

How to Invest in Commercial Property in Australia



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Abstract

Investing in commercial property in Australia offers lucrative opportunities for generating stable income and long-term capital growth. This guide explores the essential aspects of commercial property investment, including market research, types of commercial properties, and financing options. It emphasizes key factors such as location, tenant quality, lease agreements, and current market trends to ensure a successful investment. Additionally, the document delves into legal considerations, tax implications, and potential risks associated with commercial property ownership. By understanding these fundamentals and leveraging expert advice, investors can navigate the Australian commercial property market effectively to maximize returns and achieve financial goals.



1. Introduction

Commercial property investment is a significant step toward building a diversified and profitable investment portfolio. In Australia, the commercial property market encompasses office spaces, retail outlets, industrial warehouses, and more, offering investors a range of opportunities to generate high returns and steady cash flow. Unlike residential property, commercial investments often come with longer lease terms, higher rental yields, and the potential for greater capital appreciation. However, investing in commercial property requires a thorough understanding of market dynamics, legal obligations, and financial strategies. Factors such as location, property type, tenant stability, and economic conditions

play a pivotal role in determining the success of the investment. This guide aims to provide a comprehensive overview of the Australian commercial property market, highlighting the steps, considerations, and best practices for making informed investment decisions. Whether you are a first-time investor or an experienced property owner, this resource will help you navigate the complexities of commercial property investment in Australia.

2. Why Commercial Real Estate Might Make For Better Investments

If you're thinking of investing in property, you may have found resources on how to fix and flip homes. Books and TV shows often show how to get involved in this space, and certainly if you time it right, you could get a quick return on your investment. The process is typically to buy a home that needs renovation, make changes and updates, and then sell for a marked-up price that covers your expenses and brings in a profit for your work.



While it may be appealing to try buying and fixing up homes, there are other real estate investments that you may want to consider as well. In my book, “The Insider’s Edge to Real Estate Investment,” I focus on commercial real estate investments in Brisbane. In the multifamily segment, I define these as properties with at least five units. There are other types of commercial real estate investments including office, retail, and development.

Given this, before rushing out to buy a single-family home and start renovating it, it could be worthwhile to compare the two types of investments. Once you understand the differences

between residential and commercial real estate transactions, you'll be better equipped to make a decision. You could even spot opportunities that aren't easy to find, and offer a higher-than-average return.

The Holding Times are Different

If you're in the business of reselling residential properties, you're likely making a purchasing decision that's based on the repositioning and selling of the asset. This will often depend on both the improvements that are made and the market conditions. If everything aligns, you could bring in a profit when you sell. The potential short-term gain will play a significant role as you consider a home to buy.

For commercial investments, the decision doesn't always focus on the later sale. Instead, it typically hinges on the cash flow. That's not to say that investors don't speculate; however, they tend to be more focused on the income that the property can generate. Based on what they find and how the property operates, they might plan to hold the asset for the long-term.

The Competition Varies

When purchasing single-family homes, investors often find themselves competing with end-users, who are other homeowners in the area. This can present a challenge, as the other buyers on the market might not be as concerned about their bottom line. They might be willing to pay a premium to get a certain amenity or move into what they view as their dream home. This means you may have to pay more than planned to get a home you were considering for a fix and flip project.

For commercial properties, investors are usually competing with other businesses and investors. Some may want to see if the place is vacant or not, as that will impact the cash flow. I often advise that it's better to buy a property that is occupied and brings in a stream of income, as opposed to a place that is vacant and needs a tenant.

The Buying Processes are Distinct

If you're looking for residential properties, you'll generally find them through a multiple listing service (MLS) or advertised as "For Sale by Owner." Finding an off market for a residential property is quite rare, so you'll be competing with the open market to get a single-family home. This means that usually everyone else has access to the same information as you.

Commercial properties often change hands through off-market deals, where properties are not publicly listed. This creates a more inefficient marketplace and could provide opportunities. You might be able to find a great place where you could add value and have less competition when making a bid for it.

Financing is Not the Same

If you're buying a residential property that doesn't generate income, it's rare today that a lender would offer you a non-recourse loan. In most cases, you can expect to have to personally guarantee the debt. This could add pressure as you fix it up and then sell to pay back the loan. In addition, when you sell, the proceeds could be considered ordinary income and taxed at a higher rate than what you might pay for the sale of a commercial property that has been held for a long time and brings in a long-term gain.

For commercial properties, you could be eligible for a non-recourse loan, meaning you won't have to personally guarantee it. In addition, you could benefit from other tax strategies later, such as carrying out a 1031 exchange when you sell to invest in other properties.

