Te Tohu Whakahaere Pūtea
Certificate in Money Management

Wāhanga Tuatoru:
Ngā Whakatupuranga Hanganga
Module 3: Property Investment

Whakamātautau Tuatahi: Te Whakamārama Whakatupuranga Hanganga

Assessment 1: Understanding Property Investment

Ngā Whakautu Hei Tauira
Model Answers

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Part One

Task One

Identify and explain at least three trends / features in the New Zealand property market over the past 50 years.

Tauira may identify any of the trends / features identified in the Module. Although these do not have to be written in their own words, tauira must not directly copy entire paragraphs that have other information not directly related to this question. Trends / features identified could include, for example:

- ***Statistics showing the percentage increase (or the actual increase in $) in median sale prices over any period within the past 50 years (or the entire period).***
- ***General trend information – i.e. upward trend, slowing at times, but rarely decreasing.***
- ***Periods of particularly rapid growth and statistics relating to these periods.***
- ***Periods for slowed (or negative) growth.***
- ***Trends relating to affordability of property.***

Task Two

Answer the following questions:

1. What is 'equity'? Give an example of equity in relation to property ownership.

   Tauira may give a range of responses. An example response is as follows:

   "Equity is the value of assets after all liabilities have been accounted for. It represents the owner's share of the assets. It is calculated as: Total Value of Assets – Total Value of Liabilities. In regards to property ownership, equity is the difference between what the house is worth and what you owe on the mortgage. So if, for example, someone owns a property that has a market value of $400,000 and they have a mortgage of $250,000 on that property, their equity is equal to $150,000."

2. What are two ways in which equity in a property can increase?

   - ***By an increase in market values.***
   - ***By paying off the mortgage (reducing debt).***

3. What are three types of commercial investment? Identify a feature of each of these types of investment:

   - ***Industrial***
     Example of Features: Includes, for example, warehouses and factories. Is often one of the cheaper options for commercial investment.

   - ***Commercial***
     Example of Features: Includes office space. Tends to be more expensive than industrial property.

   - ***Retail***
     Example of Features: Tends to be riskier as tenants are affected more by economic conditions. For example, if the economy is in a recession, retail businesses are often affected worse than other businesses and may be more likely to close down. Retail businesses may also change locations more often as they try to find the best location for their target market.

Task Three

Complete the table below by identifying which **five** statements relate to residential property investment and which **five** statements relate to commercial property investment. (Place a 'tick' in the relevant column)

Statement	**Residential**	**Commercial**
Tenants are more likely to change frequently	✓	
The maximum you can borrow for this type of investment is usually only 60% - 70% of the value		✓
Demand by tenants is strongly affected by economic conditions		✓
Usually easier to find a tenant	✓	
The amount of money required to participate in this type of investment is usually lower	✓	
Interest rates are usually higher		✓
The landlord pays costs and repairs	✓	
It is reasonably common for investors to be able to borrow 80% of the value of the investment	✓	
The financial returns on this type of investment are usually higher		✓
The tenant usually has more freedom to conduct renovations		✓

Task Four

Complete the table below to calculate the net yields for Property A and Property B and then answer the question that follows.

	Property A	**Property B**
Value of Property	**$260,000**	**$160,000**
Gross Annual Rent	**$13,520**	**$9,880**
Annual Expenses		
▪ Rates	$1,850	$1,600
▪ Repairs & Maintenance	$400	$400
▪ Insurance	$730	$700
▪ Management Fees	$680	$500
▪ Two Weeks' Vacancy	$520	$380
Total Annual Expenses	***$4,180***	***$3,580***
Total Annual Rent less Total Annual Expenses	**$9,340**	**$6,300**
Net Yield (before tax)	**3.59%**	**3.94%**

Question: What are two other factors (in addition to the yield) that may affect the final returns on investment for Property A and Property B? *Hint: Refer to Section 4.1.1.2 of the Module.*

- ***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). Another way of saying***

this is: The increase in the market value of the properties. The more the value increases, the higher the return (i.e. 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. For example, someone who only puts a $20,000 deposit on a $100,000 property, then sells it a few months later for a much higher price (say $120,000), would get a higher return than if they had paid $100,000 outright for the property. That is, they have doubled their money (they now have $40,000 instead of $20,000) as opposed to only getting a 20% return.***

Part Two

Task Five

Use the following information to write an example of how someone could use leverage to purchase three properties over time.

