The pros and cons of Investing in Residential or Commerical Property

2014 saw a distinct rise in the number of valuations we were doing for investment portfolios in both the commercial and residential sectors.

This was a promising sign with regard to the recovery of the local and national economy as the confidence to invest in property depends largely on the perceived positivity of the marketplace. In our industry we observe how buying your first investment property can be the start of a large portfolio of investment properties and the investor becomes well versed in the marketplace and the property types. We are often asked by investors what the pros and cons are regarding investing in property and what the differences are with regard to investing in the residential sector versus the commercial sector. So what are the pros and cons when it comes to investing in either sector?

RESIDENTIAL	COMMERCIAL
Lower Returns	**Higher Returns**
Generally lower returns are expected when you invest in residential property. As a landlord you pay all outgoings such as local authority rates and insurance premiums and therefore your rental return is a GROSS return. For example, if you take a Median Rental for a three-bedroom house at $320/week, this will give you $16,640 gross per annum. If you apply that to the Median Sale Price (MSP) for a dwelling in Hawke's Bay at $280,000 this indicates a gross return of 5.9%. This is the rental return only and does not take into account any capital gains due to market growth in values.	Generally speaking, 7% - 9% is the norm for good quality commercial investment properties in Hawke's Bay. However the wider range is from 5% - 13% NET which takes into account a much wider spectrum of quality types.
More Management	**Less Managment**
Residential properties need a reasonably high amount of management due to tenant issues, vacancies, maintenance and repairs. Tenant turnover in the residential sector can be more frequent.	Tenants occupy under a term lease. Security of tenure for a tenant who is busy running a business is important and it is in their best interests to maintain the building so they can operate in a manner acceptable to their business.
High Maintenance	**Less Maintenance**
Potentially more maintenance is required by the residential landlord. This can be especially typical if you get a bad tenant. Generally speaking, if you buy at the low end maintenance tends to be higher, however, the gross return will also be higher.	The lease terms stipulate who is responsible for what, however, with the majority of leases we see the tenant is responsible for the interior and the landlord the exterior and structural items such as the roof. Also, you normally employ tradespeople to do your maintenance as opposed to residential when you often undertake the jobs yourself.

Less Obsolescence

Over time fittings date and wear. Kitchens and bathrooms will require renovations possibly over a 20 to 30-year period.

More Obsolescence

Obsolescence can be a bigger issue for commercial property especially if it is special purpose. To attract good tenants, the space provided needs to be relevant. Renovation/ refitting of premises can be very expensive and in some sectors may be required every 10-20 years.

More Tenant Turnover

As a valuer I normally allow anywhere up to 4 weeks a year as vacant. However, finding a new tenant is relatively easy.

Less Tenant Turnover

Commercial investments tend to see a lower tenant turnover. Typically, a term lease is in place; say in the rage of 5 – 10 years, and often with rights of renewal. Tenants build goodwill out of a location and there is value to the business to stay put. Finding new tenants can be more difficult and take longer periods.

Easier to Sell

Residential investment properties tend to sit in the lower capital value bracket which means that if you want to sell the property there are more buyers able to buy. This means that buying an investment property is highly competitive but easier to sell.

More Difficult to Sell

Commercial properties are possibly more difficult to sell especially if the property fits into a high capital value bracket and there are less buyers to sell tol. Seismic rating and issues surrounding a properties earthquake proneness have also impacted considerably in this area.

Finance Criteria is More Flexible

Most stakeholders or lending institutions will lend up to 80% on a residential mortgage, sometimes they have a slightly different criteria for investment property.

Finance Criteria is Less Flexible

Trading banks have their own criteria, however traditionally they have a much lower equity ratio – say 60%. Stakeholders believe there is more risk and hence the requirement to have more equity in the property when you purchase.

Seismic Strength

The Building Act 2004 long term strategy focuses on buildings that are most vulnerable in an earthquake. It does not include small residential buildings.

Seismic Strength

After the earthquake events of Christchurch, a building's seismic strength has become increasingly important to tenants, owners and stakeholders. The general sentiment and acceptance level from the market is when a building's strength is 67% or greater.

As always every property is different in terms of size, locality, construction, age and condition, surrounding properties and its proximity to services and amenities that are relevant to its market sector. The above should be used as a general guide only and we advise you seek professional advice with regard to your own personal property investment strategy.

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