As you consider residential and commercial properties, it's true that people always need a roof over their head. As such, you could find more demand in the market than for a commercial property such as a vacant office building. Still, the ultimate decision will depend on your interests and long-term goals. Once you know the market in your area, you can choose a path that makes sense for your situation.

3. Steps to a Hot Commercial Real Estate Deal



Ask any real estate professional about the benefits of investing in commercial property, and you'll likely trigger a monologue on how such properties are a better deal than residential real estate.

Commercial property owners love the additional cash flow, the beneficial economies of scale, the relatively open playing field, the abundant market for good, affordable property managers, and the chance for a potentially bigger payoff from commercial real estate.

But how do you evaluate the best properties? And what separates the great deals from the duds?

1. Learn What the Insiders Know

To be a player in commercial real estate in Brisbane, learn to think like a professional. For example, know that commercial property is valued differently than residential property. Income on commercial real estate is directly related to its usable square footage.

That's not the case with individual homes. You'll also see a bigger cash flow with commercial property. The math is simple: you'll earn more income on multifamily dwellings, for instance, than on a single-family home. Know also that commercial property leases are longer than on single-family residences.

That paves the way for greater cash flow. Lastly, if you're in a tighter credit environment, make sure to come knocking with cash in hand. Commercial property lenders like to see at least 30% down before they give a loan the green light.

2. Map Out a Plan of Action

Setting parameters is a top priority in a commercial real estate deal. For example, ask yourself how much you can afford to pay and then shop around for mortgages to get a sense of how much you will pay over the life of the mortgage. Using tools like mortgage calculators can help you develop good estimates of the total cost of your home.

Other key questions to ask yourself include: How much do you expect to make on the deal? Who are the key players? How many tenants are already on board and paying rent? How much rental space do you need to fill?

3. Learn to Recognize a Good Deal

The top real estate pros know a good deal when they see one. What's their secret? First, they have an exit strategy: The best deals are the ones you know you can walk away from.

It helps to have a sharp, landowner's eye—always be looking for damage that requires repairs, know how to assess risk, and make sure to break out the calculator to ensure that the property meets your financial goals.

4. Get Familiar With Key Commercial Real Estate Metrics

The common key metrics to use when assessing real estate include:

Net Operating Income (NOI): The NOI of a commercial real estate property is calculated by evaluating the property's first-year gross operating income and then subtracting the operating expenses for the first year. You want to have positive NOI.

Cap Rate: A real estate property's "cap"—or capitalization—rate is used to calculate the value of income-producing properties. For example, an apartment complex of five units or more, commercial office buildings, and smaller strip malls are all good candidates for a cap rate determination. Cap rates are used to estimate the net present value of future profits or cash flow; the process is also called capitalization of earnings.

Cash on Cash: Commercial real estate investors who rely on financing to purchase their properties often adhere to the cash-on-cash formula to compare the first-year performance of competing properties. Cash-on-cash takes the fact that the investor in question doesn't require 100% cash to buy the property into account, but also accounts for the fact that the investor will not keep all of the NOI because they must use some of it to make mortgage payments. To uncover cash on cash, real estate investors in Brisbane must determine the amount required to invest to purchase the property or their initial investment.

5. Look for Motivated Sellers



Like any business, customers drive real estate. Your job is to find them—specifically, those who are ready and eager to sell below market value.

The fact is that nothing happens or even matters in real estate until you find a deal, which is usually accompanied by a motivated seller. This is someone with a pressing reason to sell below market value. If your seller isn't motivated, they won't be as willing to negotiate.

6. Discover the Fine Art of Neighborhood "Farming"

An excellent way to evaluate a commercial property is to study the neighborhood it's located in by going to open houses, talking to other neighborhood owners, and looking for vacancies.

7. Use a "Three-Pronged" Approach to Evaluate Properties

Be adaptable when searching for great deals. Use the Internet, read the classified ads, and hire bird dogs to find you the best properties. Real estate bird dogs can help you find valuable investment leads in exchange for a referral fee.

What Is the Meaning of Commercial Real Estate?

Commercial real estate is properties used for business purposes as opposed to residential or industrial purposes. This would include shopping malls, office buildings, hotels, and warehouses. Most commercial real estate is leased by tenants in Brisbane for a period of time whereby they set up their business and use the space to generate income. Commercial real estate can also be bought and sold for capital appreciation.

Can You Invest in Commercial Real Estate?

