



**MAKING THE LEAP
FROM RESIDENTIAL
TO COMMERCIAL
PROPERTY**

PROPP

PortalTM



WHY TRANSITION TO COMMERCIAL PROPERTY?

The residential buy-to-let sector is becoming increasingly difficult to navigate following changes to taxation, legislation and rental reforms. Many investors are turning their heads to commercial.

This guide is designed to help residential property investors understand the benefits, challenges, and key steps involved in making the switch.

Whether you're looking to diversify your portfolio or take advantage of higher yields, this guide will provide the insights you need to make an informed decision.

WHY COMMERCIAL PROPERTY?

Higher Returns

Commercial properties typically yield between 5-10%, while residential properties average 3-5%.

Long-Term Leases

Longer lease agreements with business tenants mean fewer turnovers and more predictable income streams.

Portfolio Diversification

Investing in commercial assets adds variety and resilience to your portfolio.

If you're wondering how to get started or what pitfalls to avoid, this guide is for you.

HOW DOES BEING A COMMERCIAL LANDLORD DIFFER FROM RESIDENTIAL?

1. Lease Agreements: More Complex and Customised

Residential:

Tenancy agreements are typically short and standardised, such as Assured Shorthold Tenancy (AST) agreements in the UK, which are often 6-12 months long.

Commercial:

Leases are bespoke, often tailored to the specific needs of the tenant and the property. They can be much longer, commonly spanning 3, 5, 10, or even 25 years. They typically include rent reviews, often linked to inflation or market rent and break clauses.

2. Maintenance and Repairs: Tenant Responsibility in Many Cases

Residential:

The landlord is usually responsible for most repairs and maintenance, including structural issues and appliances.

Commercial:

In many cases, tenants are responsible for maintaining the property under Full Repairing and Insuring (FRI) leases. This includes repairs, decoration, and sometimes even structural maintenance.

3. Tenant Relationships: Professional vs. Personal

Residential:

Tenants are individuals or families, and landlords often have more personal interactions.

Commercial:

Tenants are typically businesses, which results in a more professional and transactional relationship. Businesses tend to have legal and financial advisors managing their lease agreements, and landlords work with solicitors to negotiate terms.



4. Vacancies and Tenant Turnover: Higher Stakes but Longer Stability

Residential:

Tenant turnover is more frequent, with shorter leases leading to void periods that typically last weeks to months.

Commercial:

While leases are longer and provide stable income, void periods can be much longer—potentially lasting months or even years. Filling vacancies requires targeted marketing and often involves securing specific business tenants.

5. Financial and Legal Complexity

Residential:

Managing a residential property is relatively straightforward financially, with predictable rental income and simpler taxation rules.

Commercial:

Commercial property involves more financial intricacies:

- **Business Rates:** Usually paid by tenants, not landlords.
- **Tax Relief:** Opportunities for claiming capital allowances, especially on plant and machinery, are more prevalent in commercial investments.
- **VAT Considerations:** Some commercial properties are VAT-elected, meaning rent and sales may include VAT. Landlords must understand how to navigate this.



6. Property Use and Fit-Outs

Residential:

The property's use is generally consistent (e.g., living accommodation), and landlords rarely have to make significant adjustments.

Commercial:

The type of tenant and their business operations heavily influence the property's use. For instance:

- Retail tenants may require specific layouts, shopfronts, or signage.
- Industrial tenants may need warehouses equipped with particular infrastructure.
- Landlords must collaborate with tenants to agree on fit-outs and alterations, which may involve reinstatement clauses when the lease ends.

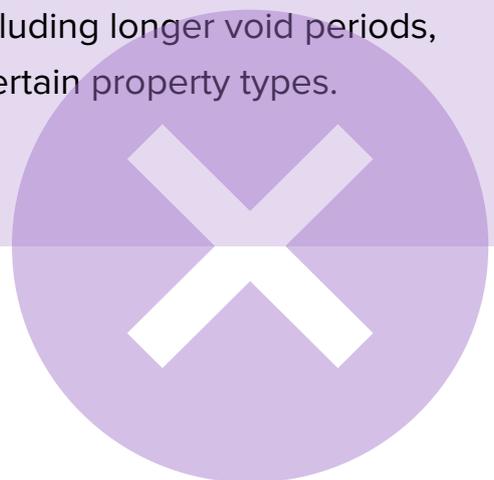
7. Risk Management and Mitigation

Residential:

Risks include tenant non-payment, property damage, and void periods. These are generally mitigated with deposits and insurance.

Commercial:

Risks are more varied and potentially higher, including longer void periods, tenant insolvency, and fluctuating demand for certain property types.



POTENTIAL PITFALLS AND RISKS IN COMMERCIAL PROPERTY

While commercial property offers attractive yields and long-term stability, it also comes with unique challenges and risks. Understanding and preparing for these pitfalls can help you make smarter investment decisions.

Don't let these put you off. Understanding the pitfalls will ensure you enter a deal with your eyes wide open and can mitigate many of the risks you may encounter.

