

PROPERTY INVESTMENT CONSIDERATIONS IN SOUTH AFRICA

BY

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INTRODUCTION AND OBJECTIVE

This treatise is concerned with property development in its role as an investment rather than as a speculative venture. The property is, therefore, one which is to be held as a rent producing development with the hope of capital appreciation as a hedge against inflation rather than for the realisation of a profit by means of a sale.

Careful and thorough investigation must be undertaken by the developer with regard to a possible project. The aspects of such considerations are dealt with in this article as follows :

1. Investigations prior to the acquisition of a property investment.
2. The illustration of certain of the considerations necessary by means of a viability study of a hypothetical case of a block of flats.
3. The post-construction administration of the property.

OWNERSHIP AND FINANCE

OWNERSHIP

Ownership of a property can be in many forms such as direct ownership by an individual, by various individuals and/or other legal entities in partnership or by means of a company.

In the case of direct ownership by an individual, the individual owns the sole title to the property. He is personally responsible for all of the liabilities relating to the property which may arise from time to time.

In the case of a partnership the asset is jointly owned by the various partners who become jointly and severally liable for the liabilities of such partnership.

In the case of company owned property, the property is owned by the company, which is a separate legal entity, and the various participants in the development hold shares in that company. The company is responsible for its own debts and obligations and the liability of the shareholders is, in this case, limited to the amount of share capital issued to them. The liability of the shareholders is thus limited unless they choose to underwrite or guarantee the obligations of the company in some way.

Because of the numerous disadvantages of owning immovable property either individually or in a partnership such as the liability for debts and difficulties in transfer when an individual wishes to dispose of his interest, the company is the most common form of ownership utilised today.

Accordingly, for the purpose of this treatise, ownership will be by way of a company in which the liability of the investor (shareholder) is limited, i.e. the private resources of the individual members of the company cannot be seized for the benefit of the company's creditors should the company become insolvent. It should, of course, be borne in mind that this limitation of liability may be offset to a greater or lesser degree by the reason of the execution of guarantees or suretyships which the lenders of finance to the company would invariably require of the shareholders. A sale, which would be effected by means of the transfer of shares, is also facilitated by the utilisation of a company and is also far less costly than the costs involved in the transferring of registered title from one owner to another. It should also be remembered that under certain circumstances tax advantages can also arise through this form of ownership.

When it is desired to float a company for the purpose of owning an immovable property which is being purchased, the actual legal processes in relation to the formation of the company would normally be undertaken at the time of the purchase of the vacant land or prior to that date. The reason being, that if one wishes to

transfer the property into the name of the company at a later date, transfer duty will be involved. The developer's attorneys would be instructed to form the company as soon as the prospective site has been selected or the Deed of Sale signed. If the Deed of Sale has already been signed, it would invariably have been purchased in the name of the purchaser "on behalf of a company in the process of formation". Transfer of the land would then eventually be registered directly into the name of the developing company prior to any construction work having taken place and thereby avoiding a double transfer and the additional costs associated with such a transaction.

FINANCE

1. The Ratio of Own Funds to Borrowed Funds

Many investors/developers aim to borrow the maximum amount possible so that the project will require a bare minimum of their own funds. The viability and success of such a course of action must be very carefully considered, bearing in mind also, the repayment requirements of the lending institution and the projected cash flow of the development.

The general objective with the borrowing of a larger amount is that the revenue remaining relates to a small capital sum and a high percentage return thereon. The main effect of borrowing money, whether from a single source or from several sources, is to add additional burdens to the income producing ability of the project as a whole. This is so firstly, because the capital outlay is increased by the additional cost of raising the borrowed money, cost of registering the loan agreement and payment of interest on the borrowed money in the start-up period and before the project is income producing and secondly, because once the project is income producing, payment of interest on borrowed money is a charge against revenue as it is money which has had to be expended in order to generate such revenue.

2. Types of Borrowing Available

Trust Companies and Banks

These two types of institutions have been grouped together as the funds provided by them are usually by way of participation mortgage bond schemes. In

such schemes the funds of various clients of the institutions are advanced and duly secured by means of the registration of a mortgage bond against the immovable property concerned.

The rate of interest payable is not only determined by the laws of supply and demand but also by certain Government regulations which stipulate the maximum rate which may be payable to an investor (i.e. the client of the institution) and such regulations also limit the maximum rate of commission which may be charged by the institution under a participation bond scheme. The total payable by the property owner at present varies between approximately 11% and 13% per annum. Such interest is normally payable quarterly in advance.

Most participation bonds are fixed for an initial period of five years, during which time no capital repayments are required. Thereafter, the institution concerned will require that the capital be repaid over a period of normally between 20 to 25 years in equal annual instalments. The interest is, of course, paid on the reducing balance from time to time. In most instances the rate of interest is fixed at a minimum during the first period of the bond and thereafter, is allowed to fluctuate upwards or downwards according

to the market rate from time to time, governed of course by the various controls aforementioned.

It is unlikely that the bond would be called up for repayment after the expiration of the initial period except in the event of default on

the part of the debtor (borrower). In the case of a development project the amount of the bond will be advanced in instalments from time to time in accordance with the building work progress and is usually made against Architects' Certificates on which are certified the value of work completed from time to time. It is usual for the institution concerned to appoint an independent valuer to check on the progress of the project so as to ensure that there is always sufficient bond capital withheld to complete the building in the event of problems arising (such as the insolvency of the borrower and/or the builder) and also so as to ensure that there is adequate security for the amount advanced.

Insofar as the amount of the bond is concerned, this will be governed by the institution's valuation of the property. At present, a bond in excess of 60% to 66% of the institution's valuation would not be granted. In the event of a larger sum being required, then additional security would have to be

furnished to the satisfaction of that institution. Participation Bond Managers are normally extremely reluctant to grant bonds against the security of hotels, boarding houses, specialised institutions, vacant land and similar types of property for which there might not always be a ready market. It should be noted that the amount granted is governed by the Participation Bonds Act No. 48 of 1964 which stipulates a maximum of 75% of valuation in the case of a reducible bond and 66% in the case of a non-reducible bond. All participation bond schemes are also precluded from granting bonds under the sum of R20 000,00, but there is no maximum laid down.

Insurance Companies

In the present time, most insurance companies do not grant many bonds as they prefer to invest their funds in their own properties. Where they have granted bonds, the rate of interest charged by them has normally been the maximum rate permissible, i.e. 14% per annum. In some cases, interest is charged quarterly in advance and in other cases, monthly or even half-yearly in arrear depending entirely upon the policy of the particular insurance company. As in the case of banks and trust companies, however, bonds are usually limited to

60% to 66% of valuation. In respect of farming properties, which certain insurance companies seem to prefer, it is interesting to note that they normally grant in the region of 30% to 40% of their valuation of that property. Some insurance company bonds are fixed, i.e. regular capital reductions are not required and the total amount of the bond becomes payable on its expiry but other insurance company bonds are of the reducible type whereby regular monthly or annual repayments are required.

Building Societies

Building Societies normally grant bonds of up to 75% of their valuation of the project concerned. Interest is charged monthly in advance and monthly repayments on account of capital and interest are normally required. The present rate of interest being charged by building societies is in the vicinity of 12½% per annum. It should be noted that legislation lays down the proportion of a building society's funds which can be devoted to projects other than normal housing.

Other

It should also be borne in mind that certain other institutions also make funds available for mortgage bond purposes, the terms and conditions relating to such being varied from institution to institution. Such institutions would include Pension Funds, Friendly Societies, etc.

Although the raising of finance by utilising the immovable property as security is the most common method utilised, it should be remembered that finance can also be provided from other sources such as bank overdraft and even personal funds available to the developer.