Yes, you can invest in commercial real estate—there are several ways to do so. You can invest through direct ownership, meaning you will purchase a commercial real estate property. You can rent it out and hold it for capital appreciation. You can invest in real estate investment trusts (REITs), which are entities that pool together capital from multiple investors and invest in commercial real estate properties. Crowdfunding platforms are also available for people to pool money and purchase properties.

What Is the 2% Rule in Real Estate?

The 2% rule in real estate states that a property is profitable if the monthly rental income is at least 2% of the purchase price. For example, if a property was purchased for \$500,000, it would need to have a monthly rental income of at least \$10,000 ($500,000 * 0.02$) to be considered profitable.

4. Financial Stability Risks from Commercial Real Estate

CRE market fundamentals are weak

Investors in global CRE markets are experiencing challenging fundamentals, especially in the office sector. Leasing demand for commercial property, particularly in the large office segment, is being affected by structural and cyclical headwinds partly brought on by the COVID-19 pandemic. A shift towards working from home has reduced office attendance rates globally, to around 60–70 per cent below pre-pandemic levels in some major cities (Graph 1). In the retail segment, the shift to online shopping has weighed on demand for many years, with the transition to online shopping gathering further momentum during the pandemic. At the same time, the industrial segment has benefited from the associated

increase in demand for logistics space. While there is some uncertainty over the outlook for these structural trends in leasing demand, the forecast slowdown in employment growth and consumption in advanced economies over the coming years is expected to weigh on demand across all CRE markets.



Lower leasing demand for office space has led to an increase in vacancy rates. Office vacancy rates in the United States and Hong Kong are now above levels seen during the global financial crisis (GFC) (Graph 2). In the United States, vacancy rates have increased the most in the largest cities and are expected to remain high as new projects currently under development reach completion. In Europe, the increase in prime office vacancy rates has been less pronounced as there has been an undersupply of prime office space in many cities alongside a greater return-to-office rate following the pandemic.

In Australia, the central business district (CBD) office vacancy rate is around its highest level since the mid-1990s, with vacancy rates around 14 per cent across both prime and secondary grade CBD offices. While strong growth in employment has helped sustain demand for prime grade office space, this has been more than satisfied by a large amount of new supply in recent years. The prime office vacancy rate is expected to remain high over the next few years as the pipeline of already commenced office construction projects reach completion. As in other countries, leasing conditions for secondary grade offices are even more challenging. There has been no growth in demand for secondary grade stock over recent quarters. Information from the Reserve Bank's liaison program suggests that many employers' preferences are shifting to higher quality office space (which often have higher sustainability ratings) over secondary to encourage workers back and to meet environmental goals.

Owners' profitability and asset valuations are declining

Higher vacancy rates and debt-servicing costs are weighing on office returns. High vacancy rates have reduced landlord income, through both higher levels of vacant stock and downward pressure on 'effective' rents (which are adjusted to include incentives attached to leases, such as rent-free periods and fitouts) on new (including renewed) leases. In Australia and the United States, effective rents on new leases remain around 5–10 per cent below pre-pandemic levels (Graph 3). Office market conditions are significantly weaker in Hong Kong, where effective rents are 25 per cent below pre-pandemic levels. In Europe, where a comparable measure of effective rents is not available, market commentary suggests effective rents have been more resilient, reflecting lower new supply, stronger tenant demand and stable lease incentives.

Alongside weak rental income, higher interest rates are adding to indebted CRE owners' debt-servicing costs. Combined, these factors are lowering interest-coverage ratios (ICRs) (earnings over interest expenses) and placing pressure on the returns accruing to indebted commercial property owners. That said, some owners have been at least partially shielded from these developments to date, through fixed or inflation-linked rent increases on existing leases, longer term fixed-rate debt or interest rate hedges.

In addition to increasing debt-servicing costs, higher interest rates weigh on CRE valuations as CRE assets are valued by discounting expected future income. Aggregate CRE valuation measures have begun to fall across most countries. In the United States, Europe and the United Kingdom, aggregate CRE valuation measures have fallen by around 10–20 per cent since mid-2022 depending on the valuation measure used (Graph 4).[1] The large fall in Europe partly reflects that the interest rates used to discount asset valuations have risen by more than in other jurisdictions. In Asia, Hong Kong has seen the largest decline in valuations; in other markets, such as Singapore, valuations have been more resilient as vacancy rates have remained low and rental growth positive.

In Australia, aggregate valuation measures have fallen by around 10 per cent in the office segment and by around 8 per cent in the retail and industrial segments since mid-2022. This is broadly consistent with recently announced revaluations of CRE assets by some listed Australian real-estate investment trusts (A-REITs) and superannuation funds.

