A COMMERCIAL OPPORTUNITY

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When I first started investing in property in the late 1990s, commercial premises let to banks were considered to be one of the safest and most hands-off property investments available. The considered view was that the chance of the bank defaulting on their rent was minimal, and the chance of the bank leaving the premises was similarly low. As a result, these investments used to change hands at gross yields of as low as 3%.

Fast forward 20 years, and the situation could not be more different. Many villages have no banks at all and their strength as a long-term covenant is not nearly as strong as was previously the case.

Such a low yield offers little if any protection to the investor in the event that any difficulties are experienced. It is not this type of commercial investment I am advocating.

The recent demise of the shopping centre firm Intu, together with many high-profile retail casualties, may suggest that investing in commercial property is to be avoided.

My view is that the recent but nonetheless seismic shift in the commercial landscape means that commercial property is worth a look. The marketplace must surely be filled with motivated sellers, whilst imminent planning policy changes means that the opportunities for developing commercial property are set to increase even further.

Here are my tips to assist you in succeeding with commercial property:

1 Consider the types of property where you are most likely to find a motivated seller. These may include hotel and B&B-type premises. Many have significant debt and none will have had any income this year due to COVID-19. Consequently, there could be some highly motivated sellers out there. Shops in secondary and tertiary locations may find trading conditions untenable and landlords may therefore be considering selling such properties. However, they may offer a perfect location for a commercial to residential conversion.

2 Be realistic about the yield you need to achieve, and don't accept a significantly lesser yield simply because the property is let to a national covenant. I pay very little attention to the quality of covenant because, big or small, commercial tenants are at risk of defaulting. Instead, I always prefer a higher gross yield in return for a local or untested covenant.

3 Understand what the future use is of the premises. Many people think that vacant commercial premises will let simply because they are given a decorative facelift. This is simply not the case. You need to understand the demand for the premises before you can assess their value. In a post-pandemic world, there is likely to be little demand for open-plan offices designed for hot desking, and considerable reconfiguration is likely to be required prior to a tenant being secured. Larger units with a large business rates obligation may be more attractive if they were subdivided to provide more affordable units. This subdivision will also insure your downside. While one tenant may default, you should still be collecting rent from the others. Alternatively, the commercial use of the premises may no longer be its best use. Consider a conversion to residential or mixed use, or identify what demand there is for other uses such as childcare facilities, training centres, storage and the like. Such action could uplift the value far more than would be the case simply by securing a household name as a tenant.

4 Consider what development opportunities are available. I often find that the development of commercial sites has not been fully explored and so it may be possible to add further accommodation, convert outbuildings or garaging, or add value by subdividing larger premises. A discussion with a planning consultant could pay you dividends!

5 Select commercial tenants carefully. Try and secure interest from firms whose product or service is more resilient to market cycles. Letting to a pharmacy or food outlet is likely to be more robust in a challenging economic backdrop than a jewellers or high-end clothing store.

6 Engage in some additional learning to understand the legal landscape of commercial letting. An understanding of the 1954 Landlord and Tenant Act, which determines whether a tenant has an automatic right to a new lease and some understanding on the law of dilapidations are essential prior to a foray into commercial property.

The advantages of commercial premises are easy to see. Managing commercial tenants is generally less labour intensive than residential units, the eviction process is far more straightforward and there is no stamp duty surcharge if you can find a mixed use property for less than £150,000. Fewer people are bidding for them and you will likely find the sellers have less of an emotional attachment to the property than their residential counterparts. This combination, together with your vision for future use, could allow you to net a bargain.

As always I am happy to assist readers of YPN and can be contacted on 01843 583000 or graham@grahamkinnear.com

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