

Buying your Commercial Property



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Introduction

While most business owners and investors have an understanding of the residential market, the commercial property market can be somewhat daunting.

But it needn't be so. Buyers who are prepared to spend time researching the market and carefully selecting an appropriate property can enjoy strong capital gains and, if you are an investor, solid cashflow.

Of course, business owners and property investors will have very different motivations for buying a commercial property and it's important to make sure you clearly understand the motivations for your purchase.

The business owner looking for premises to house their own business will have very specific requirements in terms of location, features and size.

The investor will be more focused on returns the property can produce.

The following eBook is designed to get first-time commercial property buyers on the right track. You'll find information about the different types of commercial property that exist and the three levels of research required prior to making a purchase.

You will also learn about the risks of purchasing commercial property and which experts can help.

Good luck and do your research,

James Thomson
Editor
Smart Company

The purpose test

There are two main reasons you would buy commercial property – as premises for your business or as an investment. While both groups of buyers will be looking for a property that is in the right location and has the potential to appreciate in value, the motivations and key buying criteria of both groups is likely to be quite different.

For the business owner, the key consideration will be finding a commercial property that suits the requirements and circumstances of your business. Your business premises may need to be close to key infrastructure, major suppliers or customers. It may need to accommodate specific pieces of equipment. If the business is in expansion mode, the property may need to offer room to grow.

For the investor, the motivations are likely to be much different. The investor will be more focused on the possible return to be earned on the property – factors to consider include the quality of the tenant, the stability of the lease, the rent the property is achieving and the likely cashflow the property will generate in any year. An investor may be less concerned with the precise location of the property and may also be prepared to look at different types of commercial properties.



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Types of commercial property

The terminology of the commercial property world is very different to that of the residential property market.

While residential property has two basic types – houses and units – the commercial property market can be divided into 20 different categories once you dig down into specific areas.

Here are the main commercial property types:

- Office – Office property ranges from multi-storey towers in the central business district through to single-level office buildings in the suburbs. CBD office buildings are typically categorised as being “prime” or “secondary” depending on their location, age and capacity.
- Retail – Another category that covers a wide variety of properties, from major shopping centres through to strip shops. Commonly-used categorisations include regional centres, sub-regional centres, CBD centres, neighbourhood centres and bulky goods centres.
- Industrial – This category can include factories, warehouses, depots and business parks. As with office properties, individual properties are typically categorised as being “prime” or “secondary” depending on their size and location.
- Hotel/entertainment – Australia’s great pub tradition and the importance of our tourism sector means these buildings get a category of their own. Australia’s hotel and licensed premises market is particularly active.
- Infrastructure – Privately owned pieces of infrastructure such as ports, rail, waste management facilities and road infrastructure can fall under the broad category of commercial property, although most opportunities in these areas will be beyond the scope of the first-time investor.

It’s also worth remembering that an individual property could span a number of these if it is what is commonly known as a mixed-use property. For example, it’s common to see developments that include office and retail tenancies.



When searching for property to buy or lease on realcommercial.com.au you can refine your search by these property types and more.

What buyers should be looking for

What you are looking for out of a property will depend on your purpose – that is, are you buying the property as a base for your business, as an investment, or both?

If the property is to be a home for your business, then considerations such as location, size and specific facilities will be crucial.

But there are a few items that every commercial property buyer should examine:

Yield - This is the most common word you will hear when discussing commercial property and it is the yardstick by which all commercial property investments are measured. Basic commercial property yield is calculated by taking the net income from the property in a single year (that is, rent minus costs) and dividing by the purchase price of the property.

For example, if a retail property was delivering rent of \$100,000 a year and had costs of \$30,000 a year, the net income would be \$70,000. If the property was purchased for \$1 million, the yield would be 7%.

Long-term average yields for retail property are between 4.5-7%, between 6.5-7.5% for office property and between 7.5% and 8.5% on industrial property.

Rent - The actual cash generated by a commercial property is crucial – strong cashflow is important, particularly if you plan to use the cash generated by the property to help finance a loan on the property.

Capital gains - Regardless of whether you are a business owner or an investor, you want the property you buy to appreciate in value over the long-term. Capital growth rates will vary from sector to sector, from year to year and from state to state, depending on the prevailing economic backdrop.



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Understanding the risks

Investing in commercial property is not without risk and beginners need to go into any purchase with their eyes wide open. [Some of the key risks include:](#)

- **Cost of entry.** Commercial property generally has a much higher cost of entry than residential property, so beginners will need to be sure they have their finances well planned and, if possible, equity in other assets to act as a safety net.
- **Maintenance costs.** While property outgoings (such as rates and utilities) are the responsibility of the tenant, owners are responsible for maintaining and improving the property. This can be expensive, particularly when it comes to complex mechanical systems such as air conditioning and lifts.
- **Location risks.** While the construction of a motorway near your property may help lift values, not every new nearby development will be beneficial. For example, the construction of a new shopping centre near an existing retail development may push rents down or push tenants away from your property.
- **Tenant risks.** If you are buying a commercial property as an investment, the stability and quality of your tenants will be crucial. Having multiple tenants might lessen the risk of having a single tenant who cannot pay the rent, but it can also mean more work managing various renewal periods and tenant requirements. Finding tenants can also be much harder in the commercial property market than in the residential market.

[There are also a few risks specific to buyers purchasing a property to house their business:](#)

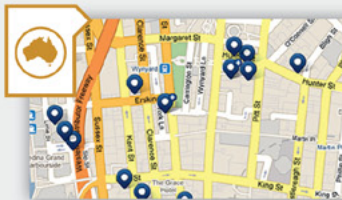
- **Capital risk.** Buying a commercial property to house your business can tie up capital that might be better employed for other purposes, such as funding expansion opportunities.
- **Business risk.** If your business starts to struggle, the pressure of maintaining and meeting loan repayments on your commercial property may further weigh you down.
- **Growth risk.** If you outgrow a commercial premises you own, moving can be a very expensive business. Furthermore, if your business requires a specific location and type of building or facilities, it may be difficult to let once you cease to occupy it.

