Investing in Premium Commercial Property space makes sound Financial sense

By SA Commercial Prop News 42 minutes ago

In the past private property investors struggled to get a foothold in the commercial property sector primarily due to the prohibitive costs of commercial property transactions.

However, the landscape has changed with the opening up of the sectional title market and more companies are now considering becoming owner-occupiers and saving significantly on rentals in the long term.

Due to the capital appreciation that property offers, as well as an income stream in the form of rent, investors regard it as an attractive asset. Investing in prime commercial property offers higher returns than investing in residential property, because the former is generally unaffected by large fluctuations in asset values. “Commercial property is also leased over a longer term than residential, which is generally only rented out for a year, meaning that considerable time and effort is required to find new tenants and conduct lease negotiations every year,” Jake Hoddinott of Barrow Properties points out. Owning Sectional Title units in the

Barrow is behind the R650 million development of Katherine & West in Sandton. Having launched in September 2011, almost half of the offices have already been sold to companies and private investors. “Owning sectional title offices in the Sandton CBD gives astute investors the opportunity to diversify their portfolios, while receiving secured annuity income and seeing significant capital appreciation,” says Hoddinott.

Buying vs. leasing

There are pros and cons for both buying and leasing, and ultimately the needs of a business, in both the short and long term, will dictate. Leasing offers businesses more flexibility and less commitment, as it is not tied into a long-term mortgage. This is especially important to consider if a company is new or in a growth phase. “Leasing suits listed organisations with external shareholders, who look for returns in the form of dividends and share value,” Hoddinott says. However, there is a level of prestige attached to owning office space and it makes sense for a mature, stable company to establish itself in its own premises within a business hub.

“A noteworthy benefit for owner-occupier businesses is that their property can be used as collateral to obtain financing or to fund future investments and this provides great scope for wealth creation. But when leasing, a company that has rented for say, 10 years, has nothing to show for it at the end of the lease period.”

In 2007, Barrow Properties completed a sectional title office development in Melrose Arch, Johannesburg. “Buyers have seen their investments perform exceedingly well despite the tough economy and this can be attributed to the prime location,” says Hoddinott. “There has been significant capital appreciation over the last five years. There have also been almost no vacancies since initial occupation and owners are now benefiting from strong rental growth from the renewal of leases. This has resulted in most of the units remaining in the possession of the original buyers.”

When leasing, the initial capital outlay is typically the first three months’ rent if the company has a good credit rating, and not the sizeable 20% to 30% of the purchase price that is required as a deposit when purchasing. In terms of rental fees, the market will dictate, but the benefit is that the payments are tax-deductible. When buying, a company can secure a long-term, fixed-rate bond and therefore the costs become a known entity.

“Many companies buy more space than they need at the time to accommodate future growth, and are able to sub-let the extra office space in the interim,” adds Hoddinott.

“Then there are the fit-out costs and whether you are a lessor or owner-occupier, these are always high. But as a lessor, consider having to pay for fit-out costs every time a lease expires and is not renewed. A benefit for buyers is that developers offer generous tenant installation allowances of up to R1 400/m^2 for a new building, which will presumably have a longer period of use than a fit-out under a lease.”

Generally, small to medium businesses are still leasing, but there is an aspiration to buy, while some of the bigger companies are leasing purely for the tax benefits. “So it really depends on your objectives. There is also the trend of property funds owning commercial space, but only leasing to large single tenants, Then there are some sectional title office owners selling space to private investors, which allows for direct investment into the property market, as opposed to investment in listed property funds.

“Some commercial developments offer an option to purchase after a period of leasing and this is an ideal, low-risk solution for a company to try out the office space and location first and if they like it, to purchase it,” concludes Hoddinott.

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