



Eclass 3 - Which type of commercial property is right for you?

-The pros and cons of the 4 types of commercial property

Office space in commercial building is the first thing that people often think of when talking about commercial property. In fact it is only one type of 3 different types of commercial properties. Each type of commercial property has its own pros and cons. In this Eclass we go through the different types of commercial property; their pros and cons so you can work out which type of commercial property best suits you.

Offices/Commercial Premises

Strata offices are the easiest form of commercial premise to get started with. They are usually within a strata commercial building amongst other commercial buildings within a business district. The offices are described on a per square metre basis and when you go to inspect it, it's really a shell. Most commercial offices are carpeted but some commercial offices that have been just build do not have any fittings so you will have to pay for it to be painted and carpeted and put in partitions (if needed). Strata offices can be a low risk investment and therefore the return is often not as high as other commercial premises but it is often a low maintenance –set and forget type of investment. Unless you are thinking of buying multiple offices within one building or a whole floor of offices, you will typically only have one tenant with them on a 3x3x3 year or a 5x5x5 year lease. (We will cover leases in detail in the next Eclass)

Office tenants often tend to be more stable, in that it is unlikely your tenant will have any building issues that they can raise with you (except perhaps if the lifts aren't working properly (you just report it to strata). Office tenants, once settled in, may stay for a long time unless they outgrow the premise. This is because the cost of relocating and the interruption to their business can be more than a rent increase. This is especially true for legal and accounting firms or dental or medical practices. To these speciality firms their rent is often only a small fraction of their overhead based on what they charge their clients.

The outgoings for a strata office are often fairly low and being under strata it is unlikely to have any unexpected costs associated with it if the strata have a fully

funded sinking fund. A strata office is easy to manage yourself (we will discuss this in detail in Eclass 13)

Below are the pros and cons of a Strata Office

PROPERTY TYPE	Office/Strata Office
Pros	Cons
Easy entry to the market – some office suites can start as low as \$150k	Strata levies – depending on the age of the building and it's amenities the levies can be high (but your tenant may pay all or part of these levies)
Set and Forget Investment	Yields can be low – around 6-7% in CBD
Part of a Strata – so you don't have to get out building insurance or take care of common area expenses or organise security or cleaning	Special Levies for building maintenance may be high – air conditioning refurbishment or roof or external painting of the building or lift repairs can trigger special levies
Easy to value by the bank so the lending process is quicker	Capital Gains may not be as high as it is based on rental yields and the surrounding properties for sale
Easy to determine rent reviews and market rent based on others in the building	Rent needs to stay competitive as other similar properties may offer the same rent
If the building is in a good location then the tenant may be happy to pay a premium to be there	
Smaller spaces in CBDs may attract a premium – this is because most of the space in a CBD is geared for head offices and large companies so the space is often 100sqm + If you have a space for 50sqm or 80sqm that maybe attractive to smaller firms therefore they may pay a premium as such spaces are scarce	

Industrial/Warehousing

Industrial property includes storage spaces, warehousing or warehousing that have office and mezzanine floor combined. This type of property generally gives you the highest return which may be 10% or more but it also carries the highest risk. This is because it can take a long time to find a tenant if you end up losing your current

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tenant or if you purchase a vacant premise. (We will cover tenanted investment vs Vacant possession in Eclass 11)

While most industrial properties are on the outskirts of the CBD or in regional centres, with the development of the internet light industry complexes have become popular with the ability to have an office at the front of the property with a mezzanine floor to keep stock and the ground floor to move stock. There are often light industrial properties within 25kms of the CBD which often makes it easier to tenant and also maintain good capital gains.

Some industry complexes have individual warehouses so you can have multiple tenants in there thus reducing your risk of losing a big tenant.

If you purchase an industrial property like the Coates Hire one we discussed in Eclass 2 you will find that the lease is usually quite long as the site may have been converted specifically for that tenant. In this case you will have security of a tenant for 10 or 15 years.

Below are the Pros and Cons for this type of Property

PROPERTY TYPE	Industrial/Warehousing
Pros	Cons
High ROI	Harder to find a tenant – once vacant could take a long time to find a new tenant
Easy to manage – if you get a large national tenant it is a set and forget investment	Property could need capital improvements on it from time to time
Freehold investment – No strata	May have additional maintenance costs.
Good investment for Regional Areas as large companies tend to have larger more stable regional offices/hubs. Places like Albury Wodonga, Wagga Wagga, Orange, Singleton, etc.	Capital Gain maybe less in regional areas while the yield maybe high

Retail/Shopfront

Retail and shopfront properties include anything that is a ground floor premise. This may be used for any of the following or more

- takeaway shop,
- restaurant, café,

- clothing store,
- medical consulting rooms,
- dental clinics,
- chemist
- hair and beauty salons
- butchers
- banks and travel agents
- even gyms can sometime be shopfronts

Retail premises are the most versatile in their usage. Although the local council will often require a change of use application; it is relatively easy to convert a dress shop to consulting rooms to even a beauty or hairdressing salon. It is just as easy to convert a café to a restaurant to a takeaway shop.