3. Some Advantages and Disadvantages of Types of Borrowing Available

Mortgage Bonds

A mortgage bond has the advantage that the borrower knows that the amount borrowed will not be called up for a fixed and determined period of time, unless, of course, he does not fully comply with the terms and conditions of the agreement. The fact that bonds are available in which capital repayments are not required for a specified number of years, allows the development to become fully revenue producing before having to finance capital repayments. A disadvantage of a mortgage bond is that in the event

of the developer deciding to change the investment purpose of the development and dispose of it under a Sectional Titles or a Block Share Scheme, the bond holder could possibly be a stumbling block by objecting to the change or requiring that certain additional terms be met before allowing the scheme to go ahead. Problems may also be encountered with the bond holder in the event of the developer deciding to dispose of his interest in the development by selling his shares therein. The bond holder may not readily approve the proposed new shareholder in substitution of the developer wishing to dispose of his interest. It is usually a condition of a mortgage bond that after a pre-determined initial period notice requiring repayment may be given by the bond holder to the developer and the developer could find himself in a difficult situation in the event of the lender deciding to recall part of the bond, if, for example, the value of the property declines as is the present situation on the property market in South Africa.

Bank Overdraft

The disadvantages of financing by use of a bank overdraft far outweigh the advantages which there might be and it is for this reason that it is very seldom found that property developments are financed from this source. The

advantage of this form of finance is that interest is only paid on the balance outstanding from time to time. In other words interest is only charged from the time when the money is actually required and as soon as surplus funds are available, even for a short period, interest is saved by a temporary reduction of the overdraft balance. Overdrafts are governed by the economic climate from time to time and also by regulations made by both the Reserve Bank and the bank providing the facilities itself. It can, and has often, happened that a borrower of very good standing with a bank is suddenly called upon to reduce part or all of the overdraft because of instructions received from the Reserve Bank to all banks requiring that they reduce overdraft ceilings. At such times the availability of funds from other sources would be very small and their rates of interest extremely high.

4. The Lenders Considerations

When assessing any development project the lender (the provider of borrowed money) would, inter alia, look very carefully at the financial strength of the borrower, the type of property that is being erected as well as the location thereof and the type of tenant who will be occupying the premises. The rentals proposed are also examined carefully so as to ensure that they are reasonable and at market levels. If they are above what is considered the reasonable market

level, they would be reduced when assessing their valuation of the project. The expenses, or at least the anticipated expenses of the property are also carefully scrutinised by specialists in their field in arriving at their valuation. Their valuation of, for example, a block of flats, would be influenced by a calculation in which the net excess of income over expenditure is capitalised at what is considered to be a reasonable rate for the particular type of property in the particular area. It is interesting to note that when assessing the value of a property the evaluator will normally arrive at a different valuation for bond purposes as compared to that for insurance purposes. The information usually required by a lender when considering an application for a loan is contained on pages 15 to 19.

In some cases the financial institution concerned will insist upon a share in the equity of the development and this depends entirely upon the policy of the particular institution and the acceptability of such equity participation on the part of the developer. Certain institutions will require a controlling interest in the property, while others find a relatively low equity participation quite acceptable. Most institutions do not, however, seek an equity involvement at all.

APPLICATION FOR A LOAN OF R

upon the security of a first mortgage bond

Based on the following information:

1 Full name of applicant _____
Address _____
Telephone _____

2 Location of property (including street name and number and erf number):
Type of property (tick applicable type) 1. House 2. Flats
Freehold/Leasehold 3. Shops 4. Offices
(delete which is inapplicable) 5. Industrial 6. Mixed

3 a) Date of purchase: _____
b) Price paid or to be paid: _____
c) Title Deed number and date: _____
d) Where is the Title Deed: _____

4 a) Purpose for which loan is required _____
b) If for part of purchase price, how is balance being provided? _____
c) If there is to be a second mortgage, please state:
(i) Name and address of lender _____
(ii) Amount of second mortgage: R _____ Interest rate _____
Terms of repayment _____

5 If the property is already mortgaged please state:
a) Name and address of lender _____
b) Amount owing: R _____ Interest rate _____
c) Date to which interest has been paid _____
d) Why the bond is being repaid _____
e) Is the bond immediately repayable or does notice have to be given? _____

DETAILS OF PROPERTY OFFERED AS SECURITY

6

- 1) Site area _____
- 2) Municipal rating valuation: Land R _____
Buildings R _____
Total R _____
- 3) Property reference number _____
- 4) Town planning zone _____
- 5) *In the case of lettable property*
 - a) Number of units, i.e., flats, shops, etc _____
 - b) Aggregate lettable area _____
 - c) *If applicable*
 - (i) Number of garages _____
 - (ii) Number of parking bays 1) Covered _____ 2) Uncovered _____
 - (iii) Number of stores _____
 - (iv) Number of outbuildings _____
 - (v) Number of lifts _____
 - (vi) Is property air conditioned? _____
 - d) Gross rental per annum R _____
 - e) Outgoings per annum R _____

N.B. A schedule of rentals and details of outgoings must be furnished with this application, and name of managing agent (if any).
- 6) In case of dwellings:
 - a) Number of living rooms _____ Bedrooms _____
Other rooms (specify) _____
 - b) Garage or car port? _____
 - c) Servants rooms? _____
 - d) Swimming pool? _____
- 7) *Construction:* Date _____
Nature of walls _____
Nature of roof _____
- 8) Is the property subject to Rent Control? Yes/No
If so, please state date of last Rent Board application _____
and result thereof _____

7 Additional information for building bond

- 9) Plans, tenders and specifications must accompany this application.
- 10) Cost of construction (exclusive of land and professional fees) R _____
- 11) Date of commencement of building: _____
- 12) Date of anticipated completion: _____
- 13) A summary of (a) lettable floor area,
(b) overall building area,
(c) anticipated rentals per unit, and
(d) anticipated overheads must accompany this application.
(Please use attached schedule.)
- 14) Cost of land: R _____
- 15) Dates and amounts of anticipated loan advances _____

- 16) Names of architects _____
builder _____

8 In the case of an individual Please state:

- a) (i) Occupation _____
- (ii) Annual income _____
- (iii) Name of bankers _____
- b) (i) What life insurance cover do you have on your own life or, in the case of a married woman, on the life of the husband?
R _____ Particulars of policy: _____
- (ii) Do you consider such life cover adequate to cover the amount of the proposed loan and other requirements in event of death? **Yes/No**
- (iii) If not, or if not covered at all, would you be interested in obtaining advice on cover that should be effected? **Yes/No**

In the case of a company Please state:

- a) Main objects of company _____

- b) Name of bankers: _____
Address: _____
- c) Full names of principal shareholders and number of shares held

d) Are all the aforesaid shareholders willing to bind themselves as sureties and co-principal debtors for the full amount of the loan **Yes/No**

e) Address of sureties _____

f) Directors and shares held _____

g) Date company incorporated _____

h) If more than 24 per cent of shares are held directly or indirectly by non-residents of South Africa, has Exchange Control sanction been

(i) applied for **Yes/No**

(ii) obtained **Yes/No**

If yes, please attach Treasury's written authority.

If not applicable, please state so _____

Note: Attach company's balance sheet and profit and loss accounts for last three years, or from commencement of business if less than three years.

9 In the case of lettable premises, are you willing to allow us to collect the rents? **Yes/No**

This application must be accompanied by a statement of the applicant's (or in the case of a company or a married woman, the sureties), assets and liabilities (including contingent liabilities and existing sureties) duly signed by the applicant, surety or auditor/accountant.

I, the undersigned (full names) _____

confirm the accuracy of the particulars herein given and agree that they form the basis upon which this application is to be considered and that any discrepancy subsequently discovered may result in the withdrawal of any loan facilities that may be offered. I further agree that in the event of this application not proceeding for any reason after inspection of the property, I shall be liable for the payment of your inspection fee.

