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Investing in Commercial Property

Successful Strategies
for the Private
Investor

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Editor
LandlordZONE™



Investment - not Speculation!

“An investment operation is one which, upon thorough analysis promises safety of principal and an adequate return”

“Operations not meeting these requirements are speculative”

Benjamin Graham THE INTELLIGENT INVESTOR

Investment Alternatives

- Cash
- Stock Market
- Pensions
- Buy-to-Let – Residential
- Commercial Property

- Balance and diversify

Residential

- + Spectacular returns over last 10 years
 - Average house now at £140,000 sold for £4,000 in 1965 (37 times)
- + Combined income and capital growth has been possible well over 16% returns – possible to borrow big!
- - Competitive letting environment – discerning tenants
- - Refurbs and facelifts
- - Tougher landlord rules and regulation on the way
- + Sustainable values – demand for housing continues
- + Planning restrictions and environmental issues help
- + Socio Demographic change

House Price Cycles

- 1957 – 73 (16 yrs) + 125 %
- 1973 – 77 (4 yrs) - 32 %
- 1977 – 79 (3 yrs) + 32.7 %
- 1979 – 82 (3 yrs) - 17.8 %
- 1982 – 89 (7 yrs) + 80 %
- 1989 – 95 (6 Yrs) - 37.1 %
- 1995 – 04 (9 yrs) + 122 %

House Prices / Average Earnings

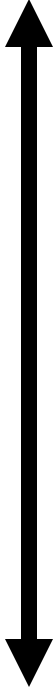
- 1964 3.4
- 1970 3.2
- 1972 4.6
- 1976 3.2
- 1979 4
- 1981 3.2
- 1988 4.8
- 1994 2.7
- 2004 5.4

DATASTREAM

Commercial Property ?

- Out-performed stock market over 10 years
 - Retail Shops
 - Offices
 - Industrial - Workshops / Units / Storage
 - Leisure
 - Mixed use – shops/offices/residential

Spectrum of Quality / Value

- Prime Commercial £1.5m +
 - Secondary Commercial £75k - £1.5m
 - Tertiary Commercial up to £75k
- 

Preserve of the Professionals?

- Traditionally:
 - Institutional Investors
 - Property Professionals
- Now – encourage the amateur

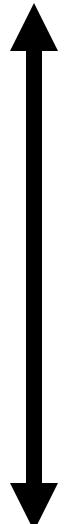
Auctions

- **Investor demand** still high but no longer feverish
 - not always supported by **occupier demand**
- Properties commonly meeting prices at auction
 - Wall of money diversifying from stocks
- **Entry level – arranging finance often difficult** given tight timescales

What are the Prospects?

- **Global uncertainty**
 - Oil prices, US economy, China, India
- **Retail faltering but still quite strong**
 - Out of town trends and changing town centres
- **Office demand has faltered in many locations:**
 - Home working, High Tech requirements
- **Industrial is more volatile**
 - Manufacturing decline, but internet home deliveries

Risk / Reward / Effort - Spectrum

- 15 % + secondary /development / conversions
 - 8% - 19% - secondary / convert
 - 5-10% prime to good secondary
 - 4% - Building Society
- 

Recent Conversion

- Parade of shops
- Newcastle
- Apartments – 2 bed
- £140,000 each
- Planning £50k
- Shops let – income £36k
- Investor to retain commercial



Retail / Residential

- Manchester
- Sale £220,000
- Rental Income £35,625
- Various leases incl. Boots Chemists
- Yielding 16.2%
- Auction, July 2002 by Pugh & Co



Retail - Restaurant

- East Lancs Rd, St Helens
- Rental £35,000 (u review c50k?)
- Sale £500,000 Freehold
- Guide (450-500k)
- 30 yr FRI lease to Forte (UK) from 1999 (br 2014)
- Yield 7%
- Pugh & Co, June 2004



Industrial Unit

- Sandycroft, Deeside
- Rental £24,000
- Sale £257,000
freehold
- Guide (£200-240k)
- PLC – 5 year FRI
from Oct 2002
- Yield 9.34%
- Pugh & Co, June 2004



