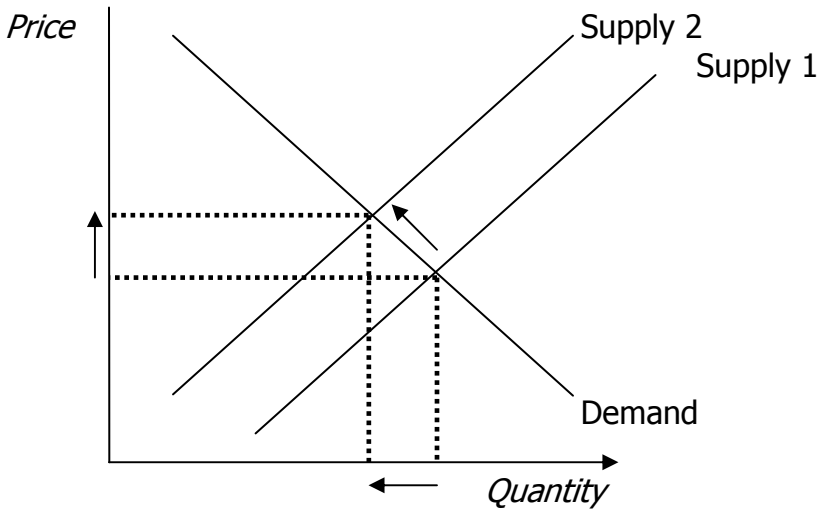
So what would make a property owner less willing to sell their property if the price hadn't changed?

A lot of the reasons can relate to changes in their personal financial situation. If they are better off financially, there is less need for them to sell a property – they are in a better position to keep the property and build their investment portfolio! Consider the following possible causes:

- Interest rates may have decreased. This makes paying the mortgage more affordable and owners are therefore less likely to need to sell.
- Incomes may have improved.
- Job security may have improved.

Now let's look at what impact a decrease in supply has on market prices:

***The Impact of a Reduction in the Supply of Property***

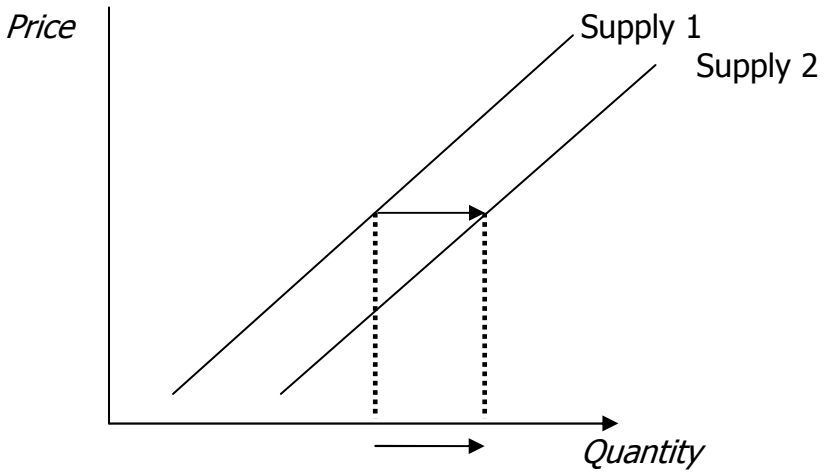



As shown in the above diagram, if the supply curve moves inwards, market prices increase and the quantity of properties sold decreases.

**Factors which move the Supply Curve Outwards**

If the supply curve of property moves outwards, this means that, for any given price, more people are prepared to sell their properties.

***An Increase in the Supply of Property***

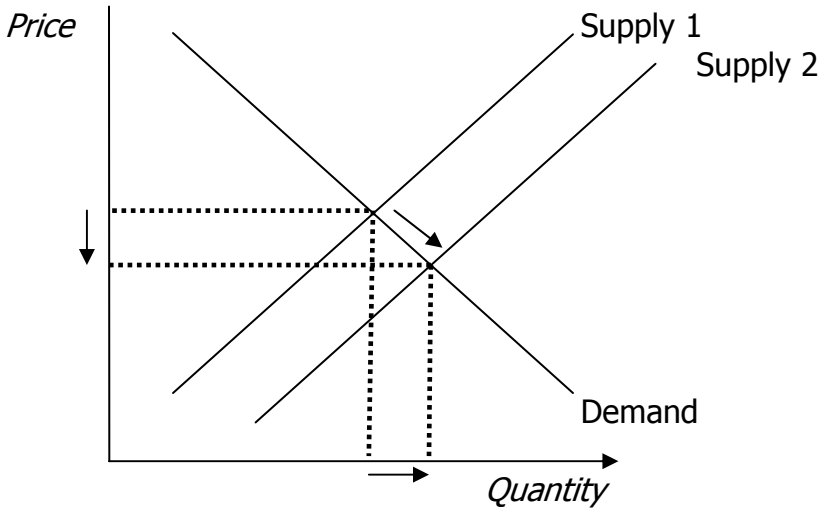


So what would make a property owner more willing to sell their property if they are not going to get any more money for it?

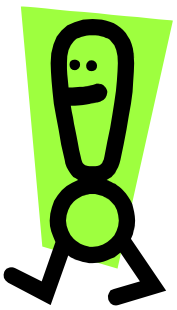
Well, for starters – the opposite reasons as to why a supply curve would move inwards. When the economy is not doing well, this affects individuals within the economy. People lose jobs and incomes fall. For those who still have a mortgage, meeting mortgage payments can become too difficult, especially when juggling other financial commitments. This forces people to sell, even if it is not a good time in terms of the price that they could get for their property.

Now let's look at what impact an increase in supply has on market prices:

***The Impact of an Increase in the Supply of Property***




As shown in the above diagram, if the supply curve moves outwards, market prices decrease and the quantity of properties sold increases.



A point to note is that a ***recession*** is not necessarily a bad thing for some property owners. In fact, property owners may struggle more if the economy is booming!

This is because in poor economic times, interest rates typically *fall*, whereas in good economic times, interest rates typically increase. When interest rates increase, meeting mortgage payments becomes more difficult.

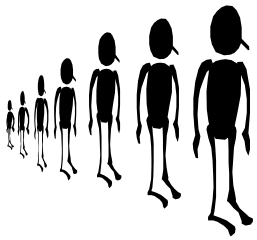
***Discussion Question:***

Why do interest rates usually decrease when the economy is in a ***recession*** and increase when the economy is booming?

### 1.1.2.3 Demand for Properties

Demand for properties in New Zealand reflects the number of people in our population wanting to buy properties. As with the supply of properties, the number of people wanting to buy is largely affected by the state of our economy.

- If the economy is doing well, people are in a better position to be able to buy and vice versa.
- However, the number of people wanting to buy is also affected by changes in the actual **number of people in our population**.



As at September 2013, New Zealand had a population of approximately 4.48 million people[6].

This is forecasted to reach 5.4 million in 2036[7].

This increase includes population growth due to the number of births being more than the number of deaths, plus growth due to ***immigration***.

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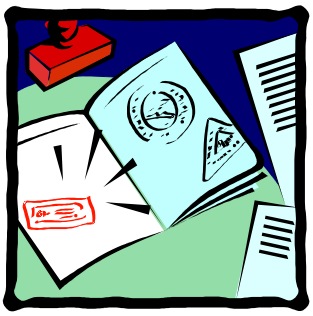
[6] Statistics New Zealand. *NZ Population Clock*. Retrieved 28 September, 2013, from http://www.statistics.govt.nz/methods_and_services/population_clock.aspx

[7] Statistics New Zealand. (July 2012). *National Population Projections: 2011 (base) – 2061.* Retrieved 28 September, 2013, from http://www.stats.govt.nz/browse_for_stats/population/estimates_and_projections/NationalPopulationProjections_HOTP2011.aspx

Immigration, which is the arrival of people from overseas to live in New Zealand, is one of the main factors which influences the New Zealand property market, especially in the larger cities.



Statistics New Zealand considers that a 'medium' projection of ***net migration*** (i.e. the number of people coming into New Zealand less the number of people moving out of New Zealand) is 12,000 per annum[8].

***Discussion Questions:***

What factors encourage ***immigration***? That is, what causes people to want to move to live in New Zealand?

How many new houses per year do you think would be needed to cater for immigration?

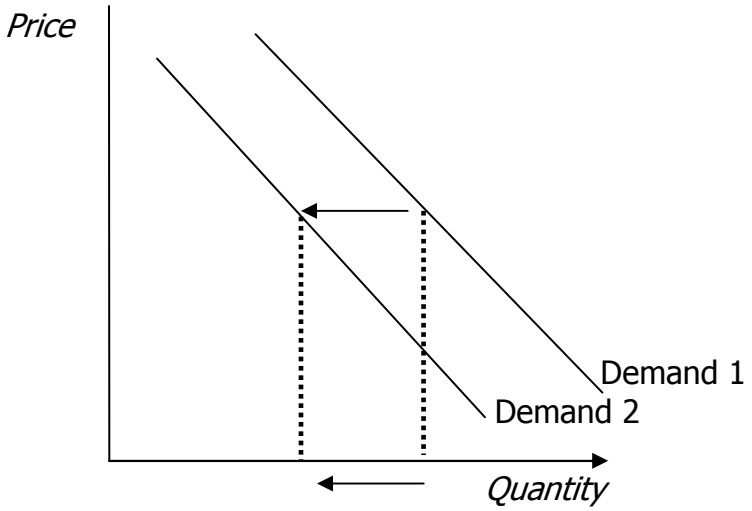
Let's now look at the factors that move the demand curve.

[8] Statistics New Zealand. (July 2012). *National Population Projections: 2011 (base) – 2061.* Retrieved 24 July, 2012, from http://www.stats.govt.nz/browse_for_stats/population/estimates_and_projections/NationalPopulationProjections_HOTP2011.aspx

## Factors which move the Demand Curve Inwards

If the demand curve of property moves inwards, this means that, for any given price, fewer people are willing to buy properties.

***A Reduction in the Demand for Property***



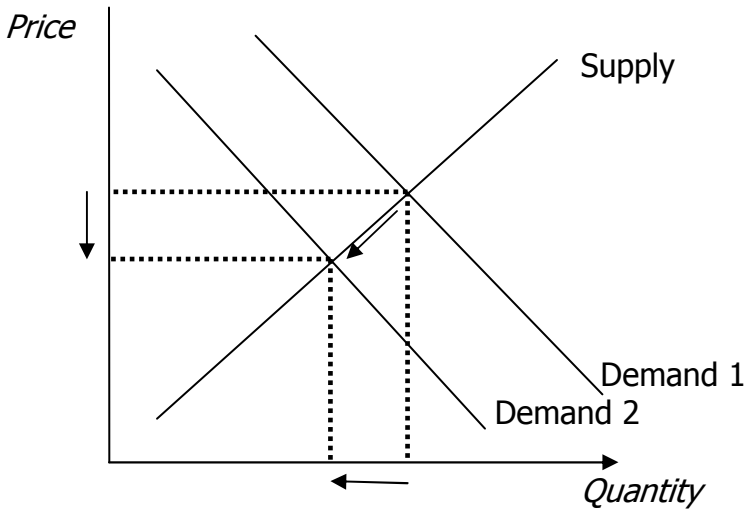

Some of the factors that move a demand curve inwards are the same factors that can move a supply curve outwards. In particular:

- If interest rates rise it becomes more expensive to service a mortgage and less people can afford to buy a house.
- If the economy is not doing well, fewer people have jobs and incomes fall, which reduces the affordability of housing.

However, in addition, the demand curve can move inwards due to **changes in the population**. If there are more people leaving New Zealand, than there are people coming to live in the country, demand for housing will fall.

Now let's look at what impact a decrease in demand has on market prices:

***The Impact of a Reduction in the Demand for Property***

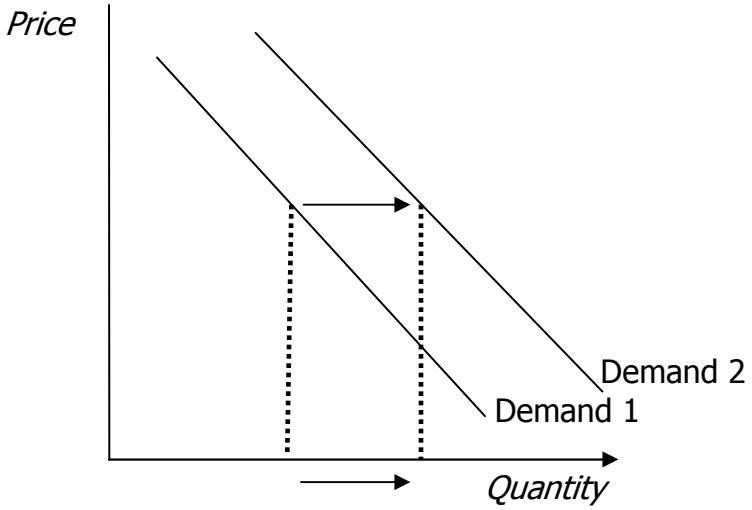



As shown in the above diagram, if the demand curve moves inwards, market prices decrease and the quantity of properties sold decreases.

**Factors which move the Demand Curve Outwards**

If the demand curve for property moves outwards, this means that, for any given price, more people are willing to buy properties.

***An Increase in the Demand for Property***

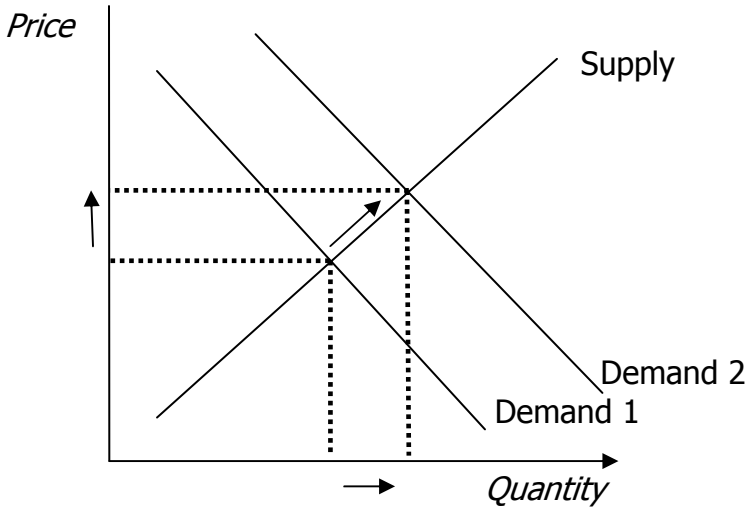


Demand for property increases for the opposite reasons than why demand would decrease. For example, demand would increase if:

- Interest rates decrease;
- Incomes and job security increase; or if
- The population increases.

Now let's look at what impact an increase in demand has on market prices:

***The Impact of an Increase in the Demand for Property***



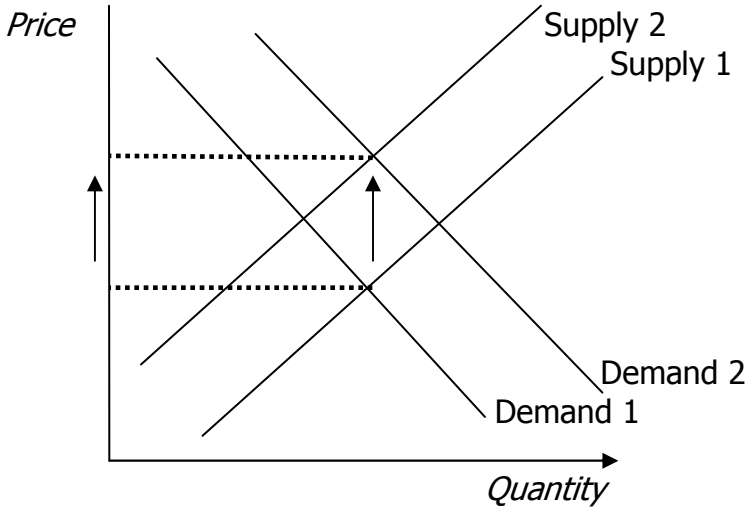

As shown in the above diagram, if the demand curve moves outwards, market prices increase as does the quantity of properties sold.

### 1.1.2.4 Changes in Supply and Demand

In the previous sub-sections we looked at the impact on property market prices due to changes in either supply or demand. The reality is, however, that **both** demand and supply can change at the same time!

Think about the factors that affect the demand and supply curves to move – some of these are the very same factors! For example, an improvement in incomes due to a strong economy can both increase demand and reduce supply, as shown in the following diagram.

***The Impact on the Property Market of Improvements in Income***



As per the above diagram, in this situation, ***market prices*** are likely to increase. Both the increase in demand plus the decrease in supply lead to higher prices.

However, **what is the impact on quantity sold?** It is not clear. In the above diagram there is no impact. However, in real life, whether or not quantity changes will depend on how much the supply curve moves relative to how much the demand curve moves.

We also need to take into account that other influences may occur at exactly the same time. For example, if income is improving, the economy is improving and interest rates are therefore also likely to be increasing. This has the opposite effect on supply and demand!

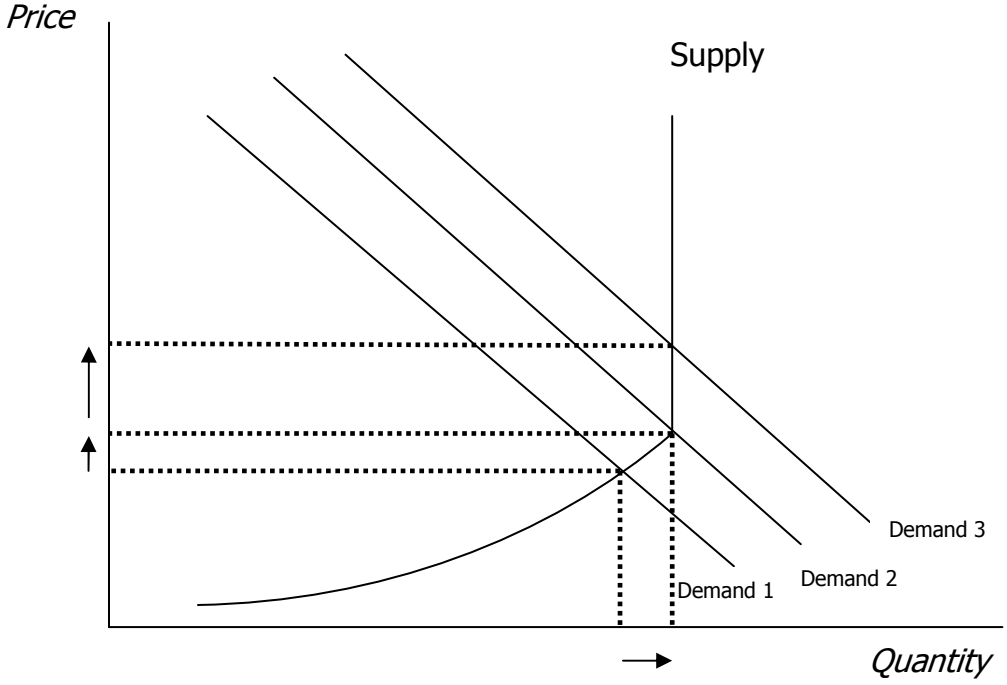
This is part of the reason why the property market is ***cyclical***. That is, when the economy booms, property prices go up, but then the market slows (and maybe even decreases) when the effect of higher interest rates kick in. However, over time, the trend is generally upwards.

### 1.1.2.5 Limitations in Supply

One of the key drivers in property market prices is that supply is limited, whereas demand is not. Although new housing developments continue to occur, in the long-run, we are limited by land area. Whilst we can grow our population, we cannot grow our land base!

This means that supply cannot indefinitely increase. At some point, regardless of the price people are willing to pay, the number of properties for sale cannot increase. Consider the following diagram:

***The Impact of the Limited Supply of Land***



This diagram shows that, initially, as demand increases (from Demand 1 to Demand 2), the quantity of property for sale also increases.

However, at some point, no further land is available. If demand increases further from Demand 2 (to Demand 3), prices increase, but quantity supplied does not. Note that the price increases by MORE than it did initially, even though the demand curve has moved by the same amount.

***Discussion Question:***

What implications does the limited supply of property have on property as an investment option?

## 1.2 Types of Property Investment

When thinking about property investment, many people automatically think of buying houses, flats or units which are then rented out to others to live in. This is called ***residential property investment.***

However, this is not the only option available for property investors – you can also consider office buildings, shops and even factories. These other forms of property investment are broadly referred to as ***commercial property investment.***

Let's look at both of these types of property investment.

### 1.2.1 Residential Property Investment

***Residential property investment*** is the most popular and common form of property investment in New Zealand. Given that everyone needs a house to live in, but not everyone can afford to (or wants to) buy their own, the popularity of residential property investment is no surprise! It is for this reason that the remaining sections of this Module also focus on this form of property investment.

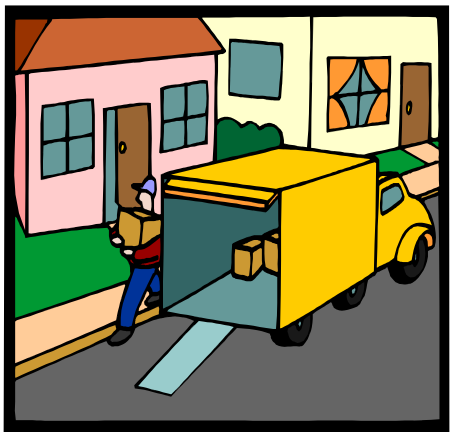
With residential property investment, it is usually **easier to find a suitable property and *tenants*** – after all, everyone needs somewhere to live, but not everyone is ready or willing to buy their own house. As such, even when the economy is not doing well, there is still a demand for rental housing.

In fact, demand may even increase during a ***recession*** in some areas – that is, when incomes are low, purchasing a house becomes even more unaffordable to many families. Other people struggle to maintain the ***mortgage*** they have and are, unfortunately, forced to sell their home and instead rent. On the other hand, people who previously rented may decide to move in with family to keep their living expenses low.

However, whilst finding tenants may be easier with residential property investment, **you may need to do it more often**. Whilst many people rent because they cannot yet afford to buy, another common reason why people rent is because their life situation does not involve being settled in one location.

For example, they may be students needing accommodation in another town just while they are studying, or they may be working in a temporary or seasonal job.

Even if they have permanent employment, they may expect to be promoted or transferred to another location or may simply be unsure of where they want to live long term and therefore not want to be 'tied down' to one location.



In comparison, with ***commercial property investment***, tenants are operating businesses that they typically plan to be in existence for 'the long haul'. Even if the owner decides to move on from the business, it is likely that they will try to sell to someone else so that the business carries on.

If you are new to property investment, residential investment is also a good choice because **entry costs are typically lower**. That is, the cost of buying a house is often lower than the cost of buying a commercial property. However, this, of course, depends on the property:

- location,
- size, and
- quality.

But, in general, you are more likely to find a good quality residential property that attracts plenty of tenants for $200,000, than you are to find a good commercial property (that is attractive to potential tenants) for this price.

Furthermore, with residential property investment, you can usually **borrow at least 80% of the money required**.

On the downside, residential property investment usually requires more 'hands-on' management of tenants and there is the **added cost** of needing to pay for repairs and maintenance.

## 1.2.2 Commercial Property Investment

### 1.2.2.1 Types of Commercial Property Investment

Commercial property investment is a broad term that includes the following types of investments:

- ***Industrial Property Investments:*** This includes places where things are made or services provided. These properties are often not accessible to the general public – for example factories, warehouses and workshops.

- ***Retail Property Investments:*** These are shops or buildings, often in the hub of towns / cities, usually open to the public.

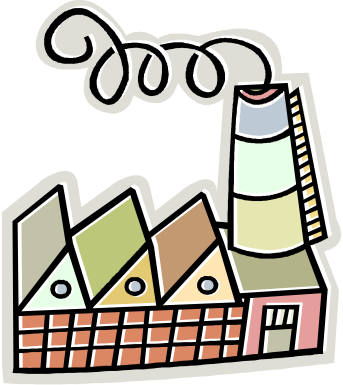
- ***Commercial Property Investments:*** This includes places where people work or do business – for example in offices, meeting places.

Note that the term 'commercial property investments', may be used to refer to the broader group of commercial property investments, which includes industrial and retail property investments, or to only refer to properties such as offices, training and conference centres, etc.

Commercial properties often have mixed purposes and may therefore fall into more than one category. For example:

- a building with a retail shop on the ground floor may have commercial offices on higher levels.
- a factory may have a retail store in front.
- an industrial workshop may be attached to a set of offices.

**Industrial Property**



Of the three types of commercial property investment, ***industrial property investment*** tends to be the cheapest. This is because the buildings themselves are often more basic and, put simply, do not need to be as nice as the other forms of commercial property. For example, often (but not always), industrial properties have very few rooms and basic concrete floors.

Industrial properties are also usually cheaper due to their location. Whereas retail properties (and to a lesser extent, commercial office space) tend to be in the centre of town, industrial properties are typically on the outskirts of town and grouped together in areas of cities where prices are cheaper.

For this reason, buying an industrial property may be a good starting point if you are interested in commercial property investment.

In general, ***tenants*** of industrial properties are non-fussy, down-to-earth people who will fix things themselves, rather than bother you, and will stay for long periods of time and pay their rent when due.

If you like this type of investment, just ensure that the basics are there:

- good high stud ceilings.
- wide doors.
- easy access.
- close to main roads.
- in areas in which other factories / warehouses are situated.

## Retail Property

Retail properties are generally the most risky type of commercial property investment. This is because ***tenants*** are largely affected by economic conditions. When the economy is in a ***recession***, consumers tend to reduce the amount of ***retail*** shopping they do before cutting back elsewhere.

This is because items sold in retail stores are more likely to be non-essential items, or items for which there are cheaper alternatives. These businesses therefore have a shorter average life-span.

In addition, some retail businesses are now choosing to close their store and instead be based completely online.

Even those retail tenants who stay in business and choose to have a physical store may move to different ***premises***. Whereas it often does not matter too much where a commercial office is situated, location is critical to retail businesses which operate from a physical store.

If a retail business has a physical store, this needs to be where their potential customers are (which is often the location with the most ***foot traffic***). So if a better shop space becomes available, for these tenants, moving may be worth the cost and hassle.

The cost of a retail property investment therefore varies a lot depending on location. Those properties in areas of high foot traffic cost much more to buy than those located elsewhere. But, on the other hand, these properties can be rented out at much higher rates and there is higher demand by tenants.

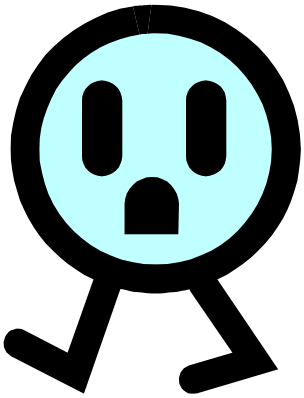
In contrast, retail properties in not-so-good locations are more likely to remain ***vacant*** (empty) for long periods of time (especially in a recession) and are harder to sell.

## Commercial (Offices) Property

Depending on factors such as size, location and quality of the premises, commercial (offices) property tends to be the more expensive option (although retail properties in very popular shopping centres are pricey!).

Commercial ***tenants*** tend to stay in business and in one location for a long period of time, largely due to the type of services they provide. For example, even in a ***recession***, people still need accounting and legal services, insurance, education and training.

If you invest in office space, look for premises that are already set up in a technology-friendly way – particularly in regards to power and phone outlets.



Also look for:

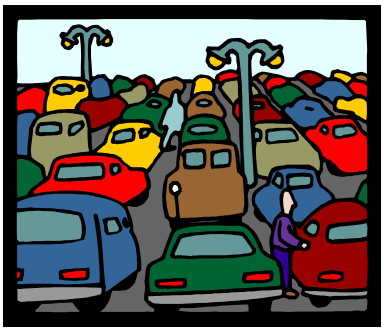
- plenty of light,
- good air-conditioning,
- quality fittings,
- attractive carpets, drapes and décor (in general).

The nicer the space, the more likely you are to attract high quality tenants who are prepared to stay for long periods of time and pay 'top dollar'.

If you have trouble filling a large office space, consider cutting it up into small offices – this may be a more profitable option in any case.

### 1.2.2.2 Points to Look for in Any Commercial Property

Regardless of what type of commercial property investment you are interested in, when looking to buy a property, look for the following features:

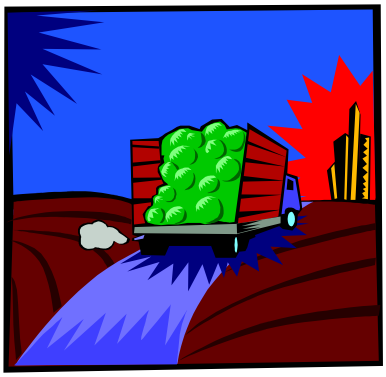


☑ Adequate parking for the intended use. ***Local authority district plans*** include specifications on how many car parks buildings need for various uses. If a building is being used for ***retail*** purposes, it typically needs more car parks than other types of commercial uses.

☑ Other rules set out in the ***Local Authority*** plans which you will have to comply with. Think about who the likely tenants for a property are and the intended uses, then visit your local council to make sure that the property fully complies with the *Resource Management Act 1991* for this use.

☑ A well-lit area.

☑ Modern facilities and in good condition.



☑ Located by main roads and / or around similar types of buildings.

☑ A building that will appeal to a wide range of tenants. If the building is too 'specialised' (i.e. suited to a limited number of purposes) it will not appeal to many potential tenants.

### 1.2.2.3 Features of Commercial Property Investment

On the whole, commercial property investment is riskier than residential property investment. Whilst it attracts longer term tenants, it is generally harder to find those tenants and properties therefore have much higher ***vacancy rates***.

That is, a commercial property is likely to stay empty for much longer than a residential property. In those weeks (or months!) that the property is not occupied, investors still need to be able to pay their mortgage.

**The higher risk involved is reflected in the lending arrangements that are available for commercial properties**.

Whereas you can usually expect to borrow 80% of the price of a residential property, it is most likely that a lender will only lend up to 60% – 70% of the price of a commercial property.

This, together with the fact that the properties tend to be more expensive, means the ***entry costs*** for an investor are much higher than for residential property.

Furthermore, the interest rates charged by lenders are usually higher for a commercial property loan than for residential property (about 1.5% higher, possibly more) and the loan is usually for a much shorter period of time. This could be only 5 years, but is often a maximum of 15 years.

However, if there is a tenant for the property, the quality of this tenant and the lease that the investor has with the tenant can affect what lenders are prepared to offer. Obviously,the better the tenant and the lease, the more favourable the loan.

Just as lenders reflect the higher risk in the terms of their lending arrangements, commercial property investors (should!) reflect it in the rent that is charged.

Remember, the higher the risk, the higher the returns you should expect!

**In other words:**

**the higher the risk,**

**the higher the rent you should charge!**

On the positive side, depending on the terms of the lease you have with the tenants of course, **usually the tenant takes responsibility for repairs and maintenance** (especially internal maintenance).

For example, if the tenant thinks a room needs to be painted – it is usually up to them to go ahead and do it. Even if the landlord is responsible for maintenance, the cost of this is usually paid for by the tenant or split between the tenant and landlord.

In comparison, with residential property investment, the ***landlord*** is responsible for the cost of all repairs and maintenance.

Also note that tenants of a commercial property investment usually have **more freedom** to conduct renovations. Whereas the tenant in a residential property typically cannot decide to go ahead and renovate the house (at least not without the landlord's consent!), it is normal for a tenant of a commercial property to do so.

Commercial tenants need to be able to 'fit out' a building and decorate it in a way that meets their business needs and branding without having to ask the landlord for approval for each change made.

They need to be able to do this so they can run their business in the way they want. Imagine if a tenant wanted to re-brand their business to attract more customers and, in doing so, needed to change the colour scheme inside their premises from beige to bright green. Now imagine that their landlord did not let them do this!

However, it is also commonplace for the landlord to require the tenant to return the premises to its original state at the end of the lease – especially if the tenant wants to do specialised alterations to the property (e.g. putting in internal walls, installing shelving and other fittings).

### 1.2.2.4 The Deed of Lease

A common feature of commercial property investment is that the terms and conditions of the tenancy are usually covered by a ***Deed of Lease***. There is a standard Deed of Lease document available for property investors to use. This is the ***Auckland District Law Society (ADLS) Commercial Deed of Lease***.

The Deed of Lease records details such as:

- the parties to the agreement (i.e. the name of the landlord and the tenant),
- the address of the premises, and
- the rental amount and the term of the lease.

A few of the other many provisions of the lease usually include:

- **Maintenance Responsibilities:**

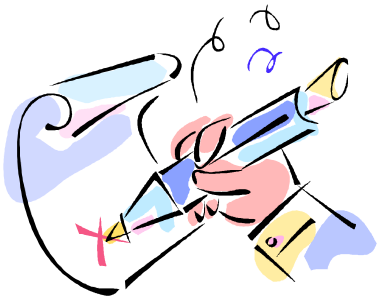
  The tenant is usually responsible for internal maintenance – that is, maintenance inside the building. But they are often responsible for external maintenance too (maintaining the outside of the building). This is especially likely to be the case if the tenant is leasing the entire building (i.e. there are no other tenants).

- **Rent Review Mechanisms:**

  Details of how often the ***landlord*** is ***entitled*** to review the rental price, and how the new rental price is to be determined are provided.

  Rent reviews often occur every 2 years and are often limited by a ***ratchet clause***. A ratchet clause prevents the rent from being lowered.

  For example, the standard ADLS lease includes a 'commencement ratchet clause' that prevents the rent from being lowered below the amount that was paid when the ***tenancy*** began. In other words, if the rent goes up, it can then go down at a later rent review, but it CANNOT go below the original amount).



- **Renewal Rights:**

  The tenant is usually given a right, but not an obligation, to renew the lease. This means that they can **choose** to lease the building for longer – if they want.

- **Outgoings:**

  With commercial property, tenants typically pay an '***outgoings***' cost in addition to the rent amount. This means that there is a rent charge to cover use of the premises, plus a charge for operational expenses (outgoings).

  There is a standard list of outgoings in the ADLS lease, which includes:

  - rates,
  - insurance,
  - maintenance fees,
  - power, etc.

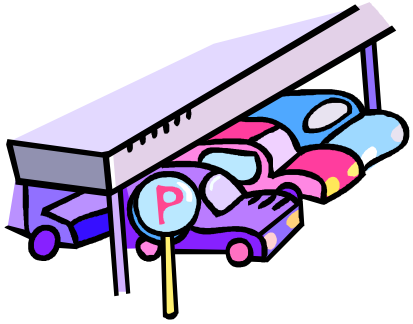
  Where there is more than one tenant, each tenant usually pays a percentage of outgoings in proportion to the floor area they occupy. So if they use 1/3 of the area, they will usually pay 1/3 of the costs.

- **Business Use:**

  It is commonly specified what the tenant can use the property for. Some uses may be specifically excluded.

- **Default Interest Rate:**

  If the tenant does not make payment when it is due (i.e. they '***default***' on payment), they are usually required to pay interest on money owing. The rate of interest applicable should be stated in the lease.




- **Car parks:**

It should be specified whether any car parks are included and the location of those parks.

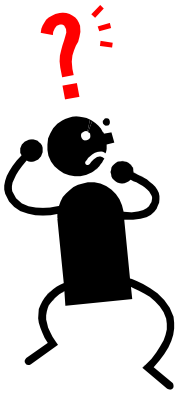
It is also common for a landlord to require that someone act as a ***guarantor*** for the lease – especially if the tenant is a ***company***.

A company is a legal entity on its own – you cannot usually chase the people involved in the company to get payment from them personally. Therefore, with a company, if the rent is not paid, it can be difficult to get the money owed. Thus, usually the directors and / or shareholders of a company will act as guarantors.

***Discussion Question:***

What other provisions would you expect to be included in a Commercial Deed of Lease?

## 1.3 Terminology and Documentation



There is a lot of 'jargon' associated with property investment. Regardless of whether you are reading a brochure about ***mortgage*** options, looking through property advertisements, talking to a ***real estate agent*** or searching online for information about property investment, you are likely to come across a number of words that relate specifically to this topic.

Throughout this module, most terms relating to property investment will be explained as they are introduced. In addition, there is a glossary of terms at the back of this Module book which you can refer to.

However, it is likely that in discussions you will have with your peers and kaiako, various terms will be mentioned *before* they are introduced. Thus, to help you to understand the content of this module, as well as any discussions you have on the topic of property investment, definitions for some of the more common terms are provided in this sub-section. Note that definitions are also given in the glossary of terms.

### 1.3.1 Property Terms

- ***Agreement for Sale & Purchase***

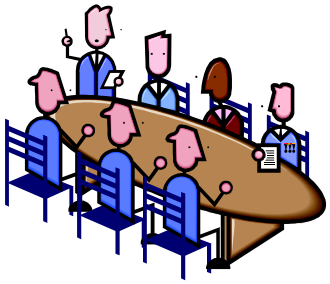
  An Agreement for Sale and Purchase (also referred to as a Sale and Purchase Agreement) is a ***legally binding*** written contract used to record the sale and / or purchase of a property from the seller to the buyer.

- ***Asking Price***

  This is the price that the person selling a property would like to receive for it. It is not necessarily the ***market value*** of the property or the price they will end up getting.

- ***Auction***

A method of selling a property whereby people interested in buying the property are all in the same location and make offers (referred to as '***bids***') for the property. The property is either sold to the highest ***bidder***, or not sold at all if the price is not satisfactory to the seller.



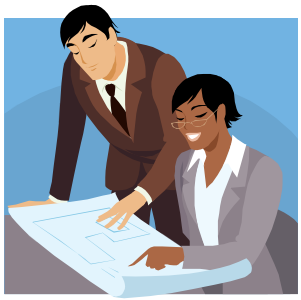
- ***Body Corporate***

A group / committee that all owners in a block of apartments belong to. This group manages the running of the building and, in particular, the upkeep of areas of the property shared by all owners (e.g. stairwells, hallways, car parks)

- ***Bond***

A sum of money paid by a ***tenant*** to the ***landlord*** to insure against ***default*** on rent payments and damage to the property. The landlord forwards this money to the ***Building and Housing Group*** (which is part of the ***Ministry of Business, Innovation and Employment***) to hold until the tenant moves out, at which time it is returned to the tenant - less any amounts owing to the landlord.

- ***Boundary***



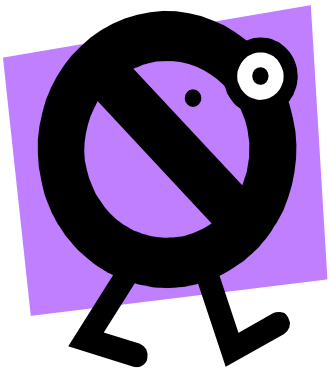
The lines that define the outside (perimeter) of a property. The boundaries are shown on a ***survey plan*** completed by a qualified ***surveyor***.

- ***Buyer's Market***

When there is a large quantity of properties available for sale, compared to the number of people looking to buy a property. This gives bargaining power to the buyer (i.e. they have more houses to choose from and may be able to negotiate lower prices).

- ***Capital Gain***

  The profits you make if the value of your property (or any other asset you own) goes up in value and you sell it for a higher price than what you paid for it.



- ***Caveat***

  A notice on a ***Title*** of a property which warns people who are searching the Title (e.g. people interested in buying the property) that someone else has some interest in or right over the property.

  Caveats prevent the owner from transferring their property unless they have the caveator's consent (the consent of the person who has lodged the caveat) or until the caveat is removed.

- ***Chattels***

  Items of movable property within a house. Chattels include things such as:

  - A stove
  - television aerial
  - carpets
  - blinds
  - curtains
  - drapes
  - light fittings

  Chattels must be specifically noted in a ***sale and purchase agreement*** if they are to be a part of the sale.

- ***Code Compliance Certificate***

  A document issued by a ***local authority*** which states that a building complies with the New Zealand ***Building Code***.

- ***Conditional Agreement***

An agreement which contains conditions that must be satisfied before all parts of the agreement are finalised.

Examples of conditions include a requirement that the purchaser sells their existing house by a certain date (to allow them to buy a new house) and a requirement that the purchaser is able to arrange satisfactory finance to complete the transaction.

Conditions can also be included by the purchaser that require the seller to do something by a specified date - for example, that settlement will take place only on the conditions that the house is painted, the windows repaired and the rubbish around the section is removed.

You need to note that even a conditional agreement IS a ***legally binding*** contract – if all conditions are met, the parties involved must fulfil their obligations.

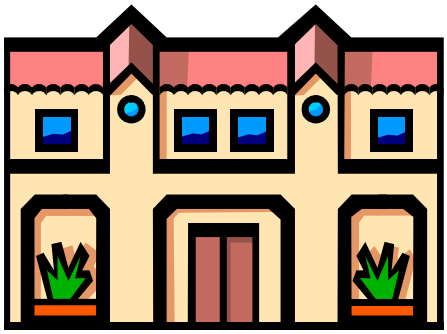
- ***Covenant***

Terms, conditions and restrictions noted on the ***Title***. If there is a covenant recorded on the Title of a property, it means that there is some legal restriction or agreement that must be kept. A covenant may affect future plans or resale of the property.

For example, covenants can:

- protect views (i.e. houses cannot be built in certain areas or over heights).
- require people to use certain types of materials when building in a certain area.
- restrict a property owner from running a business from home.

- ***Cross-Lease***



A situation where there are two or more homes on a property and the ownership of the land ***title*** is shared between the owners of the homes.

The joint owners effectively lease the land to one another. Cross-leases are common with flats.

- ***Deed of Lease***

The contract between a ***landlord*** and a ***tenant*** outlining the terms and conditions of a ***lease*** arrangement for a ***commercial property***.

- ***Deposit***

In regards to purchasing property, 'deposit' has two meanings. The deposit is:

(1) the amount of money you contribute towards the purchase of a home – that is, the amount that you do NOT borrow; and

(2) a percentage of the purchase price that the purchaser of a property gives to secure the deal.

This deposit is usually paid to the ***real estate agent*** when the ***sale and purchase agreement*** is signed, and is then either given to the seller once the agreement becomes ***unconditional*** or returned to the buyer if the conditions in the agreement are not met and the sale does not go ahead.

- ***Easement***

  A right that someone has to use land which belongs to someone else in a certain way. The most common easements are driveways that go over one person's property, so that the other person can access their own property. Easements can also provide for water, power and telephone lines to go across people's property to reach other properties. The details of an easement are recorded on a property's ***Title***.

- ***Encroachment***

  In regards to property, encroachment refers to a building or structure (e.g. a shed, wall, driveway) that illegally crosses onto a neighbour's property or a street. A common example is a fence that crosses over the boundary line onto the neighbour's property.

- ***Equity***

  The difference between the ***market value*** of the property and the amount still owed by way of a ***mortgage*** or loan. It is an amount that shows the owner's share of the value of the home – that is, if the owner sold the house and repaid the mortgage, how much money would they have left?

- ***Fee Simple***

  A type of ownership of a property, also known as ***Freehold***. This type of ownership means that you own the house and land with almost no restrictions on your rights (aside from the requirement to still follow the ***local authority's district plan***).

- ***Fittings***

Items that are part of a property, but can be removed without causing damage to it.

- ***Fixtures***

Items that are part of a property and cannot be removed without damaging either the property or the item itself, for example, cupboards.

- ***Freehold***

Also known as ***Fee Simple***, this is a type of ownership of a property. If you own a property freehold, you own the house and land with almost no restrictions on your rights (aside from the requirement to still follow the ***local authority's district plan***). Some people (incorrectly) use the term to describe the situation where a property is owned without a ***mortgage*** (i.e. there is no money owing on the property).

- ***Gearing***

This term is used to refer to borrowing money to invest. High gearing refers to using a large amount of ***debt*** compared to the amount of your own money used.

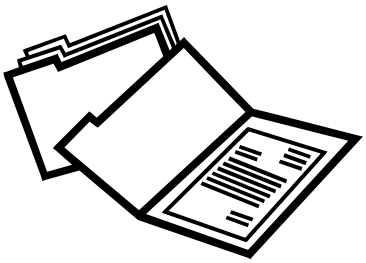
- ***Joint Agency***

A situation where a seller of a property has listed the property for sale with more than one ***real estate agency***.

- ***Joint Tenancy***

Where more than one person owns a house together and if one person dies, the other owners get that person's share of the house (regardless of what their ***will*** states).

- ***Land Information Memorandum (LIM)***



A file of information about a property, put together by the ***Local Authority***.

A LIM contains all the details that authority has about the property – for example, consents, drainage, details of any issues (e.g. with flooding or erosion), rates owing, details of special land features.

- ***Landlord***

A property owner who rents the use of their property to another person / ***entity*** in exchange for the receipt of rent.

- ***Leasehold***

A type of 'ownership' where you do not actually own the land on which a building is situated (although you usually own the building itself). Instead, rent is paid to the landowner to ***lease*** the land.

- ***Lessee***

A person / ***entity*** who leases a property from the owner.

- ***Lessor***

The owner of a property that is leased to another person / entity.

- ***Licence to Occupy***

If you buy a licence to occupy, you buy the right to live in a property for life. These licences are very commonly issued by retirement villages.

- ***Market Value***

The price that a seller can reasonably expect to receive for the sale of a property. Although the stated 'market value' of a property is typically determined by a valuer, in the end, the true market value is the price that it actually sells for.

- ***Mortgage***

A legal document that gives a lender ***security*** over your property. In other words, it gives the lender (usually a bank) the right to sell your property if you do not make the required payments on the loan.

- ***Mortgage Broker***

An individual or company that helps someone looking to purchase a property and wanting to arrange a ***mortgage***, to find a suitable lender. Mortgage brokers typically require a fee or a ***commission*** for their services, which is usually paid by the lender.

- ***Mortgagee***

The lender in a ***mortgage*** agreement – for example, the bank.

- ***Mortgagee Sale***

Occurs when a borrower does not make the required payments on a loan and the mortgagee (the lender) sells the borrower's property to recover the money owed to them.

- ***Mortgagor***

The borrower in a ***mortgage*** agreement – e.g. the property investor.

- ***Off The Plan***

To purchase a property before it is completed after having only seen the plans. Usually people who want to build a house from scratch do this.

- ***Private Sale***

The sale of property by the owner without the services of a ***real estate agent***. The homeowner takes on all the responsibility for selling their property.

- ***Project Information Memorandum (PIM)***

Similar to a ***Land Information Memorandum*** (***LIM***), a PIM is a file about a property issued by the ***local authority***. However, it only contains information about a property that is specifically relevant to a building project. It doesn't also include information about the land in general.

- ***Purchaser***

  The person who buys the property.

- ***Rateable Valuation***

  Previously called the 'Government Valuation', this is the valuation of a property that the ***Local Authority*** uses to set the rates for a property.

- ***Real Estate Agent***

  A person or ***company*** licensed to negotiate the sale or lease of property on behalf of the property owner. The real estate agent is paid a ***commission*** for their services, which is usually an amount calculated as a percentage of the purchase price.

- ***Requisition***

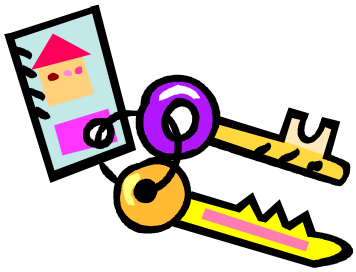
  A process where the buyer requests additional information about the ***Title***, or any other matter, of the property from the seller.

- ***Reserve Price***

  An amount the owner of a property decides on (before an ***auction***) as being the minimum amount they are prepared to accept the property to be sold for at the auction.

- ***Right of Way***

  A strip of land belonging to someone which someone else (or the general public) has the right to use. For example, a path across someone's property that people can use to access other property.



- ***Settlement***

The finalisation of the sale of a property. It involves money being paid, ***mortgage*** documentation coming into effect and the official ownership of the property (and the keys!) being transferred to the new owner.

- ***Sole Agency***

A situation where a seller of a property has listed the property for sale with only one ***real estate agency***.

- ***Survey***

A drawing or map showing the precise legal boundaries of a property, the location of improvements, ***easements***, ***rights of way***, ***encroachments*** and other physical features.

- ***Tenants in Common***

A form of joint ownership of a property. However, unlike ***joint tenancy***, if one of the owners of the property dies, they can leave their share of the property to whomever they choose – it does not automatically go to the remaining owners.

- ***Tender***

A method of selling a property whereby interested buyers submit confidential written offers of how much they are willing to pay for the property to the seller, for the seller to then consider.

- ***Title***

Ownership documentation for a property – previously referred to as the ***Certificate of Title***. In addition to identifying the owners of the property, the document provides a legal description of the land and shows various other details. *An example Title is provided in Section 1.3.2.*

- ***Unconditional***

When an agreement to buy a property does not have any conditions attached to it. A ***sale and purchase agreement***:

  - may be 'unconditional' to begin with (i.e. no conditions at all set), or
  - may become 'unconditional' by conditions being fulfilled. Once an agreement becomes unconditional, it becomes ***legally binding*** for both the purchaser and seller.

- ***Vendor***

The person (legal owner) who is selling the property.

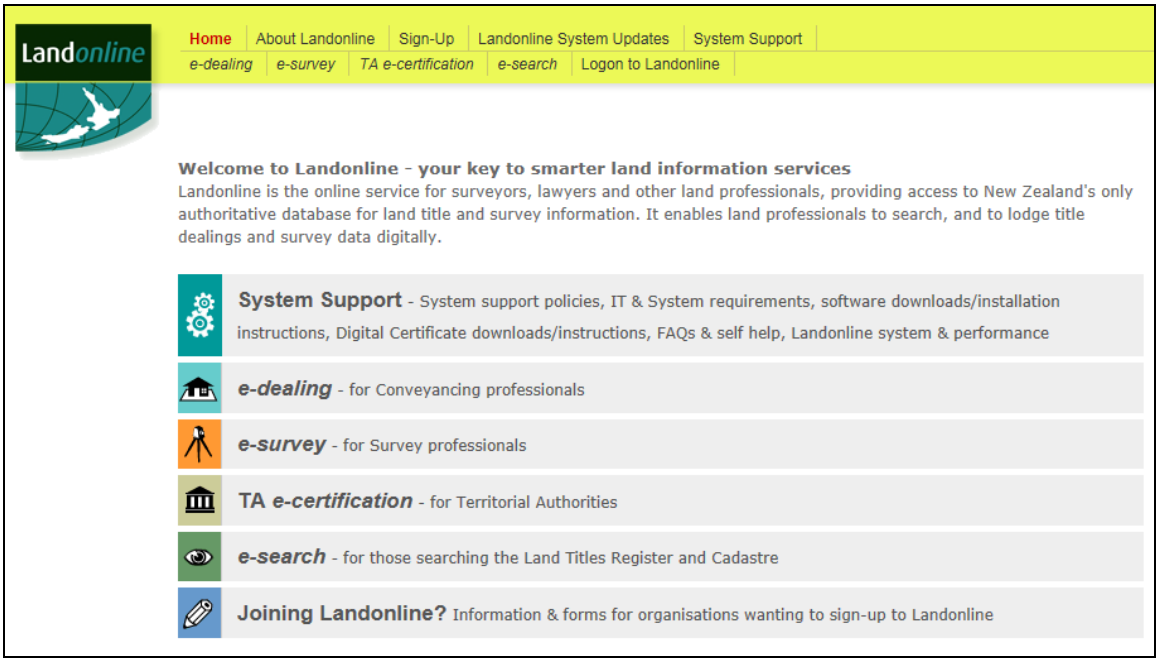
## 1.3.2 Ownership Documentation

A term that will be mentioned frequently throughout this Module is 'Title'. A ***Title*** is the official document which shows the ownership of a particular piece of land. It also outlines rights and restrictions that apply to the land.

Most privately owned land in New Zealand is held under the land title system of the *Land Transfer Act 1952*, with an exception being some forms of Māori land.

Titles replaced paper ***Certificates of Title*** in 2002. Then, in 2006, the Government introduced the requirement that all land title transactions and ***survey*** plans be lodged online, instead of completed manually (using paper documentation). This move has been phased in gradually over several years. The system that was developed to lodge this information is called ***Landonline*** and can be found on the website www.landonline.govt.nz.

***Screen Print: The Landonline Website***[9]




Although anyone can go to the Landonline website, the actual functions on the site are not designed for public access or use. In other words, not just anyone can use this website to lodge information about a property transaction.

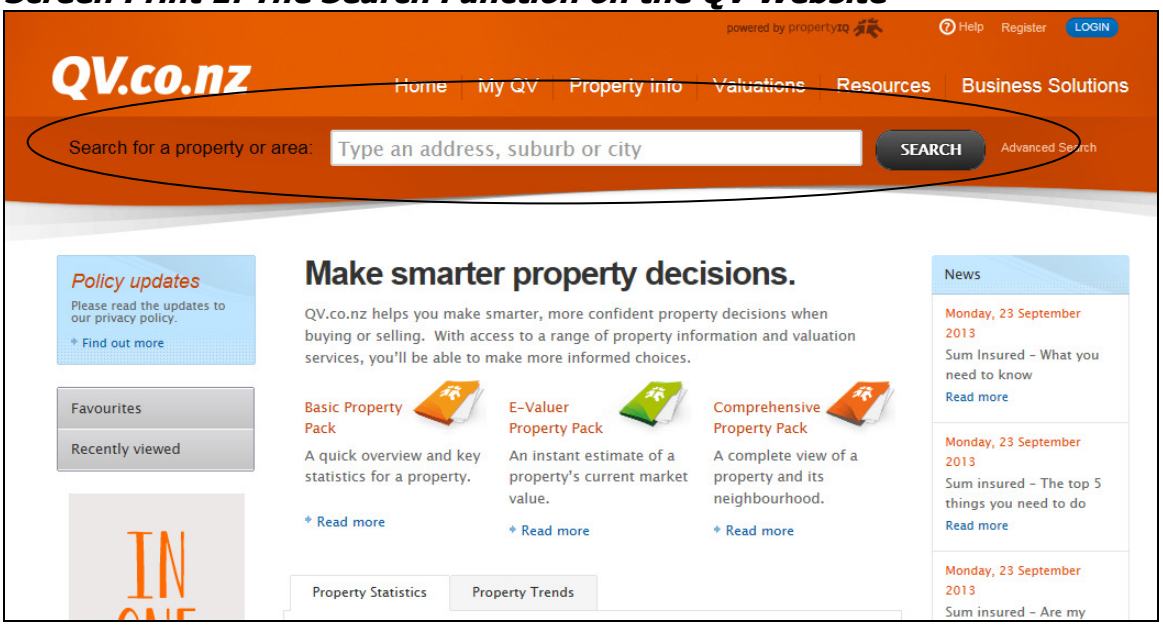
[9] Sourced from Land Information New Zealand. Crown copyright reserved. Retrieved 27 September, 2013, from http://www.landonline.govt.nz/

Instead, the Landonline website can only be accessed and used by registered users. These people are typically surveyors, lawyers and other land professionals. However, although members of the general public cannot access these functions on this website, they can still find out information about land ***titles*** from other means.

***Title*** to land in private ownership is a matter of public record. This means that anyone can find out who owns a particular property. If you are buying a property, it is important that you view the Title first to check for any restrictions that apply.

You can check the title by, for example, paying to view it on the QV website (www.qv.co.nz). QV is owned by PropertyIQ, a joint venture between Quotable Value Limited and CoreLogic. Quotable Value Limited is the company that sets ***rating valuations*** in New Zealand. First, go to the QV website and enter the address of the property in which you are interested into the 'search' field. The search field is circled on the screen print below.

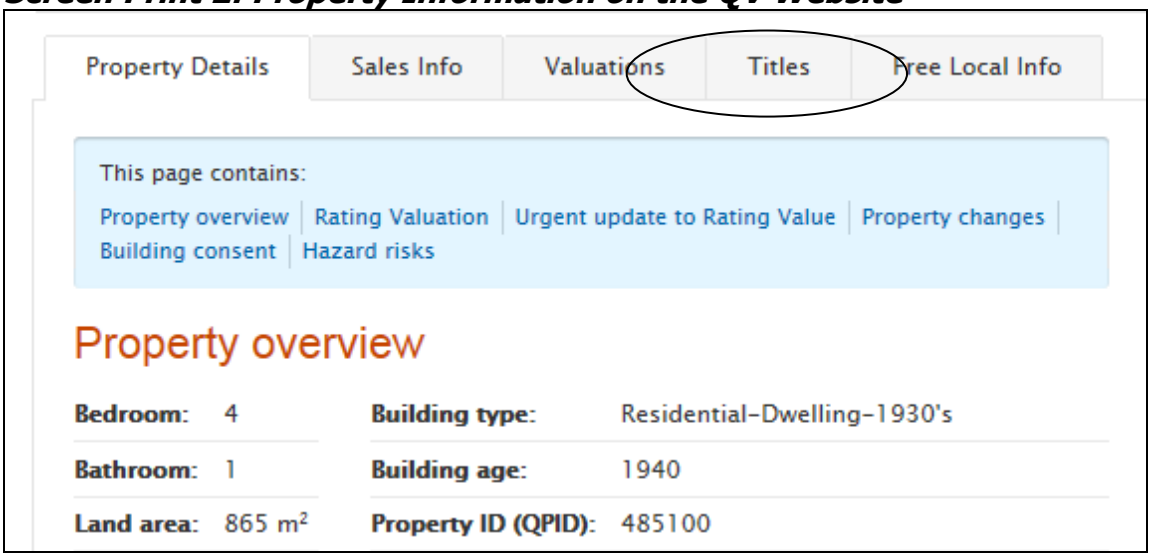
***Screen Print 1: The Search Function on the QV Website***[10]



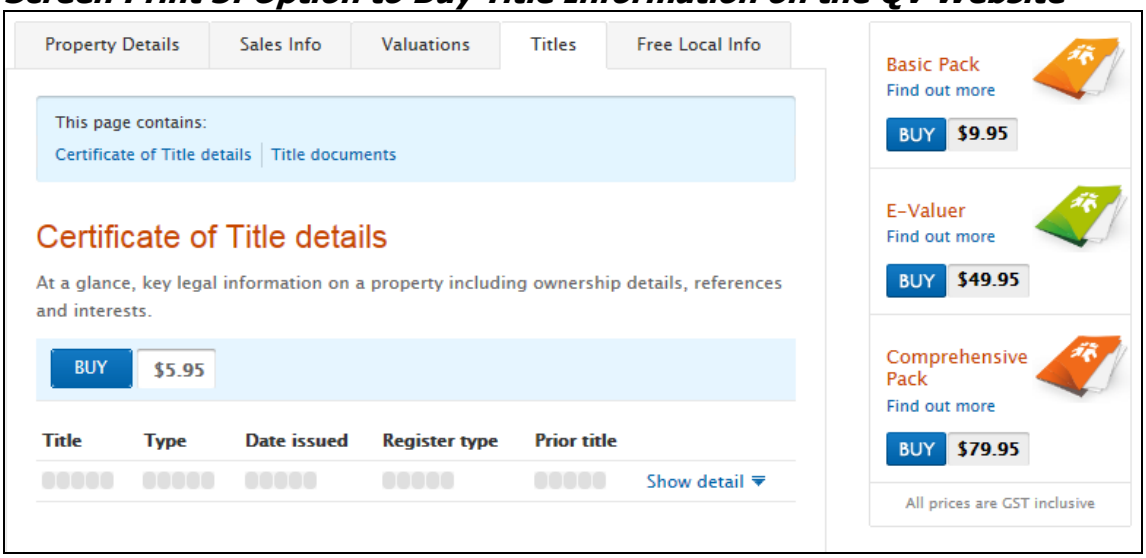

After doing this, you will be presented with a page containing details about the property. This page includes a 'tab' which you can click on and from which you can buy access to Title documentation. This is shown in Screen Prints 2 and 3.

[10] Retrieved 27 September, 2013, from http://www.qv.co.nz

***Screen Print 2: Property Information on the QV Website***[11]




***Screen Print 3: Option to Buy Title Information on the QV Website***[12]




QV also offers a range of other reports about each property. On the right hand side of Screen Print 3 (above) are three options of 'packs' of reports that you can buy. These reports include, for example, previous sales information for the property, hazard details and rating information.

[11] Retrieved 28 September, 2013, from http://www.qv.co.nz/property/property-details/31-george-street-te-kuiti/485100

[12] Retrieved 28 September, 2013, from http://www.qv.co.nz/property/titles/31-george-street-te-kuiti/485100

#### 1.3.2.1 What Information is in a Title?

An example of a title is given on the following pages. This title is for Te Papa museum in Wellington.

An explanation of the main components of a title is given below.

- **Computer Freehold Register:** This term replaces the term 'Certificate of Title'. That is, it means the same thing as 'Title'.

- **Identifier:** All titles have a unique 'identifier' code.

- **Land Registration District:** New Zealand is divided into various land districts (for land registration purposes). For example, land located in Hamilton is within the South Auckland land district.

- **Date Issued:** The date the computer freehold register was first issued.

- **Estate:** A type of ownership of a piece of land – for example, fee simple, leasehold, cross-leases. The most common type of estate is 'fee simple'. Refer to the definitions given of these terms in Section 1.3.1.

- **Area:** the area of the land in square metres or hectares.

- **Legal Description:** Land is divided into 'parcels' as per survey plans. All parcels of land have a unique code. The legal description describes the parcel of land and how it is defined by way of survey.

- **Interests:** Any interests which affect the title. Examples include mortgages and easements (which limit / restrict owners as to how they can use the land). Interests are also called 'memorials'.

A diagram is also included, which normally shows the land area and dimensions.

## Sample Title for Te Papa Museum[13]

**COMPUTER FREEHOLD REGISTER**
**UNDER LAND TRANSFER ACT 1952**

**Search Copy**

R.W. Muir
Registrar-General
of Land

**Identifier** **15901**
**Land Registration District** **Wellington**
**Date Issued** 10 October 2001

**Prior References**
WN499/270

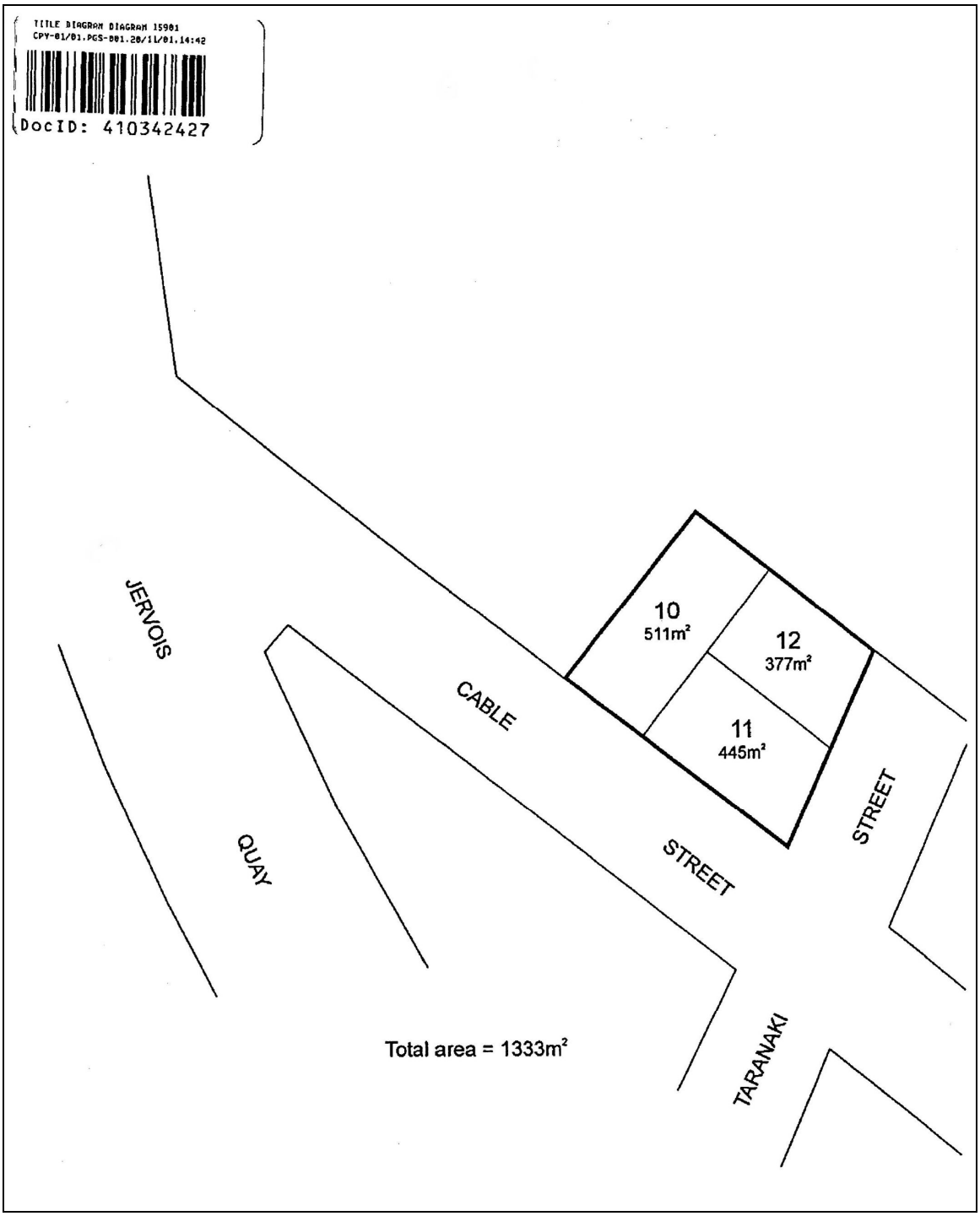
**Estate** Fee Simple
**Area** 1333 square metres more or less
**Legal Description** Lot 10-12 Deposited Plan 1660

**Proprietors**
Wellington Waterfront Limited

**Interests**
5153893.1 Lease Term 199 years from and including 15.11.2001 CT 25454 issued (Fencing Covenant) - 14.2.2002 at 9:00 am

*Transaction Id* *38269812* *Search Copy Dated 11/10/13 2:07 pm, Page 1 of 1*
*Client Reference* *fleavasa001* *Register Only*

[13] Supplied by PropertyIQ.


