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**Welcome to MSF's member information newsletter****Property market - Gardner Valuations**

2010 has proven to be a challenging year for both the commercial and industrial property markets.

Supply of property for lease in both the commercial and industrial markets continues to exceed demand, although vacancies have shown a small decline over the year to date. There has generally been no growth in rental value throughout either sector with a few exceptions. While supply continues to exceed demand, any upswing in the market is likely to be of a weak nature.

Macroeconomic conditions remain unstable and there is only very limited growth in the economy. All these factors combine to make any improvement in the markets some distance away. However, property investors are still prepared to pay good yields for properties which are well leased to good tenants. The market continues to factor in a heavy discount for vacant properties or properties with weak lease covenants.

**Examples of sales of well leased property in recent times include:**

A recent sale of a commercial property is 187-193 Broadway, Newmarket, where there is a 7 level office building with retail premises at ground floor level. The National Bank occupies the ground floor retail space of 576 s.m. and all of the first floor under a 6 year lease which runs until September 30, 2013 and the remaining four office floors are fully leased to a variety of tenants on new 6 year leases with inbuilt rental growth of 3% p.a. The building sold at auction in September 2010 for \$13.5 million reflecting a yield of 7.80% on the nett annual rental income.

The retail investment market is a sector that has continued to attract strong interest from investors. As an example 7 retail shops in the Rialto Centre at 163 Broadway, Newmarket, were offered for sale by auction in September 2010 and there was keen bidding for all 7 retail properties and yields were generally in the range 5.20% - 6.60% with two of the investments selling at slightly over 7.00% yields.

There are a number of other examples of sales of standalone retail investment property at and around yields of 6.00%.

Well leased industrial properties are selling at yields around the 8.00% mark and some slightly below 8.00% and there continues to be a take up of vacant space in the Onehunga and Penrose areas.

In looking to the future a number of property professionals are predicting we are at the bottom of the cycle and about to move into a recovery period. However, in our opinion the upturn could well still be some 12 months away.

*Tony Gardner, Managing Director*

**Investing in property – the pros and cons of various forms of property investment**

Property is another form of investment, along with shares, bonds, bank deposits, etc. that we would all like to be in. It usually gives a higher yield but is often beyond the capability of many investors. So we want to look at the several methods of property investment available to the average investor.

**Purchase your own industrial or commercial property**

If you can do this with little or no borrowing then it is the ideal method. You can have it professionally managed and enjoy a return of say, 7% or more, with the likelihood of capital gains in the long term.

**Pros:**

- Higher rate of return
- Probable capital gains
- You make the decisions
- Able to sell whenever you want although this may take months

**Cons:**

- Risk of a negative return if your building is vacant for an extended period (you still have to pay the rates and insurance)
- There may be a request from your tenant for refurbishment or an extension which will take additional capital you may not have
- The high initial cost may well limit the diversification of your investments into other areas such as shares

**Syndicates**

These are becoming increasingly popular as a means of getting into property investment with limited capital. But there are several drawbacks.

**Pros:**

- You can invest in a substantial building with a secure tenant without having to buy the lot.
- Your property will be professionally managed
- You get a regular monthly or quarterly income

**Cons:**

- You may be tied in much longer than you want if you cannot find a buyer for your share
- The building manager may agree with the tenant to substantial additions to the property that you don't have the funding for
- There can be a real difficulty in getting out if you find you need the money for an illness or lack of employment.

- Getting out of the syndicate can take a long time, maybe years rather than months
- If the syndicate agrees to borrow money to refurbish, or add on, this may limit your ability to borrow for other purposes.
- You may not be able to use your equity in the building as security for a loan.

### Listed property trusts

These are listed on the stock exchange so are very easy to get into, or out of, but the returns are proportionally less.

#### Pros:

- Ease and speed of entry and exit.
- The buildings the trust owns are usually substantial with many tenants, thus spreading risk
- Returns will keep up with high inflation.

