Property Speaking

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Welcome to the first edition of *Property Speaking* for 2021 and to a new design for this e-newsletter. We hope you not only find the articles both interesting and useful, but also enjoy the new look.

To talk further about any of the topics we have covered, or indeed on any property matter, please don't hesitate to contact us – our details are on the top right of this page.

Rent reviews in commercial leases

A variety of clauses to suit different situations

Negotiating commercial leases can involve significant crystal ball gazing. As recent times have shown, the landscape at the start of a lease can be miles away from the situation at its end. One area where the shifting sands can bite for long-term leases is the rent figures. Without appropriate rent review clauses to adjust the rent, any landlord could find themselves with a vastly undervalued rental as the lease progresses.

PAGE 2

Reverse mortgages

Increasing in popularity

The current combination of increasing living costs, rising house prices and low interest rates has seen more than property-seekers signing up to home loans. On the other side of the coin, some older homeowners are seeking 'reverse mortgages' from their lenders in order to release the growing equity in their property to help fund their retirement. We look at what a reverse mortgage involves.

PAGE 3

Property briefs

Is your property fully insured?

There are potential insurance risks for properties with shared areas, such as multi-storey town houses. Check your property will have adequate insurance cover before going unconditional on your purchase.

Stage 2 of the Residential Tenancies Act changes now in force

We remind landlords of the new provisions now in force.

Due diligence on a prospective tenant vs that person's right to privacy

The Privacy Commissioner has expressed concern that some landlords are compiling and sharing information via Facebook to blacklist unwanted tenants.

PAGE 4

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Rent reviews in commercial leases

A variety of clauses to suit different situations

Negotiating commercial leases can involve a significant amount of crystal ball gazing – particularly when some leases can last decades. As recent times have shown, the landscape at the start of a lease can be miles away from the situation at the end of the lease. One area where the shifting sands can bite for long-term leases is the rent figures. Without appropriate rent review clauses to adjust the rent, any landlord could find themselves with a vastly undervalued rental as the lease progresses.

Types of rent review

Not all rent review clauses are alike and there are various methods of calculating changes to rent.

- **Market rent review**: This review adjusts the rent so that it reflects the current market value of the lease. It allows the rent review to take into account the general market conditions and factors specific to your property such as zoning and the desirability of your property's location.

  A market rent review can be particularly helpful if you have a gross lease given the market value of the property will affect some of the operating expenses you must cover as landlord, such as insurance and rates.

  One risk of market rent reviews is they can lead to a dispute about the quantum of the actual market rent. You and your tenant may have to bear the cost of valuations or, in a worst case scenario, legal action to settle the appropriate rent.

- **CPI rent review**: The rent is aligned to the Consumer Price Index (CPI), a measure of inflation set by Statistics New Zealand. Essentially, this type of rent review helps prevent inflation decreasing the real value of the rental over time.

  A CPI rent review usually includes a set formula for calculating the rent so there is reduced likelihood of a dispute or large fluctuations in the rental figure. However, the rent adjustment cannot take into account that the value of your property might be increasing faster than the rate of inflation.

- **Fixed percentage increases**: Any rent changes are agreed at the time you enter into your lease with your tenant. This does lead to certainty up-front about the quantum of a rent increase. However, as with CPI rent reviews, this could mean the rent does not reflect the market rent if the market conditions change.

Ratchet clauses

A market rent review or a CPI rent review could, in theory, see the rent decrease if the market or the CPI falls (as relevant). This can be avoided by adding a 'ratchet' to your rent review clause, which limits when rent can be decreased as a result of a rent review.

There are two different types of ratchet clauses:

Hard ratchet: This clause only allows the rent to ever move upwards. It cannot decrease below the previous amount payable. This is more favourable to landlords than a 'soft ratchet', and

Soft ratchet: The rent can decrease as a result of the rent review but never below a set figure, such as the rent at the start of the current lease term.

Timeframes for rent review

Another significant factor to consider when negotiating rent review clauses is the frequency of rent reviews. The rent reviews could align with any lease renewals, occur annually or follow some other frequency that suits you and your tenant.

If you vary the lease to extend its expiry date, it is essential you consider how this will affect the rent review dates. If rent reviews are expressed as occurring on specific dates, you should check whether the lease should be varied to add further dates to coincide with the longer term.

Available clauses

There are standard rent review clauses included in lease formats such as the ADLS Deed of Lease, but as with any term in a lease these clauses can be negotiated with your tenant to best fit the circumstances of the lease.

We recommend you talk with us before signing any commercial lease to ensure it contains the right combination of rent review clauses to suit your plans for the lease and your tenant. +

Reverse mortgages

Increasing in popularity

The current combination of increasing living costs, rising house prices and low interest rates has seen more than property-seekers signing up to home loans. On the other side of the coin, some older homeowners are seeking 'reverse mortgages' from their lenders in order to release the growing equity in their property.

What is a reverse mortgage?

A reverse mortgage is a lending structure that allows you to access the equity you have accumulated in your home or other property. With a reverse mortgage, you borrow money from a lender using your existing home as security in order to, for example, supplement your living costs or complete renovations rather than for the purpose of acquiring a new property.