TITLE DIAGRAM DIAGRAM 15901
CPY-01/01.PGS-001.28/11/01.14:42
DocID: 410342427
JERVOIS
QUAY
CABLE
STREET
STREET
TARANAKI
10
511m²
12
377m²
11
445m²
Total area = 1333m²

# Section 2

# Your Own Home

# 2.0 Your Own Home

One of the most common goals shared by many New Zealanders is home ownership. This is a goal which is very important to us for emotional reasons. However, owning a home is also a goal of great financial significance.

That is, unlike other emotional wants which take money away from building a financial base, home ownership satisfies **both** personal and financial goals.

Throughout this section we look at home ownership as a financial investment and then look at the steps involved in getting into your own home, whether that be by purchasing an existing home or building a new one 'from scratch'.

## 2.1 Your Home as an Investment

New Zealanders have long had a dream of owning their own 'piece of paradise'. We view home ownership as adding to a sense of family; it gives stability and gives a feeling of having a permanent (long-term) home. These are factors which are important to a lot of families.

Our home is the one place in the world that we can call our own. It is a place to make memories, share stories and grow old together.

Home ownership can (and often does) form part of an investment and / or retirement strategy. However, for some, due to the cost of getting into the property market, it might not currently be an affordable strategy. Depending on your personal situation, renting a house and then taking part in other types of investments may, in fact, be a better savings strategy.

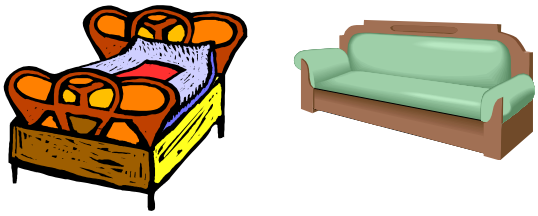
## 2.1.1 Home Ownership and Retirement

There are **two ways** in which you can save for retirement:

1. You can build up a money / asset base from which you obtain the cash you need to pay for the things you want and need in retirement;

**OR**

2. You save the goods and services you need for retirement.



**Let's look at an example:**

In retirement, you will need food. You can either save and invest enough cash to be able to pay for food in retirement, or you can try saving food now, to eat later in retirement.

Obviously, it is not practical to save food for years. It would perish and take up an extremely large amount of storage space.

It is not practical to save all of the other goods and services needed in retirement either. This is the reason why growing an asset base that produces cash is so important.

However, there are other types of goods that can be 'saved' for retirement. Perhaps the best example is that of accommodation. If we buy a house now, we can (usually) still use that house in retirement to live in. We then do not need to save enough cash to pay for housing in retirement.

If you are considering buying a home to use as part of a retirement plan, there are three broad investment approaches available:

- **Strategy 1: A Conservative, Low-risk Approach**

  If you are to take this approach, you would view the home you buy as a means of providing the necessary accommodation for your retirement.

  You would buy a modest home – one which meets your basic living needs. You would not buy one which is more expensive than you really need.

  Alternatively, you would change your house as your family situation changes. Again, each of these homes would meet your basic housing needs, but not provide much in the way of 'additional luxuries'.

  Whilst this is a form of retirement saving, many people who take this strategy do not recognise it as an investment. This is typically because, people often do not focus on finding a property that will increase substantially in value.

  Instead, people who follow this strategy are simply looking for a house (or houses) that will provide the underlying (basic) good / service they need – that is, accommodation.

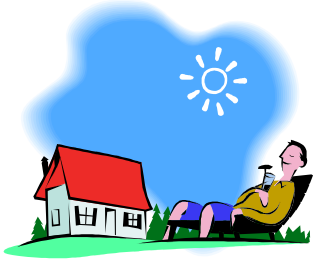
- **Strategy 2: A Strategic, Higher-risk Approach**

Under this approach, you view your home as accommodation **AND** as an investment.

This is how it works:

- You seek to buy or develop a home that will grow in value. You may also make improvements to make the house more valuable.

- But then, on (or before) retirement, you sell your home, and hopefully make a good profit.



- You then use the resulting funds to purchase a less expensive home to live in during retirement.

- You keep the remaining profit as part of your retirement fund.

A variation on this is to buy a basic house, but with a large sub-dividable section. You can then continue to live in the house during your retirement, while making a profit from selling part of the land.

This approach involves **more risk** than Strategy 1, for a couple of reasons.

Firstly, your retirement fund depends on the state of the property market when you decide to retire. If you are relying on the proceeds from your house sale (or section) to support you in retirement, you may be forced to sell the property at a time when the property market is not particularly good.

However, remember that you would also be buying in the same market. Thus, if you sold your house for $50,000 less than you expected, it is possible that you would be able to buy your replacement house for $50,000 less than you were originally prepared to pay.

Remember too, that the wider the range of other investments you have, the less dependent you will be on your housing investment strategy. Therefore, if

property prices are not as high as you would like when it comes time to sell, you may be able to afford to hold off until a time when they are.

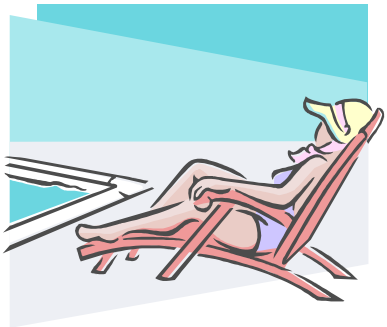
You may even be able to use other retirement savings to buy your 'replacement' home for retirement when the market is down and house prices low, and then later sell your initial, more valuable home. In the meantime you could rent out one of the two houses.

There is also a risk based on the problem that many people find it difficult to downgrade their house at retirement. They become used to living in a house of a certain size and quality, and do not want to exchange it for a smaller and cheaper option. So although they may originally intend to pursue this strategy, they may, in fact, end up pursuing Strategy 3 (The Lifestyle Approach).

- **Strategy 3: The Lifestyle Approach**

This approach involves aiming to retire in a house that meets your lifestyle desires. If you follow this strategy, on retirement, you would see your home, location and the facilities that your home includes (such as, for example, a large garden or a pool) as an important part of your retirement lifestyle.

You would have no intention of downgrading your house to obtain funds for retirement, nor would you consider living in a basic house throughout your life just so you can use any extra funds for other investments for retirement. Thus, those who follow this strategy are prepared to sacrifice some retirement income and possibly other optional activities (such as travel), to instead enjoy a nicer home.



***Discussion Question:***

What do you consider the advantages and disadvantages of each of these 3 retirement accommodation strategies? If you were to include home ownership as part of your retirement strategy, which approach would you take?

## 2.1.2 Home Ownership vs. Renting

Home ownership is not for everyone. Some people simply do not have a desire to own their home. For others, their personal circumstances mean that buying a home is not a realistic option for them at a particular point in time.

Furthermore, depending on what alternatives are available, home ownership may not even be the most financially beneficial option for someone.

Let's look at factors that need to be taken into consideration when deciding whether to buy or rent and the advantages and disadvantages of home ownership as opposed to renting.

### 2.1.2.1 Considerations

When deciding if home ownership is right for you, think about the following factors:

- **Your goals:**
  - Is home ownership an essential part of your goals in life? How important is it to you that you own your home?
  - Is the commitment involved in home ownership likely to restrict you from achieving other goals in life (e.g. perhaps non-financial goals)?

    For instance, if you have a child who is a very talented sports person, will buying a house make it very difficult for you to achieve your other goals, which may include sending your child to international sports tournaments each year?

- **Your family circumstances:**

  - What do you consider important for a family? Is it important to you that your children grow up in one house, area or neighbourhood?

  - What are your plans in regards to having children? How will this affect your income and what you can afford in regards to housing? Are you going to be able to meet mortgage payments if you need to take parental leave?

  - How many people does the house need to accommodate? For example, does it need to be big enough for you, your partner and six children, and also have a 'granny flat' or extra living area for your elderly parents to live with you? If so, will you be able to afford to buy a property of this size or will you need to rent?

- **Your age:**

  - There are many benefits to getting into home ownership sooner, rather than later.

- **Your Job:**

  - Is it important for you to have a house close to where you work? If so, can you afford to buy a house in that area?

  - How secure is your job and how happy are you in your work? Are you likely to need to move to another town in order to get other work in the future?

  - How likely is it that new job opportunities and promotions will arise which will require you to move outside the area?

- **Your willingness to make a commitment:**

  - Home ownership is a long term strategy. Although you can sell a house, you may not be able to sell it exactly when you want to, and for the price that you want. Are you prepared to make this type of commitment?

  - How much freedom do you want in your life at the moment? Although, it is often advantageous (financially) to commit to buying a house as soon as you can afford to, in doing so, you are likely to need to give up other things in life.

    This may include travel and expensive hobbies. You need to make a careful and considered decision about what is most important to you and the lifestyle you want to live.

- **Your income and financial situation:**

  - Do you have a ***deposit*** saved? You are likely to need a deposit of at least 20% of the price of the house.

  - Given your financial situation and history, are you likely to be able to get a mortgage in the near future? Although this is an important question to consider – be careful not to make assumptions.

  If you think home ownership is right for you, donot give up on it just because you think you will not be able to get a mortgage – you never know until you try.

The lists of advantages and disadvantages given in the following sub-sections highlight further factors that affect the decision of whether to buy or rent a house.

### 2.1.2.2 Home Ownership: The Advantages

- You acquire an asset that may be used to live in, or you may choose to rent out (thus producing a revenue stream) or to sell. In comparison, if you rent a house, you are not left with an asset at any point in time.

- Once you have paid off the mortgage, the costs of home ownership substantially decrease. The cost of rates, maintenance and insurance is likely to be much lower than the price you would pay to rent a similar house.

- Home ownership provides both individuals and families with a sense of stability and security.

- You do not have the risk of someone requiring you to move house (unless, of course, you fail to meet mortgage payments and are forced to sell).

  If you instead rent a house, even if you have been an ideal ***tenant***, the owner may (for example) decide to live in the house themselves or sell it, thus forcing you to move.

  This move may not come at a good time for you, and it may be that you are unable to find another house for rent that meets your needs. Moving can also be a very stressful process and, the older you get, the more stressful this can become.

- Owning a house helps make it a 'home', and not just a house. For some people, it is very important to form an emotional attachment to the place in which they live. Owning a house is more likely to allow this to occur.

- Some people cannot help but form an emotional attachment to the place in which they live – regardless of whether they own the house or not.

  Although this can be a good thing in that it fulfils that need to feel attached to a house, the problem is that, if you do not own the house, it will be even more upsetting to you if you are later forced to leave it.

  Leaving a house is likely to be even more difficult if you have, for example, planted gardens or trees that have sentimental value to you, or buried deceased pets on the premises.

- You have control over your home environment. Aside from considerations such as building permits, you do not need to ask anyone's permission for changes that you make.

You may plant a garden wherever you like, paint a room in a colour of your choosing and knock out a wall to join two rooms together if that is what you want to do.

- You can use the house as ***security*** to borrow more money. Thus, if the value of your property increases, you are able to benefit, even if you do not have any intention of selling your house.

  The additional ***equity*** in the house adds to your ***net worth*** and can be used to borrow against. Note that this is discussed further in Section 4 of this Module.

- Many people are better at paying off loans than saving. You may, for example, decide that buying a house is not the best option for you financially.

  You may work out that, in your particular circumstances, you could rent a house for cheaper than the cost of a mortgage and then save the remaining amount in some form of investment.

  However, the problem that many people face is that they are more likely to see saving as 'optional' and paying a mortgage as 'compulsory'. Thus, they are more likely to be enticed to spend any savings from renting instead of investing it.

  Having a mortgage can therefore be likened to a compulsory savings option.

- You have more control over activities that take place in your home. For example, if you want to hold a party at your house, you can do this – just be prepared to accept the possible consequences of damage being caused.

  As another example, you may choose to allow pets in your house, whereas if you are renting, it is quite common for a landlord to prohibit dogs from being on the premises.

- If damage is caused to the property, then you do not need to worry about sorting this out with the ***landlord***.

  Although no one likes having their property broken or damaged, the thought of damaging someone else's property is often worse than the thought of damaging your own property. Phoning a landlord to let them know you have caused damage is not a pleasant experience.

### 2.1.2.3 Home Ownership: The Disadvantages

- You will need to have a ***deposit*** to purchase a house. Although there are some options for buying a house with a deposit as low as 10%, lending rules which came into force in October 2013 mean that banks now generally require you to give 20% of the value of the house as a deposit.

- You have less flexibility in regards to where you live and work. People move towns for a number of reasons. Some move for work opportunities, others move to be closer to family members and others move simply for a 'change'.

  People may even feel the need to move within a town. They might do this if, for example, ***zoning*** rules prevent their children going to the school of their choice or if the crime rate in their area of town increases.

  If moving within a town, or between towns, is a likely possibility for you, renting may be a better option. You would not need to go through the hassle of buying and selling properties and facing the risk of selling a house at a less than ideal time.

  If you instead rent a house, all you need to do is give notice, then pack up, tidy up and leave.

- You are not guaranteed a profit if you decide to sell. Although, historically, over time the property market in New Zealand has performed well, there have been periods when prices have not increased or have even decreased.

If you need to sell your house at a certain time, you may end up selling it for little more, or even less, than what you paid for it.

When you add the cost of mortgage repayments, rates and maintenance to the loss (or deduct it from the minimal capital gain you receive), you may find that you would have been better off, financially, to have rented a house.

- You need to be able to commit to mortgage payments. If you are renting a house and your financial situation gets worse, it is easier to change your living situation to one that it is more affordable. You may, for example, move in with family or friends until you can afford to rent again, or may rent a cheaper house.

  In contrast, if you own a house and find that you cannot meet the mortgage payments, although you can sell the property, you may make a loss (particularly if you need to sell in a hurry and are therefore required to accept a lower selling price).

- Due to higher property prices, nowadays, it is very common for weekly rent payments to be a lot lower than mortgage payments.

For example, in your area, you may be able to rent a house which has a market value of $300,000 for $280 per week.

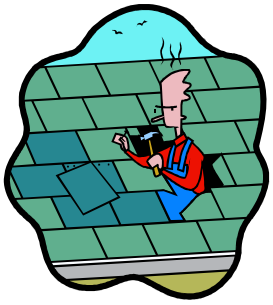
However, if you were to buy that house, assuming you put a 20% deposit on the house and obtained a 25 year mortgage at an interest rate of 8% for the remaining $240,000, your minimum weekly repayments would be approximately $427!

Therefore, until the mortgage is repaid, purchasing a house is likely to tie up a higher amount of your income. This may mean that you are financially unable to spend money on other things that you really want such as, for example, overseas travel, a new car or regular clothing purchases.

- There are additional costs associated with home ownership. These include rates, insurance and maintenance. You need to be able to budget to cover these costs on top of any mortgage payments. In addition, there are costs associated with buying and selling houses.

- Home maintenance may not be something that you want to be responsible for.

  Not everyone is a 'handyman', nor does everyone want to spend time organising trades people to fix and renovate things around the house. For these people, it is much more convenient and preferable to be able to contact a landlord (or ***property manager***) and ask that these things be taken care of for them.



## 2.1.2.4 Weighing up Opportunities

Home ownership is not necessarily the best way to reach your financial goals. Although it is quite likely that you will be able to make an attractive financial return through property investment, it is possible to make better financial returns while renting a house.

You may be asking 'how?'

To answer that, consider the two scenarios on the following pages.

***Scenario 1: Arama***

Arama has been planning to buy a house. He has saved the required deposit and knows exactly what he wants in a house. He has been house hunting and made a short-list of possible houses to buy.

However, another opportunity has recently been presented to him. His employer of the past eight years has decided to sell his engineering business so that he can retire.

The business has not been doing as well financially in the past few years as it previously did, and this has reduced the value of it. However, Arama is very confident that he can restore, and even improve, business performance.

From his own experience in the business, and from talking to customers and others in the market, Arama believes that the reason why the business hasn't been doing well is simply because his employer has lost interest in the business. In fact, he knows that his employer has opted to turn down several good contracts just because he has preferred to 'take it easy' as he has gotten older.

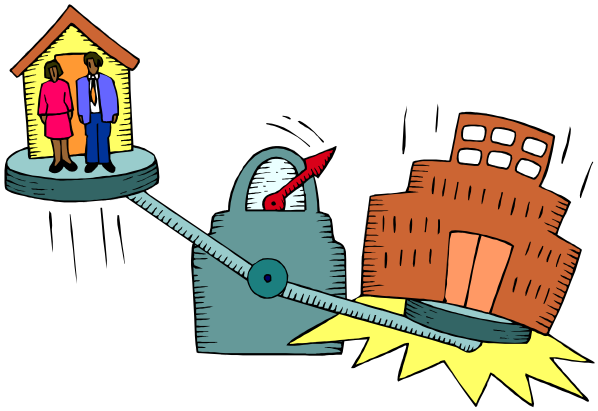
The business has also lost customers simply because it does not stock the range of engineering products that it used to. Arama believes that, if he were to buy the business and invest some money into increasing the stock on hand, he would be able to regain business from previous customers and attract new customers.

However, if Arama is to buy the business, he knows he will not be able to afford to buy a house, at least in the near future. He would need to use all of the deposit he had saved and would also need to take out a small loan to cover the purchase price and the cost of the increase in stock.

In the short-term, while the business is yet to regain customers, Arama would need to use some of the money that would usually contribute towards his wages

to instead meet loan repayment amounts. As such, even if he had enough money for a deposit, he would not be able to meet mortgage repayments as well as business loan repayments. The only way he could meet loan repayments in the short term would be for him to rent a house.

When Arama conducts a financial analysis into buying the business and compares this to the average returns achievable from home ownership, he finds that the potential returns from the business investment are much higher.



In fact, he estimates that if he was to buy the business and secure three of the large contracts that had previously been offered to the business, he would be able to repay the loan and earn enough profit to be able to purchase a house without a mortgage in as little as seven years, and still keep the business going!

In this situation, Arama therefore decides that renting is financially a better option for him, at least in the short term.

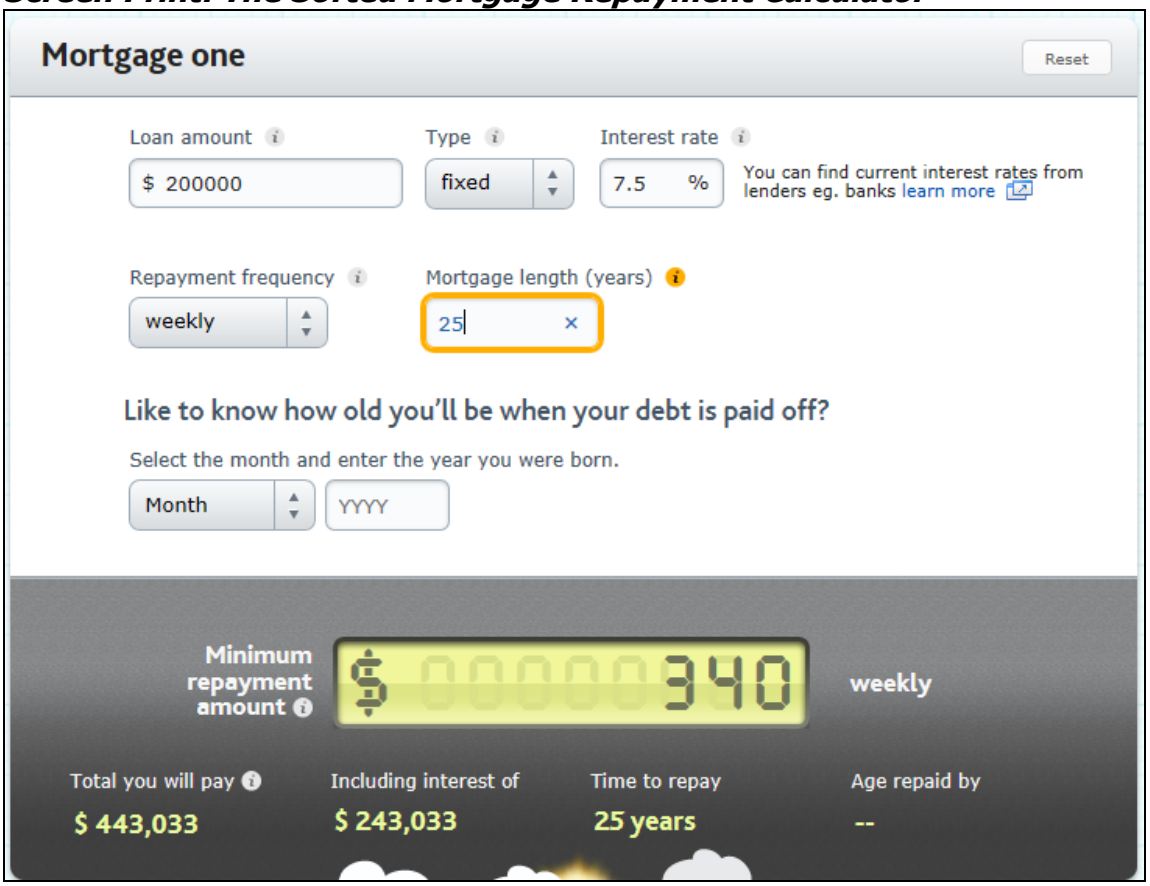
### *Scenario 2: Hemi and Margaret*

Hemi and Margaret, aged 35 and 40, respectively, have recently sold their house. They had a mortgage on the property, and after paying this off, they were left with $50,000 profit from the sale.

They are now deciding whether to use this $50,000 towards a deposit on another house or if they should rent for a while and instead invest this money elsewhere.

If the couple put the $50,000 towards purchasing a home for $250,000, they will still need a mortgage of $200,000. If this is to be spread across 25 years at an interest rate of 7.5%, their regular repayments will be $340 per week.

***Screen Print: The Sorted Mortgage Repayment Calculator[14]***




In 25 years, when Margaret turns 65 and retires, assuming a net real return of 3% per year, their home would be worth approximately $529,000. You can check this by using the compound interest formula introduced in Module 1. This formula is given below (note that the term 'future value' has replaced 'Amount to be Repaid' to reflect the fact that this is an investment, not a debt).

$$\textbf{Principal} \times (1 + \textbf{Interest Rate})^{n} = \textbf{Future Value}$$

*Where 'n' is the number of interest rate periods*

[14] Retrieved 28 September, 2013, from https://www.sorted.org.nz/calculators/mortgage-repayment

If we assume daily compounding, the relevant interest rate to use in this formula is calculated as 3% divided by 365 days (i.e. 0.03/365 = 0.000082). The relevant number to use as 'n' in the formula will then be 9,125 (i.e. 25 years x 365 days).

When we use these numbers in the compound interest formula, we can work out that the house would be worth $529,234 in 25 years.

| | | |
|---|---|---|
| **Future Value** | = | $250,000 x $(1 + 0.000082)^{9,125}$ |
| | = | $250,000 x 2.11693 |
| | = | **$529,234** |

Another option for the couple is to rent a house. Hemi and Margaret have looked around and found that the cost of renting a home worth $250,000 in their area is approximately $230 per week. This is $110 less per week than it would cost them to repay a mortgage. They are therefore considering renting a home and saving the difference of $110.

| **Weekly Mortgage** | **-** | **Rent Payment** | **=** | **Weekly Savings** |
|---|---|---|---|---|
| $340 | - | $230 | = | $110 |

The couple use an online calculator to work out what ***rate of return*** they would need to receive on their investment in order to produce an ***asset base*** equal to that of the house after 25 years.

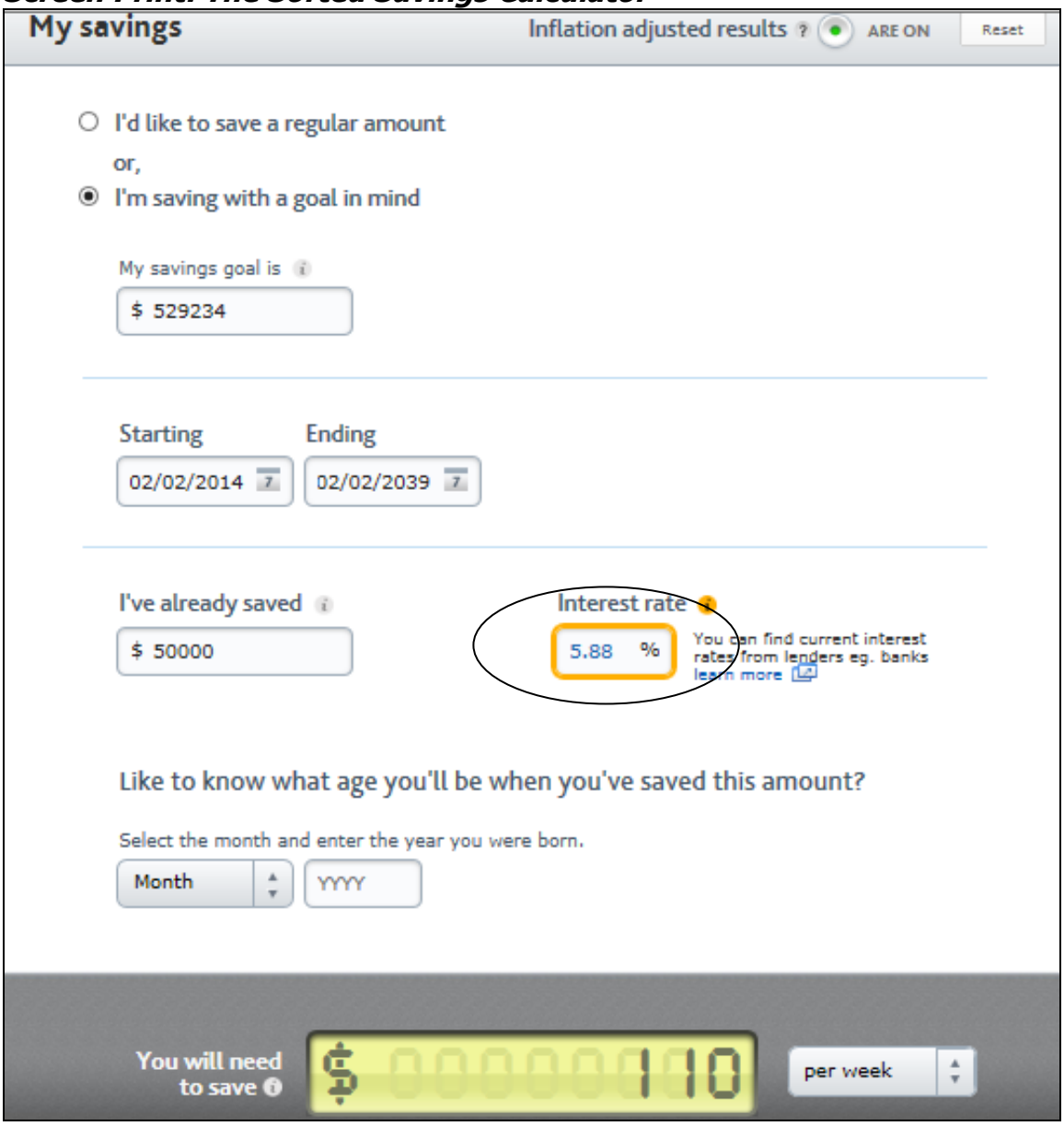
In doing this, they find that, in order to have at least $529,234 after 25 years from saving the initial $50,000 plus $110 per week, they would need to find an investment that has a net real return of at least 5.88% per annum. This is shown in the screen print on the following page.

Hemi and Margaret consider their investment options. The only option they see available to them that could produce net real returns of 5.9% or more per annum would involve investing in ***shares***. What they must now do is weigh up the potential risks and returns offered by each strategy.

On the one hand, they can purchase a house which they think will only produce a net real return of 3% per annum.

On the other hand, they can take the option of renting and then investing $110 per week in a portfolio that may potentially produce higher returns.

***Screen Print: The Sorted Savings Calculator***[15]




Although they consider that higher returns may be available from the second option, they need to decide whether the potential returns are enough to outweigh the extra risk involved with share investments combined with the risk that rental prices may increase substantially over this time period.

[15] Retrieved 28 September, 2013, from https://www.sorted.org.nz/calculators/savings

## The Rent or Buy Online Calculator

The Consumer NZ website, www.consumer.org.nz, has a very useful tool that you can use to compare the financial implications of buying and renting over a period of 20 years. Screen prints of this calculator are shown below and on the following page.

### *Screen Print 1 of the Consumer Rent or Buy Calculator*[16]

| Buying | |
|---|---|
| House price ($) | $300000 |
| Your deposit ($) | $60000 |
| Amount borrowed ($) - include any fees added to the amount borrowed. | $240000 |
| Other buying fees ($) eg. legal fees, valuation, etc | $2400 |
| Mortgage interest rate (% per annum) | 8% |
| Inflation rate (% pa) - we've assumed 3% | 3% |
| Annual house costs ($) - maintenance, rates, insurance etc.. | $4000 |
| Real annual growth in house value (% pa) - we've assumed 3% | 3% |
| **Renting** | |
| Fortnightly rent ($) | $280 |
| Real interest rate on savings (% pa) - we've assumed 2% | 2% |
| | Calculate Reset |

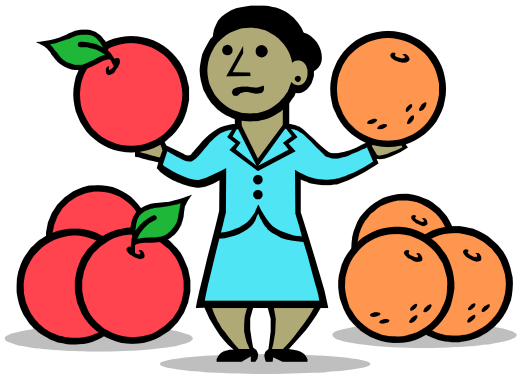
[16] Retrieved 28 September, 2013, from http://www.consumer.org.nz/reports/mortgages/rent-or-buy

***Screen Print 2 of the Consumer Rent or Buy Calculator***[17]

| Results | |
|---|---|
| Real gain (or loss) from buying a house after 20 years<br>Important: If this figure is negative, you'll lose money from buying. | $59350 |
| **This figure has been calculated using the following** | |
| Buying<br>Real annual repayment to repay mortgage over 20 years | $19007 |
| Renting<br>Real annual amount available to save<br>( annual mortgage repayment + house costs - rent) | $15727 |
| Total real amount saved after 20 years by renting<br>(deposit, house buying fees and regular savings, plus interest from the investment of this money) | $482484 |

In the example shown in the two screen prints of the Consumer Rent or Buy Calculator, if you were to buy the house, you would be $59,350 better off after 20 years than you would be if you rented a house and then invested the extra money that you would otherwise have spent on mortgage repayments.

If the figure in the 'results' box is negative, it means that you would be financially better off to rent a house.



[17] Retrieved 28 September, 2013, from http://www.consumer.org.nz/reports/mortgages/rent-or-buy

## 2.2 Getting into Your Own Home

There are several ways to go about selecting and purchasing a home. Although there are a number of standard steps that people take throughout the process, the stage at which they conduct these steps may vary. A suggested process is as follows:

1. Work out what you can afford
2. Get 'pre-approval' for a mortgage
3. Search for and select a house
4. Seek legal advice
5. Make an offer and negotiate
6. Confirm your mortgage and purchase

In this sub-section, we focus on steps 1, 3 and 4 of the process. Arranging and confirming mortgages will be discussed in the following section of the Module (Section 3), whilst the ***offer and negotiation*** process will be discussed in Section 4 in relation to property investment strategies.

### 2.2.1 What can you Afford?

One of the most important factors you need to take into consideration when deciding whether or not to purchase a house is affordability. For some people, the decision of buying a house depends on whether or not they can afford what they really want. If they cannot afford to get exactly what they want now, they would rather hold off on buying any house until they can afford to do so.

Some people, on the other hand, are prepared to purchase a house that is not quite what they want, but is what they can afford. They then plan to upgrade the house later on when they can afford to. The benefit of this approach is that it gets you into the market.

Consider the following example of Atarihia:

***Example: Atarihia***

Atarihia, who works as an office administrator, decides that she wants to buy a house. She has already saved a deposit of $42,000.

She looks around and finds that the average price of the houses that she is really interested in is $320,000. In order to buy a house such as this, she would need a mortgage of $278,000.

She does some calculations and finds that, even if the bank was prepared to offer her a mortgage given that her deposit would only be 13% of the purchase price, she would not be able to meet the mortgage payments.

Atarihia works out that she can only afford to buy a house worth $200,000 (with a mortgage of $158,000). She reluctantly decides to buy a house within this price range.

Over the next five years, Atarihia's financial situation improves. She has a change in career and gets stable and very well-paid employment as a senior marketing manager for a large organisation. She does some calculations and works out that she would be able to afford to buy a house worth $320,000 now!

Unfortunately, Atarihia finds out that, due to a boom in the property market over the last few years, houses that were previously worth $320,000 are now selling for $390,000 or more! Based on her current income alone, and a $42,000 deposit, Atarihia knows that a house such as this would, once again, be out of her reach.

However, Atarihia then takes into account how selling her current house would change the situation. Over the past five years, Atarihia has managed to pay $28,000 off her mortgage. This means that, if she were to sell her house for $200,000, she would now have a deposit of $70,000.

| **New deposit** | **= Original Deposit** | **+ Amount Paid off Mortgage** |
|---|---|---|
| $70,000 | = $42,000 | + $28,000 |

Furthermore, when Atarihia gets her house valued, she is told that it is likely to sell for at least $240,000. This is a gain of a further $40,000! Thus, to buy a house worth $395,000, Atarihia would have a deposit of approximately $110,000 and would only need a mortgage for $285,000.

Although this is slightly higher than the mortgage amount that would have been required 5 years ago (i.e. $278,000), this is still within her reach.

Atarihia is very glad that five years ago she decided to settle for a house that she wasn't 100% happy with. If she had instead rented, after paying the cost of rent, she does not think she would have been able to save a further $68,000 to increase her deposit from $42,000 to $110,000 to now be able to afford the house of her dreams.

### 2.2.1.1 Calculating Affordability

When it comes to home buying, there is not one, exact formula to use to work out what you can afford. Banks and financial institutions will have formulae that they apply, but they will generally also take other factors into consideration.

A bank (or other lender) will want to look at the current level of your income to determine what you can currently afford. But they will also want to make an assessment of how likely it is that:

- your current level of income will continue, or
- your current level of income will increase,

so that you can meet all your payments throughout the term of the loan.

As such, they are likely to ask you questions about your employment history and the nature of your employment. Clearly, someone who has worked in the same job for a number of years will be viewed more favourably than someone who changes jobs every few months.

**As a general rule:**

Your total loan repayments for all debts that you have
(not just your mortgage),
should not be more than **one third** of your income.

This is because, in addition to requiring money to pay for essentials such as food, heating and basic clothing, you need to have some money available for 'extras' and unexpected expenses.

Although someone may be able to stick to a strict 'essentials only' budget for a short time, most people are unlikely to be able to do so over the entire term of a mortgage.

So if, for example, your household has an annual, before-tax income of $57,000, it is usually best not to have a mortgage that requires any more than $19,000 per annum (i.e. $365 per week) in repayments.

| **Annual Before-Tax Income** | **/ 3** | **=** | **Maximum Debt Payments** |
|---|---|---|---|
| $57,000 | / 3 | = | $19,000 per year |
| | | = | $365 per week |

However, do not make an assessment of affordability based on the 'one third' rule alone. In addition, you need to **prepare a budget** to check expenses relative to income levels. ***Budgeting*** was covered in Module 2 of this programme.

**When it comes to getting a mortgage, you need to be as realistic as possible in regards to your budget.**

Develop your budget by working out how much you actually spent over the past few months or year and then making realistic assumptions about how your income and expenses are likely to change in the future.

Compare the surplus you got from the budget with the result you get from the 'one third' rule. There may be quite a difference.

For example, according to the 'one third' rule you could borrow up to $19,000 per annum. But your budget may show that, due to the size of your family and your lifestyle preferences, you may only be able to contribute $14,500 per year towards a mortgage.

The following table has been provided to give you an idea of the size of mortgage you may be able to afford. The figures shown in the table are estimates of the weekly mortgage payments that would be required for mortgages of various sizes and interest rates, over a 25 year period[18].

For example, if you have a mortgage of $175,000 at an interest rate of 9.5% per annum, you would need to pay approximately $352.58 per week towards the mortgage.

[18] Figures in the table are sourced from using the Sorted online mortgage repayment calculator available at http://www.sorted.org.nz/calculators/mortgage-repayments

***Weekly mortgage payments for various mortgage amounts and interest rate levels***

| **Amount of Mortgage** | **Interest Rate** | | | |
|---|---|---|---|---|
| | **6.5%** | **7.5%** | **8.5%** | **9.5%** |
| **$100,000** | $155.69 | $170.40 | $185.68 | $201.47 |
| **$125,000** | $194.61 | $213.00 | $232.09 | $251.84 |
| **$150,000** | $233.53 | $255.60 | $278.51 | $302.21 |
| **$175,000** | $272.45 | $298.20 | $324.93 | $352.58 |
| **$200,000** | $311.38 | $340.79 | $371.35 | $402.95 |
| **$225,000** | $350.30 | $383.39 | $417.77 | $453.31 |
| **$250,000** | $389.22 | $425.99 | $464.19 | $503.68 |
| **$275,000** | $428.14 | $468.59 | $510.61 | $554.05 |
| **$300,000** | $467.06 | $511.19 | $557.03 | $604.42 |

To get a quick estimate of how much you could afford to borrow:

1. Apply the 'one third' rule by dividing your annual household income by 3 to estimate the amount you can afford to contribute per year.

2. Divide the result by 52 to estimate the amount you can afford to contribute per week.

3. Work out your weekly payments for any debt you already have. Take this amount off the figure you calculated in Step 2 above. The resulting figure is an estimate of how much you can afford to spend on a mortgage per week.

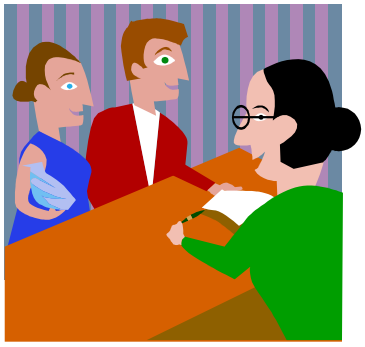
4. Next, look at the table and select which interest rate is closest to current interest rates. Look down the associated column in the table until you get to the weekly payment amount that is closest to the amount that you estimated you could afford to contribute per week. If you then look at the corresponding figure in the left column, you will see the size of the mortgage you could afford.

**For example:**

- If your household has an annual income of $78,000, according to the 'one third' rule, you would be able to contribute approximately $26,000 per year towards debt.
- This works out at $500 per week.
- If you are already paying an average of $70 per week towards other debts (e.g. hire purchases), this leaves $430 available for a mortgage.
- If the current interest rate is 7.5% per annum, you are likely to be able to afford a mortgage between $250,000 and $275,000.
- However, if a higher interest rate of 9.5% applies, a mortgage of between $200,000 and $225,000 would be more appropriate.

If you have quite a low income, it pays to shop around for a mortgage.

Do not be too discouraged if one lender turns down your application – it does not necessarily mean that all others will too.



### 2.2.1.2 The Deposit

An important part of your mortgage decision is how much ***deposit*** you will put down on your house purchase. In the past, it was reasonably common for lenders to offer mortgages to people who only had a deposit of 10% of the price of the house they wanted to buy. That is, they would lend up to about 90% of the price of the house, and in some cases more.

However, in October 2013, the Government placed new rules on lenders. Now, lenders must restrict the amount of loans they give which are more than 80% of the price of the house to 10% of their total lending. In other words, lenders will usually only be able to loan you an amount up to 80% of the price of a house. You will therefore need to provide a deposit of at least 20%. This deposit is called your ***equity.***

There are still some options available for purchasing a house with a deposit of only 10%. One example is the 'Welcome Home Loan' option, which is discussed in Section 3. Another is the 'FirstHome' policy which was also introduced in October 2013.

The **FirstHome policy** is aimed at helping people who earn less than the national average ($53,000 for an individual or $80,600 for two or more people) to purchase their first home. It does this by offering them a 10% deposit (up to a limit of $20,000) to be used towards the purchase of a state-owned house.

The Government plans on selling about 400 state-owned houses over the next few years. Thus, if you qualify for this policy, you could become a home owner without having any deposit other than that given to you by the Government.

Unless you qualify for a Welcome Home Loan or for the FirstHome policy, it is most likely that you will need a deposit of 20%. However, even if you have this deposit, a lender will not necessarily offer you a mortgage – they still want to make sure that you have a secure income to pay for the mortgage and that you have a good ***credit record***. Further, the house you are borrowing on will need to be suitable and the lender may ask you to provide a guarantor for the loan.

You may also be required to purchase some form of ***mortgage protection insurance***. This will assure the lender that you will be able to meet your mortgage payments if some kind of unfortunate situation happens.

If you were able to secure a mortgage with a deposit of less than 20%, your lender may also charge you a ***low equity premium***. This is yet another expense to add to the cost of borrowing money to purchase your house.

If you are buying a home for the first time, you will typically need to save money for a deposit. Although saving a deposit can be difficult, remember that the more you save, the lower your mortgage will be. Furthermore, saving demonstrates to potential lenders that you are committed to the purchase and that you have an ability to achieve financial goals.

If you already own a home and wish to purchase a second property, you do not necessarily need to save another 20% deposit. Instead, you can use the ***equity*** in the first home as the deposit for your new home. Remember, equity is the portion of the house that you own yourself, after paying off any debts.

### 2.2.1.3 Other Costs

Unfortunately, the amount of the deposit is not the only amount of money that you need to have available when buying a house. Additional costs typically include:

- Legal fees
- Cost of property reports (e.g. the LIM)
- A professional valuation
- Mortgage application fee

The amounts of each of these costs can vary considerably. However, altogether, it is common to expect them to be in the range of $1,700 - $2,500 (combined).

In addition, it is quite likely that there will be some immediate repairs or changes to the property that you will need (or want) to make. For instance, you may need to install an alarm, put insulation in the ceiling or put up a fence to keep your pets or children on your property. You will need to have funds available to do this.

When banks lend, they typically base the amount they offer on whatever is lowest out of the purchase price of the property and the professional valuation. They are not likely to offer extra money to cover expenses that do not add any (or much) value to the property. This means that, unless you have other assets for the bank to lend against, you'll need to come up with the money for these expenses yourself. This will affect how much money you have available for a deposit.

Before committing to the purchase of a particular house, you will need to look at the affordability of that house, taking into consideration these other costs and the amount of deposit you have available.

***Example: Margaretta and Hone***

Margaretta and Hone have sold their first home and want to put in an offer of $360,000 on a new home that they like.

They have $100,000 in a savings account for a deposit – but they know they will have to use some of this money for:

- legal fees (Hone has got a quote for $1,100).
- the LIM report (the local council charges $250).
- a professional valuation ($500).
- the mortgage application fee ($250).
- reconnections (around the $200 mark – as they will have to get a Sky dish connected to the roof, unlike their old house which already had one).
- getting a bigger gate on the property, because they have a dog (estimated cost $300).
- general repairs and maintenance required, as identified in the builder's report (which they have already paid for) – they have been quoted $3,400.

Margaretta has recently dropped her hours at work from 30 hours to 20 hours a week. Hone, a builder, is considering 'going it alone' as a plumber rather than working for the firm where he is currently employed.

The couple were paying $3,000 a month on their last mortgage but, if possible, they want to be paying a couple of hundred dollars less than this per month on their new mortgage.

They have narrowed their selection of lenders down to two lenders (offering interest rates of 6% pa and 6.2% pa respectively). Hone's choice is the '85% mortgage' lender. Since this lender is prepared to offer a home loan that only requires a 15% deposit, Hone would be able to use some of the rest of their savings to help set up his business. This lender is offering the lower interest rate of 6% pa.

From this information we can establish that Margaretta and Hone prefer to pay about $2,800 per month and have $94,000 available for a deposit. This works out as a 26.1% deposit:

| | | |
|---|---|---|
| **% Deposit** | **=** | **Amount of Deposit / House Price x 100** |
| | = | $94,000 / $360,000 x 100 |
| | = | 26.1% |

If they were to go with Hone's choice of lender, they would only require a deposit of $54,000 (15% of $360,000). However, this lender is not well known to the couple and Margaretta prefers that they use a lender which has a branch in their local town – such as her preferred lender (which is their current bank).

Using the mortgage repayment calculator at www.sorted.org.nz, Margaretta and Hone get the following results regarding two possible options:

| | **Option 1 (Margaretta)** | **Option 2 (Hone)** |
|---|---|---|
| Deposit | $94,000 | $54,000 |
| Amount Borrowed | $266,000 | $306,000 |
| Monthly Repayments | $2,800 | $2,800 |
| Interest Rate | 6.2% | 6% |
| Time to Repay | 11 years | 14 years |
| Total Amount to Repay | $366,740 | $443,843 |
| Interest to Pay | $100,740 | $137,843 |

According to the online calculator, it would take about 11 years to pay off Margaretta's preferred option. The couple would be paying $366,740 in total, which includes $100,740 interest.

In comparison, if the couple go with Hone's preferred option, they would get a lower interest rate but would be making payments for an extra three years. Furthermore, they would be paying an extra $37,103 in interest.

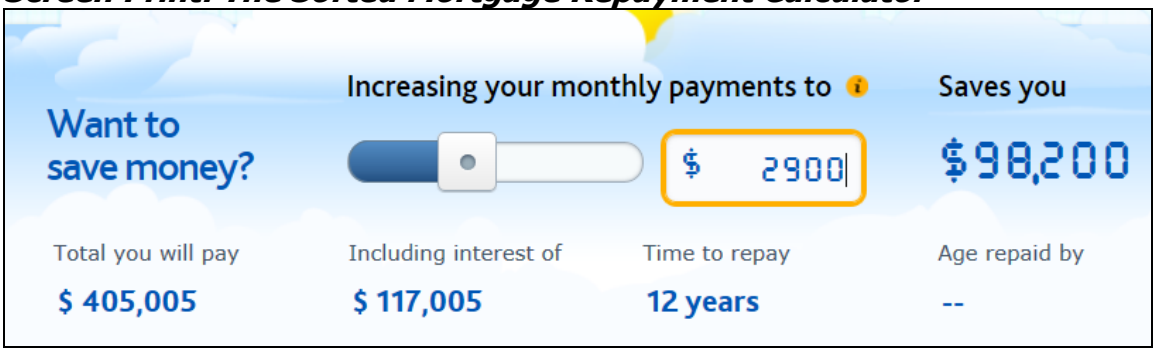
Margaretta and Hone are shocked at the difference in the results. They decide to spend an evening discussing their options further.

Their final decision is that they compromise. They choose a 20% deposit (i.e. $72,000), which is the minimum deposit that Margaretta's preferred lender requires. This would leave Hone $22,000 to use as start-up capital for his business. The other $6,000 would be set aside for legal fees, the new dog gate, etc.

Hone and Margaretta also adjust the family budget. In doing so, they believe they can add another $100 to their monthly repayments.

With repayments of $2,900 per month, a deposit of $72,000 and an interest rate of 6.2%, the mortgage would be repaid in approximately 12 years. However, the total amount paid would be $405,005, of which $117,005 would be in interest payments.

***Screen Print: The Sorted Mortgage Repayment Calculator***[19]




This option involves a saving of $20,838 in interest payments from Hone's original preferred option (which involved $137,843 in interest), but involves $16,265 more in interest than Margaretta's original preferred option.

[19] Retrieved 28 September, 2013, from https://www.sorted.org.nz/calculators/mortgage-repayment

## 2.2.2 Selecting a House

The fun and exciting part of the home ownership process is selecting a house. However, even this can be stressful! Making the 'right' decision is not always easy, especially if you have budget constraints that limit your choices.

Furthermore, when buying a house (as opposed to building one), it is unlikely that you will get *exactly* what you want. You may, for example, find a house that is the perfect size, the perfect layout, in great condition and within your price range, but this house may be located much further from where you work than you had originally been prepared to travel. This is when selecting a house becomes difficult.

Before starting the process of looking at houses, it is therefore important that you are clear about what you want in a home. In Section 4.3 of this Module, we look at a number of points you need to look for and consider when buying properties. In this sub-section, we also look at house buying considerations, however, the focus is on the factors important to buying a house to use as a home, as opposed to buying houses for purely property investment purposes.

**Note:** It would be beneficial for you to consider **both** the information in this sub-section and in Section 4.3 when buying *either* a house or an investment property.

### 2.2.2.1 Location and Zoning

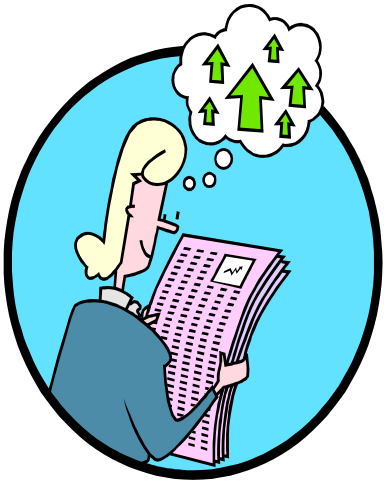
You may be familiar with the saying – "the most important things to look for in a home are **location, location, location**".

There are several reasons why buying a home in a good location is so important, perhaps the main reason being that houses in good locations usually **hold their value** much better than houses in not-so-good areas.

If there is a downturn in the property market at a time when you need to sell your home, it is therefore more likely that you should (at least) be able to get all of the money back that you paid for the house.

Also, when property prices are increasing, houses in 'good locations' will usually increase in value earlier and more quickly than those in other areas. This is because people are willing to pay a premium to enjoy the benefits and convenience of a good location.

The better the area is, the more people will want to live there, and the higher prices will be pushed due to increased demand for a limited number of houses. If you need to sell your home, there are likely to be more people interested in buying it, even if the market, as a whole, is quite slow.



One way to identify a 'good' area is, therefore, to find out about price trends in various parts of town. You can do this by personally monitoring advertised house prices in newspapers, real estate agent windows and online advertisements and sales sites (e.g. Trade Me has a popular 'Real Estate' section).

The problem with this, however, is that you may not get a real idea of how much houses are selling for – or if they are even selling at all. It is therefore a good idea to also talk to real estate agents. Ask them about areas in which houses are selling well and prices are rising.

Talk to family members and friends about their experiences in living in various areas of town. Although a real estate agent will have good information about house sales, people who have lived in a certain area will be able to share their experience as to what it was / is like to actually live in a certain place.

Also, a house in an area that is not usually considered to be amongst the best in a town may actually work out to be right for you – it may be that the neighbourhood is particularly friendly and that you consider the houses offer a lot more 'character' than those in some of the 'better' areas.

If you have no intention of selling your home, factors such as these may outweigh the potential disadvantage of a house not holding its value as much. Furthermore, it may mean that you are able to get the house you want, at a price you can afford, simply because you do not have to pay the premium for location. On the other hand, if you think you are likely to change homes, buying in a recognised 'good location' may be the best option.

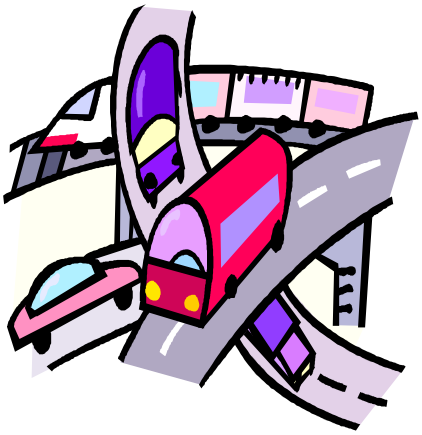
Other things to consider in regards to location include:

- **Facilities:**

  What facilities are there in the area, and what facilities are actually important to you? For example:

  - Is it important to you that you live close to shops, a certain school, parks and sporting venues?
  - Do you need public transport in your area?

  Even if these things are not that important to you, if you think you are likely to be selling your home at some stage, these are likely to be of value to someone else.



- ***Zoning*:**

'***Zoning*** is a term that refers to dividing an area up to be used for various purposes. ***Local government authorities*** (e.g. councils) are responsible for this in New Zealand – they prepare district or city plans which show what areas of land can be used for what purposes.

These plans restrict (for example) loud, industrial businesses from operating amongst residential buildings. Talk to your ***local authority*** and see if any changes are planned for the area in which you are thinking about buying. If it is important to you that you live in a quiet area, and to do your best to ensure that your house keeps its value, make sure you are not close to any commercial zones.

Zoning is also important because it may impact on what you want to do personally. If you intend to run a business from home, check with the local authority to see if the particular business type is allowed in your area. If it is not allowed, ask if it is likely that you would be able to get a ***resource consent*** which would allow you to do this business activity.

- **Style:**

  Different areas of towns were often built in different eras (time periods). The style and 'feel' of areas can therefore be very different. What appeals to one person, does not necessarily appeal to another, so there is no 'best' style to look for.

  If you are shopping for a home, as opposed to an investment property, simply look for the style and character that appeals to you. This may involve an older villa style house or a very new, modern house.

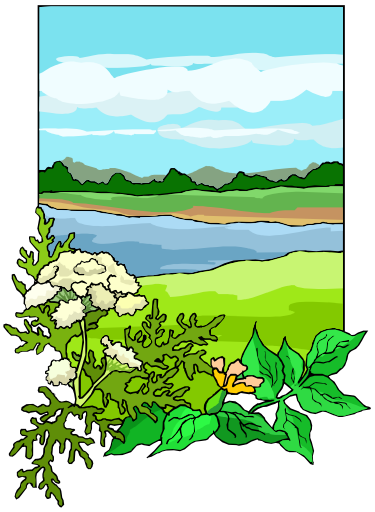
  If you are interested in buying a newer house, give preference to areas in which there is some variety in the architecture of houses and landscaping.

  Although choosing a modern house is often a good choice for a house being bought as an investment property, sometimes new development areas have a very standard and unoriginal look to them which stops people from wanting to live there.

- **Views and natural features:**

  Obviously, houses in areas that look visually appealing are likely to retain value more so than other areas. Look for good views and natural landscapes.

  If there is a beach in sight, even better! Also look for areas that have houses with established gardens.

- **Crime rates:**

Some areas have crime rates which are higher than others and, quite often, these crime rates reflect long-term trends. Thus, if an area has a history of crimes such as burglary and vandalism (including tagging), it is quite possible that this will not change in the near future.

The safety of yourself, your family and your possessions will be an important factor in determining location.

***Discussion Question:***

Where are the 'good areas' within your own town? If you live in a rural area or very small town, answer this question by thinking about the nearest medium-sized town to you.

### 2.2.2.2 House Features

It is easy to feel overwhelmed when house shopping. There are so many different features and benefits which houses can offer that it makes choosing between them difficult. To save time, stress and cost, it is a good idea to make a list of your requirements and preferences. Put this list in priority order – with those factors most important at the top of the list.

There are a number of useful tools available online to help you do this. One such tool is the 'ASB Home Buyer's Check List' found on the ASB website. This checklist has been reproduced on the following pages.

# ASB Home Buyer's Check List[20]

| | Irrelevant | Low | Medium | High | Critical |
|---|---|---|---|---|---|
| **Location Features** | | | | | |
| Neighbourhood:<br>How important to you is a desirable neighbourhood? | | | | | |
| Views / outlook<br>Do you want views of the city, water, bush, etc.? | | | | | |
| Quiet location<br>How important to you is a quiet location? | | | | | |
| School zones<br>How important to you are school zones? | | | | | |
| Sunny orientation<br>How important to you is a warm, sunny property? | | | | | |
| Distance to work<br>How important to you is it that your home is close to work? | | | | | |
| Distance to shops<br>How important is it that your home is close to shops? | | | | | |
| Public transport<br>Do you want good access to public transport? | | | | | |
| **Internal Features** | | | | | |
| Interior Condition<br>How important is it that the inside of the house is new? | | | | | |
| Bedrooms<br>How important to you is the size of the bedrooms? | | | | | |

[20] ASB. *Buying Checklist*. Retrieved 19 September, 2013, from https://www.asb.co.nz/story_images/1830_603685041010HBch_s5039.pdf

| | Irrelevant | Low | Medium | High | Critical |
|---|---|---|---|---|---|
| Living areas<br>How important to you is the size of the living areas? | | | | | |
| Indoor / outdoor flow<br>How important is indoor / outdoor flow? | | | | | |
| Kitchen<br>How important to you is the size and condition of the kitchen? | | | | | |
| Bathrooms<br>How important is the size and condition of bathrooms / ensuites? | | | | | |
| Floors / floor coverings<br>How important is the quality and condition of floors and floor coverings? | | | | | |
| Heating<br>How important is heating (fireplace, gas, central heating, etc.)? | | | | | |
| **Outside Features** | | | | | |
| Size of section<br>How important is the size of the section? | | | | | |
| Exterior condition<br>How important to you is the exterior condition? | | | | | |
| Street appeal<br>How important to you is street appeal? | | | | | |
| Low maintenance<br>Do you want a low maintenance property? | | | | | |
| Privacy<br>Do you want privacy? | | | | | |
| Gardens<br>Do you want gardens? | | | | | |
| Lawns<br>Do you want lawns? | | | | | |

| | Irrelevant | Low | Medium | High | Critical |
|---|---|---|---|---|---|
| BBQ area<br>Do you want a BBQ area? | | | | | |
| Pool / spa<br>Do you want a swimming pool? | | | | | |
| Fencing<br>How important is it that the property is fenced? | | | | | |
| **Other Features** | | | | | |
| Character / feeling<br>How important to you is the character of a house? | | | | | |
| Garage / carport<br>How important to you is a garage or carport? | | | | | |
| Off-street parking<br>How important is vehicle / boat parking? | | | | | |
| Workshop<br>Do you want a workshop? | | | | | |
| Storage space<br>Do you need good storage space? | | | | | |
| Office space<br>Do you need office space at home? | | | | | |
| Teenage space<br>Do you need space for teenagers? | | | | | |
| Security<br>How important to you is home security? | | | | | |
| Insulation<br>How important to you is insulation? | | | | | |

When you are trying to decide which features are most important, think about whether or not a feature would be relatively easy and low-cost to add later.

For example, although you may feel that a carport or garage is an essential feature, perhaps what is most important to you is that there is room to be able to add a carport or garage.

Once you have identified those features which are
'**critical**',
you'll find it easier to short-list properties
as you will be less likely to be distracted by all the
'extra features' some properties may provide.

Assume, for example, that one house has a luxurious spa bath and a large fireplace, but little internal storage area.

Also assume that a spa bath is something you hadn't thought much about and that you intended to install a heat pump to use as your main form of heating instead of using a fireplace.

However, when you walk into a house that looks very attractive and has these inviting features, unless you are very sure of what features are important, you could be tempted to buy it. Later on, once you find that you cannot 'make do' with the limited internal storage area, you may then regret your decision – particularly if you find that you do not make much use of the spa bath or the fireplace!

Once you have completed a checklist such as that given on the previous pages, make a list of those features which were identified as 'critical'. Note that, if there are other features you consider as being critical that were not on the standard checklist, add these to your list. Then, make a list which ranks those features that you identified as being of high importance, followed by those identified as being of medium importance.

As you view each property, use this list as a checklist by 'ticking' those features that the property has. If a house does not have the critical features, or if there is no potential to add them, remove this property from your list of possibilities.

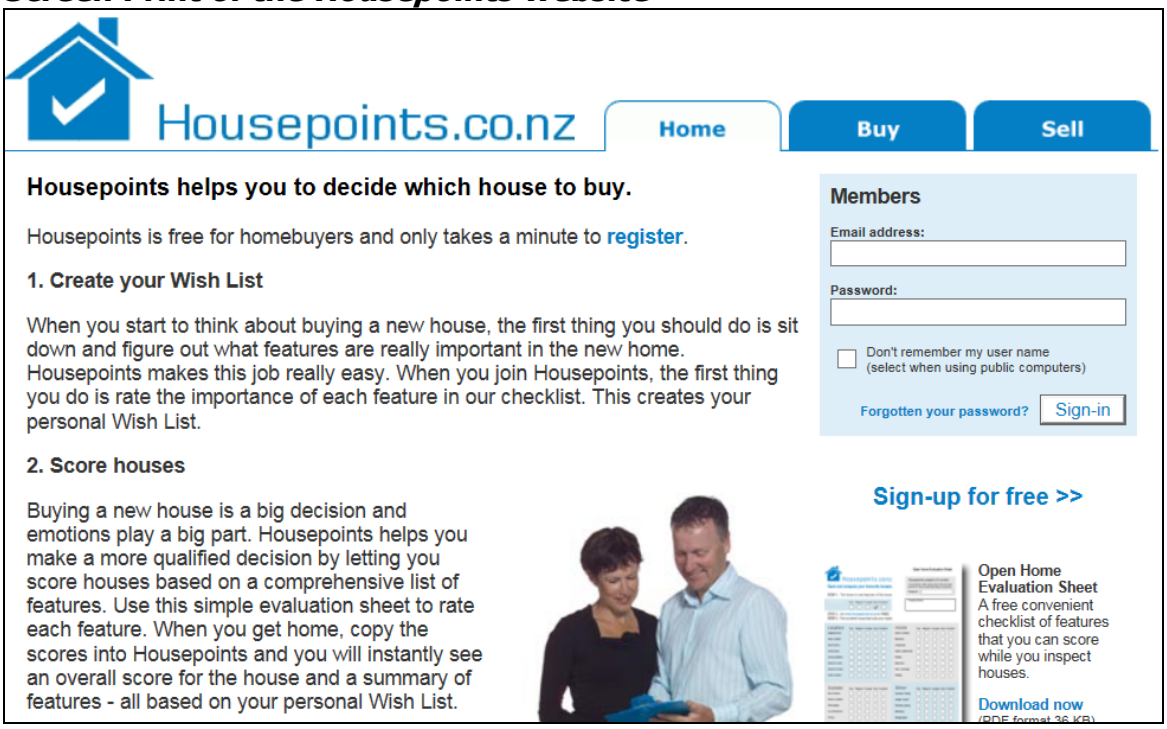
An example is as follows:

***Property Comparison Checklist***

| | **House 1** | **House 2** | **House 3** | **House 4** |
|---|---|---|---|---|
| **Critical features** | | | | |
| Flat section at least ¼ acre in size | | | | |
| Minimum of four bedrooms | | | | |
| Open plan kitchen and living area | | | | |
| Less than 15 minutes travel to work | | | | |
| | | | | |
| **Other features, in order of importance** | | | | |
| Ensuite | | | | |
| Modern bathrooms | | | | |
| Two living areas | | | | |
| Quiet location | | | | |
| Off street parking | | | | |
| Garage with internal access | | | | |
| Large bedrooms | | | | |

In addition to, or instead of, creating your own property comparison checklist, you may wish to use one of the many free tools available online. A good example is that provided on the site www.housepoints.co.nz. This tool enables you to create your 'wish list' of features, score houses and then compare the results. A screen print of the site is provided below.

***Screen Print of the Housepoints website***[21]




***Discussion Question:***

If you were to use 'scoring' to help select a house, how would you ensure that the most important features are not outweighed by features of lesser importance? For example, if you were to simply give each feature you like in a house a score out of 10, how would you make sure that a house that has lots of features which are of little importance does not receive a better overall score than a house that has the essential requirements, but not lots of minor attractive features?