1. Economic Sensitivity: Impact on Demand

- ✘ Commercial properties, especially retail and office spaces, are closely tied to the health of the economy. During economic downturns, businesses may downsize, relocate, or close altogether, leading to tenant defaults and prolonged vacancies. The COVID-19 pandemic drastically reduced demand for office spaces as businesses shifted to remote work, leaving many landlords with unoccupied properties.
- ✓ Mitigation: Diversify your portfolio by investing in different sectors (e.g. industrial, office, or mixed-use). Focus on properties in locations with strong economic fundamentals.

2. Longer and Costlier Void Periods

- ✘ Vacancy is a significant risk in commercial property, with void periods often lasting months or even years depending on market conditions. Unlike residential properties, which typically have high demand, filling a commercial unit can be time-consuming and resource-intensive.
 - ✓ Mitigation: Offer flexible lease terms or incentives, such as rent-free periods, to attract tenants, and thoroughly research tenant demand in the area before purchasing a property.
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3. Financing Challenges

- ✘ Securing financing for commercial property can be more challenging compared to residential. Lenders often require higher deposits (30-50% of the property's value) and impose stricter lending criteria.
- ✔ Mitigation: Work with a specialist commercial broker with vast experience in the market who can tell you whether a property is finance-able before you sign any deals! Hint: that's us!

4. Legal and Regulatory Complexity

- ✘ Commercial property is subject to various laws and regulations, which can add complexity to your investment. Key areas to be aware of include:
 - Security of Tenure: The Landlord and Tenant Act 1954 gives commercial tenants the right to renew their lease unless explicitly excluded in the agreement.
 - Planning Restrictions: Changing the use of a property or redeveloping it may require planning permission.
 - Building Standards: Commercial properties must comply with fire safety regulations, asbestos management, and energy efficiency standards.
- ✔ Mitigation: Work with experienced solicitors and surveyors to navigate legal requirements and conduct regular property audits to ensure ongoing compliance.



5. Higher Upfront Costs and Ongoing Expenses

✘ Commercial properties often require significant initial investment, including:

- A 30%-35% deposit
- Legal and surveying fees.
- Stamp Duty Land Tax (SDLT), which is higher for commercial properties.
- Fit-out costs to make the property suitable for tenants.

Additionally, while tenants are often responsible for maintenance under Full Repairing and Insuring (FRI) leases, landlords may still incur expenses for major structural repairs, insurance, and professional fees.

✓ Mitigation: Ensure your cash flow and contingency funds can cover unexpected costs or extended void periods.



KNOW YOUR ASSET CLASSES

Understanding which sectors are thriving and which are facing challenges can help investors make informed decisions and navigate the current landscape. In this section, we'll explore the commercial property types that are currently the "winners" and "losers."

WINNERS: ASSET CLASSES PERFORMING WELL

Industrial and Logistics Properties

Warehouses and logistics hubs are likely to continue to see rental growth, especially in areas close to major transport links (ports, airports, and motorways). Lenders are generally willing to offer competitive rates for these properties.

✓ **E-commerce Growth:**

The explosion of online shopping and e-commerce has created a massive demand for warehouses, distribution centres, and logistics hubs. Businesses need vast spaces to store and distribute goods efficiently, particularly in proximity to urban centres.

✓ **Resilience:**

Despite the economic challenges of the past few years, the industrial sector remains relatively resilient. E-commerce giants like Amazon, as well as smaller retailers, continue to fuel demand for distribution spaces.

✓ **Healthcare and Care Homes**

The need for specialised care properties (e.g., assisted living, nursing homes) is expected to grow as the population ages. However, properties in this sector require compliance with strict regulations, so ensuring regulatory standards are met is vital to long-term success.

✓ **Ageing Population:**

The UK's ageing population and the rising demand for healthcare services make care homes and healthcare-related properties an increasingly attractive investment.

✓ **Huge Demand:**

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✓ **Government Funding:**

Many healthcare and care home operators rely on government funding or private healthcare systems, offering a more stable income stream for landlords.

LOSERS: ASSET CLASSES STRUGGLING OR FACING CHALLENGES

Retail Properties

✓ **E-commerce Disruption:**

The dominance of online shopping has significantly impacted physical retail stores, leading to a decline in foot traffic and demand for high street shops and even shopping malls.

✓ **Changing Consumer Habits:**

Consumers are increasingly opting for online purchases rather than shopping in physical stores, which has led to a decrease in demand for traditional retail spaces.

✓ **Store Closures:**

Many well-known retailers have downsized or gone out of business, exacerbating vacancy rates in shopping centres and high streets.

Office Properties

While central office buildings in prime locations may still perform well, secondary office space, especially in less well-connected areas, faces significant challenges. The shift towards flexible, hybrid office environments could create opportunities in the co-working or flexible lease sectors.

✓ **Hybrid and Remote Working Trends:**

The shift towards hybrid and remote working has reduced the demand for traditional office space, especially in cities. Many businesses now see the need for smaller, more flexible workspaces, or they are relying more on remote teams.



