WHICH INVESTMENT? – INDUSTRIAL – OFFICE – RETAIL - RESIDENTIAL?

It is generally accepted practice, depending on investor needs, that any well-constructed investment should include an appropriate split between shares, property and cash. A good property portfolio should include an appropriate split between industrial, office, retail and residential investments, in order to spread the risk as each property type performs differently at different times of the cycle.

What are the major differences between these four alternatives and what are the supposed advantages, or disadvantages of each? A major reason for investing in property is the need for a regular, secure long term income with capital growth, essentially maximising cash flow over an investment period.

If one accepts that net cash income is the main criterion, which investment will maximise cash flow?

RESIDENTIAL: The impact of The National Credit Act and the newly promulgated Consumer Protection Act affords tenants opportunities to vacate early, thus adding additional risk to the investment. However, under current Financial Institution practice where buyers are struggling to get finance, demand for residential rental accommodation is high i.e. tenants are plentiful.

INDUSTRIAL: Offers an affordable investment range of R1 000 000 to multi-million rand properties. Routine maintenance, remedial work at lease-end, painting, and minor refurbishment paid by landlord, little or no new tenant installation costs. Expenses in the R9/m² - R11/m² range, generally between 15% and 18% of gross income.

OFFICES: Same investment range as industrial - from R1 000 000 to multi-million rand properties. Operating costs are high, particularly for buildings with extensive common areas and lifts. Routine maintenance, minor refurbishment paid by landlord, new tenant installation costs could be significant from R 400/m² to R 800/m². Expenses range from R15/m² to R25/m², between 20% and 25% of gross income.

RETAIL: There is a dearth of retail sectional title schemes, so entry level is normally over R3 000 000. As retail tenants generally require very particular finishes, they bear the costs of installation. Landlord costs include routine maintenance, remedial work at lease-end including painting and minor refurbishment. Little or no tenant installation costs are offset by rent free periods for the tenant. Expenses in the R 20/m² to R 25/m² range can be as high as 30% to 40% of gross income. Landlord costs increase dramatically in shopping centres with 24 hour passive and manned security, cleaning and facilities management as well as centre and promotions management. However in a Shopping Centre the loss of a tenant will impact less on cash flow as the risk is spread, unlike a single tenanted stand-alone retail property.

Operating costs, Rates, CID, sectional title or business park levies should be covered by tenants, or at the very least the increases should be paid by tenants. However, if the building is empty all of these will be covered by the owner. Routine internal maintenance should also be covered by the tenant, however, periodically this cost falls on the owner when space is vacated. Operating costs are far higher in multi-tenanted buildings than in stand-alone buildings.

Utility/Consumption charges include electricity, water, sewerage, gas, chilled air for air conditioners etc., ideally tenants pay utility charges, but availability of these services is borne by the landlord when the space is vacant.

There is the risk of no income when a single tenanted property loses its tenant, possibly over an extended period of time, while a multiple tenant investment minimises this risk.

Industrial is easier to manage as it involves less refurbishment and is less subject to location demand changes, it is therefore ideal for an inexperienced property investor. Sectional title offices and retail also offer an uncomplicated investment, however multi-tenanted buildings are more complicated and require more sophisticated management. Office tenants are often viewed as the most stable, while retail tenants and locations are vulnerable to many factors.

Economists say that we are heading for a double dip recession - which explains why vacancies are all still increasing.

These notes are essentially a summary of the various investment possibilities. As with any property investment, a proper due diligence assessment is always recommended.

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