Dated _____

Signed _____

5. The Cost to the Developer

Apart from the actual cost of the land, building, professional fees and other development costs the developer will also be required to pay interest on his loans as well as a raising fee which usually varies between 1% and 3% depending upon

- a) the availability of money at the time of the application, and
- b) its source.

Some institutions also charge a regular fee to cover their cost of re-inspection of the property from time to time.

It is also normally a requirement that the insurance of the property be placed through the agency of the lender as this enables it to govern the amount of the cover and also ensures that the premiums are regularly paid and that the policy is ceded in favour of the lender.

6. Type and Amount of Borrowing Chosen for Case Study

Although, in the past, most developers seemed to attempt to borrow as much as they possibly could, this practise is not necessarily a sound one. Unless the developer is in a financially sound position, he could find himself in difficulties if the value of property falls and the lender decides to recall a portion of the bond. Similarly, if the interest rate should rise on a large loan the borrower could once again

find himself in an embarrassing financial position. For the aforementioned reasons, the type of borrowing chosen for the purpose of the case study which follows is a fixed term bond in which the bond is fixed for a number of years (five in this case) and only the interest is due during the initial fixed period. Whilst opinions vary greatly, many developers consider that the amount of funds loaned by means of a bond should be between 40% and 60% of the total cost of the project. In the viability study which follows, the effect of various different amounts of borrowings are considered in detail. (See pages 22 onwards).

VIABILITY STUDY

The object of a viability study is to establish the anticipated return which a developer can expect to earn on the funds which he intends putting into the particular project. In other words, the developer is given an indication of what he can reasonably be expected to earn on his investment in the project. In coming to a decision as to whether or not the projected return is satisfactory, the developer would consider other possible avenues of investment available to him at that particular point in time and he would also have regard for the risks involved. Obviously, the higher the risk involved, the higher the rate of return which would be expected. If, for example, a fixed interest long term investment in a building society was to produce, say, 10% per annum, this would present a steady guaranteed return with little or no management problems and little or no risk of loss of capital. Accordingly, because of the management and the risk involved, a developer would, therefore, be entitled to expect more than 10% return on his investment in a property development. On the other hand, he would also bear in mind the fact that a property investment is regarded as a reasonable hedge against inflation, whereas an investment in a building society does not provide any protection against inflation.

When a viability study is undertaken, the possibility of changes in interest rate must be borne in mind. During the peak of building progress, in 1972/1973, many developers were quite happy to prepare a viability study on the basis of an interest rate of approximately

9% per annum which was then the current rate. A small margin for increase would most probably have been allowed for but in most cases, as it happened, this allowance was inadequate because of the phenomenal rise in interest rates from about 9% to 13% over a two to three year period. Furthermore, many developers did not allow sufficient for the large increases in rates and other expenses which have resulted in a decrease in the value of properties. At the present time, buyers are demanding anything up to 14% or 15% per annum return on their investment. When the net income is capitalised at that rate of return, the value of the property comes down dramatically when compared with the value in previous years when a return of 9% or 10% was perfectly satisfactory. Accordingly, at present many developers avoid building a property in excess of three stories in height as lift installation and maintenance cost can today be prohibitive. Maintenance plays an important part in the actual viability of a project and, therefore, the size of the block from the point of view of maintenance, must be very carefully considered as a relatively small block could be maintained with a minimum of labour whilst bigger blocks require a full time resident caretaker and perhaps a full time maintenance team as well. In addition, the long term as opposed to the short term must be very carefully considered. This may sound elementary but a number of investors/developers have found themselves in difficulties in recent years simply because of an over-optimistic viability study having been prepared at the outset. Consideration must also be given to the streamlining of building operations so as to complete the project in the shortest possible time thereby making the proposition revenue producing at

an early date. An over-optimistic view should also not be taken when determining or estimating the time which it will take to let the individual units.

For the purpose of the considerations which follow, a figure of R100 000,00 has been used as being the estimated Capital Investment and a figure of R14 000,00 has been used as the Estimated Annual Excess of Income Over Expenditure before the cost of financing borrowed money. Full details of the items usually constituting Capital Investment, Annual Income and Annual Expenditure are recorded on pages 27 - 30.

The schedule which follows clearly discloses the expected return in a number of different financial arrangements.

Investment By Developer	R10,000	R20,000	R30,000	R40,000	R50,000
Mortgage Finance Required	R90,000	R80,000	R70,000	R60,000	R50,000
Interest Payable At : 10%	R 9,000	R 8,000	R 7,000	R 6,000	R 5,000
11%	R 9,900	R 8,800	R 7,700	R 6,600	R 5,500
12%	R10,800	R 9,600	R 8,400	R 7,200	R 6,000
13%	R11,700	R10,400	R 9,100	R 7,800	R 6,500

<u>Return on Developer's</u> <u>Investment If Bond</u>					
Interest Is : 10%	50%	30%	23.3%	20%	18%
11%	41%	26%	21%	18.5%	17%
12%	32%	22%	18.7%	17%	16%
13%	23%	18%	16.3%	15.5%	15%

The foregoing schedule clearly discloses that the ratio between borrowed finance and own finance in a project, as well as different interest rates payable, has a very marked effect on the yield on the developer's finance. The figures clearly illustrate that where more borrowed funds are utilised, a higher return is earned on the developer's own finance. In coming to a decision as to the ratio to be utilised, the major considerations which face the developer will be :

1. The amount of finance which can reasonably be expected on mortgage bond and the conditions attached thereto, and
2. The funding of the repayment obligations in terms of the relevant mortgage bond.

Whilst a higher figure for borrowing will result in a higher return on the developer's own funds, it is also necessary to bear in mind that a larger amount of the surplus remaining would have to be set aside for the purpose of eventual bond repayments.

CAPITAL INVESTMENT

This would include -

Entrepreneurial Costs: Includes the fees charged by the Entrepreneur for promoting the project. These fees are usually made up of the charges involved in setting up the method of ownership (e.g. formation of company, registration of the company, stamp duties, etc.) and consultants' charges which include amongst others, investment advisors, property economists, estate agents and conveyancers.

Land Costs: Includes all expenses incurred in connection with land acquisition and registration of title. These expenses include, inter alia, purchase price, agents commission, stamp duties and survey charges.

Transfer Fees: These are fees which are payable in respect of all property transactions. They are made up of legal charges and disbursements and transfer duty.

Development Costs: Includes all construction and other project costs, such as services to site (roadways, power supply), land-scaping, etc.

Passing of Plans and Municipal Charges: Charges relative to obtaining municipal approval for the proposed development.

Professional Fees: Normal professionals required are architect, quantity surveyor and engineers.

Clerk of Works

Printing of Drawings, Typing, Etc.

Rates and Taxes (while building)

Other Charges: Includes all sundry charges and expenses such as secretarial, audit, legal, insurance, banking, etc.

Opportunity Costs on Capital Invested (until building is fully revenue producing): Includes all loss of opportunity to the investor to earn a return on the various monies expended over the period from the time of conception until the project is fully revenue producing.

ANNUAL INCOME

Annual rental income calculated on the available number of rental units at ruling market rates or at rates when block is fully revenue producing. Less allowance for vacancies which constitutes a loss of rental due to lack of demand for the rentable units.

ANNUAL EXPENDITURE

Rates and Taxes: A charge levied on property by a local body to obtain money to maintain local services. Based upon the municipal or divisional valuation. For existing properties rates can be ascertained by enquiring at the rates office but for new building rates have to be estimated.

