

Building a case for property

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Property investment is coming back into favour, but what is the safer choice for you – residential or commercial property? *Perrie Croshaw* reports.

THE global financial crisis has left some investors trapped in a state of paralysis.

Burnt by massive losses in the share market and nervous about the direction of property prices, they sit there, stock still, not knowing where to run – all cashed up with nowhere to go.

Martin Hession, head of property at Australian Unity Investments, suggests they shake themselves out of their torpor and carefully consider bricks and mortar.

“If you were looking at places to invest in the future, the worst area is cash,” he says. “With returns of say 3%–4% on cash, after tax and inflation, you are going out backwards.

“The most significant area of investment over the next few years will be in property. That’s probably where all the money coming out of cash will go,” he says.

So the next question is, what kind of property is best – commercial or residential?

“While the best returns are in commercial, your safest bet is residential,” says Peter Koulizos, university lecturer and author of *The Property Professor’s Top Australian Suburbs*.

Commercial property investment returns are high because it carries a higher risk – tenant vacancy.

“With a house, you can usually find a new tenant within a week or so, especially as the rental market remains tight,” he says. “But with the current economic crisis, it’s much harder to find a replacement tenant for your restaurant, warehouse, or office space,” he says.

And while you are doing your research, don’t forget to factor in trends toward companies downsizing, working from home, Internet shopping and mail-order business – which means fewer main street retail shops – and a fall in heavy industrial manufacturing.

So the real question is not commercial or residential, but how risk averse are you?

STICK WITH WHAT YOU KNOW

One of investment oracle Warren Buffett’s mantras is “don’t invest in something you know nothing about”. Based on this philosophy, GPs might want to consider investing in private hospitals or commercial medical rooms.

Mr Koulizos’ doctor recently asked him how he might start out in commercial property investment, so the author suggested the doctor buy his own building in which to work and rent out the other rooms – commercial property investing 101.

“He might use negative gearing to offset his high income. There are also real tax benefits for GPs doing this, especially if they consider buying through their super,” Mr Koulizos says.

But for many investors, residential investment remains the simplest property strategy.

Paul Do, investor and author of *I Buy Houses: The Property Investor's Handbook*, is wary of commercial property at present as it is driven by the business cycle much more than residential property.

And given the current economic climate, he says it's too early to tell which businesses will survive to pay the rent.

“In addition, the banks' lending criteria is much tougher, and interest rates are higher for commercial property than for residential property.”

He suggests that residential property prices may rise in the next few years due to low vacancy rates and high rental yields relative to interest rates.

But he says that timing your purchase shrewdly can make all the difference between having a profitable portfolio of properties working for you or struggling to hold and service an overpriced property.

“The right time to buy real estate was after the stock market crash in 1987, in the mid-1990s until 2000, and around 2007 onwards. Vacancy rates were low during those periods and the rental yields were relatively high compared with interest rates,” he says.

“Those two factors determine the buying zone for real estate.”

While there are some good property opportunities around, with the share market at half the value it was in 2007, “you would be mad not to buy shares now”, he adds.

Commercial versus residential property

Commercial property

- **Commercial mortgages require a deposit of at least 30 per cent. Lenders are stricter on borrowing criteria, and clean credit is always required.**
- **It can take months to find a new tenant.**
- **It's a more secure investment because leases are longer (three, five, 10 or 15 years) and they are often secured by bank guarantees.**
- **Rent is reviewed annually and is usually increased either by the CPI or by 4% – whichever is greater.**
- **Commercial property is easier to look after. If hot water or air conditioning breaks down, generally the commercial tenant will fix it. Tenants may look after the condition of the property better because the look of the property reflects their business.**
- **The capital return is often between 7% and 10 per cent.**
- **Rates are often higher but these costs are deductible.**

- Commercial property can provide greater tax deductions than residential through higher depreciation allowances.

Residential property

- Smaller entry cost. Mortgage rates are lower and you may even be able to borrow 100% of the purchase price.
- Leases are shorter (12 or 24 months) but properties are generally easier to let, meaning you will be foregoing rental earnings for a shorter period when the property is vacant.
- Residential property investors must pay all outgoings and other costs, including rates, taxes and body corporate fees, although of course this can be negatively geared.

Web resources

www.propertyweb.com.au

www.rpdata.com/indices/

www.prd.com.au/research/

www.gpsnetwork.com.au/Local-Government-Area-Research.asp

www.matusik.com.au/

www.adpia.com.au