[21] Retrieved 27 September, 2013, from http://www.housepoints.co.nz/

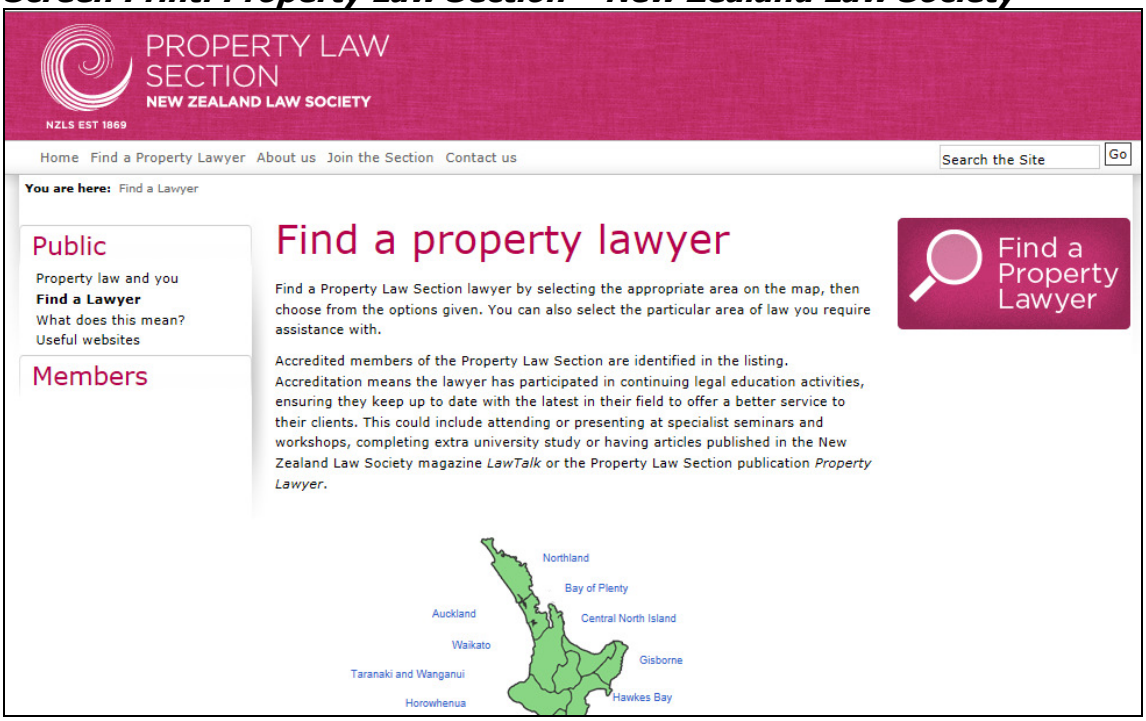
## 2.2.3 Legal Matters and Advice

Once you have found a house you like, you should get in touch with a Building Inspector. The inspector will look over the house and check things like the foundations and materials used to determine if the property is in good health.

Furthermore, before you sign an agreement to purchase a property, and preferably even before you start looking seriously for a new home, it is always important that you first get good legal advice. In contrast to a ***real estate agent***, who is there to organise the sale process, a lawyer will examine the documentation involved and help ensure your interests are protected.

You need to choose a reputable property lawyer – you can get recommendations from friends, family, work colleagues or your local district law society. Useful information and a list of property lawyers in your area are also available on the website www.propertylawyers.org.nz.

***Screen Print: Property Law Section – New Zealand Law Society***[22]




It is important that the lawyer is independent and acting only for you. It is also a good idea to ask your lawyer to write or update your ***will*** at the same time – some do this for free, or for a reduced fee, when you ask them to do the legal work for your home and mortgage.

[22] Retrieved 27 September, 2013, from http://www.propertylawyers.org.nz/public/find_a_lawyer

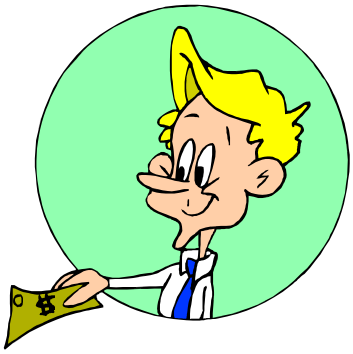
### 2.2.3.1 Conveyancing

New Zealand laws involve a certain legal process when it comes to buying property, so a lawyer is necessary. This legal process is known as ***conveyancing*** and involves transferring the ***Title*** for a property from one owner to another.

To do this, your lawyer will need to complete various documents. The documentation involved includes both paper and online documents. The New Zealand conveyancing system uses an electronic system known as 'landonline' which is designed to improve efficiency and timeliness of property transfers.

When buying a property, your lawyer's first tasks will involve organising valuations and reports and examining the seller's proposed contract.

This contract is often the real estate agent's standard ***Agreement for Sale and Purchase of Real Estate***. Even if the property is being sold by auction or tender, they will examine these documents for you.



Your lawyer can also give you advice on negotiating the price.

Once you and the seller have reached agreement, you will usually pay a deposit to the seller's real estate agent. This deposit is usually 5% to 10% of the purchase price.

**TIP:**

You may be able to negotiate this deposit. If you are told the deposit is 10%, try to reduce it to 5%, especially if there is a long time between the date you pay the deposit and the date you actually get the house. Your money is better off in your bank account earning interest!

From this point, your lawyer will then launch into the conveyancing. They will also advise you on matters you need to consider before you sign your mortgage documents.

For example, your lawyer can / will:

- ☑ Obtain a guaranteed title search that temporarily protects you against claims on the property.
- ☑ Run a check on ownership restrictions, consents, ***local authority*** plans and any other potential problems. This includes checking the '***LIM*** report' (note that LIMs are discussed in the following sub-section).
- ☑ Make sure the conditions in your agreement are met.
- ☑ Draft the mortgage documents.
- ☑ Tell you if the property is insured.
- ☑ Check if rates and other costs are paid up to date.

Your lawyer can also help you apply for a loan if you need this assistance. They can usually even discuss your financial position with you to help determine how much you can afford to borrow.

Another important role of the lawyer is to give advice on the ownership of a property. They may advise that a ***family trust*** should be established to purchase the property.

If ownership of the home is to be shared, there are two main ways of structuring this:

1. ***Joint tenancy***: In this case, you own the home together and if one person dies, the other takes over the ownership. This is a common approach to ownership if a couple are purchasing a house together.

2. ***Tenancy in common***: In this case, each of the owners own a share in the property and can leave their share to anyone they wish in their will. This is a more common option if there are several owners in a property.

As the ***settlement date*** gets closer, your lawyer will confirm the amount you are required to pay on settlement and assist you to arrange payment.

From this point, provided everything is in order, on the day of settlement your lawyer will process all legal papers to transfer ownership.

The seller's lawyer will give your lawyer the keys to the house as well as the Title to the property and your lawyer hands over the balance of the purchase price (they would have got this when your mortgage was drawn down by your bank).

After the settlement date, the lawyer will provide you with a settlement statement which contains all purchase details and they will give you a copy of the title showing you as the new registered owner of the property.

Lawyers' conveyancing fees do vary so it pays to phone around and get some quotes. If you are buying, and let's assume you'll take out a mortgage to cover 80% of the purchase price, then expect to pay over $1,000 for a standard conveyancing job.

### 2.2.3.2 Obtaining a Land Information Memorandum

Before purchasing a property, you need to examine the Land Information Memorandum (***LIM***).

A LIM is a file of information about the property, put together by the local council.

A LIM can be used to show whether any work carried out on the property has council permits and whether such things as drainage, electricity and transport access have been properly provided to the property.

It usually costs anywhere between $250 and $600 to obtain a LIM, so it is best to make sure you are fairly keen on the property before ordering one. Otherwise, if you order reports for all the properties you are considering buying, this can become very expensive!

One way to save money is to visit your council, as most councils have 'property files' that contain much the same information as a LIM and are free to view (but not available online or by fax).

If, through examining a LIM and comparing it to the property, you find that work (such as renovations) does not have council permits or permission, then this may be a problem for you. The work may cause issues for you and your home, meaning there will be costs involved to fix it up properly and get the necessary council permits. It may also create a problem when you decide to sell the property - potential purchasers may be 'put off' buying the house due to this issue, meaning that you could lose the sale or have to accept less money for it.

### 2.2.3.3 Covenants

As part of the property purchase process, your lawyer will advise you on any interests registered against the title. In particular, they will find out if there are any ***covenants*** recorded. If there is a covenant recorded on the title for a property it means that there is some legal restriction or agreement that must be kept. A covenant can restrict you from doing certain activities on the land.

For example, in some ***subdivisions***, covenants are used to keep a certain 'look and feel' in the neighbourhood. They may do this by making rules about (for example):

- The type of houses to be built.
- The minimum value of the houses.
- The colours to be used (usually neutral colours rather than bright colours).

Restrictions such as these protect other owners who have bought in that area for the reason of wanting to live in a neighbourhood that has these features.

Other examples of covenants are ones that:

- Restrict owners from keeping caravans on their land.
- Restrict owners in an area from using their homes as businesses.

- Require owners to protect a native tree on the land.
- Only allow owners to build within certain height and floor area restrictions.

- Prevent owners from using certain building materials (e.g. corrugated iron).
- Determine the type of fence style and the height used.

## 2.2.3.4 Types of Titles

Your lawyer will be particularly careful when checking the ***title*** to make sure that the details of the land are the same as those recorded in the ***agreement for sale and purchase***. Similarly, your lawyer should make sure that you understand what you are buying.

For example, there are 3 main types of land, also known as ***estates***, which give owners different sets of rights in regards to their land:

**1. *Fee Simple***

This is also known as ***freehold***. If you own fee simple land, you have very few restrictions as to what you can do with the land. In most cases, owners can do as they please without the interference of anyone else. They do, however, still need to work within the local council's district plan.

**2. *Leasehold***

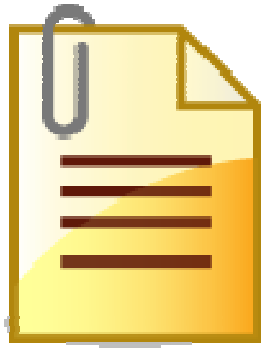
A leasehold title is a form of ownership where you do not actually purchase the land – instead, it is ***leased*** from the landowner and you pay rent for it. In many cases, you will, however, own the actual buildings on the land. The landowner then grants 'occupation rights' to the property, which allow you to use the property for a set period of time.

**3. *Cross-Lease***

Cross-lease titles are where there are two or more homes on a property and you share the ownership of the land title with others.

The joint owners effectively lease the land to one another for a period of 999 years. Cross-leases apply to flats more often than to separate houses.

Cross-lease titles were used quite often in the early 1970s because they were ***exempt*** from some resource consent and local council rules. That is, they did not need to comply with some rules. This made them a cheaper way to put two or more buildings on one piece of land.



With a cross-lease, all interests are noted on one Title and this document is known as a ***composite title***. The ***dwellings*** (houses) on the title are shown on a plan which is attached to the lease and composite title.

***Covenants*** on the titles then show areas to be set aside for the exclusive use of individual units (e.g. courtyards, gardens or parking spaces associated with specific flats / houses).

There is no such thing as a 'standard cross-lease'. Some may have very restrictive covenants which, for example, might ban 'pets' from the property. Each individual lease therefore needs to be read thoroughly to see if it suits your individual living circumstances.

**The main disadvantage of a cross-lease** is that all owners of the common land must agree before alterations are made to the property.

This can include improvements such as paths, fences and even extensions to houses and the building of garages.

Thus, although it may appear that one house is completely separate from another (e.g. there may even be a fence between two houses that makes it appear that the houses are on two separate properties), if you have a cross-lease property you cannot make changes to what appears to be 'your' property without the permission of the other owners.

Then, once the additions / alterations have been completed, the changes must be registered on **all** of the titles / flat plans. This can be expensive, depending on the number of other owners in the property.

If you are deciding whether to buy a leasehold or cross-lease property, one factor you'll need to take into consideration is how easy it will be for you to resell it in the future. If you intend to make it your home and live in it for a long period of time, or permanently, this may not be an issue. However, if you do decide to sell it, be aware that it may be harder to find a buyer.

A couple of other types of ownership include:

- ***Unit titles:***

  This is where you own a unit in a block, but common areas (e.g. stairways and parking) are managed by the 'body corporate' (all of the owners collectively).

- ***Licence to occupy:***

This is not actually a type of ownership in that you do not actually own the land or buildings. Instead, you buy the right to live in the property for life. This type of ownership is very common for retirement villages.

***Discussion Question:***

What factors would you take into consideration when selecting a lawyer to use for the conveyancing process?

## 2.2.3.5 The Sale and Purchase Agreement

New Zealand law requires that:

Any contract involving the sale or disposal of land **be in writing**.

Thus, a verbal agreement to purchase a property is NOT ***legally binding***.

As such, one of the first tasks for your lawyer in the process of you purchasing a property is to examine the sale and purchase contract.

The contract commonly used is one that was created by (and continues to be monitored and revised by) the ***Real Estate Institute of New Zealand*** (***REINZ***) and the Auckland District Law Society.

It is referred to as the ***Standard Agreement for Sale and Purchase of Real Estate***.

A copy of the latest version of this agreement can be found on the website of the Auckland District Law Society at http://www.adls.org.nz/adlsi-store/legal-documents/sample-forms/. This version of the agreement shows all changes between the current version of the agreement and the previous version.

It is a good idea to use the standard agreement, as lawyers are very familiar with its terms.

## Contract Conditions

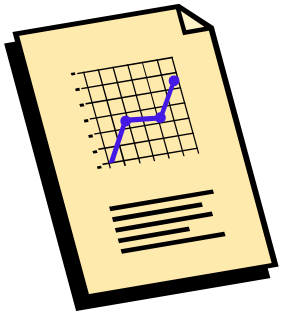
When buying a property, buyers often require that some conditions be met before the transaction is finalised. These conditions are outlined in the sale and purchase agreement as 'subject to' clauses.

Your lawyer should advise you as to which clauses you need to include. Furthermore, the REINZ publishes a booklet called 'Useful Clauses and Authorities' that includes numerous clauses you may wish to include in the agreement.

However, some of the most common clauses inserted by buyers include:

- **'Subject to finance':**

  If you need to arrange and / or confirm finance to purchase a property, it is important that you insert this clause. This way, you will not have to proceed with the purchase if you cannot get the funding required.



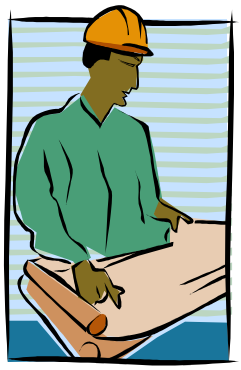
- **'Subject to a valuation report':**

  This enables you to check the market value of the property and back out of the arrangement if the value is substantially lower. If you are borrowing money to purchase the property, getting a valuation report is likely to be a requirement of the lender.

- **'Subject to the sale of another home':**

  If you already own the house you live in and are looking to purchase a new home, it is quite possible that you will find your 'ideal new home' before you manage to sell your existing house.

  If so, unless you can arrange (and meet payments for) finance for both properties, you will need a clause such as this to give you time to sell your current home.

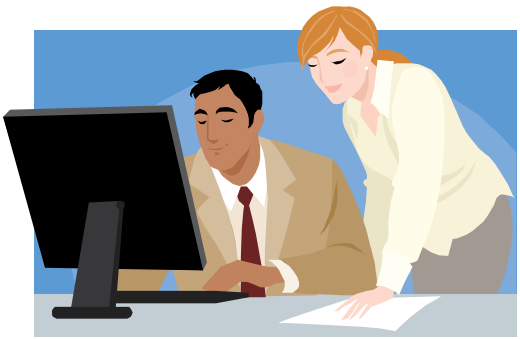


- **'Subject to an engineer's report':**

This clause enables you the opportunity to get a report to check out any structural or land issues and back out of the arrangement if the resulting report identifies problems.

- **'Subject to a title search':**

If your lawyer has not already completed a title search, it is highly recommended that they do one before the agreement becomes unconditional.



A title search will enable you to back out of the arrangement if it is found that there are problems with the title, or that there are unfavourable restrictions, covenants or easements that you should have been aware of.

- **'Subject to a LIM report':**

LIM (Land Information Memorandum) reports were discussed earlier in this section. If there is anything unfavourable in the LIM report, you will not have to proceed with the purchase.

- **'Subject to a building report':**

Similar to an engineer's report, a building report allows you to check for any structural issues with the building and identify if there are any maintenance problems that are likely to cost you money.

If you include 'subject to' clauses such as those outlined previously, **make sure that you specify the condition must be 'satisfactory' to you**.

For example, if you only specify that a sale is subject to obtaining a LIM report, once you have obtained the LIM report you will still need to go ahead with the purchase regardless of whether you are happy with the contents of that report!

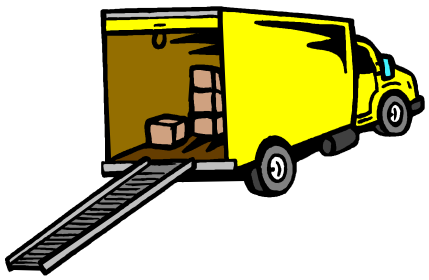
**Sellers may also have some conditions.**

For example, a seller may include an 'escape clause', also known as a 'rollover clause' as a condition. With this clause, if they get a better offer from another prospective buyer, they can give you a deadline to make your agreement ***unconditional***. If you do not meet the deadline, the seller can then accept the other offer.

Once all conditions have been met, the sale becomes ***unconditional*** and the sale proceeds.

- The sale and purchase agreement will specify a ***settlement date*** which is the date on which you must pay the outstanding balance on the house and the documents for the transfer of the property are exchanged.

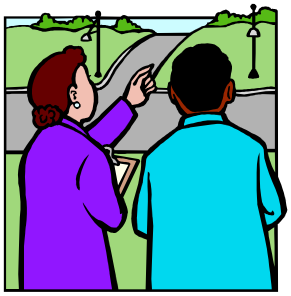
- It will also specify a ***possession date***. This is the date by which the ***vendor*** must leave the property to you so you can move in. The settlement date and the possession date are often the same.



## 2.3 Building a House

Sometimes, the only way to get what you really want in a home is to build one. Building a home from scratch obviously involves quite a different process and different considerations to buying an existing house. Before looking at the building process, let's look at some of the advantages and disadvantages of building:

**Advantages**



- Sections for new houses are often found in areas of expansion, rather than decline. If you intend to sell at a later stage, or are relying on the equity in your house to borrow further, this will help maintain (and hopefully increase) the value of your house.

- You get the kind of home you want – within your budget constraints.

- You will not need to start your life in the house by renovating to change the things that you do not like.

- Everything is brand new, so you should not need to worry about wear and tear for quite some time.

- You get personal satisfaction and potentially a greater connection to your home, from being involved in its design process.

**Disadvantages**

- It usually costs more to build a house than it does to buy a similar existing house.

- Costs may escalate. You need to have a contingency budget for this.

- The building process can be very stressful – especially dealing with the various parties involved.

- More time consuming. You will need to spend time selecting colours, fittings, heating systems, etc.

- It takes much longer and expected timeframes can easily be delayed for a variety of reasons (e.g. bad weather or materials not arriving on time)

- Once the house is finished, you also need to give consideration to landscaping and putting in driveways.

- Available sections are limited in many places, so you may have less choice about where to live.

- Although designers can show you high-tech images of the expected appearance of your home, you may not be able to know exactly how things will look and may therefore be disappointed with the final product.

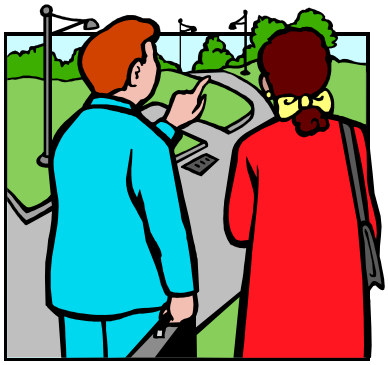
- If you are building in a new area or ***subdivision***, it is hard to know what the area will be like. Another potential problem with new areas is that new neighbours may build out your view or their houses may be unappealing to you.

- A new house may have some 'teething' problems which need to be fixed (and possibly at some cost, or at least, at some inconvenience).

**The Building Process**

The website www.consumerbuild.org.nz is a valuable source of information for anyone considering building or renovating a home. The following sub-sections contain a summary of the building process, adapted from this website[23].

## 2.3.1 Step 1: Choosing a Section

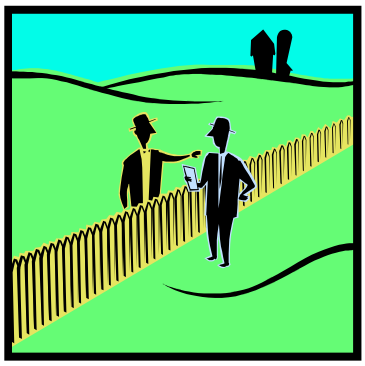


When choosing a section, consider the 'location' factors discussed in Section 2.2.2.

For example, look at what facilities and schools are in the area, ask about the value of houses in the area and note the visual appeal of an area.

However, when you check the ***local authority's*** District Plan for details regarding ***zoning***, also pay attention to any height or boundary restrictions that may impact on your building plans.

Also check ***survey*** details about your section. When you view an empty section, it may appear obvious as to where the boundaries are, but the boundaries may, in fact, be quite different than expected.



For example, it could be the case that a previous neighbour may have built their fence inside their own boundary, making your section appear much larger than it really is.

If you were to simply assume this land is yours and build or landscape on it, this could become very problematic if the neighbours (current or future) decided they wanted to correct their fence and make use of this part of their land.

[23] Consumerbuild. *Step by Step.* Retrieved 22 May, 2009, from http://www.consumerbuild.org.nz/publish/stepbystep/step-buildingnew.php

If you cannot find the survey pegs or have any doubts about their placement, **getting the section re-surveyed would be a good idea**. Although this will involve extra cost in the short term, it may avoid substantial cost in the future.

Factors that you should pay particular attention to when selecting a section to build on are the **ground stability** and the **quality of the soil**. You need to make sure that the section is stable to build on, but that the ground is not so solid that it becomes very costly and difficult to work with.

Some examples of problems that may occur include:

- Erosion.
- Unstable banks.
- A section built over hidden waste could slowly sink.
- A large amount of soft topsoil may require you to lay foundations much deeper than anticipated.
- There may be very little soil, with very hard rock close below the surface.

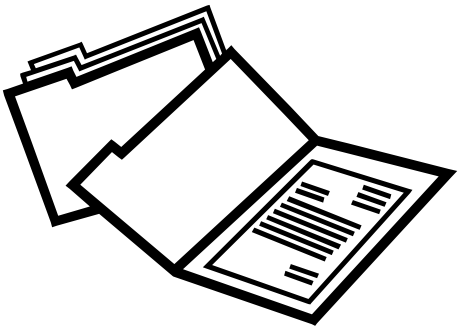
If any of these situations do apply, it doesn't necessarily mean that you cannot build on the site, but it may mean that:

- there are limitations on the materials you can use (e.g. not too heavy),
- there are some parts of the section that you should not build on, or that
- the costs involved in preparing the section for building are higher than usual.

To find these details out about the section, engage the services of a geo-technical engineer.

If you are building in a new ***subdivision***, it is most likely that the developer will have already done this and will have a report available for you to view.

In addition, the ***LIM*** (remember, this stands for 'Land Information Memorandum') may include some relevant information about the site.



You may also choose to request a **Hazard Report** through the QV website (www.qv.co.nz). This report provides information about potential risks such as earthquakes, tsunamis, floods and landslides specific to the site. Note that this type of report is not available for every section.

An example of part of a Hazard Report for Te Papa museum is given below. Note that this is not the full report.

***Excerpt from a Hazard Report for Te Papa***[24]

## Hazard risks

This hazard summary allows you to gain better understanding of the natural hazards that may affect a property.

| Hazard type | Description | Risk level |
|---|---|---|
| Earthquake Hazard | Earthquake frequency | High |
| Earthquake Hazard | Likely response in a strong distant earthquake | High |
| Earthquake Hazard | Likely response in a strong close by earthquake | Medium |
| Earthquake Hazard | Susceptibility to liquefaction | High |
| Earthquake Hazard | Susceptibility to fault rupture | Low |
| Landslide Hazard | Susceptibility to landslide as assessed from slope/rock strength model | Low |
| Coastal Hazard | Is this property in an area that could be susceptible to tsunami inundation? | High |
| Flood Hazard | Is this property in an area where soils data indicate that it may be susceptible to flooding? | Low |

[24] Image supplied courtesy of PropertyIQ, owner of www.qv.co.nz.

## 2.3.2 Step 2: Organising Finances

The process of getting into your own home, as outlined at the start of Section 2.2, identified 'working out what you can afford' prior to searching for a house. When it comes to building a house, this is still the case. Before you start looking for a section (Step 1 above), you should already have a good idea of what you can afford.

However, after finding a section, you will need to re-visit your financial situation. In particular, you will need to consider how the price of the section will impact on the affordability of the house you want to build.

Before you commit yourself to the section, you will also need to get a valuation to check that the price is reasonable. This valuation may be necessary for mortgage purposes.

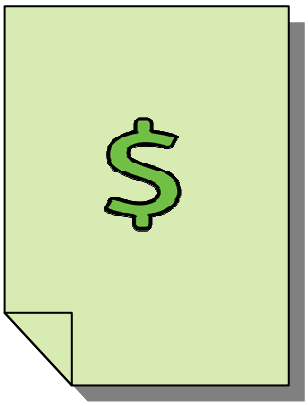
**Mortgages for Building Projects**

Obtaining a mortgage for a building project is quite different from obtaining a mortgage for an existing house.

**The main difference is:**
it is unlikely that the full amount of money required will be released from the lender **at the beginning** of the project.

This is because the lender prefers to only lend based on what ***security*** is available. The risk to the lender is that they will give you the full sum of money, but that the work will not be fully completed. As a result, if you did not repay the mortgage, the lender would be unlikely to be able to recover their money by selling the land and an unfinished (or non-existent) house.

The lender is therefore more likely to release the money you need in stages – these are called ***progress payments***. In order to grant your loan and release the first payment (referred to as a ***drawdown***), it is likely you will need to give the bank:



- ☑ **A professional registered valuation** which shows the current value (which is likely to only be the value of the bare section) along with the 'tentative on completion' value of the house. The 'tentative on completion' value is the valuer's estimate of the finished value of your home, which will be based on the land value and your building plans.

- ☑ **Confirmation that you own the land**, or a sale and purchase agreement for the land.

- ☑ **Full costs and quotations for the job**. If you do not have fixed-price contracts with those involved in the building project, you are likely to need to allow a certain percentage extra (e.g. say 15%), for extra costs.

- ☑ **Building consent**, including a Project Information Memorandum (PIM) – these are discussed further in Section 2.3.7.

- ☑ A copy of the **builder's all-risk insurance policy** which covers the property.

Then, each time you require a further ***drawdown*** on the mortgage, you may be asked for a 'progress valuation' to show the **current value** of the house.

It is therefore important that you try to ensure that the ***progress payment schedule*** required by your builder is going to match the amounts that the lender will allow you to drawdown.

An example of a progress payment schedule given on the Mortgage Warehouse website is reproduced below:

***Example Progress Payments for a Builder***[25]

| Construction Stage | Example Draw Down |
|---|---|
| Deposit | 10% |
| Foundations | 10% |
| Floor, framing and roof | 20% |
| Lock-up | 25% |
| Internal lining and doors | 25% |
| Completion | 10% |

So if, for example, your builder required the above progress payment schedule, you would need to work with your bank to ensure that 40% of the total contract amount would be either already released (or available for release) by the time the floor, framing and roofing were complete.

**The bank may only be prepared to release this amount if it reflects the value of work completed to that point.**

If you do not work closely with your bank and the builder in confirming the payment schedule right from the start, the risk you could face is that the bank will not release money when you need it. This will mean that you will not be able to pay the builder the amount that they want when they want it. The builder may then stop working on your house until that payment is made.

[25] Mortgage Warehouse. *Getting a Loan to Build a House.* Retrieved 19 April, 2011, from http://www.mortgagewarehouse.co.nz/mortgages/house-plans

Another risk when building is that the expected final value of the completed house may decrease throughout the project. In other words, it may work out that the value of your house is LESS than what you expected.

The problem with this is that the lender may not be willing to release the amount of funds that was agreed with the builder.

This may happen, for example, if property prices in the area decrease so much that the valuer does not consider that the 'tentative on completion value' of the house will be as high as the cost of building.

In addition to a progress valuation, each time you drawdown funds on your mortgage you are likely to need to supply the lender with a copy of the builder's invoice.

For the final drawdown (on completion of the job), you will need to supply a final valuation along with a ***Code Compliance Certificate***.

## 2.3.3 Step 3: Choosing the Designer

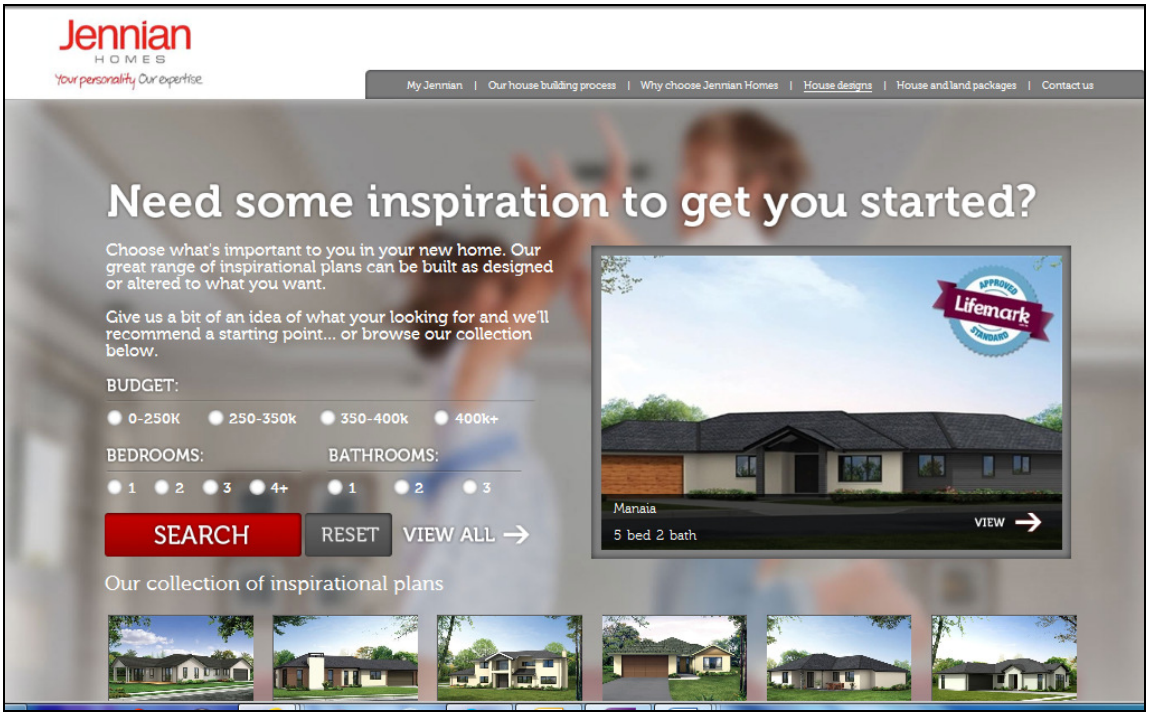
There are different options in regards to house design. You may choose:

- a new home that is already standing or is under construction (a 'spec' house – that is, one which is built on speculation, without a pre-arranged buyer).
- to select from a range of pre-existing plans that a designer has developed and possibly even make alterations to these plans.
- to have a house custom-designed for you.

A popular choice is to use companies such as Jennian Homes, Signature Homes and Golden Homes which offer a wide range of plans that customers can tailor to their needs. These companies often show some of their plans on their website. The below screen print shows a function on the Jennian Homes website that allows you to search for plans that meet your requirements in terms of your budget as well as the desired number of bedrooms and bathrooms.

One of the main benefits of using companies such as Jennian Homes is that they manage the entire home-building process.

***Screen Print: The 'View House Designs' Section of the Jennian Homes Website[26]***




[26] Retrieved 27 September, 2013, from http://www.jennian.co.nz/search?all=true

However, if this is not your preference, and you do not want a 'spec' house, you will need to choose an architect, an architectural designer, or an architectural draughtsperson:

- In New Zealand, an ***architect*** is someone who is registered with the New Zealand Registered Architects Board (NZRAB).

  Someone cannot call themselves an architect unless they have met the NZRAB registration requirements and cannot practise unless they hold a 'practising certificate' issued by the NZRAB.

  Most architects will have a university degree in architecture and be competent in the management of the building process, as well as the design of the building.

- Like an architect, an ***architectural designer*** is someone who specialises in building design and construction, and probably has a tertiary qualification in architecture, but is not registered with the NZRAB (and therefore cannot call themselves an 'architect').

- An ***architectural draughtsperson*** is usually not as skilled as an architect or architectural designer, but may have some tertiary training. Depending on what you want done, and the uniqueness and 'flair' you are trying to achieve, this may be a good low-cost option.

Once you have chosen your designer, you will need to meet with them to discuss your ideas. Although your designer will have plenty of ideas themselves, you need to tell them what you want so that they can better fulfil your needs. If you do not, you risk spending a lot of money while they come up with various plans that do not quite suit your taste or meet your expectations.

Therefore, before meeting with them, make a list of exactly what you want in your house, preferably listed in order of priority. Even gather ideas for materials, ***fixtures*** and ***fittings***.

## 2.3.4 Step 4: Selecting a Project Manager

Decide whether you are going to manage the building project yourself, or whether you are going to engage someone else to do this for you.

In terms of your options, you could:

- engage a professional project manager, or
- the architect / designer or main contractor may perform this role.

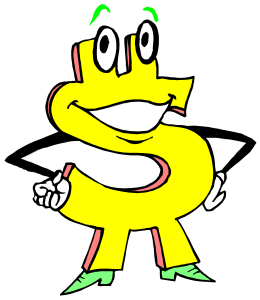
If you are using a building company such as Golden Homes or Jennian Homes, they will take on the project management role.

Some people like to have the experience of managing and being hands-on in building their homes.

Others find the experience frustrating and time consuming. They therefore prefer to use the services of a project manager.

**Do not underestimate the time and effort involved in managing a building project yourself.**

One of the biggest considerations in making the decision of whether to engage a project manager is cost. However, although you may save some money on project management fees by managing the project yourself, these fees are often money very well spent. Using a professional project manager may actually save you a considerable amount in the long run (especially if you do not have a good understanding of the building industry).



Furthermore, remember it is not only the direct cost you need to consider – your time also has a value.

The time you spend trying to manage a project may be able to be better spent elsewhere – for example, working extra hours to earn extra income to pay for your new home!

## 2.3.5 Step 5: Choosing the Builder

Whether or not you carry out this step yourself depends on what approach you took to project management in Step 4.

If you are not the project manager, depending on your arrangement with the project manager, it is quite likely that they will select the builder and tradespeople themselves.

If you are personally going to act as the project manager, you will need to choose your builder. To do this, **ask for recommendations** from other people who have recently had building work performed.

Based on this feedback, and on your research regarding other builders available, **prepare a shortlist of builders** to approach for quotes. When you do this, make sure the builders are confident that they can perform the work within your required timeframes. Also **be clear on what work tasks** you actually want to contract them for.

There are three main types of contracts you can have with a builder:

**1. A Full Contract:**

Under a full contract, the builder becomes the main contractor and is responsible for subcontractors. Their quote should include the following tasks:

- ☑ Supplying all the materials.
- ☑ Hiring subcontractors such as the plumber, electrician and interior decorator

- ☑ Getting consents.
- ☑ Liaison with the ***architect*** / designer.
- ☑ Health and safety on the building site.
- ☑ Arranging inspections by the Council inspector.
- ☑ Managing the building phase.

## 2. A Labour-Only Contract:

Under this type of contract, the builder is only responsible for the building. The remaining tasks, including supplying of materials, hiring of subcontractors and health and safety on the building site, remain your responsibility (or that of the project manager).

If you use this type of contract, it is best to try to secure a set price, instead of an hourly rate. This is so that you know exactly how much it will cost and so that the builder has more incentive to get the work done within a reasonable timeframe (as they will not want to exceed the hours allocated).

## 3. A Managed Labour-Only Contract:

This is part-way between a full contract and a labour-only contract. You will decide with the builder who is responsible for what. If you use this approach, you need to be very clear from the start as to what the builder is and is not responsible for. This is essential for a good working relationship.

Unless you choose the full-contract option, it is likely that you will then be responsible for also contracting all other tradespeople. This includes painters, plasterers, plumbers and electricians (for example).

Before you ask a builder to supply a quote, decide which approach you want to take so that you can ask all builders to quote on the same basis.

**This will make it easier for you to compare quotes.**

**When choosing a builder, take into account the following factors:**

- **Price:**

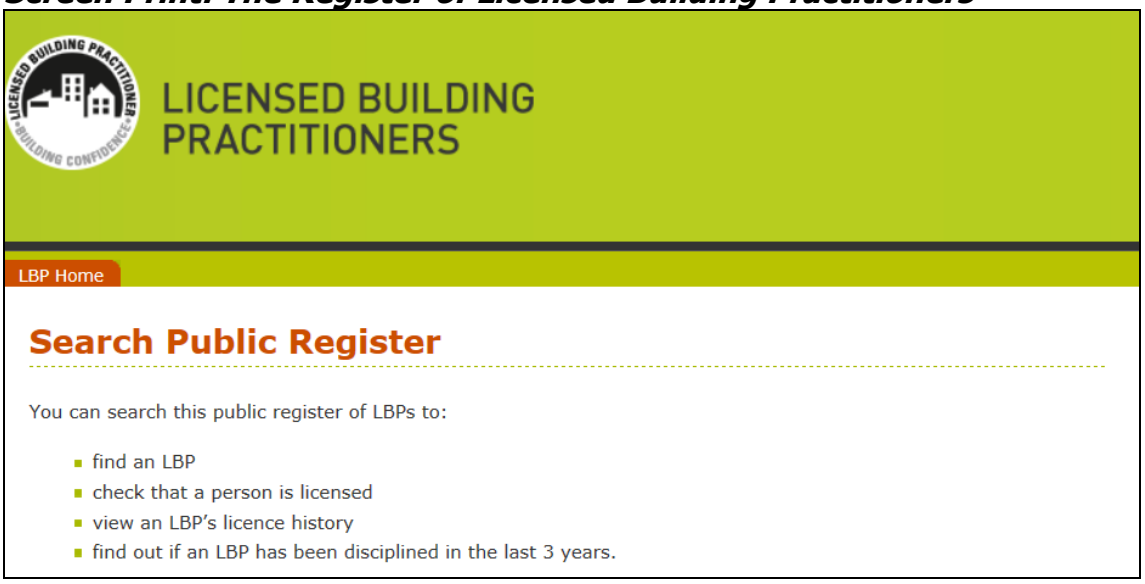
  Do not automatically choose the cheapest option. If one builder is much cheaper than the others, this does not necessarily mean that they can do the job to the standard you want at a lower price.

  Instead, it may mean that they are forced to cut costs along the way. Or they may need to revise the price throughout the job by, for example, bringing to your attention 'extra and unexpected' costs that have arisen. Expect to pay a fair price for the job.

- **Qualifications and Licensing:**

  Find out what qualifications they have and check the register of licensed practitioners, available on the ***Building and Housing Group*** website at http://www.dbh.govt.nz/lbp-register to see if they are licensed.

***Screen Print: The Register of Licensed Building Practitioners***[27]




- **Guarantee:**

  Ask if they offer a guarantee and, if so, find out the details of this guarantee.

[27] Retrieved 27 September, 2013, from http://lbp.dbh.govt.nz/publicregister/search.aspx

- **Examples of their Work:**

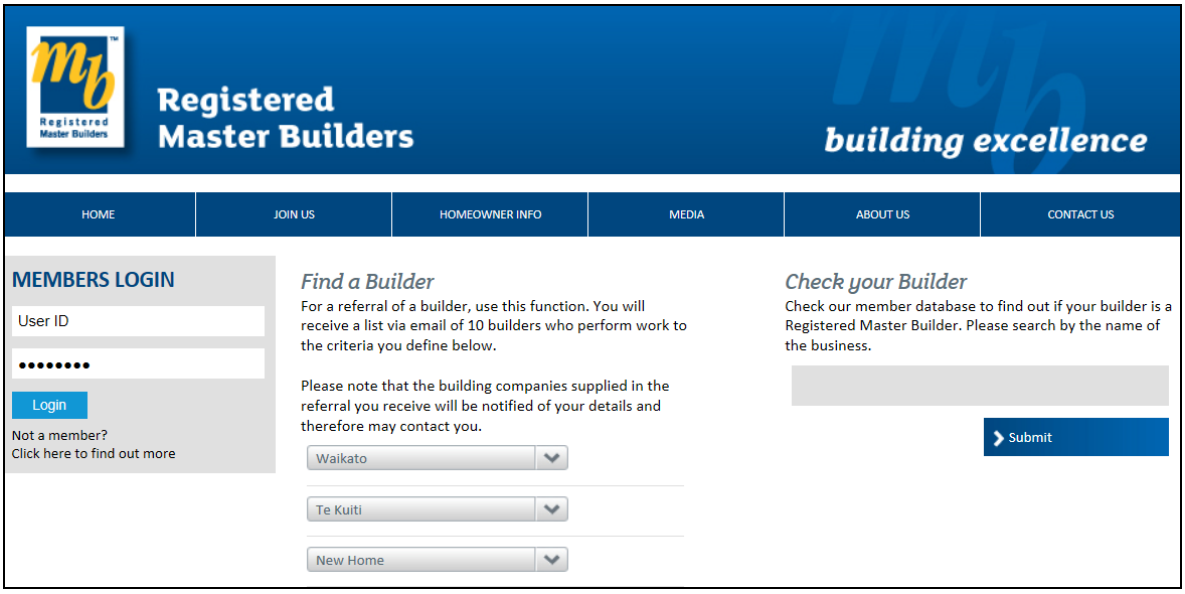
  Ask the builder for references. If they are able to supply them, meet with these people and ask about their experiences with the builder in regards to skill, honesty and integrity, communication, costs and ability to work within the timeframes required. If you can, also personally view the work performed.

- **Membership of Trade Organisations:**

  There are benefits to selecting builders who are members of reputable trade organisations such as the Registered Master Builders Federation (www.masterbuilder.org.nz) or the New Zealand Certified Builders Association (www.certified.co.nz). One of the main benefits of these organisations is that they provide a guarantee on the work performed by member builders.

  To ensure that you get a builder who is a member of a trade organisation, use the 'search' function on the organisation's website to locate a builder in your area. The following screen print shows the 'Find a Builder' function on the Registered Master Builders Federation website. This function allows you to specify your location and the type of work you want carried out. It then provides you with a list of builders who are able to do that work for you.

***Screen Print: The 'Find a Builder' Function on the Registered Master Builders Federation Website[28]***




[28] Retrieved 30 September, 2013, from http://www.masterbuilder.org.nz/find-a-builder.aspx

## 2.3.6 Step 6: Organising the Contract

This step refers to organising the contract with your builder and other tradespeople (if applicable). Again, whether or not you carry out this step yourself depends on what approach you took to project management in Step 4.

As mentioned in Step 5, there are three main types of contracts that you can have with a builder:

1. A full contract.
2. A labour-only contract.
3. A managed labour-only contract.

If you choose a full contract, the builder will be responsible for organising contracts with all subcontractors.

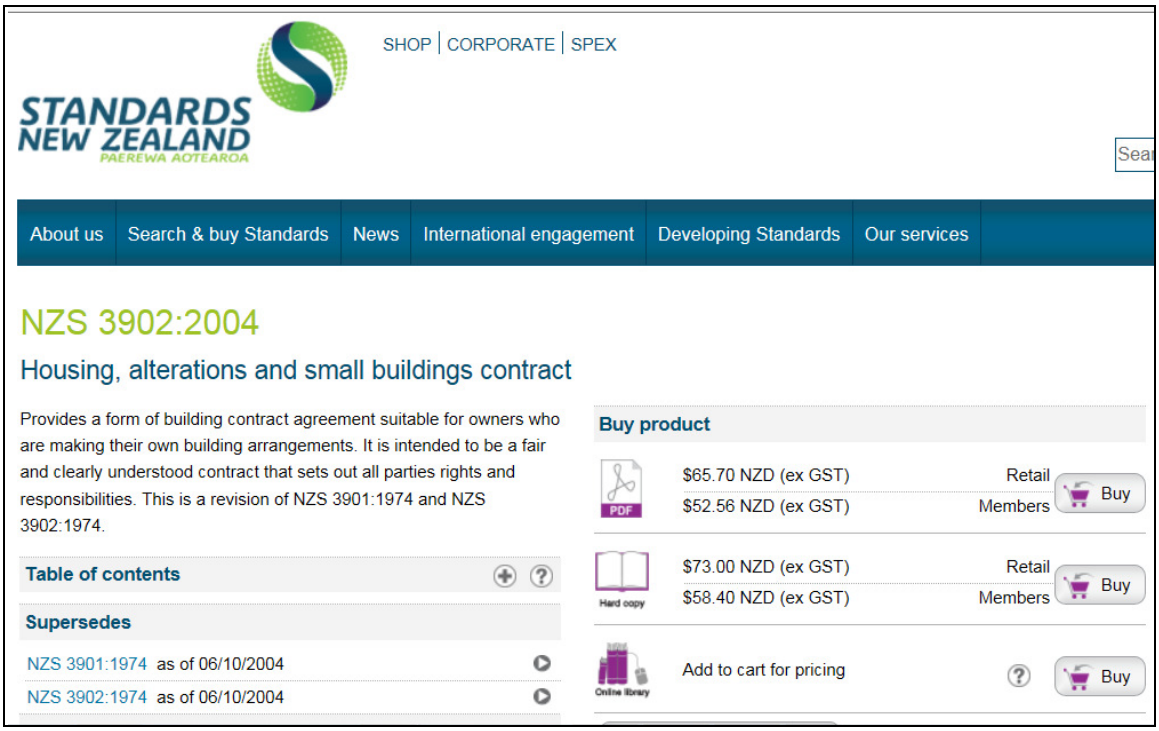
Although a building contract does not have to be in writing in order to be legally enforceable, putting it in writing is definitely the best way to go.

This way, if things do not go right, it is clear as to who was responsible for what (provided that you made it clear in the contract!).

In regards to developing a contract, it is a good idea to use the New Zealand standard contract that has been independently developed by Standards New Zealand. This contract, called the **NZS 3902:2004 House Building Contract**, is available for purchase on www.standards.co.nz. (Refer to the screen print on the following page).

Alternatively, your builder may have their own form of contract that they prefer to use. If so, it is a good idea to still purchase the New Zealand standard contract just so that you can compare this to your builder's own contract to make sure it is fair and reasonable.

***Screen Print: The New Zealand Standard Building Contract Available on the Standards New Zealand Website[29]***




Other standard contracts are also available from:

- Certified Builders Association of New Zealand (CBANZ).
- Registered Master Builders Federation (RMBF).
- NZ Institute of Architects (NZIA).

The CBANZ and RMBF standard contracts are only available to members of these organisations, but the NZIA contract is available for general public purchase.

[29] Retrieved 27 September, 2013, from http://www.standards.co.nz/web-shop/?action=viewSearchProduct&mod=catalog&pid=3902%3A2004%28NZS%29&searchId=1546551&searchOrderingIndex=1&searchSessionId=22C14D1586468CB02DA014AFB264596E

## The Content of a Contract

Make sure that your contract with your builder covers the following points[30]:

- ☑ What the project includes and the work that is to be done.
- ☑ The schedule for the work and what happens if there are delays (e.g. you may negotiate penalties for delays).
- ☑ The payment schedule – how much you will pay and when.
- ☑ Who is responsible for what.
- ☑ Details of the builder's insurance and guarantees, including the fixing of defects and damage caused during building.
- ☑ How disputes will be managed.
- ☑ Who pays for building fees and consents.
- ☑ How changes and variations to the contract will be managed.
- ☑ What happens if costs go up.
- ☑ A requirement to leave the site neat and tidy on completion.
- ☑ A definition of 'practical completion' of the job.
- ☑ The retention amount that is withheld until the work is completed.

***Discussion Question:***

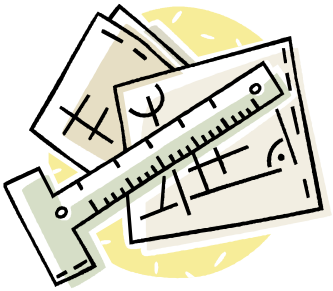
What else do you think should be covered within a building contract?

[30] National Bank. *Finalising the Building Contract.* Retrieved 23 May, 2009, from http://www.homebuyerscentre.co.nz/building/content.aspx?PostingID=295.

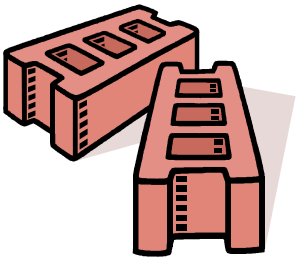
## Warranties

Under legislation, workmanship on homes is automatically covered by ***warranties***, regardless of whether these warranties are written into the contract. Furthermore, a contract cannot be changed so that the warranties do not apply (i.e. a builder cannot 'contract out' of them).

These warranties are outlined in Section 397 of the *Building Act 2004* and are as follows:



- That the building work will be carried out:
  - In a **proper and competent manner**, and
  - In **accordance with the plans** and specifications set out in the contract, and
  - In accordance with the relevant **building consent**.



- That all **materials** to be supplied for use in the building work:
  - Will be **suitable** for the purpose for which they will be used, and
  - Unless otherwise stated in the contract, will be **new**.

- That the building work will be carried out in accordance with, and will comply with, all **laws and legal requirements**, including, without limitation the *Building Act 2004* and regulations.

- That the building work will:
  - Be carried out with reasonable **care and skill**, and
  - Be **completed by the date** (or within the period) specified in the contract or, if no date or period is so specified, within a reasonable time.

- That the household unit, if it is to be occupied on completion of building work, will be **suitable for occupation** on completion of that building work.

- If the contract states the particular purpose for which the building work is required, or the result that the owner wishes the building work to achieve, that the building work and any materials used will:
  - Be reasonably fit for that purpose, or
  - Be of such a nature and quality that they might reasonably be expected to achieve that result.

## 2.3.7 Step 7: Building and Resource Consents

Under the *Building Act 2004*, if you are planning to build a new house or do alterations to an existing house, you must get a ***building consent*** before construction begins (unless the particular work is ***exempt*** from this requirement).

Building consents are issued by ***Building Consent Authorities*** (***BCAs***). All local Councils are BCAs, however, private building certifiers can also apply for registration to become a BCA.

Examples of some of the types of work that are ***exempt*** (and therefore do not need a building consent) include:

- **Retaining walls** up to 1.5 metres in height, providing they are not carrying any load other than the ground.

- **Garden sheds** that only have one level (e.g. are not 2 storey or more), are less than 10 square metres in floor area, and do not include any sanitary facilities or facilities for the storage of drinking water, and are not positioned any closer than the shed's own height to a boundary.

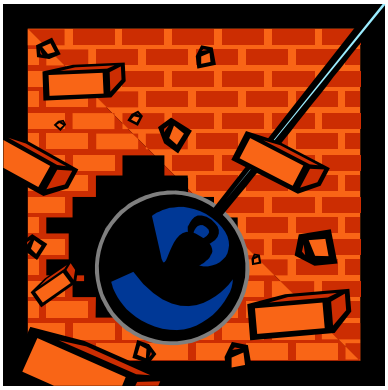
- Closing in an existing **veranda or patio** where the floor area does not exceed five square metres.

- Construction, alteration or removal of an **internal wall** of an existing building, but only if structural stability is not reduced, the means of fire escape is not affected, or the wall is not made of bricks or concrete blocks mortared together.

Thus, construction of a new house certainly does **NOT** fall within the 'exempt' category!

If you do not get a building consent before commencing construction, you will be committing an offence under the *Building Act 2004* and may be liable for a fine of up to $100,000, plus up to $10,000 for each day the offence continues[31].

If it is found that you do not have building consent for work, the BCA could possibly make you pull something down or make changes to work conducted, depending on whether it is dangerous or unsanitary.



**Applying for a Building Consent**

Although you are responsible as the owner of a property to apply for a building consent, this is usually a task that your project manager does. Application forms are available from your local council office or possibly via their website.

In addition to filling out the form, you are usually required to supply the following information, **amongst other details**:

- The ***Title*** for the land (or a copy of the Sale and Purchase Agreement if you have only just bought the land and do not yet have the Title).
- Specifications which clearly describe the materials to be used.
- A description of your intended inspections of the work in progress.
- Engineers' reports and calculations.
- Water supply details.

[31] Ministry of Business, Innovation and Employment. *Penalties*. Retrieved 1 October, 2013, from http://www.dbh.govt.nz/bomd-penalties

- Site plans.
- Foundation plans.
- Drainage plans.
- Floor plans.
- Bracing plans showing detail of the wall layout with windows, doors, roof layout, bracing type, etc.

- Elevations showing, for example, accurate ground lines and floor levels in relation to finished ground levels.

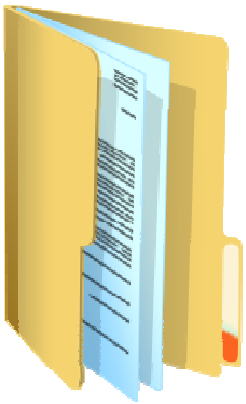
The BCA will look at your application and the information you supply to see if the proposed house complies with the ***Building Code***.

Thus, if you are putting in the application yourself (which you may need to do if you do not appoint a project manager), you will need to ensure you are familiar with the Building Code.

After issuing a building consent, the BCA will inspect the building work at specific stages throughout the building process.

They will be checking to make sure the building work complies with the building consent. It is your responsibility (or the responsibility of your project manager) to let the BCA know when these stages have been reached.

Before applying for a building consent, it is a good idea to get a ***Project Information Memorandum (PIM)***.



A PIM is similar to a Land Information Memorandum (***LIM***), and is also issued by local authorities. But, unlike a LIM, it only contains information about a site that is specifically relevant to a building project.

It does NOT include information about the land in general. For example, a PIM may provide details of water and waste systems on a site and permitted points at which a footpath may be crossed.

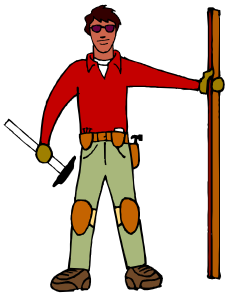
Although a PIM is a legal requirement that will be issued with the Building Consent, **it is a good idea to get it earlier**. The reason for this is simply because information within the PIM may identify problems that could prevent the Building Consent from being approved.

**Resource Consents**

Under the *Resource Management Act 1991,* all councils have to prepare regional, city or district plans that show how they will manage the environment in their area.

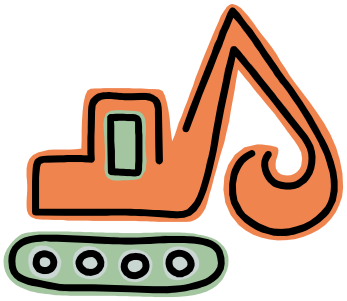
If you want to do something on your land that is not provided for under these plans, you will need to apply for ***resource consent***. In doing this, you will be required to provide an assessment of the potential environmental effects of your project.

When preparing your plans, your designer should be able to advise you if anything you intend to do will require resource consent.



- A common example, of something that may require resource consent when building a house, is an intention to situate the house closer to your boundary than the district plan allows.

- Another example is a house which has foundations that require major earthworks.



Depending on the nature of what you want to do, the resource consent application process may be non-notified, limited notified or publicly notified:

- **Non-notified** means that the process will not involve the public.
- **Limited notified** means that the process may involve seeking input (submissions) from a few members of the public – typically close neighbours who may be affected by your plans.
- **Publicly notified** means that the process will involve inviting submissions from the general public. This is done if the council considers that the potential environmental impact of your proposed building work will be more than minor.

### 2.3.8 Step 8: Construction

The usual order of activities involved in building a house is as follows[32]:

1. Excavate the section and lay the foundations.
2. Pour concrete floors.
3. Construct the framing.
4. Put the roof on.
5. Mount the windows.
6. Put on the exterior cladding.

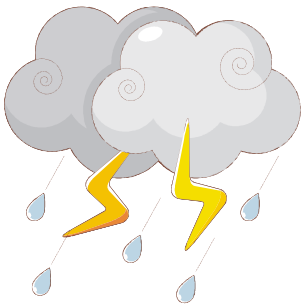
[32] Consumer Build. *Monitoring Progress.* Retrieved 24 May, 2009, from http://www.consumerbuild.org.nz/publish/phase/buildingphase-monitoring.php

7. Organise plumbing and wiring.
8. Fit insulation.
9. Put in doors.
10. Install cabinets and interior lining.
11. Tile floors and walls.
12. Carry out final plumbing and electrical work.
13. Paint the house and complete any finishing work.
14. Lay the floor coverings.

Throughout this process you will need to pay the builder ***progress payments*** as per the progress payment schedule agreed to in your contract.

Although an 'average' house can often be built within 12 weeks, there are plenty of reasons why it may take longer than this.

For example, there are a number of different parties involved in the process, from site excavators and plumbers, to bricklayers and roofers. If there is a shortage of skilled tradespeople in your area at the time you want to build, your project may be delayed while you wait for the availability of these people.



Other factors such as bad weather and delays in the availability of supplies can also extend timeframes.

So whilst your builder should have an estimate of the expected building timeframe within the contract, there may be delays caused by factors outside of their control.

If you are the project manager, you will need to oversee and inspect construction work. The ***BCA*** (this is the ***Building Consent Authority***), will also be inspecting work done to ensure it complies with the original plans and specifications for which the Building Consent was issued.

***Discussion Question:***

What do you think the duties of a Project Manager would be during the construction stage?

## 2.3.9 Step 9: Upon Completion

Once the house is complete, you will need to advise the ***BCA*** so that they can make a final inspection of the house and you can then apply for a **Code Compliance Certificate**.

If the BCA finds that the work completed does not comply with the original building consent issued, they may choose to issue a 'Notice to Fix' outlining changes / corrections to be made. The BCA will then only issue a Code Compliance Certificate once instructions outlined in the Notice to Fix are complied with.

**Obtaining a Code Compliance Certificate is important for several reasons:**

- Firstly, it is likely to be a condition of the final drawdown from your mortgage being released – your lender needs to know that the house has been properly built before they give you the money to make your final payment to the builder.

- Secondly, if you later try to sell the house, having a Code Compliance Certificate is likely to be a condition of the sale.

- Thirdly, getting this certificate gives you peace of mind that your house meets certain quality and safety standards.

If you do not apply for the Code Compliance Certificate within two years of the Building Consent being issued, the BCA is likely to follow up with you to get this done.

.... And of course, following completion of the actual house, the next thing to think about is **landscaping**!

# Section 3

# Mortgages

# 3.0 Mortgages

Buying a house will most likely be one of the biggest purchases you will ever make in your lifetime and for the majority of us that means having to borrow money from a lender.

The term '***mortgage***' is commonly used to describe the money you borrow to buy your home. However, technically, a mortgage is actually the legal agreement that gives a lender security over your property. The actual debt is a 'home loan'. However, the term 'mortgage' is used more often in this module (instead of 'home loan') as this is a word that most people are familiar with.

The legal documentation (the paperwork!) for having a mortgage will refer to you, the borrower, as the ***mortgagor*** and to the lender as the ***mortgagee***.

Another important part of understanding mortgages is knowing what is meant by the words ***mortgage principal***, ***term of a mortgage*** and ***interest payable***.

- ***Mortgage principal*** means the actual amount of money that you borrow from a lender for your home, such as $200,000.

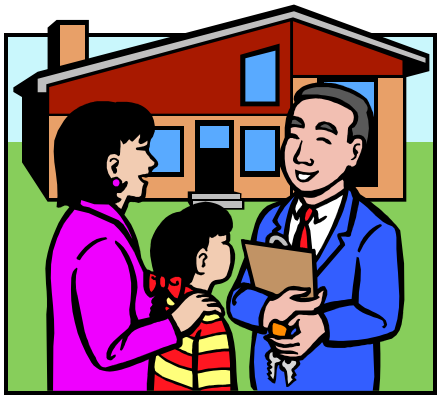
- The ***term of a mortgage*** refers to how long you decide to take to pay your mortgage off. For example, you may decide to choose 25 years as the term of your mortgage.

- The ***interest payable*** is the interest that you will have to pay to the lender on top of the actual principal that you have borrowed. For example you may get a mortgage from Lender X for $150,000 which has an interest rate of 10% and the interest payable will be the amount you pay in interest on the principal over the term of the mortgage.

## 3.1 Types of Mortgages

When you decide to go ahead and get a mortgage to purchase a house, there are a number of different options that you should take into consideration. You need to be able to select the type of mortgage that will best suit your circumstances.

Some of the relevant factors that influence the type of mortgage you should have include:



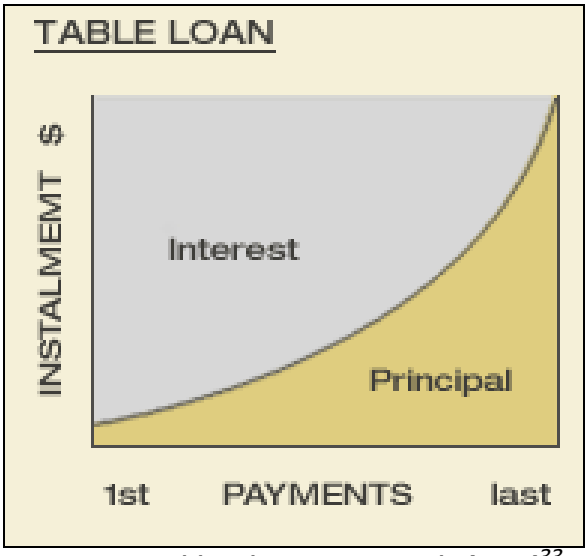
- How old you are.
- How much you intend to borrow.
- The timeframe in which you want to pay your mortgage off.
- The amount of your income.
- When you receive your income (for example, weekly, fortnightly, monthly).
- Whether you are buying the house as a financial investment that you intend to sell after a period of time.
- Your ability to stick to a budget and control your mortgage payments.
- Whether you are self-employed.
- The number of dependents you are supporting.

In this sub-section, we will look at the various types of mortgages available, as well as how the ***term of the mortgage*** and the amount of the ***mortgage principal*** will impact on the interest you will have to pay over the time you have the mortgage for.

There are also different types of interest rates that you can choose for your mortgage – this will be discussed in Section 3.2. For now, to help keep things clearer for the following examples, **we will assume that interest rates do not change over the term of the mortgage**.

## 3.1.1 Table Mortgage

A ***table mortgage*** is one where
the mortgage repayments you make **do not change**
over the life of the mortgage.




*Source: Auckland Savings Bank (ASB)*[33]

**Key Points**

- Part of your regular payment goes towards paying off the ***principal*** and part goes towards paying off the interest.
- You can choose a term of up to 30 years with most lenders.
- A table mortgage is the most common form of mortgage in New Zealand.

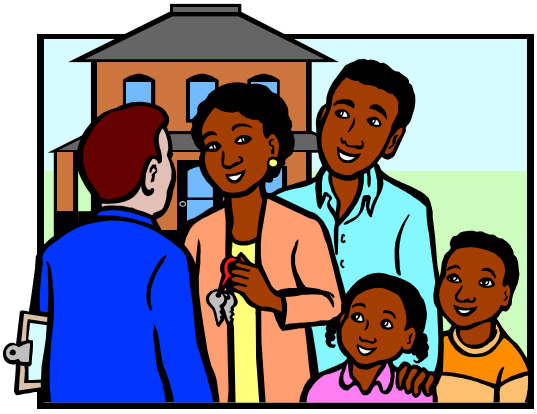
- As the graph shows, your early mortgage repayments are mainly made up of interest, with a small amount of principal.
- This ratio changes as you pay off your mortgage, so that your last repayments are mainly principal, with a small amount of interest.

[33] Auckland Savings Bank. Retrieved 20 September, 2013, from https://www.asb.co.nz/personal/home-loans/types-of-home-loans/table .

### *Table Mortgage Example*

Pita (33) and Deda (35) have found a family home for themselves and their two children (aged 6 and 8).

Pita has permanent full-time work and is on a monthly salary. In addition, Deda earns $200 each school week from the teacher aide job she has at her children's school. The children are growing fast and it seems there is always one bill or another to pay, from their sports fees to new school uniforms. Deda's income is almost always completely used to pay for these bills.



- Pita and Deda purchase the house for $306,250.
- They have a deposit of $61,250 which leaves $245,000 which they borrow from their bank at an interest rate of 6.45% per annum (pa).
- Pita and Deda want to pay off their mortgage before they reach 55, so they decide the term of their home loan will be 20 years.

Given their personal circumstances, Pita and Deda decide the best thing to do is to repay their mortgage with a *set monthly amount,* which will be deducted automatically from Pita's monthly salary.