Sewerage Fees

Refuse Removal

Caretakers' Wages

Property Repairs and Maintenance

Water

Electricity

Insurances

Rent Collection Commission

Administration Charges

Secretarial Fees

Auditor's Fees

Assumed Details of the Case Study for Consideration -

- i) Project costing R100,000 to be held for investment purposes.
- ii) Bond finance of R60,000 available as follows :
 - Interest at 12% per annum
 - Fixed for 5 years
 - Annual capital repayments of R3,000 per annum after initial 5 years (i.e. R3,000 p.a. for 20 years)
- iii) Estimated Annual Excess of Income over Expenditure of R14,000.
- iv) Rent increases over the years will be sufficient to meet increases in bond interest rates and other expenses such as increased maintenance as the building ages.

Expected Results of Case Study -

Years 1 to 5 :

i) Excess of Income over Expenditure (before bond interest)	14,000
ii) Interest on Bond (12% on R60,000)	<u>7,200</u>
iii) Net Return (before taxation) (17% on R40,000 invested)	6,800
iv) Company Taxation (including Loan Levy) (+ 50%)	<u>3,400</u>
v) Net Return (after taxation)	<u><u>R3,400</u></u>

Year 6 :

The above amount of R3,400 will be reduced by R3,000 in order to meet the bond repayment required.

Years 7 to 25 :

- i) Interest on Bond will Reduce by R360 per annum (12% on R3,000)
- ii) Net Return (before taxation) will Increase by R360 per annum (0.9% on R40,000 invested)
- iii) Company Taxation will Increase by R180 per annum.
- iv) Net Return (after taxation) will Increase by R180 per annum.
- v) Bond Completely Repaid at End of Year 25.

Year 26 Onwards :

Property fully paid for and earning 14% on investment of R100,000 (R40,000 + (R3,000 x 20))

Conclusions -

- i) Return (before taxation) of between 17% in year 1 and 14% from year 26 onwards is reasonable by present day levels.
- ii) Negotiations to avoid complete repayment of bond could result in an increased return (for example, if the bond were pegged after repayment of R30,000 then net return would amount to R10,400 (R14,000 - R3,600) or $\frac{+}{-}$ 14.86% on investment of R70,000 (R40,000 + R30,000))
- iii) Development to be recommended as viable if owners do not expect large cash flow initially. (For example, in year 6 only R400 would be available but this would increase by R180 per annum to R7,000 in year 26 and thereafter).

ADMINISTRATION OF DEVELOPMENT

From Acquisition of Land to Completion of Building Project

(1) Cash Requirements Plan (budget)

The object of the cash requirements plan is to list the relevant expenses pertaining to the development of the project in such a manner that the developer is able to budget for the expenses revealed in the plan and thus have made provision to meet the various expenses as and when they become due.

The costs reflected in the cash requirements plan will be arranged into time sequence. By liason between the design team, namely architect, quantity surveyor, etc., a list of the major cost items in sequence will be produced. This list is in effect a forecast showing what amounts and when cash will be required to meet claims arising from the construction of the project.

The accuracy of the forecast is important as the developer could be placed in an embarrassing position should there be too little cash to meet a claim due to inadequate scheduling of the plan. On the other hand for the developer to have too much cash on hand than required to meet expenses at that point could mean a loss of earnings by way of interest foregone.

(2) Cash Flow To Meet Budget

At this stage the developer will not be receiving an income from the project. All charges be they building construction costs, interest on loan, professional fees incurred etc., have to be funded by either the developer's own capital or by capital the developer has

managed to secure in the form of a loan.

The developer's available funds for the project are usually invested to earn the highest percentage yield or interest for the period until such funds are required. The rate of interest and the placement of the funds in various investment forms are dependent on the developer's particular tax incidence. Thus the highest percentage yield is the highest possible interest that could be earned in light of the developer's tax incidence and the limited periods for which the funds could be invested. By use of the cash requirements plan, the expected cash flow which will be required to fund the project can be devised and, accordingly, the developer arranges his resources, so that as cash is required by the project it becomes available (to meet the cash flow).

The cash requirement will vary, building up as the project gets under way from the inception stage through to actual construction work. The cash flow remains high during the construction period although towards the end of the construction period the flow tapers off.

The cash requirements of the project whilst under construction are funded, firstly, from the developer's equity in the project and thereafter from the borrowed funds arranged. This will continue until all of the bond, less a certain percentage held back for retention purposes, has been disbursed. Completion of the project (the final account) in theory should coincide with the final draw on the bond.

The "Cash Requirements Plan" and the "Cash Flow To Meet Budget" can be best illustrated by the following schedule which utilises the assumed figures contained in the viability study.

	<u>Jan</u>	<u>Feb</u>	<u>March</u>	<u>April</u>	<u>May</u>	<u>June</u>	<u>July</u>	<u>Aug</u>	<u>Sept</u>	<u>Oct</u>	<u>Nov</u>	
CASH REQUIREMENTS PLAN												
Purchase of Land (Included are survey fees, transfer fees, etc.) (This land is taken on a 3 months transfer).			9,500									
Professional fees, Scrutiny fees, etc.	600	2,600										
Building Construction (Included are professional fees, dead interest on money, etc.)			4,000	16,100	19,500	20,300	15,200	5,900				
Final Account (Including release of reten- tion, professional fees, dead interest on money during building period).											6,300	
<u>TOTAL</u>	R600	R2,600	R13,500	R16,100	R19,500	R20,300	R15,200	R5,900			R6,300	R100,000
CASH FLOW PLAN												
Developers Funds (R40,000)	600	2,600	13,500	16,100	7,200							40,000
Borrowed Funds (R60,000)					12,300	20,300	15,200	5,900			6,300	60,000
<u>TOTAL</u>	R600	R2,600	R13,500	R16,100	R19,500	R20,300	R15,200	R5,900			R6,300	R100,000

(3) Protection of Investment

In discussing the above we must consider the requirements of the developer.

Firstly, to adequately protect his investment the developer relies heavily on his design team, namely, the architect and quantity surveyor as well as the building contract drawn between the developer and contractor. The architect will be in charge of supervision and quality control while the quantity surveyor, by preparing the monthly valuation certificate which the architect authorises, ensures that at each stage the building contractor is not overpaid for any section of the work performed. The contract signed between the builder and contractor will have numerous protection clauses built in. Reference to the standard form of building contract document in South Africa entitled "Agreement and Schedule of Conditions of Building Contracts" will give the prospective investor in property development further information on this aspect. It is also advisable that this form of contract be entered into between himself (the developer) and the building contractor before the construction of the project is commenced.

Secondly, to ensure that the building is indeed built according to plan with the correct materials as specified, a Clerk of Works may be employed by the developer. The Clerk of Works, who is on site during the construction activity, keeps an eye on the builder's use of material and his building methods and reports to the developer's agent, the architect, any discrepancies he notices to the requirements as detailed in the contract documents, drawings, plans, specifications, etc. In this manner the developer's overall protection of his investment is enhanced.

It should be noted that it is general practice that the institution from whom the developer has raised finance (in this case a bond) will also be concerned to see that their investment is covered by a sound and well constructed building. In consequence the institution will send a valuer to the site regularly to check that any payments certified are in fact a true reflection of the work performed at any particular stage. It is in the institutions interest to do this, as a poorly constructed or finished off building has a low value and might in an extreme case be below the value as determined for the purpose of the bond.

Security of the site is left up to the contractor as a clause is normally inserted in the contract documents allowing the contractor to price for the cost involved in watching and lighting as may be required. The effect of this clause is that the developer does not have to worry about guarding the site to ensure against theft, etc.

