**01:**
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# The case for investing in Australia's commercial property market

## In a lower for longer environment (that's gone on longer than most anticipated), the commercial property sector is holding its own.

Australia's interest rates are low and staying low. Just when we thought it couldn't possibly go any lower, at October end the Reserve Bank of Australia (RBA) cut the cash rate to a historic 0.10% and confirmed rates will not be raised for at least the next three years.

While interest rates have been low for some time – the cash rate was 0.75% this time last year – the speed at which rates have fallen has certainly fueled investors' fears for their future income levels, particularly retirees.

Still, such an environment doesn't necessarily mean fewer opportunities; opportunities are still there, just not in the usual places.

Australian investors' – particularly retirees' – love affair with residential property is well known but, as AMP Capital's Christopher Davitt[01] points out, it may not necessarily be to their benefit.

"Over the last 20 years or so residential and commercial property have given about the same sort of return at about 8%. But the lion's share of the return from residential property comes in the form of price appreciation or capital growth," he explains.

This makes a lot of sense for those that are still working and can negatively gear the property due to very little income, he says.

But it's a different story for those who are approaching or already in retirement.

"A lot of people reach a point where they step back from work and they need their investments to work for them, providing a regular and reliable income, and this is where commercial property can play a role," Davitt says.

Unfortunately, commercial property hasn't always been the easiest sector to gain access to and some of the vehicles that are available aren't quite as safe as an investor might like. For example, investing in a listed property trust opens investors up to daily pricing risk, while being a part of a syndicate means money being tied up for lengthy periods of time.

By investing in AMP Capital's open-ended Wholesale Australian Property Fund investors can avoid concentration risk, instead accessing a diversified mix of properties, sectors, locations and a wide range of tenants.

The key, Davitt says, is securing well located buildings that will draw a lot of tenants: "We don't want purpose-built, specialised facilities where, if the tenant leaves, we're going to be a price taker because there's only a limited pool of tenants that will take those buildings."

Some of the 26 assets in the portfolio include office buildings outside of city CBDs, industrial warehouses and smaller shopping centres, home to about 400 tenants across a variety of industries, none of which account for more than 5% of fund revenue.

The properties typically fall within the $20-$250 million price range, which Davitt describes as somewhat niche, being that they are beyond the price point of private investors but not large enough to be on the radar of institutional and offshore investors.

Tenants within the retail portfolio include Woolworths, Coles and Aldi, while the likes of Visy Industries and Jaguar Land Rover can be found in the industrial portfolio. The office portfolio is home to both corporate and government tenants, at both the federal and state levels.

The fund also uses low debt; it can go up to 25% but typically targets 15%. Other funds of its calibre typically use 30-40% of debt, Davitt says.

Uniquely, investors can also redeem their investments monthly, offering access to liquidity when they find themselves in need. Another added bonus is zero performance fees and no sell spread.

Of course, the elephant in the room in all of this is the COVID-19 pandemic which has seen lockdowns and restrictions imposed, having a detrimental impact on many a commercial property and their tenants.

However, within the fund, occupancy has remained high, sitting at 96% as at October; valuations also rose in September for the portfolio and across all sectors.

And, as protective measures ease, Davitt says it looks as though the pandemic may have some positive outcomes for investors over the mid to long term.

For example, in the office space in the post-COVID era, tenants are looking to move away from the CBD to cut down on rental expenses.

"At the same time, there's investor interest because they're seeing tenants come into these markets," Davitt says.

"Our investments in Mascot in Sydney, St Kilda in Melbourne, Southbank in Brisbane and Mawson Lakes in Adelaide have set us up well for the next phase of the cycle."

When it comes to retail, the fund targets small, neighbourhood shopping centres that are anchored by major supermarkets and/or fresh food.

A recent report by Shopping Centre News found about half of Mini Guns – shopping centres with a gross lettable area of between 6000 and 20,000 square metres – saw improved performance in the 12 months to July this year, while those that reported falls were able to keep these below 5% for the most part.

This was largely because the majority are local and convenient for shoppers and, with many essential businesses operating within them, were able to avoid the closures or partial closures forced upon the likes of Westfield malls.

For AMP Capital's fund, fashion retailers comprise just 2.8% of the portfolio, instead opting for retailers that provide services that are difficult or impossible to access online, such as hairdressers, beauty salons, optometrists, and gyms.

"These characteristics make the income rather robust and that gives us confidence of being able to generate that 5% yield," Davitt says.

Available on all major platforms, the AMP Capital Wholesale Australian Property Fund is currently paying a distribution of 5.75%; this, at a time when 10-year bonds sit at 0.75%.

"For many investors, that's reason enough [to invest], but it's also worth thinking about the pricing side," Davitt notes.

"Often after there's been aggressive falls in interest rates, we see asset values and commercial property prices rise and I wouldn't be surprised to see that happen early in 2021 with the charge led by international investors that see Australia as a great place to invest." **FS**

**The quote**

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