In essence, a reverse mortgage is a home loan than operates slightly differently from other home loans.

The specific terms and conditions of a reverse mortgage will depend on the loan agreement you sign. However, the terms of a reverse mortgage often include the following:

- **No repayments are required until your death, your home is sold or you stop living in your home**. This avoids your loan being a day-to-day burden, but it does mean that your loan will only increase over time as the equity is released and interest accrues.
- **The interest rate is often at the lender's variable rate which is higher than the fixed rates available for other types of home loans**. Variable interest rates are low now, but you may see your interest rate increase significantly before the end of your loan term.
- **The interest on the loan usually compounds monthly**. This means that if you are not making repayments, your interest will be added to the balance of your loan at the end of each month.
- **As security for the loan, the lender will require a mortgage over your home**. This mortgage will give your lender the ability to – in a worst case scenario – force the sale of your home if you do not repay your loan when required or you otherwise breach the loan conditions.

How can your interests be safeguarded?

While a reverse mortgage may provide short-term cash flow, it also can have significant consequences for your long-term retirement plans. You should ask for financial advice to ensure the reverse mortgage will not prevent you fulfilling any other plans you have – such as the funds you need for rest home care. There may be other options – such as selling your home and downsizing – that would be better suited to your plans.

A reverse mortgage is subject to the standard legal protections around a consumer credit contract, such as the requirement that your lender discloses the terms of your loan to you before you sign.

However, not all loan contracts are alike. You should talk with us about the specific terms of your loan to make sure, if appropriate, that:

- You can continue living in your home if your partner/spouse moves out or dies
- Your lender will not require repayments except when you die or when you move out of your home, and
- There are limits on the amounts you can borrow so that your loan and the accrued interest does not exceed the value of your home (meaning that the remainder of the loan must be paid out of your savings or other assets).

Talk with your family

You should think about talking with your family before signing on the dotted line with your lender. A reverse mortgage will reduce the amount available for your family's inheritance. Addressing your children's expectations early will help avoid unexpected surprises for them later.

Reverse mortgages can be a saviour to older people who are asset rich but cash flow poor. There are, however, a number of fishhooks for the unwary. If you are considering a reverse mortgage, do be in touch with us so we can help you look at options to free up equity in your home. +

Property briefs

Is your property fully insured?

There are potential insurance risks for properties that have shared areas, for example multi-storey town houses, semi-detached homes which share a party wall, and cross lease properties which have carports, the Insurance Council of New Zealand has warned.

If your property does not have a body corporate that manages insurance cover for the whole property, and if you and your neighbours have different insurance providers, you may find that any shared property such as carports, party walls and roofs will not be covered by your insurance.

When you obtain finance through a bank or other lender, generally you agree that you will maintain adequate insurance to cover the replacement of your property if it is damaged or destroyed. If your insurance cover is insufficient, or if there are gaps in your cover, this can result in you breaching the conditions of your home loan.

If you are buying a property, it is wise to check that suitable insurance cover is available before you go unconditional on your purchase. If you would like to make your purchase agreement conditional on finding suitable insurance cover before going unconditional — we can guide you on this.

Stage 2 of the Residential Tenancies Act changes now in force

The second stage of the three-phase Residential Tenancies Amendment Act 2020 came into force on 11 February 2021.

We remind landlords that:

+ You can no longer end a periodic tenancy by giving your tenant a 90 days' notice 'no-cause termination'
+ If you are selling your rental property and need to provide vacant possession under your sale agreement, you must provide your tenant with at least 90 days' notice, up from the previous notice period of 45 days
+ At the end of a fixed term tenancy, the tenancy will automatically roll over to a periodic tenancy unless the parties agree, the tenant provides notice or you have grounds to terminate the tenancy
+ If you are listing your property for rent, you must specify the rental amount on the listing. This is required even if you are listing via Trade Me, Facebook or your supermarket noticeboard
+ If your tenant asks to make minor alterations to the property or if they ask to assign the tenancy, then you must consider your tenant's request and you cannot unreasonably decline their request, and
+ The Tenancy Tribunal can now make awards of up to $100,000; successful landlords and tenants can apply for a suppression order to remove their identifying details from publication.

More information on the changes now in force can be found **here**.

Due diligence on a prospective tenant vs that person's right to privacy

The Privacy Commissioner has expressed concern that landlords are compiling and sharing information via Facebook to blacklist unwanted tenants. This is in breach of a tenant's right to privacy.

As a landlord, you are justified in collecting personal information about tenants or prospective tenants such as proof of their identity, whether they have any pets and information to determine if they can pay the rent. However, you are unlikely to be justified in collecting information about their nationality, marital status, gender or banking history. Do read our article on the 'KFC test' in the Spring 2019 edition of *Property Speaking* **here**.

Now that it is more difficult to remove an unwanted tenant from your rental property, it is crucial to do your due diligence on a prospective tenant. With that in mind, you must remember that tenants have the right to privacy and, in doing your due diligence on a prospective tenant, you can only collect information which is actually relevant to assess their suitability as a tenant. +