Key points:

- This person has $60,000 to go towards a deposit on a house.
- They want to buy the properties within **10** years.
- Their bank will let them borrow up to 80% of the value of each property.
- They wish to purchase the following properties:
  - Property 1: Valued at $300,000
  - Property 2: Valued at $240,000
  - Property 3: Valued at $350,000

When writing your example, you are required to refer to specific amounts.

IMPORTANT: You are to make your own assumptions. For example, what do you assume the values of Property 1 and Property 2 to be when Property 3 is purchased?

You can assume anything you want. For example, when the person buys Property 2, you could assume that:

- property prices have only slightly increased, or
- property prices have increased by a lot, and
- the person has paid nothing off their mortgage, or
- they have paid (for instance) $20,000 off their mortgage.

Refer to the example of Steve and Tiari given in Section 4.2.3 of your Module for guidance.

Details of tauira answers will vary. An example is as follows:

The investor would use the $60,000 as a deposit on Property 1, and borrow the remaining 80% of the value ($240,000). Within the two years, the property market may experience a boom, with market values increasing by around 8% per year. That is, within two years, the investor may have only paid off $13,000 of their mortgage, but the house may now be worth $345,000. Their equity in the property has therefore increased by $58,000 to $118,000 (i.e. $345,000 - $227,000 = $118,000). Given that

the total value of Property 1 plus Property 2 would be $585,000, the investor could secure a mortgage for the second property. Their equity would be $118,000 and the total amount of the mortgages would be $467,000 ($227,000 plus $240,000). The mortgages therefore represent 79.8% of the value of the properties.

Over the next seven years, the property market may slow down, but still continue to grow. The investor may have paid a further $45,000 off their mortgages, so that they would only owe $422,000. The value of Property 1 may have increased by 10% to $379,500 and the value of Property 2 may have also increased by 10% to $264,000. The two properties together are now worth $643,500, meaning the investor has $221,500 equity ($643,500 - $422,000). If they were to buy Property 3 for $350,000, the total value of all three properties would be $993,500, and the value of the mortgages would be $772,000 ($422,000 plus $350,000). The mortgages therefore represent 77.7% of the value of the properties. Considering they are able to borrow up to 80% of the value, they would be able to buy this property.

Task Six

Answer the following questions about leverage:

4. If an investor has already used leverage to purchase several properties and they are currently still paying the mortgages on these properties:

   What may stop this investor from continuing to use leverage to buy properties? Explain your response.

   Their ability to pay the mortgages can restrict the investor. Although their equity may increase, their debt is also likely to increase. They need to be able to at least pay the additional interest on this debt (for an interest-only mortgage). For most mortgages, they will also need to make principal repayments.

5. What impact does leveraging have on the rate of return on your investment?

   Support your response by giving an example in which you calculate the rate of return in two different scenarios – one in which leveraging is used, the other in which it is not used.

   Leveraging increases the return on your investment. Assume that someone decides to buy an investment property for $300,000 and believes that, if they spend an extra $20,000 on renovations, they would be able to sell the house for $350,000 within a couple of months (a profit of $30,000). If they have $320,000 and were able to buy the house and do the renovations without a mortgage, their return would be calculated as $30,000 / $320,000 = 9.38%.

   However, if they instead just put a 20% deposit on the house (i.e. $60,000) and paid for the renovations with cash, they would only have put $80,000 on the house. Their return would then be calculated as $30,000 / $80,000 = 37.5%. In the meantime, they could have used the rest of their cash that they did not spend on the house towards another investment.

Part Three

Task Seven

Before purchasing an investment property, you should do a careful inspection of the condition of that property. For each of the 10 factors listed below, identify at least one factor that you should make note of during an inspection. An example of how to complete this task is given for you:

Example: Flooring – check under furniture for stains or worn patches in the carpet.

Tauira may give a variety of correct responses. Some example responses are given below.

- Water: ***Do the taps work?***
  How large is the hot water cylinder?
- Toilet: ***How well do the toilets flush?***
  Are they cracked or damaged in any way?
- Walls and ceilings: ***Is there any mould?***
  Are there any bulges or cracks that may indicate leakages?
- Doors and windows: ***Do these close properly?***
  How secure are the locks?
- Boundaries: ***Where are the boundaries in relation to the fences?***
- Drainage: ***Are there any boggy patches?***
  Where does storm water flow to?
- Security: ***Is there good street lighting?***
  Do doors and windows close properly?
- Power: ***Do all power points work?***
  What condition is the switchboard in?
- Underneath the Building: ***Are the piles in good condition?***
  Are there signs of rotting in the floorboards?
- Bathrooms: ***Are there signs of mildew or rotting in the walls?***
  What condition are the fittings in?

