

COMMERCIAL REAL ESTATE INVESTOR'S GUIDE

**Making money as a
commercial property investor
in New Zealand**

Compiled by Peter Aranyi



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To Pearl, forever

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What to look for in a commercial investment

SOME ATTRIBUTES TO LOOK FOR when you're considering a commercial property are common to the whole range of classes. Others are more important (even *essential*) for a successful investment in one sector but less significant in others.

Land area

General rule: The bigger the better. Size *does* matter in commercial property.

Some investors rush out and buy a building for its return or income but ignore the fact that it's sitting on only a small plot of land. Always remember what you're buying is the *land* — forever and a day. The building is only there for 20–30 years, sometimes less. The land remains, and the size of that land (and what you can do with it) is critical. The land value is what you should be looking for. A good piece of advice is to forget what's on it now and look to the future — *buy the*

biggest piece of land you can get.

The major disadvantage when buying unit properties (unless you own them all) is that you can't redevelop the land at will without consulting the other unit owners. It's better to buy stand-alone buildings — with as much land as you can get. If you make mistakes in a commercial investment a large piece of land will help you get out of the problem. If you buy a problem property with a small piece of land, you're in trouble.

Siting (building position)

Is the building sitting at the front or to one side or in the middle of the site? This will have an impact on future extension, the development options and carparking. It's much better if the building is to one side of the section, or in a corner — so you can expand or develop adjacent to the existing buildings.

If the building is poorly sited it may be that your only options are to relocate it or demolish it — both expensive.

With a big piece of land and a building sited in a corner, you can build on other parts of the site, perhaps even signing up a tenant before you build.

Market rentals

You *must* know what market rentals on commercial buildings are for the various classes in the areas you are considering. This is crucial simply because market rental for an office building may be \$100 per square metre, so if you have 10,000m², that's 10,000 multiplied by 100 — that's your market rental per year. This is basic to your comparison of different buildings.

Crucially, you need to know the market rentals so you can recognize a bargain when you see it.

It also helps to know the basic building costs. You need to know what it would cost to replicate the building somewhere else, because new space will compete with your building for tenants.

Remember to allow for refurbishment costs when considering market rentals. At the end of a lease, you may have to refurbish the building to get a new tenant.

Hot tip

Remember rental income determines your commercial investment's value. Always keep up to date with rents in your area.

Traffic flow patterns

Consider both foot traffic and vehicle traffic.

This is absolutely imperative for retail and determines your rental returns. It's a numbers game. For every 100 people who walk past a retailer's door, perhaps 50 will come in sooner or later, and 30 will buy something.

Don't buy a retail investment in an area where nobody walks past. It's generally this simple: for retail, if people don't walk past then the business won't work. As a landlord, foot traffic determines the value of your property. Across the road you could have an identical building, but with only 60% of the foot traffic because, say, it's on the shady side of the street (people like to walk in the sunshine, especially in the morning). The rental of that property will be at best 80% of the building across the road, but typically only 50%–60% of the rental. You can get foot traffic figures from the Valuers Institute and sometimes from your local authority.

Hot tip

Buy on the sunny side of street. One side will have more sun than the other. The building with sunshine in the morning will generally have more foot traffic (see above). Yes, the sun does move during the day, but this general rule is worth noting.

Industrial buildings need to be located in areas where they're easy to access by vehicle, not just big trucks (although that too is necessary, see below). More and more, industrial buildings are being converted to mixed use premises — where widgets are being made or stored at the back of the building and sold at the front. To sell products successfully your tenants need people driving past their door, and some street visibility, which translates into free advertising.

If possible, get an aerial view of your target area to help you see the traffic flows. Go to the local authority and get aerial photographs. The council can also give you traffic flow figures for most arterial routes.

If you're buying industrial, put yourself in the position of truck drivers: can they deliver goods to this building? A large truck and trailer can't get down narrow streets — and if they can't, you've cut out a range of potential tenants.