Further falls in valuation measures are likely, though the magnitude and pace are uncertain. Discount rates on CRE valuations have not yet fully reflected higher interest rates as valuations typically take some time to reflect changes in fundamentals. This is because transactions are infrequent (particularly during periods of heightened uncertainty) and costly, and they have long lead times so sale prices tend to lag actual conditions.

The share prices of listed real-estate investment trusts (REITs) can provide more timely (albeit imperfect) information on valuations, as REIT shares are highly liquid and their value largely reflects estimates of the value of trusts' underlying holdings of CRE.

5. How to Buy Commercial Real Estate



Commercial real estate investing can be a lucrative venture for those with the right experience or for those who hire expert advisers. If you are new to investing in commercial real estate properties in Brisbane, there are a number of factors that you should consider before investing, including the risks and benefits of the investment, the type of property you want to acquire, and the best way to protect your personal assets. Each type of commercial property brings with it unique challenges and it is best to surround yourself with experienced investors and professionals to help guide you through the process.

Evaluating Your Real Estate Investment

Understand the different types of commercial real estate. Commercial real estate isn't just shopping centers and office space. Instead, the term refers to any property used for business purposes, included residential spaces leased out to tenants and raw land that will be developed.

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Analyze the risks of commercial real estate investment. In deciding to purchase a property, a potential owner must consider the risks as well as the potential benefits.

Examine your investment strategy. While some residential real estate investors will purchase, rehab and resell a property for a profit within a small time frame, commercial real estate investment typically requires a longer time commitment. Some experts recommend that commercial property investors hold onto the property for at least ten years to see a significant and stable return on their investment. If you are looking to make money quickly, with little time commitment, commercial real estate may not be your best option.

Find financing. Generally, individuals cannot finance the purchase of a commercial real estate venture on their own. In order to raise the significant amount of capital that is required in a commercial real estate investment in Brisbane, the investor will generally have to find outside financing. This means applying for a commercial loan, working out seller financing with the current owner, or finding partner investors to raise the funds and to help guide the investment.

Locating and Retaining Experts

Find an experienced commercial real estate broker. In order to locate and acquire prime commercial real estate, you should hire a commercial real estate broker who has significant experience with commercial properties.

Find a commercial real estate attorney. These attorneys will be experienced in dealing with contracts, property law, and state and local laws regarding real estate transactions. You want to find an attorney who has experience representing commercial real estate buyers.

Hire a certified public accountant (CPA). You want a CPA who is experienced working with commercial real estate transactions. A CPA can help you evaluate the financials of a property, advise you about its investment potential, prepare financial statements and review contracts (although this will primarily be the responsibility of your attorney).

Locating and Inspecting Properties

Explore a variety of types of commercial properties. When deciding what type of commercial property you want to purchase, ask your broker to explain the different types of commercial properties and the benefits and drawbacks for each. Even if you have invested in commercial property in the past, you should still make a full evaluation of what type of property best suits your current needs.

Determine available uses. In addition to finding the right location, your property must be zoned for the type of business that you want conducted.

Investigate why the owner is selling the property. There can be any number of reasons why a person or business is looking to sell its commercial property holdings.

Examine potential expansion. While you may have a modest or semi-modest approach to your investment initially, you should always be thinking about future expansion of the property. You should determine if there is room for growth or are there leasing alternatives if your business fails to thrive.

6. Tips to Manage Commercial Property Effectively



Commercial property ownership is easy, but management can be challenging when you are new to the industry. Many first-time investors find it hard to supervise the administrative and operational work related to the assets. Savvy investors with diverse portfolios usually hire a property manager to collect rent and maintain common areas. They become the bridge of communication between the landlords and the tenants. However, new investors may not require the services of a manager and can take charge of the responsibilities.

Besides rent and maintenance, property owners must also manage other elements related to commercial leases. These include lease renewal, relationship management, repair,

restoration, safety, and marketing. Here are a few tips for managing commercial property effectively. These will help manage the properties financially, physically, and responsibly.

1. Supervise Your Commercial Property

If you have acquired Brisbane commercial real estate, you must ensure that you are always aware of the asset's condition. You must visit the space often to understand how the tenant maintains it and how it appears from the outside and inside. As the property owner, you must know the regulations and permits required to run a business from the space.

