Introduction to Module 3: Property Investment

Module Overview and Learning Outcomes

Te Wananga o Aotearoa

Module Overview

Introduction:

- Home ownership is a common dream, shared by many New Zealanders.
- The lifestyle factors associated with home ownership appeal to us.
- However, home ownership also has financial appeal.
- Through home ownership, we can satisfy both personal aspirations and financial goals.
- This Module looks at both home ownership and property investment as tools that can be used to build wealth.

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Resources

- The Module
- The Activity Workbook
- The Lesson Plan Workbook
- Assessment Handouts (2)

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Learning Hours

Lessons (five 3-hour lessons)	15 hours
Lesson Review & Assessments	75 hours
Activity Workbook (5 hours per week)	25 hours
Recommended Readings and Activities	25 hours
Support Workshops	10 hours
TOTAL	150 hours

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Module 3 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.

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The L & N Learning Outcomes for CMM Module 3

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

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

** These are numeracy learning outcomes.*

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Assessments

- There are two assessments for this Module:
- Assessment 1: Understanding Property Investment:
  - A template-based assessment with a variety of types of tasks (e.g. Short answer questions, true / false questions, completing tables, calculating rental yields, etc.)
- Assessment 2: Home Ownership
  - A case study is given. Tauira answer questions about home ownership and mortgages in relation to the case study.

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Module 3: Property Investment

Section 1: The New Zealand Property Market

Te Wananga o Aotearoa

Section Contents

1. The New Zealand Property Market

   1.1 Trends in the New Zealand Property Market

   1.2 Types of Property Investment

   1.3 Terminology and Documentation

Te Wananga o Aotearoa

Introduction

- Property is one of the most popular forms of investment among New Zealanders.
- Reasons for appeal:
  - House prices go up in the long term.
  - Demand for housing.
  - A physical asset.
  - Banks will lend you money to invest.
  - May not need a cash deposit.
  - Claim expenses on rental properties.
  - Not paying someone else's mortgage.
  - A compulsory form of saving.

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1.1: Trends in the NZ Property Market

- Over the past 60 years, property prices have increased significantly, but it hasn't been a smooth ride upwards.
- In some periods *real* values have fallen.
- Home Loan Affordability – a mortgage is sometimes considered as affordable if the mortgage payment is no more than 40% of take-home pay. Has been as high as 80%, but is currently around 60%.
- Refer to graph of regional differences on page 19.
- Study in 2011 found housing in NZ 'severely unaffordable' and worse than in Los Angeles and New York. Refer to page 20.

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Supply and Demand Curves

- Supply and demand curves are introduced in Section 1.1
- Tauira do NOT have to understand how these work.
- Only given as they may help some people understand changes in the market.
- However, they are not going to be of any use to anyone unless a simple and clear explanation is given.

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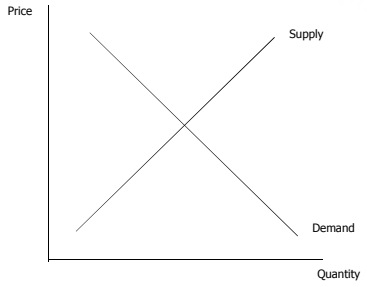
Supply and Demand



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Supply and Demand Curve Questions

In pairs, answer these questions by using real-life examples:

- Why does the demand curve slope downwards?
- Why does the supply curve slope upwards?
- Why might a demand curve move outwards?
- Why might a demand curve move inwards?
- Why might a supply curve move outwards?
- Why might a supply curve move inwards?

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1.2: Types of Property Investment

- Residential Property Investment
  - Most popular and common – why?
- Three types of commercial property
- Industrial Property
  - Tends to be cheapest type of commercial property.
- Retail Property
  - Generally most risky – affected by economic conditions.
- Commercial (Office) Property
  - Tends to be most expensive – depending on size, location, quality, etc.
- Features of Commercial Property Investment (p 46)
- The Deed of Lease (p 48)
  - Standard document – ADSLS Commercial Deed of Lease
  - Provisions

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1.3: Terminology & Documentation

- Property Terminology
  - E.g. Cross-Lease, Easement, Equity, Fee Simple, Freehold, Land Information Memorandum (LIM), Rateable Valuation, Tender, Unconditional, etc.
- Ownership Documentation
  - Titles (replaced paper Certificate of Titles in 2002)
  - Titles a matter of public record - can view the Title on 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 NZ.
  - What information is in a Title? – example of Te Papa given on pp 68-69

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Assessing Learning Outcome 1 (M3A1)

- Demonstrate an understanding of the New Zealand property market and of the basic features of property as an investment strategy.