Services

Services in modern buildings may include such things as data-cabling, plumbing, lifts, and heating. Generally air-conditioning is a must in most office or retail buildings. If these services are not well set up the installation (or retrofitting) can be quite expensive. Much more technology goes into a building these days. If you're talking to an accounting firm, the first thing they'll ask is, "Where can we put our phone system, jetstream, computer servers?"

Companies today are very power hungry and need power and data-cabling to feed their myriad computer workstations. It's essential that your building can accommodate their needs. Chances are, when the building was designed most businesses didn't have computers (let alone networks) and air-conditioning was opening a window; that's all changed.

When you're looking at purchasing an old building make sure you are able to fit the new services without too much expense. Get on a ladder and look above the ceiling tiles. If there's space between the ceiling and bottom of the next floor (or the roof), check whether you can get cabling, ducting, maybe even air-conditioning in. Make sure you have room. In buildings where you can't, you often see ducting running around ceilings, floors and walls which is much inferior to hidden cabling and services. In many cases, the ceilings of one floor are the concrete floor of the level above, hence the reason for facilities to be on the walls. Get a consultant to report on the viability of the building for expanding services.

Also, toilets can be a big issue. To add one toilet to a building can be expensive. Count the number of toilets, check council regulations and make sure you have enough for your projected number of occupants. In an office building, if the tenant hires more females, the law is that they require more toilets than males. (Strange, but true.)

Frontage, visibility — profile to the street

This is of great significance to your tenants. How much of the building faces the street? The bigger the frontage the better. Many older buildings are long and narrow at the front, and therefore invisible (worthless) from a street frontage and promotional point of view. Tenants know the cheapest advertising is their street frontage and therefore want a profile. A building that people can drive past and *see* is worth more

than a better building tucked away down an alley.

All types of businesses need this visibility — not just retailers. Office tenants want profile for prestige. These days even industrial tenants such as furniture manufacturers want visibility from the street for their ‘factory shop’.

Good aspect ratio — depth to width

When it comes to valuing floor space in retail investments, space at the back of a deep narrow shop is almost worthless. It’s much better to have a wide shop than a deep one.

What to look for: if you have a ten metre frontage (width) you want a depth of no more than about 30 metres. (A 15 metre frontage pays more rental.) About a 3:1 aspect ratio is best.

A valuer will value space near the front of the shop more highly per square metre than space at the back — and that’s realistic.

Carparking

It used to be just the bosses who needed a carpark; now everybody does. A building with carparks will be far more attractive to tenants. If a company has 25 employees, you will be asked to supply five to ten carparks. It’s much harder to find tenants for buildings which don’t have carparks.

Hot Tip

Don’t buy an office building without carparks (or some cunning plan to provide them) as you won’t tenant it.

A good rule of thumb: one carpark per 100m².

Handy to public carparking

Your retail or office building must be handy to public carparking. Shopping mall designers make sure that very

few carparks are more than 50 metres away from the door. Experience has shown that people aren't willing to walk further than this. This applies even if they run marathons or even the Coast-to-Coast race as a hobby. People just won't go shopping there if they have to walk too far from their car.

Also, watch the local council: be aware of any plans to take public carparks away from outside your shop — or to put planters outside as a beautification project. If people can't park near your shop, there'll be less foot traffic.

Hot Tip

Less foot traffic = less business = lower rent = less value

Transport access

This is an indispensable requirement in every class. If a manufacturer can't get goods delivered to (or taken away from) an industrial building, then they won't lease it from you — simple. A lot of deliveries are made by big truck and trailer units these days, not the little bread vans of yesteryear.

Truckies need to be able to get in and out without drama. An otherwise great building down a narrow street is useless. It's also much better if trucks can drive *around* the building — or have a turning area in your yard — rather than being forced to drive in and back out of the same driveway.

When evaluating a building, an architect can draw circles of different sizes on your plan to show you the various truck turning circles.

Stud height

Stud height is the height of the walls or the ceiling height. As we have seen, in commercial investments the floor area is the basis of your rental amount. Particularly for industrial properties, rentals on commercial properties are calculated per square metre (or square foot). This is completely different from residential rental properties where rent is basically so many dollars per bedroom, maybe with a factor for transport.

