

Value Investments

With global uncertainty and dramatic changes in the property sector, Healy Hynes examines the opportunities available in value investments.

Fundamental changes are now underway in the commercial property market. A number of factors, from the introduction of BER certification, changes in the landlord tenant act, not to mention retailer uncertainty are combining to create what may be regarded as an upheaval in the commercial landscape.

Commercial landlord and tenant law is undergoing the biggest change of the last 15 years, and all with very little fanfare from the sector. As and from July 20th 2008, all commercial tenants can opt out of their statutory entitlement to renew their leases.

Under Section 47 of the Civil Law (Miscellaneous Provisions) Act 2008 the opt-out is now available to all tenants of business premises, provided that the tenant has obtained independent legal advice and signed a Deed of Renunciation.

Prior to this, the only way to prevent renewal rights accruing for the tenant was to ensure that a tenancy was for less than five years, hence the prevalence of four-year eleven-month and four-year nine-month leases. The lack of contracting out therefore resulted in a high degree of inflexibility and made sub-letting difficult.

Advantages

Whilst this may not sound like an earth-shattering development, it does offer certain advantages. Among them are for building owners who have short to medium term plans to re-develop or refurbish premises. They will now be able to obtain vacant possession when needed and continue to rent the premises without the risk of renewal rights accruing following the expiration of existing leases.

In addition, concession and franchise relationships in larger premises, such as department stores, may no longer be deemed tenancies, assuming of course that the lease is structured appropriately. An interesting twist to the new arrangement is that the renunciation does not need to be in place prior to the date of lease commencement, which raises interesting possibilities for existing leases.

Although the full ramifications of this new arrangement are yet to be seen, greater flexibility should be well received in the market and will hopefully act as a stimulus for increased commercial activity. This increased flexibility comes at a time of unprecedented uncertainty in the commercial property market. Changed economic circumstances have led to a re-evaluation of commercial lettings, with tenants now being able to command more favourable terms of contract.

Retailers looking for shorter-term leases have become more prevalent, in addition to extended rent-free periods and fit-out rentalisation. Landlord concerns

for stability of tenure have resulted in greater up front accommodation of retailer concerns for cashflow.

Another side effect of the changed circumstances is the increased availability of tenanted commercial buildings as hard-pressed owners look to reduce their exposure. Once they would have been a rarity, with developers particularly keen to hang on to commercial units whilst disposing of upper floor residential units. These same developers are now more eager to release these units, both to owner/occupiers and to investors. However, bank funding is a critical factor in the area. Concerns for the headline-attracting residential sector have resulted in a dearth of funds being made available to the commercial investor or business. This effect will peter off as the sector stabilises and property values find their floor.

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Taking a longer-term perspective, commercial property offers the potential for capital gain and investment growth over a ten to twenty-year period at a level unchallenged by other investment options.

- ▶ A terraced property bought in 1972 for €3,100 is now worth €250,000 yielding €10,000 per annum.
- ▶ A commercial building bought in the same year for €15,000 is now worth €2.5m with a rent roll in the region of €100,000 per annum.
- ▶ A building bought for €7,000 in 1975 is now worth €250,000, returning €9,000 per annum.
- ▶ Looking at more recent investments, a commercial building bought for €75,000 in 1997 now yields €29,000 per annum with a capital value of €600,000.

Considering the fact that most property investments are done on a 70 – 90 per cent leverage, you are looking at ventures now worth to 800 times their original stake over 35 years, a compound interest of almost twenty per cent per annum. With bank deposits and pensions returning four to six per cent, the comparison is striking.

A New Cycle

We are now entering into the beginning of a new property cycle. A buyers' market, where yields are increasing and purchase prices are lowering. All markets are cyclical and this situation that now presents itself is the opportunity canny investors have been waiting for, for many years. This is the motto on which Warren Buffet, the Oracle of Omaha, widely regarded as the most astute investor in the marketplace, has grown his Berkshire Hathaway empire: "buy when others are selling, sell when others are buying."

The criteria for evaluating investment vehicles differ from those when looking for a family home and whilst capital appreciation can be anticipated, it should not be factored into affordability calculations. Looking for the "quick flip" is not where your focus should be. Instead evaluate the options over the longer term with an eye to Value Investing.

There are several ways to evaluate such options, such as buying low price to rent ratios. Although this may indicate a higher risk in the venture, in a buyers' market, yields have softened across the board, offering the opportunity, not only for rental growth but also for yields strengthening.

Numerous academics have published studies investigating the effects of buying value investments. These studies have consistently found that value outperform stocks and the market as a whole. And by looking around and acting to lock in the opportunities now presenting, perhaps you too can ensure the future security of you and your loved ones.



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