

FREQUENTLY ASKED PROPERTY QUESTIONS

PPI get a lot of questions regarding the buying, selling, leasing and management of property. See below for some of our more frequently asked property questions:

What is Floor Area Ratio (FAR)?

The ratio of the total area of the floor of a building to the total area of the land upon which it stands. Between one municipality and another, differences can exist in working out the ratio. Decentralised nodes tend to have low bulk: city centres have high bulk.

What is Freehold Title?

Unlike sectional title, freehold title means that the property owner holds tenure over the entire property and not just a portion of it.

What is Gearing?

Also referred to as leverage. A property owner's debt as a percentage of the value of the property. Also called loan to value.

What is Gross Lettable Area (GLA)?

This is the total area that can be rented out to tenants. It usually includes common areas such as kitchens and bathrooms, but excludes parking and fire escapes.

What is a Gross Lease?

A lease where the tenant pays a single monthly rental, inclusive of all costs. With this type of contracts, the landlord bears the risk of increased operating expenses.

What is Initial Yield?

The net rental income from the first year of a property investment divided by the value of the property expressed as a percentage; also an indicator of risk.

What is Net Lease?

A lease with a provision for the tenant to pay, in addition to rent, certain costs associated with the operation of the property.

What is P-Grade Office Space?

Grade P stands for premium and SAPOA defines P-grade office space as top-quality.

What is Rental Concession /Tenant Incentive?

Concessions a landlord may offer to a tenant in order to secure tenancy.

What is a yield?

(Also known as a cap rate) Income from a property calculated as a percentage of value. The rental yield is calculated, by dividing the annual net rental received by the asking price of the property.

i.e.:	Net monthly rental	R10, 000.00
	Operating costs	R 2,500.00
	Parking – monthly	<u>R 1,900.00</u>
	Gross Monthly rental	<u>R14, 400.00</u>
	Total net monthly rental	R11, 900.00
	Annual net rental	R142, 800.00

Asking price	R 1500 000.00
Calculation	R142, 800.00 ÷ 1 500 000%
Selling yield	9.52%

Alternatively if a seller is selling his property on a yield basis and provides you with the net annual income, you can determine the selling price as follows:

Asking yield	11%
Annual net rental	R142, 800.00
Calculation	R142, 800.00 ÷ 11%
Selling price	R1 298,000.00

How do I value property?

To do a comprehensive valuation on a property, it would be best to calculate the internal rate of return (IRR). The IRR is calculated by first determining the total cash flow derived from an investment during the anticipated investment period i.e. 10 years and then calculating an annual investment return %. This % is calculated by discounting all the net annual cash flow's to a net present value of nil, thereby resulting in an annual investment return % which takes all the cash flow generated from the investment into account. It is imperative to ensure that all the outgoing expenses are accounted for in determining the net annual income i.e.:

- Rates and taxes
- Common electricity
- Insurance
- Security
- Building maintenance and repairs
- Levies
- Commissions, marketing costs, advertising etc.
- Income tax
- Capital gains tax
- Transfer and bond registration costs (transfer duty, VAT etc)
- Property financing (bond amount, bond period, interest rate, deposit)
- Additional operating costs

As can be seen from the list of the variables above, the IRR will provide an investor with the most comprehensive and accurate indication of investment return.

Why do I need a property broker to help me locate a property?

Proactive agents have knowledge of sites available to lease that may not be listed or available for the open market. Because brokers hold non-exclusive mandates from a large number of institutional property owners, they are able to show you the most comprehensive list of suitable properties. Moreover, an experienced broker has the market knowledge to negotiate a competitive rental.

Why are escalation rates so high? Why aren't they linked to CPI?

Property escalations rates have no direct relationship with the rate of inflation. Investors have a choice of possible investment vehicles which range from the money market, stocks and bonds, to property and they compare the returns /risks involved before making an investment.

A landlord/investor requires an annual percentage % return on their investment, regardless of

where the money is invested. In property, this return would be a combination of both the rental income and the capital growth of the property. In developing his property investment model, the landlord would project his cash-flows and returns for 10 years, taking into consideration the risks associated with potential vacancy factors, maintenance costs etc.

Who pays the broker's services?

