Commercial property investment - the do's and don'ts

Traditional savings vehicles may not always be the best option for small and medium enterprises (SMEs), says Jeremy Lang, regional general manager at Business Partners Limited, investing for growth may be more beneficial than sitting on a lump sum of cash.

Jeremy Lang, regional general manager, Business Partners Limited

Lang says that in the current economic environment, investing in property may be a viable option for SME owners to consider as a long-term savings mechanism.

“In 2016, industrial property was the top performing sector in the South African property market, with a total return of 13.6%. Over the last 10 years, it has proven to be a relatively stable and resilient asset class in terms of generating positive returns over the medium- to long-term,” says Lang. “As such, both commercial and industrial property are good investment options for small business owners to consider in current economic conditions.”

Lang says that quality commercial and industrial property in South Africa continues to generate positive risk adjusted yields, especially in the larger metropolitan areas, and that property is generally a stable asset class as it is less exposed to shocks in the global economy. “Any of the imminent setbacks to the global and local economy will reflect immediately in the JSE indices, but not necessarily in property values.

“Property is an asset class that can generate monthly cash flows as well as capital appreciation where value cannot be eroded as quickly in comparison to some of the other asset classes.”

Lang, however, says that although property generally offers good returns, it does require effort to ensure that these are maximised. He provides SME owners with a list of factors to consider before taking the plunge into property investment:

Timing: Although any form of savings should be kick-started sooner rather than later, it is imperative to only buy property once a business is established and operations are relatively stable.

Affordability: If the business is currently operating from a rented space, consider the current rent paid and compare it to the proposed bond repayment (include the property rates and taxes, maintenance expenses and deposit). It is important to ensure that the business’ cash flow is healthy enough to cover all of these expenses and repayments. Ensure that affordability checks have been carefully calculated and that the bond repayment is within the business’ reach.

Financing: While property can be an income generating asset, borrowing too much money can leave the business over in-debted. Be careful not to over pay for the property, and if the property needs to be financed, ensure that the monthly repayments are within your means.

Due diligence: When considering investing in commercial or industrial property, business owners should conduct the necessary technical due diligence – especially around the structural integrity of the building, business zoning rights, site development plans and any other restrictions listed in the title deeds of the property.

Don’t rely on inflation: When planning to invest in commercial property it is imperative to note that in the current economic environment, rental escalation is under pressure, and that a 10% increase may be unrealistic. Business owners also need to be cautious about the rising costs related to owning a property, including rates and taxes, maintenance, security and general cleaning costs. If this is understated, it can materially affect the return on investment.

Diversification: As a property investor, consider diversifying the investment portfolio by investing in properties in different geographic locations and industry sectors.