**Thus, the ideal mortgage for this family is a table mortgage**.

To work out what their regular mortgage payment will be, Pita and Deda need to put their information into a mortgage repayment calculator, which can be found on most banks' websites and also on a range of other financial websites such as www.sorted.org.nz and www.loanhub.co.nz.

They decide to use the mortgage calculator on the BNZ website. When they enter in the details of the mortgage and press the 'calculate' button, the result is as follows:

- For a loan amount of $245,000 over 20 years at an interest rate of 6.45% pa, **their monthly payment is $1,819.45 per month**.

This is shown on the following screen print:

***Bank of New Zealand Mortgage Repayment Calculator***[34]

**What will my home loan repayments be?**

| | |
|---|---|
| Amount of loan | $ 245,000.00 |
| Interest rate p.a. | 6.45 |
| Repayment frequency | Monthly |
| Length of loan | 20 years |

Your monthly repayments would be **$1,819.45**

Pita and Deda will need to pay $1,819.45 every month for the next 20 years. This means they will pay a total of $436,668.

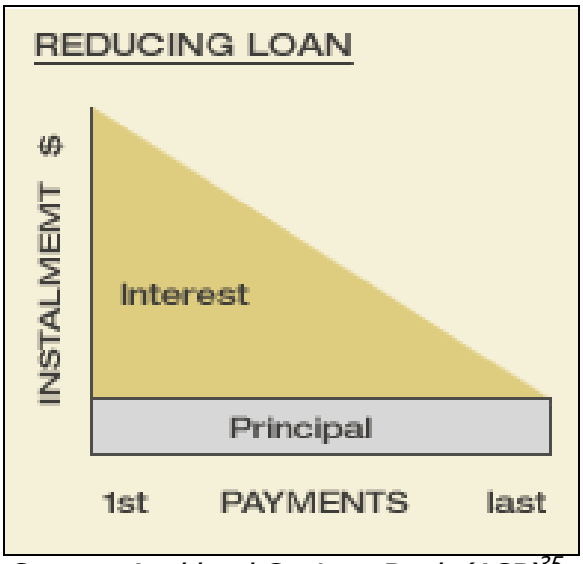
| | | | | |
|---|---|---|---|---|
| **Total Amount Paid** | **=** | **Monthly Amount x 12 months x 20 years** | | |
| | = | $1,819.45 | x 12 | x 20 |
| | = | $436,668 | | |

Remember that the original amount they borrowed was only $245,000. This means that the interest alone over the next 20 years will be $191,668 – over 75% of the amount of the original loan!

[34] Bank of New Zealand. Retrieved 27 September, 2013, from https://www.bnz.co.nz/personal-banking/home-loans/mortgage-calculators/what-will-my-home-loan-repayments-be

## 3.1.2 Reducing Mortgage

A ***reducing mortgage*** is one where
the mortgage repayments you make **decrease**
over the life of the mortgage.




*Source: Auckland Savings Bank (ASB)*[35]

**Key Points**

- The amount of the principal you pay in each payment remains the same.
- The amount of interest you pay in each payment reduces because the amount of principal you owe gets less.
- Therefore, the amount of each payment changes – it decreases with each payment.
- The least common form of mortgage in New Zealand.

If you have a reducing mortgage:

- every repayment period you make a payment of an agreed amount of principal (perhaps $1,800 each month – depending on what you can afford); AND
- you also make an interest payment which is based on how much principal you still owe.

This type of mortgage suits people who know they are going to have high income for a period of time but then expect their income to fall.

[35] Auckland Savings Bank. Retrieved 29 September, 2013, from https://www.asb.co.nz/Personal/Home-Loans/Types-of-home-loans/Reducing

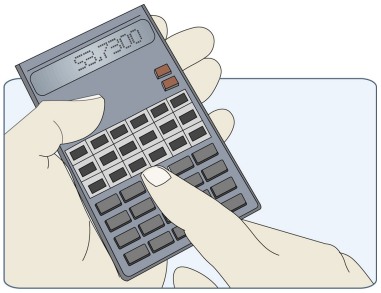
***Reducing Mortgage Example***

Ra (25) and Ariana (22) have been partners for a couple of years. Ra and Ariana have both recently graduated from university and do not have much work experience. They are therefore very happy when they both manage to secure excellent jobs on great salaries.

Ra and Ariana have talked about the future and have goals in mind of buying a house and starting a family. Ariana is keen to progress her career and doesn't want to start a family until she is around 30. Also, when she has children (they want two) Ariana would like to be a 'stay at home Mum' for at least the first 3 years of the children's lives.

- Ra and Ariana have found a wonderful little flat that they have set their hearts on buying and purchase the property for $315,000.
- They have a deposit of $63,000 (part of which was gifted to them by Ra's grandmother).
- They borrow the remaining $252,000 from the bank at 8% interest per annum (pa) over a 10 year period.

Ra and Ariana want to pay off more of their mortgage in the next 8 years while they are both on good incomes. Then, when the children 'arrive', they want to have lower mortgage payments, as they plan to be living on only Ra's salary for a few years.




Given their personal circumstances, Ra and Ariana decide that a reducing mortgage is the ideal type of mortgage for them. They are both paid fortnightly, so fortnightly payments would suit them best.

Based on their income and expenses, they decide that their regular fortnightly principal repayment will be $1,000.

With a reducing mortgage, the payment made each period (in this instance, fortnightly) will be different depending on how much principal has been paid off to date. This makes it difficult for Ra and Ariana to know the exact amount of their mortgage repayment each time, but they can make an estimate!

For instance, the first payment will be approximately $1,775. This includes the $1,000 fortnightly payment plus an interest payment of around $775. The interest payment can be *estimated* as follows:

| | | |
|---|---|---|
| **Estimate of 1st Interest Payment** | **=** | **Principal Owing x Interest Rate / 26** |
| **In Year 1** | = | $252,000 x 8% / 26 |
| | = | $20,160 / 26 (i.e. there are 26 fortnights in a year) |
| | = | $775.38 |

Note that this **will not** be the exact amount of interest as there are not exactly 26 fortnights per year (i.e. 26 x 14 days = 364 days, not 365 days) and interest is likely to be ***compounded*** daily. However, these calculations produce a very close estimate.

**Now we will compare this first payment amount to payments at later dates.**

**Let's say it is now the end of Year 3 of Ra and Ariana's mortgage.**

- So far, they have paid off $78,000 of the mortgage principal (3 years x 26 fortnights = 78 payments of $1000 principal payment).
- This means at the end of Year 3 their mortgage principal is $174,000 ($252,000 - $78,000 = $174,000).

For the first fortnightly payment in Year 4, the interest part of the mortgage payment would have reduced to $535.38. This calculation is shown below.

| | | |
|---|---|---|
| **Estimate of 1st Interest Payment In Year 4** | = | **Principal Owing x Interest Rate / 26** |
| | = | $174,000 x 8% / 26 |
| | = | $13,920 / 26 |
| | = | $535.38 |

- Thus the mortgage payment would be $1,000 (the principal repayment) plus $535.38 (the interest repayment) giving a total of **$1,535.38**.

**What about the 2nd Interest Payment in Year 4?**

Now, a total of $79,000 would have been paid off the mortgage principal, leaving $173,000 mortgage principal owing.

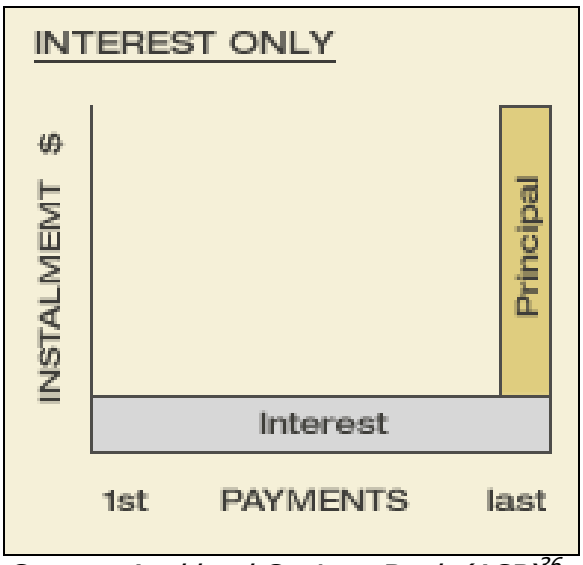
| | | |
|---|---|---|
| **Estimate of 2nd Interest Payment In Year 4** | = | **Principal Owing x Interest Rate / 26** |
| | = | $173,000 x 8% / 26 |
| | = | $13,840 / 26 |
| | = | $532.31 |

- Thus the mortgage payment would be $1,000 (the principal repayment) plus $532.31 (the interest repayment) giving a total of **$1,532.31**.
- This is **$3.07 less** than the payment made the previous fortnight.

This is just a brief example to show how the calculations for a reducing mortgage work, but this is something that your lender will work out for you automatically each payment period (phew!).

## 3.1.3 Interest-Only Mortgage

An ***interest-only mortgage*** is one where
**no** principal repayments are made
until the end of the mortgage.




*Source: Auckland Savings Bank (ASB)*[36]

**Key Points**

- As the name suggests, you only pay interest during the term of the mortgage.
- The principal is repaid in one lump sum at the end of the term. The final interest payment is also paid at this time.
- If the interest rate stays the same, the amount of interest you pay in each payment stays the same.

If you have an interest-only mortgage, you need to find a way to repay the principal in one lump sum at the end of the term. Common ways of finding the money to do this include:

- Selling the house.
- Agreeing with your lender to 'roll the loan over' for another period.
- ***Refinancing*** with another lender (getting a mortgage from someone else).

[36] Auckland Savings Bank. Retrieved 29 September, 2013, from https://www.asb.co.nz/Personal/Home-Loans/Types-of-home-loans/Interest-only

Depending on your circumstances, this type of mortgage is less commonly offered by lenders. The reason for this is that lenders would rather see you reduce the amount you owe every repayment period. As such, some lenders will offer a loan that is initially interest-only for a short period of time (perhaps 1 or 2 years), but then converts to a ***table mortgage***.

Interest-only mortgages are more commonly used when buying a house:

- for investment purposes (i.e. to be used as a rental house), AND
- that you intend to sell in the near future,

than if buying a house as a permanent home.

This is because the owners do not mind if they need to sell the house to get the money in order to repay the mortgage principal.

The idea is that, hopefully, the value of the house will be higher when it is sold, so they will make a profit when they sell. In other words:

(Sale Price + Rent Received) – (Purchase Price + Interest and Expenses Paid)

= Profit (hopefully!)

Some investors like interest-only mortgages as they:

- help their cashflow situation in the short-term, and / or
- enable them to borrow a larger amount of money.

That is, as the investor only has to meet interest payments, they can buy higher value properties or more properties than they otherwise would. Alternatively, they could use the extra money for renovations or other purposes.

However, with an interest-only mortgage, the principal is not actually decreasing, so...

**the amount of interest paid in the long term is MORE than what is paid with other forms of mortgages.**

This is one reason why using interest-only mortgages is not necessarily the best option for investors.

Another reason why using an interest-only mortgage may not be a good idea relates to the fact that you need to be able to pay the mortgage off in full at the end of the period. Unless you have an arrangement with your lender to convert the mortgage to another type of mortgage, this could be a problem.

The most common way to pay out an interest-only mortgage is to sell the property (or another property).

However, it may not be the best time to do so – if the market is low, you may not be able to get what you had hoped for the property.

Similarly, if there is little interest in your house, you may need to sell it for less than what you intended just to be able to get the money in time to repay the mortgage. This means that it is possible that you may get less than what you paid for the house and be left with money owing!

A third reason why an interest-only mortgage may not be good for you is that you may change your mind and decide that you do not want to sell the property.

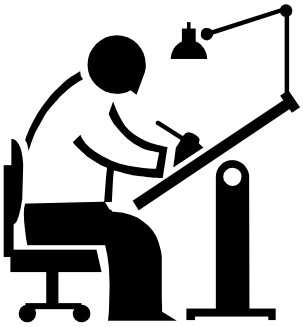
For instance, you may find that you get really good rental income from the property. However, if you cannot arrange further finance, you could be forced to sell.

***Interest-Only Mortgage Example:***

Patrick is a solo Dad who has the day-to-day care of his 2 children, Willy, aged 7, and Angela, 12. He is self-employed as a Graphic Designer.

Patrick, age 40, decides it is time for his family to move out of their small rented flat and buy a house which has a separate sleep-out (or something like this), from which he can run his business.

One weekend, while doing the 'open home' rounds, Patrick spots a great house and puts an offer in of $280,000 subject to finance. He has $60,000 tucked away in a savings account for a deposit.



However, Patrick has not had much work in the last 6 months due to a downturn in the industry. He intends to expand his range of services after the house move to get over this problem.

In addition, he has scoped out a couple of potential new clients – large businesses who are looking at outsourcing their graphic design needs.

When chatting to a mortgage broker, who specialises in advising on mortgages for the self-employed, Patrick is told that Lender Y is offering 2 year interest-only mortgages, converting to a table mortgage in Year 3. The current interest rate is 5.8% per annum.

Given his personal circumstances, Patrick decides that an interest-only mortgage is the ideal type of mortgage for him at this time. The main reason is that he may only be able to make small repayments in the short term. Patrick is confident that his business will pick up, and that converting to a table mortgage in Year 3 will not be a problem.

As he would like to have the house paid off by the time he is 65 years old, Patrick chooses a 25-year term for his mortgage. He also chooses to make weekly repayments.

Patrick can estimate his Year 1 and 2 weekly payments in the following way:

| | | |
|---|---|---|
| **Estimate of Interest Payments In Years 1 & 2** | = | **Principal Owing x Interest Rate / 52 weeks** |
| | = | $220,000 x 5.8% / 52 |
| | = | $12,760 / 52 |
| | = | $245.38 |

As the weekly repayments for the first two years (104 weeks) are based *only* on the interest, Patrick's weekly payments for this period of the mortgage will be approximately $245.38. Note that, while payments will be very close to this amount, it will not exactly be this amount due to factors such as the daily compounding of interest.

**TIP:**

To get a more accurate estimate of the interest payments, use the ***compound interest*** formula which was introduced in Module 1.

Note that it is likely that interest will compound daily.

At the end of Year 2, Patrick's mortgage converts to a table mortgage. To work out his repayments we will use one of the many table mortgage repayment calculators online. Remember the length of the loan is now only 23 years.

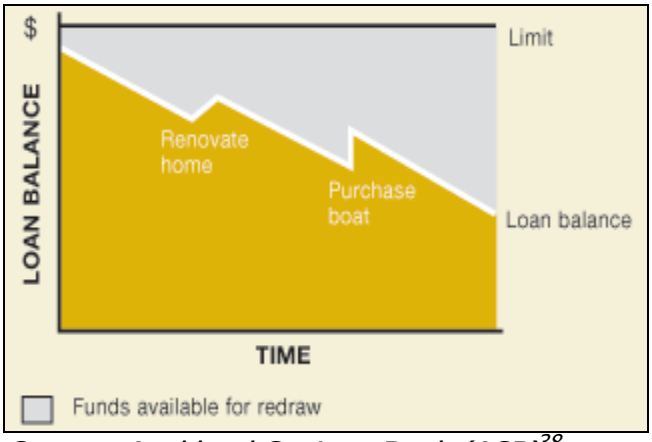
The calculator returns the following information: for a loan amount of $220,000 (the principal amount has not changed in the first 2 years) over 23 years at an interest rate of 5.8% p.a., the repayment amount is $333 per week[37].

As you can see, an interest-only mortgage has enabled Patrick to have a lower weekly repayment amount of $245.38 while he is growing his Graphic Design business. In Year 3, when Patrick is more financially stable, he will be able to afford the higher weekly repayment amount of $333.

[37] Retrieved 29 September, 2013, from http://www.sorted.org.nz/calculators/mortgage-repayments/

## 3.1.4 Line-Of-Credit / Revolving Credit Mortgage

A ***line-of-credit mortgage***, most commonly called by lenders a ***revolving credit mortgage*** is like a big ***overdraft*** which allows you to make payments of any size, whenever you like and also allows you to withdraw money whenever you like.




*Source: Auckland Savings Bank (ASB)*[38]

**Key Points**

- There is no set regular payment.
- You can withdraw money (up to a certain limit) from the account whenever you like.
- Now one of the most popular forms of mortgage in New Zealand.
- The interest rate which applies is always the bank's floating rate, which is usually higher than the fixed-term interest rate.

People often use their revolving credit mortgage as their main bank account. That is, they get their salaries and wages paid directly into it, and then use the account to pay their bills and general living expenses. They even have an eftpos card for this account – just like a normal ***transactional account***.

But unlike a normal account, because the account is like one big overdraft, when you check your account balance it will be a very large negative number! Maybe as much as -$200,000 or -$300,000!

[38] Auckland Savings Bank. Retrieved 29 September, 2013, from https://www.asb.co.nz/Personal/Home-Loans/Types-of-home-loans/Orbit

The main **advantages** of using a revolving credit mortgage account as your main bank account are that:

1. For the short time that your salary (or wages) is in the bank account, your interest payments will be slightly reduced.
2. Anything left over after paying all expenses is automatically put on your mortgage. This also reduces the amount of interest owing.

**Example**

So, for instance, assume you have $150,000 owing on your mortgage.

Now assume you are paid wages of $1000 into your bank account on a Wednesday, and then you pay $500 of bills on a Thursday and withdraw $100 spending money on a Saturday.

If you then do not receive, or withdraw, any more money until the next Wednesday:

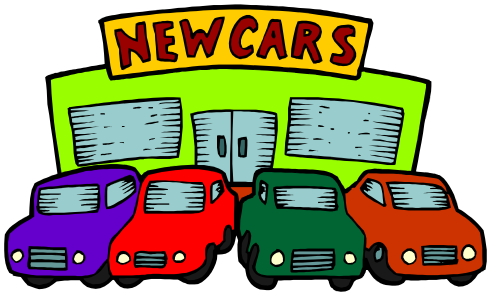
- On Wednesday, the amount of interest you owe will be calculated based on a balance of -$149,000.
- On Thursday and Friday, the amount of interest you owe will be calculated based on a balance of -$149,500.
- From Saturday through to Tuesday, the amount of interest you owe will be calculated based on a balance of -$149,600. In total, you will have paid $400 off your mortgage.

In comparison, if you instead had a different type of mortgage where you made a weekly payment of $400 per week on a Wednesday, you would be charged interest on a balance of -$149,600 for the entire week.

In addition, if you needed an extra $50 spending money – you would not have been able to get this.

**Another key advantage** of this type of mortgage is that, after paying off some of your balance, you have the freedom to draw money out again when you need it.

As shown in the example graph previously, you could use money from your mortgage to renovate the house or purchase a boat!




Therefore, if you really need a new car, you could simply withdraw from your revolving credit mortgage instead of getting vehicle finance.

This could even **save you money**, because the interest rate on your mortgage is likely to be much lower than the interest rate for vehicle finance.

**Who is a revolving credit mortgage suitable for?**

- A revolving credit mortgage particularly suits people with uneven incomes, since there are no fixed repayments (although sometimes there may be a minimum repayment over a certain period of time).

- It also suits people who expect they may be able to contribute lump sum payments towards their mortgage. This is because there are no penalties for paying the mortgage off faster than expected.

**Warning!**

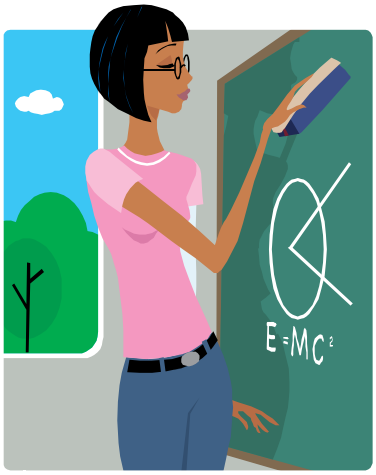
You do need to be very disciplined with your money to manage this type of mortgage. If you do not stick to a budget, and you instead spend up large whenever you feel like it, your mortgage will not decrease!

Instead, you may end up taking a lot longer to pay the mortgage off, and spend a LOT more in interest over this time.

There is another variation of a revolving credit mortgage available. Some lenders reduce the level of credit available over time, along with your ability to draw on it, until it is repaid. This is called a ***declining revolving credit facility***.

This variation of a line-of-credit mortgage can help you to be more disciplined in your repayments as it reduces the level up to which you can borrow.

***Revolving Credit Mortgage Example:***



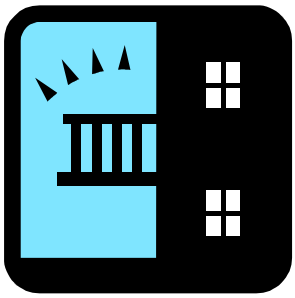

Kataraina is in her early thirties, independent with no children or current partner. She earns a fortnightly salary of $1,700 in her job as a school teacher at a Kaupapa Māori High School.

In addition, she does private science and maths tutoring on an irregular basis (she tends to do more in Term 4 when mainstream students are 'cramming' for their end of year exams).

Kataraina also has shares in a business which is expected to pay her lump sum dividends of approximately $10,000 (after-tax) twice a year.

Kataraina has only been back in New Zealand for a couple of years after working and travelling through Europe for five years. She is keen to do some more overseas travel, but she also wants to purchase some property and get her mortgage paid off as fast as she can.

Kataraina has a $53,750 deposit that she puts towards the purchase of her first home, which she has bought for $268,750. Kataraina acknowledges that her house is not 'top of the range', but she is happy because she thinks it is a good starting point.



She has set herself a goal of 10 years to pay her mortgage off, but is thinking of doing some renovations (like adding a deck on) perhaps in three or four years' time.

Given her personal circumstances, Kataraina decides to get a revolving credit mortgage of $215,000 for a ten year period.

- The current interest rate is 5.74% pa.

- Kataraina's fortnightly salary and occasional private tutoring fees go straight into her revolving credit bank account, which she uses not only for her mortgage, but also for her daily living expenses.

- Kataraina expects that, after paying all of her expenses and the interest on the principal, she will usually be contributing about $1,600 per month towards the mortgage.

- However, she will also be making lump sum payments of approximately $10,000 every six months.

- She will draw down up to $20,000 on her mortgage when she decides to do her renovations.

Kataraina had originally considered a mortgage option whereby she would only have to make regular monthly repayments of $1,600. However, she has decided that a revolving credit option whereby she can put her surplus funds (from tutoring and from dividends in the business) towards repaying her mortgage is better than putting these funds in a separate savings account.

In fact by doing this, Kataraina will:

- reduce the total interest she will pay on her mortgage, PLUS
- avoid paying tax on any savings account interest.

The balance of Kataraina's revolving credit mortgage account will change on a daily basis, depending on how much money she owes that day.

Accordingly, the amount of interest payable on the mortgage is calculated on a daily basis and can change substantially from day to day.

For the purpose of this example, let's take a 'day's snapshot' of how much interest Kataraina will pay.

On 9 March (3 months into her mortgage) Kataraina's balance in her revolving credit account is $212,000 overdrawn. That day, her fortnightly salary of $1,700 goes into her account, changing her balance to $210,300 overdrawn.

Assuming the interest rate is 5.74% at that time, interest charged on the mortgage on 9 March (for one day) will be calculated as follows:

| | | |
|---|---|---|
| **Estimate of Daily Interest Payable** | **=** | **Principal Owing x Interest Rate / 365 days** |
| | = | $210,300 x 5.74% / 365 |
| | = | $12,071.22 / 365 |
| | = | $33.07 |

For that one particular day, Kataraina will need to pay interest of $33.07. There is therefore an incentive for her to get her revolving credit balance as low as possible.

She can do this by reducing her living expenses and making an effort to leave more than the $1,600 each month (that she set for herself) in her account. If Kataraina does this, then the daily interest amount charged to the account will be lower as more and more of the principal amount borrowed gets reduced.

***Discussion Question:***

Why do you think revolving credit mortgages have become more popular in recent years?

## 3.1.5 Bridging Finance and Second Mortgages

***Bridging Finance*** is a short-term ***interest-only mortgage***
that lets you buy a new home
before you have sold your old home.

**Key Points:**

- Usually, the interest rates for bridging finance are higher than those for other types of mortgages (discussed previously).
- A fee of several hundred dollars may also apply.
- This type of finance is one which you do not want to have for very long, but, is there as a short-term measure so that you do not miss the opportunity to buy a particular house just because you haven't yet sold your existing home.

A ***Second Mortgage*** is a second home loan
***secured*** against your house,
usually from another lender.

**Key Points:**

- Some lenders will charge interest rates of one to three per cent higher than the first mortgage rate on the house, some charge the same.
- Most lenders prefer to take over your whole mortgage (and lend you more money) rather than offer a second mortgage.
- The only advantage of a second mortgage is that it can provide another source of cash (for renovations, for example) if your first mortgage lender will not allow you to extend your existing mortgage with them.

A ***second mortgage*** (or in fact extending your first mortgage) will only be possible if there is now more ***equity*** in your house. That is, your house will have more equity if the value of it has increased as a result of:

- changes in the property market over time (often over a period of years),
- improvements that you have made to it, or
- if you have repaid a reasonably large part of the principal on your original mortgage.

***Second Mortgage Example:***

In March 2012, Tevita, a keen DIY man, bought a house for $200,000 with a $40,000 deposit and a $160,000 mortgage from Lender A. Over the next two years, he knocked a few walls out here and there, added some beautifully landscaped gardens and a sleep-out onto the side of the garage.

In March 2014, Tevita decides he is going to add an in-ground swimming pool and a spa pool to his property. This is going to cost $100,000, but he has only paid $10,000 off his mortgage to date.

Fortunately for Tevita, the value of his house has increased over this time.

Tevita gets a professional valuation done in March 2014, which reports an estimated market value of $350,000. This increase in value is due to general increases in market values in the area in which he lives AND due to the quality renovations he has done.

Tevita therefore gets a second mortgage from Lender B for $100,000 to build his swimming pool and spa pool. His total debt over his property, before doing the renovations, is now just over 70% which is an acceptable amount of debt to have for a house.

**% Debt = (First Mortgage + Second Mortgage) / House Value x 100**

= ($150,000 + $100,000) / $350,000 x 100

= $250,000 / $350,000 x 100

= 71.43%

## 3.2 Choosing a Mortgage

This sub-section will go through the process of getting a mortgage, including how to decide which lender to go with and what type of interest rate to choose. Key factors influencing these decisions include:

- how much you can realistically afford to pay in each mortgage repayment period, and
- the amount (if any) of a deposit that you can gather.

However, before we look at what you can afford, let's look at the impacts of the term of the mortgage and the frequency of your payments on how much you will actually need to pay.

### 3.2.1 Term and Repayment Frequency of the Mortgage

When you looked at the examples used to demonstrate the different types of mortgages in Section 3.1, you may have noticed that there were differences in the term (length) that the mortgage was to be paid off in (from 25 years to 10 years) and also in the regularity of the mortgage repayments (from weekly to monthly).

Because your mortgage is usually so big and for such a long period, it is important that you take whatever steps you can in order to reduce the overall cost of your mortgage.

Key steps that you can take include:

- reducing the time over which you will repay your mortgage, and
- increasing the frequency of your mortgage payments.

This is demonstrated in the following scenarios.

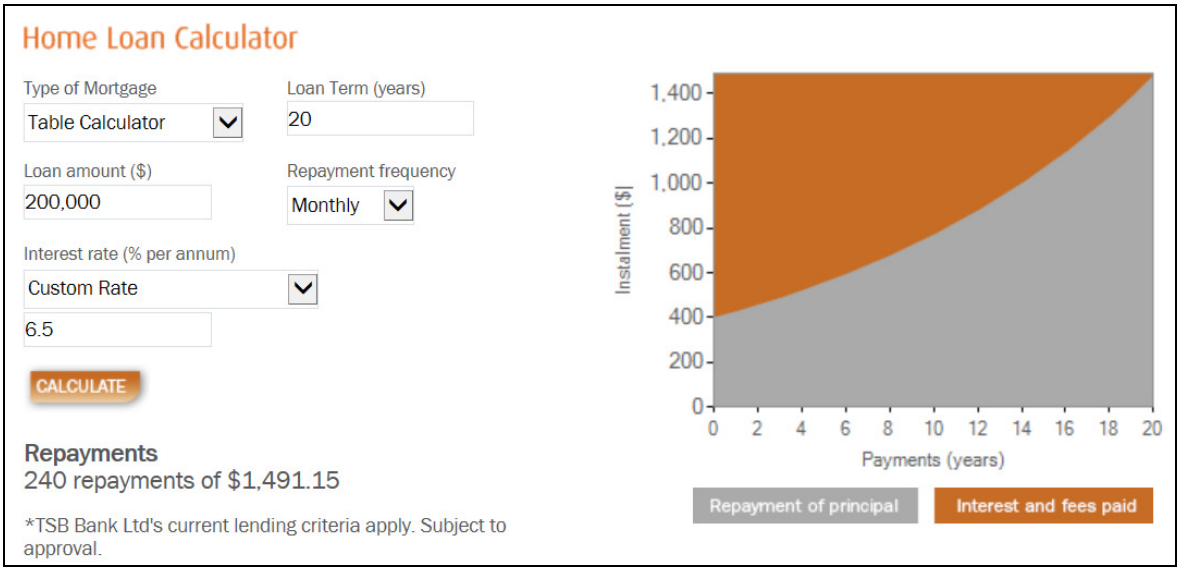
**Payment Period and Frequency Examples:**

**Scenario A: 20 Year Term with Monthly Payments**

Tim and Lisa are siblings who have gone halves in a rental property investment. They have a ***table mortgage*** of $200,000 at 6.5% per annum interest, with a 20 year term period on which they make monthly payments.

Using a mortgage repayment calculator, the payment amount is calculated as $1,491.15 per month.

***Screen Print: TSB Bank Home Loan Calculator***[39]




| | |
|---|---|
| **Total Amount to Pay** | **= Monthly Payment x 12 months x 20 years** |
| | = $1,491.15 x 12 months x 20 years |
| | = $357,876 |

Tim and Lisa would therefore pay $157,876 in interest on top of the $200,000 mortgage principal.

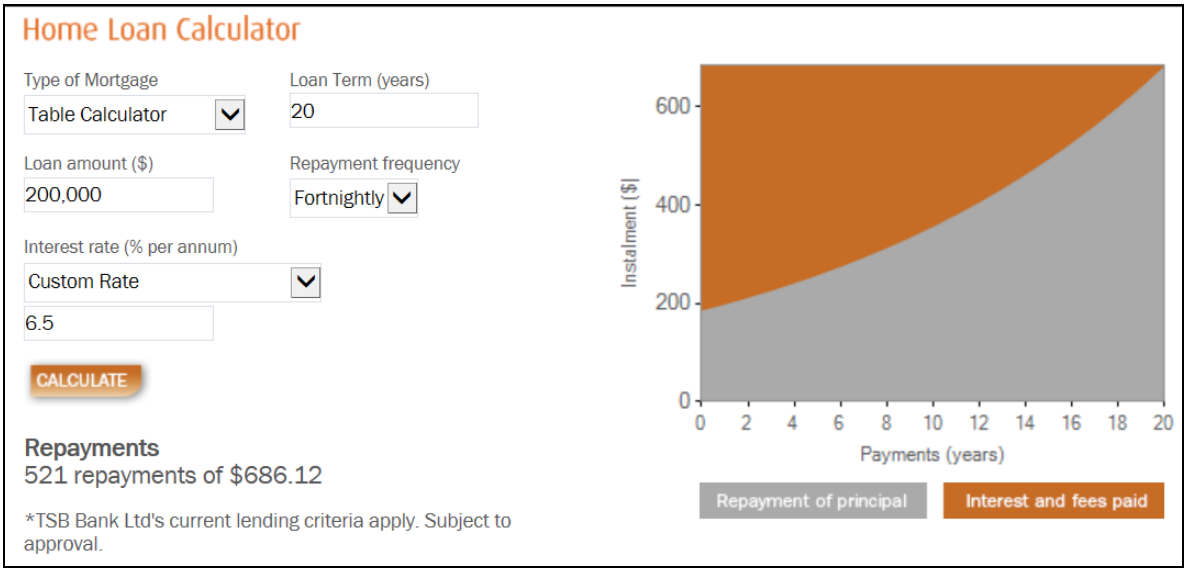
[39] Retrieved 27 September, 2013, from http://www.tsbbank.co.nz/Loans/Calculator.aspx

## Scenario B: 20 Year Term with Fortnightly Payments

Now assume Tim and Lisa had the same mortgage principal ($200,000), the same interest rate (6.5% pa) and the same term (20 years), but decided to make fortnightly repayments instead of monthly repayments.

Using a mortgage repayment calculator, the payment amount is calculated as $686.12 per fortnight.

***Screen Print: TSB Bank Home Loan Calculator***[40]




| | |
|---|---|
| **Total Amount to Pay** | **= Payment x 26 fortnights x 20 years** |
| | = $686.12 x 26 fortnights x 20 years |
| | = $356,782.40 |

Over a term of 20 years, Tim and Lisa would therefore pay $156,782.40 in interest on top of the $200,000 mortgage principal. This is $1,093.60 LESS than what they would pay if they were to pay monthly.

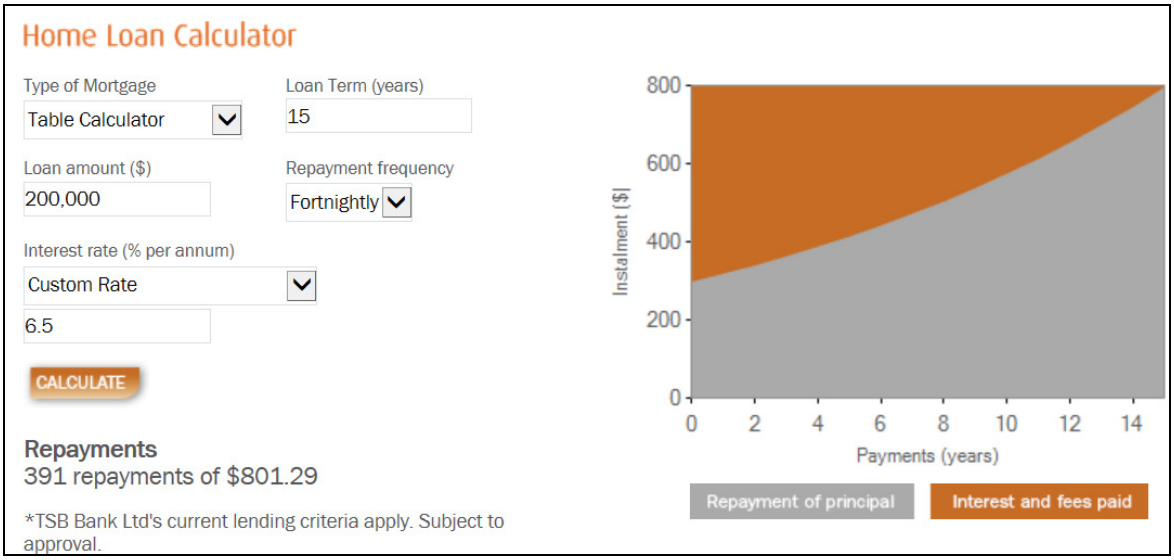
[40] Retrieved 27 September, 2013, from http://www.tsbbank.co.nz/Loans/Calculator.aspx

## Scenario C: 15 Year Term with Fortnightly Payments

In this third scenario, we will assume that Tim and Lisa had the same mortgage principal ($200,000) and the same interest rate (6.5% pa), but decided to make fortnightly payments AND reduce the term to 15 years.

Using a mortgage repayment calculator, the payment amount is calculated as $801.29 per fortnight.

***Screen Print: TSB Bank Home Loan Calculator***[41]




**Total Amount to Pay = Payment x 26 fortnights x 15 years**

= $801.29 x 26 fortnights x 15 years

= $312,503.10

Over a term of 15 years, Tim and Lisa would therefore pay only 112,503.10 in interest on top of the $200,000 mortgage principal. This is a whopping:

- **$45,372.90 less** than in Scenario A, and
- **$44,279.30 less** than in Scenario B!

[41] Retrieved 27 September, 2013, from http://www.tsbbank.co.nz/Loans/Calculator.aspx

## 3.2.2 Which Interest Rate Should I Choose?

When looking at your mortgage options you need to make a decision as to whether to choose a ***fixed interest rate***, a ***floating interest rate*** (also known as a ***variable interest rate***) or a mix of both.

With a ***fixed interest rate***,

the interest you pay is set for a period of time,

usually anywhere between 6 months and 5 years.

At the end of the term, a fixed interest rate automatically moves to a floating rate unless you negotiate another fixed term.

With a ***floating interest rate***,

Lenders will lift or lower the interest rate

as interest rates in general go up or down.

In Module 2, you were introduced to the role of the ***Reserve Bank of New Zealand*** (***RBNZ***) and the ***Official Cash Rate*** (***OCR***). When the RBNZ changes the OCR, floating interest rates will change.

**Advantages of a fixed interest rate:**

- ☑ You know exactly how much each payment will be over the fixed interest term of the mortgage. In comparison, if you have a floating interest rate, it may rise faster than expected, making it difficult for you to meet your mortgage payments.

- ☑ Fixed interest rates are often lower than floating interest rates as lenders compete with fixed price specials.

**Disadvantages of a fixed interest rate:**

☒ Mortgage arrangements which have fixed interest rates often have limits on how much you can increase repayments, or make lump sum payments without paying ***penalty fees***.

☒ If you take a long fixed term rate (say of three years or more), there is quite a risk that floating interest rates may drop below your fixed interest rate. You would then be paying more interest than you need to.

In contrast, if you have a variable interest rate on your mortgage, it is more likely that you will be able to:

☑ ***consolidate*** other higher interest rate debt you may have (such as a car hire purchase) and put it on your floating rate interest mortgage, and/or

☑ make your repayments higher, or make a lump sum payment, **without** being penalised.

The majority of lenders have their interest rates displayed on their website, such as in the following example. In this example, you can see that the fixed rates, for up to 18 months, were **LOWER** than the variable rate at this particular point in time. However, this is not always the case. Please note that these rates are likely to have changed since this content was written. You will need to visit the TSB Bank website if you want to view current rates.

***Screen Print from the TSB Bank Website***[42]

Rate options

| Term | Rate | Effective from |
|---|---|---|
| 6 Months Fixed | from 5.35 % p.a. | 04/10/2013 |
| 1 Year Fixed | from 5.40 % p.a. | 04/10/2013 |
| 18 Months Fixed | from 5.65 % p.a. | 04/10/2013 |
| 2 Years Fixed | from 5.85 % p.a. | 04/10/2013 |
| 3 Years Fixed | from 6.45 % p.a. | 04/10/2013 |
| 4 Years Fixed | from 6.80 % p.a. | 04/10/2013 |
| 5 Years Fixed | from 7.00 % p.a. | 04/10/2013 |
| Revolving Credit | from 5.79 % p.a. | 04/10/2013 |
| Housing Variable | from 5.79 % p.a. | 04/10/2013 |

[42] TSB. Retrieved 4 October, 2013, from http://www.tsbbank.co.nz/Loans/RateOptions.aspx

## Other Interest Rate Options

There is also a combination of floating and fixed interest rates called a ***capped interest rate***, but this is not commonly offered by many banks. Kiwibank is one example of a bank which offers capped interest rates.

A ***capped interest rate***,

is a ***floating interest rate***,

which cannot rise above a certain level in a specific period of time.

For example, a ***capped interest rate*** may be set so that it cannot increase above 7.2% within the next three years, but it can rise and fall at any level below 7.2%.

In addition, it is possible to **split your mortgage** between fixed and floating interest rates. This lets you make extra repayments, without charge, on the floating rate portion while you get lower rates on the fixed portion.

How you split your mortgage is an important decision.

- Take into consideration the total 'extra' cash you are likely to get from, for example, work bonuses over the period you have set the fixed interest rate for.
- Any amount of ***principal*** that you feel you may be able to pay back within the period of the fixed portion of the mortgage can be put on the floating portion.
- Consider the likely trend in interest rates. This is not always easy! However, historically, fixed interest rates have usually been cheaper than floating interest rates.

**TIP:**

There is an excellent article available at http://www.westpac.co.nz/olcontent/olcontent.nsf/AttachmentsByTitle/Wondering+about+interest+rates/$FILE/Wondering+about+interest+rates.pdf with some tips on how or when you choose between fixed and floating interest rates.

### ***Selection of Interest Rate Example 1: The Holmes Family***

The Holmes family is currently renting but has found a house that they would like to purchase. At $650,000, it is quite expensive.

However, they are fortunate to have savings of $128,000 (resulting from the sale of their previous home) that they can use as a deposit.

They have a regular income of $1,858 per week (after tax). Of this, they are able to put between $600 and $630 per week towards mortgage payments.

The family look around for the 'best deal' in interest rates and decide they would like to take advantage of a rate of 6.99% fixed for 36 months, a rate which, at the time, is particularly competitive.

The Holmes family also has a holiday bach at the beach which they believe will sell sometime over the next six months.

They do not owe any money on this bach and expect it to sell for approximately $220,000.

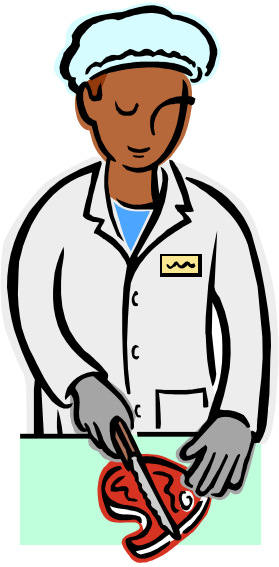
One of the conditions of the 6.99% fixed rate option is that penalties apply if lump sum payments are made. Thus, they will not be able to pay down their mortgage using the proceeds from their bach without being financially penalised.

The Holmes family decide to split their mortgage, having a ***fixed interest rate*** portion and a ***floating interest rate*** portion. They put:

- $220,000 on the floating interest rate portion, and
- the remaining $302,000 on the fixed portion.

The weekly payments for the fixed rate part of the loan are $580.17. The family put the remaining part of their weekly budget that they can devote to the mortgage (between $20 and $50) on the floating interest portion, which happens to have a higher interest rate of 7.85%. When they sell their bach, they are able to pay off this part of their mortgage completely.

***Selection of Interest Rate Example 2: Raimona***



Raimona works in a factory and her work is seasonal in nature.

She would like to get a permanent (non-seasonal) job and is therefore enrolled in a distance learning programme. In the weeks that she does not have much, or any, work she focuses on her studies.

Raimona earns enough money in her seasonal work to see her through her non-work weeks. However, she would prefer to make lump sum payments and higher repayments when working and then drop her repayments down when she is out of work.

Thus, at this time, the best option for Raimona would be to go with a ***variable interest rate*** mortgage.

When Raimona gets her new permanent work, with regular income, then this may be the ideal time for her to swap over to a fixed interest rate mortgage.

Alternatively, she could then put most of her mortgage on a fixed interest rate and leave the balance on either a ***revolving credit mortgage*** facility or some other variable interest rate mortgage facility.

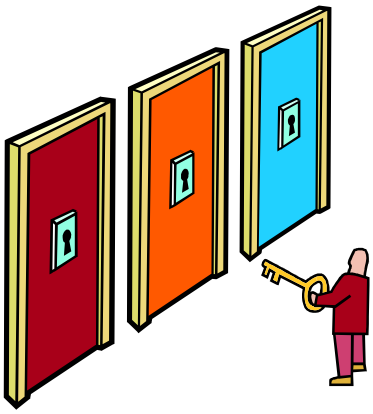
***Discussion Question:***

If you know that you want a fixed rate of interest on your mortgage, how might you decide which term to lock yourself into?

For example, 6 months at 5.6% or 3 years at 6.2%?

## 3.2.3 Which Lender Should I Choose?

There are many sources of mortgage finance. This can make it even more challenging to identify the mortgage that best suits your needs and circumstances! This sub-section will give you an insight to the many things to think about when choosing a lender.



It does pay to 'keep an ear out' for what lenders are offering. Lenders frequently offer specials and compete with one another over the best deals.

Additionally, there is no reason why you cannot **switch lenders**. For example, you could have a mortgage for two years with Lender A and then change over to a mortgage with Lender B which better suits your current needs.

However, before switching lenders, find out what **fees** Lender A will charge you for repaying your mortgage early and switching to Lender B. Although, it is possible that Lender B may agree to pay these charges for you, as an incentive for you to borrow from them - in such a competitive market there is no harm in negotiating!

Also, do not think just because you have always been with Bank XYZ for years that you have to get your mortgage from them. Using the same bank can have some advantages (as we learnt in Module 1), but you could, in fact, be able to make serious savings by using a more competitive lender. Thus, do not be afraid to 'shop around'.

**Your goal is to repay your mortgage as fast as possible, so look for the 'cheapest' finance available!**

### 3.2.3.1 Lenders

Mortgage lenders can be broadly divided into two categories:

1. **Banks**, and

2. **Non-Bank Lenders**.

The mainstream banks (such as ANZ, BNZ, ASB and Westpac, to name a few) are the main source of mortgages in New Zealand.

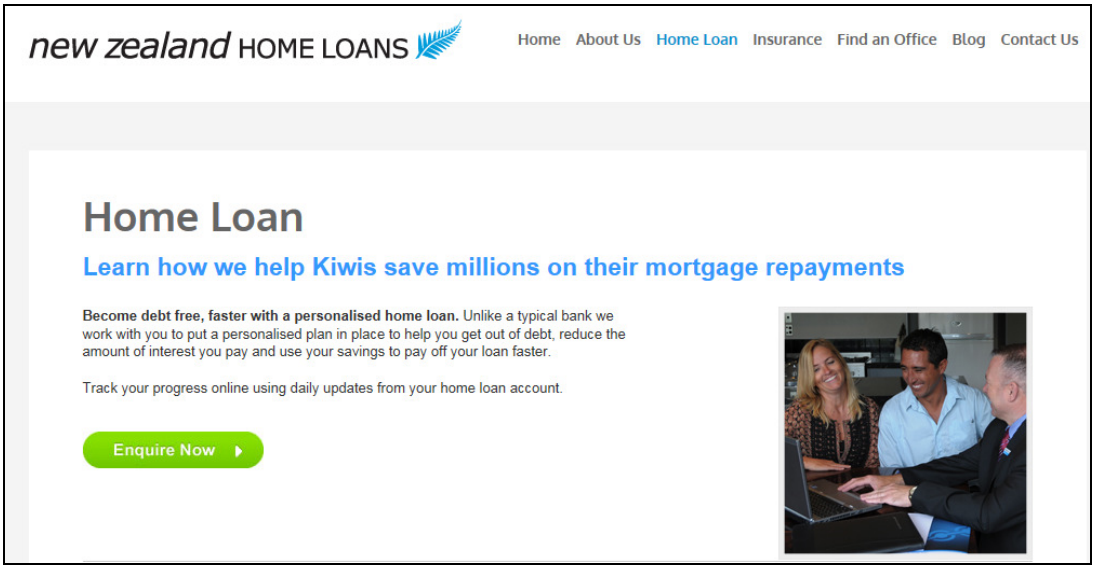
Banks advertise heavily in the newspapers and on TV. They often have special deals like contributing to your legal costs.

They also compete using extra services such as fee discounts on your day-to-day banking to entice you to borrow from them.

Non-Bank Lenders include:

- ***finance companies***;
- ***insurance companies***;
- ***building societies***;
- ***credit unions***, and
- other lenders such as New Zealand Home Loans (www.nzhomeloans.co.nz).

***Screen Print: The New Zealand Home Loans Website***[43]




[43] Retrieved 27 September, 2013, from http://www.nzhomeloans.co.nz/Home+Loan.html

## Shopping for Lenders

If you are going to 'shop around' between banks and non-bank lenders yourself, it pays to be prepared with a list of details that you want information about.

Examples of questions to ask include:

- How much is the application fee?
- What other fees will be charged?
- What will be the total cost of this loan, including the fees and interest for the sum I am borrowing and the term I have chosen?
- How much deposit do you require?
- What changes can I make after the mortgage is set up?

Lenders have become innovative in their attempts to woo property buyers. A few examples of some of the **mortgage options available** are as follows:

## 'Offset' Mortgages

These are a relatively new option being offered by some lenders. With an ***offset mortgage***, when calculating the amount of interest you have to pay, the bank first takes into account how much money you have in your other accounts with that bank.

For example, if you have a mortgage of $100,000 and also have a savings account with $2,980 in it and a transactional account with $1,020 in it (with that same bank), the bank only charges you interest on $96,000 instead of $100,000.

| | |
|---|---|
| **Principal for Interest Calculations** | **= Mortgage Amount – Other Account Balances** |
| | = $100,000 – ($2,980 + $1,020) |
| | = $100,000 - $4,000 |
| | = $96,000 |

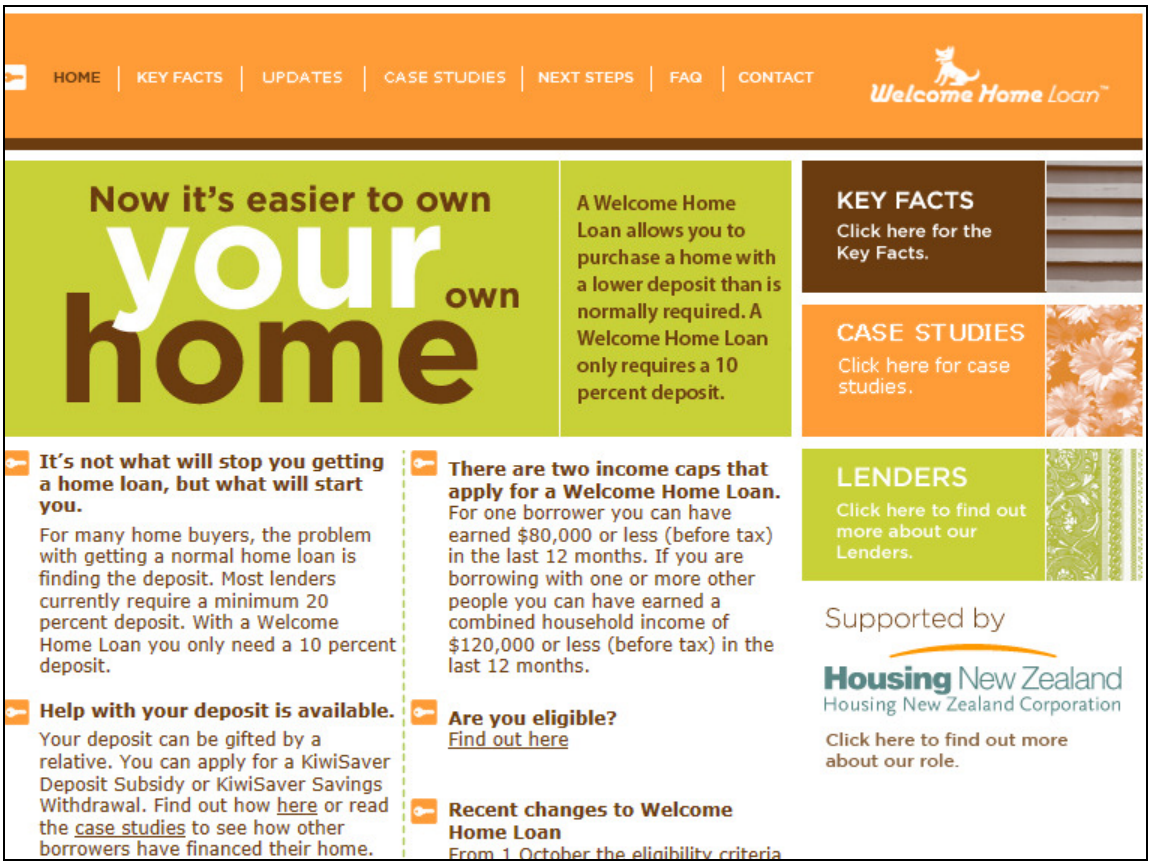
Some examples of lenders offering this type of product include KiwiBank (Offset Mortgage product) and BNZ (TotalMoney product).

## 'Welcome Home' Loans

These mortgages are a government initiative to help people who do not have much of a deposit saved to buy a home. The Government, through Housing New Zealand Corporation, provides lenders with Lenders Mortgage Insurance. This reduces the risk for these lenders to approve mortgage applications that they may otherwise turn down.

Information about Welcome Home Loans can be found on the website www.welcomehomeloan.co.nz

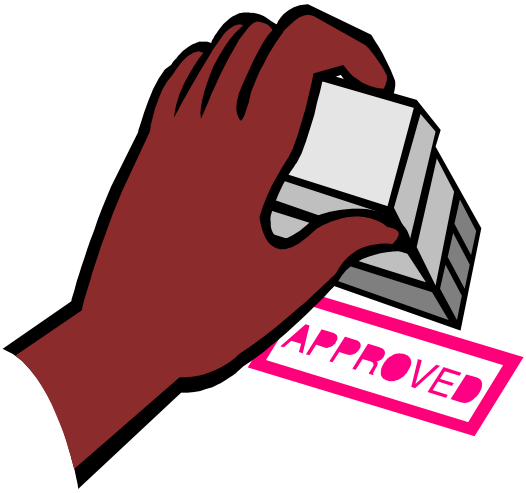
***Screen Print: The Welcome Home Loan Website***[44]




The key features of Welcome Home Loans changed on 1 October 2013. Previously, buyers were able to borrow up to $200,000 without any deposit at all. However, when the Government changed bank lending rules (which limited lending to buyers who had a deposit of less than 20%), new rules came into force for Welcome Home Loans. The main change was that buyers now require a minimum deposit of 10%.

[44] Retrieved 1 October, 2013, from http://www.welcomehomeloan.co.nz/index.php

**Welcome Home Loan Key Facts**




- The 'Welcome Home' loan lets a buyer who has an income of up to $80,000 buy a house with only a 10% deposit. If there are two or more people who want to buy a house together, the combined maximum income they can have is $120,000.

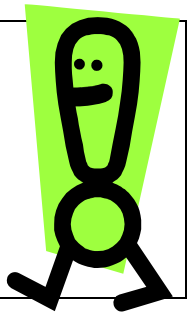
- In most areas in New Zealand, the maximum purchase price of a house is $300,000. However, in selected areas, the maximum amount is higher. For example, it is $485,000 in Auckland and $400,000 in Christchurch City.

The lenders who currently offer these mortgages are:

- Kiwibank
- TSB Bank
- NZCU Baywide (Credit Union)
- HBS Bank
- Nelson Building Society
- SBS Bank (Southland Building Society)
- CBS Canterbury (Building Society)
- Fletcher Challenge Employees Credit Union
- Westpac

A key point is that the Government provides insurance for the **lender** – not for the people buying the house.

That is, the people buying the house still need to make their mortgage payments if they want to keep their house!



**Shared Home Loans**

These allow up to six people to buy a property together (refer to www.bankdirect.co.nz).

This type of mortgage would suit family members, investors or flatmates who want to club together to buy a house. However, borrowers need legal protection in case other borrowers fail to meet their obligations.

**Longer Terms**

It is common for lenders to limit the term of mortgages to a maximum of 30 years. However, longer term loans are sometimes available. Given that property prices are now very high relative to average incomes in New Zealand, sometimes the only way someone can afford to buy a house is to purchase it over a longer term.

However, you have to remember that, while a longer mortgage term may make repayments more affordable, it adds a huge amount to the total interest bill!

***Discussion Question:***

What are some of the mortgage deals that you have seen on offer recently?

### 3.2.3.2 Mortgage Brokers and Fundit

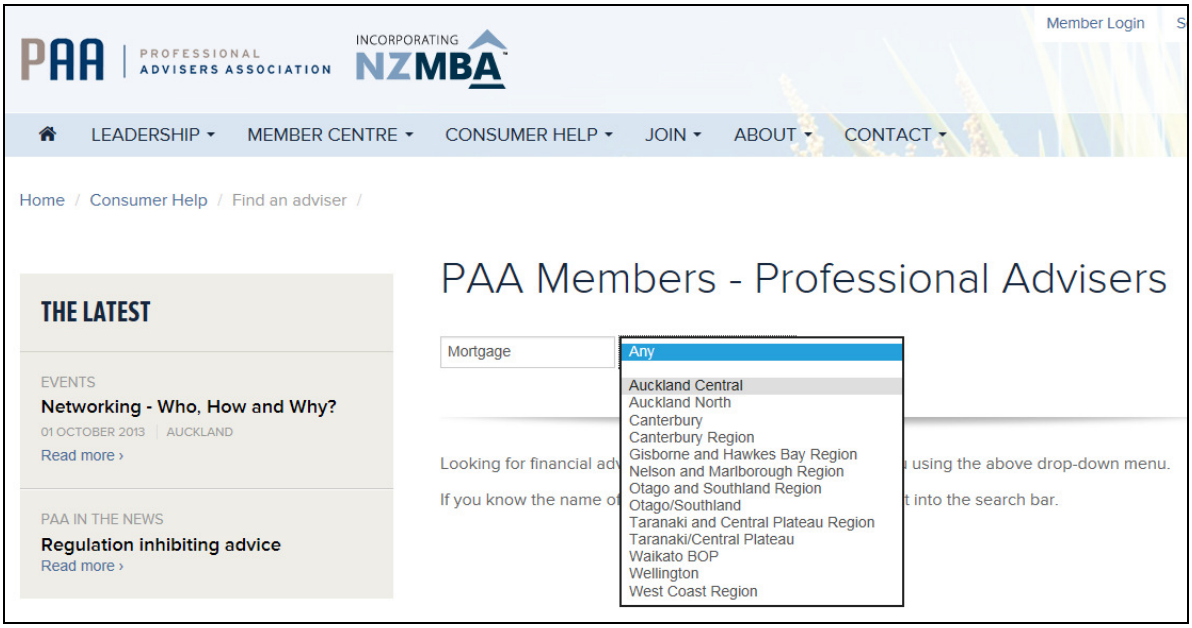
A lot of home buyers now get their mortgage through a ***mortgage broker***. The role of a mortgage broker is **not t**o directly loan you money. Instead, they do the 'shopping around' for you.

If you are too busy, or just do not want to do the work involved in finding the best mortgage deal, then a mortgage broker can be very valuable. Mortgage brokers can also arrange house valuations and ***mortgage protection insurance*** (if you want this). As the mortgage broker's costs are usually paid by the lenders, going to a mortgage broker should not cost you any more than going directly to a mainstream bank.

It is best to use only those mortgage brokers who belong to the Mortgage Brokers Association, which is now part of the Professional Advisers Association (www.paa.co.nz). This will be to your advantage, as members operate to a ***code of ethics*** requiring them to work in your best interests. This reduces concerns that the mortgage broker will simply recommend to you the lender from which they get the best deal, instead of finding the one that will give YOU the best deal.

The PAA website includes a search function to help you find a broker in your region. This is shown in the following screen print.

***Screen Print: The Search Function on the PAA Website***[45]




[45] Retrieved 27 September, 2013, from http://www.paa.co.nz/findadviser

A point to know about mortgage brokers is that they do not usually cover the whole market of lenders available.

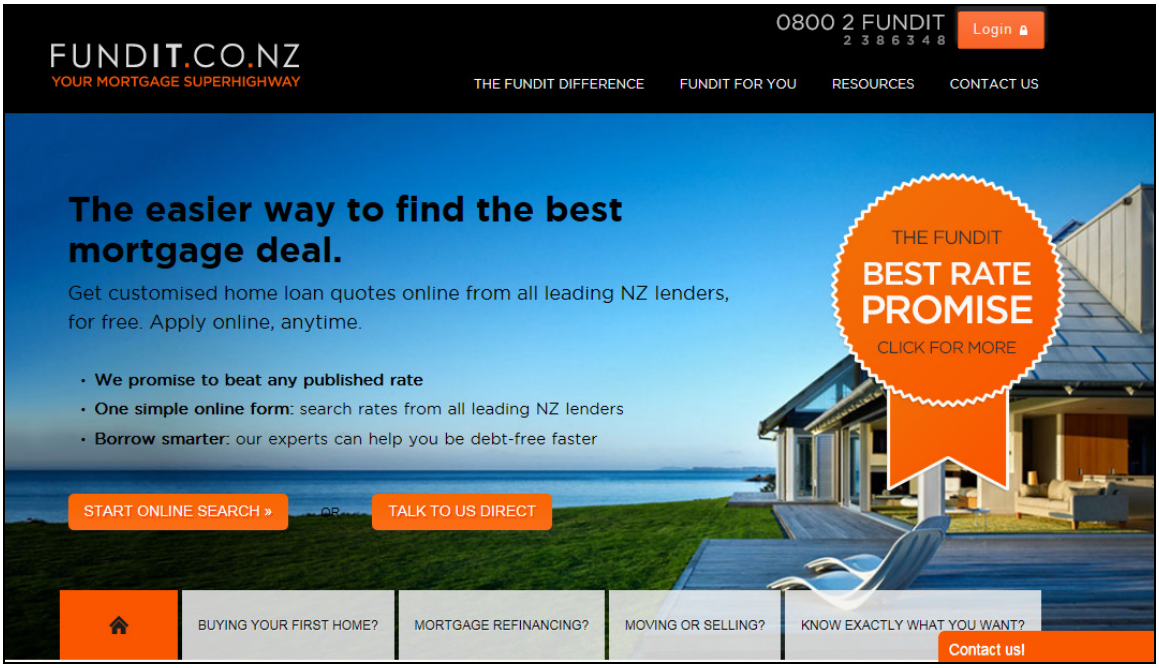
Thus, the deal they offer you should be the best **from the selection of lenders they work with** *but* it may not be the best overall market deal available for your needs and circumstances.

It is therefore a good idea to ask your broker which lenders they DO and DO NOT deal with. You might want to look at some of the other options available.

## Fundit

An alternative to a mortgage broker is the Fundit website, www.fundit.co.nz. This is an auction website, meaning that lenders compete to provide you with a mortgage. That is, the opportunity to give you a home loan is presented to numerous lenders, including all major banks. These lenders then decide if they want to have you as a customer and, if so, they compete with other lenders to offer you the best deal.

***Screen Print of the Fundit Website***[46]




[46] Retrieved 27 September, 2013, from http://www.fundit.co.nz/

One of the key benefits of using Fundit is that the auction encourages lenders to offer you very competitive interest rates. Furthermore, Fundit offers a 'Best Rate Promise' – if you are able to get a lower interest rate elsewhere, Fundit will beat it by 0.1% for up to one year if you apply for the same kind of mortgage through Fundit[47].

Another benefit of using Fundit, as opposed to a mortgage broker, is that all participating lenders have the same opportunity to present you with an offer. In comparison, when you use a mortgage broker, they may encourage you to choose the lender which gives them (the mortgage broker) the best ***commission***.

When you use Fundit, the process of getting a mortgage is much faster than it is if you instead approach each lender separately.

A summary of the process for using Fundit is as follows:

1. You complete a "30 second rate check". After entering basic information such as the amount of your deposit, the purchase price of the house and your annual income, Fundit will do a quick check to see if it is likely that you will be able to get a loan and, if so, for what amount and at what interest rate.

2. You complete an application form online. This is reviewed by Fundit before being made available to banks and non-bank lenders to view.

3. Lenders present 'bids', showing what interest rate they would be prepared to offer you. However, these are presented to you anonymously. In other words, at this stage, you do not know the names of the lenders.

4. You choose the deal you like best. Fundit will then let you know the identity of the lender.

5. You decide whether or not you want to proceed with applying for a loan with the selected lender. If you do continue, you will need to fill out the lender's loan application documents. Fundit then submits these documents to the lender.

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[47] Image retrieved 9 October, 2013, from http://www.fundit.co.nz/about-fundit/best-rate-promise/. Some conditions apply to the 'Best Rate Promise'.

## 3.2.4 Lender Requirements

Although the mortgage market is competitive, lenders will not simply hand over money to anyone who asks.

It is important that, even before you approach a lender, you know what their requirements are.

This way, you can make sure that you will be viewed by the lender as someone they really want to do business with – this will also help you to be in a strong position to 'negotiate' the best deal.

A good 'rule of thumb' is to understand that the majority of lenders tend to assess borrowers in terms of their character and cashflow. You need to present yourself in a good light to your lender and have the information requested of you at your fingertips.

If you make a good impression, when negotiating for your mortgage, it is possible that you may get:

- a reduction in the up-front application fee,
- your lawyer's costs subsidised, and / or
- the requirement for a registered valuation of your house waived (i.e. you do not have to get this valuation), etc.

Banks are quite competitive and offer special deals from time to time. Examples of such deals include free house insurance for a year, a free ipad and special interest rates. Thus, if you know that you can demonstrate to lenders that you are of 'low risk' to them (i.e. it is very likely that you will be able to easily repay the loan), do not be afraid to negotiate a good deal or to look elsewhere for lenders who are prepared to offer you one!

## The Loan-to-Value Ratio

The size of the mortgage you want compared with the value of the house is called a ***loan-to-value ratio*** (***LVR***) or a ***loan-to-security ratio*** (***LSR***).

