

BUYING A COMMERCIAL BUILDING

When buying a commercial building, apart from the many general matters referred to in the paper "**Buying a property**", and in particular the need to obtain a building report on the condition of the building and a land information memorandum (LIM) there are a number of additional matters a prudent purchaser must consider.

These are:

1. Whether the building is tenanted, the terms contained in the lease(s) and an assessment of the financial standing of each tenant.
2. How the purchase price for the property is apportioned between the value of the land, building and the chattels.
3. The condition of the chattels.
4. The zoning and permitted use of the land as they relate to the existing use or intended use of the property.
5. The Building Act 2004.
6. The Goods and Services Tax Act 1985.

We will now consider each of these matters in turn.

Lease

The sale price for all commercial buildings is determined by the location of the property, the rental income and the strength of the tenant. For example, a well located property with a good tenant will sell for a higher price than a property which is not so well located with a tenant of a lower quality.

As with all property the most important consideration is location. Having found a property in the right location the next consideration is to examine the leases. The leases will disclose:

1. The term (i.e. number of years) of the lease. Is the tenant locked into a long term lease or is the lease about to expire? If the lease is about to expire how easy will it be to relet the premises?
2. The rent payable by the tenant, how often the rent may be reviewed - usually every two or three years and, in the case of a lease to a private company, whether or not the shareholders of the company have guaranteed the payment of the rent and the performance of the tenant's obligations under the lease.
3. The obligations of the landlord and tenant respectively. These obligations can vary considerably. For example, in a building where there is only one tenant the tenant is usually responsible for maintaining not only the interior of the building but also the exterior of the building and any adjoining land (parking area, lawns, gardens etc). If the building is old, as the time approaches to demolish and replace the building, it is common for the lease to contain a "**demolition clause**" which entitles the landlord to terminate the lease on giving the tenant written notice for a period specified in the lease.

The covenant to repair is particularly important. As a general rule the tenant is required

to repair and maintain the premises and to keep them in good and substantial repair and condition, fair wear and tear excepted. The High Court has decided however that a tenant's requirement to maintain premises in good and substantial repair and condition **does not include inherent defects**. This decision emphasises the importance of obtaining a building report on the condition of a building.

The next consideration is to satisfy yourself about the financial standing of the tenants and to investigate the type of business conducted by each tenant. Changes are constantly occurring and a business which is profitable today may become unprofitable in the future. For example, petrol stations are forever expanding the variety of goods they sell. If a tenant in the building you wish to purchase sells takeaway food and a near-by petrol station starts to sell the same or similar takeaway food the profitability of the tenant's business may be severely affected and cause the tenant to close down.

Ask the vendor to provide you with any information held by the vendor about the financial position of each tenant. Whenever a new lease is negotiated it is usual to ask the prospective tenant to provide a statement of affairs similar to that required by a bank when considering a loan application. If the landlord cannot provide you with the necessary information, obtain a credit report on each tenant.

Your enquiries into both the type of business conducted by the tenant and the financial position of each tenant will involve a consideration of the economy in general. For example, most retail shops are more profitable when the economy is expanding and less profitable when the economy is in recession. If the Government is proposing to relax import controls which will result in an increased supply of cheaper overseas products how will the imported products affect a tenant's business?

It is becoming increasingly common for persons in business to implement strategies to protect their personal assets. If you do not make careful enquiries about the financial position of the tenant you may find that if the tenant makes default in payment of the rent/outgoings on the building that the tenant does not own any assets.

Arrangements with tenant

Occasionally, prior to a property being offered for sale the vendor may agree with the tenant to change the terms of the lease, carry out repairs to the building or replace old chattels, for example a carpet. Ask the vendor if the vendor has made any such arrangements with a tenant. If the answer is yes obtain full details of the arrangement from the vendors, decide what effect the agreement will have on you, discuss the matter with the tenant to ensure that the tenant and the vendor are in agreement and, where appropriate, include a suitable condition in the agreement to record the arrangement. In every case we strongly recommend you to discuss the matter with us before you sign the agreement for sale and purchase so that we can take steps to ensure that you are adequately protected.

Apportionment of purchase price

When purchasing a commercial building it is desirable to agree on a breakdown of the purchase price between the value of the land, building and any chattels included in the purchase price to enable you to claim depreciation at the rates applicable to the building and chattels. The vendor will endeavour to value the building and chattels at their depreciated value in the accounts of the vendor. These values however may be below the market value for the building and chattels. It is in your interests for the values to be as high as possible so as to maximise your claim for depreciation. If you cannot agree with the vendor on the values it will

be necessary either to instruct a valuer to determine the value of the building and chattels or to apportion the value of the land and buildings in the proportion used for the property by Quotable Value New Zealand (formerly Valuation New Zealand). We do not recommend using Quotable Value New Zealand figures except for properties where the building/chattels are very old and, as a consequence the values are very low.

Condition of chattels

If the building contains an air-conditioning system, fire protection system, lifts or any similar equipment take care to check the condition of the equipment. Where appropriate arrange for a suitably qualified person to provide you with a report on the condition of the equipment, when the equipment is likely to require replacement and an estimate of the replacement cost.

Insurance

When you insure a commercial building it is important to give the insurance company copies of all leases so that the insurance company is aware of those terms in the leases which affect the type and cost of the insurance cover you wish to arrange. For example, some lease forms prevent an insurance company from suing a tenant whose negligence causes damage. If you are not insured for tenant's negligence and cannot sue the tenant you will have to pay for the damage. To be safe, be explicit, so there is no room for doubt.