Tauira are required to:

- Give an overview of trends in the NZ property market over the past 50 years.
- Answer questions relating to understanding equity and how it changes (Section 4).
- Identify types of commercial investment (e.g. industrial, retail) and a feature of each.
- Identify features of residential property investment vs. commercial property investment.
- Calculate net yields (Section 4)

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Section 1: Review of Activities

Te Wananga o Aotearoa

Module 3: Property Investment

Section 2:
Your Own Home

Te Wananga o Aotearoa

Section Contents

2. Your Own Home
   2.1 Your Home as an Investment
   2.2 Getting into Your Own Home
   2.3 Building a House

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2.1: Your Home as an Investment

- Home Ownership and Retirement
  - Two ways to save for retirement.
  - Accommodation is a good example of a good that can be 'saved' for retirement.
  - Three broad strategies: 1. Buying a house that meets basic living needs; 2. buying a house as an investment – downsize when retire; 3. Lifestyle approach.
- Home Ownership vs. Renting
  - Home ownership is not for everyone.
  - Advantages & Disadvantages
  - Refer two examples (pages 87 to 91)
  - There is a 'Rent or Buy' online calculator on www.consumer.org.nz – p 92

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2.2: Getting Into Your Own Home

- A suggested process is given on page 94
- Work out what you can afford
  - Buy what you can afford now and upgrade later, or wait until you can afford what you really want?
  - The 'One-third' Rule. Similar to the 40% rule mentionned earlier in the Module. Also recall the 3 x annual income rule.
  - Really need to prepare a budget instead of relying on rules.
  - Refer table on page 99.
  - The deposit – how much is required? There are new lending rules.
  - The 'FirstHome' policy – introduced in October 2013 (page 101)

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2.2: Getting Into Your Own Home (cont.)

- Selecting a house
- Location and zoning
  - Why is buying in a 'good' location so important
- House features
  - List preferences in priority order – identify 'critical' features.
  - Tools – e.g. ASB Home Buyer's Check List and www.housepoints.co.nz
- Legal matters and advice
  - Choosing a property lawyer – www.propertylawyers.org.nz.
  - What is conveyancing?
  - Types of Title (e.g. Fee simple)
  - The Sale and Purchase Agreement & 'subject to' clauses – (p127-130).

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2.3: Building a House

- Discussion regarding advantages and disadvantages of building vs. buying.
- The Steps in the Process
  1. Choosing a Section
  2. Organising Finance (process differs from buying a house)
  3. Choosing the Designer
  4. Selecting a Project Manager
  5. Choosing the Builder – online registers (p 145 & 146)
  6. Organising the Contract – Standards NZ has one you can buy.
  7. Building and Resource Consents
  8. Construction
  9. Upon Completion – Code Compliance Certificate

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Assessing Learning Outcome 2 (M3A2)

- Understand and evaluate home ownership in given situations

Tauira are required to answer questions relating to a case study scenario. These questions cover:

- Recommending an option – home ownership or renting.
- Explaining cross-leases.
- Conditions that are often put in an offer (e.g. Subject to finance).
- Advantages and disadvantages of building vs. buying.