Although it is called a ratio, it is actually expressed as a percentage. Here is an example of how it is calculated:

If Deanna and Karl want to get a mortgage for $230,000 on a house of $300,000 then it is said to have an LVR of 77%.

| | | |
|---|---|---|
| **LVR** | **=** | **Amount of Mortgage / Value of House x 100** |
| | = | $230,000 / $300,000 x 100 |
| | = | 76.67% |

Several years ago, many lenders were prepared to go as high as an LVR of 100% and some even higher. In fact, sometimes ***102% mortgages*** were available – these allowed you to borrow enough to cover the purchase price of the house AND the costs associated with making a purchase (e.g. legal costs).

However, nowadays, lenders are **unlikely to lend beyond an LVR of 80%**.

In other words, it is most likely that you will need to have a deposit of at least 20% to purchase a house.

The reason for this is that the ***Reserve Bank of New Zealand*** introduced lending rules in October 2013 which restricted the volume of lending that banks can hold in which the LVR is higher than 80%. Now, only 10% of the total value of any new loans that banks make can have an LVR higher than 80%.

These rules were introduced in response to increasing house prices. It is hoped that the effect will be to reduce house prices (or at least slow the increase of house prices), especially in Auckland.

## Your Credit Record

The reality is that lenders will check your ***credit rating***, so make sure you are honest right from the start of the application process. If you are a credit risk to the lender, then they may ask you to provide a much higher deposit or they may turn you down.

Remember, you can check out your own file with credit agencies such as Veda Advantage and Dun & Bradstreet. You can apply online to request a copy of your credit file. Go to either:

- Veda Advantage – http://www.mycreditfile.co.nz/personal-products or
- Dun & Bradstreet – https://www.checkyourcredit.co.nz/Personal

There could be several reasons why you may have a poor credit rating / credit record. Some examples include:

- Unpaid (or late) hire purchase payments.
- Unpaid (or late) bills – e.g. telephone bills.
- If you have just gone into business and you cannot show, as yet, what your level of income is going to be.
- If you are temporarily in financial trouble – for example, after a relationship breakup.

If you do have a poor credit rating or credit record, then you may still be able to get a mortgage. You could try applying for a ***low doc mortgage***. These mortgages get their name because they do not require the same amount of documentation as for standard mortgage applications.

The disadvantage of such mortgages is they often carry higher fees and interest rates because they have a higher risk for the lender. However, you can usually shift to a standard type of mortgage (and thus reduce your interest payments) after a few years once your financial situation becomes more secure.

## The Documentation

Once you have worked out exactly what sort of mortgage you will take out (table, reducing, revolving credit, a combination) and your choice of lender and interest rate/s (fixed, floating, capped, a combination) then it is time to begin the documentation process.

The documents that your lender will ask you to provide include:

- **A copy of the Sale and Purchase Agreement**

- **Up to date details of other outstanding debts you have**

This may include credit card debt, hire purchases, a personal bank loan, etc.

Note that a student loan and the repayments you make on it will be counted as will any other debts.

A large student loan debt will reduce the amount you can borrow to purchase a house.

- **Proof of income**

  This could include payslips if you are employed or yearly accounts if you are self-employed.

- **A current budget**

  This would identify what your regular expenses are and whether your current income will be able to sustain the proposed mortgage payments.

- **A registered valuer's report**

  This is particularly important in times where houses are selling at market values well above the ratings value of the house. It is also highly likely to be necessary if you are intending to borrow more than 80% of the house price.

  An independent report from a registered valuer is likely to cost you $500 - $800 or more.

  An excellent source of information on property values can be found on the QV website at www.qv.co.nz. In most cases, lenders will usually use the lower value of the registered valuation and the purchase price when approving your mortgage.

- **Identification**

  Common forms of identification include a driver's licence or passport. Identification is particularly important if you are using a lender that you have not used or banked with before.

- **A copy of the *rating valuation* (RV)**

  This is the valuation that the ***rates*** on the property are based on. It is available from your local Council.

In addition, a mortgage lender will often require you to obtain a ***Land Information Memorandum*** (***LIM***). As you learnt earlier in this Module, the LIM provides information held by the ***local authority*** on the property.

Note that the standard Agreement for Sale and Purchase of Property in fact has a LIM condition inserted as a standard term.

Take the time to fill out the forms completely and accurately – obtaining a mortgage is not a fast process!

**Do not sign the form** until you are absolutely sure you understand the information and documentation that the lender has asked you to provide.

Also, do not sign it until the lender has discussed the amount of the **application fee** with you.

It can often cost several hundred dollars to set up a mortgage.

However, as noted earlier, the fee is often negotiable so do not just settle by saying 'yes' – try to get it waived or at least reduced!

## 3.3 Other Considerations

This sub-section will focus on other considerations involved in getting a mortgage and of owning your own property, including legal implications. Remember, before you sign any mortgage documentation, and potentially before you even start to seriously look for a home, it is always important to first get good legal advice.

### 3.3.1 Obtaining Pre-Approval

Getting ***pre-approval*** for a home loan can be very advantageous and may sometimes be necessary. Pre-approval means that you get finance approved from the bank before you put in an offer on a property.

Imagine the following scenario:

*You are just starting the house hunting process. Given that it is 'early days' you do not expect to want to buy anything yet – you just want to get 'a feel' for what is available. Therefore, without seeing your bank about a mortgage, you go along to a real estate agent and ask to be shown a few properties.*

*The very first one you visit is absolutely perfect – it has everything you want in a home and the vendors are motivated to make a sale very quickly. As there is a lot of interest in the property, you immediately put in an offer which is 'subject to obtaining finance'.*

*The vendors look at all offers and, although your offer is for the highest price, they decide to negotiate with another interested buyer who has finance arranged – they would rather go with the 'sure thing' than risk losing the sale. You miss out on your dream home, simply because you did not obtain pre-approval for your loan.*

The earlier you select a mortgage provider, the better. If you have pre-approval for finance, you can go house shopping with confidence and both real estate agents and ***vendors*** (house sellers) will take you more seriously.

The pre-approval process may be able to be completed quite quickly. A number of banks have an online form that you can complete to apply for pre-approval. Once you have supplied all of the required information, the bank may be able to give you pre-approval within a day.

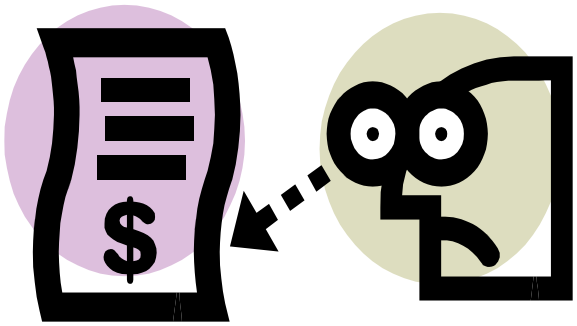
## 3.3.2 Mortgage Protection Insurance

As indicated in Section 3.2.2, you may need to take out ***mortgage protection insurance*** (or some other form of insurance that provides the same type of protection).

***Mortgage protection insurance*** covers
a borrower's loan repayments
in the event that they are not able to meet them.

A lender is more likely to require you to have this type of insurance if you are borrowing a high proportion of the house's value. That is, if the ***LVR*** (the loan-to-value) ratio is high.

This is because, if you ***default*** on your mortgage and do not have insurance, it is possible that a ***mortgagee sale*** will not recover all the money you owe the lender.




For example, assume that you buy a house for $200,000, and borrow 90% of the money. Your mortgage would therefore be $180,000.

If you cannot meet your mortgage payments, and the bank decides to sell the house to get their money back, it is quite possible that they might not be able to get the full $180,000 for the house.

Even if a lender does not require you to get mortgage protection insurance, you may consider it anyway, especially if there is only one income earner in the household and / or you have dependents.

This will avoid the family home being sold if the 'breadwinner' can no longer pay the mortgage due to circumstances beyond your control such as the loss of a job, disability or death.

However, there are also **other insurance options** available that would cover your mortgage repayments in various situations. Examples include term ***life insurance*** (which will pay out if you die) and ***income protection insurance*** (which will pay out if you become sick or disabled and are unable to carry on with your job). It is best to get quotes for each option, as you may find you receive better cover from these other forms of insurances for little or no extra cost (or even less cost!).

## 3.3.3 Guarantors

You may find that your lender requires you to provide a ***guarantor*** for the mortgage you are applying for – particularly if you:

- do not have a great credit rating,
- have the minimum required deposit, and / or
- are under the age of 18 (this is because it can be difficult to enforce a credit contract against someone who is under this age).

A ***guarantor*** is someone else who signs a legal agreement that they will repay the loan (or part) if you do not.

What the lender will often do is ask that a guarantor (often a family member such as a parent or relative) put up an asset of their own as ***security***.

A common example of security provided by guarantors is their own house. This means the guarantor's house could be sold to meet the shortfall should you start to fall back from your mortgage repayments.

**If you ask a person to become a guarantor for you, it is important that you tell them that they should get independent legal advice.**

**It is a huge risk** you are asking someone to take and it is not a role to be stepped into lightly. It is important to note that, as a borrower, you do not have to agree to find a guarantor but you may not get the mortgage without one!

## 3.3.4 I Now Own My House!

So you now own your own house – what a great feeling this can be!

Your property cannot be sold without your home loan being repaid *and* the mortgage removed (***discharged***) from the ***Title***.

The only time your lender could sell your property is if you fail to do what your mortgage requires you to do (such as meet your regular mortgage payments). However, the lender must first meet certain legal requirements also and this includes giving you the opportunity to remedy any defaults should the situation arise.

This is why it is so important that you understand the consequences of signing your mortgage as it is such a major life decision.

Another point of note is the question:

**What should you do with your mortgage once you have paid it off?**

Some lenders may suggest that it is a good idea to leave the mortgage security over the house in place.

Their argument is that, if the mortgage is there, it will be easier for you to borrow again in the future and you will save in lawyer fees if you want to borrow from that same lender in the future. This is true, however...

... if you choose to leave the mortgage security in place, **make sure you are aware of what this means.**

For example, if you enter an agreement whereby you become a guarantor for one of your children buying a property, then the bank can move on the security it has for *your* mortgage (that is, your house!) if something goes wrong with the guaranteed mortgage.

In situations where there may be risks such as this, what you are better to do is have the mortgage ***discharged*** (removed off the Title) and then re-mortgage if you need to borrow again. However, be aware that there are costs associated with doing this. Your lawyer may charge you around $300 to discharge a mortgage and, if you want to put one back in place in the future, that may cost even more. Your bank may also charge a fee for discharging the mortgage.

# Section 4

# Property Investment Strategies

# 4.0 Property Investment Strategies

Property investment is a popular wealth-building tool. There are a number of features of property investment that appeal to a wide range of people. These include, for example, features such as:

- it being a medium-risk investment,
- investors have a physical asset in their possession, and
- property values are unlikely to get close to nil.

In this section, we look at some of the other features and benefits of property investment. In particular, we discuss:

1. the two types of ***financial returns*** that property investment can generate, and

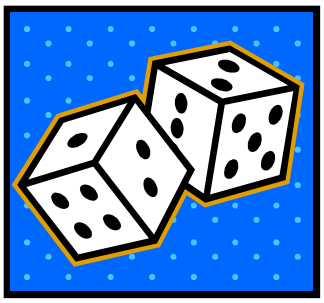
2. how a ***portfolio*** of investment properties can be built relatively quickly through the use of debt. We also look at how the use of debt can increase financial returns.

Also covered in this section are tips for selecting investment properties to purchase, as well as a discussion on the various ways in which property can be bought.

## 4.1 Property as an Investment Strategy

In Module 2 we had an introduction to risk and ***diversification***.

To recap, there is some risk in ALL investments. There are many types and sources of risk. But in broad terms, when it comes to investing, the main risk is as follows:



**RISK:**

This is the chance that you might not get all your money back

and that your financial returns end up being lower than you expected

(or even negative).

We also learnt about ***diversification*** as a means of reducing risk in Module 2. It can be summarised as follows:

**DIVERSIFICATION:**

If you put your 'investment eggs' in a number of different 'baskets'

(e.g. term deposits, shares and property),

and if one of these investments makes a loss or doesn't perform as expected,

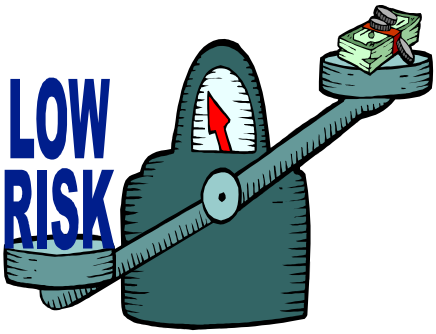
the impact on your overall wealth

is not as bad as it would be if you had put all your money in one investment.

In fact, with diversification, poor returns from one investment could even be offset by higher-than-expected returns from another investment.

Investing in property is a preferred investment method for many people. This is for many reasons (refer to the benefits of property investment outlined earlier in this Module), including risk.

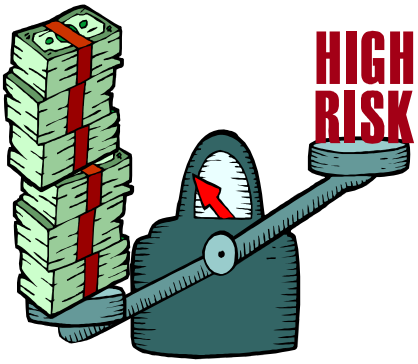
When it comes to property investment, people often feel that there is **less risk** involved due to the fact that:




1. you have a **physical asset** in your possession and it is therefore unlikely that you will completely lose all of your money; and

2. **land is a scarce resource**. That is, the population and demand for land will continue to grow in the long run, so even if the market is not doing well at one time, it is likely to recover.

However, **on the other hand**, when it comes to property investment, it can also be more **difficult to fully *diversify* your *portfolio***. This is because property usually (but not always) requires a relatively large financial commitment.



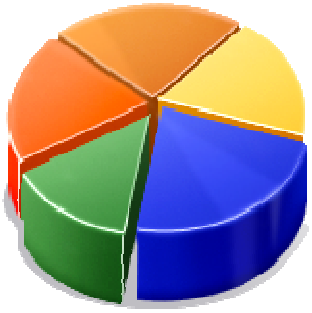

For example, if you want to invest in a $300,000 house, it is likely that you will need a deposit of $60,000 (20%). Then, on top of this you need to service the loan.

For the average person, this leaves very little money for other forms of investment to diversify their portfolio. But there are ways around this. For example, you can ***leverage*** your ***equity*** to build a property investment ***portfolio*** (this will be discussed later in the Module), or you can join with others to reduce the required commitment.

***Example***

Mere has saved $30,000 and wants to build a ***diversified investment portfolio***. She wants to include property within that portfolio, but knows that she would need to commit the full $30,000 to one investment alone if she were to do this.

Furthermore, Mere wants to be quite 'hands off' with her investments as she also wants the freedom to travel around the world.



Mere doesn't mind sharing or entering into an investment with others, so she decides to add $5,000 to other cash put forward by family members towards a property investment.

Together, they manage to put together a larger deposit than Mere would have been able to on her own.

They decide to buy a house in the suburb nearest to Mere's Aunty so that they can keep an eye on the house.

The family seeks professional legal advice for the arrangement to make sure everyone's interests are protected and to minimise potential disagreements and problems between the family members involved.

## 4.1.1 Financial Returns

So how do we make money from residential property?

Property investment provides two forms of potential returns – one that offers short term benefits and one that offers long term benefits. These are:

1. **Rental income**

This is the money your tenant pays you to use your property investment. You receive this throughout the entire investment, provided that you have tenants in your property of course!

However, the actual returns you make depend on what you spend on your property. If you spend more in maintenance, paying interest on the mortgage, etc. than you receive in rental income, you will make a loss.

2. **Capital gains**

These are the profits you make if the property goes **up** in value and you sell it for a higher price than what you paid for it. However, it is also possible to make a loss here. The best way to try to get capital gains is by buying a property below market value.

If you are going to invest in property, you need to think about your financial goals and risk profile in order to decide which type of gain is more important to you. If rental returns are most important to you, you are likely to choose a different property than you would if ***capital gains*** are most important.

Answer questions such as:

- Am I investing to generate a regular income?
- Am I prepared to go without an income in the hope that capital gains will be very worthwhile?
- Can I afford to spend more on paying the mortgage than I receive in rental income?
- How much risk am I prepared to take on? Am I relatively risk averse and would prefer short-term regular gains over long-term capital gains?

#### 4.1.1.1 Negative Gearing

In recent years, it has become difficult to find properties that will provide investors with a positive ***cashflow***. In other words, it is difficult to find properties which earn more rental income, than what you need to pay in mortgage payments, rates, insurance and other expenses.

At times when there has been a boom in property prices, mortgage payments have notably increased. However, given that incomes do not usually rise in line with property prices, at times when the property market is booming, the average New Zealander cannot necessarily afford to pay higher rents. Thus, although rental prices may be increased, they still do not usually match the increase in mortgage payments.

As a result, it is now common for mortgage payments to be much higher than rental income. This means that many properties nowadays are 'negatively geared'.

***Negative gearing*** occurs when
someone borrows money to make an investment
(e.g. they take out a mortgage to invest in property),
but the income on that investment
does not cover the interest on the loan.

Obviously, negative gearing is a much riskier approach to property investment than buying a property with positive cashflows. This is because, until the mortgage is paid off, the investor is totally relying on capital gains to recover their money and make a profit.

Before buying a property, you need to get an idea of the rent which it may receive. You need to know this so that you can see if it is enough to cover the costs of the loan as well as the costs associated with owning the property (e.g. maintenance, insurance and rates).

To do this, you can check out similar places listed with local rental agencies or in the local newspaper.

Also check out the Ministry of Business, Innovation and Employment website which has a 'Market Rent' section that provides information on average rents for homes around the country. Two screen prints showing this function are given below.

The first screen print shows the main page of the section, where you select which region of New Zealand you are interested in. The second screen print shows example results for Taradale, in Napier.

### *Screen Print 1: The 'Market Rent' Section of the MBIE Website*[48]

**Market Rent**

**1 March 2013 - 31 August 2013**

Market rent is described (in the Residential Tenancies Act) as what a willing landlord might reasonably expect to receive, and a willing tenant might reasonably expect to pay for the tenancy, in comparison with rent levels for similar properties in similar areas.

Market rent is a useful guide when you are deciding what the rent will be. It needs to be comparable to the rent charged for other properties of a similar type, size and location. (If you are charging significantly higher rent than for other similar properties, the Tenancy Tribunal can order you to reduce it.)

Information on Where to live is available on the Immigration New Zealand's website.

Find out what weekly rent is being charged in your area. Select a region:

**more information**

Latest Market Rent figures

Seminars for new landlords

Explanation of statistical terms

Disclaimer, copyright and use of Market rent data

| Region | City/District |
|---|---|
| Northland | [Far North / Kaipara / Whangarei] |
| Auckland | [Auckland / Franklin / Manukau / North Shore / Papakura / Rodney / Waitakere] |
| Waikato | [Franklin / Hamilton / Hauraki / Matamata / Otorohanga / Piako / Rotorua / South Waikato / Taupo / Tauranga / Thames-Coromandel / Waipa / Waitomo / Western Bay of Plenty] |
| Bay of Plenty | [Kawerau / Opotiki / Rotorua / Taupo / Tauranga / Western Bay of Plenty / Whakatane] |
| Gisborne | |

### *Screen Print 2: Example Market Rent Results*[49]

**Market rent**

**01-MAR-2013-31-AUG-2013**

**Area:** Napier - Taradale/Awatoto

| Bedrooms | Dwelling | Bonds Received | Average Rent | Standard Deviation | Lower Quartile | Median Rent | Upper Quartile |
|---|---|---|---|---|---|---|---|
| 2 | Flat | 26 | $245 | 22.61 | $230 | $250 | $260 |
| 4 | House | 31 | $392 | 54.22 | $350 | $380 | $422 |
| 3 | House | 130 | $328 | 43.37 | $300 | $330 | $350 |
| 2 | House | 26 | $294 | 43.85 | $260 | $285 | $330 |

**Note:** When printing this table you may need to change your print settings to landscape format, to ensure all columns i printed.

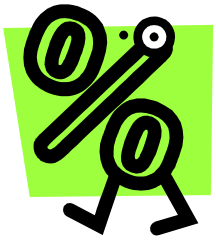
[48] Retrieved 27 September, 2013, from http://www.dbh.govt.nz/market-rent

[49] Retrieved 27 September, 2013, from http://www.dbh.govt.nz/Utilities/marketrent/market-rent.aspx?CategoryId=258&SubCatId=6&SubCat1Id=63&SubCat2Id=71&SubCat3Id=72&ArticleId=53&Version=1.2&TLA=Napier&RegionId=6

### 4.1.1.2 The Yield

Property investment is very different from buying a home to live in with your family. You can think of it like running a business – all decisions are motivated by financial equations. For instance, when you are choosing which property to buy, you should calculate the ***yield*** of each property and compare them.

The ***yield*** is the percentage return that you get on your investment from rental returns.



Both a ***gross yield*** and a ***net yield*** can be calculated. However, when discussing yields, it is usually the 'net yield' that is referred to.

#### The *Gross Yield*

The gross yield is calculated by dividing the annual rental income by the value of the property. The purchase price is typically used for the property value figure (although the current value can also be used).

**Gross Yield = Annual Rental Income / Property Value x 100**

Consider the following example:

***Example: Tahi's Gross Yields***

Tahi is considering purchasing one of two properties.

He thinks he would be able to buy one of these properties for $210,000 and get weekly rent of $210.

The other property would cost him $230,000, but he would be able to get $225 rent per week.

He calculates the gross yields as follows:

| | | |
|---|---|---|
| **Gross Yield (Property 1)** | = | **Annual Rental Income / Property Value x 100** |
| | = | ($210 x 52 weeks) / $210,000 x 100 |
| | = | $10,920 / $210,000 x 100 |
| | = | 5.20% |

| | | |
|---|---|---|
| **Gross Yield (Property 2)** | = | **Annual Rental Income / Property Value x 100** |
| | = | ($225 x 52 weeks) / $230,000 x 100 |
| | = | $11,700 / $230,000 x 100 |
| | = | 5.09% |

Based on gross yield alone, Property 1 (with the higher percentage yield) would provide Tahi with the best return on his investment.

However, remember that this does not take into account expenses or the return that Tahi may be able to realise through capital gains.

## The *Net Yield*

The net yield takes into account the expenses associated with owning the property. It is calculated as the annual rental income *less expenses* divided by the value of the property.

**Net Yield = (Rental Income – Expenses) / Property Value x 100**

**Examples of expenses include:**

- Rates
- Repairs and Maintenance
- Insurance
- Property Management Fees (fees you may pay to a professional ***property manager***)
- ***Body Corporate Fees*** (these typically apply to flats / apartments)
- ***Vacancy Costs***

***Vacancy costs*** are the costs of missing out on rent due to not having a tenant at all times.

It is normal practice to allow for at least 2 weeks vacancy per year, however, you should take into account your local market when deciding how many weeks vacancy you should allow for.

For example, if there is a lot of rental housing in the area and / or jobs are very seasonal, you may have difficulty finding tenants or tenants may change quite frequently. As such, your property may not have tenants in it for a number of weeks each year.

**What costs are not included in the yield?**

The following costs are **not included** when calculating the yield:

☒ Costs associated with any mortgage (e.g. interest)

☒ Tax

The final return that an investor gets on a property investment takes into account these factors as well as the yield, capital gains and the extent to which leverage is used (this is discussed in Section 4.2).

**The final return that an investor may get on a property is therefore affected by:**

☑ The rental income

☑ The expenses included when calculating the net yield

☑ Costs associated with the mortgage, such as interest

☑ Tax costs and advantages

☑ The price which the property sells for less the price which you paid for it (which, in turn, will affect the capital gains)

☑ Money you spend on *improvements* to the property (as opposed to repairs and maintenance, which is included amongst expenses for the net yield).

☑ The amount of money that you actually invest in the property. This will affect the 'percentage return' (This is discussed in Section 4.2).

The following example of how to calculate net yield (or simply 'yield') continues on from the example given previously of Tahi and his two property investment options.

***Example: Tahi's Net Yields***

Tahi would now like to calculate the net yield for the two investment properties to see if Property 1 provides the best return on this basis. He does this by finding out (or estimating) the expenses for each property.

Tahi allows for the possibility of the property not having tenants for quite the entire year. For his town, Tahi thinks that he needs to allow for three weeks vacancy per year, regardless of which property he purchases. He calculates the yield as outlined in the following table:

***Tahi's Property Yields – Scenario 1***

| | **Property 1** | **Property 2** |
|---|---|---|
| **Gross Annual Rent** | **$10,920** | **$11,700** |
| **Annual Expenses** | | |
| ▪ Rates | $2,401 | $2,462 |
| ▪ Repairs & Maintenance | $600 | $200 |
| ▪ Insurance | $796 | $821 |
| ▪ Management Fees | $819 | $878 |
| ▪ 3 weeks vacancy | $630 | $675 |
| ***Total Annual Expenses*** | ***$5,246*** | ***$5,036*** |
| | | |
| **Total Annual Rent - Total Annual Expenses** | **$5,674** | **$6,664** |
| **Value of Property** | **$210,000** | **$230,000** |
| | | |
| **Net Yield (before tax)** | **2.70%** | **2.90%** |

**Net Yield (Property 1)** **= Rental Income – Expenses / Property Value x 100**

= $5,674 / $210,000 x 100

= 2.70%

**Net Yield (Property 2)** **= Rental Income – Expenses / Property Value x 100**

= $6,664 / $230,000 x 100

= 2.90%

Based on net yield, Property 2 would provide Tahi with the best financial return.

A point to note is that an investment decision should not be made based on yield alone. He should also consider the other factors which could affect the final return on the investment.

For example, it could be that Property 1 is in a high-growth area and, as such, the value of the property may increase much more, relative to the value of Property 2.

## Should I Use Current Values or Purchase Prices?

As mentioned previously, yield calculations often use the purchase price of the property as the property value figure. However, the current value of the property can also be used. Each of these figures provides different information.

**If you calculate the yield based on the purchase price**, this allows you to compare two or more potential purchases to decide which house has the better return on money invested.

This calculation is therefore good when you are deciding which house to buy.

In contrast, **if you calculate the yield based on the current value**, you can assess how an existing investment is performing.

This information can help you make decisions of whether it would be better to sell the property and instead buy another (or use the money for a different type of investment).

***Example: Tahi***

Tahi decides to purchase Property 2, which had a purchase price of $230,000 and a yield of 2.9%. He rents it out at $225 per week.

Over the next few years, property prices in the area of Property 2 skyrocket. After seeing the neighbouring properties sell and earn huge capital gains, Tahi decides to get his investment property revalued.

He does so and is told that, at the very least, the house is now worth $300,000! Tahi also does some research into rental prices.

Despite the boom in property prices, Tahi finds that he would only be able to increase the rent to a maximum of $260 per week. If he were to increase it any higher, people would simply choose to live in other areas of town where there are lower rents and plenty of houses available. Furthermore, he finds that people who are financially able to pay more than $260 per week tend to buy their house instead of rent.

Tahi recalculates the yield, based on current prices and a higher rental price of $260 per week. In his calculations he allows for the fact that rates have increased. He also takes into consideration the fact that if he charges higher rents, his vacancy costs will be higher, as well as his property management costs (his property manager charges 7.5% of the rental price).

Tahi also does some research into other houses on the market. He finds one that has a yield of 3.2% and is in an area which has yet to experience the boom in prices, but which he considers has good growth potential.

***Tahi's Property Yields – Scenario 2***

| | **Property 2** |
|---|---|
| **Gross Annual Rent** | **$13,520** |
| **Annual Expenses** | |
| ▪ Rates | $2,890 |
| ▪ Repairs & Maintenance | $200 |
| ▪ Insurance | $821 |
| ▪ Management Fees | $1,014 |
| ▪ 3 weeks vacancy | $780 |
| ***Total Annual Expenses*** | ***$5,705*** |
| | |
| **Total Annual Rent less Total Annual Expenses** | **$7,815** |
| **Value of Property** | **$300,000** |
| | |
| **Net Yield (before tax)** | **2.61%** |

**Net Yield = Rental Income – Expenses / Property Value x 100**

= $7,815 / $300,000 x 100

= 2.61%

As Tahi does not believe property prices in the area of his current investment property will increase much more, he decides to sell it in order to realise the capital gain in the property. He then uses the money to buy the new property which provides a higher yield (3.2%).

## Maximising the Yield

Charging higher rental prices increases the yield for a property. However, sometimes it is not feasible to increase prices.

Whether or not you can charge higher rental prices depends on:

- demand for rental housing in the region (if there are a lot of people looking for houses to rent),
- what other ***landlords*** are charging for similar houses,
- the affordability of buying houses (if it is affordable, people will choose to do this instead of rent), and
- whether people feel like they are getting value for their money.

Maintenance and ***renovations*** are tools that can be used to increase the yield. By making improvements to a property, and keeping it in good condition, people are more likely to pay higher rents.

However, when doing this, you need to make sure that the amount you spend does not outweigh the benefits.

Note that, **when you spend money on maintenance**, you increase the costs associated with owning the property. This will **decrease the yield**, UNLESS the amount you spend is outweighed by the increase in rental prices.

Similarly, **if you spend money on improvements** to a property (as opposed to maintenance) you are increasing the value of the property. This also decreases the yield. Examples of improvements include new bathrooms and the addition of a garage.

Therefore, before making an improvement to a property, **check the impact on the yield and on the likely capital gains**. For example, there is no point spending an extra $600 per year on maintenance if it only allows you to increase rents by $5 per week ($260 per year)!

#### 4.1.1.3 Capital Gains

***Capital gains*** are the financial returns
that you receive if you sell your investment property
for MORE than what it cost you to purchase it
(plus what you spent on improvements).

For example, if you bought a house for $160,000 (including all associated costs), then spent $25,000 putting a new kitchen and bathroom in it, then sold it for $215,000, you would have a capital gain of $30,000.

**Capital Gain = Sale Price – Purchase Costs – Improvements**

= $215,000 - $160,000 - $25,000

= $215,000 - $185,000

= $30,000

The amount of capital gain is mostly influenced by the market. As shown in Section 1 of this Module, property values tend to increase over time, so unless you are forced to sell at a time when the market is low, on average, you can expect to make some capital gains with a property investment.

Given that it is now difficult to find properties which return more rental income than the cost of interest on a mortgage, this is very important. In fact, many property investors now rely on capital gains as their main form of financial returns.

The best way to get capital gains is to buy properties at prices below market value. It is possible to find bargains – there are always people who need to sell their house in a hurry and are willing to accept a lower price for it. There is a saying – '*you make your money when you buy a property, **not** when you sell it!*'

## 4.1.2 Taxation

In New Zealand, the way that financial returns on property investments are taxed depends on the type of return. Rental returns are treated differently than returns from capital gains.

### 4.1.2.1 Taxation of Rental Returns

Rental income is taxed like income for a business. That is, expenses are deducted from income received to determine ***profit***. If there is any profit, income tax is paid on it.

Thus, if you do have investment properties, it is in your interest to keep good records of the expenses involved. This is so that, instead of paying tax on all of the rental income, you only pay tax on the profit.

**'Deductible' and 'Non-Deductible' Expenses**

When you are working out the profit (or loss) from rental income, most of the costs of having a rental property can be ***deducted*** (subtracted) from the rental income. Remember, it is an advantage to you if costs are subtracted from income because it means your profit will be lower, and you will pay less tax.

However, there are some costs associated with having a rental property which the IRD does **not** allow you to take into consideration when working out your profit.

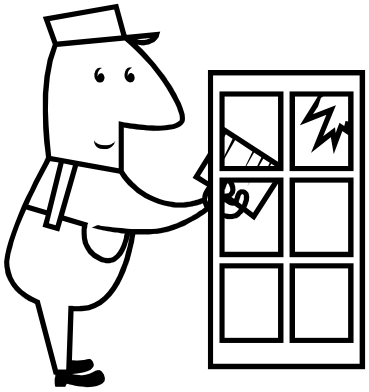
Costs that you ARE allowed to subtract from income are called ***deductible expenses***.

Costs that you ARE NOT allowed to subtract from income are called ***non-deductible expenses***.

***Deductible Expenses***

The types of rental expenses that are considered ***deductible*** for tax purposes include (but are not limited to):

- Mortgage interest (but not repayments of loan ***principal***)
- Rates
- Insurance
- Repairs and maintenance costs (but not costs of ***capital improvements*** to the property)



- Property manager fees
- Accountant fees
- Motor vehicle and travel expenses. This must be 'reasonable'. Furthermore, you need to keep a log of all travel for at least three months. Mileage is claimed at IRD rates (refer to www.ird.govt.nz)
- Property valuation fees (to get a loan)
- Bank fees
- Legal fees (except for conveyancing costs)
- ***Depreciation*** on ***fixtures*** and ***chattels***

Remember, ***fixtures*** are items of property within a house which cannot be removed without causing damage to the house. Examples include cupboards which are built into the house and a stove top which is built into a kitchen bench.

On the other hand, ***chattels*** are items of property within a house which can easily be removed. Examples include a dishwasher and curtains.

However, note that the full cost of the fixtures and chattels is not deductible all at once. Instead, only a portion of the cost is. This is referred to as ***depreciation***.

***Depreciation*** is an accounting procedure which accounts for a loss in value of an asset. It is NOT an actual expense which comes out of your bank account.

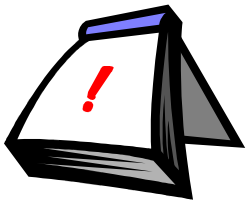
Instead of deducting the entire cost of a fixture or chattel as an expense in one year, the cost of the asset is spread out over the 'useful lifetime' of an asset.

**Here is an example to demonstrate how it works:**

For example, assume you were to buy a heat pump and air conditioning system for $8,000 and that these systems have an expected useful life of 8 years.

Instead of claiming the full $8,000 as an expense in the year you purchased the heat pump, you would depreciate the asset and claim a portion each year (e.g. $1,000 per year).

The IRD determines exactly what portion of the initial cost you may claim on an asset per year. This amount is a ***deductible expense***. The exact portion of the cost which is deductible depends on the type of asset.



It is important to note that you can only claim expenses while a property is rented or available for rent. Furthermore, new rules were introduced for the 2013-2014 financial year regarding what portion of expenses can be claimed while a property is not in use.

So if, for example, you use a rental property as your holiday home for one month of the year, you cannot claim expenses for that month. In addition, if that property is unused for 62 days or more of the year, there will be restrictions on what portion of other expenses you can claim.

Another very important fact is that an investor cannot treat their home expenses in this way. A family home is of a private nature and not the same thing as an investment property. That is, expenses are not tax deductible.

This could be considered as ***tax evasion***. This is a very serious matter which can cost you a lot in penalties (penalties may be in excess of 100% on the amount payable).

### *Non-Deductible Expenses*

Based on the previous few pages, you may have already worked out what expenses are ***non-deductible***. The main non-deductible expenses are as follows:

- ☒ Mortgage ***principal*** payments (i.e. the actual price you pay for the property – note that the interest payments ARE deductible.)

- ☒ The cost of ***capital improvements***. These are improvements to the property (as opposed to general repairs and maintenance). Examples of capital improvements include such things as the addition of a garage or deck, or the complete renovation of a kitchen or bathroom.

- ☒ The full cost of ***fixtures*** and ***chattels*** (remember, this is spread over a number of years and called '***depreciation***').

- ☒ Real estate agent's fees that you pay when selling the property.

- ☒ ***Depreciation*** on the actual building or land.

Up until March 2011, people could claim ***depreciation*** on the value of a building. That is, they could assume that the value of the house would decrease over time due to wear and tear, and could therefore record up to 3% of the cost of the house as a depreciation expense each year. This could literally save people thousands of dollars each year in tax!

However, this is no longer possible. In any case, it wasn't always a good idea to claim depreciation on a building as a ***deductible expense***. This is because if the house actually increased in value, and you sold the house for more than you had paid for it, you would have to pay back all the tax you had previously saved!

## Ownership Structure

The amount of tax to be paid depends on the structure under which the property is owned.

For instance, if you set up a ***company*** to own the investment property, profits are taxed at the company tax rate (i.e. 28%).

But, if you instead own the investment personally, in your own name, the profit from your rental property is added to your annual income. Your entire income, including the profits from your rental property, is then taxed at the relevant ***marginal personal tax rate***. The current personal tax rates are:

| Income Range | Marginal Personal Tax Rate |
|---|---|
| $0 - $14,000 | 10.5% |
| $14,001 - $48,000 | 17.5% |
| $48,001 - $70,000 | 30% |
| $70,001 or more | 33% |

If there is a loss, instead of a profit, this may possibly be offset against personal income. In other words, your overall income might be reduced by the loss. The benefit of this is that you would pay less tax.

For example, if you personally earned $45,000 from your full-time job, and you also had a rental property which made a loss of $5,000, it may be possible that you would pay tax based on $40,000 – not $45,000.

However, whether or not you can use losses from property investments to reduce your income (and thus the amount of tax you pay) also **depends on what structure the property investment is owned under**.

If a property is owned personally or in a partnership, losses can be offset against personal income, but if it is owned by a company, they cannot.

There is another option called a ***Look-Through Company (LTC)***.

### *LTCs* and *LAQCs*

Before 2011, one of the most popular structures for owning property was called an ***LAQC***. This stands for ***loss attributing qualifying company***. The main benefit of LAQCs was that, if the company made a loss, this loss could be offset against personal income. This would reduce the tax they needed to pay.

However, due to changes to legislation made in 2010, since 31 March 2011, the LAQC structure no longer exists. All LAQCs were required to change to a new structure.

They could, for example, become an ordinary company or a sole trader or partnership. Another option is to use the new ***Look-Through Company (LTC)*** structure.

An LTC is a new structure which is similar to an LAQC. Two of the main differences between these structures are as follows:

1. If you have an LTC, the **profits must be passed on to the shareholders** (as well as the losses). In comparison, under the old LAQC structure, you could choose to keep profits in the company so they would be taxed separately.

   So, for instance, assume you have an LTC and are on the top marginal tax rate of 33%. If your rental property makes a profit, this profit will be joined together with your personal income and taxed at 33%. If you instead owned the rental property under a company, the profit would be taxed at the lower rate of 28%.

2. There are some **restrictions about the amount of losses that you can offset** against your personal income. The rules around this are quite complicated. If you are considering having an LTC, it is best you get advice from your accountant about this.

***Example: Rihari***

Rihari set up a ***look-through company (LTC)*** to buy some property investments. The company purchases two properties, both of which have mortgages.

The interest payments on these mortgages are much more than the rental income. As a result, the LTC is expected to make an income loss of approximately $13,520 per annum.

Throughout the year, Rihari then earns a $54,000 salary from his full-time job. He pays tax on this throughout the year via the PAYE system. **A total of $9,220 of income tax is paid**. This is calculated as follows:

- The first $14,000 is taxed at 10.5%: $1,470
- The next $34,000 (from $14,001 to $48,000) is taxed at 17.5%: $5,950
- The last $6,000 (from $48,001 to $54,000) is taxed at 30%: $1,800

However, as he is the only shareholder of the LTC, at the end of the income tax year, the full loss of the company (which turns out to be $14,200) gets offset against Rihari's personal income. This means that Rihari's overall income for the year is only $39,800.

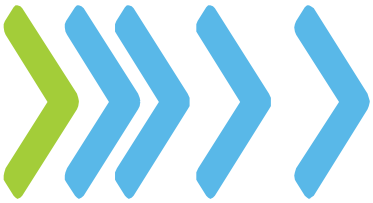
Based on this, **the total income tax payable is only $5,985**. This is calculated as follows:

- The first $14,000 is taxed at 10.5%: $1,470
- The next $25,800 (from $14,001 to $39,800) is taxed at 17.5%: $4,515

**Rihari is therefore eligible for a tax refund of $3,235.**

**This is calculated as $9,220 - $5,985.**

If Rihari had instead owned the properties under an ordinary ***company***, he would not have been able to offset the losses against his personal income. That does not, however, mean that he would not have been able to offset those losses against any income at all:



With a normal company, a loss can be offset against future profits.

That is, losses can be 'carried forward'.

Therefore if, for example, the company had made a profit of $20,000 the following year, the loss of $14,200 could be deducted from this. Rihari would then only need to pay tax on $5,800, instead of $20,000.

But the reality with property investment is that it can be a very long time before any profit is made – that is, this may not happen until mortgages have been paid off.

**What if the LTC makes a profit?**

Let's continue with the example of Rihari. Since Rihari has an LTC, if the LTC makes a profit, this profit will be joined together and taxed with his personal income.

For instance, if the LTC made a profit of $20,000, this amount would be added to Rihari's salary (remember, this is $54,000). Rihari would therefore need to pay tax on $74,000, based on the personal marginal tax rates.

Also remember that the top personal marginal tax rate is 33%. Since Rihari's total income is over $70,000, some of the profit will be taxed at 33%, and the rest at 30%. If Rihari instead had a company (not an LTC), the company would have to pay tax on the lower rate of 28%.

It is very important that you seek professional advice when deciding what ownership structure is best for your situation.

The decision of whether an LTC is a good idea will depend, to some extent, on whether you expect the rental properties to make a loss or a profit.

#### 4.1.2.2 Taxation of Capital Returns

Under current legislation in New Zealand, not all capital gains are taxed. Under the *Income Tax Act 2007*, any returns made from the sale of property are only counted as income if the property was purchased for the purpose of disposing of it. This means that whether or not your ***capital returns*** are treated as income will depend on your **intention** when you bought the property.

So if you:

buy a property which you think will rise in value

AND you intend to sell it once it rises in value

so that you can make a profit,

any profit that you make WILL be taxable.

On the other hand, if you buy a property to be used as a family home and then later decide to sell it, any gain from this sale is NOT counted as taxable income.

But you need to be aware that if you buy and sell your 'family home' a lot, this may look suspicious to the IRD.

There is then a risk that the IRD will consider that you are actually buying houses with the purpose of making capital gains. If so, you will need to pay tax on the profits.

The IRD publishes a very useful guide to taxation of residential properties called 'IR313: Buying and Selling Residential Property'. This guide, which is available on the IRD website, contains numerous case study examples to demonstrate circumstances under which capital gains are taxable.

Some of these case studies are as follows[50]:

[50] IRD. (2011). *Buying and Selling Residential Property,* p.7. Retrieved 2 May, 2011, from http://www.ird.govt.nz/resources/3/0/305950004bbe5936836ed3bc87554a30/ir313.pdf

### *Case Study Example 1: Joe and Gail*

Joe and Gail buy a second property as a rental. They also hope, in the long term, that the property could be sold for a profit.

Joe and Gail's main reason for buying the property is for rental income – the hope of a higher resale value is not a primary reason for the purchase.

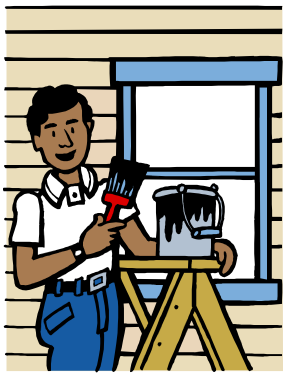
In this case, the rental income and recovery of any depreciation they claim against the property is taxable. Any profit from the eventual sale of the property is unlikely to be taxable.

### *Case Study Example 2: Bill and Dean*

Bill and Dean buy rundown properties that need minor work to get them into a saleable condition. They aim to make a profit on their sales. They also live in the houses while they work on them and do not own another home.

Although Bill and Dean use each of the houses as a home, their main reason for buying the properties is to resell them at a higher price. They must pay tax on the profits because they have a history of regularly buying and selling properties.

### *Case Study Example 3: Mark and Jan*



Mark and Jan buy a property as a family home. They are keen on DIY and do a lot of work on the house to make it more comfortable and hope this will increase its eventual resale value. Then Mark gets a job in another city and they sell their home at a substantial gain.

Although Mark and Jan have worked on the property, they had no real intention of reselling it when they bought it. As a family home, the profit made on the house is not taxable.

## What if my intention changes?

You may, for example, buy an investment property with the main intention of keeping it as a rental property and receiving rental returns. That is, you may have no intention of ever selling it.

On the other hand, you may buy a property with the intention of selling it at a profit, and then decide that you actually want to keep the house.

**In each of these situations, what matters is the *original* intention.**

For instance, assume that you did buy a property with the intention of selling it a few years later at a profit. Now assume that the property market slumps, so you instead live in it for a while, then rent it out, and eventually sell it 15 years later. If you make a profit, the sale is likely to be taxable.

A key point to note is as follows:

**Even if you hold a property for a long period of time, the profits may be taxable.**

It is commonly thought that if you hold a property for long enough, the profit made is not taxable. This is not true – there is no time limit as it is your intention (or reason) for buying the property which counts.

So if you buy a property and hold it for 30 years before selling it, you will still need to pay tax on the profits if you originally purchased it with the intention of making a capital gain long term.

## How does the IRD know what my original intention was?

The IRD takes into account a number of factors when working out what they think your original intention is for purchasing a property.

Some examples of these factors, as outlined in the IR313 publication, are as follows:

- Arrangements and **discussions with the bank** – does the bank have on its file whether you mentioned that you are buying a property with the intention of selling it and making a profit?
- Discussions with the **real estate agent(s)**.
- If the property was rented out, **how long was it rented out for?** Long-term or a fixed short-term?
- Were any **plans drawn up for the property**? What did these indicate?
- Notes made on **council documents**.
- Actual or planned **involvement in the community** – attendance at schools, membership of clubs, etc. So, for example, if you made long-term commitments within a community and then ended up selling the property and moving to another town, it is most likely that your original intention had not been to sell the property and make the profit (as there are indications that you expected to stay in the community).
- **Terms of the financial arrangements**. For example, did you arrange an interest-only mortgage? If so, unless you had also arranged to convert this to another type of mortgage, this may indicate that you had intended to sell the property in order to pay the mortgage at the end of the mortgage term.

The actions that you take before and after a purchase can also help the IRD work out what your intent was. If you, or someone associated with you, is in the business of dealing in, developing or subdividing land, this may also indicate an intention to sell the property at a profit.

## 4.2 Leveraging your Equity

### 4.2.1 What is Equity?

In Module 2, the term ***equity*** was introduced in relation to determining your ***net worth***. The following example was given to demonstrate the concepts of net worth and equity:

***Example: Jordan's Net Worth***

Jordan buys a house for $200,000. He pays a deposit of $40,000 and borrows the remaining $160,000 from the bank. What is Jordan's net worth? In other words, if Jordan sold his house tomorrow (assuming he finds a buyer who will pay $200,000 plus any selling expenses), how much cash would he have?

Let's take a look at what Jordan owns – things that are of lasting value. These are called ***assets***. What does he owe the bank? These are called ***liabilities***. Jordan's net worth will be the difference between what he owns (assets) and what he owes (liabilities).

We can show this using the following equation:

| | | | | |
|---|---|---|---|---|
| **Asset** | **=** | **Liabilities** | **+** | **Equity** |
| **(house)** | **=** | **(mortgage to bank)** | **+** | **(net worth)** |
| $200,000 | = | $160,000 | + | $40,000 |

We can say that Jordan is worth $40,000. This is the amount that would be left if Jordan sold his house and paid back the bank.

In the previous example of Jordan, the term ***equity*** was introduced as being the difference between the value of Assets and Liabilities. That is,

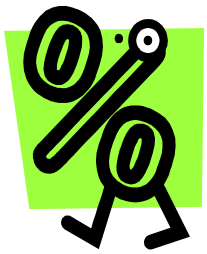
***Assets – Liabilities = Equity***

In relation to property investment:

- The ***asset*** is the property,
- The ***liability*** is typically the mortgage, and
- ***Equity*** is then the difference between these two figures.

**Equity is often expressed as a percentage of the property value**.

For example, if your property is worth $300,000 and you have a mortgage of $200,000, then you have $100,000 equity in your house.



This is equal to 33% equity.

**% Equity = Equity / Property Value x 100**

= ($300,000 - $200,000) / $300,000 x 100

= $100,000 / $300,000 x 10

= 33%

**Other Types of Equity**

There are two other commonly referred to types of equity in regards to property investment:

- ***Net value:***

  This is what the property is worth less sale costs, any outstanding loan or mortgage amounts and any tax payable on capital gains.

  **Net Value = Property Value – Sale Costs – Mortgage Owing - Tax**

  In other words if you sold the property, net value is the amount that you would 'walk away with'.

- ***Borrowable equity:***

  This tells you how much you can borrow. It is calculated as the value of the property multiplied by 80 per cent, less any amount that you owe on the property.

  **Borrowable Equity = (Property Value x 0.8) – Mortgage Owing**

  The reason that the value of the property is multiplied by 80% is because this is the proportion of the value of a property that lenders are usually prepared to lend. That is, you give a 20% deposit and the lender will loan up to 80% of the cost.

Let's look at an example to understand the rationale for borrowable equity.

***Example: Piripi and Alice***

Piripi and Alice own a house and are planning to refinance it by increasing their mortgage. They want to do this so they can use the extra funds for other purposes (specifically, a deposit on an investment property plus an overseas holiday).

Their house only cost $190,000, but they have recently had it valued at $260,000. The couple still owe $110,000 on their mortgage. The equity they have in their house is therefore $150,000. But this doesn't mean they can borrow $150,000.

If Piripi and Alice were to re-mortgage their house, and the bank was prepared to loan up to 80% of the value, they would be able to increase their mortgage to $208,000. (Remember, the percentage that the bank is prepared to lend is referred to as the 'loan-to-value ratio' or 'LVR'). We can work this out as follows:

| | | |
|---|---|---|
| **Mortgage Value** | **=** | **Property Value x LVR** |
| | = | $260,000 x 0.8 |
| | = | $208,000 |

Since they already owe $110,000, this means they would increase their mortgage by $98,000. This amount ($98,000) is referred to as their 'borrowable equity'.

**Borrowable Equity = (Property Value x 0.8) – Mortgage Owing**

= ($260,000 x 0.8) - $110,000

= $208,000 - $110,000

= $98,000

## 4.2.2 Building Equity

Equity increases in two ways:

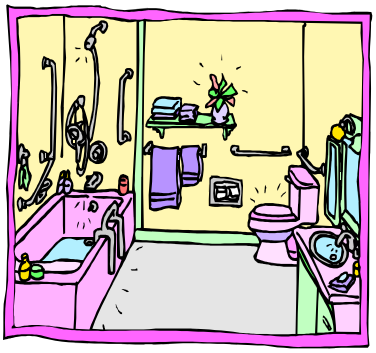
1. by the reduction of debt, and / or
2. by the increase in the value of the asset.

Every time you pay off some of your mortgage, your equity in the property increases. The most common way to increase the value of a property is to leave it to the market – over time, market values tend to increase which, in turn, increases your equity. To make the 'waiting' approach work well, you need to be quite selective about which properties you purchase. Look for those that are in areas with high growth potential.

However, you can also take a more active approach to increasing equity. The best way is to **purchase properties below market value**. Also consider these ways to build equity in a property:

- **Renovation**. Be careful about what renovations you choose to do as it is easy to ***overcapitalise*** (i.e. spend more money than you create in value).

  It is commonly found that renovating areas like a bathroom and kitchen create more value than spending money on special features such as a pool or home theatre room.



- **Create a *subdivision* from a larger block of land**. The local council will have rules around the minimum size of each section and for subdivision in general. This can be a costly exercise and you will usually need the assistance of a ***surveyor*** and lawyer.

- **Create a *Unit Development* from a single piece of land**. These types of developments are more common in urban areas. They are often characterised by having multiple apartment or townhouse-type properties. As with subdivisions, there are rules around the number and size of units, as well as utilities (e.g. water and sewerage) and driveways.

## 4.2.3 Leveraging Equity

***Leveraging*** is commonly used in property investment. The terms ***leverage*** and ***leveraging*** have a wide range of meanings, depending on the topic you are discussing.

In relation to property investment,
***leveraging*** is a term used to describe
buying property with borrowed money.

**The advantages of leveraging are that:**

- it can multiply the return on your investment, and that
- you can buy more investment properties than you could if you were to use your own money.

### 4.2.3.1 Increasing Investment Returns

When you use leverage with property investments, you increase the potential returns on your investment (as well as the potential losses).

Remember, the 'return on investment' is often expressed as a percentage. It is the amount of profit you earn from an investment compared to the amount of money you invest. Here is how it is calculated:

**Return on Investment = Profit / Original Investment x 100**

Here is an example to demonstrate this:

***Example: Kiana's Investment Returns***

- Kiana arranges with the bank to borrow 80% of the money she needs to buy a property.
- The property costs $300,000.
- This means Kiana initially only contributes $60,000 of her own money towards it ($60,000 is 20% of $300,000).
- Kiana rents the house out and the rent that the tenant pays covers the costs associated with owning the house for the year. It also covers the cost of interest on her mortgage.
- One year later, Kiana decides to sell the house, however, in that time, property market prices have increased by 10%.
- Kiana therefore manages to sell her house for $330,000.

**This means that Kiana has made a 50% return on her investment!**

Kiana's deposit of $60,000 has made a capital gain of $30,000.

Kiana will receive her deposit, plus this gain back

(however, note that tax may apply).

She now has $90,000, instead of only $60,000!

**Return on Investment = Profit / Original Investment x 100**

= ($330,000 - $300,000) / $60,000 x 100

= $30,000 / $60,000 x 100

= 50%

**Think of it another way:**

Let's assume that Kiana had bought the $300,000 house using only her own money. In other words, instead of borrowing $240,000 from the bank, she saved up $300,000 and spent it all on the house. If Kiana had done this, she would have only received a 10% return on her investment.

**Return on Investment = Profit / Original Investment x 100**

= ($330,000 - $300,000) / $300,000 x 100

= $30,000 / $300,000 x 100

= 10%

This is much lower than the 50% return she would get from leveraging!

**Let's compare this with Savings in a Bank**

Assume that Kiana had $60,000 and buying the $300,000 house using only her own money was not an option. If Kiana had not used leverage to buy the house, she could have chosen to put her $60,000 savings in a term deposit.

If a rate of 5% (compounded daily) applied, Kiana would have $63,145.46 in total after 12 months (not taking tax into account) in the term deposit. You can check this using the ***compound interest*** formula introduced in Module 1.

**Total Savings = Principal x (1 + Interest Rate)$^{n}$**

= $60,000 x (1+ (.05 / 365 days))$^{365}$

= $60,000 x (1.00014)$^{365}$

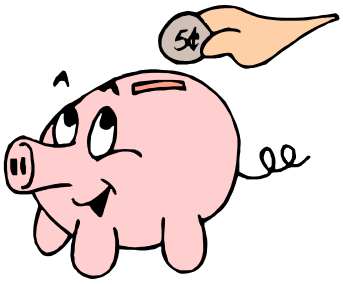
= $63,145.46

That is a profit of $3,145.46, which is $26,854.54 less than what she would receive from leveraging her property investment!

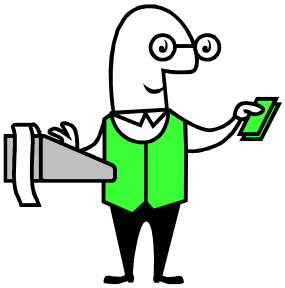
### 4.2.3.2 Purchasing Multiple Properties

The second advantage of ***leveraging*** is that you can buy more investment properties, in a shorter period of time, than you could if you were to use your own money.

There are several approaches to investing in property. These include:



1. Saving the money required to buy a property and purchasing it outright (with no mortgage). Then saving more money to buy another property, and so on.



2. Saving a deposit for one property and getting a mortgage, and then saving another deposit for the next property and arranging another mortgage, and so on.

3. Saving a deposit for one property and getting a mortgage. Then, once equity in the first property has increased, use that equity to borrow more money for a second property, and so on.

The second and third options above both involve ***leveraging***, however, the third option uses it more.

Someone could also use a combination of these two options – that is, they could save a deposit at the same time that they wait for equity in the property to increase. They would then use both a deposit and equity in an existing property to buy another property.

Let's use the example of Steve and Tiari to see how leveraging can enable someone to build their investment portfolio quicker:

***Example: Steve and Tiari***

Steve and Tiari have $40,000 that they want to use as a deposit towards an investment property. As the bank will only lend them up to 80% of the value of the property, the most the couple can spend on a house is $200,000. This is calculated as follows:

**Maximum Value of House** **= Deposit Available / % Deposit Required**

= $40,000 / 20%

= $40,000 / 0.2

= $200,000

The couple find a house they would like to purchase that is on the market for $208,000 and negotiate with the owners to buy it for $200,000. They pay a $40,000 deposit and the bank lends them $160,000. They have therefore now purchased their first investment property.

Over the next four years, there is strong growth in the property market in the area due to a new shopping centre and several new schools opening. The house that they bought for $200,000 is now worth $285,000 and they have paid $18,000 off their mortgage. This means they now have $143,000 of equity in the property, and a mortgage of $142,000.

**Equity** **= Property Value - Mortgage**

= $285,000 – ($160,000 - $18,000)

= $285,000 - $142,000

= $143,000

At this time, the couple decide to buy a second property. Unfortunately they have not managed to save another deposit at all, but the bank tells them they can use the equity that has built up in the house to buy this other property.

The bank manager explains that what will happen, in effect, is that the bank will:

- add the value of both properties together, and then
- lend them up to 80% of this amount.

The maximum value of the next property the couple can purchase is therefore calculated as follows:

**Maximum Value of Both Properties = Equity Available / % Equity Required**

= $143,000 / 20%

= $715,000

**Maximum Value of 2nd Property = Maximum Value of Both Properties - Value of 1st Property**

= $715,000 - $285,000

= $430,000

Steve and Tiari decide to spend the total amount available to them. They therefore purchase a second property for $430,000. The total value of property they own is therefore $715,000 and the total debt owed is $572,000.

After three years of steady growth in the property market, Steve and Tiari get their two properties re-valued.

- The first property is now worth $312,000.
- The second property is worth $452,000.
- Together, the two properties are therefore now worth $764,000.

Over these last three years, $34,000 more has been paid off the mortgage, leaving $538,000 owing. This means that the total amount of equity in both properties is $226,000.

**Equity = Property Values - Mortgage**

= $764,000 – ($572,000 - $34,000)

= $764,000 - $538,000

= $226,000

They would like to purchase a third property, but again, they do not have a deposit saved. They therefore intend to use the equity in their existing properties to do this.

The maximum value of the next property the couple can purchase is therefore calculated as follows:

**Maximum Value of All Properties = Equity Available / % Equity Required**

= $226,000 / 20%

= $1,130,000

| | | |
|---|---|---|
| **Maximum Value of 3rd Property** | **= Maximum Value - All Properties** | **Value of 1st and 2nd Properties** |
| | = $1,130,000 - $764,000 | |
| | = $366,000 | |

Although Steve and Tiari can now spend $366,000 on a third property, they decide to spend less this time. They find a house that is on the market and manage to negotiate the price down to $360,000. This has left $6,000 of equity still available to them. The total value of all the property they own is therefore $1,124,000 and the total debt owed is $898,000 ($538,000 + $360,000)

| | |
|---|---|
| **Property Values** | **= Equity + Mortgage** |
| $312,000 + $452,000 + $360,000 | = $226,000 + $898,000 |
| | = $1,124,000 |

Within the next year, property prices skyrocket and the total value of all three properties combined increases by over 8.5% to $1,220,400. During this time, only $15,000 was paid off the mortgage, leaving $883,000 owing. Equity in the three properties is thus $337,400.

| | |
|---|---|
| **Equity** | **= Property Values - Mortgage** |
| | = $1,220,400 – ($898,000 - $15,000) |
| | = $1,220,400 - $883,000 |
| | = $337,400 |

The couple decide to purchase yet another property and find that they can borrow up to $466,600. This is calculated as follows.

| | |
|---|---|
| **Maximum Value of All Properties** | **= Equity Available / % Equity Required** |
| | = $337,400 / 20% |
| | = $1,687,000 |

| | |
|---|---|
| **Maximum Value of 4th Property** | **= Maximum Value - All Properties  Value of 1st , 2nd and 3rd Properties** |
| | = $1,687,000 - $1,220,400 |
| | = $466,600 |

The couple then purchase a property for $450,000. This is $16,600 less than the amount available to them. Their mortgage increases by $450,000 to $1,333,000.

**Steve and Tiari then evaluate their financial position:**

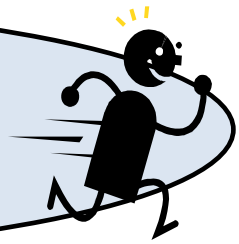
- After a total of eight years in the property market, they have accumulated four properties with a combined value of **$1,670,400**.
- They owe $1,333,000 of this amount to the bank. That equals 79.8% of the value of the properties ($1,333,000 / $1,670,400 x 100 = 79.8%).
- The remaining 20.2% is equity. **This is $337,400 of equity**.
- During these eight years, they have paid a total of $67,000 in mortgage principal (calculated as $18,000 + $34,000 + $15,000).
- When added to their original deposit of $40,000, this is a total of $107,000 that they have contributed.
- This means that the remaining **$230,400** of their equity ($337,400 – $107,000) resulted from property market returns.
- If Steve and Tiari had not used leverage to pay for any of the properties, it is quite likely that they would still be saving to buy the first property. That is, they may have only managed to save this $107,000 to put towards the first house.

**The details of the case study of Steve and Tiari are summarised in the following table:**

| | (A) Total Value of Existing Property | (B) Debt | (C) Equity =(A)-(B) | (D) Maximum Value of All Properties =(C) / 20% | (E) Amount Available to buy another Property =(D)-(A) |
|---|---|---|---|---|---|
| 1a. Initial Situation | $0 | $0 | $40,000 | $200,000 | $200,000 |
| 1b. Purchase of 1st Property | $200,000 | $160,000 | $40,000 | $200,000 | - |
| 2a. Four Years Later | $285,000 | ($160,000 - $18,000) = $142,000 | $143,000 | $715,000 | $430,000 |
| 2b. Purchase of 2nd Property | $715,000 | $572,000 | $143,000 | $715,000 | - |
| 3a. Another 3 Years Later | $764,000 | ($572,000 - $34,000) = $538,000 | $226,000 | $1,130,000 | $366,000 |
| 3b. Purchase of 3rd Property | $1,124,000 | $898,000 | $226,000 | $1,130,000 | $6,000 |
| 4a. Another Year Later | $1,220,400 | ($898,000 - $15,000) = $883,000 | $337,400 | $1,687,000 | $466,600 |
| 4b. Purchase of 4th Property | $1,670,400 | $1,333,000 | $337,400 | $1,687,000 | $16,600 |

So what does this mean?

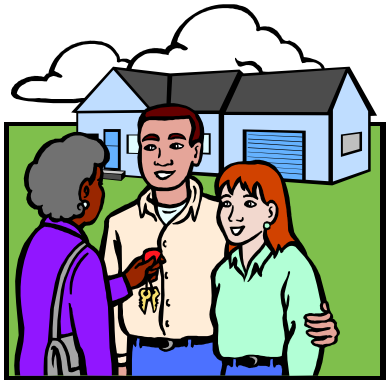
***Leveraging*** *also allows you to build up a large* ***portfolio*** *of investment properties quickly.*



### 4.2.3.3 Possible Tax Advantages

Because mortgage interest is a ***tax-deductible expense*** for an investment property (but not for your family home), there can also be tax advantages associated with leveraging. This is demonstrated in the following example.

***Example: Te Arahi and Megan***



Te Arahi and Megan own their own home, with a mortgage. They have just inherited $45,000 from Te Arahi's grandfather and have decided that they would like to buy a rental property.

As they know it is likely that they will be able to borrow 80% of the cost of a property, they look for a place with a maximum value of $225,000.

**Maximum Value of House = Deposit Available / % Deposit Required**

= $45,000 / 20%

= $40,000 / 0.2

= $225,000

They find one that they like for $205,000 and decide to use the $45,000 as a deposit.

When they go to a mortgage broker for help to find the best mortgage, the broker suggests they finance the purchase differently.

The broker points out that interest on a loan borrowed for investment purposes is ***tax deductible***, but interest on their own home loan is not.

This means that they would be better to use the $45,000 cash to reduce their **own home loan**.

They could then **borrow $45,000** against the equity in their home to pay the deposit on the investment property.

**The overall outcome of this would be as follows:**

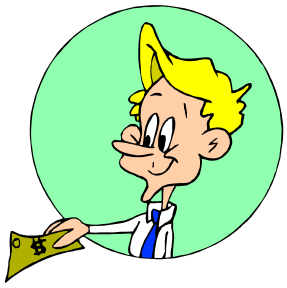
- If Te Arahi and Megan follow the broker's advice, they still end up with the same amount of debt in total.
- However, their personal mortgage will be $45,000 lower, meaning that they will personally save the interest on this amount.
- Te Arahi and Megan will still need to pay interest on the $45,000 they borrow as a deposit on the investment property, HOWEVER, this interest will be counted as a deductible expense.
- The interest on the $45,000 borrowed will reduce profit for the investment property.
- As a result of lower profit, less income tax will need to be paid.