Insurance of the works is normally required of the contractor and adequate insurance is required to be taken out in the joint names of the contractor and the developer. The developer would be well advised to ensure that the contractor has indeed taken out the necessary insurance and that the contractor keeps the premiums for the insurance policies up to date. As the building progresses so the replacement value of the building increases necessitating constant up-dating of the insurance policies and the developer through his agent, the architect, must check to see that the contractor has suitably up-dated the insurance as required. The standard form of builders contract in South Africa normally has the following requirement in so far as the insurable risks are concerned:

"The Contractor shall in the names of the Employer and the Contractor insure the Works including all unfixed materials and goods (excluding temporary structures and all plant, tools and equipment owned or hired by the Contractor or his employees or any Sub-Contractor or his employees) intended for delivery to and placed on or adjacent to the Works against physical destruction or damage by the risks insured under a Fire Insurance Policy suitably endorsed to include the risks known as 'Special Perils', 'Riot and Strike', 'Earthquake', 'Fire and Shock' and 'Explosion' in so far as the said risks are insurable. Such insurance

- (i) shall be for a sum not less than the full value of the said Works, materials and goods, plus 10% to cover professional fees;
- (ii) shall be with a company approved by the Employer who shall not unreasonably withhold such approval; and
- (iii) shall not be cancelled or otherwise terminated until seven days after the Contractor has given written notice to the Employer of his intention to deliver up the Works and to cancel this insurance.

The said policy or policies together with all premium receipts shall be deposited with the Architect.

Should the Contractor make default, the Employer may insure as aforesaid and deduct the premiums paid from any monies due or to become due to the Contractor."

Insurance against theft of any materials whether fixed or unfixed on site or adjacent to the works is also sometimes desirable. The contractor should also insure in the joint names of the developer and himself against injury to persons and property.

The abovementioned insurances will not be necessary if the contractor has a contractors all risks insurance, which is an annual "blanket" cover (including public liability). Once the developer has been assured that the contractor has this policy with a suitable amount of cover for the project in mind, he can rest assured. For further details of this type of policy, please see page 40 - 48.

CONTRACTORS' ALL RISKS INSURANCE

ANNUAL "BLANKET" COVER

(Including Public Liability)

This Policy and the Schedule shall be read together as one contract and any word or expression to which a specific meaning has been attached in any part of the Policy or the Schedule shall bear such specific meaning wherever it may appear.

WHEREAS the Insured has applied to the Company for the insurance hereinafter expressed and has paid or agreed to pay the Premium

THE COMPANY will indemnify the Insured to the conditions and the General Exceptions of this Policy in accordance with the terms, exceptions and provisions of Section I and II of the Policy and of any endorsement hereto.

PROVIDED ALWAYS that the due observance and fulfilment by or on behalf of the Insured of the Conditions of this Policy in so far as they relate to anything to be done or complied with by the Insured, and the truth of any statements made by or on behalf of the Insured, in connection with the application for this Insurance (which statement together with any declaration signed by or on behalf of the Insured shall be the basis of this contract and shall be regarded as incorporated herein) shall be conditions precedent to the Company's liability under the Policy.

THE GENERAL EXCEPTIONS:

The Company will not indemnify the Insured under this Policy

1. In respect of any loss damage or liability directly or indirectly or proximately or remotely occasioned by or contributed to by or arising from

- (i) War civil war invasion act of foreign enemy hostilities (whether war be declared or not) rebellion revolution insurrection civil commotion assuming the proportions of a popular rising or military or usurped power - or the act of any person acting on behalf of or in connection with any organisation with activities directed towards the overthrow by force of the Government de jure or de facto to the influencing of it by terrorism or violence.

- (ii) Ionising radiations or contamination by radioactivity from any nuclear fuel or from any nuclear waste from the combustion of nuclear fuel.

For the purpose of this Exception the term "combustion" shall include any self-sustaining process of nuclear fission.

- (iii) Nuclear weapons material.

- (iv) Confiscation nationalisation or requisition or destruction of or damage to property by or under the order of any Government de jure or de facto or any Public or Local Authority.

2. Unless otherwise agreed by endorsement hereto from time to time, in respect of any loss damage or liability as insured by Sections I and II hereof arising out of or in connection with any Contract for the construction of bridges over water, dock or harbour works, breakwaters, dams or weirs, reservoirs, viaducts, or other works on or over or about water, or contracts for sewerage for water reticulation or drainage schemes carried out on behalf of any Government Department Public Authority Public Utility Company or Township Owner.

SECTION I : CONTRACT WORKS INSURANCE

The Company will indemnify the Insured under this Section of the Policy against accidental loss of or accidental damage to the Property Insured occurring on or about any Contract Site within the Territorial Limits during the Period of Insurance from any cause not hereinafter excepted.

Provided always that the liability of the Company shall be limited to the reasonable cost of repairing replacing or reinstating the said Property and shall not exceed as regards any one Contract Site the sum insured mentioned in the Schedule nor the final Contract Price as certified by the Architect/Engineer.

REINSTATEMENT:

Subject always to the Insured's agreeing to the payment of a pro rata additional premium for the remaining Period of Insurance, the Sum Insured under this section of the Policy shall be deemed to be automatically reinstated as from the date of any loss or damage by the amount payable in respect thereof.

DEMOLITION AND CLEARING : CONSULTANT'S FEES:

It is understood and agreed that the Sum Insured includes, unless otherwise stated:

- (a) Any costs necessarily incurred by the Insured in respect of the demolition of structures or the removal of debris, and in providing erecting and maintaining any hoarding required during demolition site clearing or reconstruction;
- (b) Architects' Quantity Surveyors' and/or Consulting Engineers' fees (excluding any such fees incurred in connection with the preparation of a claim hereunder) necessarily insured by the Insured in connection with the replacement or reinstatement of the Property Insured.

following any loss or damage against which the Insured is indemnified by this Section of the Policy.

THE INTEREST OF THE PRINCIPAL:

Where in terms of any Contract entered into by the Insured in the course of and for the purpose of the Business the Insured is required to effect insurance against loss or damage to the Contract Works in the joint names of the Insured and the Principal, the interest of the said Principal shall be deemed to have been duly noted hereon.

THE EXCEPTIONS TO SECTION I:

The Company will not indemnify the Insured under this section in respect of:

1. Any costs of replacing reinstating or making good any defective work or defective materials or normal wear and tear or gradual deterioration (but physical loss or damage arising in consequence of such defective work defective materials wear and tear or deterioration to any part of the Property Insured not immediately affected thereby shall not be deemed to be excluded by this Exception).
2. Loss or damage due to or arising from or in consequence of defective design.
3. Loss of or damage to :
 - (a) Any locomotive rolling stock aircraft, watercraft or crane.
 - (b) Any trailer or mechanically propelled vehicle other than mobile plant used on the Contract Site as a tool of trade and not otherwise insured.
 - (c) Cash bank notes cheques stamps postal or money order or securities.
4. That part of any loss or damage to any plant or equipment that arises directly from and consists of its own mechanical or electrical breakdown or derangement.
5. Unexplained shortages or shortages evidenced only by stocktaking or inventory.
6. Loss of or damage to the permanent works or any part thereof occurring during any maintenance period other than from:
 - (a) a cause occurring before the commencement of maintenance period;
 - (b) any act or omission of the Insured in the course of any work carried out in pursuance of the Insured's obligations with regard to maintenance under the Contract.

THE EXCESS:

In respect of any one event or occurrence the Company shall in addition not be liable under this Section

1. For the amount of the Excess specified with regard to:
 - (a) Loss or damage arising out of storm tempest flood subsidence or collapse;
 - (b) Loss or damage arising from any other cause except fire riot lightning or explosion.

The Company will indemnify the Insured under this Section of the Policy against all sums the Insured shall become legally liable to pay as damages including claimants' costs and expenses in respect of

- (a) Accidental bodily injury to or accidental disease or illness of persons (fatal or non-fatal)
- (b) Accidental damage to property

occurring during any Period of Insurance and caused by the Insured or the Insured's servants or agents (including sub-contractors or such sub-contractors' servants) in the course of the Business or by any defect in on or about the premises occupied by the Insured for the purposes of the Business.