Leisure Properties (Pubs, Restaurants, Hotels)

Pubs, restaurants, and hotels are often more volatile and sensitive to shifts in consumer behaviour, local lockdowns, or economic downturns

Properties in highly sought-after tourist locations or with established brands may fare better, but the sector as a whole remains relatively unstable.

✓ **Impact of COVID-19:**

The dominance of online shopping has significantly impacted physical retail stores, leading to a decline in foot traffic and demand for high street shops and even shopping malls.

✓ **Changing Consumer Preferences:**

While some consumers have returned to dining out and staying in hotels, others have grown accustomed to at-home alternatives, such as home delivery services, remote work, and leisure activities at home.

✓ **High Operational Costs:**

The hospitality industry often faces higher operational costs compared to other commercial sectors, which can make it harder for operators to remain profitable.





THE BENEFITS OF COMMERCIAL PROPERTY INVESTMENT

Higher Yields:

Commercial properties offer higher returns than residential, often between 6-8% net yield, compared to 3-5% for residential properties.

Longer Leases:

Typical commercial leases range from 3-25 years, providing stability. Many leases also include rent reviews, often upward-only.

Professional Relationships:

Tenants are typically businesses that maintain a professional relationship, minimising disputes and property wear.

Tax Advantages:

- **Capital Allowances:** Significant tax relief is available for certain commercial property costs, such as plant and machinery.
- **Business Rates:** In some cases, business tenants are responsible for paying these, easing the landlord's burden.

Tenant Pool Diversity:

From shops to warehouses, office spaces, and mixed-use developments, commercial property offers access to a wide range of business tenants.



STEPS TO MAKE THE TRANSITION

Making the leap from residential to commercial property is a bold but rewarding move. With higher yields, longer leases, and opportunities for portfolio diversification, commercial property can elevate your investment strategy.

Ready to take the first step? Contact a commercial property expert or explore local property investment seminars to gain hands-on knowledge.

- 1** Educate Yourself: Research the commercial property market and attend seminars, or speak to an expert.
- 2** Assemble a Team: Work closely with a commercial broker, property solicitors, surveyors, and accountants.
- 3** Identify the Right Property: Evaluate location, demand, square footage, and tenant profiles.
- 4** Secure Finance: Understand your options by scoping out a deal with a commercial broker before making any decisions.
- 5** Conduct Due Diligence: Carefully assess the property's condition, lease terms, and tenant history.

NEXT STEPS

Consult with Propp's property finance experts to navigate the complexities of commercial property investment. Use our tools and services to ensure a seamless journey from selection to completion.



READY TO GO?

Contact a commercial specialist at Propp for tailored advice and funding solutions.

NOT QUITE READY, BUT ON THE WAY?

Sign up to [Propp Portal](#) for free!

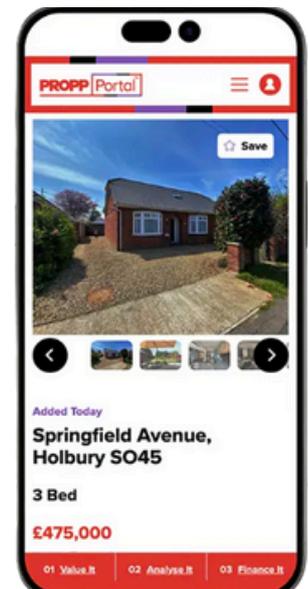
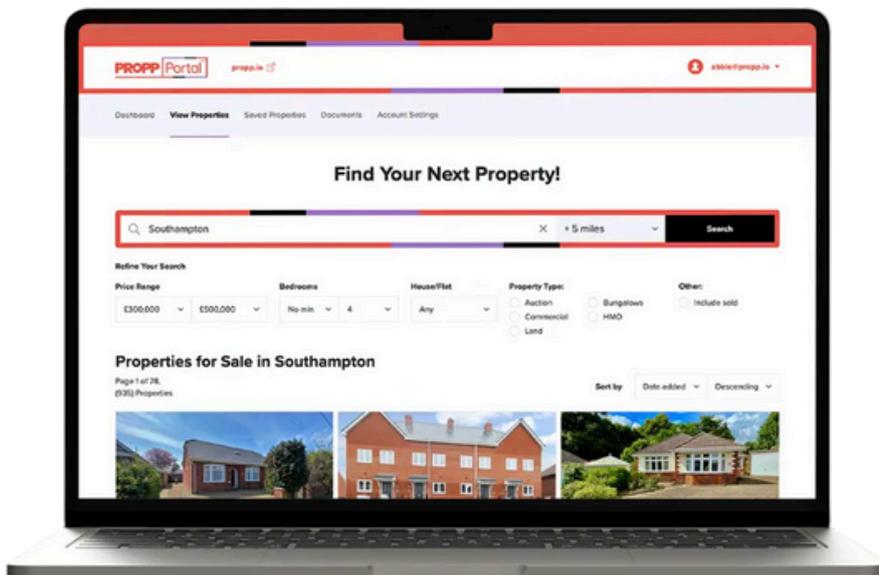
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