**This method of financing their purchase could potentially save the couple thousands of dollars.**

### 4.2.3.4 Risks and Restrictions of Leveraging

Although leveraging can increase your returns and allow you to build a property investment portfolio quickly, it does have its disadvantages.

The main problem with using a lot of leveraging is that it means you have to manage a significant level of debt. For many people this can be very stressful.



Furthermore, whether or not you will be able to continue to build a ***portfolio*** of property investments will depend on whether you can make the mortgage payments.

Ideally, the rental income received from tenants should be enough to cover all costs associated with owning a property, including the cost of interest on the mortgage. However, as discussed earlier in this section of the Module, this is now quite uncommon.

Due to the high property prices, nowadays in New Zealand, more often than not, property investments are ***negatively geared***. Remember, negative gearing means that the cost of the mortgage is more than the rental income received.

If an investment is negatively geared, investors need to contribute towards the cost of the properties.

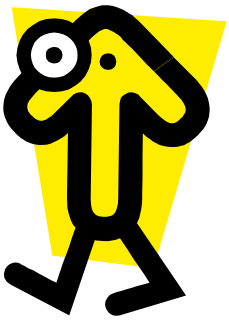
As such, an investor with several properties is not likely to be able to continually use leverage to build their wealth because they would eventually run out of money to cover the mortgage payments.

**The more an investor is leveraged, the higher the risks associated with not being able to meet mortgage payments.**

For example, consider these risks:

- **An increase in interest rates** has a larger impact on the ability to meet loan repayments.

  For example, assume an investor only has one property with a mortgage of $150,000. If interest rates were to increase by 1% per annum (assuming simple interest), they would need to pay an extra $1,500 per annum ($125 per month) in interest.

  However, if they had a $600,000 mortgage, they would need to pay an extra $6,000 per annum ($500 per month) in interest. This is calculated as 1% of $600,000.

- **A reduction in demand for rental housing** in the area (or a surplus of rental housing available), may make it difficult to get tenants.

  If a house stays empty for a long time in between tenants (with no rent coming in) it can be difficult to meet repayments. The more houses that do not have tenants, the more difficult this becomes.

- If there is **a downturn in the property market**, you may have to sell one or more properties at a loss. If you are leveraged you could end up still owing money on your home loan even though you no longer own the property.

  For example, if you bought a property for $250,000, with a 20% deposit, this means your mortgage would be $200,000. If you struggled to meet your mortgage payments, and needed to urgently sell the house, you may need to sell it for less than $200,000.

Thus, the fact that you can leverage finance to fund your property investment goals should not be your only reason for entering the property investment game. As with any other investment, there are risks which must be considered.

## 4.3 Purchasing Properties

Shopping for an investment property can be quite different from shopping for a family home. When you shop for a home, emotional factors can play a large part in your decision.

For example, certain trees on the property may appeal to you because you are able to hang a children's swing from them.

Or, the particular style of a house may remind you of your grandparents' house about which you have many great childhood memories.

As another example, a house may need quite a bit of repair, but because it has a homely, warm feel to it, you may be prepared to live in it and do the work as required.

In comparison, **buying an investment property is a business decision.**

In this sub-section we look at:

- factors to take into consideration when selecting investment properties, and
- the different methods by which properties may be purchased – auction, tender and offer.

Also discussed are some tips for working with real estate agents through the buying process.

## 4.3.1 Real Estate Agents

Although some people choose to sell properties privately, most still prefer to list with at least one ***real estate agent***.

As a buyer, it is likely that you will want to see a range of properties. Thus, although you may look at private sales on, for example, the Trade Me website, in most cases you will also need to work with a real estate agent.

Real estate agents are paid ***commission*** to sell houses. This is usually a percentage of the purchase price of each property. This fee is paid by the person selling the house (the ***vendor***).

It is therefore in the real estate agent's interests to sell a house for the best possible price.

However, they also need to balance price with volume – if the price is too high, they will make no sales and thus receive no income!

Real estate agents are from all walks of life, some have been in the game for a long time, and others are newer. They are like any group: some are good and others not so good.

**Here are some tips for working with real estate agents:**

- **Be wary of techniques to 'up-sell' to you.**

For example, an agent may show you several properties that are within your price range, but are not quite what you asked for. They may then show you one that has all the features you want, but has a price that is just above your stated price range.

This will encourage you to spend that little bit more, as you may start to believe you are unlikely to find what you want within your price range. *Just remember, this is not necessarily the case*.

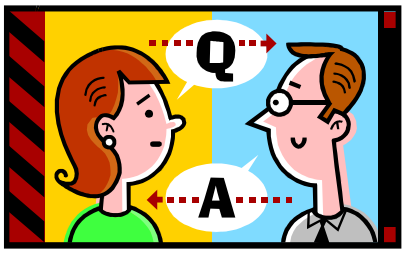
- **Be well prepared before you meet with an agent.**

  This involves being clear as to what you are looking for in a house. An agent is more likely to be able to find what you want if you can give them a list of specific features that you require in a property. Tell the agent to ONLY show you houses that meet all of your requirements – that way you will not be tempted to buy a property that is not completely suitable.

  Remember that you are buying a house as an investment property – not your own home, so if you are very clear about the features you want, you are less likely to get distracted by other details which personally appeal to you.

- **Inspect properties closely and ask agents a lot of questions.**

  An agent does NOT have a legal obligation to point out any defects in a property, but they are not allowed to make misleading statements about it. So if you ask a direct question, they are not allowed to lie.




- **Remember that real estate agents only show you properties that are listed with their agency.**

  It may therefore pay to meet with agents from several agencies.

- **Ask your friends and family for recommendations.**

  Talk to people who have recently bought a property to see what their experiences were.

  - Was a particular agent quite pushy?
  - Were they understanding of the buyer's needs?
  - Did they present a range of houses in the buyer's price range?

- **Let the agent know that you are serious about buying a property.**

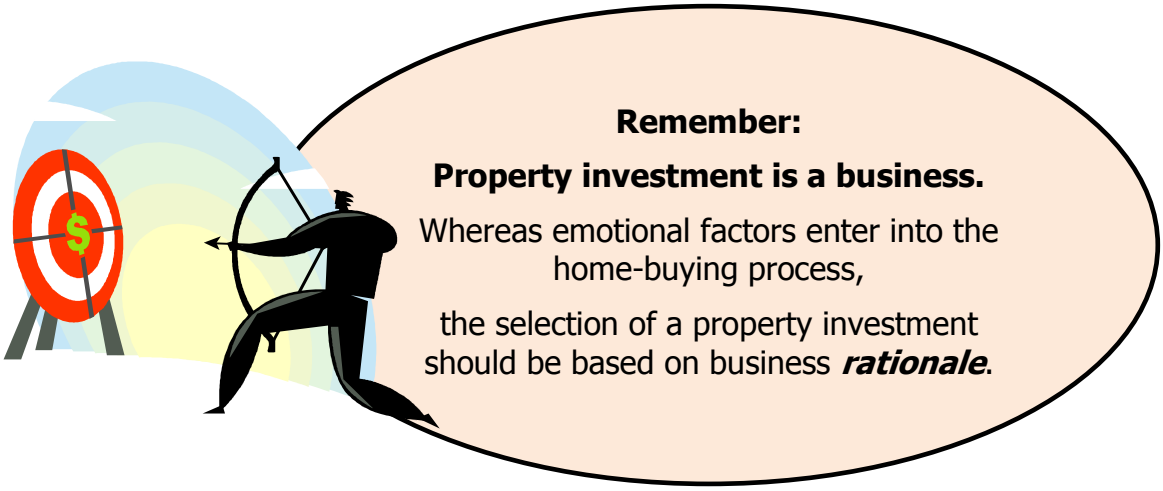
  This way, they will not feel like you are wasting their time and will work hard to find properties that meet your requirements.

## 4.3.2 What to Look For

In Section 2.2 we discussed the process of selecting a house to make your home. Specifically, we looked at desired property features and the process of selecting which house is right for you.

When it comes to property investment, the tips and points outlined in Section 2.2. are still relevant. For example, it is still very important to think about location and ***zoning*** matters.

The ASB Home Buyer's Checklist and Property Comparison Checklist (both provided in Section 2.2) are also valuable tools that can be used to help identify suitable properties. However, the difference is that you are not necessarily looking for a house that personally appeals to you or suits your personal situation.




Therefore, although (for example) established gardens may be something that you prefer in a home, is it something that tenants want?

And, if tenants did not care for them properly, what affect would this have on the value of the house and appeal of the property to future tenants?

In this sub-section we identify factors to watch out for when selecting investment properties. Just as many of the points outlined in Section 2.2 in relation to purchasing a home apply to purchasing a rental property, many of the tips given in this sub-section also apply to purchasing your own home.

### 4.3.2.1 Maximising Returns

The different types of financial returns from investment properties were outlined earlier in this section. These include rental income returns and ***capital gains***. When looking for an investment property you need to be clear as to what you want in regards to returns.

- If gaining a regular and positive cashflow is important, you will need to find a property which can generate more rental income than it costs to maintain the property and pay mortgage costs.

- If, however, you are willing to give up profit from rental income in return for the possibility of higher capital gains, finding a property with high growth potential is most important.

In general, many investors tend to look for properties that provide **both types of returns**.

Furthermore, even if an investor prefers to earn profits from rental income as opposed to capital gains, looking for a property with growth potential is still important. This is because, even if the investor doesn't intend to sell the property to receive these gains, the increase in equity can be used for ***leveraging*** the purchase of further investment properties.

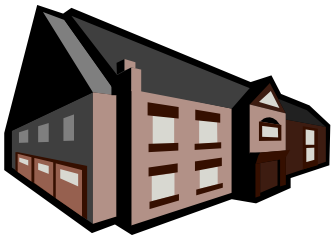
In other words:

- the faster the value of the property increases,
- the sooner you are able to borrow against the property to buy more properties.

Therefore, instead of only having one rental property which provides a positive cashflow, you could have several!

**Here are some general tips to help you maximise your returns:**

- **Houses tend to have higher rental prices** than flats, but because flats are generally cheaper than houses, they tend to provide better rental ***yields***.



- **Location is more important** than whether the property is a house or flat – especially if capital gains are your priority. Review the tips about location given in Section 2.2.

In particular, popular rental areas include those surrounding:

  - High decile schools.
  - Public transport.
  - Shopping centres.
  - Work places with high staff numbers (e.g. universities, hospitals and large corporate businesses).

- Consider the **type of tenant** that you are likely to be able to attract for each property. Are these the type of tenants you want to attract?

  For example, if the area is close to a university, you are likely to get interest from university students – is this what you want? Will it be difficult to attract any tenants at all?

- Look for **low maintenance** cladding, roofing and window joinery to reduce money spent on repairs.

- Look for a **low maintenance section**. If you do buy a property with beautiful gardens, do not pay more for the property than it is worth without the gardens.

  Remember – not all tenants will care for your property the way that you would and not all tenants are keen gardeners.

  It is quite possible that those beautiful gardens could soon turn into an overgrown mess. This can then put off possible tenants and reduce the property's value. If this is the case, it may be in your best interests to get rid of the gardens!

- Look for a property that has the **potential to add value**.

  - Can you easily add another bedroom?
  - What about extending a garage from a single to a double or triple?
  - Would the resulting increase in value outweigh the costs of doing so?
  - Is the property sub-dividable?

- If a property is in an area which already has **too much rental housing**, you may have more difficulty finding suitable tenants.

  This could increase your ***vacancy rates*** and thus reduce your rental returns.

- Aim to buy a property for at least 10% **below what you believe market value is**. You can do this by making offers on properties for which the current owners need (or want) a quick sale. Remember, the best way to ensure you make a capital gain is to make your money when you buy the property, as opposed to waiting and hoping that values in general will increase later on.

### 4.3.2.2 What do Tenants Want?

When you go shopping for an investment property, you need to put yourself in the shoes of your ***tenant***. Remember, property investment is a business – your product is accommodation and your customers are your tenants. In order to get the best financial returns from your business, **you need to meet customer needs**.

**So what do tenants want? Generally speaking, tenants look for:**

☑ Clean, tidy and well-maintained properties

☑ Off-street parking (a garage is even better)

☑ Good kitchens and bathrooms with good light and ventilation

☑ Properties that are easy to look after

However, to be more specific about what tenants want, you need to first decide **what kind of tenant you want**. For example:

- If you want to attract families with young children, that are respectable and no fuss, you will need to look for properties in quiet, family orientated areas, with space for children to play outside or at nearby parks and recreation areas.

- If you want to attract professionals, you should buy modern, low maintenance properties. Professionals will usually pay a higher rent for nicer properties.

***Discussion Question:***

What are the characteristics of your 'ideal tenant'? Why?

### 4.3.2.3 Inspecting Properties

One of the key features of a rental property that both ***landlords*** and ***tenants*** typically want is **low maintenance**.

As a landlord, you do not want the hassle and expense of continually being asked to investigate and fix problems with a house that you do not even live in.

Similarly, tenants want to live in a problem-free environment.

They do not want to have the hassle of contacting the landlord or property manager on a frequent basis to report problems. Nor do tenants want their home life interrupted by tradespeople coming to fix these issues.

Therefore, once you have found a number of properties that meet your core requirements of what you want in a house (e.g. good location and 'x' number of bedrooms), you will need to inspect the physical condition of these.

A checklist of what you should look for in each part of the house is given over the following pages.

***Property Condition Checklist***

| | **Tick**<br>*(if response indicates the property is in good condition)* |
|---|---|
| **House Structure** | |
| ▪ The Floor:<br>▫ Is it level?<br>▫ Does it move when you walk / jump on it?<br>▫ Is there any rot or borer holes?<br>▫ Are concrete floors free from cracks? | |
| ▪ Walls and Ceilings:<br>▫ Are they insulated?<br>▫ Are there any stains, mould, bulges or cracks that could indicate leaks?<br>▫ Is there any fresh paint and plaster that could be a cover-up of problem areas? | |
| ▪ Under the House:<br>▫ Are there any cracks in the foundations?<br>▫ Are there rotten or sinking piles? (Check the piles below ground level for soft rot).<br>▫ Are there any signs of damp, leaks, borer, gaps or rot in the floorboards? | |
| ▪ Doors and Windows:<br>▫ Do they open without sticking? If they do not open freely, this may be a sign that the house has moved.<br>▫ Do handles and locks work? Are the locks very secure?<br>▫ Are the rubber seals on aluminium in good condition? | |

| | **Tick**<br>*(if response indicates the property is in good condition)* |
|---|---|
| ▪ Inside the Roof:<br>▫ Are there any leaks or holes?<br>▫ Is the roof sagging?<br>▫ Is it insulated? | |
| **The Kitchen** | |
| ▪ Cupboards:<br>▫ Is there enough storage?<br>▫ Do they open and close properly? | |
| ▪ Appliances:<br>▫ Do the stove, rangehood, oven and hotplates work properly?<br>▫ If there is a dishwasher, is it included in the sale? If so, does it work properly? If there is not a dishwasher, is there room to add one?<br>▫ Is there room for a microwave oven?<br>▫ How large is the space for a refrigerator?<br>▫ Is there a food waste disposal unit and, if so, does it work? | |
| ▪ Are there sufficient power points and do these all work properly? | |
| ▪ Is the lighting adequate? | |
| ▪ Water:<br>▫ Do taps work properly?<br>▫ Is the water pressure strong?<br>▫ Does water in the sinks drain away quickly? | |
| ▪ Is there enough bench space? | |

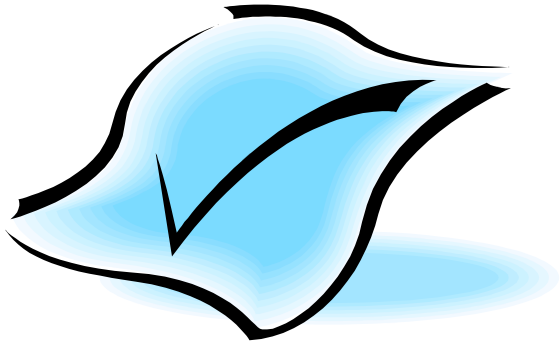
| | **Tick**<br>*(if response indicates the property is in good condition)* |
|---|---|
| **Bathrooms** | |
| ▪ Fans and ventilation:<br>▫ Is there sufficient ventilation?<br>▫ Is there an exhaust fan?<br>▫ Do fans vent to the outside? (If they do not they can cause fires). | |
| ▪ Bath, shower and basins:<br>▫ Is the shower free from leaks?<br>▫ Are signs around them of mildew, leaks or rot?<br>▫ Are there any cracks or stains? | |
| ▪ Toilets:<br>▫ Are there any cracks or stains?<br>▫ Does it flush strongly? | |
| ▪ Are there mirrors, cupboards and towel rails? | |
| ▪ Water:<br>▫ Do taps work properly?<br>▫ Is the water pressure strong?<br>▫ Does water in the sinks drain away quickly? | |
| ▪ Walls:<br>▫ Are wall coverings and paintwork in good condition?<br>▫ Are there signs of mildew or rotting? | |
| **Living Areas and Bedrooms** | |
| ▪ Flooring: | |

| | **Tick**<br>*(if response indicates the property is in good condition)* |
|---|---|
| ▫ Will carpets need to be replaced in the near future?<br>▫ Are there any signs of wear or any stains that are currently being hidden by mats and furniture?<br>▫ Are tiles in good condition and, if not, are there any spare tiles that come with the sale of the house? | |
| ▪ Is there good natural lighting in all rooms? | |
| ▪ Is there good ventilation in all rooms? | |
| Power:<br>▪ Are there sufficient power points in each room and are these suitably located?<br>▪ Do all power points work?<br>▪ Are fittings, switches and sockets in good repair?<br>▪ What condition is the switchboard in?<br>▪ Are there enough lights in each room? | |
| ▪ Does the size and shape of rooms easily accommodate for 'average' furniture? | |
| ▪ Are doorways and passageways wide enough to move furniture through? | |
| ▪ Is there a TV aerial included in the sale? Is reception good? | |
| ▪ Heating:<br>▫ Is there heating in living areas?<br>▫ If there is central heating or heat pumps, do they work?<br>▫ If there is a fireplace, does it work and is the chimney in good condition? | |

| | **Tick**<br>*(if response indicates the property is in good condition)* |
|---|---|
| ▫ If there are gas fires, are the flames strong (if not, is there a blockage?), and are they vented to outside the house? | |
| ▪ Fittings and chattels:<br>▫ Are all desired fittings and chattels (e.g. curtains, blinds, air conditioning units, heating appliances) included in the sale?<br>▫ Are all chattels in good working order? | |
| ▪ Are wall coverings and paintwork in good condition? | |
| **Outside the House** | |
| ▪ Walls:<br>▫ Is the paintwork in good condition?<br>▫ Are there any rotten or broken boards or cracks in the walls?<br>▫ Is the plaster in good condition? | |
| ▪ Roof:<br>▫ Are there any cracked tiles?<br>▫ Is there any rust?<br>▫ Are there holes or signs of leaks? | |
| ▪ Sheds and Garages:<br>▫ Are these in good condition?<br>▫ Have they been built with permits?<br>▫ Do the locks work? | |
| ▪ Are the guttering and downpipes in good condition? | |
| ▪ If there are any retaining walls, are they in good condition and secure? | |

| | **Tick**<br>*(if response indicates the property is in good condition)* |
|---|---|
| ▪ Are fences in good condition? | |
| ▪ If there is a pool or spa, is it in good condition and operational? | |
| ▪ Drainage:<br>▫ Are there any boggy patches in the ground?<br>▫ Where does storm water flow to? Are there storm water drains?<br>▫ Is it a flood-prone area? | |
| ▪ Driveways and paths:<br>▫ Are these in good condition?<br>▫ Is the slope of the driveway easy for cars to enter, turn around, and exit? | |
| ▪ Is there a washing line and, if so, is it in good condition? | |
| ▪ Is there any sign of erosion on banks? | |
| ▪ Boundaries:<br>▫ Are fences located on or within boundaries?<br>▫ Will any planned renovations be able to occur within boundaries? | |
| **Other** | |
| ▪ Is the hot water cylinder large enough? | |
| ▪ Laundry:<br>▫ Is there room for a clothes dryer?<br>▫ Will the washing machine fit well and be installed easily?<br>▫ Are there sufficient power points? | |

| | **Tick**<br>*(if response indicates the property is in good condition)* |
|---|---|
| ▫ Do taps work well?<br>▫ Are there any signs of damp or rot? | |
| ▪ Are there any unpleasant smells and if so, can these be removed? | |
| ▪ Are there likely to be problems with noise? E.g. from traffic or nearby businesses? | |
| ▪ Security:<br>▫ Is there a security system and if so, is it included in the sale and does it work well?<br>▫ Is the access well lit?<br>▫ Is there good street lighting?<br>▫ Do external doors have suitable locks?<br>▫ Do windows fasten securely? | |
| ▪ Is the sewerage connected to the town system or is a septic tank used? If a septic tank is used, are there likely to be any problems with it? | |

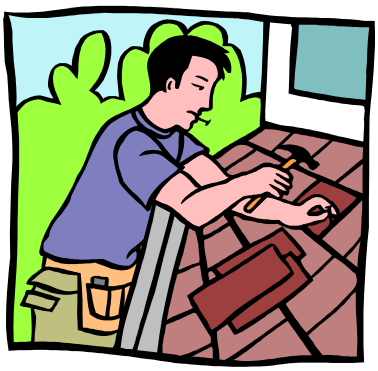


## Leaky Houses

One of the key factors to look for in a property is leakiness. All houses are capable of leaking if not built correctly. The ***Building and Housing Group*** provides a list of features that are known to increase the risk of leaking.

This list includes the following[51]:

- Monolithic claddings, including texture coated fibre cement, EIFS (polystyrene boards with a plaster and paint finish), and stucco.
- More than one cladding system used on the house.
- Lack of roof overhang or eaves.
- Complicated roof design.
- Balconies, particularly above rooms.
- Internal gutters.
- Wall claddings in contact with the ground.
- Lack of flashings (waterproofing strips) to windows and doors.



**If you see any potential signs of leaking**, or are not sure, get an experienced building surveyor (one with weather-tightness expertise) to inspect the property.

The following groups can help you find a qualified building consultant with weather-tightness expertise in your area:

- The New Zealand Institute of Architects (www.nzia.co.nz)
- The New Zealand Institute of Building Surveyors (www.buildingsurveyors.co.nz)
- The Institution of Professional Engineers New Zealand (www.ipenz.org.nz)

[51] Department of Building and Housing. *Buying a House: A Checklist to Help Home Buyers Make Informed Decisions.* Retrieved 3 May, 2011, from http://www.dbh.govt.nz/UserFiles/File/Publications/Building/consumer/home-buyers.pdf

## 4.3.3 Methods of Purchasing a Property

Most properties are purchased through an ***offer and negotiation*** process:

- The prospective buyer makes the ***vendor*** an offer, then
- The two parties negotiate and (hopefully) eventually a price to sell / buy the property is agreed on.

The two other methods of buying properties include ***auctions*** and ***tenders***. All three methods are introduced in this sub-section.

### 4.3.3.1 Offer and Negotiation

Buying based on ***offer and negotiation*** involves
the prospective buyer making an offer to the ***vendor***
for a property and the two parties
then (usually, but not necessarily) negotiating a deal.

This method of purchase is most often done through a real estate agent using a standard ***Sale and Purchase Agreement***. This agreement was introduced in Section 1 of this Module.

The buyer makes a written offer using the Sale and Purchase Agreement, which the real estate agent then takes to the vendor for their consideration.

If the vendor accepts the offer, they sign the agreement.

However, usually, some negotiation takes place, with the vendor making a ***counter offer*** back to the buyer. A ***counter offer*** is where they change something in the agreement – usually the price – then sign it and send it back to the buyer for them to consider.

This process then continues until an agreement is reached or either party decides not to proceed with the transaction.

Once signed by both parties, the Sale and Purchase Agreement becomes a ***legally binding*** contract.

Therefore, if you are buying through ***offer and negotiation***, it is important that you get your lawyer to check the agreement before you sign it and to also check any of the changes made to the agreement during the negotiation process.

If the house is being sold privately (without the use of a real estate agent), the role of your lawyer becomes even more important as you will be negotiating directly with the seller.

## Payment

When an agreement is reached, the buyer pays a deposit (usually of between 5% and 10% of the sale price) to the real estate agent.

Remember, however, that you may be able to negotiate this price. Real estate agents usually take their commission from the deposit you pay, so as long as you are offering a deposit higher than the amount of commission (which is usually around 4%), there may be room for negotiation.

If the house is being sold privately, this deposit is instead paid to your lawyer, who will arrange for it to be held in a safe trust account.

As covered earlier in the Module, at this point the buyer's lawyer then goes through the ***conveyancing*** process.

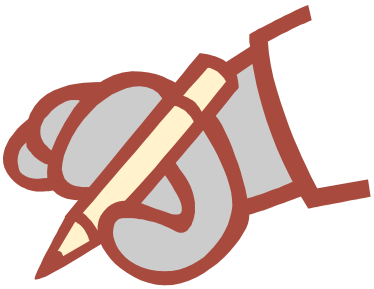
When all conditions of the offer have been met, the offer becomes ***unconditional*** and the sale goes ahead.

If the conditions are **not** met, the buyer's deposit is returned to them and the sale does not go ahead.

## The Negotiation Process

A common negotiation involves a process similar to this:

- The seller puts their house on the market for a price that is a higher than the ***market value***. For example, a house that is worth about $325,000 may be put on the market for $340,000.



- The potential buyer makes an offer that is less than both the ***asking price*** and the ***market value***. Following on from the above example, this may be $315,000.

- The seller then ***counter offers*** with a price lower than their asking price – e.g. $330,000.

- Both parties continue to negotiate. If the seller is unwilling to drop the price further, the buyer may negotiate to have some of the existing ***chattels*** included in the sale – for example, a security system or heating units.

- The parties either:
  - settle on a price close to the market value; or
  - are unable to come to an agreement and therefore stop negotiations.

However, negotiation does not always follow this process, nor does it always run smoothly.

- The seller may, for example, place the house on the market at a price much higher than the market value and be unwilling to negotiate.

- Or, the buyer may put in an offer a lot lower than the true market value, and this offer may then be beaten by another prospective buyer.

## Tips for Purchasing by Offer and Negotiation

- **Just because it is common to place an offer that is below the seller's asking price, this does not necessarily mean you should do so.**

  If the seller has priced the house fairly, and there is a lot of interest in the house from other prospective buyers, it may be in your best interests to simply pay the asking price in order to make sure you get the house.

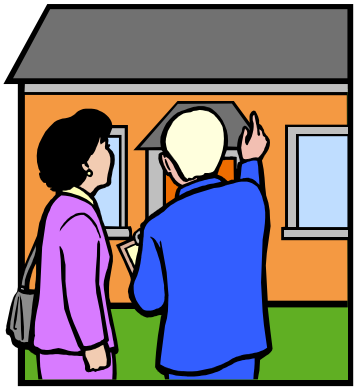
- **If you are very keen on a particular property, tell the seller that you have a guaranteed bank loan (provided that you do!).**

  This signals that you are a committed buyer and the seller may be more willing to negotiate with you than other prospective buyers.

- **If there is a lot of interest in a property, try to be the first buyer to make an offer.**

  The seller may then feel committed to seeing out the negotiation process with you.

- **When you submit your offer, include a clause that allows you to show potential tenants through the house before the possession date.**



This clause can save you hundreds of dollars in lost rent. If you are able to show tenants the house while the vendors are still living in it, there is a chance you will be able to arrange tenants to move in straight after you gain possession of the house. You therefore can start earning rent straight away.

Vendors are usually happy to accept this type of clause because it doesn't cost anything AND it indicates that you are keen to purchase a property.

- **Consider including a clause that states the offer is only valid for 24 hours.**

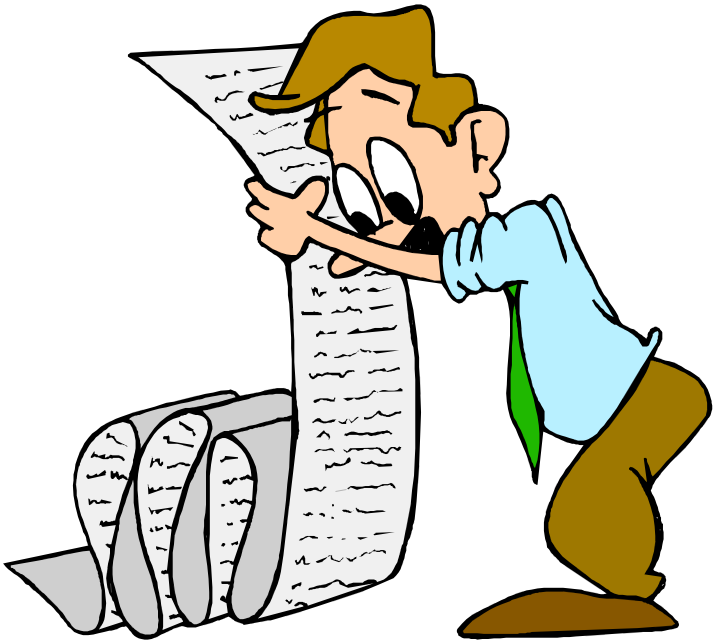
  This places greater pressure on the seller to make a decision and speeds up the negotiation process.

- **The more conditions you place on your offer, the weaker your offer will appear to the seller.**

  Remember, examples of other conditions include: making the offer 'subject to finance', 'subject to a satisfactory LIM', 'subject to a market valuation'. If there is a lot of interest in the property from other prospective buyers, think particularly carefully about what conditions you place in an offer.

  Some conditions make it sound like you are very unsure about buying the house, whereas other conditions (such as a condition to show prospective tenants through the house) make you seem keen to purchase.

  If you are serious about the property, and are able to remove the need for some of these other conditions quickly before placing the offer, do so (e.g. get a market valuation before placing the offer).



## Properties Sold With a Price 'By Negotiation'

Sometimes a seller lists their house for sale with the price as being 'by negotiation'. That is, instead of setting a price (e.g. $300,000) or giving a price range (e.g. $280,000 - $310,000), they leave it for the buyer to submit an offer.

Advertising a house for sale in this way indicates that the seller is not sure what price they should charge and what price the market would be willing to pay.

- They do not want to set a price that is too high, because this will discourage potential buyers from considering the house.
- On the other hand, they do not want to set it low and miss out on a higher price.

However, the **disadvantage** to a seller of advertising the price as being 'by negotiation' is that many people are reluctant to make an offer. Buyers tend to assume that the price expected by the seller is likely to be much higher than they can afford. As a result, they may not put in an offer at all.

However, if you are a buyer and are genuinely interested in a property, if it is being sold with a 'by negotiation' price, this may actually be an **advantage** to you. Why?

- There is likely to be **less interest** among other buyers in the property, which reduces competition.
- The seller may find it difficult to find a buyer and may therefore be more willing to consider any offers they get, even if they are quite low.

Just remember, you do not know how much the seller actually wants for the property – so do not assume they want a high price.

If you put in an offer, you may be surprised to find it is accepted.

### 4.3.3.2 Auctions

An ***auction*** is a process of buying and selling goods by offering them to potential buyers to bid on, and then selling them to the highest bidder.

When it comes to property, auctions are often used if the seller needs to make a sale by a particular date.

An auction is a process of buying and selling goods by offering them to potential buyers to bid on, and then selling them to the highest bidder. Auctions are also often used if it is difficult to place a value on a property due to it having **special features** that some people would be willing to pay a lot for, but others not.

For example, an older house may have quite a 'grand' appearance, with arched windows, high ceilings and a large staircase, but need a lot of work.

Some people may be willing to pay a lot for the 'character' of the house, whereas others may not think these features are special at all (and might even think it is not worth too much because of the amount of repairs needed).

By offering a property for sale by auction, a seller can make sure they get a minimum price (referred to as the ***reserve price***) and then let buyers determine the remaining value of the property.

This way, they are more likely to get the 'best price' for the property. If they instead, for example, listed a property on the market for a certain price, buyers would not pay more than this price (although some may have been prepared to pay more if the price was set higher).

Auctions can also be used to help drive up the value of a property. If a buyer really wants a property, it is not uncommon for them to decide to pay that 'little bit more' in an auction situation.

This is good for a seller, but not so good for the buyer if they get too caught up in the process and pay more for a property than the value they see in it.

In some cases, a vendor may be prepared to consider offers **before the auction date**. If so, the property is likely to be advertised as 'for auction, if not sold prior'.

In this situation, talk to the real estate agent about the process for **early offers** – it may be that, if you intend to place an offer, everyone else that has registered an interest in attending the auction will need to be informed of this. As a result, they too may choose to submit an offer.

## How Does An Auction Work?

An auction is run by an ***auctioneer***. The auctioneer starts the bidding by inviting buyers to call out a price to start bidding at.

The auctioneer will then let everyone know the ***incremental amount*** they will accept for higher bids. For example, they may specify that each bid is for an extra $10,000. Thus, if the bidding opened at $150,000, the next person to bid would be bidding $160,000.

When specifying bid amounts, the auctioneer is likely to start high and then go low as the buyers move towards settling on a price.

For example, to begin with, the auctioneer may be looking for bids of $10,000, but once buyers stop making bids, they will then reduce this to, say, $5,000, then $1,000 and then maybe even less.

The vendor usually sets a ***reserve price*** (remember, this is the minimum amount that they would be prepared to sell the property for), which only they and the auctioneer will know.

If the reserve price has not been met and the auction is moving very slowly, the auctioneer or the vendor may bid against you. This is called a ***vendor bid***. If this happens, the auctioneer will announce something like:

- "on behalf of the owners, I bid $XX,000", or
- "the bid is with me at $XX,000".

However, they can only do this **until the reserve is met**.

Once the bidding reaches the reserve price, the auctioneer will either pause to talk to the owner or declare the property as being ***on the market***.

This means that the highest bidder from that point on will win the auction.

If the bidding doesn't reach or exceed the reserve price at all, the property is ***passed in***, meaning that it doesn't sell at the auction.

Even when a property is passed in, it quite often sells immediately after the auction. This is because the highest bidder then has the first opportunity to negotiate with the seller to purchase the property.

If the negotiations are unsuccessful, the auctioneer may still present other offers from other bidders to the owners.

If the property is sold, the buyer immediately pays a deposit (usually 10%) to the auctioneer.

The ***settlement date*** is then usually 20 days later.

## The Advantages and Disadvantages of Buying a House at an Auction

**Advantages:**

☑ **You may not have to pay as much as you were prepared to pay for a property.**

You only have to pay slightly more than the next highest bidder to get the property. So if, for example, you were prepared to pay $400,000 for a house, and the next highest bidder only bids as far as $385,000, you could potentially get the property for only $385,500.

☑ **You can get an idea about the level of demand for the property by counting the number of bidders at the auction.**

In comparison, when you buy by ***offer and negotiation*** (or by ***tender***), you cannot be sure how many other interested parties there are. As a result, you may miss out on a property by trying to negotiate a price which is too low.

☑ **The process is very quick and there is a set timeframe**.

You know what day the auction is going to take place and the auction may only take 10 minutes. In comparison, when you buy by ***offer and negotiation***, negotiations may drag out over a number of weeks.

☑ **The seller has to pay auction costs and is therefore highly motivated to sell on the day.**

If the auction is passed in and you are the highest bidder, there is a good chance you will be able to negotiate to get the property.

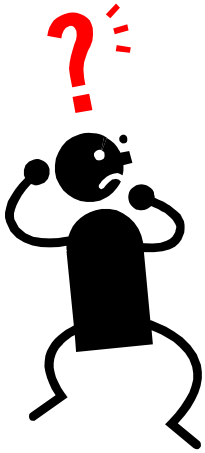
**Disadvantages:**

☒ **You may pay more than you intended.**

It is easy to get carried away with the auction process and bid more than you originally intended – especially if the auctioneer is quite pushy.

Some people get very excited in an auction and decide to pay 'a little bit more' and end up paying much more than they usually would have!

☒ **You may lose track of the bidding denominations in the auction process**.



In other words, you may, for example, think that you are bidding an extra $1,000, when really you are bidding an extra $5,000! This is more likely to happen if the auction is going at a fast speed.

☒ **The auction process can be very stressful for some people.**

☒ **You need to do all of your research on the property before the auction.**

This could include, for example, getting a ***LIM*** report, a valuation and a building report. This all costs money, yet only one bidder at the auction will be successful. This means all others will have spent money on reports but not end up with the property.

In comparison, if you buy a house by offer and negotiation, you may choose to only gather these reports once your offer has been accepted.

## Tips for Buying at an Auction

**Before the Auction:**

- Work out how much the property is worth and **decide how much you are willing to pay for it**.

- Get a copy of the ***sale and purchase agreement*** and go through this with your lawyer, so you are very clear on the terms of the sale.

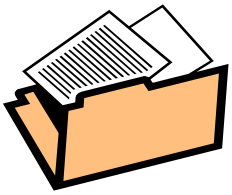
- **Arrange finance** so you can bid with confidence. Also make sure you have the money ready to pay a deposit to the auctioneer.

- **Do not pay too much attention to what the real estate agent tells you the house will sell for.** They could give a higher price to encourage you to bid high – alternatively, if you are unsure about going to the auction, they may say it will be lower than they expect just so that they can get you there and bidding.

- **Do not tell the real estate agent what you are willing to pay for the property!** They may tell the seller and the seller may therefore set a higher ***reserve price*** based on this.

- If you do not think you will be comfortable with the stress of bidding at an auction, **have a friend or a professional assist you**. But if you are going to use someone else to bid for you, make sure they know your highest price.

- **Go to a few auctions first** so you are familiar with the auction process and are less nervous when it comes to bidding for a property you want to buy.



- **Do your research** on the property by ordering / gathering all reports necessary (e.g. a LIM report) in order for you to make a decision.

**At the Auction:**

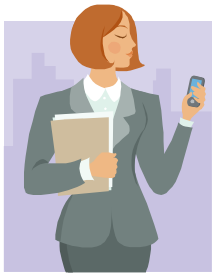
- Take someone with you to the auction and get them to **write down the bids** on a piece of paper so that you can quickly see the current highest bid.

- Make note of **bidding denominations** so that if you make a bid, you know exactly how much you are bidding for. For example, if you make a bid, are you bidding an extra $1,000 or an extra $5,000? If you have someone with you, again get them to write them down.

- **Stick to the maximum price** that you set for yourself before the auction. Do not be tempted to go that little bit further... especially if you are bidding more than your finance arrangements!

- One strategy is to **wait until the bidding is nearing the end**, where some of the bidders have pulled out, before making a bid. This way you do not get caught up in the bidding frenzy.

  Remember, the auctioneer will give you plenty of time to make a bid before closing off the auction – you will not miss out by waiting.



- When you make a bid – **be calm, but give the impression of being serious** about getting the property. This may discourage other potential buyers from bidding against you and driving the price up.

#### 4.3.3.3 Tenders

A ***tender*** is a process of selling a property
by inviting potential buyers
to make confidential written offers.

With a tender, potential buyers need to submit their offers by a certain date. The ***vendor*** then considers all the offers at the same time. No official ***reserve price*** is set, but if no offers are satisfactory, the vendor may choose not to sell their house.

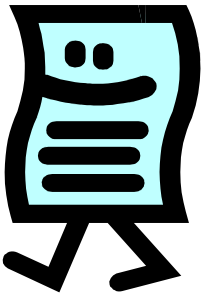
If the offers are reasonable, the vendor will usually choose to either accept the best offer, or negotiate with the person whose offer they like best.

Details of the final sale price are kept confidential
– they are not communicated out to unsuccessful buyers.

In some cases, you may be able to buy a property that is being sold by tender before the tender date. That is, the ***vendor*** may reserve the right to consider offers early. However, if the tender is a 'closed tender', this means offers will NOT be considered before the tender closing date.

Also as per the ***auction*** process, if offers are considered before the tender closing date, it is quite possible that the real estate agent will notify everyone else who has registered an interest in the property so that they too can submit an offer to be considered early.

If you are interested in buying a property that is to be sold by tender, start by registering your interest in the property with the real estate agent and asking for a copy of the tender document. This document provides details of how and when the tender must be made.



Get your lawyer to look through the tender document and advise you of anything you need to be aware of before preparing a written offer.

Also, before submitting an offer, it is a good idea to do all the research needed on the property (e.g. market valuation and LIM report) as, if your offer is successful, you will be committed to the purchase.

You can choose to include **conditions** in your offer. For example, you may include a 'subject to a satisfactory LIM report' condition.

- The advantage of including conditions is that you would only need to pay the cost of getting reports if the vendor is interested in your offer (which they probably only will be if it is the offer with the highest price).

- The disadvantage is that it makes your offer a little less attractive. Another potential buyer may have offered a similar price, but with fewer conditions.

## The Advantages and Disadvantages of Buying a House via a Tender

The main **disadvantage** of the tendering process, to a potential buyer, is that you do not know how much other people are willing to pay. All offers are confidential.

This is very different from an ***auction***, whereby bids made by each potential buyer are communicated to all other potential buyers.

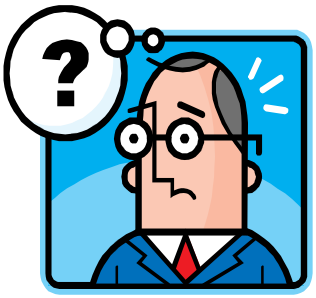
You may therefore submit an offer which is lower than what you are willing to pay, in the hope that it will be the best offer submitted. However, your offer may be too low and, as a result, you miss out on the property.

If the vendor then chooses to sell to, or negotiate with, another potential buyer, there is nothing you can do to change your offer. In fact, as unsuccessful bidders are not even informed of the final sale price, you will not even know how much you would have needed to offer in order to get the property!

**As such,**

**the tender process encourages potential buyers**

**to offer their best price.**



On the other hand, if you submit an offer containing your best price and are successful in getting the property, you are likely to be left wondering:

- if the vendor was actually prepared to sell for much less, and
- if your offer was for far more than anyone else's.

If so, it is possible that you may have been able to get the property cheaper. Accordingly, selling by tender is usually better for the vendor, than it is for the buyer.

However, an **advantage** to potential buyers of buying a house via a tender is that the process often discourages some people from making an offer.

As with buying a house by ***offer and negotiation*** when the price is 'by negotiation', some people do not bother submitting an offer. This is because they assume the price they are willing to pay will be too low.

On the other hand, others do not like submitting an offer because they worry that they will end up paying too much for the property. This reduces competition amongst buyers for a property, making it more likely that the vendor will either choose to accept your offer or to negotiate further with you.

# Section 5

# Property Management

# 5.0 Property Management

So, you have purchased an investment property –
**Congratulations!**

Is it now time to sit back and watch your rental income pour in

and the value of your equity grow?

Not quite.

In order for a property investment to provide the rental and / or capital returns you seek, ongoing management is required.

You need to make sure that:

- the property has tenants,
- the agreement you have with your tenants is properly documented, and that
- your tenants pay the rent on time and look after your property properly,

all at the same time as you fulfil your legal responsibilities as a landlord.

In effect, operating a successful property investment almost requires the owner to be:

- a business owner,
- financial manager,
- people manager,
- marketing manager,
- customer relations manager and
- asset manager.

This section therefore covers the considerations and processes involved in the effective management of your investment. There is a particular focus on your role as a ***landlord***.

When it comes to renting out properties, the main piece of legislation that property investors need to be familiar with is the ***Residential Tenancies Act 1986***.

This Act covers everything from:

- setting the rent, through to
- the contents of a ***tenancy agreement***,
- ***tenant*** and ***landlord*** responsibilities, and
- ***termination*** of tenancy.

Throughout the first two sub-sections of this part of the Module, the key requirements of 'the Act' (as it will be referred to) that all landlords need to be aware of are outlined.

The final sub-section of the Module covers yet another important aspect of managing your investment... that being **selling it**!

There are numerous reasons why you may want to sell an investment property. For example, it could be the case that:

- you have planned to use the proceeds from the sale to buy an ***annuity*** for retirement;
- market values in your area have increased a lot so you want to sell to receive a profit (and then buy a different property in another, cheaper, area); or that
- you have found another property that provides a better rental yield.

Regardless of the reason, you need to have an understanding of the sale process and of factors to take into consideration when making key decisions - such as that of setting the price so as to maximise your ***capital returns***!

## 5.1 Renting out your Property

Property management can be a lot of work. For some properties, depending on the state of the property and on the tenants it attracts, it takes much more work than for others.

One way you can reduce the work involved is by taking particular care in the property you select. Instead of opting for a house that needs a little T.L.C. (tender, loving care), find one that is likely to have very few maintenance requirements. If it is a nice, tidy house, it will be more likely to attract tenants who will look after it well and pay the rent when due.

Another way you can reduce the work involved is to use the services of a professional ***property manager***.

A professional ***property manager*** is
a person or business who has the responsibility
for looking after the daily running of an
investment property.
They charge property owners a fee for their services.

In this sub-section we look at the option of using a professional property manager, and the advantages and disadvantages of it.

We then look at the considerations involved in preparing to rent out a property – namely, the important issues of setting the rental price and then finding the perfect tenants.

## 5.1.1 Self-Manage or Use a Professional?

The first decision you need to make when it comes to managing your property and tenants relates to who will do this job. Do you want to do it yourself (or give the job to a friend or family member) or use the services of a professional property manager?

Some say this decision is a matter of **how you value your time**:

- Is your time better spent elsewhere – like looking for more property investments?
- What about if you work full time?
- Will you have the time (and energy) to make your investment a success?

Some people choose to self-manage first, but then use a property manager later on. This allows them to get some experience, see how big the job can be, and evaluate (and appreciate) the effectiveness of the property manager that they eventually choose to use.

However, a point to keep in mind if taking this approach is that people who poorly manage their own properties may actually cost themselves a lot of money. This is because, if you get the 'wrong' tenants, they may cause damage to the property, not pay their rent, or not stay for long. You could then be left with higher ***vacancy rates*** (the property being left empty for a longer period of time).

Think about the cost of this – if your property was left empty for an extra two weeks per year, how much rent would you miss out on? How does this compare to the cost of a property manager?

### 5.1.1.1 Using a Professional Property Manager

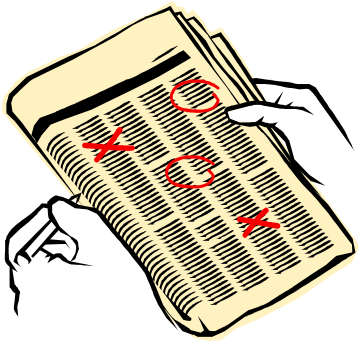
Property Managers are professional agents or businesses that you pay to manage your investment property on your behalf. Property managers may be individuals working alone or as part of a larger company.

There are numerous companies dedicated to providing these services – you can find them through conducting an online search. Alternatively (or, in addition), ask your real estate agent, friends or family for recommendations.

**Services Provided**

Some of the tasks property managers *may* carry out include:

- Marketing your property for rent. This may involve placing listings on websites (e.g. TradeMe), putting signage on the property, advertising in local newspapers, etc.



- Giving advice on determining an appropriate amount of rent.

- Finding suitable tenants. This involves showing possible tenants the property, reviewing applications, interviewing and performing reference checks.

- Arranging the ***tenancy agreement*** and completing requirements regarding payment of the ***bond***.

- Collecting rent and making sure it is paid on time. This includes 'chasing up' tenants who fall behind in payments.

- Organising any repairs and maintenance required.

- Conducting regular inspections to make sure the property is being kept in good condition. This may include preparing reports with detailed photos or videos.

- Conducting final inspections after tenants move out and arranging for the refund of the ***bond***.

- Preparing applications for dispute resolution and attending ***mediation*** and ***Tenancy Tribunal hearings*** (if required).

- Arranging general yard work.

## Advantages and Disadvantages

There are a number of **advantages** to using a property manager. To begin with, think about the skills needed to look after a property.

If you review the list of tasks that a property manager may perform for you, you will see that a good property manager needs to have:

- Good verbal and written communication skills.
- Awareness of laws associated with ***tenancy***.
- Confidence in working with other people.
- Knowledge of maintenance solutions (or who to call if maintenance is required).
- Marketing skills.
- General business expertise.

**Ask yourself honestly** – do you have what it takes? Do you even have an interest in doing this work? Are you experienced at it?

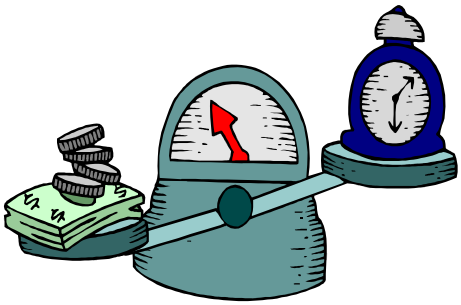
Property management can be very **stressful**, even for those with experience.

Take the example of a situation where your tenant moves out and you need to find a new tenant. You do not know when a tenant is going to give you notice that they are to move out – they may do this:

- at a time when you have a major deadline on at your full-time job,
- when you have your annual family holiday planned (and paid for!) or
- when you have a family member who is sick and in hospital.

Imagine the stress that would cause you if you had to manage the process of finding a new tenant, while you are worrying about your personal situation.

Put simply, a property manager makes your investment less time-consuming. This is great for someone who has money, but not time, to invest.



When it comes to investing, you need to **place a value on your time**. Would your overall financial situation be improved by using a property manager?

That is, think about the extra income you could potentially earn if you used the time it would take you to manage your property to instead work overtime at your job.

Of course **property managers charge fees.** The amount of these fees will impact on your financial returns and your cashflow. On average, expect to pay around 6% to 10% of rent income in property management fees. Although this may sound a lot, if the manager is good, this may prove to be a saving in the long run.

**Consider this example:**

- You rent a property out at $250 per week.
- This is $13,000 in rent per year.
- If a property manager charges fees of 8%, it will cost you $1,040 to use their services per year.
- However, if using the property manager reduces your ***vacancy rates*** by an average of two weeks per year, this is a saving of $500.
- That means that all of the other services provided by the property manager, in effect, only cost you $540 per year.
- Now, think about the hours involved in doing this work (interviewing new tenants, chasing tenants for late rent payments, arranging maintenance, etc.) – do you think you are getting value for money?

The above example shows how using a property manager can help improve your rental income by reducing vacancy rates. However, a property manager can also help maximise rental income by giving guidance on the amount of rent to charge. This ensures you do not overcharge customers, which will also help keep vacancy rates to a minimum.

### 5.1.1.2 Self-Managing

The second option is to manage your investment property yourself. The biggest advantage of self-management is that, if done well, it (may) save money and increase your investment returns.

However, as demonstrated previously in the discussion regarding professional property managers, self-management can sometimes actually end up costing you more!

Self-management can also be an **advantage** because sometimes people like to feel involved in their investments. This way, they feel they have **more control over decisions** that affect their investment.

For example, if you self-manage your property investment, you are able to choose the tenants you want. You do not need to worry about someone else misunderstanding what type of tenant you prefer.

By being involved in your investment, **you are more aware of the condition of your property** and of the way in which tenants are treating it. You can also keep an eye out for potential problems in regards to major repair work that may need to be undertaken or for renovation work that may be beneficial (or even necessary).

However, the flipside of this level of involvement is that some investors fall into the trap of viewing the investment property on an emotional level. If a tenant does not turn out to be as perfect as you thought and does not treat your property in the same way that you treat your own home, this can cause more stress and tension than is really necessary.

### 5.1.1.3 Using a Friend or Family Member

Some investors choose to have a family member or friend manage their investment. This may happen if, for example:

- they have bought a property in a town other than where they live (in New Zealand or overseas), or
- their friend / family member has more experience in property management than them and is willing to take on the role.

The problem here is that it is most often the case that, unless they are a paid professional, another person will not manage your property to the same standard as you would want.

For example, they may have very different ideas about who would be a suitable tenant. You therefore need to decide whether this is worth the risk – that is, pay a professional to do it properly, or get this service from a family member or friend for little or no direct cost... aside from the potential costs associated with them not doing the job properly!

**Family or Friends as Tenants**

Another scenario is if you get your family or friends to live in your property as tenants. You might then treat this very informally. Due to the close relationship you have with your tenants, essential documents such as ***tenancy agreements*** may not get signed.

**The problem with this arrangement is:**

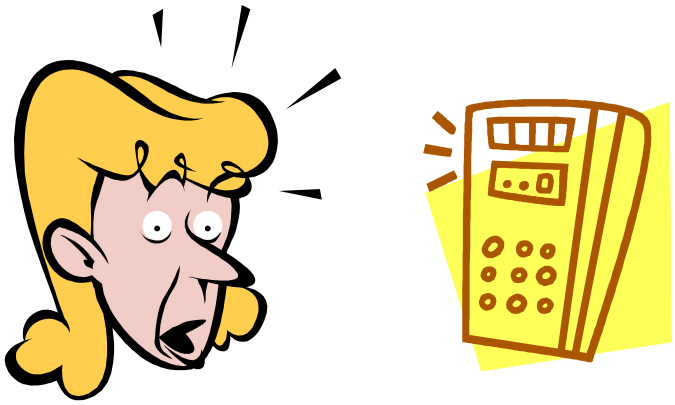
**What happens when things go wrong?**

- What if they start falling behind with rent payments?
- What if you start getting complaints from the neighbours?
- What if the gardens become overgrown?

Will you be as keen to 'go after' your own family (as tenants) as you would be with someone you are not related to? In addition, if no documentation has been completed, there is nothing to safeguard either you or your tenants in regards to rights and responsibilities.

Also, remember this is an investment. Unless you bought the property with the intention of providing for family, you might be missing out on rent that you would otherwise get with alternative tenants.

For example, you might have a house that could be rented out at $300 per week, yet choose to charge a family member $270 per week. **This adds up to $1,560 that you are missing out on over the period of a year!**

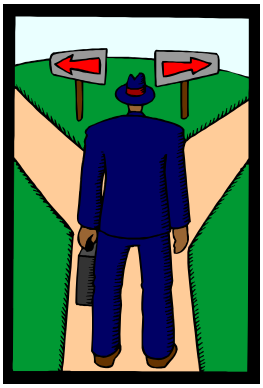


On the other hand, some people may rent to family as only a short-term solution. That is, they may be content with providing a place for family and friends to stay in the short term, but have the intention of renting it to the general public at market rates in the future.

That is fine, but if you do this, you must ensure that your family and friends keep the property in good condition AND you must make sure you know what this is costing you in lower rents.

## 5.1.2 Setting Rent

The amount of rent that you ask for your property has a large impact on the financial returns you receive.



- If you set the rent too low, you miss out on potential income.
- BUT, if you set it too high, you may find it more difficult to find and keep tenants, meaning that, yet again, you would miss out on potential income.

Two of the main factors you need to take into consideration when setting the rental price is your ***cashflow position*** and ***market rent***. Market rent can be affected by factors such as the demand for properties in the area and the location of your property.

### 5.1.2.1 Property Cashflows

***Property cashflows*** are the amounts of money that are received and paid, usually on an ongoing basis, relating to a property investment.

The main ***cash inflows*** are, of course, rental income.

***Cash outflows*** include payments such as:

- Rates,
- Maintenance,
- Interest,
- Insurance, and
- Property management fees.

The cashflow position of a property investment refers to whether an investment is cashflow neutral, cashflow positive or cashflow negative.

- ***Cashflow Neutral:***

  If the rental income (and any other amounts received) is equal to the amount of cash outflows, the investment is said to be 'cashflow neutral'.

**Rental Income = Cash Outflows = Cashflow Neutral**

- ***Cashflow Positive:***

  If the rental income (and any other amounts received) is more than the amount of outflows, leaving you with a positive balance in your bank account, the investment is said to be 'cashflow positive'.

**Rental Income > Cash Outflows = Cashflow Positive**

- ***Cashflow Negative:***

  If rental income (and any other amounts received) is not sufficient to cover all outgoings associated with owning the property, the investment is 'cashflow negative'.

**Rental Income < Cash Outflows = Cashflow Negative**

**There are different ways to determine the cashflow position of an investment, depending on which cash outflows you take into account.**

- Some people choose to include the **principal payments** on their mortgage, whereas others only include the part of their mortgage payments that relates to interest. If you do include principal payments, your cash position may change over time as your payments reduce.

- Similarly, some people include any **tax** that they will have to pay as a cash outflow (or any tax refund they will get as a cash inflow), whereas others do not. If you do not take tax into consideration, you are calculating pre-tax cashflows.

**There is some debate about which calculation is best:**
With or without principal payments? With or without tax?

However, note that if you DO include BOTH

the principal payments on your mortgage

AND the impact of any tax,

the cashflow position will accurately reflect

your overall cash situation.

That is, it will reflect whether or not you have any money in the bank!

There is even an argument to work out the mortgage repayment based on the full purchase price of the property (i.e. including any ***deposit*** you paid). This is because it enables you to compare the overall cashflow effects of two different properties.

Let's look at an example of how to calculate the cash position of an investment:

***Example: Sene and Filo***

Sene and Filo recently bought an investment property for $150,000, using $30,000 they had saved for the deposit and getting a mortgage for the other $120,000.

Over a 15 year period, at an interest rate of 7%, they will need to make weekly payments of $248 to cover both the interest and principal on the mortgage.

Sene and Filo find some good tenants and they enter into a tenancy agreement for $200 per week. Although they hope the tenants will remain in the property long term, they think it is best to allow for 2 weeks' vacancy per year.

Sene and Filo want to keep their expenses to a minimum so they decide to manage the property themselves. Their annual costs therefore only include rates of $1,830, insurance of $790, repairs and maintenance of $300. This is a total of $2,920. By the year's end their records look like this:

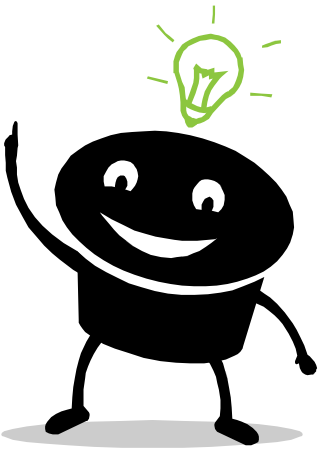
| | **$** | **$** |
|---|---|---|
| Rental Income less Vacancy ($200 x 50 weeks) | | 10,000.00 |
| ***Less: Cash Outflows*** | | |
| Expenses | 2,920.00 | |
| Mortgage Repayment ($248 x 52 weeks) | 12,896.00 | |
| *Total Cash Outflows* | | 15,816.00 |
| **Cashflow Position** | | **-5,816.00** |

Sene and Filo discover that their investment is ***cashflow negative***.

Depending on the ownership structure of the investment, they may be able to offset this loss of $5,816 against personal income to reduce the amount of income tax payable. The amount by which it could reduce would depend on their relevant personal tax rates.

In any case, although this would reduce the amount of the loss, it would not completely remove it. Sene and Filo would therefore need to be able to support this investment with additional funds from, for example, their salaries.

### 5.1.2.2 Market Rent



After reading about ***cashflow negative***, ***cashflow neutral*** and ***cashflow positive*** investments, you may decide that the best idea is to simply set the rent payment high enough to, at the very least, have a ***cashflow neutral*** property.

For instance, in the previous example of Sene and Filo, total cash outflows were $15,816. In order to cover this, the rent would need to be at least $316 per week ($15,816 / 50 weeks – remember, 2 weeks is allowed for vacancy).

However, when it comes to ***residential tenancy*** situations (i.e. renting homes), this is **not always possible**. In fact, nowadays, if you have a mortgage on your property it is more common for you to have a ***cashflow negative*** investment, at least until this debt is repaid.

**There are two reasons for this:**

1. renters may not be prepared to pay that amount of rent for your property, particularly if there are cheaper options available, and
2. rental prices are limited by law.

**Legislation**

Under the *Residential Tenancies Act 1986* (the Act), a landlord is not allowed to charge rent that exceeds '***market rent***' by a 'substantial amount'. ***Market rent*** is described in Section 25 of the Act as follows:

> *"the rent that,*
> *without regard to the personal circumstances of the landlord or the tenant,*
> *a willing landlord might reasonably expect to receive*
> *and a willing tenant might reasonably expect to pay for the tenancy,*
> *taking into consideration the general level of rents*
> *for comparable tenancies of comparable premises*
> *in the locality or in similar localities".*

**IMPORTANT:**

If a tenant believes that they are being charged rent that is a 'substantial amount' above ***market rent***, they can apply to the ***Tenancy Tribunal*** to have their rent payment reduced so it is in line with market rent.

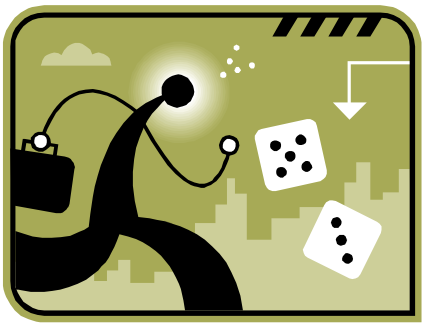
However, if they have a fixed-term tenancy, they must make this application within three months of the tenancy commencing (or within three months of a rent review).

As a landlord, you are usually able to increase the amount of rent you charge a tenant on a regular annual basis, provided that the increase is still in line with market rent and certain conditions are met.

For example, you must give the tenant notice in writing of the increase at least 60 days before the increase takes effect.

You may also increase the rent if you make substantial improvements to the premises. However, again there are conditions around this. In particular, the tenant has to either consent to the improvements being made or you would have to have had expenses that could not have reasonably been foreseen when the rent was last set.

As a result of this legislation, and of levels of property prices in New Zealand, it is becoming increasing difficult to find ***cashflow positive*** investments. This means that often, when an investor takes out a loan to invest in a property, they are using ***negative gearing*** until the property is paid off. Remember, this means that the income received is not enough to cover the cost of servicing the loan.



The risk associated with this is that, as an investor, you rely more heavily on ***capital gains***.

If you need to sell the property at a time when the market is low, you risk receiving less for the property than you paid for it, and you would also have to have covered the cost of the cashflow shortage in the meantime.

## 5.1.3 Finding Tenants

When you buy an investment property, it may already have tenants in it. If so, great!

If not, you may take the opportunity to improve and tidy up the property before letting it out in the hope of getting better rent. If you do this, the key is to do it quickly! The benefit of increased rent can quickly be outweighed by the cost of vacancy.

Think of improvements that take two weeks to conduct and which only increase rent by $10 per week.

- This is an increase in income of $520 per annum.
- If the annual rent was originally any more than $260 per week (i.e. $520 per fortnight), or if improvements take more than two weeks, you would lose money within the first year.

### 5.1.3.1 Who are your Desired Tenants?

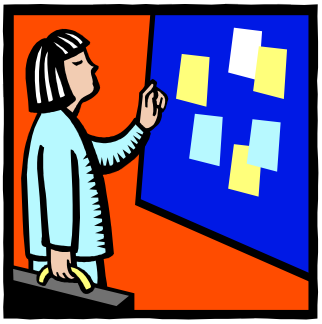
Before you start the search for tenants, you need to be clear about what type of tenants you are looking for. You should already have a good idea of this given that this is something you should have taken into consideration when selecting the investment property (i.e. what type of tenants do I want, and what type of tenants will this investment property attract?).

When you know who you want to attract, you can *target the marketing* of your property to these people.

**You do this by:**

- Using promotional methods that would appeal to the 'target audience'. For example, how would your desired tenants perceive:
  - A flyer in their mailbox?
  - A newspaper advertisement?
  - Signage outside the house?

- Ensuring the content and 'look' of your advertisements will appeal to your target audience. For example, if you want to attract families, you would highlight the family-friendly features of the property in advertisements.



- Advertising in places that your target audience is most likely to look. For example, what sort of newspaper would they look in? Would they be more likely to look online? What about community news boards?

**IMPORTANT:**

Make sure that you do not illegally ***discriminate*** through the application process when advertising for and selecting tenants.

Anti-discrimination laws (namely the *Human Rights Act 1993*) do apply.

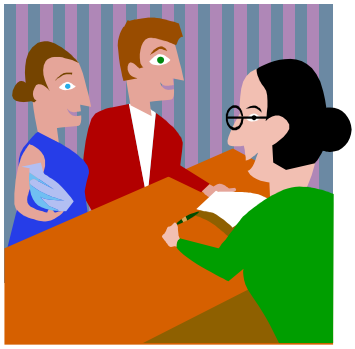
This means that you cannot turn down applicants on the basis of, for example:

- Race,
- Religion,
- Sexual orientation,
- whether or not the applicants have children, etc.

For example, you MUST NOT advertise for 'a Māori, Christian family' or a 'married couple without children'.