Retail tenancies have gone through some major changes in recent years with the trusty newsagency and video stores dying out and with the needs of bank branches diminishing due to internet banking. As such it is important to find the right tenant for your premise (we cover this in detail in Eclass 12)

The key to retail properties is location. Do you want a retail premise within a shopping mall or within a strip of shops?

Answer: It depends on the traffic flow – so where you get the most amount of foot traffic. If you are in a shopping mall you will need anchor stores such as one of the major supermarket chains, as well as possibly a food court and some good clothing chains. Some town centres have 2 or 3 shopping malls so there is always one that is the top performer and one as the low performing one.

If the retail premise is to be within a strip of shops you will need to see what the property is surrounded by on either side and also how much foot traffic there is. Check if you are close to a bus stop or train station and a bank or a chemist to ensure enough foot traffic. You may find that one side of the street performs better than the other simply because one side has a public parking lot while the other side doesn't.

Below are the Pros and Cons of Retail Property

PROPERTY TYPE	Retail/Shopfront
Pros	Cons
Easy to convert to other tenancy needs	Usually strata – so strata fees
If Strata – less additional maintenance costs	More likely to have smaller local tenants over national tenants
Usually amongst other shops in a hub in a central location	May not get enough foot traffic resulting in lost of tenants who

	depend on high traffic areas for business growth
Rent can be more variable as shopfronts tend to be more unique – this is especially true if it is already fitted out and your tenant does not need to pay any fitout costs	Sometimes you may have to entice a new tenant by contributing to part of the fitout costs or paying for removal of the old fitout
Shorter Vacancies – Retail can be easily converted to other uses so it is often easier to find a tenant after one leaves	More likely to have break ins, damage to property and vandalism which is a flow on issue from your tenant
With the right tenant it can be set and forget investment	It may be time consuming in the beginning to find the right tenant

Mixed Tenancies

While there are mainly 3 types of commercial properties there is another type of commercial property that is called Mixed Tenancies which is for the higher end investors. They are typically freehold commercial buildings so expect to pay around \$1.5Million + in regional areas and probably around \$2.2Million+ in City areas. These properties can be up to \$10m or even \$20m.

Mixed tenancies is the term given to a commercial building premise where the tenants are a mixed kind. So you may purchase a freehold building that has retail shops downstairs and offices upstairs and a storage room/shed at the back of the building. Alternatively you may be interested in a commercial building that has a mixture of office and shopfront downstairs and residential units and storage upstairs. Mixed tenancies are almost always freehold buildings meaning there are no strata and you are the owner to the whole building. While the building is zoned commercial you can still have residential premises upstairs. These type of properties can also be zoned mixture of residential and commercial but is located in a commercial area or strip. This is because back 30 or 40 years ago the shop owners use to live at the back of the shop or on top of the shop. These residential premises has now been modified so you cannot gain access from the shopfront, usually there is a separate entrance at the back of the building or a separate doorway beside the retail shopfront that allows you access to upstairs Some of these residential tenancies have the option to be converted into offices with some minor layout changes (subject to council approval).

Here are the Pros and Cons for this type of property

Property Type	Mixed Tenancies
Pros	Cons
Less income loss – since you have smaller tenants, losing one tenant is only likely to be a small percentage of your cash flow overall	Can be time consuming to self-manage as there are lots of issues that may come up from different tenants all the time so this type of property is not a passive investment
Easier to find a tenant – smaller tenancies can often be easier to find a tenant for as they are often small local operations looking for an office or aspiring entrepreneurs wanting to start a shopfront business or a cafe	Renewals of leases can come up more frequently – requiring more time commitment on your part to negotiate the leases (even with an agent involved)
Freehold building meaning no strata fees or strata approvals needed for capital works or changes to the building	More out of pocket expenses such as common area cleaning, common area electricity, gardening and general building maintenance
Ability to charge higher prices for smaller rental spaces so maximising your rental return	Smaller tenancy leases may not be as secure as larger tenants
May have the option to strata the building then sell off each unit/lot individually for higher capital gain	

Tip – For mixed tenancies you want to make sure not one tenant is more than about 35% of your overall rental income. This is to safeguard yourself in case that tenant leaves. If you have one large tenant that is 50% or more of your incomes you might want to work out ways to increase the other tenants' leases or find additional revenues of income in your building to reduce that ratio. There are several ways to do that including looking at expanding the current property if you have space at the back of the building, signage space on the front of the building, converting a residential premise into an office or subdividing a current office.

Exercise

1. Now that you understand the different types of commercial properties and their pros and cons; go back to the IMs and the summary table you previously created in eclass 2 and make a decision on which of the three properties you are going to cross off your list of potential properties. You are to keep two properties you are still interested in and put aside the IM and summary table of the one you do not want. This can be based on what is covered today in eclass3 or on what is in the IM. Find a property out of the three that you think would suit you **the least** and eliminate it from the pile for now.
(even if you decide not to buy any of the 3 properties this exercise helps you to start narrowing down your choice and get a more in depth look at the ones you do decide to keep)
2. Once you have completed the above – go through your IMs and see if the leases have been provided as part of the IM, if not you will need to email the agent for a copy of the leases. We will go through different leases and lease terms in Eclass 4 and what to look for in a lease.