

Commercial Property 101: What every farmer should know

For many New Zealand farmers, the rhythm of income is dictated by the land – weather, commodity prices, and global demand all play their part. This means, as the agricultural sector continues to face future volatility, more farmers are looking beyond the paddock for ways to stabilise and diversify their financial returns. One avenue that's gaining traction as interest rates fall is commercial property investment. But what does it really involve, and how can farmers make sense of the jargon and risks to make informed decisions?

Why Commercial Property?

Unlike farming, where income is tied to production cycles and market swings, commercial property investments, such as MyFarm's current Duncannon Horticulture offer, provide the potential for steady, lease-based income. The right investment can provide not only reliable cash flow but also long-term capital appreciation. For farmers, this means a chance to balance the unpredictability of agricultural returns with a more predictable income stream, one that's underpinned by contracts and market dynamics quite different from those of rural land.

Understanding the Basics

Commercial property refers to real estate used for business purposes: warehouses, offices, industrial units, and specialised facilities like packhouses or coolstores. The sector has its own language, and understanding key terms is essential:

- **Yield (Cap Rate):** This is the annual rental return as a percentage of the property's value. A lower yield signals lower risk and higher prices; a higher yield suggests greater risk or weaker property attributes.
- **Net Operating Income (NOI):** Rent minus property expenses. Many leases are "net", meaning tenants cover most outgoings.
- **Lease Term:** The length of time a tenant is contracted to rent the property. Longer leases can mean more stable income over the long-term.
- **Rent Review & CPI Adjustment:** Mechanisms to adjust rent over time, often linked to inflation or fixed increases.
- **Loan-to-Value Ratio (LVR):** The proportion of the property's value funded by debt. Lower is considered safer but returns may be affected during times of low interest rates.
- **Weighted Average Lease Term (WALT):** Average lease duration across all tenants, indicating income security.

- **Triple Net Lease:** A lease type where the tenant is responsible for most property-related liabilities, making it favourable for landlords.
- **Carry:** The difference between yield and interest rate costs. Positive carry means interest rates are lower than the rental return, boosting investor cash returns.
- **Cap Rate Compression:** When market cap rates fall, property prices rise, assuming income remains stable.

What Drives Value?

The value of a commercial property is fundamentally linked to the income it produces. The basic formula is:

$$\text{Value} = \frac{\text{Net Operating Income}}{\text{Cap Rate}}$$

For example, a building with \$1 million of NOI and a cap rate of 6.7% is worth \$14.93 million. But what influences these numbers?

- **Rental Income & Growth Potential:** Higher rents and the potential for increases (via CPI or fixed reviews) drive value.
- **Location:** Properties in high-demand areas—near ports, cities, or growth regions—command higher rents and lower vacancy.
- **Property Quality & Type:** Modern, well-maintained, and purpose-built facilities attract better tenants and rents. Specialised assets can be lucrative if demand is strong but may face longer vacancies if the tenant leaves.
- **Tenant & Lease Strength:** Long leases to financially strong ("blue chip") tenants are highly valued. Triple net leases are especially attractive.
- **Vacancy Risk:** Fully leased properties are more valuable. High market vacancy rates or short lease terms increase risk and lower value.
- **Market Yield (Cap Rate) & Interest Rates:** Cap rates reflect investor expectations. When interest rates rise, cap rates tend to rise (values fall); when rates fall, cap rates compress (values rise).

- **Growth Prospects:** Properties with under-market rents or strong sectoral growth prospects may be valued more highly.
- **Alternate Investments:** If other investments (e.g., term deposits, farm expansions) offer higher returns, property yields must rise to remain competitive.

Timing Matters

Commercial property, like farming, is cyclical. Interest rates play a significant role. When rates decrease, borrowing becomes cheaper, boosting purchasing power and making property investments more appealing. Cap rates often shrink and property values rise. Conversely, when rates rise, borrowing is more expensive, demand drops, cap rates expand, and property values decline.

For example, in 2021, with the Official Cash Rate (OCR) at 0.25%, prime industrial yields were 4–5%. By 2023, with the OCR at 5.5%, yields rose to 6–7%, and values fell 10–20% in some segments. As rates ease in 2025, cap rates are expected to decline again, which may boost values. However, there can often be a lag between interest rates shifting and cap rates moving to reflect the new environment.

Strategies for Farmers

- **Buy in High-Rate Environments:** Yields are higher, prices are lower. If you can hold through the cycle, you may benefit from capital gains as rates fall.
- **Sell or Refinance in Low-Rate Environments:** Values peak, and refinancing can lock in low interest costs.
- **Keep an eye on strategic opportunities:** As an example, MyFarm's Duncannon Horticulture LP, which is open for investment now, has secured a property acquisition at a 7.75% cap rate. This cap rate in the current lower interest environment is advantageous for investors, and comes from a combination of good purchasing, the benefit of good timing as cap rates still lag behind interest rates and the property being a specialised rural commercial asset.



MyFarm's Duncannon Horticulture Limited Partnership. Now open now for investment, forecasting monthly cash returns of 7.5% p.a

Practical Considerations

Farmers considering commercial property should weigh several factors:

- **Income:** Assess the rent, lease terms, and tenant reliability.
- **Costs:** Understand who pays outgoings and budget for future capital expenditure.
- **Value & Yield:** Compare the yield to market benchmarks and alternative investments.
- **Growth & Upside:** Consider rental growth built into the lease, location trends, lease longevity, and possible development potential.
- **Risk & Vacancy:** Evaluate tenant risk and your ability to handle vacancies or rising rates.

Investment Routes

- **Direct Ownership:** Buy a property individually or with family.
- **Syndicates/Funds:** Pool capital with others for larger assets (e.g. MyFarm syndicates).
- **Sale and Leaseback:** Sell the business property you own and lease it back, freeing up capital.

Leverage Your Sector Knowledge

Farmers often have unique insights into rural commercial property – packhouses, coolstores, and other assets that city investors may overlook.

These assets can offer higher yields

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and reliable tenants tied to the strength of the primary sector.

In summary, commercial property investment offers the potential for a stable, lease-based income stream and for capital growth, making it an excellent complement to farming. Success requires understanding the fundamentals – yields, leases, tenants, and timing – and applying the same diligence as you would to any major farm investment. Listen to experts, do thorough due diligence, and think long-term.

With patience and care, commercial property can provide financial resilience and a valuable legacy for farming families.

Interested in finding out more? MyFarm offers a range of off-farm investment opportunities for wholesale investors, including our current offer: a lease-based rural commercial property investment, forecast to pay monthly distributions of 7.5% p.a. To find out more, visit myfarm.co.nz

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