So although you may design marketing materials that will appeal to some types of people more than others (and thus encourage these people to apply), you need to be careful not to ***breach*** their rights throughout any part of the marketing and application process.

### 5.1.3.2 Application Forms



It is very tempting to let your house out to the first friendly person who comes along – after all, the sooner you get a tenant, the sooner you start earning rent.

Of course, the first person is not necessarily the best person. However, the more people you meet with, the more difficult it may be to make a choice, especially because it may become difficult to remember all the relevant details about each applicant

Application forms are a great tool to help evaluate tenant options. Using an application form:

- Ensures you gather the same information about each tenant.
- Records information (so you do not need to remember it).
- Makes it easier to compare potential tenants against specific criteria that you may have, which enables you to make a more 'business-like' decision.

If you have a lot of interest in your property, application forms can be used to develop a shortlist of tenants to meet with. When someone asks about your property, you can email the form to them or ask that they stop by to pick one up from you.

Set a timeframe for the return of forms (do not make it too long – after all, your aim is to have your property tenanted as soon as possible!) and on that date, evaluate each application.

If you have any essential criteria, start by weeding out those who do not meet this. For example, having non-smokers may be a 'must' for you.

Once you have identified those people who are most likely to be suitable tenants, you can arrange to meet with them and show them the house. Following this, you would choose the one you like best to conduct ***referee checks*** for (and ideally credit checks – provided that you have sought their permission for this).

**So what details should be in an application form?**

Instead of trying to develop your own application form, you can use one of the many examples available online. The Building and Housing Group, for example, provides a free Pre-tenancy Application Form that can be downloaded from http://www.dbh.govt.nz/tenancy-pre-tenancy. You can either use these forms as they are, or change them to cover the questions you want.

Question areas that you should cover in your application form include:

- **Full names** of applicants plus forms of photo identification that can be used to verify details (e.g. passport or driver's licence).

- **Contact details:** These are needed so you can get in touch with them about their application.

- **Current residence:** Find out their current address and ask the reason for leaving it. Also request the landlord's name and phone number and ask that they be used as a ***referee***. If the tenant has only lived there for a short period of time, also ask these details for their previous residence.

- **Employment:** Find out their current employer and how long they have been with them in order to get an idea of whether their income is secure.

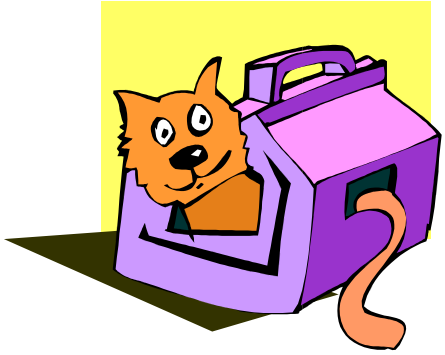
- **Emergency contact details:** Get alternative contact details (e.g. of a close relative) in case you have difficulty getting in touch with the applicant once they are tenants.

- ***Referees*:** Ask for the contact details of two people who can act as referees. At least one of these should be the current or previous landlord. Ideally, the other referee should also be able to comment on the applicant's credit-worthiness and / or stability of employment, etc.

- A **statement of declaration** that applicants sign to say that they agree to the information they have supplied being used as necessary to obtain personal references and conduct a credit check.

**Other questions you may wish to ask could cover:**

- **Smoking:** If an applicant is a smoker, do not dismiss them straight away – they may be excellent tenants who will only ever smoke outside.



- **Pets:** What type of pets do they have and are they indoor or outdoor pets?

- **Details of other occupants:** Who else will be living in the property? How old are they and what relationship do they have to the main applicants (e.g. son? Aunty? Friend?).

- **Lawn mowing:** Do they have a lawn mower? If not, how do they intend to look after the section?

- **Vehicles:** Find out the number of vehicles that will be at the property. If parking space is limited and there are a number of vehicles, be aware that cars may end up parked on lawns.

- **Insurance:** Under the Act, a tenant is responsible for damage that they (or their invited guests) cause intentionally or carelessly.

  So if, for example, a tenant happens to burn the place down through being careless with the stove, the landlord's insurance company will pay out if the landlord has house insurance, but they will then take a claim against the tenant to recover this.

  It is a good idea to at least remind tenants of their risk and recommend that they have insurance to cover this situation. Remember, this may be covered within their home contents insurance policy.

### 5.1.3.3 Referees and Checks

Within the application process you should have obtained details for at least two ***referees***, as well as written permission from the prospective tenant to conduct ***referee checks*** and a credit check.

Do not bother requiring written references – this slows the process down and can restrict some potentially great tenants from applying simply on the basis that their current or past landlord doesn't have the time to write a reference. Besides, it is always best to talk directly with a referee as it provides the opportunity for you to ask questions and you can usually get more honest and insightful responses.

Ideally, one of the referees will be their **current landlord**. The main points to find out are:

- whether the tenant has a good track record of paying the rent on time, and
- if they keep the place tidy and in good condition.

Other considerations are matters such as how well they fit in with neighbours.

One point to be wary of is ensuring that when you conduct a referee check, you are, in fact, talking to the current (or a past) landlord.

**Make sure that the prospective tenant has not just given you the name and contact details of a friend or family member!**

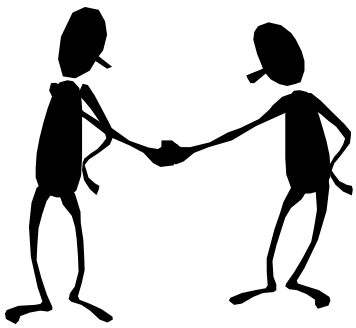
You can do this by checking the Title for the property to see who owns it and then making sure the phone number you are using to contact the person is listed under their name in the phone book. If you are only given a cellphone number to contact the person it will be more difficult to confirm that you are not just talking to a friend who is pretending to be the landlord!

In regards to credit checks, you learnt about ***credit files*** in Module 1. Provided that you have the prospective tenant's consent, you can purchase a copy of their credit file from companies such as Veda (www.veda.co.nz) and Dun & Bradstreet (www.dnb.co.nz).

## 5.2 Managing Tenants

The focus of this sub-section of the Module is on your legal rights and responsibilities as a landlord. The way in which you manage the relationship you have with your tenants is governed by the *Residential Tenancies Act 1986* (the Act).

The Act covers all areas of tenancy, from setting the rent and selecting a tenant, through to going into the property during the tenancy and the processes involved in the termination (end) of a tenancy.



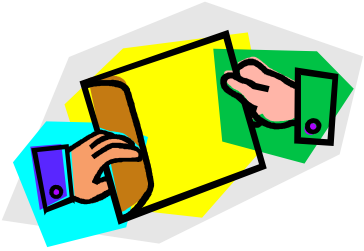
If you and your tenants are clear on the rights and responsibilities of each party, as outlined in the Act, this can help avoid tenancy problems.

However, for the situations in which the tenancy relationship does not run as smoothly as hoped, the Act provides for ways to assist, resolve and settle issues. This is largely done through ***mediation*** and the ***Tenancy Tribunal***.

### 5.2.1 The Tenancy Agreement

Under the Act, every ***tenancy agreement*** must be in writing and signed by both the landlord and the tenant. If you make a change (a variation) to the agreement, or renew it, this must also be in writing and signed.

In addition, the landlord must provide a tenant with a copy of the agreement before the tenancy starts. Similarly, they must provide them with a copy of any variation or renewal before it comes into effect.



Do not worry – you do not need to develop an agreement yourself! The Building and Housing Group has a standard agreement that you can use. You can get this from their website www.dbh.govt.nz.

#### 5.2.1.1 The Required Contents of a Tenancy Agreement

Under the Act, every tenancy agreement must include at least the following information:

- The full name and contact address of the landlord.
- The full name and contact address of the tenant (if this is different from the address of the premises to which the agreement relates).
- The address of the premises.
- The date of the tenancy agreement.
- The date of the commencement of the tenancy (if this is different from the date of the tenancy agreement).
- The landlord's address for service.
- The tenant's address for service.
- Whether the tenant is under the age of 18.
- The amount of any bond.
- The rent payable.
- The frequency of the rent payments.
- The place or bank account number where the rent is to be paid.
- A statement (if applicable) that the tenant shall pay any fee or other charge for services rendered by any solicitor or real estate agent relating to the grant or assignment of the tenancy.
- A statement (if applicable) that the tenant shall pay for any metered water provided to the premises.
- A list of any chattels provided by the landlord.
- If the tenancy is a fixed-term tenancy, the date on which the tenancy will terminate.

When giving address details, the Act specifically says that a Post Office box number, or other similar postal address, is not sufficient. That is, physical addresses must be given in the agreement.

### 5.2.1.2 The Bond

**What is a Bond?**

A ***bond*** is money that a landlord may ask tenants to pay when they move into a property.

The bond is held to cover any unpaid rent or damage to the property that is the tenant's fault.

If the rent is paid in full and the property is properly looked after, at the end of the tenancy, the bond money is refunded to the tenant.

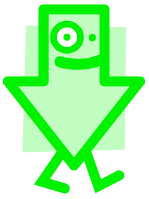
**How much is the Bond?**

Under the Act, the **maximum** amount that a landlord can request from tenants is equivalent to **4 weeks' rent**.

For example, the weekly rent is $250, the maximum bond amount that can be requested is $1,000. Landlords may choose to request less, or even none at all.

Sometimes throughout the term of a tenancy, the landlord may want to change the amount of rent. If they do, this could affect the bond:

- If the landlord **increases the rent**, they may request that a further sum be paid towards the bond. So if, for example, the rent increased from $250 to $260 per week, an extra $40 may be requested. This is calculated as $10 x 4 weeks.



- If the landlord **decreases the rent**, part of the bond **must be returned** to the tenant. So if, for example, the rent decreased from $250 to $235 per week, $60 must be returned to the tenant. This is calculated as $15 x 4 weeks.

## Who holds the bond?

Although the tenant typically pays the bond money to the landlord, this money is not held by the landlord.

Instead, the landlord is required, by law, to send the following to the ***Building and Housing Group*** (which is part of the Ministry for Business, Innovation and Employment).

- a cheque for the amount of the bond, along with
- a Bond Lodgement Form that is signed by both the landlord and the tenant.

This must be done within 23 working days of receiving the bond. The landlord must also give the tenant a written receipt for the bond.

The Building and Housing Group holds the bond money in a trust account and issues a receipt to the landlord and sends a copy to the tenant.

If the tenant wants to send the bond directly to the Building and Housing Group, and you are happy for them to do so, this is possible. In this case, the Building and Housing Group will issue a receipt to the tenant and send a copy to you (the landlord).

## Refunding the bond

In order to retrieve the bond money from the Building and Housing Group, a **Bond Refund form** must be filled out.

- The **landlord** may complete this form at any stage throughout the tenancy or at the end of the tenancy, whereas
- The **tenant** can only do this after the tenancy has ended.

The party filling out the form specifies:

- how much of the bond is to be paid to the landlord, and
- how much is to be paid to the tenant.

If any of the bond is to be paid to the landlord, **a reason for this must be given** for this. For example, was it due to:

- Rent not being paid?
- Damage caused?
- Cleaning costs?

How the bond is then refunded depends on who signs the bond refund form:

| **Parties who have signed the Bond Refund Form** | **What Happens?** |
|---|---|
| Both the landlord AND the tenant | The Building and Housing Group will go ahead and issue the refund, as per the details on the form. |
| Only ONE party | The Building and Housing Group will give the other party 10 working days to contest (argue) the amount.<br><br>If the other party does argue the amount of the bond to be refunded to them, the Building and Housing Group refers this matter to the ***Tenancy Tribunal*** to be sorted out. |
| Neither party (i.e. neither the landlord nor the tenant applies to the Building and Housing Group to get the bond refunded) | The Building and Housing Group may apply to the Tenancy Tribunal to determine how the bond money is to be returned – how much the landlord is to receive and how much the tenant is to receive. |

### 5.2.1.3 Rent in Advance

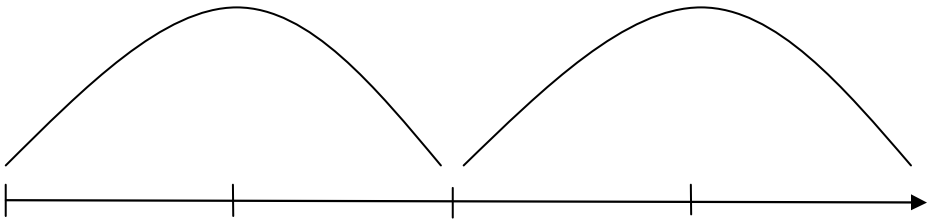
Under the Act, a landlord cannot require their tenant to pay rent for any more than **2 weeks in advance**. However, they also **cannot** ask for the next rent payment to be paid before the end of the period for which rent has already been paid.

So if, for example:

- on the 1st of July, a tenant pays rent to cover the two week period from 1 July to 14 July,
- the landlord cannot require the tenant to pay the next week's rent on the 8th July (even though, as of that date, the tenant would only be one week ahead in their rent).

A landlord cannot require the tenant to pay rent with a post-dated cheque either (that is, a cheque with a future date on it). Nor can they require any other form of post-dated payment.

**Example of Two Weeks Rent in Advance**



**1st July:**
2 weeks rent in advance covers the period from 1st July to 14th July

**8th July:**
Cannot ask for a rent payment, even though the tenant is now only 1 week in advance

**15th July:**
2 weeks rent in advance covers the period from 15th July to 28th July

**22nd July:**
Cannot ask for a rent payment, even though the tenant is now only 1 week in advance

### 5.2.1.4 Outgoings

***Outgoings*** include costs associated with owning and running a property. When it comes to residential properties, the Act specifies who is responsible for paying for each type of expense. This is as follows:

**Costs to be paid by the landlord:**

- Rates
- Insurance premiums (for the actual property, not the tenant's contents)
- Water charges (as below, in some cases the tenant may be responsible for paying these)

**Costs to be paid by the tenant:**

- All charges for electricity or gas supplied to the premises.
- Water charges – this is only if:
  - the premises has a separate water meter and water is charged on the basis of metered usage, AND if
  - it is stated within the tenancy agreement that the tenant will be responsible for this cost.

### 5.2.1.5 Term of Tenancy

There are two types of residential tenancy arrangements – periodic and fixed term.

1. A ***periodic tenancy*** is one that continues ***indefinitely***, with payments made in defined periods (e.g. weekly, fortnightly or monthly), until either party gives notice to terminate (end) the agreement.

   That is, there is no set end date – the tenant will live in the house until some point in the future when either the tenant, or the landlord, decides to end the tenancy.

   This is the most common type of agreement to enter into – especially if you are looking to find long-term tenants for your investment property.

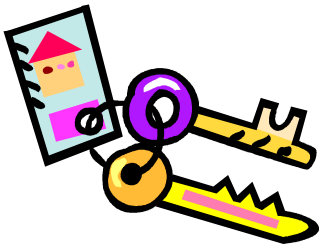
2. In comparison, a ***fixed term tenancy*** is one where the landlord and tenant agree that the tenancy will only be for a certain time period. However, under an amendment to the *Residential Tenancies Act*, fixed term tenancies now become ***periodic tenancies*** at the end of the fixed term *unless* either the landlord or the tenant informs the other party in writing that they want the tenancy to end on the agreed date. They must do this between 21 and 90 days of the end of the fixed term.

   You are most likely to enter into this type of tenancy if you need your property to be vacant at a particular time.

If you have a fixed term agreement with your tenant, you cannot terminate (end) the agreement earlier than the date given in the contract simply by giving the tenant notice that it is to end.

### 5.2.1.6 *Assignment* and *Subletting* by the Tenant

***Assignment*** occurs when the tenant transfers their rights in regards to the tenancy agreement to another party.



In other words, the tenant would arrange for someone else to live in the house as the tenant, and would then not be involved in the tenancy arrangement anymore. The person who they 'assigned' this role to would take over all responsibilities as the tenant.

BUT, if a tenant ***sublets*** the property, this means that they continue to rent the property, but then rent out part or all of it to someone else.

**If you do not want the tenant to be able to assign or sublet**, you may include a provision in the tenancy agreement which says that assignment and subletting is not allowed.

If you do not include a clause such as this in the agreement, the tenant cannot assign, sublet or part with the possession of the property without your prior written consent; however, *you cannot unreasonably withhold your consent or attach any unreasonable conditions to it*. Therefore, if you do not want this to occur, it is best that you expressly say it is not allowed in the tenancy agreement.

## 5.2.2 Ongoing Management and Responsibilities

Once you have found your perfect tenant, signed the rental agreement and fulfilled your obligations in regards to the bond, most of the hard work is done... hopefully! If you have found the right tenant, and if your property was in good condition when you rented it out, your rent will be received on time and you will have minimal interruptions in regards to maintenance and repair work.

However, even with the best tenants, there is still some work to be done in terms of record keeping. Furthermore, you need to be aware of your responsibilities as a landlord, as well as the responsibilities of your tenant, so that you can ensure a happy working relationship between the parties. And if things do not go as smoothly as hoped, you also need to know procedures in regards to resolving tenancy problems.

### 5.2.2.1 Record Keeping

Every landlord of a residential property (remember, a residential property is one that people live in) is required to keep proper business records which show:

1. **All payments of rent** paid by (or on behalf of) the tenant. These records must be kept up-to-date. They must also be in good enough order for the landlord to be able to prepare a written statement for the tenant showing rent payments owing and made for any rent period, if requested in writing by the tenant.

2. **Any bond payment** made by (or on behalf of) the tenant.

This could be kept in a spreadsheet – as shown below.

***Example Record Keeping***

| | | | | | | |
|---|---|---|---|---|---|---|
| 1 | **Record of Rent Accrued and Received** | | | | | |
| 2 | | | | | | |
| 3 | **Date** | **Description** | **Period** | **Accrued** | **Received** | **Balance (Amount Owing)** |
| 4 | 01-Jun-14 | Bond | N/A | 690 | | 690 |
| 5 | 01-Jun-14 | Rent | 01 June 2014 - 14 June 2014 | 460 | | 1150 |
| 6 | 01-Jun-14 | Payment Received | | | 1150 | 0 |
| 7 | 15-Jun-14 | Rent | 15 June 2014 - 28 June 2014 | 460 | | 460 |
| 8 | 15-Jun-14 | Payment Received | | | 460 | 0 |
| 9 | 29-Jun-14 | Rent | 29 June 2014 - 12 July 2014 | 460 | | 460 |
| 10 | 29-Jun-14 | Payment Received | | | 230 | 230 |
| 11 | 04-Jul-14 | Payment Received | | | 230 | 0 |
| 12 | 13-Jul-14 | Rent | 13 July 2014 - 26 July 2014 | 460 | | 460 |
| 13 | 13-Jul-14 | Payment Received | | | 460 | 0 |
| 14 | | | | | | 0 |

Under the Act, landlords must also prepare **written receipts** for their tenants to acknowledge rent received *unless* one of the following applies:

- ☑ The rent is paid out of a bank account in the tenant's name via an ***automatic payment*** (AP).
- ☑ The rent is paid by way of a non-negotiable personal cheque from a bank account in the tenant's name.
- ☑ The tenant pays the rent directly into a bank account nominated by the landlord that is ONLY used for receiving rent (note that this bank account can be used for a number of properties owned by the landlord).
- ☑ The rent is deducted directly from the tenant's pay (or from any benefit that they receive) and paid into a bank account nominated by the landlord.

If the tenant pays the landlord in cash, the receipt must be issued **at the time the payment is received**.

However, if it is paid by some other means, the landlord has **72 hours** to issue the receipt.

### 5.2.2.2 Landlord Responsibilities

It is important that, as a landlord, you are aware of your legal responsibilities to your tenant. Specifically, you are required to:

- Provide the premises to the tenant in a **reasonable state of cleanliness**.
- Provide the premises, and maintain it, in a **reasonable state of repair**, taking into consideration the age and character of the premises, as well as the period during which the premises are likely to remain habitable.

- Comply with all **legal requirements** (under any Act) in respect of buildings, health and safety, that apply to the premises.

- **Compensate the tenant** if the tenant needs to pay money to fix something, but only if the expenses are reasonable and where:
  - The need for the repair was not their fault AND, if left unrepaired, would have been likely to cause injury to someone or to property, or is serious and urgent, and
  - The tenant has made a reasonable attempt to notify the landlord of the need for the repairs to be done.

- Take all reasonable steps to ensure that none of your other tenants interfere with **the reasonable peace, comfort and privacy of the tenant**.

If the tenant has ***breached*** their responsibilities under the Act (as outlined in the following sub-section), you do NOT have to repair any damage caused as a result of this, nor are you obliged to compensate them in any way.

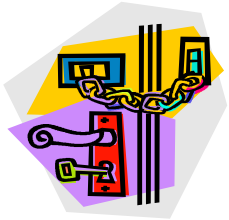
**Some of the other key responsibilities of a landlord are as follows:**

- **Interference with Services:** You must not interfere with the supply of gas, electricity, water, telephone services, or any other services to the premises. This may only be done if it is necessary in order to avoid danger to any person or so that maintenance and repair work can be carried out.

- **Locks:** You must provide and maintain such locks (and other similar devices) as necessary to ensure that the premises are reasonably secure.

  Furthermore you must NOT:
  - alter any existing lock (or other similar device),
  - add a new lock, or
  - remove a lock

  without the consent of the tenant. Note that the tenant is not allowed to alter, add or remove locks either, without your consent.



- **Intention to Sell:** If you put the premises on the market to sell / dispose of it, you need to give written notice of this to the tenant. If the property is already on the market when you are trying to find tenants, you must inform interested tenants of this fact.

- **Appointment of an Agent:** If you are going to be out of New Zealand for more than 21 days at a time, you must appoint an agent based in New Zealand to fulfil your landlord duties while you are away.

  This needs to be done before you leave the country. If you are already overseas and you unexpectedly need to extend your stay beyond 21 days, you must appoint an agent as soon as possible.

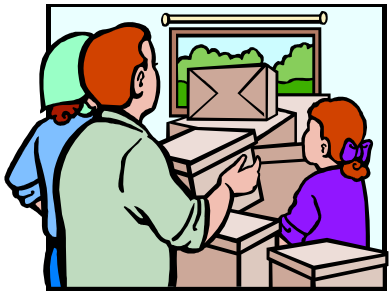
  Once you have an agent, you are required to let your tenants know their name and contact address so they can contact them if necessary. If there is a bond for the tenancy, you must also provide these details to the Building and Housing Group.

### 5.2.2.3 Tenant Responsibilities

It is also important that, as a landlord, you are aware of *your tenant's* legal responsibilities to you. These are outlined below.

**Tenants are required to:**

- **Pay the rent** as, and when, it is due and payable under the tenancy agreement.
- Ensure that the premises are used principally for **residential purposes** (as opposed to mainly being used to operate a business).
- Keep the premises **reasonably clean and tidy**.
- **Notify you (the landlord) of any damage** to the premises, or of the need for any repairs, as soon as possible.
- On termination of the tenancy, leave the premises, taking with them all of their goods, but leaving behind all ***chattels*** you had provided to them to use.



- Leave the premises in a reasonably clean and tidy condition (with all rubbish removed) once the tenancy is terminated.

- On termination of the tenancy, return all keys and security cards that you had provided them with.

**Tenants must NOT:**

- Intentionally or carelessly damage (or permit any other person to damage) the premises.

- Use the premises (or permit it to be used) for any unlawful purpose.

- Cause (or permit) any interference with the reasonable peace, comfort, or privacy of any of the landlord's other tenants, or of any other person living in the neighbourhood.

If the premises are damaged during the term of the tenancy, it is up to the tenant to prove that that this was not intentional or a result of them being careless (or allowing anyone else to intentionally damage it or be careless).

If they cannot prove this, they will be responsible for repairing the damage or covering the costs of doing so.

**What if a tenant causes damage?**

If a tenant (or their visitors) does cause damage to your property, either intentionally or through being careless, they must tell you. You may then ask the tenant to repair the damage OR for them to pay the cost for you to get the damage repaired. If you ask them to cover the costs, these costs must be reasonable. For example, you cannot make them pay $400 for a job that is usually fixed for under $200.

If the damage is not too bad, and the tenant is still living in the house, you can issue the tenant with a notice to fix the problem within 14 days. A template that you can use for this purpose is given on the Building and Housing Group website.

***Screen Print: Template for Landlords to Send to Tenants***[52]

**14 days' notice – breach of landlord responsibilities (from tenant)**

**What sort of publication it is**: Letter template
**Who it's for**: Landlords and tenants
**What it contains**: This is a template letter for a tenant to send to a landlord who hasn't met their responsibilities. It notifies the landlord that they have 14 days' notice to fix the situation.
**How to get it**: Download it or call 0800 83 62 62 (0800 TENANCY)

- Download a 14 days' notice - breach of landlord responsibilities [RTF 68 KB, 1 page] This version of the letter template is designed to be used electronically
- Download a 14 days' notice - breach of landlord responsibilities [PDF 18 KB, 1 page] This version of the letter template is designed for printing and handwritten responses

If the tenant still doesn't fix the problem, you can apply to the Tenancy Tribunal to sort it out. They could issue a work order, require that compensation be paid or allow you to terminate the tenancy. If the damage is quite major, you do not need to issue a notice to the tenant for them to fix the problem first. Instead, you can go straight to the Tenancy Tribunal.

**Other points to note:**

- **Limitations on Occupants:**

  If the tenancy agreement specifies a maximum number of people that may live in the house during the tenancy, the tenant is required to abide by this.

- **Locks:**

  The tenant is not permitted to alter, add or remove any locks (or similar devices) without your consent.

[52] Retrieved 27 September, 2013, from http://www.dbh.govt.nz/pub-sorting-out-problems

- **Access to the Property:**

  As outlined in the following sub-section, the tenant must allow you reasonable access to your property.

- **Fixtures and Renovations:**

  The tenant must NOT:

  - Affix any ***fixture*** to the premises, or
  - Make any renovation, alteration or addition to, the premises

  unless the tenancy agreement provides for this or if you (the landlord) give your written consent (note – you cannot withhold consent unreasonably). This includes installing **digital television equipment**.

  If the tenant then removes their fixture and finds that it has caused damage, they must inform you. It is then your choice as to whether the tenant repairs the damage or pays the costs for you to repair the damage. The tenant is **not** allowed to remove a fixture if it is going to cause damage to the premises which cannot be fixed.

Given the potential damage that could be caused by a tenant removing digital television equipment that they have purchased, some landlords choose to purchase and install this equipment themselves.

### 5.2.2.4 Inspections and Your Rights of Entry

As a landlord, you have the right to enter your investment property while it has tenants in it to check the condition of it.

However, the most you are legally entitled to do this is **once every four weeks**. In reality, this is very often.

**Legal Rights of Entry**

It is important to note that, even though you own your investment property, if there are tenants in it, you cannot enter the actual house whenever you feel like doing so. Instead, in most cases you must get the tenant's permission.

However, this does not mean that your tenants can always deny you entry to your property – they must allow you **reasonable access**.

There are some situations in which you can enter the premises **without the tenant's consent**. These include if:

1. It is an emergency.

2. You are conducting an inspection of the premises – provided that you do not do this more than once every four weeks.*

3. You are checking that the tenant has satisfactorily completed any work you required them to do as a result of them ***breaching*** their responsibilities (e.g. if they had intentionally caused damage and you required them to repair it).*

4. You are checking that the tenant has satisfactorily completed any other work they agreed to do.*

5. You are carrying out necessary repairs or maintenance.*

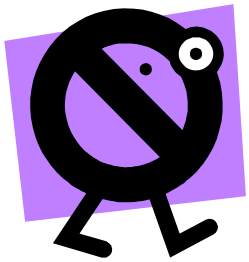
6. You are doing so based on an order of the Tenancy Tribunal.

** For the situations indicated by points 2 to 5 above, you must give the tenant between 48 hours and 14 days notice that you are going to enter the premises on that particular day.*

*Furthermore, you may only enter the premises between the hours of 8am and 7pm.*

If you give the required notice, and are at the property for one of the reasons outlined above, **the tenant cannot deny you access**.

If the property is on the market for sale, you can enter the premises to show it to prospective purchasers or a registered valuer, provided that you get permission from the tenant first.



The tenant cannot, however, decide to not give you permission for this unless they have a good reason for doing so.

However, they can make some reasonable conditions regarding it. For instance, they may say – *"yes, you can show the house to prospective purchasers, but not on a Sunday because that's when we have a special family lunch"*.

The same applies if you need to show the premises to prospective tenants. This would occur if the current tenants were about to move out (e.g. if they had given notice of their intention to move) and you needed to find new tenants.

A point to note is that these rules apply to entering the actual building. These rules do not stop you from, for example, walking onto the section and knocking on the door to ask if you may visit.

Also, unless you are highly concerned about the way your tenants may be treating the property, it is best to visit them and inspect the premises less often than every four weeks.

Remember, the more you bother your tenants,
the less comfortable they will feel in your property, and
the more likely they will be to look elsewhere to live.

You need to ask yourself – is bothering your tenants worth the cost?

The cost of your property being vacant may be more than the cost of any damage you think your tenants may incur.

## 5.2.3 Resolving Problems and End of Tenancy

### 5.2.3.1 Tenancy Problems

Unfortunately, sometimes tenancy relationships do not work well. If you have a problem with your tenant, the best place to start is to try talking to them about it. Do this as early as possible – the longer you leave it, the larger the problem may become.

If you find it difficult to resolve a problem, you can get assistance from the ***Building and Housing Group***. The Building and Housing Group can give you advice about ways to deal with problems and can advise you on tenancy law. If you still cannot solve the problem yourself, you can use the ***mediation*** service provided by the Building and Housing Group.

**What is Mediation?**

***Mediation*** is a process whereby a neutral person helps you and your tenant to work through your problems and come to a solution. A neutral person is someone who has no personal interest in the outcome of the issue.

If you use the Building and Housing Group mediation service, agreements that you come to with your tenant can be ***legally binding***. This means that you must stick to those decisions.

However, it is NOT the mediator who makes the decision – it is up to you and the tenant. If the two of you cannot agree, the next step is to go to the ***Tenancy Tribunal*** for a hearing.

**The Tenancy Tribunal**

The ***Tenancy Tribunal*** resolves matters that landlords and tenants cannot resolve themselves. At a Tribunal hearing, someone (called an '***adjudicator***'):

- listens to both parties tell their side of the story,
- hears any witnesses,
- looks at any evidence available, and then
- makes a decision as to how the matter will be finalised.

The decision that the ***adjudicator*** makes is referred to as a 'Tribunal order', and is binding. That is, you **must** follow it.

If you apply to the Tribunal to resolve a problem, you must attend the Tribunal hearing. If you do not, your application will be dismissed.

If the other party (i.e. your tenant) does not appear, the hearing will go ahead, but their view will not be heard. Thus, the Tribunal can still make a binding decision based on only one side of the story.

Note that it costs $20.44 to make an application to the Tribunal.

## So What Should You Do If the Tenant is Behind in Paying Rent?

Perhaps the most common problem is that a tenant ***breaches*** their responsibilities by not paying the rent on time. If this happens to you, do NOT take or dispose of any of the tenant's belongings!

Even if the tenant owes you money and has caused damage to the property, you cannot, for example, take the bicycle outside the house and sell it to recover some of your costs!

Under the Act, tenants' goods may NOT be taken by the landlord **for any reason** relating to the tenancy.

As with any tenancy problem, the **first** thing you should do if your tenant is behind in their rent is to contact them to discuss the problem. After all, it is possible that the reason they missed a missed payment was due to a bank error, and they are not even aware that this has occurred!

The **next step** is to issue a ***14 days' notice*** – a letter which alerts the tenant to an issue and gives them 14 days to resolve it.

Note that (as mentioned earlier in this Section) 14 days' notices can be issued for other purposes too. For instance, you could issue one of these notices if the tenant has caused damage to the property and you would like them to repair it. Remember, a template for this letter is given on the Building and Housing Group website (www.dbh.govt.nz).

**What if they still do not pay the rent owing?**

If you send your tenant a 14 days' notice and the tenant does not resolve the problem within that time, the next step is to apply to the ***Tenancy Tribunal*** for help.

Note that, if the tenant is more than **21 days in *arrears***, you do not have to send them a notice first – you can apply straight to the Tribunal. However, if they are less than 21 days in arrears, you will need to send the notice first.

Also note that, when determining how many days in arrears the rent is, you **cannot** count rent paid in advance. So if the tenant is supposed to pay two weeks' rent in advance, and they missed their rent payment which was due yesterday, they are only one day in arrears.

If the rent is found to be at least 21 days in arrears, the Tribunal may make an order to terminate (end) the tenancy. But if the Tribunal considers that:

- it is likely that the tenant will pay any rent owing within a period specified by the Tribunal, and
- that it is unlikely the tenant would miss their payments again,

they may instead make a conditional order which gives the tenant an opportunity to pay the rent.

However, the order is 'conditional' in that, if the tenant does not do this within the time allowed, the tenancy is automatically terminated.

### 5.2.3.2 Ending a Tenancy

If you want to end a tenancy arrangement, the manner in which this can be done largely depends on the term of the tenancy arrangement.

- In the case of a ***fixed-term tenancy*** agreement, the tenancy generally ends on the date stated in the agreement.
- In the case of a ***periodic tenancy***, written notice is usually required.

The **minimum period of notice** required in order to end a periodic tenancy depends on who gives the notice.

- If the tenant decides they want to move out, they only need to give **21** days' notice – regardless of their reason.
- In comparison, as a landlord, you may have to give up to **90** days' notice!

However, there are some cases in which you (the landlord) may be able to give as little as 42 days' notice. These are if:

- You or a member of your family now want to live in the house.
- The property is usually used by your employees and you now require the property to be available for this purpose (although if this is the case, you must have stated in the tenancy agreement that the property is usually used for this purpose so the tenant is aware that this situation may arise).
- You are selling the property and the buyer requires that it does not have tenants in it.

In each of these situations, the notice of termination that you give to tenants must set out the reasons for the tenancy ending. Note that this only applies if you are giving less than 90 days' notice.

Other situations in which a tenancy can be terminated are if:

- The tenant buys the property.
- The tenant wants to end the tenancy early and the landlord gives their written consent for this to happen.
- The premises are destroyed (not as a result of the tenancy agreement being breached) or are so seriously damaged that they should not be lived in.
- Ordered by the Tribunal.

As discussed in the previous sub-section, the Tribunal can order that a tenancy be terminated if the rent is **more than 21 days in arrears**.

The Tribunal can also make this type of order for other ***breaches*** of responsibility or in the case of assault. For example, the Tribunal can end a tenancy if the tenant has assaulted, or threatened to assault you or someone else such as a neighbour.

Thus, if there is a major problem with your tenant that you have not been able to resolve using 14 days' notices, you do not necessarily have to wait 90 days (or until the end of a fixed-term arrangement) before you can get rid of the tenant. Instead, you can apply to the Tribunal to terminate the tenancy sooner.

***Screen Print: Online Service for Making a Tribunal Application***[53]

**Making a Tenancy Tribunal Application Online**

**Welcome to the Tenancy Tribunal online application service.**

You can make an application to the Tenancy Tribunal for help to resolve a dispute with a tenant or landlord, if you are unable to resolve your problem by yourselves. Submitting an application starts the legal process for dispute resolution. You will then be offered mediation – where trained mediators from the Ministry of Business, Innovation and Employment work with you to help settle the dispute. If the dispute is not resolved by mediation, then you can have the matter referred to the Tenancy Tribunal.

**What should you do first?**

Communicate with your landlord or tenant and try to resolve the dispute together. There are a range of things that you should do **before** you make an application to the Tenancy Tribunal. For more information see sorting out problems or call us on 0800 TENANCY (0800 836 262).

[53] Retrieved 27 September, 2013, from https://secure.dbh.govt.nz/TenancyTribunal/default.aspx

### 5.2.3.3 After the Tenancy is Over

When a tenancy comes to an end, the tenant is (obviously) expected to move out of the premises. They are to take all of their possessions and leave those that belong to the landlord. The property is to be left in a reasonably clean and tidy condition.

Of course, this does not always happen. Quite often, landlords find that:

- they need to spend extra time and money on cleaning the property,
- repairs need to be done, and that
- the tenants have left items behind.

Worst still, sometimes the tenants do not actually leave!

### What if the Tenant Doesn't Move Out?

If your tenant does not move out of the house after the tenancy has been terminated, you can get a ***possession order*** to require them to do so.

If you do not do this within **90 days**, it is deemed that you have entered into a ***periodic tenancy*** on the same terms and conditions as the original tenancy agreement.

In other words, it is considered that you have agreed for them to continue to be your tenant. Therefore, if you do not want the tenant in the premises and they will not move out, get a possession order!

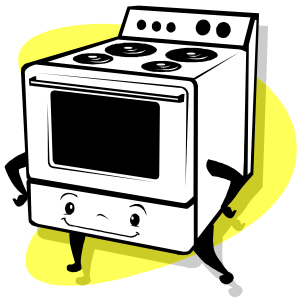
## Final Inspection

Once your tenant does leave, you need to conduct a final inspection of the property. The main aim of this is to check the condition of the property so you can work out how much of the bond should be returned.

It is a good idea to do the final inspection with the tenant. Therefore, arrange a time when the tenant can meet with you to hand over keys and go through the property. Allow at least an hour for this.

Walk through the property, room by room to check for damage. In doing this, you need to be prepared to accept *reasonable* wear and tear as your cost (e.g. minor tears in wallpaper or small scratches on doors). Look for damage that may be hidden. So, for example, if there are any mats or moveable items in the property, shift them to see if they are covering anything (e.g. stains in the carpet or holes in a wall).

Also check that all of the chattels that were in the house when you rented it out have been left behind.



**Check carefully** – for example, just because the oven is still present, this doesn't mean that the oven racks are!

Look for these smaller items as well as things such as sink plugs... and do not forget to get all the keys back from the tenant!

## After the Inspection

Following the inspection, hopefully both you and the tenant can agree on how much of the bond is to go back to the tenant. Will the tenant get the full amount or will some be allocated to you? If you agree on how it is to be distributed, you can fill out the Bond Refund form and both sign it.

Once the Bond Refund form is returned to the Building and Housing Group, the bond will be paid to you and the tenant as per the amounts specified in the form. If you do not agree, this is likely to be referred to the ***Tenancy Tribunal***.

## What if the Tenant Leaves Items Behind?

If your tenant leaves some of their possessions behind when they move out of the house, this does not automatically make them yours. What you should (and can) do with the goods depends on what they are.

If the goods left behind are food or other perishable items, you can dispose of them in any way that you choose.

But in the case of other goods, you are required to make reasonable efforts to contact the tenant and agree with them on a period within which they are to collect the goods.

If you are unable to contact the tenant or agree on a period within which to collect the goods, you need to securely store any personal documents that are amongst the goods left behind. As for the remaining items, you have two options.

### Option 1: Disposal of goods following an assessment of market value

This option requires you to make reasonable efforts to assess the ***market value*** of the goods that the tenant has left behind. If the value of the goods is less than the cost of storing, transporting and selling them, you can immediately dispose of the goods in any way you want.

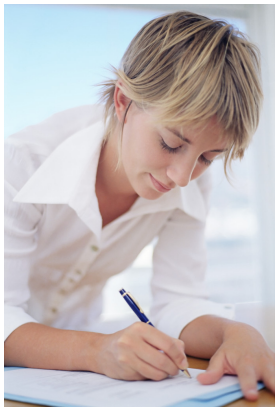
If the goods are worth more than the cost of storing, transporting and selling them, you must store them safely for at least 35 days for the tenant to claim.

If the tenant doesn't claim them within that time, you can either:

- continue to store them in order to give the tenant more time to claim them, or
- do the following:
  - take any personal documents belonging to the tenant to the nearest Police station and obtain a receipt for them from a Police employee, and

- sell the other goods by a public auction or by a private contract at a reasonable market price. If you do this, you will need to apply to the Tenancy Tribunal for an order which states how much of the proceeds of the sale you are able to keep to cover your costs and money owed to you.

**Option 2: Applying to the Tribunal for an Order**



The second option is to store the goods safely and apply to the Tenancy Tribunal for an order to be able to dispose of them.

The Tribunal will either:

- order them to be returned to the tenant, or
- make an order that allows you to sell them or dispose of them in another way.

If the items are to be sold, the order will state how much money (if any) from the proceeds of the sale you are entitled to keep. You will be entitled to some of the proceeds if, for example, there have been costs associated with storing the goods or if the tenant owes you money. All other proceeds are to be sent to the Building and Housing Group.

If the proceeds from the sale of the goods are not enough to cover your costs or any amounts that the tenant owes you, you can seek reimbursement out of their bond money. But if there is money left over from the sale of the goods, the tenant may apply to the Building and Housing Group for this to be paid to them (provided they do this within a year).

## 5.3 Selling an Investment Property

When selling an investment property, there are some key decisions to be made, research to be undertaken and professional advice to be sought. Ultimately, your aim is to get the best capital gains possible from your property within the timeframe that you want the house to sell.

Factors that will affect this price include:

- The actual asking price that you set.
- Who sells your property.
- The method of sale.
- The way you present your property to the market.

Each of these factors is covered in this sub-section, along with the actual process involved in selling a property.

### 5.3.1 The Sale Process

The broad steps in the sale process are listed below and then covered within this sub-section.

1. Seek legal advice
2. Decide if you are going to sell privately or use an agent
3. Decide which method you will use to sell your house – for example, by auction?
4. Prepare your house for sale
5. Get your home valued
6. Set an asking price
7. Promote your property
8. Consider and negotiate offers
9. Arrange settlement

These steps do not strictly need to be followed in the order shown. Furthermore, some of the steps may vary depending on the method you choose to sell your property – for example tender, auction or offer and negotiation.

**An important point you need to note if you have a mortgage is:**

Before you get too far through the sale process, **speak to your lender** regarding your intention to sell the house.

Your lender will want to know that you will receive enough money to cover the amount you owe them. Therefore it is a good idea that you have some idea of the value of your home before you meet with them.

### 5.3.1.1 Seek Legal Advice

Early on in the sale process it is a good idea to meet with your lawyer. First you will need to decide if you are happy to continue to use the services of the lawyer you used when you purchased the property. Although you may have been happy to use them through the purchase process, you may not feel confident using them to sell the property.

Make sure that your lawyer has the right experience for the work you want them to do.

For example, if you are selling a ***commercial*** investment property, find out if they have handled many of these types of sales previously.

A reason why it is good to meet with your lawyer early is that they can let you know which parts of the sale process they are able to give you advice about.

**Your lawyer should be able to**[54]:

- Advise you on the legal aspects of selling your property privately (if this is something you are interested in doing).
- Provide you with an appropriate ***sale and purchase agreement*** and help you to understand how to complete it.
- Check all offers received on the property.
- Communicate with the buyer's lawyer.
- Receive and hold the deposit.
- Arrange for the ***Title*** to be transferred.
- Arrange mortgage repayments and the release of associated documents if required by lenders.

- Receive final payment from the buyer's lawyer and hand the keys over.
- Organise the transfer of rates payments as at the ***settlement date***.
- Notify Quotable Value and the ***local authority*** of the sale.
- Arrange payment of the net proceeds. This is the amount received after all costs are deducted from the sale of a piece of property, a loan, or some type of security.

When you meet with your lawyer, check how much their assistance is going to cost you. In some instances you may be able to arrange a fixed price. A number of lawyers offer this for the ***conveyancing*** part of the sale. Remember, ***conveyancing*** is the legal process that involves transferring the ***Title*** for a property from one owner to another and the completion of various accompanying documentation to effect that change.

However, note that your lawyer may not be willing to give you a fixed price for some parts of this work. This is because it can be difficult to know, in advance, how many hours will be involved.

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[54] Citizens Advice Bureau. (October 2006). *Information Sheet: Selling a House Privately.* Retrieved 6 May, 2011, from http://www.sellourhouse.co.nz/soh_docs/CAB_SellingHousePrivately.pdf

### 5.3.1.2 Sell Privately or Use an Agent?

One of the first decisions you will need to make if selling a property is whether you will manage the sale process yourself (i.e. sell privately) or if you will use the services of a real estate agent.

This decision, and the advantages and disadvantages of each option, is covered in detail in Section 5.3.3.

### 5.3.1.3 Determine the Method of Sale

The various methods of selling a property were introduced in Section 4.3.3, where they were discussed in relation to purchasing a property. These methods included ***offer and negotiation***, ***auction*** and ***tender***.

It is recommended that you get some advice as to which method of sale to use. If you are using a real estate agent, they will be able to advise you on which may be suitable for your particular property.

#### *Offer and Negotiation*

Selling a property based on 'offer and negotiation' involves buyers making offers to you, which you then consider and (may choose to) negotiate.

If you use this method, you will need to either:

- set an ***asking price*** (or range of prices) for your property, or
- advertise the price as being '***by negotiation***'.

**The disadvantage of setting an asking price** is that it is highly unlikely that you will get more than the price set. In fact, it is not even likely that you will get the asking price.

This method therefore effectively places an 'upper limit' on how much you will receive for your property. One way that you could get more than your asking price is if there are two or more very keen buyers who are competing for the property and willing to pay more in order to get the property.

**The disadvantage of advertising the price as being 'by negotiation'**, was discussed in Section 4.3.3.1. Basically, it puts potential buyers off making an offer.

This is because they either:

- assume that the price expected by the seller is likely to be much higher than they can afford, or
- are not willing to go through the hassle of making an offer just *in case* the price expected by the seller is higher than they can afford.

***Auction***

If you sell your house via an auction, you do not set an '***asking price***' that potential buyers are told about. Instead, you set a '***reserve price***'. The reserve price is the minimum price that you are prepared to sell the house for at the auction.

A **disadvantage** of selling by auction is that it is a more expensive option. There are usually higher marketing costs, as well as the costs of the actual auction itself (e.g. paying the auctioneer).

On the other hand, an **advantage** of selling via an auction is that you do not indicate an upper limit on the price of the property. Buyers are therefore more likely to offer higher prices than if you were to sell by ***offer and negotiation***.

***Example: Keri***

Keri has decided to sell her investment property. She would prefer to receive at least $335,000 for it, but would be prepared to sell for as little as $327,000. Keri is now deciding the best way to sell her house to get the price she wants.

If Keri puts the house on the market for sale by ***offer and negotiation***, in order to receive $335,000, she thinks she will need to set a higher asking price (say $345,000). This will allow room to negotiate down.

In a 'best case' scenario, Keri may be able to negotiate a price higher than $335,000, but it is unlikely that she will negotiate a price higher than $345,000.

Keri then considers selling the house by auction. If she does this, she could set the reserve price at $327,000 and then let buyers compete against each other to determine the value of the property. It is quite possible that the resulting price would be higher than $345,000, especially if some buyers get carried away with the auction process and offer more than they would under usual negotiations!

Keri is therefore leaning towards selling the house by auction, but she decides that it is best to talk to her real estate agent first to see if they think her property will have enough interest from possible buyers for an auction.

Another **advantage** of using an auction to sell a property is that it helps sell a property faster. There is a set timeframe in place, whereas a house being sold by offer and negotiation may be on the market for months (or longer!).

However, selling by auction does not *guarantee* a quick sale. This is because you cannot be sure that your reserve price will be met.

If the reserve price is not met, you then have the problem of deciding whether you will:

- simply pay the costs of the auction and leave the property on the market (in which case you will need to pay more auction costs if you choose to try to sell by auction again at a later date), or
- sell for less than your reserve price.

Selling by auction is more suited to some properties than others. If a property has unique features that are hard to value, selling via auction can be an advantage. This is because it leaves valuation to the market.

Consider the following example:

***Example: Te Mira's Plantation***

Te Mira has a property for sale that, based on other sales of similar houses in the area, would usually be expected to sell for about $400,000. This is an amount that Te Mira would consider accepting for his property.

However, unlike other houses in the area, Te Mira's property has a unique plantation of native trees that would appeal highly to a small number of people. This plantation did not cost him anything, so he doesn't need to worry about recovering any costs. However, if there is anyone around who is prepared to pay more than $400,000 for this feature, he doesn't want to miss the opportunity of selling at a higher price.

Te Mira initially considered selling his property by offer and negotiation, but could not decide what asking price to set.

- If he set the price around $400,000, this would not reflect the value of the native trees, but would attract more buyers and encourage a sale.
- If he instead set it higher (say $480,000) to reflect this unique feature, he would put off a number of people from making an offer.

He is aware that, the higher he sets the price, the more he risks losing buyer interest. After all, it may be that there is no one currently looking to buy a property who places extra value on this special feature.

Te Mira instead decides to sell by auction. This way, if there are people who are willing to pay more for the feature, they can do so. However, given that he is prepared to sell the property for $400,000, if there is no one willing to pay more than this, he is still reasonably likely to sell his property.

***Tender***

***Tendering*** is the process of selling a property by inviting confidential written offers from potential buyers.

Remember, no ***reserve price*** or ***asking price*** is set. Instead, you simply invite prospective buyers to make an offer.

You usually consider all offers at the same time, after the closing date of the tender, and then either accept an offer or choose to negotiate further with an interested buyer.

The main **advantage** of selling by tender is that it encourages interested buyers to submit their best offer. Also, as with an auction, there is no 'upper limit' placed on the sale price.

But the **disadvantage** is that the tender process may discourage some people from making an offer at all. This might be because they worry that they may offer more than they need to. In other cases it is because they do not want to go through the hassle of submitting an offer that is then rejected by the vendor.

## 5.3.1.4 Prepare your House for Sale

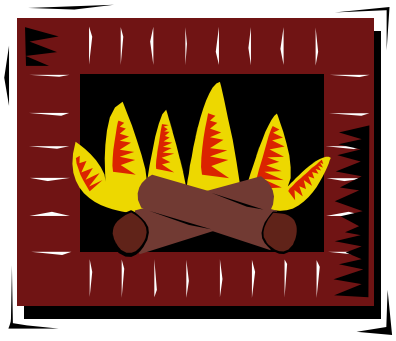
The next step is to get your house ready to be sold. There are a lot of relatively inexpensive things you can do which will increase the **appeal** of your property and thus **increase its perceived value**.

The idea is to make your property as tidy as possible in order to attract buyers and justify the asking price. Suggestions of how to do this are given on the following pages.

## Adding Appeal to the Inside of a Property

The following is a list of simple and easy things that you can do to the inside of your property to enhance it prior to being viewed by prospective buyers[55]:

- Clean the oven, hobs and extractor fan.
- Make sure any appliances that are chattels (therefore a part of the sale) are in working order.
- Clean out the pantry, drawers, cupboards and wardrobes to create space.
- Clear benches and sills of clutter.
- Check to make sure doors and windows open freely.
- Clean windows inside and out.
- Have carpets professionally cleaned.
- Wash and polish wood, vinyl or tile floors.
- Check for any minor repairs and action accordingly.
- Replace broken lights and switches.
- Repair dripping taps and any leaks.
- Wash interior paintwork.
- Clean showers and take down or replace old shower curtains.
- Replace old or cracked toilet seats.
- Put new clean towels in the bathroom.
- Put vases of flowers in main rooms.
- Leave lights on in dark areas or rooms.



- Make sure the house is warm in winter.
- Clean fireplaces and dress (e.g. place pinecones in the fire place).
- Leave some windows open in summer.
- Consider hiring items or artwork to update the look of your property.
- Ensure there are no unpleasant smells inside the home.

[55] Adapted from Anzatea Ltd. (2005). *Tips for Sellers.* Retrieved 3 July, 2009, from http://www.jeremyclement.co.nz/public/default.php?page=20

**Adding Appeal to the Outside of a Property**

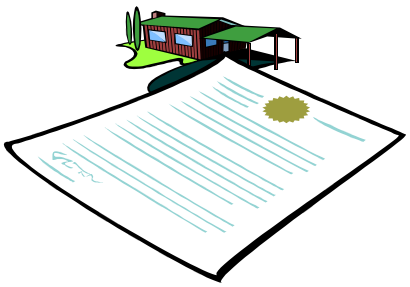
The outside of your property is the first thing that prospective buyers will see when they come to view. Make sure that you give a good first impression by following these simple recommendations[56]:

- Wash external paintwork. This is easily achieved with a water blaster.
- Clean out the garage, if applicable.
- Remove any rubbish from the section.
- Mow the lawns and tidy up the garden.
- Prune hedges and trees to allow more light into the house.
- Clean outdoor furniture.
- Sweep paths and clean away any moss.
- Paint and tidy up your letterbox.

- Clean and repair fences, repaint if necessary.
- Clear gutters and any blocked drains.
- Plant plenty of cheap, colourful flowers.
- Place flowerpots around the entrance.
- Water gardens and fertilise lawns in the weeks and months before viewing.

## 5.3.1.5 Get your House Valued

Home valuations are discussed in detail in Section 5.3.2.



[56] Adapted from Anzatea Ltd. (2005). *Tips for Sellers.* Retrieved 3 July, 2009, from http://www.jeremyclement.co.nz/public/default.php?page=20

### 5.3.1.6 Set an Asking Price

Setting an asking price is discussed together with property valuations in Section 5.3.2.

If you are selling via an auction or tender, you do not set an 'asking price'.

- For an auction though, you do need to set a reserve price.
- For a sale via tender, you need to decide the minimum offer price you would be willing to consider.

### 5.3.1.7 Promote your Property

Once your property is on the market, promotion begins. If you have decided to use the services of a real estate agent, they will take care of this for you. However, if you are selling privately, it is all up to you!

The aim of marketing is to find as many buyers as possible for your property. This way, they may start competing to buy your house. This, in turn, might push up the sale price.

But before you start creating materials or purchasing ad space in a newspaper, you need to set yourself a marketing budget. Spreading your budget across a range of promotional methods can be a good idea, providing that you do not spread your money too thinly.

If you put together a **schedule of marketing activities** before you start spending money on promoting, you can plan for a mix of types of promotion.

A schedule of marketing activities is basically just a plan showing what marketing you will do, on what dates, and how much it will cost.

If you put together a **marketing schedule** it can also give you a tool to track your results against. That is, you can write down the number of enquiries you get from each type of promotion (e.g. newspaper advertisement, flyers or signage) so that you know what works best.

This way, if you need to conduct extra promotion, you can easily work out which forms of promotion provide the best value for your money and continue with these.

There are a number of ways that you can market your property. Some of these include online methods, signage, newspapers, brochures and flyers, viewings and open homes.

## Online Marketing

Online marketing may prove to be the best way to get your property viewed by a large audience at a relatively low price.

You can start by using social media such as Facebook to informally promote your property for free. That is, it costs absolutely nothing to put an album of photos of your property on your Facebook page and let all of your friends know that it is for sale. Many towns and regions also have 'buy and sell' pages that you can use to advertise anything for sale.

In addition, you can advertise on websites specifically dedicated to property sales. Using these will involve a cost, but the potential audience may be very large. Sites to consider advertising on in New Zealand are:

- TradeMe Property (www.trademe.co.nz/property)
- Homesell (www.homesell.co.nz)
- Private Lane (www.realestate.gen.nz)

The TradeMe website is one of the most popular sites, of all the internet websites, visited by New Zealanders. It has over 3.2 million active members[57] and can have more than 2 million auctions running online at any given time. The sheer volume of people who could potentially see your advertisement is huge. Given that it only costs $299 to list your property, this is an affordable option especially compared to that of a real estate agent.

[57] Retrieved 27 September, 2013, from http://www.trademe.co.nz/About-Trade-Me/Site-Stats

***Screen Print: TradeMe Property***[58]

## Signage

'For sale' signage and open home signs can be purchased relatively cheaply. Corflute open home signs that you see directing you towards a property can be bought for around $15 each, and 'for sale' signs from around $50.

Contact local sign writers in your area by looking them up in the Yellow Pages, or conduct a search on www.google.co.nz and enquire online for a quote. Alternatively, it is likely that signs will be available for sale on Trade Me (www.trademe.co.nz).

[58] Retrieved 27 September, 2013, from http://www.trademe.co.nz/property

## Newspapers

Newspapers and specialist real estate supplements are useful in getting your property 'out there'.

Obviously, if you are not using the services of a real estate agent, you will need to contact the newspaper directly to find out details of advertisement sizes and prices. These can vary a lot, depending on what newspaper you are advertising in and the size of your advertisement.

When you contact a newspaper company (or other type of publication) to enquire about advertising, also ask about **distribution numbers**. That is:

- How many copies do they sell?
- How many people are likely to view your advertisement?

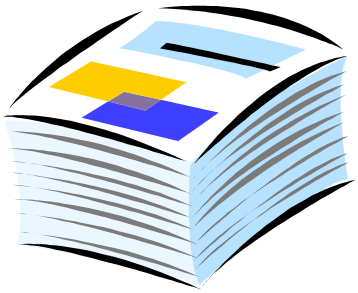
Weigh up their prices against their distribution numbers to figure out which publication provides the best value for money.

When it comes to deciding what **information** to feature in your advertisement, spend some time studying other real estate advertisements.

- What do you like about the ads?
- Is there anything else you wish they had told you about the property?

You can then use this information to develop the content of your advertisement.

## Brochures and Flyers



Brochures and flyers can be created easily at home with a computer and basic desktop publishing software.

**Microsoft Office Publisher** or even **Microsoft Word** can be used to insert pictures, typeset details and produce simple but attractive marketing materials. Simply print or take them to be photocopied at a library, bookshop or print house.

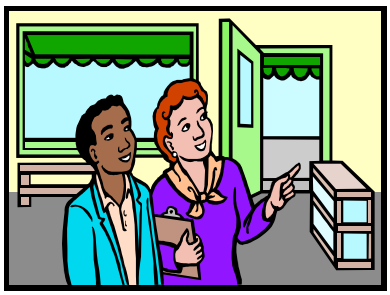
If you:

- do not have access to a computer,
- lack confidence in your ability to create the materials, or
- are concerned that the low quality of your flyer will not reflect well on the quality of your home,

contact your local **newspaper** or **print house** for professional assistance. They generally offer design services and may be able to make something appropriate at a very reasonable price.

In order to print the correct number of brochures, consider the size of the geographic area you are covering along with the cost. Distribution could be something you do yourself, or you could outsource it by including your flyer in the local pamphlet or newspaper run.

## Viewings and Open Homes



If you are selling your home privately, you also need to arrange appointment times for interested buyers to view the house, as well as for '***open home***' days.

These are important ingredients in the marketing mix. Ads and brochures are simply representations and descriptions of the property.

Giving potential buyers the opportunity to see and be in the home can often assist buyers in seriously considering putting in an offer.

**Key Tip: Be Honest!**

Throughout the promotion and sale process, it is important that you are honest in any information you provide. This includes information in your advertisements as well as when answering questions from potential buyers.

If you mislead a buyer, they may have the right to get out of any agreement you make with them.

### 5.3.1.8 Consider and Negotiate Offers

This step of the process applies to sales by ***offer and negotiation*** as well as to sales by ***tender***.

However, it may also apply to properties sold by ***auction*** – after all, if a property does not meet the ***reserve price***, you may choose to negotiate further with a bidder.

## Negotiations

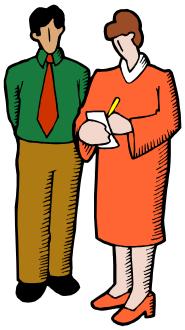
In the case of sales by offer and negotiation, buyers usually submit offers using a standard ***Sale and Purchase agreement***. In most cases, the initial offer an interested buyer submits has conditions attached (remember, these conditions may relate to, for example, obtaining finance or getting a satisfactory LIM report).

If the purchase price offered is not high enough, you (the vendor) can make a ***counter offer***.

This is done by:

- crossing out the price the buyer has entered on the agreement,
- writing the price you want, and then
- initialling the change.

You then sign the agreement and return it to the buyer to consider and accept or come back to you with another offer.



If you have used a real estate agent to sell your property remember that they work for you and that it is in their best interest for you to get the best price for your property.

The higher the price they get for your property, the more ***commission*** they get as payment! They will therefore offer useful advice through the negotiation process.

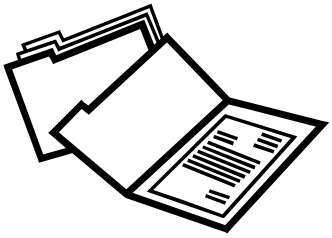
If you have chosen to sell your property privately, you may choose to seek advice from your lawyer.

## Accepting an Offer

Once both parties are satisfied with the price and terms or conditions of the sale, the agreement is signed by both the buyer and the vendor and the contract becomes ***legally binding***.

The buyer will pay a deposit which is held by the real estate agent or your lawyer (until the sale becomes ***unconditional*** and ***settlement*** occurs).

At this time, both you and the buyer need to carry out any actions that you have agreed to in those conditions.



- For you (the vendor), this could mean replacing a broken window or doing other types of repairs and maintenance.
- For the buyer, this could include getting a builder's report or attempting to secure finance for the purchase.

Once all conditions are met, the contract becomes ***unconditional*** and the final stage of the selling process (settlement) begins.

## 5.3.1.9 Arrange Settlement

Remember, there are some parts of the sale process that, in accordance with New Zealand law, must be carried out by a lawyer. Most of these services relate to the ***conveyancing*** process (the legal transferring of the Title from the vendor to the buyer).

During this time, make sure you are **easily contactable** and can make the time to meet with your lawyer when required. This way, you can make sure the process goes quickly and smoothly.

The conveyancing processes kick into gear as soon as the Sale and Purchase Agreement becomes ***unconditional***. The buyer's lawyer will start gathering the required documentation to organise the sale and to prepare for the transfer of the Title to their client.

**Possession and Settlement Dates**

The Sale and Purchase Agreement will specify the date(s) that possession and settlement takes place.

Remember:

- The ***possession date*** is the date on which the buyer has the right to occupy the property, whereas
- The ***settlement date*** is the date on which the purchase price (less the deposit which has already been paid) and necessary documents are exchanged.

  These dates are usually the same and most often fall on a Friday.

Something to be aware of is that the possession and settlement dates could, however, be months after accepting the offer.

## 5.3.2 Determining the Price

The price that you ask for your house is an important decision.

**If you put the price too high**, you may scare off potential buyers. The house may then be left on the market for longer than you want.

Setting a high price does not even guarantee that you will sell your house for more; if you really want a sale, you may be forced to lower it.

Furthermore, if you need to sell the house within a particular timeframe, you may be forced to lower the price below what you believe to be reasonable simply because you have run out of time to find a buyer.

In comparison, **if you set a 'fair' price**, you will have more interest from buyers throughout the period you aim to sell.

This means that it is less likely that you will need to drop your price at the last moment in order to make a sale.

The disadvantage to this, of course, is that (depending on the method you use to sell your property) you also lose the opportunity for a higher sale price. For example, if you put your house on the market for $180,000, it is very unlikely that a buyer will offer you $200,000 for it!

**Key Tip:**

One of the most important things to keep in mind when determining the asking price of a property is to set it just a bit higher than the price you would be satisfied selling it at. This gives you room to negotiate. 5% above an independent valuation price is usually appropriate.

There are essentially two ways you can work out what 'asking price' to put on a property – you can either:

1. ask someone else's opinion; or you can
2. determine your own valuation.

### 5.3.2.1 Obtaining a Valuation

When it comes to conducting a valuation, having someone with industry experience come to your house and give their opinion on what your property is worth is probably the easiest option.

However, even if you take this approach, it does NOT necessarily mean that you should set the asking price at this level.

You should also take into consideration:

- how much you personally need to get from the sale of the house in order to achieve your financial goals, as well as
- how much buyers will want to negotiate.

If you are selling by offer and negotiation, it is normal for vendors to be prepared to negotiate a lower price than what they are asking for. Therefore, you may choose to set the price higher in order to settle for a price around the ***market value***.

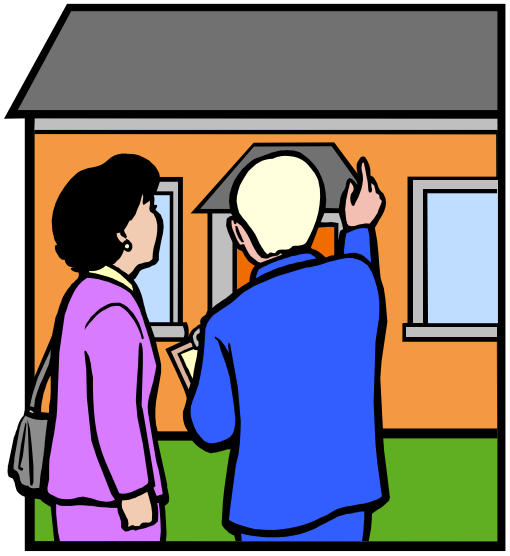
The two main sources of advice about your asking price include real estate agents and professional property valuers.

## Real Estate Agents

Because real estate agents want people to list their property with them, most real estate agents will offer vendors an 'obligation-free' valuation. That is, they will give you an estimate of how much your house is worth, even if you have not committed to using them to sell your property.

The real estate agent will visit your property and then, based on the current market situation and similar houses that have sold in the area, will give you an estimate.

