Time to look at other property options rather than residential

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With price growth for the housing and apartment market expected to slow and possible price falls in some cities, some investors are opting for non-residential property.

Forensic psychiatrist Michael Giuffrida prefers industrial and commercial property.

Sydneysider Michael Giuffrida has made good money investing in non-residential investment property. Photo: Jessica Hromas

The 69-year-old, who lives on Sydney's North Shore, runs a self-managed super fund with his wife, which holds non-residential property.

"I've been involved in buying, developing, leasing and selling mainly industrial but sometimes office and commercial property since I was 18 years old as a sideline," Dr Giuffrida says.

Much of that has been investing directly in properties rather than investing through a fund manager.

He has been in syndicates for the past 15 years. He is still a member of a syndicate that has strata offices that are currently being sold.

Non-residential properties, such as office blocks in Australia's capital cities, have tenants that are locked in for between three and five years.

Often, the net rental yield will be easily at least twice the typical 2 per cent that is earned on residential property.

Dugald Higgins, senior investment analyst at researcher Zenith Investment Partners, says residential property tends to have strong capital appreciation over time, whereas most of the returns from non-residential property are from income with moderate capital growth.

Residential property investors will often "negatively gear", which is where the losses on the investment can be used to reduce the income tax they pay on their salaries.

The aim of many of these loss-making residential property investors is to eventually sell the properties for big capital gains.

But analysts are saying easy capital gains of recent years on residential property are becoming much harder to come by.

BIS Shrapnel, in its latest Residential Property Prospects report, says nearly all capital cities are building apartments at record rates. BIS Shrapnel has long been pointing to oversupply in some parts of the inner-Melbourne apartment market in particular.

Oversupply in inner Melbourne is already biting investors. For example, Corelogic figures show almost 12 per cent of those selling Melbourne units during the first three months of this year sold them at a loss.

Winston Sammut, managing director of Folkestone Maxim Asset Management, says non-residential property includes not only office blocks, retail property and industrial property, but also child care centres, retirement villages and even service stations.

The drivers of these investments can be very different from those of residential property, Sammut says.

His Folkestone Maxim A-REIT Securities Fund has made good money from Australian real estate investment trusts (A-REITs), the trusts that are listed on the Australian sharemarket, that invest in industrial property.

Demand is being driven by the internet retailers such as Amazon who need to have warehouses in the suburbs of major cities from which they can ship their goods to customers, Sammut says.

Jason Huljich, the chief executive of Unlisted Property Funds at Centuria, says commercial property, such as office blocks, can be very good investments.

He says the best commercial property investments are those with increasing demand due to new transport links and a lack of other developments.

The favoured tenants are government organisations and ASX-listed companies that tend to have long lease periods, he says.

Investors have a number ways that they can get exposure to non-residential property.

There are the property securities funds, such as Winston Summut's, that are unlisted managed funds that invest in A-REITs.

Units in these are bought and sold just like shares. Fund managers aim to select the trusts that will do better than the market after fees and costs.

They are the easiest way for small investors to get instant diversification with daily access to their money.

There are property syndicates that are managed by AMP, Charter Hall, Centuria and Australian Unity, among others.

Typically, a single property such as an office block is bought, where the investment minimum is between $10,000 and $50,000.

The investment term is usually five or seven years, during which time unit holders cannot get their money back. After the initial investment term, a unit holder meeting is called to decide whether to sell the property or extend the term.

Investors receive income along the way. When sold, investors hope to receive some capital gains on their initial investment capital; though that's never guaranteed.

The third route is to invest directly in A-REITs.

Analysts says well-diversified A-REITs pay a fairly consistent 3.5 to 6 per cent a year with expected capital appreciation of 1 or 2 percentage points above inflation over the longer term.

However, being listed their unit prices can be affected by sentiment.

For example, the prices of listed property trusts fell sharply during the global financial crisis.

Some analysts are warning that following the very strong performances of the A-REIT sector over the past several years, the valuations of some A-REITs are looking stretched.

The A-REIT sector has produced an average annual total return (income plus capital appreciation) of 18 per cent over the past five years.

Winston Summut says a lot of money has been invested in A-REITs from offshore, which has helped push up prices.

Offshore investors often have interest rates that are close to zero and they find the yields available on A-REITs very attractive, he says.

Sammut says the very good performances of the A-REIT sector cannot last.