

DAVID ENGLEHART on COMMERCIAL PROPERTY

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The effect so far of the lockdown and the ongoing implications for the commercial property market are many.

Without putting these in any particular order of importance, and without my comments intending to represent advice but merely my personal view of what I see, here are just a few things to consider.

1 Have we seen the worst of it?

The short answer is no.

2 What is the next stage?

I suspect that we may well get ongoing problems with localised and perhaps regional lockdowns from time to time.

3 How will this affect trade?

So far the effect has been devastating upon the country's economy. I believe we may well end up with a large scale unemployment situation and this will have a serious widespread knock on effect upon businesses.

4 What are the immediate effects upon the commercial property sector?

All businesses need income to survive. In the case of the commercial property sector income can come from two sources. One is the investment source whereby properties yield a rent. The other is the development sector where a commercial property developer builds offices, shops or whatever and sells or lets them off.

Clearly when certain business properties are locked down by government restriction there is no income for the tenant and if there is no income logic says that either difficulty will arise in paying the rent or it will not be possible to pay it at all no matter how hard the tenant tries. This will account for the fact that a substantial proportion of the March quarters rent remains unpaid and my guess is that a similar proportion, or perhaps slightly less, will remain unpaid in respect of the June quarter. The value of a commercial property is normally assessed on the basis of a number of items and a yield factor. The percentage yield varies depending upon a number of factors. However, I have noticed on some of the auction details being provided, that properties are being advertised at an anticipated price with a somewhat higher percentage yield than they were before. In short the value of the property appears to have gone down and this could be widespread.

5 Are commercial property companies going to run into financial difficulty?

That depends on a number of factors. Long established companies which have a low ratio of loan to value are probably breathing a sigh of relief that they are in that position. Many companies which are heavily borrowed against their portfolios may well face the risk of banks putting in receivers

6 Are some tenants taking advantage of the situation?

I would like to think that by and large landlords and tenants could find a solution for each individual property with mutual respect and goodwill. Whereas the government tend to intervene when the private sector and ordinary people are involved such as tenants, employees and the like, when it comes to property companies I suspect they are not high on the government's list. So what can one do?

Much depends on the relationship that property companies have with their bankers and their ability to maximise the amount of rent they can obtain from their tenants. Each property and each tenant are different and have issues which should be considered individually.

7 **Multiple Lettings**

One interesting aspect of the crisis is the tendency for tenants with multiple units sending standard communications to their landlords setting out their proposals. There is one matter here that both parties should bear in mind.

Section 34 of the Landlord and Tenant Act 1954 states that upon a new tenancy being granted by Court Order then amongst other matters the rent to be fixed shall be disregarded as to the following:

- (1) Any effect on rent of the fact the tenant has, or his predecessors in title have, been in occupation of the holding.
- (2) Any good will attached to the holding by reason of the carrying on there of the business of the tenant (whether by him or a predecessor of his at the business).
- (3) Any effect on rent of an improvement to which this paragraph applies.
- (4) In the case of a holding comprising licenced premises any addition to its value attributable to the licence, if it appears to the Court that having regard to the terms of the current tenancy and any other relevant circumstances the benefit of the licence belongs to the tenant.

The really interesting one is number (2). It specifically excludes from the calculation the mere fact that the tenant may have been more successful than other tenants in a similar business in premises of similar rentable value.

In my view, unless the 1954 Act is adjusted, which would be most unusual in this particular circumstance, then theoretically the fact that the tenant is not doing very well through no fault of the landlord should not affect the rent payable. In the same way that if a tenant is a roaring success the landlord should not be expected to share in that.

8 **Same Tenant variable premises**

The reason I mention the previous point is because many of the multiple tenants are working on the assumption that landlords as a whole should subsidise problems they may have in premises which are perhaps not in such an advantageous position by reducing rents from premises which are thriving.

Let us take one example. There may be a catering premises offering off sales with a unit in central Brighton. There may be a unit in the centre of a commercial street, or streets, providing exactly the same commodity. There may be another unit in a busy road but not central.

For the next few months, in theory, if the commodity they sell is attractive the premises in central Brighton are likely to be very busy. There seems little doubt that people flood down to Brighton on trains from London and then walk straight to the sea. Up until now, the central premises, the commercial street premises and the busy road will have been closed.

For the next three months at least during the summer season the central premises should be very busy.

The commercial unit however may suffer from workers working at home

The busy road could now have a substantial amount of passing trade but may not as the general public are still a bit wary.