This is an **informal valuation** and **doesn't usually involve a written report**. Nonetheless, it can be a worthwhile starting point for you.



It is a good idea to ask several agents from a range of agencies for a valuation. This will give you more confidence about how accurate their opinions are.

Another **advantage** of asking several real estate agents for a valuation is that it gives you the opportunity to meet with the various agents in your area. This will allow you to decide which one(s) you like best and whether you would use them to sell the property.

The problem is that the valuations given may be very different from one agent to the next. Because of this, it is best if you have some understanding of how valuations are conducted so you can work out which price is best for your house.

You can find local real estate agents online or in the Yellow Pages. If the real estate agent's reputation or house-selling results are important to you, ask the agent to refer you to prior customers. It is also a good idea to talk to people you know who have recently sold a house to ask who they used and to describe their experience with that agent.

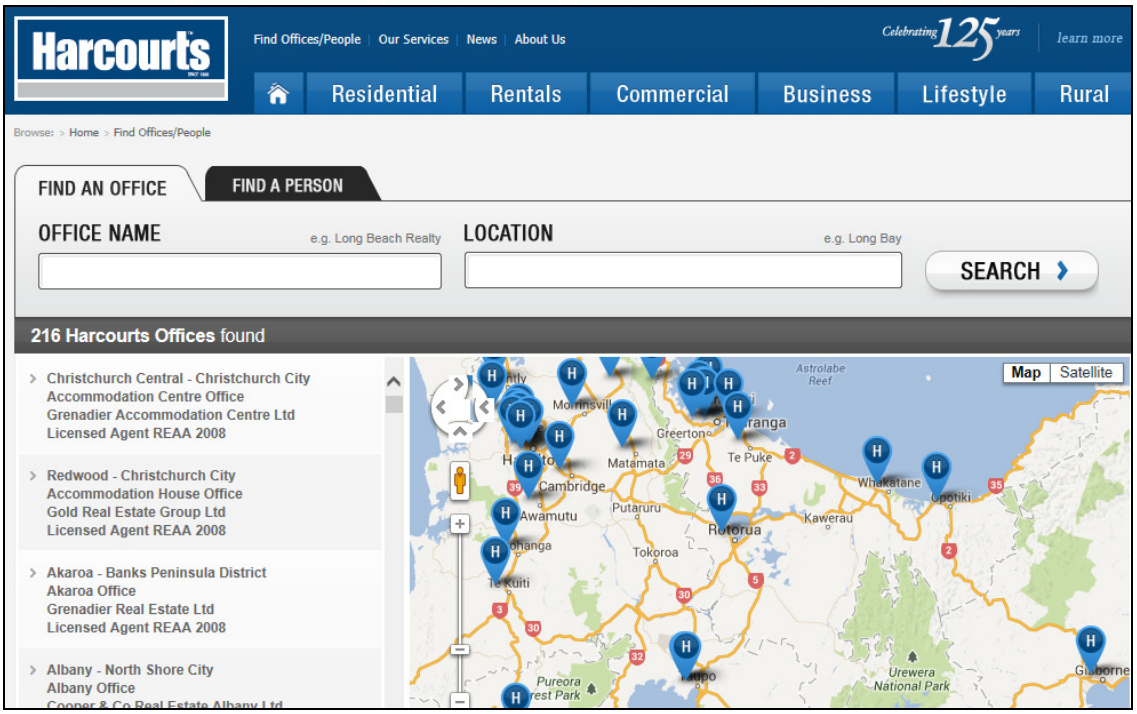
There are a number of large well-known agencies that operate around the country. Some examples include:

- L.J. Hooker
- Harcourts
- First National
- Bayleys
- Ray White

Note that the reputations of the various real estate agencies will differ from region to region, depending on the quality of their agents. Thus, when looking for a recommendation of who to use, it is best to talk to people in your own area who have experience with the local branches of these companies.

These agencies are likely to have contact details of the agents in your area on their website (as shown in the following screen print).

***Screen Print: The 'Find an Office' Function on the Harcourts Website***[59]




[59] Retrieved 27 September, 2013, from http://www.harcourts.co.nz/Offices

## Professional Property Valuations

The main alternative to asking a real estate agent for a valuation opinion is to use the services of a professional property valuer. If you do this, make sure you use a ***registered property valuer*** who has a current certificate. Also make sure they have experience in your area.

**To become a registered valuer**, a person must go through a fairly intensive application process through the Valuers' Registration Board.

As part of the registration process, applicants need to:

- ☑ Have an appropriate university degree.
- ☑ Have at least three years' practical experience.
- ☑ Submit 20 valuations they have prepared.
- ☑ Be of good character and reputation, as evidenced by at least three referees.

Once registered, they are governed by the *Valuers Act 1948*. They also are required to take part in ongoing professional development training every year.

### How much will it cost?

Registered valuers typically charge somewhere between $500 and $800 to provide you with a detailed written valuation of your property.

Although you need to pay for this service, bear in mind that registered property valuers are professionals who are trained and experienced in this field. They prepare valuations for sales, purchases, renting, mortgages, insurance and rates **on a daily basis** and should therefore have a very good understanding of prices in the market area that they cover.

Valuers generally offer a range of different reports depending on what you need to know and why. They can advise you on which of these reports will meet your specific purposes so that you do not spend more than you need.

**A valuer's report should include information about:**

- The condition of the exterior and interior of the house.
- The condition of the foundations (piles), wiring and plumbing.
- The grounds, section and any physical aspects associated with this. For example, swimming pools or retaining walls.
- Location of the property.
- ***Comparable sales*** in the area.

Property appraisals use ***comparable sales*** to help work out the value of a property.

This involves comparing a property to other similar (comparable) properties recently sold in the area.

To work out whether a property is 'comparable', the following factors, amongst others, are taken into consideration:

☑ Style of home (e.g. 1 level / 2 levels, brick, weatherboard).

☑ Size of the land area and floor size of the dwelling.

☑ Age of the home.

☑ Location and the amenities connected to the location (e.g. parks, swimming pools, views to ocean).

☑ ***Chattels***.

Other characteristics taken into account could include the number of bedrooms and bathrooms or garage space.

## Finding a Valuer

The Yellow Pages is a good place to start if you are trying to locate a valuer in your area. Another option is to ask friends or family who have sold or bought recently who they used, or to ask your solicitor to recommend a valuer to you.

Of course, the internet is a great tool to use also – simply conduct a search using Google or another search engine. Alternatively, use a directory such as 'Finda' (www.finda.co.nz), which has a large number of registered valuers listed. The Finda site provides you with a link to the valuer's website, phone numbers, email address and a map of where to find them.

## Valuation Information Provided by QV

The QV website (www.qv.co.nz) which was introduced earlier in this module, offers several forms of valuation information for sale. The following screen print shows a list of reports that are available and the prices for these reports, as well as details for buying 'packs' of reports (as at September 2013).

***Screen Print: Reports offered by QV***[60]

| Pricing | | Basic Property Pack $9.95 | E-Valuer Property Pack $49.95 | Comprehensive Property Pack $79.95 |
|---|---|---|---|---|
| **Individual information** | **Cost** | | | |
| Property overview | FREE | ✓ | ✓ | ✓ |
| Property photo | FREE | ✓ | ✓ | ✓ |
| Rating Valuation | $3.25 | ✓ | ✓ | ✓ |
| Property changes | $5.95 | – | – | ✓ |
| Building consent | $4.95 | – | – | ✓ |
| Hazard risks | $9.95 | – | – | ✓ |
| Previous sales of the property | $4.95 | ✓ | – | ✓ |
| Local area sales (up to 30) | $27.95 | – | – | ✓ |
| E-Valuer (incl. up to 10 comparable sales) | $49.95 | – | ✓ | ✓ |
| Certificate of Title details | $5.95 | ✓ | – | ✓ |
| **Total package cost** (prices GST | | **$9.95** | **$49.95** | **$79.95** |

[60] Retrieved 29 September, 2013, from http://www.qv.co.nz/n/property-info/phoenix-13

If you choose to purchase either the 'E-Valuer Property Pack' or the 'Comprehensive Property Pack', amongst the various reports you will receive will be:

- ***Rating Valuation*** information for your property, as well as
- an instant estimate of your property's value based on recent, nearby comparable sales in the area.

However, if you want more than an estimate, QV also provides the option of purchasing a **full market valuation**.

This will be conducted by a registered valuer and involves a full inspection of your property.

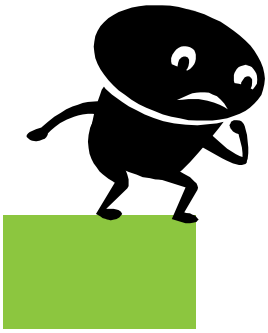
### 5.3.2.2 Conducting your own Valuation

Remember, it is up to you what price you set as your 'asking price' or the minimum you will accept for the property. Although you may use a professional's advice to guide you in this, ultimately, the decision is up to you.

When looking at valuing your investment property, at the top of your mind will be what you paid for the property originally. The purpose of an investment is to increase that investment's value and make a profit on your original investment.

Therefore, you may start the valuation process by working out how much you would need to sell the property for in order to achieve the ***rate of return*** on your investment that you aimed for. However:

**Ultimately, in real estate the price you receive usually depends on the *market* – that is, what buyers are currently paying**.



If the price you calculated based on your desired financial return is a lot higher than market prices, unless you are prepared to wait a long time for your property to sell, you may need to consider lowering it.

Alternatively, you could consider not setting an asking price, and instead offering it for sale by, for example, ***tender***, to see if anyone is willing to pay the price you want.

But before you get this far, make sure you first have some idea of what people are currently willing to pay for houses. As mentioned earlier, you can get a professional valuation report. This is a good idea, but you should also conduct a basic valuation of your own. This way, you can be sure and confident about your valuer's recommendation.

If you have an understanding of how valuations are made, and are aware of current price trends in your area, you will be in a position to question anything you do not agree with relating to the reported values.

Things you need to take into consideration when looking at the value of your property include:

- The state of the property market.
- Current interest rates (remember, the higher the interest rate, the lower the prices that buyers can afford to pay).
- The type and features of the property.
- ***Comparable sales***.

National newspapers, television news reports and online news websites are excellent sources of information in regards to the overall property market and interest rates. It is not difficult or very time consuming at all to find recent articles on these topics that are relevant to property investment.

For example, you could go to the news website www.stuff.co.nz, enter 'Property Market' in the search field and a list of recent articles will be displayed.

As for finding details about comparable sales, local newspapers and real estate supplements found in newspapers are a fantastic source of information. Quite often they include properties that have recently sold and show the price which they sold for. By going through these resources you can identify properties similar to yours and use the sale prices to guide you in working out your asking price.

You can also get information about comparable sales from the QV website. Refer to the screen print given earlier in this subsection of the list of reports offered by QV. Near the bottom of the list is something called 'Local area sales'. If you purchase this, you will be given access to information about up to 30 local sales in the area for the past 12 months. You can search through this information and filter results based on the number of bedrooms or age of the property, as well as how recent the sale was and how close it was to your house.

The QV website also offers you statistics on house prices and sales in different regions of New Zealand free of charge (see screen print below).

***Screen Print: Residential Sales Prices Function on QV Website***[61]

## Residential sales prices - by suburb

This gives you the number of sales in your suburb, median sale prices and the percentage difference between sale prices and Capital Value.

Area: Manawatu District

Property Types: Houses

Show

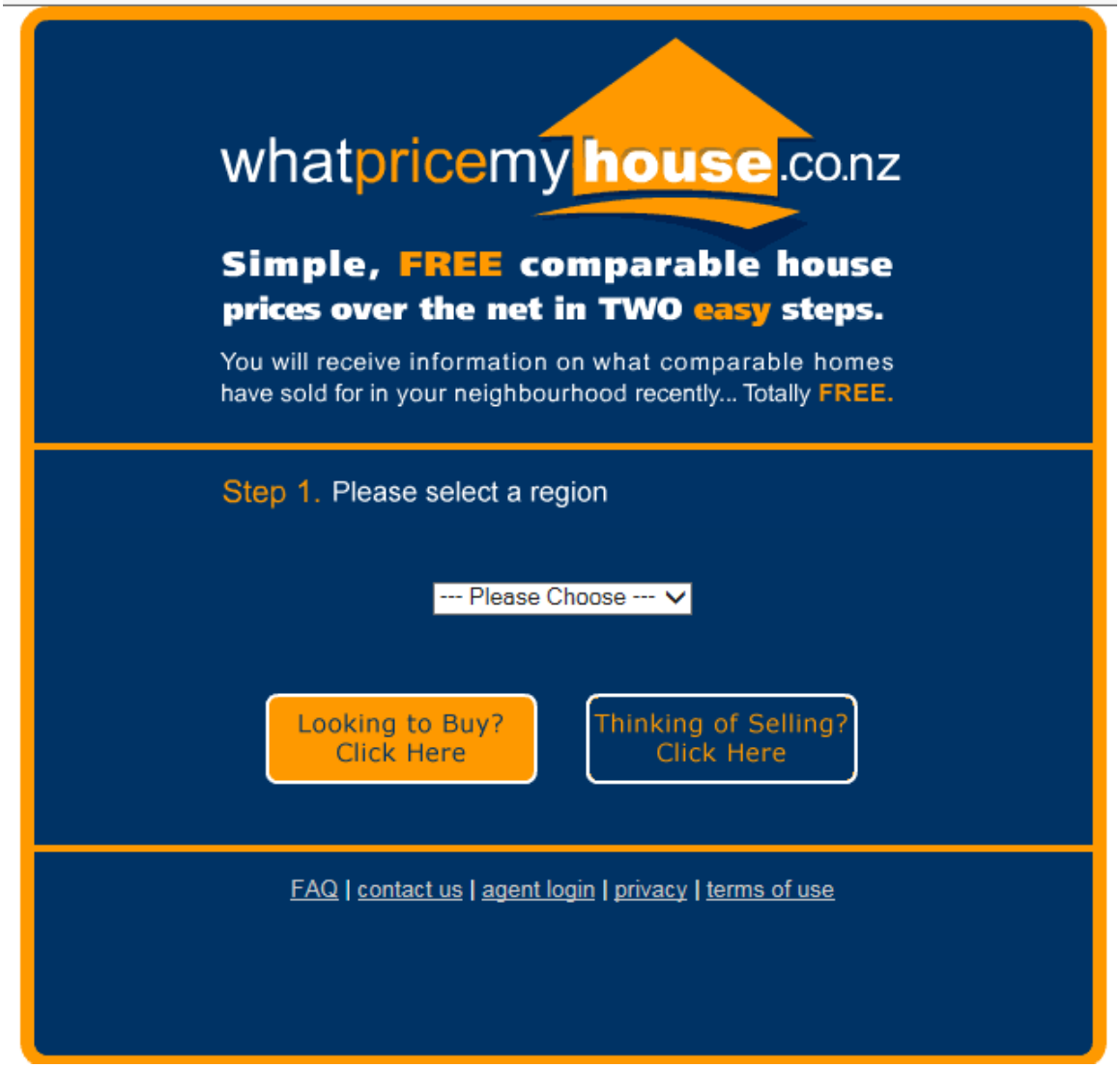
| Suburb | Number of Sales | Median Sale Price | Difference Between Sales Price and CV | Capital Value Date |
|---|---|---|---|---|
| Apiti | 1 | $96,000 | -12.0% | Aug 2010 |
| Ashhurst | 11 | $264,000 | 9.0% | Aug 2010 |
| Awahuri | 1 | $239,000 | -4.0% | Aug 2010 |
| Bulls | 8 | $219,500 | 4.0% | Aug 2010 |
| Bunnythorpe | 4 | $278,500 | .0% | Aug 2010 |
| Feilding | 59 | $224,000 | -2.0% | Aug 2010 |

[61] Retrieved 27 September, 2013, from http://www.qv.co.nz/resources/residential-sales-prices-by-suburb

Another option is to use the website www.whatpricemyhouse.co.nz to find information about sales in your area. This particular site offers two different types of reports:

1. The 'quick report' option gives you information on properties sold in your region.
2. The 'comparable sales report' gives you a break-down of sale prices of *similar* properties sold in your area.

***Screen Print: The 'whatpricemyhouse.co.nz' Website***[62]




[62] Retrieved 27 September, 2013, from http://www.whatpricemyhouse.co.nz/

### 5.3.2.3 Rateable Valuations

When setting the price for your property, do not base it on the ***rateable valuation*** (also known as the ***rating valuation***). The ***Rateable Valuation (RV)*** was previously known as the ***Government Valuation (GV)***.

> The Rateable Valuation is the valuation of your property
> that the ***Local Authority*** uses when working out
> the amount of rates that you need to pay for the property.

The ***RV*** of a property is determined by Quotable Value. It can be viewed via the QV website (www.qv.co.nz). Quotable Value holds individual details about each property, which include a plan of the main improvements, age, materials, floor area, construction type, etc. It then uses this information, together with market sales data in the area, to work out the RV.

> Although RVs are based on market sales,
> it is important to note that,
> as it is not ***feasible*** for every property in the country to be inspected before setting this valuation,
> the RV for your property does **NOT** factor in
> the overall **appeal and features** of your property
> (other than those recorded in plans).

An RV does not, for example, take the following factors into account[63]:

- Appeal of the location.
- Street front aesthetics.
- Recently painted interiors.
- Sunny backyards.
- Noisy neighbours.
- Any preparation you have put into a property before selling it.

[63] Parker, M. (25.11.2008). *What is the Value of the Rateable Values?* Retrieved 3 July, 2009, from http://voices.realestate.co.nz/noaddedfluff/tag/rateable-values/

- The condition of the grounds – for example, whether you have beautiful gardens or an overgrown mess of weeds.
- The effects of interest rates, local redundancies and other market conditions.

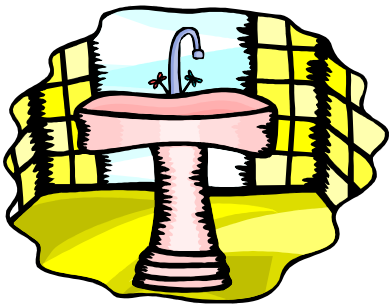
Furthermore, RVs are based on market sales **at one point in time**. As the real estate market can ***fluctuate*** notably, an RV cannot be expected to represent a close value for very long.

One point to note is that the term 'RV' may also be taken to mean ***Registered Valuation***. Therefore, if you are ever told the RV of a property, clarify whether it is the registered or rateable value that is being reported.

### 5.3.2.4 Adding Value

If you are not happy with the estimated market value of your property, you may wish to consider ways to add value to it before you sell. If you do this, you need to be very careful not to ***over capitalise***. This means spending more money than you are likely to get back.

For example, let's say that you paid $190 000 for your property three years ago. If you invested in a brand new kitchen for your property and this cost you $22,000, you would need to sell the property for at least $212,000 to simply break even on your initial investment.



**This does not mean that you should not invest in major renovations.**

After all, in some cases an out-dated kitchen or a bathroom in need of repair can reduce the value of a house by more than the cost of fixing it.

Instead, analyse the likely impact on the value as closely as you can. Prepare a 'worst case' scenario as well as a 'likely scenario' so that you are aware of the risk you are facing.

Real estate agents and valuers can also offer you advice in regards to how to add value to your property before selling. Check with them first before committing to any major renovation.

Instead of, or as well as, conducting major renovations, you can add value to your house fairly inexpensively by increasing its **appeal**. Ideas on how to do this were covered in Section 5.3.1.4.

**If you have tenants in your property** and you intend to ***renovate***, you will also need to take into account how you will manage this.

- Will you be able to come to an arrangement with them to access the property while they are still living in it?
- Will they demand lower rent during this time?
- Or will you need to give your tenants notice and do the renovations while the property is empty? If so, you will need to add the cost of lost rental income to the cost of the repairs in order to decide whether this is worthwhile to you.

## 5.3.3 Selling Via a Real Estate Agent or Selling Privately?

When considering selling your investment property you will need to decide whether you go with a real estate agent, or try and sell your property privately. Both options have their advantages and disadvantages, but it is important to understand how both scenarios work so that you can make the right decision for you.

### 5.3.3.1 Using a Real Estate Agent

In New Zealand it is still most common for property sales to be conducted with the assistance of a registered real estate agent.

**Advantages**

There are a number of advantages to using a real estate agent when trying to sell an investment property. These are outlined below[64].

A real estate agent:

- Can advise you on the selling price.
- Can give suggestions on how to best present the property and increase its perceived value.
- Arranges the advertising of the property and pays the advertising costs (unless you agree in advance to pay these costs).
- Acts as first point of contact for potential buyers, responding to their enquiries.
- Advises you, the vendor, about current market conditions.
- Shows potential buyers around the property.
- Can negotiate the sale and purchase agreement with the buyer on your behalf.
- Has access to, and knowledge of, a pool of potential buyers.
- Has knowledge of the legal procedures involved in selling a property.

[64] Adapted from: Citizens Advice Bureau. (October 2006). *Information Sheet: Selling a House Privately.* Retrieved 4 July, 2009, from http://www.cab.org.nz/information/11%20Selling%20a%20House%20Privately.pdf

## Misrepresentation

Real estate agents represent YOU legally in parts of the sales process, but are bound by certain laws in doing so.

In particular, if a real estate agent 'misrepresents' anything about the property to a buyer, YOU as the vendor could be held ***liable***.

An example of this sort of situation could be if the agent told the buyer that the entire house had been rewired two years ago when, in fact, only *one part* of the house was rewired.

If the buyer were to find this out, they would have the right to complain. You might even end up **having to pay** for additional work to be done in order to correct the situation.

This is a reason why it is important to have a reputable agent that you can trust working for you. It also highlights the need to be **specific and clear** in the information you provide to the agent about the property.

## What about the Cost?

Selling via a real estate agent means that you will need to pay the agency ***commission*** on the sale.

The commission is usually an amount calculated as a percentage of the purchase price.

Agencies usually charge around 4%, but this amount could be up to 6% or more of the purchase price. Although 4% may sound like a low percentage, when you are dealing with properties the actual cost can be very expensive.

For example, take the example of a house that sells for $337,500. If the agent charges a standard 4% commission, they would receive $13,500. This amount would then be split between the agent(s) and the agency that they work for.

A point to note when discussing fees with real estate agents is that **fees may be negotiable**. Speak with your agent and try to work together to come to an agreement that suits both parties.

There are however, different types of real estate agencies that offer different commission and payment structures.

## Flat-Fee Agencies

***Flat-fee agencies*** offer a range of services, often put together in packages, for prospective sellers to choose from.

An example of a business providing flat-fee services is Green Door (www.greendoor.co.nz). Although Green Door is a licensed real estate agency, it also has a private sales division which offers 'marketing packages' to vendors. When you buy one of these marketing packages, you are not engaging licensed real estate agency services. Instead, you are simply buying a range of tools that you can use to help you to sell your house yourself.

***Screen Print: The Green Door Website***[65]

[65] Retrieved 27 September, 2013, from http://greendoor.co.nz/

A few examples of what is included in some of these packs are as follows:

- A professional photography service.
- Promotion on key websites including TradeMe.
- 'For Sale' and 'Open Home' signage.
- Colour flyers.
- Social media marketing through Green Door's blog, Facebook and Twitter accounts.
- Print media advertising in select local publications.

Package prices start from $1,499 + GST, which is substantially cheaper than paying a standard agent's commission.

It is important to note that flat-fee agencies typically **require payment upfront** for their services.

In comparison, real estate agents that are on standard commission are usually only paid once the sale has gone unconditional and are paid out of the deposit received from the buyer.

Thus, if you choose to use the services of a flat-fee agency, you cannot use the money you receive from selling your house to pay for this cost – you will need to have money (or access to finance) to pay for this in advance.

## How Many Agencies?

You are not necessarily restricted to using only one real estate agency.

- If you choose to use one real estate agent, this is referred to as a ***sole agency*** arrangement.
- If you choose to use multiple agencies, this is a ***general agency*** arrangement.

According to Consumer NZ[66], ***sole agency*** is the most common method used by vendors who have real estate agents selling their property. This arrangement gives one agent the **exclusive right** to try and sell the property within a set time period, as agreed on by the property owner.

**Most agencies try to lock you into 60 or 90 day periods**. If you can, negotiate a period of 30 days, with the right to list with other agents after that 30 day period has expired.

Also consider negotiating for the overall agreement to end after a three month time period if the house is not sold in that time - *the shorter you can make the exclusive listing period, the quicker your agent will have to work in order to sell your property*.

If you have a ***general agency*** arrangement, also called ***multiple listing***, you list your property with more than one agency, but only pay commission to the agency that actually sells the property.

Although under this arrangement you have more people working to sell your property, it is argued that general agency arrangements do not motivate agents to work as hard at selling your property.

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### 5.3.3.2 Selling Privately

**Selling a house privately means that you sell your property without a real estate agent acting on your behalf.**

**Advantages**

- **Save Money**

  The main advantage to selling privately is that you do not have to pay a real estate agent the commission that is usually associated with a sale.

  As stated previously, agent fees are typically 4% of the total sales price of the property, but may be higher. In some cases there could even be marketing or advertising fees on top of this. Selling privately allows you to avoid paying these fees and possibly save you a lot of money. However, note that if you do sell privately, **you will need to pay marketing costs yourself**.

- **You Control the Sale**

  You show people through the house at times that suit you.

  Sometimes agents show potential buyers through a house when vendors are unaware (although they shouldn't!), or they want to do so at a time when it is inconvenient or your house is not as tidy as you would like.

- **You Know your Home Best**

  You know lots more about your property than anyone else. This means that you can genuinely show enthusiasm about certain features, let people know which rooms and during which time of the day the sun pours in and whether there is insulation in the walls and ceilings, etc. Your personal knowledge can help you market your home.

  Remember, if you instead use an agent and they accidentally tell the buyer incorrect information, you may be accountable for **misleading** the buyer. If you sell privately, you can make sure mistakes like this are avoided.

- **Work for Yourself**

  It is unlikely that if you were to go with an agent that you would be the only vendor they were working for at that time. When you sell privately you are working for yourself and your sale is your priority. You are not relying on anyone else and you do not need to wait to have an agent return your call or provide you with feedback.

**Important:**

If you do choose to sell privately, the **role of your lawyer** becomes more important than ever. Experienced property lawyers can provide you with a range of services throughout the private sale process.

Make sure you ask your lawyer about their costs before deciding to sell privately and before engaging their services.

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**Clip Art Images**
Clip Art Images were retrieved from Microsoft Clip Art Online.

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# Glossary of Terms

**100% Mortgage:** A ***mortgage*** for the full price of a property. The buyer does not pay a ***deposit***.

**102% Mortgage:** A ***mortgage*** that covers the full price of a property PLUS a little bit more to cover the costs associated with buying a property. The buyer does not pay a ***deposit***.

**Adjudicator:** Someone who oversees, listens to and makes decisions about a formal argument.

**ADLS:** Auckland District Law Society.

**Agreement for Sale & Purchase (of Real Estate):** A ***legally binding*** written contract used to record the sale and purchase of a property. Also called a ***Sale and Purchase Agreement***.

**Annuity:** A type of arrangement for income during retirement years. With this arrangement, someone pays an amount of money to an ***insurance company*** and, in return, the insurance company agrees to pay them regular (smaller) payments which either continue for a set number of years or continue until the person dies. It is like paying to make sure you get ***superannuation*** payments, instead of trying to invest and live off money you have saved for retirement yourself.

**Architect:** Someone who designs houses and other buildings, who is registered with the New Zealand Registered Architects Board.

**Architectural Designer:** Someone who designs houses and other buildings, but is *not* registered with the New Zealand Registered Architects Board.

**Architectural Draughtsperson:** Someone who specialises in building design, but is usually not as skilled as an ***architect*** or ***architectural designer.***

**Arrears:** Behind on payments. For example, if a ***tenant's*** rent is 'in arrears', this means they haven't paid all of the rent that they are supposed to.

**Asking Price:** The price that the person selling a property would like to receive for it. This is not necessarily the ***market value*** of the property or the price they will end up getting.

**Asset:** Something of value. In this programme it usually refers to items that someone can own that have a monetary value. Examples include houses, savings, investments and vehicles.

**Asset Base:** A group of ***assets***.

**Assignment:** When a ***tenant*** gives their right to be a tenant to someone else whom they (the tenant) have chosen. They are then no longer the tenant themselves.

**Auckland District Law Society Commercial Deed of Lease:** The standard ***Deed of Lease*** which is available for property investors to use.

**Auction:** A method of selling a property where people interested in buying the property are all in the same location and make offers (referred to as '***bids***') for the property. The property is either sold to the highest ***bidder***, or not sold at all if the best price is not satisfactory to the seller.

**Auctioneer:** A person who carries out an ***auction***. The auctioneer introduces the property for sale, accepts ***bids*** from interested buyers and announces when / if the property is sold.

**Automatic Payment:** A payment that you set up to automatically come out of your bank account. You specify the amount of the payment, and how often it is withdrawn from your account. Automatic payments are best suited for payments that are the same amount every week / fortnight / month etc.

**Banking Ombudsman:** A service which helps people sort out problems with their banking service providers. The service is free and is independent of Government and the banks.

**BCA:** Short for ***Building Consent Authority***.

**Beneficiaries:** More than one **beneficiary**. That is, the plural for beneficiary.

**Beneficiary:** Someone who receives some kind of benefit. In regards to ***family trusts***, a beneficiary is someone who is able to receive assets or income from that family trust. Some types of beneficiaries are entitled to the assets of a trust, whereas others are only entitled to be *considered* to receive assets of a trust.

**Bid(s):** An offer of a price. At an ***auction*** people bid (offer prices) to buy a property.

**Bidder(s):** Someone making a ***bid***.

**Body Corporate:** A group / committee that all owners in a block of apartments belong to. This group manages the running of the building and, in particular, the upkeep of areas of the property shared by all owners.

**Body Corporate Fees:** Fees which owners in a block of apartments pay to cover the costs of running the building. For example, it could cover the cost of cleaning shared areas (stairways, etc.), gardening, fire equipment and security equipment.

**Bond:** An amount of money that a ***tenant*** pays to the ***landlord*** at the beginning of the ***tenancy***, in case the ***tenant*** does not pay all of their rent or causes damage to the property. The ***landlord*** sends this money to the ***Building and Housing Group*** to hold until the ***tenant*** moves out. It is then returned to the ***tenant***, less any amounts owing to the landlord.

**Boom(ing):** A 'boom' is a time when things (such as business, the economy and sharemarkets) are performing well.

**Borrowable Equity:** A calculation which shows you how much more money you are likely to be able to borrow. It is calculated as 80% of the value of your property, less any amount you already owe on an existing ***mortgage***.

**Bottom out:** When prices (such as property prices) drop to the lowest point they have been to for a while, before rising again.

**Boundary:** The lines that show where a property ends. It shows the outside of a property. Boundary lines are shown on a ***survey plan***.

**Breach(ed)(es):** When rules are broken. If someone does not do what they are required to do under a contract (or by law).

**Bridging Finance:** A short-term ***interest-only mortgage*** that lets you buy a new home before you have sold your old home.

**Budget:** A list of all planned amounts of income and expenditure.

**Budgeting:** The process of putting together a ***budget*** and then monitoring (watching) your income and expenditure to keep it within that budget.

**Building and Housing Group:** Part of the ***Ministry of Business, Innovation and Employment***. This was previously a separate government department in New Zealand (called the ***Department of Building and Housing***), responsible for matters relating to building and housing. The aim of the Building and Housing Group is to improve building quality and housing availability in New Zealand.

**Building Code:** A set of standards that all new building work in New Zealand is required by law to meet.

**Building Consent:** A formal approval, issued by a ***Building Consent Authority***, for you to go ahead and carry out a building project. A building consent confirms that the building work you want to do meets the requirements of the **Building Code**.

**Building Consent Authorities:** An entity which is registered to be able to issue ***building consents***.

**Building Society:** A type of ***financial institution*** which is owned by its members (people who have saved money in an account or borrowed from them) and is set up under the *Building Societies Act 1965*. Originally building societies were formed to help their members buy houses, but now they provide a range of financial services.

**Buyer's Market:** When there is a large number of properties available for sale, compared to the number of people looking to buy a property. This gives buyers more power to negotiate lower prices.

**By Negotiation:** When a ***vendor*** chooses to sell their house by ***Offer and Negotiation***, but does not set a price. Instead, they invite potential buyers to offer a price first.

**Capital:** ***Assets*** of value, usually money and property such as land and buildings.

**Capital Gain(s):** ***Profit*** earned on an ***asset***. For example, when you purchase a house and then sell it for a higher amount, the profit you make is the capital gain.

**Capital Improvements:** Improvements to a property that increase the property's value. This does *not* include general repairs and maintenance. An example is adding a deck to a property.

**Capital Return:** The ***rate of return*** you get from ***capital gains***.

**Capped Interest Rate:** A ***floating interest rate*** which cannot rise above a certain level in a specific period of time.

**Cashflow:** The movement of cash. It refers to when and how much cash is received, compared to when and how much cash is paid.

**Cashflow Negative:** A situation which happens when the amount of cash you receive is less than the amount you need to pay. If you have a cashflow negative ***investment property***, you will have to use money from a different source (e.g. your own personal income) to help cover the costs of the property.

**Cashflow Neutral:** A situation which happens when the amount of cash you receive is the same as the amount you need to pay.

**Cashflow Position:** This refers to whether an investment is ***cashflow neutral***, ***cashflow positive*** or ***cashflow negative***.

**Cashflow Positive:** A situation which happens when the amount of cash you receive is more than the amount you need to pay. If you have a cashflow positive ***investment property***, the cash you receive from rental income will cover all amounts you need to pay and leave you with extra cash.

**Caveat:** A notice on a ***Title*** of a property which warns people that someone else has some interest in, or right over, the property. If there is a caveat on a property, the owner cannot sell their property unless they have permission from the person who lodged the caveat, or until the caveat is removed.

**Certificate of Title:** The term that was previously used instead of ***Title***.

**Chattels:** Items of moveable property within a house. Common examples include stoves, curtains and light fittings.

**Code Compliance Certificate:** A document which states that a building meets the requirements of the New Zealand ***Building Code***. This document is issued by a ***local authority***.

**Code of Ethics:** A set of rules about the way that people must behave or act. If you are part of an organisation, and that organisation has a code of ethics for its members, then you must agree to follow these rules. 'Ethics' relate to what is considered 'right' and 'wrong'. Therefore, a code of ethics will outline what behaviours the organisation considers to be 'right'. It generally requires people to act honestly and respectfully.

**Collateral:** An item of yours which a lender is allowed to take and sell so they can get back money that you owe to them (if you fail to make payments). Also called ***'security'***.

**Commercial:** This is a term that is used in relation to business and commerce.

**Commercial Property:** A property that is used by a business. It is not used as a house.

**Commercial Property Investment:** An ***investment property*** where the property purchased is a ***commercial property***. That is, the tenants for the property are operating a business.

There are three types of commercial property investment, one of which is also called 'commercial property investment'. This refers to properties that are used for offices, meetings, etc. (The other two types are ***retail property investments*** and ***industrial property investments***).

**Commission:** A type of payment which is based on outcomes. For example, a ***real estate agent*** who is paid on commission gets paid a fee for every property they sell.

**Company:** A type of business organisation. If you use this business structure, the business is a separate legal ***entity*** from yourself. It is run by one or more ***directors*** and is owned by one or more ***shareholders***.

**Comparable Sales:** Properties in the area which are similar to yours and have recently been sold. Valuers look at the prices at which these properties sold to work out the current ***market value*** of your property.

**Composite Title:** The ***Title*** for land where a ***cross-lease*** applies. That is, land that has more than one house on it. This commonly applies to flats and apartments.

**Compound Interest:** ***Interest*** which is earned on interest that has already been earned. For example, if you save $100 and earn $2 interest, then the next time interest is calculated, it is calculated based on the total amount of money you now have saved ($102) instead of only the original amount ($100).

**Compounded:** Interest is calculated and added to the amount already owing (including any interest previously calculated).

**Conditional Agreement:** An agreement that has been made, but is not finalised until all of the conditions in the agreement are met. It is common for a ***Sale and Purchase Agreement*** to include conditions such as the agreement only going ahead if the buyer can get satisfactory finance to buy the property.

**Consolidate:** Join together. E.g. join together several debts into one loan.

**Conveyancing:** The legal process involved in buying and selling ***real estate***.

**Counter Offer:** This may happen when people are negotiating to buy and sell something. If one party has made an offer to another party, and this offer is not accepted, they may change something about the offer, then offer it back to the first party for them to reconsider. For example, someone wanting to buy a property may offer the vendor $190,000 for the property. The vendor may cross this price out, change it to $197,000 then offer it back to the buyer to see if they are willing to pay this amount.

**Covenant:** If there is a covenant on the Title of a property, this means that there is a legal restriction or agreement relating to that property which must be kept. For example, a covenant may stop the owner from building a two-storied house as it could block views for other people.

**Credit Rating:** An estimate of how likely it is that someone (or a business or organisation) will be able to pay their debts. It is based on someone's history of borrowing and making payments.

**Credit Record:** Someone's record of how well they have paid their debts in the past.

**Credit Union:** A ***financial institution*** that is owned and operated by its members. It is not-for-profit and the members save and borrow from each other. Members must have a ***mutual interest***, meaning that they all must have something in common.

**Cross Lease:** A situation where there are two or more houses on a property and the owners of these houses all share the land ***Title***. The owners basically ***lease*** the land to one another.

**Cyclical:** Going in cycles. In regards to property investment, cyclical refers to the fact that property prices tend to go through stages where they grow fast, slow down, maybe decrease a little, before increasing again (and so on).

**Debt:** Something owed to someone else. In this Module, debt refers to money that is owed.

**Declining Revolving Credit Facility:** A ***revolving credit mortgage*** where the amount of money you can borrow reduces over time as you pay off the mortgage.

**Deduct(ed)(ing):** Take away. Subtract.

**Deductible Expense(s):** Costs that you are allowed to include when you are working out ***profit***. Remember. Profit = Income – Expenses. The more expenses you include, the lower your profit will be, and the less tax you will then need to pay.

**Deed of Lease:** The contract between a ***landlord*** and a ***tenant*** for a ***commercial property***.

**Default:** This refers to when you do not make payment when payment is due.

**Department of Building and Housing:** This was the government department in New Zealand responsible for matters relating to building and housing. This department is now referred to as the ***Building and Housing Group*** and is part of the ***Ministry of Business, Innovation and Employment***.

**Deposit:** In regards to purchasing property, 'deposit' has two meanings.

(1) The amount of their own money that someone uses to buy a property. The rest of the price of the property is borrowed.

(2) A percentage of the purchase price for a property that the buyer gives to secure the deal as soon as the ***Sale and Purchase Agreement*** is signed.

**Depreciation:** The process of spreading the cost of an asset over the useful life of that asset. Instead of recording the entire cost of an asset as an expense in the financial accounts at the time it is bought, only part of the cost is recorded. This reflects the fact that the asset is still worth something at the end of the year.

**Director:** A director of a company is someone who has the job of overseeing the management of a ***company***. For most small businesses, the company directors manage the company themselves.

**Discharged:** If your ***mortgage*** is discharged, this means that it is removed from the property ***Title***. If this is done, the lender cannot use your property as ***security*** anymore. This is typically done when someone finishes paying off their mortgage, however, some people choose not to do this so they can use their house as security to borrow more money for other purposes (such as to buy more properties).

**Discriminate:** Treating people differently because of, for example, their age, religion or race.

**District Plan:** A document which local authorities must prepare, which sets out plans to manage the effects of activities on the environment.

**Diversification:** Spreading your money across a number of types of investments to reduce risk. That is,nvesting in a range of different investments instead of putting all of your money in only one or two investments.

**Diversified Investment Portfolio:** When you have spread your money across a range of types of investments, this is referred to as having a 'diversified investment portfolio'.

**Diversify(ing):** To invest in a range of different types of investments. Refer to ***diversification***.

**Drawdown:** Using part of the amount of your ***mortgage***. For example, if you are building a house, and the bank has given approval for a mortgage of $300,000, it may allow you to 'drawdown' 20% of this once the first part of the house is built.

**Dwelling:** A building which is made for people to live in.

**Easement:** A right that someone has to use land which belongs to someone else in a certain way. The most common easements are driveways that go over one person's property, so that the other person can get to their own property.

**Encroachment:** A building or structure (such as a shed or fence) that illegally crosses onto a neighbour's property or a street.

**Entitle(d):** Have a right to something (or to do something).

**Entity:** Something which has a separate existence. For example, each person is an entity. Companies and other organisations are also entities.

**Entry Costs:** The amount of money needed to get involved with a type of investment. For example, for an investment property, it includes the cost of the deposit, lawyer fees, valuation reports.

**Equity:** The difference between the value of ***assets*** and the value of ***liabilities***. In relation to home ownership, equity is the ***market value*** of a house less the amount of ***debt*** owing on that house.

**Estates:** Types of land.

**Family Trust:** A type of ***trust*** in which family assets, such as a family home, are held. Assets are placed in a family trust for legal protection.

**Feasible:** Practical, possible under the circumstances, doable.

**Fee Simple:** A type of ownership of a property which means that you own the house and the land with almost no restrictions on your rights as to what you can do on that property. Also known as ***freehold***.

**Finance Companies:** Companies which are in the business of lending money to people. Unlike a bank, they do not accept deposits. In other words, you can borrow money from a finance company, but you cannot open a savings account with one.

**Financial Institution:** An organisation that is in the business of dealing with money. Common services provided by a financial institution include borrowing, lending and investing money.

**Financial Return(s):** The profit received on an ***investment***. It is usually calculated as a percentage of the original investment. For example, if someone invests $200 and earns interest of $6, the financial return is 3%.

**Fittings:** Items that are part of a property, but can be removed without causing damage to it.

**Fixed Interest Rate:** An ***interest rate*** that does not change for a certain period of time. For example, you may borrow money at an interest rate of 8% ***per annum*** for two years – over this two year period, the amount of interest you pay remains at 8% per annum.

**Fixed Term Tenancy:** A ***tenancy*** which the ***landlord*** and ***tenant*** agree will only be for a certain period of time and will finish on a specific date. This type of agreement becomes a ***periodic tenancy*** on the specific date unless either the landlord or the tenant notifies the other party that they want the tenancy to end on the agreed date. This notification must be in writing and must be given between 21 and 90 days before the end of the fixed term.

**Fixtures:** Items that are part of a property and cannot be removed without damaging either the property or the item itself.

**Flat-Fee Agencies:** Businesses which sell houses and charge a set fee for their services, instead of charging ***commission***.

**Floating Interest Rate:** An ***interest rate*** that may change over a period of time. Lenders change floating interest rates depending on the ***official cash rate (OCR)***. That is, if the OCR increases, so will floating interest rates.

**Fluctuate:** Change – go up and down. If a price fluctuates, it often goes up and down.

**Foot Traffic:** People who walk by a particular location. If a property gets high foot traffic, it means a lot of people walk past it.

**Freehold:** A type of ownership of a property which means that you own the house and the land with almost no restrictions on your rights as to what you can do on that property. Also known as ***fee simple***. If you own a freehold property, this *does not* mean that you do not have a ***mortgage***.

**Gearing:** Borrowing money to invest. 'High gearing' refers to using a large amount of ***debt*** compared to the amount of your own money used.

**General Agency:** Refer to ***Joint Agency***.

**Government Valuation:** The term that was previously used instead of ***Rating Valuation***.

**Gross Yield:** The ***financial return*** you get on your property investment, calculated as the annual rental income / property value x 100.

**Guarantor:** Someone who agrees to be responsible for paying your ***debt*** if you do not make the required payments at the required times.

**GV:** Short for ***Government Valuation***.

**Immigration:** The arrival of people from overseas to live in New Zealand.

**Income Protection Insurance:** A type of ***insurance policy*** which provides cover for situations where you are unable to work and therefore unable to earn an income.

**Incremental Amount:** The amount of an increase in price. For example, at an auction, each time someone makes a bid, they may be offering to increase the price by $10,000 or $1,000.

**Indefinitely:** No set end date. It is not yet known when (or if) something will finish.

**Industrial Property Investment:** A type of ***commercial property investment***. Industrial properties are used by businesses as factories, warehouses and workshops.

**Inflation:** The general increase in prices of goods and services over time.

**Insurance:** A promise that you will get compensation (some sort of payment) if you experience a loss.

**Insurance Company:** A business which sells insurance to people and other organisations. This business agrees to make a payment to the people (or organisations) it insures if they suffer a loss.

**Insurance Policy:** A contract between an insurance company and an insured person (or organisation) which states the key terms and conditions for providing the insurance. For example, it will outline what specifically is insured, the value of a payment that will be made in the event that a loss happens and how long the insurance lasts for.

**Interest:** The price someone pays for borrowing money.

**Interest-Only Mortgage:** A mortgage where no principal repayments are made until the end of the mortgage.

**Interest Payable:** The interest must be paid to a lender, on top of the actual ***principal*** that is borrowed.

**Interest Rate:** The percentage of the total amount of money borrowed that is charged as ***interest***.

**Investment Property:** A property that someone purchases for the main reason of trying to make money. It is *not* a property that someone purchases to mainly use as their home.

**Joint Agency:** A situation where a seller of a property has listed the property for sale with more than one ***real estate agency***.

**Joint Tenancy:** Where more than one person owns a house together and if *one* person dies, the other owners get that person's share of the house (regardless of what their ***will*** states).

**Land Information Memorandum:** A file of information about a property. This file is put together by the ***Local Authority***. It is usually referred to as a '***LIM***'.

**Landlord:** The owner of a house or building which is rented to someone else to use.

**LAQC:** Short for ***Loss Attributing Qualifying Company***.

**Lease(d):** An agreement for someone to use / rent property that belongs to someone else. If you have a ***commercial property***, you lease this to a business to use.

**Leasehold:** A type of 'ownership' of a property where you do not actually own the land on which a building is placed (although you usually own the building itself). Instead, rent is paid to the landowner to ***lease*** the land.

**Legally binding:** Something that can be enforced by law.

**Lessee:** A person / ***entity*** who ***leases*** a property from the owner.

**Lessor:** The owner of a property that is ***leased*** to another person / ***entity***.

**Leverage:** Borrowed money. Refer to ***leveraging***.

**Leveraging:** Using borrowed money to make an ***investment***.

**Liabilities:** More than one ***liability***.

**Liability:** Something that you owe. A debt.

**Liable:** Legally responsible. If you are liable to pay for something, this means that, by law, you must make payment.

**Licence to Occupy:** If you buy a licence to occupy, you buy the right to live in a property for life. These licences are very commonly issued by retirement villages.

**Life Insurance:** A type of ***insurance*** on the life of a person. If the person dies, an amount of money is paid to whoever owns the insurance policy (the policy holder).

**LIM:** Short for ***Land Information Memorandum***.

**Line-of-Credit Mortgage:** Refer to ***Revolving Credit Mortgage***.

**Loan-to-Security Ratio:** The size of a ***mortgage*** divided by the value of the property. Also called a ***Loan-to-Value Ratio***.

**Loan-to-Value Ratio:** The size of a ***mortgage*** divided by the value of the property. Also called a ***Loan-to-Security Ratio***.

**Local Authority:** A local government organisation. It includes local councils, regional councils, etc.

**Local Government Authorities:** Refer to ***Local Authority***.

**Look-Through Company:** A new type of company which was introduced in 2011. This structure replaces ***loss attributing qualifying companies***, but has some differences. If you have a look-through company, both the profits and the losses of the business are joined together with your personal income and then tax is calculated.

**Loss Attributing Qualifying Company:** A type of company which was commonly used by property investors in New Zealand. This was a popular structure because investors were able to offset losses made by the company against their personal income (and therefore reduce the tax they paid). However, this type of company no longer exists. The closest alternative is now a ***Look-Through Company***.

**Low Doc Mortgage:** A ***mortgage*** where the lender does not require you to supply the same amount of documentation as usual. These mortgages often have higher fees and interest rates because they are riskier for the lender.

**Low Equity Premium:** A fee that a lender may charge you if the amount of your ***deposit*** to buy a property is very small.

**LSR:** Short for ***Loan-to-Security Ratio***.

**LTC:** Short for ***Look-Through Company***.

**LVR:** Short for ***Loan-to-Value Ratio***.

**LSR:** Short for ***Loan-to-Security Ratio***.

**Marginal Personal Tax Rate:** The highest tax rate that a person needs to pay on any income they earn. For example, if someone earns $50,000, their marginal tax rate is 30%. But, if their income increases to over $70,000, their marginal tax rate will then be 33% (all income *over* $70,000 will be taxed at 33%).

**Market Price(s):** Refer to ***Market Value***.

**Market Rent:** The amount of rent that a ***landlord*** might reasonably expect to receive, and a **tenant** reasonably expect to pay, taking into consideration the general level of rent prices of similar houses in the area. (Note that a formal definition is given in the Module).

**Market Value:** The price that would be paid for an item if it was to be sold in an 'open market'. In regards to property, it is the price that people would be willing to pay for a house if that house was to be offered for sale to the general public.

**Median:** Middle. The median house price is the middle house price. This is different from the average house price, as the average house price involves adding up all the prices of houses and then dividing this number by the number of houses.

**Mediation:** A process where someone helps two people (e.g. a ***landlord*** and a ***tenant***) work through their problems and come to a solution.

**Ministry of Business, Innovation and Employment:** A government department, formed in 2012, which is responsible for areas such as economic development, building and housing, science and innovation, and employment in New Zealand.

**Mortgage:** A special type of loan agreement which is used to buy property. The lender uses the property as ***security*** for the loan, meaning that they can take the property and sell it if the required repayments are not made by the borrower.

**Mortgage Broker:** A person or organisation who identifies providers of ***mortgages*** (such as banks) for people looking to obtain a mortgage. In other words, it is someone who matches someone who needs a mortgage, with a ***financial institution*** who can provide that mortgage. A mortgage broker is supposed to find the best mortgage option for their customer out of the financial institutions which they deal with.

**Mortgage Principal:** The actual amount of money that you borrow from a lender to buy a property.

**Mortgage Protection Insurance:** A type of ***insurance*** that covers the cost of paying your ***mortgage*** if you die. It may also provide cover in case of a serious disability or illness.

**Mortgagee:** The lender in a mortgage arrangement – e.g. the bank.

**Mortgagee Sale:** When someone falls behind in paying their ***mortgage*** and the bank sells the property to get their money back.

**Mortgagor:** The borrower in a ***mortgage*** agreement – e.g. the property investor or home owner.

**Multiple Listing:** Refer to ***Joint Agency***.

**Mutual:** Common, same. If two people have a mutual interest, they have an interest in common. That is, one person has an interest that the other person also has.

**Negative Gearing**: This happens when someone borrows money to make an investment (e.g. they take out a mortgage to invest in a property), but the income on that investment does not cover the interest on the loan.

**Net Migration:** The number of people coming into the country, less the number of people moving out of the country.

**Net Value:** One way of measuring ***equity*** which shows how much money you would 'walk away with' if you were to sell a property. It is calculated as the value of the property less the costs of selling the property, paying back the mortgage and paying any tax owing.

**Net Worth:** The total value of someone's ***assets***, less the total value of their ***liabilities***. It is the same as ***equity***.

**Net Yield:** The ***financial return*** you get on your property investment, calculated as the annual rental income (less expenses) / property value x 100. Costs that are *not* counted as expenses include tax and ***mortgage costs***.

**Nominal:** An amount which does not take out the effect of inflation.

**Non-Deductible Expense(s):** Costs that you are NOT allowed to include when you are working out ***profit***. Remember that Profit = Income – Expenses. The more expenses you include, the lower your profit will be, and the less tax you will need to pay.

**OCR:** Short for ***Official Cash Rate***.

**Off the Plan:** To purchase a property before it is completed after having only seen the plans.

**Offer and Negotiation:** A method of buying a property which involves the person wanting to buy the property making an offer to the ***vendor*** of how much they are willing to pay. The two parties then (usually, but not necessarily) negotiate a deal.

**Official Cash Rate:** The ***interest rate*** that the ***Reserve Bank of New Zealand*** sets to control the level of prices (and thus the amount of ***inflation***) in New Zealand. This is the rate that the ***RBNZ*** pays and charges other banks in New Zealand on the accounts that they have with them (the RBNZ). As a result, the interest rates that banks charge their customers depend on the Official Cash Rate.

**Offset Mortgage:** A ***mortgage*** for which you are only charged interest on the balance of the mortgage, less any amounts you have in savings and / or transactional accounts with that bank.

**On the Market:** When an ***auction*** is held for a property and the price that ***bidders*** are offering reaches the ***reserve price***. At this point, the property is 'on the market' and will sell to the highest bidder.

**Outgoings:** Expenses involved in running a property.

**Overcapitalisation:** When more money is spent on a project than you are likely to earn in profits. An example would be spending $20,000 re-wallpapering and re-carpeting a house, but the value of your property only increasing by $5,000.

**Overcapitalise:** See ***Overcapitalisation***.

**Overdraft:** An overdraft occurs when the amount of money withdrawn from a bank account is more than the funds available in the account. An overdraft facility is therefore a service which banks provide that allows people to withdraw more money (up to a set amount) than is in their bank accounts.

**Passed In:** When an ***auction*** is held for a property, but the price does not reach the ***reserve price***, so the property does not sell.

**Penalty Fees**: Fees charged to penalise / punish you for something you have (or have not) done.

**Per annum:** Per year. ***Interest rates*** are often given as an amount 'per annum'. That means the rate of interest charged, each year.

**Periodic Tenancy:** A ***tenancy*** which is NOT for a set period of time and will finish on a specific date. In other words, the ***tenant*** will continue to use the property, paying rent for agreed periods (e.g. two weeks at a time), until either the ***landlord*** or ***tenant*** decides to end the arrangement.

**PIM:** Short for ***Project Information Memorandum***.

**Portfolio:** In regards to investments, a portfolio is a collection of investments.

**Possession Date:** This is the date by which someone who buys a property is actually ***entitled*** to move in and start using it.

**Possession Order:** An order made by the ***Tenancy Tribunal*** which requires a ***tenant*** to move out of a property.

**Pre-Approval:** When finance is approved from a lender *before* you put in an offer to buy a property.

**Premises:** A property. Includes both the land and the building.

**Principal:** The actual amount of money that has been borrowed.

**Private Sale:** The sale of a property by the owner. The owner does *not* use the services of a ***real estate agent***.

**Profit:** Income less expenses. Note that profit is not the same thing as income. Instead, it is what is left over after ***deducting*** expenses.

**Progress Payment Schedule:** The plan of when ***progress payments*** will be made. This plan shows what work needs to be completed in order for the bank to release ***mortgage*** money to you.

**Progress Payments:** If you are building a house, a lender does not give you all of the money for your ***mortgage*** at once. Instead, it gives it to you in stages, as parts of the building project are completed. These payments are called progress payments.

**Project Information Memorandum:** A file containing information about a property, put together by a ***local authority***. The difference between this and a ***Land Information Memorandum*** is that it only contains information about a property that is relevant to a building project. It does not also include information about the land in general.

**Property Manager(s):** A person or business that you pay to manage your ***investment property*** for you. They provide services such as finding ***tenants***, ensuring rent is paid and organising repairs and maintenance.

**Purchaser:** The person who buys a property.

**Ratchet Clause:** A statement in a ***lease*** agreement which says that the rent cannot be reduced below a certain level.

**Rateable Valuation:** The valuation of a property that the ***local authority*** uses to set the rates for the property. It used to be called the ***Government Valuation*** (***GV***). It is also called the ***Rating Valuation***, or ***RV*** for short.

**Rate of Return:** The 'return' you get from an investment is the amount of money you earn from it. The rate of return is therefore the amount of income you receive calculated as a percentage of your original investment.

**Rates:** The tax that a ***local authority*** charges property owners in their area in order to get money to pay for their activities (e.g. road works, public pools, water systems).

**Rating Valuation:** The valuation of a property that the ***local authority*** uses to set the rates for the property. It used to be called the ***Government Valuation*** (***GV***). It is also called the ***Rateable Valuation***, or ***RV*** for short.

**Rationale:** A logical explanation. A reasonable explanation. That is, an explanation which makes 'sense'.

**RBNZ:** Short for the ***Reserve Bank of New Zealand***.

**Real Estate:** Land as well as improvements to land such as houses, fences and other buildings.

**Real Estate Agency:** A business which is licensed to negotiate the sale or lease of property on behalf of the property owner. This business may employ a number of ***real estate agents*** to do this.

**Real Estate Agent:** A person or company which is licensed to negotiate the sale or lease of property on behalf of the property owner. A real estate agent advertises property for sale and helps throughout the sale process.

**Real Estate Institute of New Zealand:** An organisation in New Zealand that promotes professionalism in the ***real estate*** industry.

**Real Returns:** ***Financial returns*** which take into account the effect of ***inflation***.

**Recession:** A period of time when the general economy declines. For example, at this time the overall value of goods and services sold reduces and unemployment increases.

**Reducing Mortgage:** A ***mortgage*** where the mortgage repayments you make decrease over the life of the mortgage.

**Referee(s):** In a ***tenancy*** situation, a referee is someone who the ***landlord*** can contact to ask questions that will help them decide if someone will be a good ***tenant***. Examples of referees include a potential tenant's current landlord and employer.

**Referee Check:** The process of contacting a potential tenant's ***referees*** to ask questions that will help the ***landlord*** decide if the potential ***tenant*** will be a good tenant.

**Refinancing:** Getting a new loan to replace an existing loan. The new loan is secured by the same assets as the original loan, but has different terms. For example, it may have a longer time to repay the loan.

**Registered Property Valuer:** Someone who specialises in valuing property and is registered with the Valuers' Registration Board in New Zealand.

**Registered Valuation:** A valuation of a property which is prepared by a ***Registered Property Valuer***.

**REINZ:** Short for ***Real Estate Institute of New Zealand.***

**Renovate:** The process of renewing / improving a property.

**Renovation(s):** Improvements to a property.

**Requisition:** A process where the buyer of a property requests additional information about the ***Title***, or any other matter relating to the property, from the seller.

**Reserve Bank of New Zealand:** The central bank of New Zealand. It is mainly responsible for looking after the level of ***inflation*** in New Zealand. It does this by controlling a special ***interest rate*** called the ***Official Cash Rate***. It is also solely responsible for issuing New Zealand dollars and coins, and supervises other banks in the New Zealand banking system.

**Reserve Price:** An amount the owner of a property decides on (before an ***auction***) as being the minimum price they are prepared to sell the property for at the auction.

**Residential Property Investment:** An ***investment property*** that is to be used as a house. In other words, buying a house that you intend to rent to someone else to live in. It is *not* a property that is mainly used to run a business in.

***Residential Tenancies Act 1986:*** The main legislation in New Zealand that covers the responsibilities of a ***landlord*** and a ***tenant***.

**Resource Consent:** Permission from a ***local authority*** to carry out an activity on a property which is not allowed based on the ***District Plan***.

**Retail:** The selling of goods directly to customers.

**Retail Property Investment:** A type of commercial property investment. Retail properties are used by businesses which operate shops.

**Revolving Credit:** A revolving credit mortgage is like a big ***overdraft***. Usually, people with a revolving credit mortgage put the revolving credit facility on the bank account that they use most often. Therefore, every time wages or other income is paid into the bank account, the mortgage is being paid off, and every time money is withdrawn from the account to (for example) pay bills, the amount of money owing on the mortgage increases.

**Right of Way:** A strip of land that belongs to someone which someone else (or the general public) has the right to use. An example is a path across someone's property that people can use to get to other property.

**RV:** Short for ***Rateable Valuation*** or ***Rating Valuation***. Can also be short for ***Registered Valuation***.

**Sale and Purchase Agreement:** A ***legally binding*** written contract used to record the sale and purchase of a property. Also called an ***Agreement for Sale & Purchase***.

**Secured:** An investment is 'secured' if the borrower has provided ***security*** to the lender for the money they borrowed.

**Security:** An item of yours that a lender is allowed to take and sell so that they can get back money that you owe to them (if you fail to make payments). Also called '***collateral***'.

**Settlement:** The process whereby the sale of a property is finalised. It involves money being paid, the ***mortgage*** coming into effect and the ownership of the property being transferred to the new owner.

**Settlement Date:** The date on which ***settlement*** happens.

**Share(s):** The ownership of a company is divided into shares. Therefore, if you own a share, you have part-ownership of a company.

**Shareholder:** Someone (or a business or organisation) who owns ***shares***.

**Sole Agency:** A situation where a seller of a property has listed the property for sale with only one ***real estate agency***.

**Subdivision:** A section of land which has been divided into smaller pieces. A subdivision can involve buying a large area of unused land, then dividing it up into sections for houses to be built on, or it can involve dividing a section that already has a house on into two or more smaller sections.

**Sublet(s):** A situation where a tenant continues to rent a property, but then rents out part (or all) of the property to someone else.

**Subletting:** Refer to ***Sublet***.

**Superannuation:** A payment made to someone who is retired from work. Also called a 'pension'.

**Survey:** A drawing or map showing the exact legal ***boundaries*** of a property, the location of improvements, ***easements***, ***rights of way***, ***encroachments*** and other physical features.

**Survey Plan:** Refer to ***Survey***.

**Surveyor:** Someone who measures and maps land, and uses this information to create ***survey plans***.

**Table Mortgage:** A ***mortgage*** where the mortgage repayments you make do not change over the life of the mortgage.

**Tax-Deductible Expense(s):** Refer to ***Deductible Expenses***.

**Tax Evasion:** Intentionally (not by mistake) avoiding paying tax. This includes stating that your expenses are higher than they really are, just so that your profit looks lower (so that your tax bill will also be lower).

**Tenancy:** A situation where someone (a ***tenant***) is renting a property from the property owner.

**Tenancy Agreement:** A contract between a ***landlord*** and a ***tenant***, which sets out important details about the tenancy arrangement. It includes, for example, the amount of rent that is to be paid.

**Tenancy Tribunal:** A special Court that makes decisions about problems that ***landlords*** and ***tenants*** are not able to sort out themselves.

**Tenant:** Someone who pays rent to use (or live in) a property which is owned by someone else.

**Tenants in Common:** A way of owning property along with someone else. If you and someone own a house together as 'tenants in common', when you die, your share of the property goes into your estate. It does NOT automatically go to the other person who owns part of the house. You can choose to leave this property to someone else (e.g. your son / daughter).

**Tender:** A method of selling a property whereby interested buyers submit confidential written offers of how much they are willing to pay for the property to the seller, for the seller to then consider.

**Term of a Mortgage:** The length of time that a ***mortgage*** is for.

**Termination:** End; the act of ending something (e.g. ending a ***tenancy***).

**Title:** A property title records details about a property including who the legal owners are. If someone is said to 'keep the title' of a property, this means they continue to own it.

**Transactional Account:** A bank account that has a large number of transactions (money goes in, and out, of the account very frequently). They are usually used for receiving wages and salary and paying all bills and expenses.

**Trust:** A type of legal structure in which ***assets*** are held. Assets placed in a trust are held for the benefit of people and other ***entities*** which are identified as being the ***beneficiaries*** of that trust.

**Unconditional:** When an agreement to buy a property does not have any conditions attached to it. A ***sale and purchase agreement*** may be 'unconditional' to begin with, or may originally be a ***conditional agreement*** and then become 'unconditional' once all of the conditions have been met.

**Unit Development:** Property developments where buildings with more than one housing 'units' in them are built on one piece of land. Examples include apartment buildings and flats.

**Unit Title:** Where you own a unit in a block of units (e.g. an apartment in a block of apartments), but some areas of the block are shared with other owners and managed by the ***body corporate***.

**Vacancy Costs:** The amount of rental income that you miss out on when your ***investment property*** is ***vacant***.

**Vacancy Rate(s):** The proportion of time that a property is ***vacant*** in a year.

**Vacant:** Empty. A property that does not have a ***tenant*** in it.

**Variable Interest Rate:** Refer to ***Floating Interest Rate***.

**Vendor(s):** The legal owner of a property who is selling their property.

**Vendor Bid:** Where the ***auctioneer*** at an ***auction*** makes a bid on behalf of the ***vendor*** to try and get the price up to the ***reserve price***.

**Warranties:** A warranty is a promise or a guarantee.

**Will:** A document that sets out what you would like to occur after you die. This document usually shows how you would like your property distributed. A will may cover matters such as who you want to look after your children.

**Yield:** The ***financial return*** that you get on your property investment from rental income, calculated as a percentage of the property value. There are different ways of calculating it. Refer to ***Gross Yield*** and ***Net Yield***.

**Zoning:** The way in which a ***local authority*** divides up land to be used for different purposes. For example, in some parts of town, land is only to be used for ***commercial*** purposes, whereas in other parts of town, land is only to be used for residential purposes (i.e. houses to live in).

A type of zoning also applies to some schools. People who live within a particular area around the school are given priority to be able to enrol in that school. The Ministry of Education provides information about zoning on the website www.schoolzones.co.nz.