

## Maximum capital performance

Whilst residential is the easiest and most widely understood form of property investment, many individuals have missed out on the substantial wealth which can be created in alternative property sectors, such as commercial, retail, industrial and lifestyle.

### Commercial property investment

Usually characterised by large capital requirements, commercial property investment requires an understanding of highly segmented markets and sensitive supply/demand factors. Yet it provides some distinct investment advantages over its residential counterpart:

- **Commercial yields are usually higher.** In the order of 7-to-9%, commercial yields are three times higher than the current residential yields of 2-to-3%.
- **Growth prospects.** Commercial investments prospects are bright with strengthening rents, falling incentives and tightening sale yields contributing to strong capital growth. This position is supported by many analysts, including *Ernst and Young*, which is forecasting rental increases of 9% over the next three years and *BIS Shrapnel* forecasting capital gains of 68% over the same period. In contrast, residential boomed with the market softening. Many analysts contend that this market is overpriced with some believing a correction of between 30-to-50% is possible. Notwithstanding such forecasts, this market is clearly depressed and any short/medium term capital gains will be poor.
- **Diversification.** By investing in diverse assets one can ensure that they are not unduly exposed to the market forces of one sector.
- **Recoverable costs.** In commercial property the vast majority of costs, such as rates, taxes, insurances, maintenance and make good costs are payable by the tenant whereas for residential property it is the landlord who is responsible for such costs.

### What, when, where

When selecting commercial properties for maximum capital performance, it is useful to apply the maxim "What, When, Where", which can be summarised as follows:

- **What.** Purchase assets which have high land components, are functional, able to be let, and ideally possess development potential.

- **When.** This is concerned with the timing of the market cycle, that is, purchasing at the bottom and selling at the top of the cycle.

- **Where.** The market should have stable supply and demand, and ideally be a mature market.

In applying this maxim to the retail, industrial, lifestyle and apartment markets, it is clear today that these segments are either fully or overpriced. Conversely, at this time we see opportunities for astute investors to participate successfully in commercial property.

### What should you be looking for in a commercial property investment?

- **Lease.** Consider the length and terms of the lease, and how it impacts upon the property value. That is, will the property still be valued at its purchase price with or without the current tenant? Sometimes the quality of a tenant can inflate or deflate the value of a property. This is important as it gives you an appreciation for the underlying asset base that you are purchasing.
- **Land vs building value.** When considering a commercial property, obtain an opinion on what the land/buildings split is as a proportion of the purchase price. Land appreciates and buildings depreciate so it's essential to ensure that the land value forms the majority of the asset's purchase price.
- **Return.** What yield is the property going to return, and what are the requirements of the landlord and tenant in any leasing arrangement? Also consider the ability to release any commercial property, particularly where the property may be deemed to be of a specialised use or nature.

Opportunities can presently be found in the commercial property market in the range of \$5-to-50 million. For the great proportion of investors, this level is out of reach. However, property syndicates may provide investors with the opportunity to access commercial property investments at a fraction of the cost.

Look out for our next article on how to access syndicates and the benefits they provide such as cash flow and tax planning, as well as the potential to make strong gains in the current business-led investment cycle that is strengthening the Australian economy. [wcm](http://www.wcm.com.au)



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