#### Cons:

- Management fees are often very high, sometimes unreasonably so!
- The value of your investment may drop faster in recessionary times.
- Management can decide to get into risky property development without you having any say in the matter.
- Buildings are often highly geared which can produce negative returns in difficult times.

### Mutual Superannuation Fund

This fund invests in a range of solidly tenanted, industrial and commercial buildings without any borrowing and so there is little risk.

#### Pros:

- Your risk is spread across a number of diversified buildings in the \$750,000 to \$3 million range.
- You can invest a lump sum or regular payments as low as \$50 per month.
- Professional management that is not getting rich on the proceeds.
- No borrowing against the properties reduces the risk.
- No fees charged to your account.
- Profits credited tax-paid to your account annually.
- You can draw money out progressively.

#### Cons:

- Money cannot be withdrawn immediately. Six months notice is required

### Investing at a lower tax rate

- The current income tax rate schedules allow an individual to earn up to \$14,000 per annum (total annual income) at a personal tax rate of 10.5%.
- Members of Portfolio Investment Entity (PIE) can make an election for a personal tax rate to apply to their income from the PIE (subject to the total level of their combined PIE + personal income).
- Up to \$48,000 combined PIE and personal taxable income the member can still elect 10.5%.
- It is possible to invest in a PIE to take advantage of this situation or to enrol minors as a member of a PIE and take advantage in this way

#### Both MSF and SMF, your superannuation schemes, are PIES

- We recommend that parents, grandparents (for their children/grandchildren) or those with taxable income under the thresholds, consider splitting their income in this way.
- This will save tax and boost the savings of the member by up to an extra 11.5c per \$ of income earned – a worthwhile advantage.
- We set out below the new rates from 1/10/2010
- Even at the upper income levels there are savings to be made.

Taxable income	Taxable + PIE income	PIE tax rate
\$0-\$14,000	\$0-\$48,000	10.5%
\$0-\$14,000	\$48,001-\$70,000	17.5%
\$14,001-\$48,000	\$0-\$70,000	17.5%
\$48,001 and over	Any	28%
Any	\$70,001 and over	28%

### Protecting capital and generating income

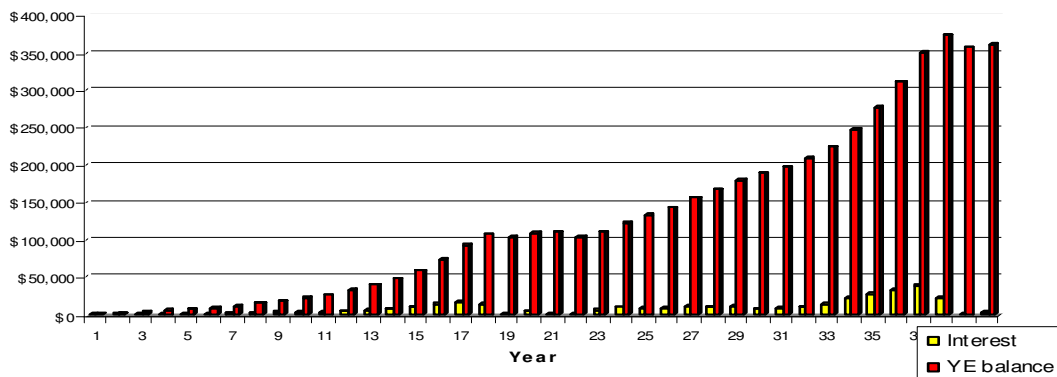
**Two key strategies** – diversification and income

**Diversification** is a powerful antidote to uncertainty. Careful meaningful, measured diversification across assets classes, sectors, geographies and securities is the best insurance against uncertainty

**Income** –during uncertain times it becomes a great deal more tolerable if your investment is paying a dividend

### Compounding interest – makes a difference

Returns from investing \$1,000 pa for 40 years in MSF - The Property Fund, after compounding the income after tax. This shows an average compound rate of 8.94% after tax



MSF – The Property Fund

SMF – The Share Fund

MSF KiwiSaver Scheme