In a property sale, the brokers commission, or fee is paid by the seller. It is normally a percentage of the selling price, based on industry norms and forms part of the selling price. This fee is payable on transfer of the property into the name of the purchaser

In a lease, the broker's commission is normally paid by the lessor (landlord). This is normally a pre-arranged percentage of the rental based on industry norms.

Who is responsible for the payment of alterations to the premises?

The landlord provides an allowance for any alterations to the premises. This amount is intended to be a contribution only. Any amounts exceeding the allowance are for the tenant's account.

What is Zero Rating for VAT Purposes?

The following is required (even though SARS will go into more detail depending on the specific circumstances of the transaction):

- The seller has an existing tenant in the property that he is selling (and therefore the entity is income earning)
- The seller sells the property to the purchaser, and the purchaser will in effect replace the seller as the tenant's landlord (and therefore take over the income earning activity)
- The tenancy will extend beyond the registration of the property.

The tenant and the purchaser have to be separate entities, even though they may have the same members / shareholders. Please keep in mind that the ultimate decision lies with SARS on whether the transaction conforms with SARS' requirements and be zero rates. It is still possible that SARS declines the application for zero rating, even with this clause contained in the sale agreement. It all depends on the circumstances in the transaction. SARS can at any time rule that the transaction cannot be zero rated (even after it was submitted to SARS and the VAT exemption lodged and registered with the transaction in the Deeds Office), at which time the purchaser will have to pay the VAT over to the seller so that the seller can submit the VAT to SARS.

What is the difference between usable area and lettable area?

Lettable area includes a proportionate percentage of common areas, such as entrance foyers, stairwells and toilets. Usable area is the balance of space left for the tenant's exclusive use.

What fees apply to operating costs?

Security, Rates and Taxes, Building Insurance, External Building Maintenance, Garden Maintenance, Air Conditioning Maintenance, Management Fee, Audit Fee, RSC Levies, Common area electricity, Common area cleaning, Lift Maintenance, Provision of toilet services, Bank Charges and Pest Control. The above items are in most instances included in the operating costs and if not will be stated separately in the lease agreement.

What are Consumption Charges?

These are charged as per consumption and are not included in the operating costs. i.e.: Electricity, water, refuse and sewerage charges.

What additional costs are payable over and above gross rental?

You will be charged for consumables, like water, electricity, refuse and sewerage; the maintenance of air-conditioning, as well as parking and storage.

What is Space Planning?

With workspaces evolving it is worth planning your space through a simple space planning exercise to assess the correct space required. Selecting the correct space up front allows you to use your space as a strategic asset, inspire and envision your organisation. This is done in a scientific manner to display how much space each department requires as well as all special facilities.

What are the benefits of sale and leaseback?

With investors seeking yield enhancement for their portfolios or longer term hold strategies, it simply doesn't make sense for certain corporates to retain their freehold property. Advisors are able to assist in unlocking the embedded values of such properties.

Proceeds from the sale of these properties are fed back into the core business. This generates a higher return on capital than the cost of the funds. For the purpose of the core business this offers a far more attractive commercial proposition.

The benefits of sale and lease back include:

- Capital is freed up to fund Capex, merger or acquisition activity.
- Funds can be reallocated to core business activities.
- Realise your tax benefits. Offset the lease costs as an operating expense.
- Seller remains in day-to-day control of the property.
- Improve your balance sheet through the cash sale of your property.
- By pricing the property just below market value, investors are attracted.
- One off income statement (profit), reflecting the realised profit over book value.
- The property value risk is transferred to a third party, on a fully transparent basis.

Sale and leasebacks also form part of 'property investments'. This type of transaction offers companies the ability to sell and realise 100% of the equity in their own property. This is done by signing a lease with themselves over their building and selling the property to an investor based on the strength and terms of the lease and tenant covenant at a determined capex rate or yield. The use of the 'sale and leaseback' tool offers an owner occupier a mechanism to free up equity they have in a property and use it elsewhere. Sale-leaseback transactions also diversify the funding sources of capital for a company outside the typical debt and equity markets and provide long-term capital with no financial covenants.

What are the points to consider when making a property investment?

An investment property is a property which has been purchased with the intention of earning a return on the investment, either through rent (income) or the future resale of the property (capital growth) or both. This can be either a long term investment (own and tenant) or a short term, flipping a property, (where a property is refurbished and sold at a profit).

