Become a commercial property value investor, not a market investor

By Tony Bales

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Now is the perfect opportunity to become a value investor in commercial and industrial property and to ditch the generalist market investor approach. For the past few years, most physical industrial and commercial properties have shown good capital appreciation and income returns, and many investors took to purchasing any available commercial or industrial property. However, this will not be the case moving forward.

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Enter the age of value investing

The market has changed. Wise investors are seeking out properties in specific locations with specific fundamentals – properties that offer an investment that will grow at an above-average rate. Enter the age of value investing.

Value investing is investing in a property that has been undervalued or where one can purchase the property at a below-market price. The specific benefits are an above-market appreciation in either the capital value or rental income or both. In a sophisticated market, finding properties that offer value may involve sifting through a lot of various opportunities.

What is value for one investor may not be value for another. For example, a passive investor may offload a property to one who has the capacity, time and inclination to develop it and unlock the potential value. Investors all have different profiles, such as knowledge, capacity, skills, etc. thus ensuring constant value arbitrage in the commercial and industrial property market.

It is also important to distinguish between the listed property sector and investing directly in physical property. Unfortunately, the listed property sector has had a torrid last 18 months. Investing in listed shares is different from investing in specific physical properties. It is vitally important to understand what the drivers of the listed property sector are versus the drivers of physical commercial and industrial property. Value investing in the listed property sector is different from valuing investing in specific properties.

How does an individual investor go about determining what is an appropriate “value purchase”?

Firstly one needs to understand the difference between price and value. Price is what one pays, while value is what one receives. This may sound like a simple statement, but its implications run deep. Buying investment property at too high a price isn't good value and is the surest way to limit future returns. However, commercial property can double or triple in value for an investor who can spot hidden growth potential, develop a strategy to unlock that untapped value and execute that plan.

Here are a list of questions that buyers should ask themselves:

- Do I have an excellent understanding of the property I wish to buy?
- Does the purchase price offer upside potential?
- What is it about this property that will ensure its value grows faster than other properties?
- What do I need to do to ensure this potential value is unlocked as soon as possible?

The highest returns come from buying commercial investment property at a price that doesn't reflect its inherent attributes. Value investors follow strategies to find, and mine, those features. The key here is to understand exactly what is value for oneself. The greatest value investor of all time, Warren Buffett, did not buy any technology shares during the boom in the late 1990s – a move for which he faced major criticism. However, his actions were well rewarded in the end as today he is one of the wealthiest people in the world. And he has now included tech shares in his investment portfolio.

Value has no borders

Another aspect to understand is that of internationalisation.

Investors must see the value concept as one that has no borders. What may seem overpriced to South Africans might be value for international players due to the higher yields. Conversely, when the US dollar strengthens, we must expect the SA property market to offer less value than more developed countries, and hence investors will move funds to those countries that offer them more perceived value. It’s simple. We are part of the international economy and cannot ignore the fact – it affects our commercial and industrial property market and the concept of value.

The most successful commercial property investors in the next 24 months are going to be those focused, knowledgeable players who exploit the concept of value investing. As Warren Buffett says, be a property analyst, not a market analyst.

ABOUT THE AUTHOR

Tony Bales, principal dealmaker, Epping Property