In the event of legal liability attaching

- (a) Personally to any director or employee of the Insured
- (b) To the Principal

for the payment of any damages, costs and expenses against which the Insured is indemnified hereunder, the Company will also indemnify such director, employee or Principal jointly and severally with the Insured in terms of this Policy but only if and to the extent that such director, employee or Principal shall as though named as the Insured hereunder observe, fulfil and be subject to the terms, exceptions and conditions of the Policy and is not entitled to such indemnity under any other insurance Policy.

Provided always that the total liability of the Company for all such damages, costs and expenses as aforesaid payable in respect of all claims arising out of any one occurrence or event shall not exceed the Limit of Indemnity.

The Company will in addition pay any costs and expenses incurred by the Insured with the Company's written consent.

THE EXCEPTIONS TO SECTION II:

The Company will not indemnify the Insured under this Section in respect of :

1. Bodily injury to or disease or illness of persons employed by the Insured under a contract of service or apprenticeship if such injury, disease or illness arises out of and in the course of such employment.

2. Damage to any property insured under Section 1 of this Policy or any other property owned or held in trust or on commission by or leased let rented hired or lent to the Insured or for which the Insured has otherwise assumed or acquired responsibility. ⁴⁵
3. Any Bodily injury disease illness or damage:
- (a) caused by or resulting from defective design on the part of the Insured or the Insured's servants or agents.
 - (b) occurring after the completion and handing over of any work and caused by or resulting from any defect error or omission, whether in or of execution material or otherwise, in the carrying out of such work;
 - (c) caused by or through or in connection with the ownership possession or use of
 - (i) any aircraft watercraft locomotive or rolling stock,
 - (ii) any trailer or mechanically propelled vehicle; Provided that this Exception shall not relieve the Company of liability to indemnify the Insured in respect of bodily injury or damage to property caused by mobile plant used on the Contract Site as a tool of trade, or caused or arising beyond the limits of any carriageway or thoroughfare in connection with the loading of any trailer or vehicle, but only in so far as such injury or damage is not insured by any other insurance Policy or is not required to be insured in terms of any enactment or proclamation relating to the use or ownership of vehicles.
 - (d) caused by vibration or by the removal or weakening of or interference with support to or the subsidence of the whole or part of any building or other structure;
 - (e) caused by or in connection with or arising out of:
 - (i) the use following the erection repair renovation or maintenance by or on behalf of the Insured, or the ownership possession hiring letting renting or leasing, of any spectators stand;
 - (ii) the manufacture possession or use of explosives (for blasting purposes or otherwise);
 - (iii) the underground working of any colliery mine;
 - (iv) foul berthing; stevedoring work, any work at or about or connected with docks harbours piers breakwaters or harbour or dockside services or installations of any kind.
 - (f) Liability assumed by Agreement (other than under any General Conditions of Contract) that would not have attached to the Insured in the absence of such agreement.

1. The Insured shall give written notice to the Company as soon as possible after the occurrence of any event that may give rise to a claim for indemnity hereunder and shall give all such additional information as the Company may require.

In the event of the loss of theft of or wilful damage to any property insured under Section I the Insured shall also give immediate notice to the Police and shall take all practicable steps to recover the Property lost or stolen and at the Company's expense to prosecute the guilty parties.

2. No admission offer promise payment or indemnity shall be made or given by or on behalf of the Insured without the written consent of the Company, which shall be entitled in the name of the Insured but at its own expense to take over and conduct the defence and settlement of any claim or to prosecute for its own benefit any claim for indemnity or damages or otherwise, The Company shall have full discretion in all such matters as aforesaid and the Insured shall give all such information and assistance as the Company may reasonably require.
3. The Insured shall exercise all reasonable care in the selection, employment and supervision of all employees and in the prevention of any injury disease illness loss or damage against which this Policy indemnifies the Insured.
4. If at the time of any occurrence giving rise to a claim for indemnity under this Policy there shall be any other insurance effected by or on behalf of the Insured and covering the same loss damage or liability the Company shall not be liable to pay or contribute more than its rateable proportion of any such claim.

5. If the Premium or any part thereof is calculated on estimates (whether of wages, turnover, output, employees or otherwise) supplied by the Insured, the Insured shall keep an accurate record of all particulars relating thereto that may be required by the Company and shall at all reasonable times allow the Company to inspect such record. Within one month of the termination of each Period of Insurance the Insured shall declare the required particulars to the Company. The Company shall thereupon adjust the Premium accordingly, and any difference between the premium paid and the premium due by the Insured shall be met by a further payment by or a refund to the Insured as the case may be.
6. The Insurance by this Policy shall be subject to cancellation by the Company or the Insured on 30 (thirty) days' notice by registered letter addressed to the other party. In the event of such notice being given, the current Period of Insurance shall be deemed to terminate for all purposes hereunder on the date on which the said notice expires.
7. It is a condition precedent to any right of action or suit against the Company in connection with any claim for Indemnity hereunder that all disputes that may lawfully be referred to arbitration shall be so referred to an Arbitrator appointed in writing by the parties hereto or if a single Arbitrator cannot be agreed upon to an Arbitration Committee consisting of an Arbitrator appointed by the Company an Arbitrator appointed by the Insured and an Umpire appointed by the Arbitrators. If either party does not make an appointment in terms hereof within sixty days of the date of any notice in writing requesting such an appointment the other party may appoint a sole Arbitrator.

An Award by the Arbitrator or by a majority of the Arbitration Committee shall be binding on the parties and no action or suit for the setting aside of such Award shall be taken by or on behalf of either party unless commenced within three months of the date of the Award.

8. If the Company shall disclaim liability for any claim for indemnity made by the Insured or for any costs and expenses in connection therewith and the Insured does not take steps to refer the matter to Arbitration in accordance with Condition 7 of this Policy or (in the event of a dispute that may not lawfully be referred to arbitration) does not institute proceedings for an action or suit at law within six months of the date of such disclaimer the Company shall be entitled to assume that the claim has been abandoned and shall not thereafter be liable to make any payment whatsoever in connection therewith.

After Completion of Building Project

(1) Cash Requirements Plan (budget)

The object of this is to show what items of expenditure are likely to be generated by the project after the building construction period is over. By arranging these expected expenses into a cash requirements plan the developer can thus be shown a forecast of what amounts of cash are required and when they will be required. These expenses include finance charges on borrowed funds, operating expenses, for example, rates and taxes, rent collections, maintenance costs, etc., and, at a later stage, capital repayments on the bond.

The developer using the cash requirements plan can control the expenses of running the completed project. A graph can be drawn showing expected expenses for the project as a whole and relating actual expenses to this graph by drawing in the actual monthly expenses. In this way the developer can try to make reductions in the expenses of the project as well as being made aware of any increases in the running expenses of the project.

(2) Cash Flow to Meet Budget

The project once complete will, hopefully, at this stage be revenue producing thus relieving the burden on the developer's financial resources.

The income production from the project is used to meet the expenses of the project in the amounts and at the times they are required as set out in the cash requirements plan. The income position can also be shown on a graph on which the optimum monthly income has been drawn as an indicator. The actual income produced each month is shown on the graph and indicates the resources of the project.

In the position where the project is completed and revenue producing, the funding of the expenses of running the project is by way of the rent income. This revenue when the project reaches its maximum rental producing potential should not only fund the expense of running and all incidental expenses of the project but should have sufficient over to more than cover the interest charges on the borrowed portion of the funds used to finance the project. An allowance should also be set aside to pay off the capital borrowed.

In the event of a shortfall between the income received from the project and the expenses generated, the developer will have to fund the difference from his own cash resources or by funds acquired elsewhere, i.e. short term finance (for example a second bond or even an overdraft facility) until the revenue from the project enables the developer to dispense with the additional borrowed finance.