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Section 2: Review of Activities

Te Wananga o Aotearoa

Module 3: Property Investment

Section 3: Mortgages

Te Wananga o Aotearoa

Section Contents

3. Mortgages
   - 3.1 Types of Mortgages
   - 3.2 Choosing a Mortgage
   - 3.3 Other Considerations

Te Wananga o Aotearoa

3.1: Types of Mortgages

- Discussion of factors that may influence the type of mortgage you choose.
- Table Mortgage
- Reducing Mortgage
- Interest-only Mortgage
  - What are the advantages and disadvantages of this?
- Revolving Credit Mortgage
  - What are the advantages and disadvantages of this?
- Bridging Finance and Second Mortgages

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3.2: Choosing a Mortgage

- Term and Repayment Frequency – the impact on total payments (example on pp 187-188)
- Interest rate: Fixed vs. Floating; Splitting (some fixed); capped; term of fixed rate.
- Choice of lender
  - Can switch lenders, but may be a cost.
  - Non-bank lenders – e.g. Finance companies, building societies, other lenders – e.g. New Zealand Home Loans.
  - Mortgage options available e.g. Offset mortgages, Welcome Home Loans (pp 195-196).
- Mortgage brokers. Search function on www.paa.co.nz
- The Fundit auction website. Offers a 'Best Rate Promise' – p.200
- Lender Requirements (pp 201-206)

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3.3: Other Considerations

- Obtaining pre-approval
- Mortgage protection insurance – weigh up cost against other options
- Guarantors
- Getting the mortgage discharged

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Assessing Learning Outcome 3 (M3A2)

- Identify and analyse mortgage options

Tauira are required to answer questions relating to a case study scenario. These questions cover:

- Calculating and understanding loan to value ratios.
- Simple calculations relating to the amount of interest and payments made on a mortgage.
- Identifying reasons why various types of mortgages (interest-only, reducing, revolving credit) may or may not be suitable.
- The impact of time and frequency of payments on total mortgage payments.
- Choosing a lender and the documentation a lender requires.

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Section 3:
Review of Activities

Te Wananga o Aotearoa

Module 3: Property Investment

Section 4:
Property Investment Strategies

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Introduction

- When it comes to property investment, people often feel there is less risk involved due to the fact that you have a physical asset in your possession and land is a scarce resource.
- On the other hand, it can be more difficult to fully diversify your portfolio as property usually (but not always) requires a large financial investment.

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Section Contents

4. Property Investment Strategies
   - 4.1 Property as an Investment Strategy
   - 4.2 Leveraging your Equity
   - 4.3 Purchasing Properties

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4.1: Property as an Investment Strategy

- Property is often viewed as low risk BUT can be difficult to diversify.
- 2 types of financial returns – identify what is important, considering risk profile.
- Negative gearing – it is difficult to find properties that provide investors with a positive cashflow.
- Market rent – refer page 221.
- Calculation of the yield and how this can be used.
  - Gross Yield vs Net Yield
  - Current values or Purchase prices?

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4.1: Property as an Investment Strategy

- What are capital gains?
- "You make your money when you buy a house, not when you sell it"
- Taxation of rental returns – deductible expenses and non-deductible expenses (e.g. buildings). Refer pages 233-235.
- Look-Through-Companies. How do these differ from LAQCs?
- Taxation of capital returns – depend on the original intention (page 243).

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4.2: Leveraging Your Equity

- What is equity?
- Other types of equity – Net Value and Borrowable Equity.
- How do you build equity?
- What does 'leveraging' mean?
- How can leveraging increase your investment returns? p250
- How can leveraging help you build a property portfolio faster? Example of Steve & Tiari pp 253 - 258
- Possible tax advantages – mortgage interest is deductible. p259
- Risks and restrictions of leveraging. P 261.

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4.3: Purchasing Properties

- Buying an investment property is a business decision whereas buing a family home involves emotional considerations.
- Discussion on real estate agents – what are some tips for working with them?
- What to look for:
  - refer back to tips in Section 2.2 relating to buying a home (e.g. Location).
  - Look to maximise returns (pp 267 – 268).
  - What do tenants want? Remember, the tenant is your customer.
  - Inspecting properties – use a checklist (pp 272 – 278).

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4.3: Purchasing Properties (cont.)

- Methods of purchasing a property
- Offer and Negotiation
  - Discussion regarding the process - any tips?
  - Properties sold with a price 'by negotiation'
- Auctions
  - Why would someone choose to sell by auction?
  - What are the advantages and disadvantages to a buyer?
  - How does it work and what are some tips?
- Tenders
  - What are the advantages and disadvantages?

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Assessing Learning Outcome 4 (M3A1)

- Demonstrate an understanding of using leverage to purchase property.