Retail Shop / Offices

- Windsor, Berkshire
- Sale £1m freehold
- Guide (£975k-£1m)
- Basement, ground and 3 upper floors – 3 shop frontages.
- Total Rents £77,500 reviews 2005
- Yield 7.75%
- Allsop & Co, July 2004



Shop with Flat

- Croydon
- Sale £265k Freehold
- Guide £260,000
- Let to Unwins Ltd, guaranteed by Unwins Wine Group Ltd
- Lease to 2020, review 2010
- Includes maisonette above let on overriding lease with shop
- Rental Income £17,500
- Yield 6.6%
- Allsop & Co July 2005



Pros - ComProp 1

- Relatively **High Income**
- **Steady growth in value** if unspectacular
- Established UK property **market structure**
- Institutional Lease principles – **clear return**
- Tenants accept **FRI lease** - protects landlord rights
- **Established disciplines** for valuation, finance, service charges, rent reviews, lease renewals etc.
- The property market has **SOME liquidity**.

Pros - ComProp 2

- Upward only **rent reviews** – 3 to 5 years
- **Long leases** compared to residential
- Commercial generally requires less initial **refurbishment** cost
- Often **minimal management** involvement
- Managing agent – not necessary?
- SIPP investment

Cons: ComProp

- Higher commercial **lending rates**.
- Higher **average lot values** – more difficult to spread risk – but syndicated investments?
- Less spectacular rises in **capital values**, compared to residential
- Values can go down in **declining areas** or where occupancy rates decline

Finance - Commercial

- More difficult to raise finance
- Every deal is different – no packages like buy-to-let
- Different lenders have different policies so you need to shop around
- Rates vary - 1% to 5% above base for £500K to £1m
- Experienced brokers
 - Mathew Farrow – **The Money Centre**
 - Jonathan Moore – **Mortgages for Business**
- Buy-to-let – borrow up to 85% LTV
- Commercial – borrow up to 60 / 70% LTV

More on Finance

- Lenders carry out thorough **due diligence**:
 - **Quality of property**, land, development or conversion
 - **Quality of the tenant** or prospective tenants – blue chip (Top FTSE 25) with long lease offer greatest **covenant strength**.
 - **Quality of Applicant** – “a **track record** is worth its weight in gold”
 - **Quality of builders**, use of architects and professionals

Development & Conversations

- More **work**, more **risk**, greater **returns**?
- Risk reduction – **alternative uses, attractions**
- Spread risk - **more units**, more tenants
- Considerations:
 - **Planning** consents and uses
 - The **Building** – defects and building regulations
 - Local **objections** / protests
 - **Neighbour** problems
 - **Contaminant** problems
 - **Environmental**, Conservation Areas, listed buildings

Investment Considerations

- Understand your **market - research**
- Location, Location, Location
- Do your **project costings**
- Do your **final valuation** – know what the building is worth to **YOU** and don't pay more
- Understand and read **leases** and the requirements of the **1954 Landlord & Tenant Act** – recent changes.

Investment Considerations

- **VAT** – is the building subject to VAT ?
- **Flats over Shops Scheme** and other tax incentives
- **SDLT** – new tax, new rules and more paperwork
- Building Regulations
 - DDA, Sound Insulation, Thermal Insulation, Fire Barriers and Doors, Emergency Lighting, Fire Alarm Systems, Fire Certificates, Security etc
- Capital Allowances
- Tax Planning – CGT, Inheritance Tax, Company, Private
- Lease Registration – Lease Plans - Land Registry

Managing Tenants

- Be **pro-active** in maintaining **asset value**:
 - **Maintain** the property – preferably at the tenant's expense – service charges (FRI)
 - **Automate** rent collection
 - Act immediately if there's a **rent problem**
 - Fulfil your **legal obligations** – gas checks etc
 - Maintain rents at **market levels** – you owe it to yourself and your descendants



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Commercial Property Investment Guide

- Investing in commercial property for the first time ?
- Written by Kevin Smith and Richard Bowser - [Editor of Property Investor News](#) - 68 page - A4 booklet.
- [Purchase \(£29.95\)](#)
[LandlordZONE™](#)