A common mistake made by a companies and individuals is buying property for status reasons and the 'theory' that paying off your own asset is better than paying for someone else's asset.

Unfortunately, this thought process usually doesn't work and the owners of the property often waste management and financial resources and eventually sell the property back into the market.

For some small companies owning their own property poses unforeseen risks:

- For owners who see their property as a good investment, with a built in tenant (i.e.: themselves), they are in essence doubling up their investment risk. If their business hits hard times it can simultaneously put their property investment at risk. If their goal in

owning a property is to diversify their investments they are often better off investing in other investment properties separate from their investment in their company.

- If diversification is not the goal, then they should ask if they are better off investing in property or rather focus on growing the business they already have. Often the business itself gives a better return on Capital.

Is there a right or wrong answer as to whether a company should lease or own the property from which they operate their business or not?

- Leasing frees up capital for a company to operate its business
- Buying the property gives the company control of its operating facilities.

The company's cash flow, cash requirements, management resources and flexibility for needing the particular facility will help determine the answer.

I am thinking of moving my business – what do I need to know?

- Firstly ask yourself why are you moving?
- Do I require additional space / less space?
- Is my current location no longer desirable and convenient?
- Are my rentals above market?
- Are my landlord/managing agent maintaining the building and providing a satisfactory service?
- Does the configuration of my current office space provide the right work environment?
- Do my premises portray the right corporate image for my brand/company?
- Rental levels and vacancies in desired locations
- Space planning exercise to determine optimum size required
- Tenant installation allowance provided for new premises

How does the commercial property industry work?

Most property owners appoint brokers on a non-exclusive basis to lease the premises on their behalf. The owner grants the agent a performance-based mandate. This means that the agent earns a commission payable by the landlord/owner on conclusion of a lease agreement.

In terms of fire safety at what stage should I require sprinklers at my warehouse?

In terms of the National Building Regulations SABS 0400-1990, it states that any building with a floor area exceeding 2500m², or where any racking / stacking exceeding 3 meters in height, the area requires protection by an automatic fire sprinkler system. In addition, where the floor area exceeds 5000m², an early warning smoke detection system must also be installed.

For a 6000m² warehouse, the following options must be considered:

- The entire building is to be fully sprinkler protected to SABS 0287 regulations
- Water storage tanks and fire pumps may be required based on the design density of the sprinkler system and whether in-rack sprinklers are required (if stacking exceeds 3 meters)
- The warehouse and office component can be subdivided up into fire divisions of less than 2500m² in floor area by means of full height 60 minute rated firewalls with Class B fire doors (2 hours) to omit the sprinkler installation (but the stacking may not exceed 3 meters in height)
- Alternate fixed fire protection systems such as a high expansion Foam Flooding System or an Inert Gas Flooding System can be considered but these installations are very costly and impractical in most instances.

Are owners open to negotiating rental prices?

The owner's willingness to negotiate rental depends on a number of factors, especially the length of time for which the premises have remained vacant as well as general vacancies in the area. Other factors that will be considered are the tenant's credibility, alterations required to the premises, the length of the lease and market rentals.

How are rates & taxes apportioned in multi tenanted buildings?

Rates and taxes are usually allocated on a pro rata basis in terms of lettable area versus total lettable area of the building, and are adjusted as and when local authorities alter their assessment rates payable in respect of the property.

How does Value Added Tax (VAT) affect property leases?

The net rental operating cost and rates and taxes usually exclude VAT, which is added on the total amount on the rental statement.

What is A-Grade Office Space?

The SA Property Owners' Association (SAPOA) defines A- Grade office space generally not older than 15 years or which has had major renovation, has high- quality modern finishes, air conditioning, adequate onsite parking and is getting rents near the top of the range.

What is B-Grade Office Space?

Older buildings with accommodation and finishes close to modern standards as a result of refurbishments, with onsite parking and air conditioning.

What is C-Grade Office Space?

Buildings with older finishes and services that may have onsite parking and air-conditioning.

What is Capital Gain?

Increase in capital value of a property on which tax is payable, either when sold or deemed by tax rule to be incurred.

What is Capitalisation (CAP) Rate?

A ratio of the relationship between a year's cash flow and the present value of the cash flow. The rate at which the net income of a building is capitalized into perpetuity to derive its market value. Cap Rates are the property equivalent of the forward earning yield of listed shares.