After being locked down for months the recent photographs of the beaches at Brighton and elsewhere demonstrate there is a pent up desire to get out and enjoy the seaside.

The busy road will now, all being well, come strongly back to life but I am told this is not yet the case.

So if in the commercial area you have say 50% of the people working at the offices and 50% from home then there is going to be a drop in turnover and possibly in the usually busy road so they may want and get concessions. It is right though that the central unit should also be subject to the same concessions if it is making more profit than usual, not less?

9 **Turnover rents**

What is the answer to the question as to the position of the premises being of some importance with regard to the time it takes to get back on its feet? As I understand it many tenants are suggesting a future based on turnover rent. Will that be the answer? I confess to a degree of cynicism. Very many years ago I was involved in a substantial VAT fraud case. It did open my eyes as to what went on in turnover rent premises. Maybe I am being too cynical and maybe it is a way forward.

10 **Commercial use to residential use**

The government has stated that they are going to ease some of the Town and Country planning laws with regard to the conversion of retail and office premises in high streets to residential. As I have been extolling the virtues of doing that for some years I do not intend to dwell too much save to say that from a commercial property landlord's point of view it will add substantially to management problems unless the management of the lettings of the property to residential tenants is hived off to agents.

11 **Recording the concessions or adjustments to a Lease properly**

If arrangements are entered into between a landlord and tenant how important is it to record these in a proper manner? The short answer is that it is crucial. After all, do you want to give concessions to help a tenant who has been out of business and is now only partly able to function only to find that once it has been recorded and agreed the tenant sells on their lease for a handsome profit? These sort of aspects can be dealt with in an agreement between landlord and tenant. Also sub-lettings must be prohibited in such a case as the immediate tenant can otherwise benefit from the concession and then make it up by charging a higher rent to a sub-tenant.

12 **Increasing lengths of Leases as a result of concessions**

This is very much an economic argument and relates to the fact that concessions given to the tenants in many cases have to be made up with further payments later. In addition, from a landlord's point of view, if the concession they have given means they are writing off some of the rent because the tenant will not be able to afford both ongoing rent in the future as well as the arrears then it seems only just that the landlord should have the benefit of the tenant confirming that at the end of the existing lease it will be extended automatically for say three, five, seven years or whatever depending upon the rent review pattern.

13 **Home working and open plan offices**

There is another aspect relating to the value of commercial properties which needs to be considered. When permitted development was brought in, this enabled a large number of offices, mostly small, to be converted readily into residential units unless the planning authority could produce some particularly good reason why they shouldn't be, or they were in an area zoned by the planning authority which excluded permitted development. The effect of this was to create a shortage of office accommodation. This meant that office rents rose higher than they would have done if the situation had been as it was before permitted development. This then in turn increased the value of the Landlords reversion. Whether there will be a downturn because of the attraction to many people of working from home remains to be seen. Office working has also had its problems with regard to open plan offices where it is more difficult for people to stay apart..

14 **Possible knock on effect on high street rents of removal of properties for residential purposes**

Following on from my comments regarding permitted development with regard to offices, a similar position could occur with the latest suggestions as to permitted development of retail outlets in high street and the

like. A client of mine made a very valid point in so far as there is a likelihood that those retail outlets that continue to trade in high streets will possibly become busier and attract higher rents and the residential use, which will be the future of the permitted development of other retail outlets in the same neighbourhood, will attract a lower value so far as investors are concerned. I can see it is likely to come to pass that a number of commercial property companies will need to dispose of assets in order to balance their books. I think the worst example of a recession that I can recall was in the early 1970's with other examples being the 9 or 10 year cycle of recessions or mini recessions we tend to have where if the property companies get caught at a bad time with regard to liquidity or tenant failure, disposals have to take place.

15 **Try to keep on good terms with your Tenant**

For the reasons mentioned above many commercial property landlords may come to terms with their tenants to keep them in possession and not force them into administration or liquidation. On top of all the other problems commercial property owners have, particularly with reference to the retail trade, is online shopping. It is becoming increasingly popular but I see it has been suggested in the press that there may well be a tax levied on online shopping to make it slightly less attractive.

16 **Don't let your Tenant be the one to lose business through staff rudeness to customers**

One of the issues I have heard about is the apparent rudeness of shop staff to customers as a result of the need for people to keep their distance. It could pay Landlords perhaps to visit their tenant's premises with a view to seeing how the customers are being treated. In many cases the people who obtain profits from the premises are not hands on the shop floor and may be unaware that the goodwill of their business is being dissipated by belligerent employees.

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