FINANCIAL REVIEW

There's a buying opportunity in commercial property, but it won't last

Cashed-up investors that act fast can pick up assets at good prices.

Sam Tamblyn *Contributor*

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It's a sad irony for some property investors that just as interest rates are starting to come down, they can no longer hold on and are selling up.

And it's a stark reminder for property players that more than just one or two rate cuts will be needed to reinvigorate the commercial property sector.

A lot of these vendors bought their properties or started developing them in the past three to five years, when interest rates were sitting at record lows and have held on through the commercial property sector decline, hoping for an improvement.

The best return potential is for quality offices in blue chip locations close to infrastructure. **Bethany Rae**

There's a buying opportunity in commercial property, but it won't last (15 April 2025)
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But the rapid rise in interest rates has been accompanied by a surge in construction costs and softer market conditions, meaning owners have to offer disproportionate incentives to secure tenants.

With a decline in many commercial property values compared to purchase prices and the erosion of investors' equity, banks are losing patience with developers who can't meet repayments and are pushing them to sell up.

This dynamic creates an opportunity for cashed-up buyers to pick up assets at good prices, including some below replacement costs, just as it looks like the tide is about to turn.

A good example was the recent sale of 1-3 Como Street in Melbourne's Malvern, a newly built office building, which was listed for sale by a residential property developer after construction costs became unmanageable.

RF CorVal, a Sydney-based boutique real estate fund manager, bought the Malvern property in late 2024 for just a touch over $18 million.

That represents about a 35 per cent discount to the original asking price of about $28 million, which was sought in early 2024 before the property was repossessed.

The Como Street sale was unusual in that it was actively marketed as a distressed sale. Usually, banks let owners sell properties on their own terms because vendors don't want to market a property that could be perceived as being in trouble.

What it means for potential investors is that they have to be alive to opportunities, line up financing and get themselves a seat at the table when vendors are seeking expressions of interest, only make bids at prices that make financial sense, and not wait for the green light of a "distressed sale" whereby the interested buyer pool is likely to increase.

You'll never know what sort of price someone is prepared to accept unless you're part of the process and put in an offer via an expression of interest, private sale or auction campaign.

This can create opportunities, especially for patient investors who are prepared to wait out a process and let a property come to them via an agent or potentially a receiver.

The best return potential is for quality offices in blue chip, central locations or locations close to transport and other infrastructure.

Many investors over the past few years have been caught out buying properties in the middle or outer rings of Australian cities where the fundamentals aren't as strong and then having to offer generous incentives and sometimes additional capital expenditure to generate sales or secure tenants.

Don't count on too many rate cuts

One of the things that got distressed sellers in trouble was making very bullish assumptions about the assets they purchased.

And when these overly optimistic projections fell short for whatever reason – difficulty finding tenants, surging construction costs or high interest rates – there was no spare capacity in the numbers to keep meeting repayments, and equity erosion took place.

It's a good lesson for investors – take a conservative approach when to financial modelling. Investors need to buy into these assets with an entrepreneurial but also realistic mindset. It means, for instance, that they shouldn't bank on a cascade of rate cuts this year, with the risk that US President Donald Trump's enthusiastic pursuit of trade tariffs could reignite global inflation.

Investors should be taking a back-to-basics approach, although arguably they should never take their eyes off the fundamentals no matter how hot the market. Rather than buy and hope, they need to secure assets with real cash flows and work them hard to drive returns.

Distressed sales are concentrated on development sites and offices, but there could also be potential opportunities in retail and industrial assets. But investors need to think long and hard before buying an unfinished project because replacement costs are often higher than sale prices, so there might well be better value in existing properties.

The market for these assets looks like it's close to a turning point, where the fundamentals are aligning and will reward investors who buy conservatively. But the opportunity won't last forever.

If rates come down further as this year progresses, more and more investors will come back into the commercial property sector, potentially seeing increasing competition and asset prices.