What is Decentralisation (or Suburbanisation?)

Alternative commercial nodes that have formed as a result of city growth and urbanization.

What is Depreciation?

As properties age, they lose value because of "wear and tear" and "Obsolescence". The Building's value depreciates as a result.

What is Developments Rights?

The legal ability to develop a piece of land, usually as confirmed by a town planning scheme.

What is Sales and Leaseback?

A financing arrangement in a property that is sold by its owner/user, who simultaneously leases the property from the buyer for continued use.

What is Vacancy Rate?

Indicates the level of empty space in a specific area or building and is usually expressed as a percentage of the gross leasable area. The inverse is the occupancy rate.

Which Properties does PPI have access to?

PPI are not confined to any specific properties or portfolios. Through our extensive network of listed property funds to smaller private landlords we effectively have access to almost every building available in the market.

What is generally included in operating costs?

Operating Costs are all the costs incurred by the landlord in maintaining and running the building. These costs generally include the following:

- Security
- External cleaning including windows
- Cleaning of common areas
- External maintenance of building
- Maintenance of the garden areas
- Insurance of the building against usual risks
- Maintenance of lifts
- Meter Reading Charges
- Property Management and administration fees
- Provision of consumables to the toilets

How are escalations determined?

There is a widespread misconception that the escalation rate charged by landlords is some form of inflation protection. It is not. It is a contractual mechanism to ensure rental growth. The fundamental reason behind this mechanism is to provide comfort to the investor that he or she will obtain an adequate investment return. An investor into real estate is investing for a total return and that total return must be attractive enough to justify the additional risk which is perceived to accompany the investment.

What are the considerations in the Purchase vs Lease debate?

- Personal control over the property
- Security of Capital
- Positive/Negative operating yields
- Leverage for further lending
- Cash Flow liquidity for gearing
- Management Burden
- Legal complexity
- Inflation, deflation and real estate cycles

How does one determine exact space requirements?

As a general rule of thumb, one can estimate requirements at $\pm 20\text{m}^2$ per person. This includes common areas within your offices such as the reception area, boardroom, meeting rooms and kitchen area. This varies according to more specific requirements and effective space utilization. PPI can facilitate a full space analysis through an interior design firm in order to determine your exact needs.

What is a standard Lease Period for commercial property?

Generally landlords require a lease term of a minimum of three years. Fitting out allowances are usually also dependant on the length of the lease. For lease periods exceeding five years a rent review would be a pre-requisite. Options to renew a lease after the expiry of an initial term can be

granted.

What is a Turnover Rental Clause?

Turnover rental clauses are usually applicable to shops and restaurants whereby the Lessee pays a percentage % of turnover over and above the base rental.

What are Bank Guarantees / Deposits and Surety ships?

Landlords will require either a deposit or irrevocable bank guarantee to a negotiated amount as a deposit for the duration of the lease agreement. Personal surety ships may be required from the directors or members. The latter indicates confidence of lease signatories in their own business which is obviously an assuring factor to landlords.

What is a Hypothec waiver?

Most companies that lease equipment to tenants require the landlord to sign a hypothec waiver in the event of the tenant's default in their commitment to the landlord. The landlord must be in possession of the signed hypothec waiver.

When must I make my rental payment?

Monthly rental is usually payable in advance on or before the first day (which is not a Saturday, Sunday or public holiday) of each month. Lease fees and deposits are payable on or before the earlier of the date on which the tenant takes occupation of the leased premises.

Is the Landlord or tenant responsible for maintenance?

The tenant is liable for maintaining at his cost the inside of the leased premises in good order and condition, fair wear and tear accepted. The exterior of the building and internal common areas are the responsibility of the landlord.

Is the Landlord or Tenant responsible for security?

The landlord usually provides building security. The tenant is however in normal circumstances responsible for security and insurance with regard to the leased premises.

Is the Landlord or Tenant responsible for cleaning services?

In most instances the tenant is responsible for the cleaning of the inside of the leased premises and the landlord is responsible for the cleanliness of the common areas and parking areas.

What is meant by House Rules?

Most buildings have a set of house rules which provides the owners and tenant with important information with regard to hours of attendance, building management, staff, air conditioning, parking, transport of stock in and out of the building and fire drill procedures.