Task Eight

The statement below is not correct. Explain why.

Statement: "If you are buying a property for investment purposes, it is always best to get an interest-only loan."

Example Correct Responses:

- ***You need to be able to pay for the property at the end of the period. You may be forced to sell it at a price lower than what you want in order to get the funds to do this.***
- ***You may not want to sell the property yet. Unless you have other funds to pay off the mortgage, you may be forced to sell.***

Task Nine

Answer the following questions / complete the following tasks relating to methods of purchasing a property.

6. What is the main disadvantage of buying a property via a tender as opposed to buying at an auction?

   You do not know how much other people are willing to pay. You may therefore submit a bid which is too low and miss out on the property (when you were really prepared to pay higher), or you may submit your best bid and get the house, but actually pay significantly more than what anyone else was offering or more than the seller expected to receive.

7. Identify whether each of the statements below, relating to purchasing a property via a tender process, are true or false.

   - There is no reserve price — ***True*** / False
   - You cannot put conditions into your tender offer — True / ***False***
   - The final price paid by the buyer is communicated to everyone who submitted a tender offer — True / ***False***

8. Some properties are advertised for sale with the price being 'by negotiation'. Why may it be of benefit to you to make an offer on a property being sold in this way?

One reason is that many people are reluctant to make an offer on a property that is advertised as 'by negotiation'. This reduces competition amongst buyers for the property and the seller may find it difficult to find a buyer (and therefore more willing to consider your offer, even if it is relatively low).

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.

9. If you are bidding for a property being sold by auction, when may the auctioneer or the vendor bid against you?

They can bid against you until the reserve price is met.

10. Assume that someone you know wants to try to purchase a property that is being sold by auction. What are three useful tips you could give that person about the auction process?

Tauira responses may vary. Examples include:

- ***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.***
- ***Be clear on the maximum amount you are willing to pay for a property before you go to the auction. Stick to your maximum – do not be tempted to go over it.***
- ***If you are using 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 not pay too much attention to what the real estate agent tells you the house will sell for. They will probably give a higher price to encourage you to bid high.***
- ***Make sure you carefully listen to bid denominations. That is, are the bids going up by $5,000 at a time or $10,000? You do not want to accidentally place a bid that is higher than you are prepared to pay.***

Part Four

Task Ten

11. When might the Tenancy Tribunal get involved in setting the amount of rent you charge your tenant?

Under the Residential Tenancies Act 1986, a landlord is not allowed to charge rent that exceeds 'market rent' by a 'substantial amount'. Therefore, if the rent you charge is not comparable to the rent charged for other properties of a similar type, size and location, the Tenancy Tribunal can order you to reduce it.

12. Identify **and explain** two factors that should be taken into consideration when deciding how much rent to charge for a property.

Tauira responses may vary. The two factors most expected include:

- ***Market rent in the area: Under the Residential Tenancies Act 1986, a landlord is not allowed to charge rent that exceeds 'market rent' by a 'substantial amount'.***
- ***Cashflow Position: Ideally, investors would like their investment to be at least cashflow neutral, but preferably cashflow positive.***

A few other acceptable example responses include:

- ***Demand for properties: If there are many empty properties available to rent in relation to potential tenants, you may need to consider a lower price in order to get a tenant when you want one.***
- ***The location of the property: Properties in a highly sought after zone or in good proximity to key facilities, schools, etc. may charge more.***
- ***The size of the property: The larger the property, the higher the price.***
- ***The condition of the property***

13. What are two advantages of using a property manager? *Note: identify advantages, NOT services provided by a property manager.*

Tauira responses may vary. A few examples include:

- ***Reduces stress.***

- ***Makes your investment less time consuming – good for someone who has money to invest, but no time.***
- ***Good for someone who wants to invest in property, but does not have the skills needed to look after a property themselves (e.g. 'handyman' skills for repairs and maintenance or communication skills for liaising with tenants).***
- ***They can help you to maximise rental income without overcharging customers.***

Tauira should not directly identify services provided by a property manager, unless they do so as part of the explanation. For example, they could say "Reduces stress because they manage tenants who do not pay on time", but not "Manage tenants who do not pay on time".

14. What are two advantages of self-managing a property investment?

Tauira responses may vary. A few examples include:

- ***Cheaper***
- ***You are more aware of the condition of your property and of the way tenants are treating it***
- ***Select the tenants you want***

15. What are four services / tasks that a property manager is likely to provide?

Tauira responses may vary. A few examples include:

- ***Conduct property inspections***
- ***Handle repairs and maintenance***
- ***Collect rent and 'chase up' tenants who fall behind in payments***
- ***Give advice on determining rents***
- ***Select tenants***

Task Eleven

Identify whether the statements in the table below, relating to responsibilities of a tenant, are true or false.

