

A Guide To Commercial Property Investing

You will require an understanding of the complex market factors in play, including differing financing requirements, property management options, leasing arrangements and a good understanding of all the potential risks in order to be successful in commercial property investing.

Understanding these factors will provide a solid and reliable basis for the selection of commercial investment properties being either retail, industrial or office that will succeed.

The following considerations will help to identify suitable locations and opportunities for investment.

Understand the commercial property market drivers

The fundamental driver for commercial property growth is demand. However, commercial demand is driven by economic factors as well as population growth.

Growing commercial markets are supported by strong international, national and local economies, and a strong economy is fundamental for any successful commercial property investment.

Factors that influence demand are:

Demographics

Different segments of the population seeking new opportunities, are motivated to relocate to different locations hence create an increased (or new) demand for healthcare services, childcare facilities etc.

Lifestyle is also becoming more important, with more people want to work closer to their homes. "Lifestyle" suburbs with small offices are on the increase.

Infrastructure development

The development of infrastructure can increase the demand for commercial property. Affordable land and access to good roads provides impetus for logistics/transport companies to move their storage/warehousing facilities.

Interest rates

The Reserve Bank of Australia manages inflation with the use of interest rates. Increasing interest rates helps slow growth; the cost of money is higher and the rate at which companies can grow is reduced. Consumer spending is also reduced with increasing rates. This slows the demand for both commercial and residential property.

Retail spending

Consumer spending increases demand for products, hence the requirement for warehousing and retail outlets increase.

Population growth

Strong population growth has led to new suburbs are being developed, and shopping centres and other stores and services are required.

Understand the risks

Being awareness of the risks will enable an investor to be prepared for adverse circumstances.

Risks to be consider:

📌 Lease terms

A long term lease of between 3–5 years or more can have advantages, but it may take a long time to find a tenant if the property becomes vacant. An investor will need to be able to handle the carrying costs during a prolonged period of vacancy.

📌 Supply/demand

Changes in supply conditions can create potential problems. An increase in new property coming onto the market in the same area creates a threat to existing tenancies as tenants may look to upgrade or expand. Strong supply can also reduce potential yields.

📌 Size of commercial property

The bigger the property size, the harder it can be to lease than a smaller property. It will cost will also more to hold.

📌 Changes in infrastructure

Changes in infrastructure will have a beneficial and negative effect on commercial property returns. Infrastructure can attract commercial investment to an area, but it can also have a negative effect of drawing tenants from existing areas.

Investment structures

Commercial properties can be purchased by companies, individuals, SMSF's, trusts (Property, Unit and Family trusts) as well as syndicates.

Finance

Financing a commercial property is a more complex and detailed process than residential funding. There are specialist lenders that only deal in commercial property finance due to the complexity of some transactions. Banks will typically lend up to 70% of the value of the property depending on the purpose and type of the security.

The Lease

The details in the lease are critical, and considerations are:

- 📌 Leases can be three, five or even 10 years with an option to renew.
- 📌 Rental increases linked to CPI.
- 📌 The tenant pays all outgoings. This includes rates, water, body corporate fees, etc.
- 📌 The tenant makes good any physical changes. This enables the owner to rent to a suitable tenant when the existing tenant leaves.
- 📌 Leases over a certain value need to be registered with the Department of Lands (NSW) or equivalent in each state.
- 📌 Some types of tenancies may require special council approval, such as medical centres, childcare centres etc.

Management

Commercial agents (instead of residential agents) usually manage the commercial property, and undertake the negotiations in trying to arrange attractive deals for matching or aligned businesses.