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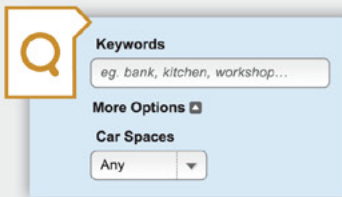
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The new Map view in the search results pages pinpoints the locations of the properties in the area you're searching.



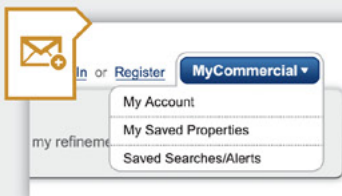
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Researching the market

Like any investment, a commercial property purchase needs to be carefully researched at three levels – a market-wide level, a location level and an individual property level.

At the market level, there are a number of factors to watch:

- Economic growth. Demand for commercial property is directly related to the performance of the economy – when growth is rising, businesses will be growing and looking for new premises as they expand. Look at long-term forecasts and focus on the specific areas (for example, a state or territory) where you are looking to invest.
- Interest rates. Perhaps the most important piece of economic data to monitor is interest rates, which will affect property valuations, tenant demand and, most importantly, financing costs.
- Employment data. Over the long-term, employment data has been shown to be a good proxy for commercial property demand. Where possible, get data specific to your potential investment – if you are buying in a particular state, closely examine employment data for that state.
- Vacancy rates. The vacancy rate for commercial property in your chosen market – that is, the proportion of properties that are currently not leased – is another important measure of demand at a point in time.
- Recent transactions. Commercial property buyers should monitor sales results and reports of leasing deals to get a feel for market trends.
- Industry-specific research. Major real estate companies, banks and economic forecasting firms regularly produce research on the performance of the commercial property sector and its various sub-sectors.
- Other investment returns. If you are buying a commercial property as an investor, it's crucial to keep an eye on investment returns from other asset classes, such as shares, residential property and fixed interest. If commercial property returns are unfavourable when compared to these other asset classes, investors may want to tread with extra caution.



Search the 'Sold/Leased' section of realcommercial.com.au to see recently sold or leased properties.

Researching the location

Once you feel confident that you've researched the market thoroughly and it is the right time to buy a commercial property, it's time to start researching locations.

Factors to consider when scouting locations for a property include:

- Demographics of the area. Demographic trends that might impact your commercial property purchase includes population growth, employment, housing structure and even the age of residents in the area.
- Business profile. What businesses can be found around the location? Heavy industry? Retail facilities? Business or office parks? All of these could impact demand for your property.
- Infrastructure. The proximity of the business to key transport infrastructure (ports, rail depots or road infrastructure) is always important, but will be particularly so if you are buying the commercial property to use as your business premises.
- Amenities. The proximity of a commercial property to amenities such as shopping centres and public transport can have a great impact on its attractiveness to tenants.
- Planning or regulatory changes. Potential planning changes can have a big impact on the future value of your product. For example, plans for a new motorway could mean your business becomes much more attractive to tenants. However, the building of new developments in your area could create the problem of oversupply.



On the new realcommercial.com.au, you can now search in Map view to see all property available in the area. Also using Street View and points of interest by TrueLocal you can really get to know the area.

Researching the property

You've picked the right location, you've zeroed in on what looks like the perfect property – now it's time for some serious due diligence. [There is a long list of items that you will need to check, including:](#)

- Condition of building and need for repairs or maintenance.
- Site access, including disabled access.
- Condition of utility services (water, sewerage, power).
- Parking and vehicle access.
- Land and building measurements.
- Distance to amenities (meals, banking services, postal service).
- Environmental issues (for example, site pollution due to previous uses of the site).
- Condition of heating/cooling systems.
- Condition of lifts.
- Condition of grounds.
- State of floor coverings.
- Pest control history.
- Fire services.
- Opportunities to expand or sub-lease space.

Bringing in experts to assist with the inspection of any of these items may be required, depending on your personal level of expertise.

The other major area of due diligence is on tenant arrangements. Buyers need to carefully scrutinise the contracts in place with tenants, paying close attention to the length of leases, terms and conditions and renewal details. Lease contracts can be lengthy and complex, so getting expert assistance is essential.



Find the commercial property that's right for you

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With the most office, retail, and industrial properties for sale or lease, you'll be able to find, compare, and research the commercial property that's right for you.

Expert help

Buying commercial property is not a simple process and first-time buyers should try and get as much help as they can.

As in the residential market, buyers' agents can assist investors and owner occupiers with the process of researching and selecting an appropriate property for a buyer's budget. Specialist commercial real estate agents can also help guide you through the buying process.

A lawyer with experience in commercial property is essential for a buyer of any experience level. A lawyer will be able to examine contracts for purchase, look over contracts that are in place with tenants and provide advice on tax issues.

An accountant could also provide valuable advice, particularly for business owners who wish to use the property as their premises and may need help modelling the financial impact of property ownership on the broader business. An accountant will also be able to advise a buyer on the tax implications of their purchase.

Similarly, a financial planner will be able to advise an investor on the impact of a commercial property purchase on their wider portfolio.

Finally, buyers will also need to seek the help of a bank or finance company representative specialising in commercial property.



Now that you have a good overview on what factors you need to consider when buying a commercial property, a good place to start your search is Australia's number one commercial property site, realcommercial.com.au. With great new features like map based searching, enhanced refinements and street search, finding the right commercial property is now faster and easier.