Tenant Obligations	**True**	**False**
A tenant must inform the landlord of any damage to the property as soon as possible.	✓	
A tenant may only sublet without informing the landlord provided that they obtain a written guarantee from the sub-lessor that rents will be paid on time.		✓
A tenant must allow the landlord reasonable access to the property.	✓	
A tenant must be present every time a landlord conducts an inspection.		✓
A tenant may not make any alterations to the property without the landlord's permission.	✓	
A tenant must pay for any intentional or careless damage that they cause.	✓	

Identify whether the statements in the table below, relating to responsibilities of a landlord, are true or false.

Landlord Obligations	**True**	**False**
A landlord must provide a receipt if the tenant pays in cash.	✓	
A landlord must provide the tenant at least 60 days' written notice of a rent increase.	✓	
A landlord must provide the tenant with at least 24 hours' notice of an inspection.		✓
If repairs are required to a property, the landlord may enter the property at any time.		✓
The landlord must pay for the rates and the house insurance.	✓	
The landlord must tell the tenant if they intend to sell the property.	✓	

The landlord must make sure locks and fastenings on the property are working properly.	✓	
The landlord must pay for all electricity and gas used by the tenant.		✓

Task Twelve

Identify five steps commonly followed in the process of selling a house. For each of these steps, identify one 'tip' that you would offer a vendor.

As per the Marking Schedule, tauira do not need to identify steps in the correct order. A list of example steps is provided below along with one (or two) example(s) of a tip. Tauira responses may vary from these suggested answers:

Step	**Tip**
Talk with your lender about your plans to sell.	Make sure you have some idea of what you are likely to receive for your property.
Seek legal advice.	Check 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, have they handled many of these types of sales previously?
Decide if you would like to sell privately or list with one or more agencies and choose your agent(s), if applicable.	If you choose to sell through a sole agency, sign up for a short period at a time in order to give them more incentive to sell quickly.
Determine what method you would like to use to sell (e.g. offer and negotiation, auction, tender).	Get advice to help you with your decision. If you are using an agent, they will be able to advise you on what may be suitable for your property.
Prepare your home for sale.	Be careful not to overspend on changes to your house. Get advice from your agent as to whether the changes / repairs you intend to carry out are likely to increase the value of your house by more than the cost of carrying out the changes / repairs.

Get your home valued.	Make sure you use a registered valuer who has a current certificate and make sure they have experience in your area.
Set an asking price (or a tender date).	Unless advised otherwise by your agent, avoid advertising the price as being 'by negotiation' as it may deter potential buyers.
Promote your property.	Be honest in answering questions from potential buyers. If you mislead a buyer, they may have a right to get out of any agreement you make.
Consider and negotiate offers.	Use your lawyer to assist you in this process.
Arrange settlement and transfer of ownership through your lawyer.	Make sure you are easily contactable and make time to meet with your lawyer when required to make the process go quickly and smoothly.

Task Thirteen

Answer the following questions / complete the following tasks relating to the financial management and taxation of property investments.

16. Identify five costs relating to property investment that can be claimed as expenses for tax purposes.

Example responses include:

- ***Rent***
- ***Insurance***
- ***Bank fees***
- ***Interest on the mortgage***
- ***Repairs and maintenance***
- ***Accountant's fees***
- ***Property manager fees***
- ***Legal fees for loan or rent agreements***
- ***Property valuation fee (to get a mortgage)***
- ***Motor vehicle and travel expenses***
- ***Part of the cost of a home office, etc.***
- ***Depreciation on fixtures and chattels***

NOTE: depreciation on buildings can NOT be claimed anymore.

17. Identify two expenses relating to property investment that CANNOT be claimed as expenses for tax purposes.

Example responses include:

- ***Mortgage principal payments (only the interest is deductible)***
- ***Legal fees for buying or selling a property***
- ***Real estate fees for selling a property***
- ***The cost of capital improvements to the property***
- ***Depreciation on buildings or land***
- ***The full cost of fixtures and fittings (only the depreciation amount can be claimed each year)***

18. In what situation would the profit from selling a house be taxable? That is, if you bought a house and then later sold it for a higher price, in what situation would you have to pay tax on the profit you earned?

If the house was bought with the intention of selling it to make a profit, the profit would be taxable.