Tauira are required to:

- Write an example of how someone, who has $60,000 to be used as a deposit, can use leverage to purchase 3 properties over a period of 10 years, assuming they can borrow up to 80%. An example is given in Section 4.2.3.2. of the Module (and in the Activity Workbook).
- Identify what may restrict an investor to continue to use leverage to build their wealth.
- Give an example to show the impact that leveraging has on the rate of return of an investment.

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Assessing Learning Outcome 5 (M3A1)

- Demonstrate an understanding of key considerations in, and components of, the process of purchasing investment properties.

Tauira are required to:

- Identify factors that you should look for when inspecting a property.
- Explain why it is not always the best option to get an interest-only loan if purchasing a property for investment purposes.
- Identify benefits and features of various methods of buying a property (i.e. negotiation, tender, auction).

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Section 4: Review of Activities

Te Wananga o Aotearoa

Module 3: Property Investment

Section 5: Property Management

Te Wananga o Aotearoa

Section Contents

5. Property Management
   - 5.1 Renting out your Property
   - 5.2 Managing Tenants
   - 5.3 Selling an Investment Property

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Introduction

- In order to receive the rental and / or capital returns sought after, ongoing management is required.
- When renting out properties, the main piece of legislation that tauira need to be familiar with is the *Residential Tenancies Act 1986* (the Act).

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5.1: Renting out your Property

- Self-manage or use a professional?
- Setting rent
  - Consider property cashflows
  - Market rent – you cannot simply set the rent high enough to have a cashflow neutral investment (refer page 314).
- Finding Tenants
  - Cost of taking time to find tenants.
  - Who are your desired tenants? Anti-discrimination laws apply.
  - Using application forms – DBH have a template online.
  - Referees and credit checks.

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5.2: Managing Tenants

- The tenancy agreement
  - Under law this must be in writing.
  - The bond – how much, who holds it, how do you get it refunded?
  - Rent in advance – maximum of 2 weeks. Can't ask for next payment before expiry of the period for which rent is already paid (refer page 327)
  - Outgoings – who pays for what? Page 328
  - Fixed term vs. Period tenancy. Note: Fixed term agreements now become periodic unless one of the paries advises in writing otherwise between 21 and 90 days of the end of the term.
  - Assignment and subletting. Ensure a clause is in the agreement as you cannot unreasonably withhold consent otherwise.

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5.2: Managing Tenants (cont.)

- Record keeping
  - Need to keep rent records good enough to be able to provide tenants with a written statement when requested.
  - Must prepare written receipts to acknowledge rent received in some circumstances – page 331.
- Landlord responsibilies. Appointment of an agent if overseas.
- Tenant responsibilities. Note digital tv installation (page 336).
- Inspections and rights of entry (pp 336-337)
- Tenancy problems – what if the tenant is behind with the rent?
- Ending a tenancy – 21 days' vs 90 days' (or 42 days') notice.
- What if they leave items behind (pp 346 – 347).

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5.3: Selling an Investment Property

The sale process:

1. Seek legal advice.
2. Decide whether to sell privately or use an agent.
3. Determine the method of sale.
4. Prepare your home for sale.
5. Get your home valued.
6. Set an asking price.
7. Promote your property.
   - Determine your budget and create a marketing schedule.
   - Refer tips given in the Module.
8. Consider and negotiate offers.
9. Arrange settlement.

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5.3: Selling an Investment Property (cont.)

- Determining the Price
  - Risks of setting it too high or too low
  - Obtaining a valuation – real estate agents and professional valuations
  - Reports offered by QV – page 371
  - Information available to do it yourself – pp 374 and 375.
  - Rateable valuations
  - Adding value
- Selling via a Real Estate Agent vs. Selling Privately
  - Advantages and costs

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Assessing Learning Outcome 6 (M3A1)

- Demonstrate an understanding of key issues involved with maintaining and selling investment properties.

Tauira are required to:

- Answer questions relating to setting the amount of rent.
- Answer questions relating to the role of property managers.
- Identify if statements relating to tenant and landlord obligations are true or false.
- Identify steps involved in the process of selling a house.
- Identify costs that can, and cannot, be claimed as expenses for tax purposes (Section 4).

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Section 5: Review of Activities

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