The reasons for a shortfall occurring are numerous, not least amongst them being an over optimistic appraisal of the letting capabilities of the project at the desired rental figures.

(3) Protection of Investment

Supervision

The building must be properly staffed to obtain the maximum performance at the lowest overall cost. From a supervision-point of view, it is essential that sufficient is done to ensure that rental growth is maintained at its optimum level. If maintenance is neglected or kept to the bare minimum, tenant/^{develop}relationships can become strained leading to vacancies, etc.

The supervision, therefore, required by the project once revenue producing will be -

(a) the administering of the funds accruing from the rental of the project. By use of the cash requirement plan and cash flow the financial supervision is made far simpler, being the balancing of the incoming money from rental to the expenses and funding any shortfall or banking any excess as the case may be.

(b) the supervision of the project to see that it remains a rent producing investment is far more detailed and requires the co-ordination of all aspects of repair work required as necessary, the leasing of the rental units and the everyday running of the project.

The supervision can be performed by the developer himself or he can appoint administrators for the project who will handle all aspects of supervision (tenants complaints, general repairs, etc.).

Insurance

To safeguard against all the possible risks which might beset the project now completed, the developer takes out insurance. The normal insurances which a developer should consider insuring the project for are as follows:-

- A. (i) Fire, lightning, thunderbolt, subterranean fire, explosion.
- (ii) Riot, civil commotion, strikes, lock-outs, labour disturbances or persons of malicious intent.
- (iii) Storm, tempest, flood.

- (iv) Earthquake
- (v) Aircraft
- (vi) Bursting or overflowing
- (vii) Impact
- (viii) Housebreaking, etc.

- B. Loss of Rent
- C. Property Owners Liability
- D. Accidental damage to public supply or mains connections.
- E. Another insurance to consider taking out is a policy to cover damage to any plate glass in the building.

The above insurances provides the developer with cover and while the cost of this type of insurance is not cheap, it more than amply justifies its being taken out should a claim arise.

The cost of the insurance premiums are treated as an expense against the rental received from the investment.

Tenant Selection

This phase of the project demands a certain amount of caution due to the fact that if a poor selection is made and in consequence the project developes a "bad name" the rental producing potential will drop and maintenance costs will increase.

In the siting of the project and subsequent purchase of the land the developer would, along with his advisors, have given a great deal of attention to the type of tenant to go for and for which the project will be designed to attract.

Some of the considerations which would have been considered are the proximity to public transport (an attribute of site location of great importance when the lower or poorer level of the social strata is to be catered for), the amount of parking which will be available, the site proximity to shopping facilities, etc.

The site's attributes such as bulking factor, zoning, height restrictions, set backs, etc., would have been investigated to enable the developer to ensure that the project will be so designed to give the optimum number of rentable units (in the sizes or areas to suit the prospective tenants requirements).

To ensure that the correct type of tenant is found from those attracted to the units a selection or weeding out process is required.

In order to establish whether or not the prospective tenant is suitable for the block, information is required regarding the income he earns, where he works, his bankers, how long he has worked with present firm, his previous address, how long he stayed at his previous address, trade references, etc. Please see pages 54 - 55 for an example.

The aims of the questions, normally contained in a questionnaire (an application form) which each prospective tenant fills in, are to bring out the tenant's financial standing, the maturity and stability of the tenant and his ability to accept and recognise responsibility.

The rental charge of the units will, to a certain extent, determine the type of applicant. (Most developers (private or institutional) have the criteria that rental must not exceed 25 - 30% of the tenants' income).

NAME:

MARITAL STATUS:

If married, are you married in Community of Property?

If not a South African Citizen, how long have you been in South Africa?

Identity or Passport No:

Date of Birth: Place of Birth:

Name of your Employer:

Address:

Phone No:

Capacity in which employed: Monthly Income:

Name of immediate Superior: Length of Service:

Do you own a car? Reg. No:

Husband/Wife's full name:

Name of Employer: Phone No:

Capacity in which employed: Monthly Income:

Name of immediate Superior: Length of Service:

Number of Children:

State Names and Ages:

Which schools do they attend:

NAME & ADDRESS OF NEAREST RELATIVE:

Have you any other dependents?

Name and address:

Your present address:

..... Phone No:

Present Landlord/ Agent:

Monthly Rental: Duration of Tenancy:

If less than one year give previous address:

Reason for vacating:

Do you have any HIRE PURCHASE accounts?

GIVE DETAILS

Name of Company :

Address :

Monthly payments :

Account No. :

Have you signed SURETYSHIP for anyone?

GIVE DETAILS :

.....

Give two trade references where you have accounts, including:

	<u>FIRM</u>	<u>BRANCH</u>	<u>ACCOUNT NO.</u>
1.

2.

.....

.....

.....

.....

State name of Bank/Building Society:

BANK :

Branch: Account No:

BUILDING SOCIETY :

Branch: Account No:

Once the applicant has been accepted a lease is signed. The normal period of a lease is at least 1 year and should contain, inter alia, the following main clauses:

1. Description of the property subject to the Lease.
2. Use to which the premises may be put.
3. Period of Lease.
4. Rental, including basis of any option to renew.
5. Rates - provision for Lessee to pay a pro-rata share of any increases in rates.
6. Payment of electricity charges.
7. Cession and Sub-letting.
8. Signs - the Lessee is not entitled to display signs on the premises without prior consent of the Lessor. The Lessor undertakes to install a notice board to display names of tenants.
9. Insurance - the Lessee is prohibited from keeping anything on the premises which would result in the insurances of the Lessor being increased.
10. Alterations and additions - the Lessee will not be permitted to carry out alterations or additions without the Lessor's consent. Usually provision is made that at termination of the Lease, the Lessee shall restore the premises or alternatively, the alterations become the property of the Lessor without compensation.
11. Electrical installations - the Lessee is not allowed to change or interfere with the installations in the premises.

12. Internal repairs - the Lessee's responsibility should be clearly defined.
13. External and other repairs - effected by the Lessor.
14. Cleaning.
15. Cost of drawing and executing lease document and stamp duty.
16. Enforcement by Lessor - enabling the Lessor to carry out the Lessee's obligations if the Lessee fails to do so and includes recovering the costs and expenses from the Lessee.
17. Notice of vacancy.
18. Entry on premises - the Lessor to be entitled to enter at reasonable times to inspect and carry out any work connected with the building.
19. Default or breach provision to enable the Lessor to cancel the lease.
20. Non-completion of the premises at commencement date.
21. Business hours.

Rent Collection

The collection of rent from the tenant of the development can be handled in two ways :-

- (a) The rent collection can be performed by the owner. In this instance the controls necessary to reduce non-payment of rental and bad debts are the owner's responsibility. If the development is one of any appreciable size, the problems to the owner, often make this method not worth the trouble.
- (b) Rent collection by a reputable rent collecting agency. The collection agency will charge the owner for the service they provide. Normally the charge is a percentage of the gross rental of the development and is in the order of 5% thereof.

Maintenance

As the project is one in which long term capital appreciation is anticipated, great attention should be paid to the finishes used initially regarding durability and low costs of maintenance as well as the design of the building in facilitating repairs and services.

Finishes chosen for the project to be held as an investment should normally be of high quality to attempt to reduce future maintenance costs. The question of whether to use cheap finishes which have to be frequently and regularly maintained, or expensive quality finishes needing little or no maintenance can be resolved by comparing the immediate high cost of expensive finishes against the discounted value of future expenditure on maintaining cheaper finishes.

The design of the building should be considered from a maintenance point of view. Due to good design it may be relatively cheap and easy to reach surfaces requiring repairs, cleaning or painting, conversly poor design may contribute to high maintenance costs. For example, it is cheaper to paint a building by using a cradle if the building has been so designed and equipped than would be the case if scaffolding has to be used. In the former case the investor's maintenance staff could probably do the job while in the latter case the services of a contractor would have to be obtained.