Zoning and permitted use of land

Do not assume that whatever businesses use the premises comply with the permitted use of the land. All councils are required to review their district plan every five years and the current use of the property may no longer comply with the district plan. In this regard, if the business using the land complied with the use permitted under the district plan when the business commenced the business will have existing use rights.

If you are contemplating changing the use of the land check that the proposed use complies with the district plan.

Always check the district plan and the permitted use of the land. Are there any plans to re-zone any land to develop a new shopping centre or industrial estate which may affect a tenant's business or reduce demand for space in the building?

While you are viewing the District Plan also consider what effect the redevelopment of the adjoining properties could have on the property you wish to purchase.

Building Act 2004

The Building Act ("**Act**") was introduced to ensure buildings are safe and sanitary and have suitable means of escape from fire. This is not new! There has always been a requirement for safety systems and features of a building to be installed and maintained to the minimum requirements of the New Zealand standard for that system. All the Act has done is to formalise a method to identify the systems and features within a building and record the required inspections and maintenance. It has been developed for the safety of the occupants of a building so that they know the systems and features are working correctly. For example, it could be very dangerous to find out when a building is on fire that the sprinklers are not working.

All buildings containing lifts, travelators or escalators, certain fire protection systems (such as

sprinklers), mechanical ventilation or air conditioning systems serving all or a major part of a building and other mechanical, electrical, hydraulic or electronic systems must have compliance schedules. The compliance schedule is issued by the local council and will show the inspection, maintenance and reporting procedures required in relation to those systems. The inspections and maintenance must be carried out throughout the year at the frequency required for the system.

Each year on the anniversary date of the issue of the compliance schedule the owner of the building must supply a building warrant of fitness (W.O.F.) to the council. The annual W.O.F. is a statement by the owner that the owner has complied with the requirements of the compliance schedule during the previous 12 months. With the warrant of fitness the owner must provide a written report from an independent qualified person (IQP) relating to the requirements of the compliance schedule. A copy of the building warrant of fitness must be publicly displayed in the building. The compliance schedule must also be available for inspection by anyone who has statutory authority to inspect the building and must be kept either in the building, in some other building within the area administered by the council or in some other place agreed upon by the owner and the council.

To summarise, there are three steps for a building owner in the W.O.F. regime, obtain a code compliance schedule, undertake the stipulated checks and maintenance, usually with an I.Q.P. and sign and display the warrant.

It is very important for the owner to supply and display the warrant of fitness. Under s.108 of the Act a fine of up to \$20,000.00 may be imposed.

If the building you wish to purchase contains any of the equipment previously referred to ask the land agent to provide you with copies of the compliance schedule, building warrant of fitness and the report provided by the independent qualified person.

Goods and Services Tax

GST is generally payable on the sale of land and buildings by a registered person in the course of a taxable activity.

The time of supply for GST purposes can be triggered by the signing of an unconditional agreement for sale and purchase, the receipt of a deposit by a person other than a stakeholder, for example a land agent, or any earlier issue of a tax invoice.

The sale will be zero rated when it constitutes the supply of a going concern to a registered person.

The rules relating to the payment of GST are too complex to discuss in detail in this paper and therefore if you are considering purchasing a commercial property we invite you to consult us immediately. Under no circumstances sign an agreement for sale and purchase before you obtain advice.

Area of land and location of building on land

If you are purchasing a commercial property where the land has not been recently surveyed, or you are purchasing an old building on a property which has not been recently surveyed we advise you to arrange for a surveyor to check the location of the boundaries/position of the building in relation to the boundaries. Particular care is required if the certificate of title for the property discloses that the title is "**limited as to parcels**" which means that the area of the land

is not guaranteed. If you are contemplating redeveloping the site the area of the land is a very important consideration.

Due diligence investigation

If for any reason you wish to sign the agreement before you have completed your investigations into the property we advise you to make your offer conditional on carrying out a due diligence investigation in respect of the building. The following is a draft condition which must be amended to meet your particular requirements:

DUE DILIGENCE INVESTIGATION

This agreement is conditional for 20 working days from the date of this agreement upon the purchaser being satisfied that the property is suitable for the purchaser's intended use of the property at the agreed purchase price following the purchaser undertaking a due and diligence investigation of the property, including but not limited to, an investigation of:

- (a) the soundness and quality of the building;
- (b) town planning and other zoning or permitted use aspects of the property as they relate to the purchaser's use or intended use of the property;
- (c) the identification of the position of the building in relation to the boundaries of the land;
- (d) all legal and title issues relating to the property and any encumbrances or memorials recorded on the title;
- (e) the current deeds of lease and statement of lessee's position regarding rights of renewal.

This clause is inserted for the benefit of the purchaser.

Signing the agreement

When buying a commercial property it is important to remember the advice contained in the adage "**let the buyer beware**". We advise you to instruct the land agent to fax us a copy of any offer you wish to make before you sign the agreement for sale and purchase. Immediately we receive the copy agreement we will check the agreement and telephone you with our comments. After our discussion we will make any necessary changes to the agreement and fax the amended agreement to the land agent and yourself if you have a facsimile machine so that the agreement you are required to sign includes the changes.

WARNING

We remind you that an agreement for sale and purchase is a binding legal contract. We advise you to read not only everything which is typed or handwritten on the printed form but also the general terms - the fine print - which contain a number of onerous terms on the part of a purchaser, for example, interest for both last minute and late settlement. We also remind you that the agent is the representative of the vendor and is under a duty to act in the best interests of the vendor.