You must be aware of the current market value of the property, cost of outgoings, trending rents in the location for similar assets and monthly maintenance costs. Landlords should have complete knowledge of zoning laws, council rates, taxes and other regulations in Queensland that can impact their income and vacancy periods. Understanding and monitoring the property is vital for easy management.

2. Maintain the Property for Better Income



Maintenance is an ongoing activity that should be taken seriously for upkeep of the property. The landlord must plan the servicing of appliances in the building after a few months and get the walls repainted whenever the paint starts chipping or fading. They must keep evaluating the infrastructure of the property and hire landscaping services to keep the outdoor area looking green and manicured.

Regular and on-time maintenance of the entire space ensures the heating and cooling are working properly, the electrical systems are in order, and there are no plumbing-related issues. The tenant is responsible for the damages caused to the building during their operations, and the landlord must oversee the repair work to ensure quality. They must also

check if the tenant is using the property as per the norms and state laws and is not violating any of the clauses of the commercial lease. Inspections can help prevent the breakdown of machines that can affect the tenant's operations and lead to losses.

3. Upgrade and Enhance Property Value

As the property ages, it starts losing its value. However, the depreciation in value can be reversed by upgrading the commercial real estate Brisbane. Landlords must follow the latest industry trends and adopt them to create an attractive space that can attract and retain tenants. Regular enhancements can also help generate capital appreciation at the time of the property's sale.

Many property owners add new features to increase the value of their real estate in Brisbane, such as smart lights, energy-efficient lighting, solar panels, rainwater harvesting systems, low-flow toilets, chemical-free wall paints, adjustable and adaptable furniture, movable partitions, green spaces, breakout zones, etc. These amenities help increase the appeal and price of the property.

4. Build Lasting Relationships With Tenants

One of the significant tasks of property management is maintaining lasting relationships with tenants. It helps to keep the tenancy trouble-free and prevent disputes that can escalate and lead to litigations. Landlords must perform their duties according to the lease agreement and act fairly while dealing with the lessees.

They must meet their tenants face-to-face regularly to build rapport and foster a strong bond. This will also help to renew the lease agreement for another term, which can reduce the cost of looking for a new tenant and managing the expense of the vacancy period. Communicating and maintaining transparency is vital to building a relationship based on trust and respect.

5. Automate Repetitive Tasks With Software

Technological advancements are not only helpful for businesses but also property owners. They have helped in the adoption of software and tool that aid in automation of exhaustive and time-consuming activities. Owners with diversified portfolios need to keep track of rents collected from each property, arrears and evictions, inspection schedules, management costs and maintenance records.

Property management software can help maintain all records, streamline accounting, and allow online rent payments. It has features for tracking the maintenance of Brisbane commercial real estate and managing leases. It keeps track of compliance and helps send messages to tenants about rent and maintenance.

6. Hire the Best Teams for Operational Tasks



Property management involves various tasks including landscaping, plumbing, electrical work, commercial cleaning of common areas, etc. The landlord must hire the best people in the business to deliver these services and ensure the longevity of the real estate. They also need the services of an accountant and a lawyer to deal with the lease related responsibilities.

Whether they need to create the budget for the property or follow up with a tenant for rental payment, they need the assistance of a professional. These experts can make the management part a cakewalk for the owner and free up his time. They can also help reduce vacancy periods by listing properties and marketing them effectively.

7. Pay Attention to Safety and Security

Safety is of utmost importance in the current age. The landlord must offer high-quality security services on the premises because businesses have become vulnerable and can be targeted by competitors. The building must have CCTV cameras, fire alarms, authorised card access, smart parking, and control room for remote surveillance. The tenant must follow the workplace health and safety laws to avoid injuries and fatal accidents.

Owners of commercial real estate in Brisbane must train the guards and workers on-site in fire drills and emergency action plans. The lifts must have emergency systems to keep the occupants safe in case of a breakdown. The landlord must conduct mock drills and risk assessments to ensure the property and its occupants operate in a safe zone.

Conclusion

Investing in commercial property in Australia can be a rewarding endeavor, offering opportunities for consistent income and long-term growth. However, success in this market hinges on careful planning, market research, and an understanding of the unique factors that influence commercial real estate in Brisbane. By assessing key elements such as property location, tenant quality, lease agreements, and financial feasibility, investors can minimize risks and maximize returns. Additionally, staying informed about market trends, legal obligations, and tax implications is crucial for making sound investment decisions. Engaging with industry professionals and seeking expert advice can further enhance the likelihood of achieving financial goals. Ultimately, with strategic planning and due diligence, commercial property investment in Australia can be a powerful avenue for wealth creation and portfolio diversification.

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