A quick or large turnover of tenants will cause the maintenance costs to rise and this is another reason why the tenant selection process discussed earlier must be as thorough as possible to avoid the wrong type of tenant entering into a lease in the project.

As maintenance is one of the largest or most costly of the expenses arising directly from the completed project, it is to the developer's advantage to formulate how the maintenance of the building is to be handled. Dependent on the size of the building (and its complexity) there are a number of methods :-

1. The developer can employ his own maintenance team.
2. The maintenance can be handled by a resident handyman in conjunction with the caretaker, who will call in any specialist as required.
3. The caretaker of the building can be both caretaker and handyman.
4. The caretaker will attend to all complaints and general repairs and service by calling in a service firm or firms as required.

For the maintenance and service of complex machinery such as a lift, the developer, no matter what scheme (1 - 4 above) he uses, should employ a firm of lift maintenance specialists.

OTHER

The following, although aspects of financial consideration, have not been embodied in the case outlined above and are included here to show their effect on investment in a project.

The units are normally intended for letting purposes. These units could well be intended for eventual sale under a Block Share or a Sectional Title Scheme.

With either of these two methods of sale, certain principles will apply.

Sale by Sectional Title

"Sectional Title" is the purchase of a unit, in a building, defined more explicitly by a Deed of Sale, which indicates the area and proportions of the building and the unit purchased. Under this scheme the purchaser is specifically buying a portion of a building and as such, has a right of ownership in the stated portion or unit bought.

Care must be exercised in the raising of the initial and end finance by the developer. Some institutions will not consider funding Sectional Title Schemes at all while others will require the total bond granted to be repaid as soon as the Body Corporate has been formed or when 50% of the units have been sold.

An important feature to note is that the building should be built in accordance with the Sectional Title Act requirements to facilitate selling under this method, otherwise it could make it difficult to proceed with the sale of units if the block is not built in the required manner.

Sale by a Block Share Scheme

A Block Share scheme involves a purchase of a portion of a property by way of a shares purchase in a company which

entitles the purchaser to occupation of a certain portion of the property owned by that company.

A point to note here is that this scheme does not give the shareholder registered title to his unit (the purchaser has not purchased an actual unit) and thus has only a right of occupancy of the unit as well as a right of way to the common areas of the project.

This system of sale of units, if it can be called a sale of a unit, has some serious disadvantages and professional advice must be obtained when embarking on the scheme.

If, for example, the block is a rent controlled block of flats, then the purchaser would not be allowed to give the present occupants of his unit notice, nor can he evict them. In a Sectional Title scheme, he would be able to give the present tenants notice as he has a right of title.

A further disadvantage occurs when the purchaser wishes to sell his shares. The permission of the other shareholders in the company must be obtained prior to selling.

In both schemes the purchaser contributes to a management fund to provide maintenance and service to the building.

Special Requirements

The problems of tenants requirements can involve a building owner in considerable expense, unforeseen at the initial planning and costing stage, more so in office or commercial developments than in a block of flats.

The standard to which the building is to be finished will have a bearing on the type of tenant that will lease space in the building. The more prestige the building, the more selective the tenant will become.

Normally, a tenant for this quality of building will sign a longer lease than in cheap rented accommodation and will make such improvements as seen fit. In an office building

such features could be a board room, more furnishings, executive suites, etc.

A modern office building is normally constructed on a module or grid basis so that design of partitioning lay-outs, air-conditioning, lighting, power outlets, etc., can be related to the module. Any departure from the module will thus increase the building cost as special components would have to be made.

A tenant located on a number of floors will generate inter-floor traffic and this can cause disruption to the lift programme for the remainder of the building. Such a tenant could cause additional lifts or alternatively a good staircase access between the floors to become necessary and thus increase the cost of building.

To try to minimise the disruptive effect of tenants in the building, the owner should note the following :-

- a) To avoid wherever possible wet trades (brick, strong rooms, etc.)
- b) Avoid plumbing alterations (such as doctors' or dentists' consulting rooms). Doctors and dentists consulting rooms may perhaps occupy a reception area approximately 15 m^2 and a surgery of 10 m^2 plus a developing room of 5 m^2 and the additional requirements of plumbing and gas and water, etc., make these types of tenant more trouble and more costly to the owner than say a professional firm which requires 10 times the amount of space.
- c) Plan partitioning to module. (This avoids relocation of air-conditioning, lighting, ceilings and floor located power outlets).

- d) The options of finishes available to tenants should be kept to the bare minimum. (For example, a single colour per floor of both partitions and floor finishes should be used).
- e) The owner is usually inclined to go for the tenant occupying large space. This can lead to a problem when the firm wants to expand. For example, a tenant who occupies half the building will invariably want an option or a right of first refusal on other floors in the building. This places a restriction on the letting of the balance of the building as any space next door or on the next floor to the large tenant can only be leased for a short period of time.

An Alternative Method of Appraisal of Investment (Discounted Cash Flow)

To enable the developer or investor to choose between various investment opportunities he requires a basis on which to compare the performance of the opportunities.

In the case study above the ratio of the expected net annual income to the total capital cost gives the calculated rate of return. This is the basis on which comparison can be made.

Another method which, unlike the above method, takes into account both variations in the flow of income as well as in the annual cash flow (to meet expenses) is the principle of discounting.

Discounting involves the discounting of sums receivable or expendable at a future date to their present monetary worth based on the idea that capital today is worth more than the same amount receivable in the future. The reasoning behind this being the fact that money received now can be invested to earn a return in the intervening period.

The converse is also true that expenses if due now will have a certain monetary value but expenses due in the future will have a lesser value than the face value. To explain more fully, money can be set aside earning compound interest until due to meet future expenses and thus a lesser sum need be put away at present to meet future expenses.

Although this method can be used to analyse the case study it has not been considered here as the intricacies of this method lie outside the overall scope of this treatise.

SOURCES OF INFORMATION USED IN THIS TREATISE

Reference Books

<u>Name of Book/Document</u>	<u>Author</u>
Feasibility Study Guidelines	Lloyd D. Hanford Sr. CPM.
Investments in Land and Property	W.A. Leach. E.G. Wenham
Partners in Property	Brian P. Whitehouse
South African Mercantile and Company Law	J.T.R. Gibson B.A. LL.B. (Cape)
Standard Form of Building Contract in South Africa	
University of Cape Town Lecture Notes What Every Real Estate Agent/Property Owner Should Know About Income Tax	David Shrand
Papers presented at the University of the Witwatersrand (2nd August - 20th September, 1972) entitled :- Economic Viability Studies For Capital Projects Computer Based Models	Professor G.W. John and N.R. Lofts
Financing And Blending Of Finances, Cash Flows And Lease-Backs	H.H. Rabe
Leasing And Management Of The Complete Project	Roland B. Walker.

Personal Interviews and Discussions

<u>Individual</u>	<u>Position Held</u>
Mr. S. Bloch	Practising Quantity Surveyor
Mr. Fichardt (Board of Executors)	Manager Property Investment Department
Mr. P. Meakin (Meakin Real Estate)	Director Estate Agency

Mr. J. Rosen	Insurance Broker
Mr. B. Field (Murray & Stewart Properties)	Financial Director
Mr. Stephens (Syfrets Trust Company Limited)	Manager Mortgage Negotiations
Mr. M. Darwood (Southern Life Association)	Manager Property Administration
Mr. J. Eager (Southern Life Association)	Manager Property Construction
Mr. J. Johnston (Southern Life Association)	Marketing Co-Ordinator
Mr. Labuschagne (Trust Bank - Property Division)	Senior Manager Property
Mr. J. Zabow	Chartered Accountant (S.A.)
Mr. A. Daitsh	Property Developer