For example, if you have a building with say, 1,000 square metres floor area, that 1,000m² is multiplied by the market rental per square metre for that type of space in your location to calculate an annual market rental — which in turn will give you the value of the building. (See the section on Cap rates.)

But both tenants and landlords these days understand that it is silly measuring in just two dimensions (the floor area — so many square metres), as in many industrial buildings and warehouses people stack things *up*. If the ceiling is twice as high in one building as another, effectively you have double the storage space (cubic metres or m³), which gives you half the rental rate. Industrial tenants are aware of this and the market says ‘the higher the better’.

Hot Tip

Aim for a stud height of six metres or more, with four metres the absolute minimum.

Container doors

Containerisation has become prevalent. Many industrial tenants need to either take deliveries from container trucks or load their outward goods onto a container truck. You need to be able to back a container truck into most industrial (and some retail) buildings today, and if you can't, you cut out half

the tenant market. An otherwise suitable building with low doors will be harder to let. With six-metre high doors, you'd have a bit to spare.

Clear span

Clear span means the building doesn't have any internal columns supporting the roof. It's cheaper to build a building *with* columns — because without columns in a large building the walls need to be thicker and the roof frame stronger. Don't buy a building that has a lot of pillars in the middle. Go for clear span. Also, pillars generally mean lower ceilings — which means your industrial tenant won't be able to drive high fork hoists and store as much as in a higher stud building.

In a retail building with pillars, tenants have more trouble working out their internal traffic flow. Retailing is very sophisticated these days and designers will look at an area, lay it all out and work out the patterns of how people walk. From research, designers know that when people walk into a building they will generally turn right. So they design their stores to lead people down a path that takes them through the shop, to the back of the building — and create 'hot spots' where their high margin items are sold. (Some stores are more subtle about this than others.)

If you have pillars all through your building, it reduces your potential tenant's options; they can't do all that they want — which means, given a choice, they won't rent your building! Instead of getting a tenant to pay you \$500 or \$1,000 per square metre, you may find yourself limited to \$200 per square metre.

Other developments in the area

Look at what is actually happening in the surrounding area. Other developments can have a major effect (positive or negative) on your target building and what you intend doing with it. To find this information, talk to agents and valuers, go to your local council and get all the building permits released in the area. Physically go and look at things happening. Build and utilize your contacts and networks. This is imperative. Find out what's going on.

Brand-new developments tend to charge more rental per square metre (because they have to cover their costs, and being new, can often get it). This tends to drag up the prices of space nearby — but only if you as landlord are aware of it.

You can spend a lot of time very valuably drinking coffee or chatting with contacts on different occasions and gathering all the information you need to get your deals. This is called Market Knowledge — gained by getting out there and talking to the right people (not fixing holes in walls).

Prestige

The 'prestige factor' is critical for office buildings. Most companies (or their managers) prefer prestigious buildings. Some firms, such as lawyers or accountants, like to look important and prefer big 'trophy' buildings. The key areas are usually the foyer and entrance way. The offices themselves can be made to look nice in almost any building but the foyer and entrance may take more work. Often companies set out to make their foyer look like a hotel lobby, with couches and coffee tables to make the environment useful as well as attractive.

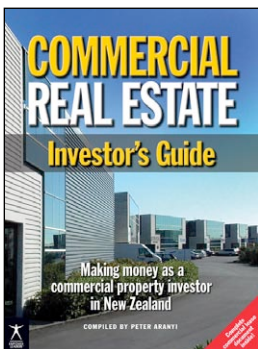
To evaluate this factor, when you look at a building, ask yourself, "Would I be happy to put my own name on it?" — that's what you want your tenant to do.

Environment

Designers have come to realize that the environment *around* a building is significant. Staff want to work close to a gym, or go for a latte at a nearby cafe.

Hot Tip

Consider investing away from home. Don't just invest in your own backyard — as you probably should with your residential properties. With commercial investments, it doesn't really matter how far away from home the building is. You're generally dealing with longer-term lease agreements made with people of sound commercial mind. They pay the rent because if they don't you can lock the doors within seven days and their business will fail. You can also get very attractive deals in less fashionable towns other than the main centres.



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