

Non-listed commercial property still under strain

By [Zeenat Moorad](#)

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Although reports indicate a dramatic improvement in SA's commercial property industry, gains are limited to listed property funds, Gary Palmer, CEO of asset-backed lender, Paragon Lending Solutions said on Tuesday, 24 April 2012.

"Promising growth in the commercial property industry reported on last week was largely limited to listed property funds and will not be felt by investors investing in non-listed property," he commented.

The SA Property Owners Association's property index, International Property Databank (IPD), last week revealed that listed property funds achieved a return of 12.2% compared with 2.6% for the equity market and 10.1% for bonds.

Palmer said that while listed property funds were enjoying good growth at the moment, the average investor wanting to invest in commercial property was still facing significant challenges - especially in terms of the pressure on rentals, increased vacancies and reduced escalations.

According to Palmer, capital growth on listed property was strong because listed properties generally had strong tenants and good governance.

"Listed funds are doing well as they have access to funding and tenants are often stronger. This is a key indicator of a good commercial property investment. However, it is much more challenging to obtain these factors in the non-listed market," he said.

Apart from vacancy issues, the size of deposits required for the purchase of a commercial property has increased over the past years, adding more pressure to investors.

In the past, a deposit of 20%-25% would have been sufficient to secure the purchase of a commercial property.

Nowadays, buyers are required to put down in excess of 35%-40% of the price as a deposit - which causes significant problems for an investor.

Palmer pointed out that even though interest rates were at an all-time low, this was not necessarily helping investors.

"Banks used to lend at prime-minus rates. However, investors would be hard-pressed to find a bank that will lend at anything less than prime. Therefore, even though interest rates are lower, the benefits are not being passed on to the average investor," he noted.

This means that many investors looking to put their money in commercial property will find it difficult to obtain funding from the banks unless they put down a substantial deposit and unless there are long term leases in place.

Investors should seek alternative funding from second-tier lenders who could provide funding against commercial property even though the leases may be short term and may not be considered blue chip by the bank, Palmer advised.

"Alternative lenders will look at the potential future income that the property can generate, while the banks focus purely on the serviceability of the loan," he added.

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