



Mutiny and Cannibalism?

Raft of the Medusa by Théodore Géricault

Since we reported in April the crisis in the banking sector has spilled over into the real economy. The storms in the wholesale financial markets show no sign of abating with Lehman Bros drowning in oceans of debt and Merrill Lynch's rescue still dependent on Bank of America's due diligence.

Meanwhile the Bank of England expects our economy to remain flat over the next 18 months with OECD forecasting the UK economy will shrink marginally, by 0.2% over the next six months.

We ask, "Is the property market in Kent and South East London as desperate as "The Raft of the Medusa"?"

Well, probably not! Our experience is that the commercial market does not feel as it did in the early 1990's and, with intelligent pricing, well constructed marketing campaigns and an active and energetic agency team, Hindwoods is saving clients from the worst of the downturn.

Since the beginning of the second quarter of 2008 we have completed on 60+ deals in the Kent and South London area (see attached) and we remain very active in the market. Trends have emerged as the fulcrum in negotiations has shifted in favour of the occupier.

- More property coming onto the market – although mainly secondary.
- Occupiers spending more time reviewing alternative properties and slower decision making process.
- Increase in rent-free periods/incentives.

Hindwoods provide advice on all aspects of commercial property and anyone considering buying or selling commercial property in Kent or South London are invited to contact:-

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- Increased frequency in tenant break clauses.
- Toughening of bank lending terms.
- Pressure on rents to be paid monthly, not quarterly, especially in retail sector.
- Very low levels of speculative development.
- Low levels of investment transactions persist.

Some practical issues:-

Business Tenancies

With a buoyant market for so many years landlords have tended to look at lease renewals rather like rent reviews – oh goody another opportunity to hike that rent. Unfortunately, unlike most rent review clauses, the 1954 Landlord & Tenant Act contains no upwards only provision. Rents can go down as well as up.

Also, before you serve that Section 25 Notice, it is worth thinking how your tenant may react. With such uncertainty in the current market and the economy in general, no businessman wants to be forced into making long term commitments. Is this the best time to force your tenant to make such a decision? Given the opportunity the tenant will probably opt for caution and seek a short-term lease or one with tenant break options. The value of the investment is as much about covenant strength and lease length and its effects on yield as the quantum of rent. It may be better to delay that S25 Notice for a while if there is limited rental growth and wait for happier times.

Of course, if you have a rather more pessimistic outlook for the market, you may prefer to grab what you can now but beware a tenant who cannot meet his quarterly rent payment – no one wants an empty property to let in a poor market, especially with empty property rates.

Residential Leasehold Reform

In the current market many lessees are asking whether now is the right time to be extending their lease. Surely if the price is falling then the premium does too? Well to an extent "yes" but not by the same amount. Because the current value of the extended lease is deferred to the end of the term the net effect of a 10% drop in market value over a one year period is about 4% off your premium for a lease with 81 years unexpired. At 50 years unexpired the figure is about 5.5%.

Due to other valuation provisions, if your outstanding lease term is approaching 80 years, it will be advantageous to serve notice to extend the term or purchase the freehold.

Lessees should not forget that, whilst they are waiting for the market to hit rock bottom, their lease length is also shortening which counters the effect of falling values. The gamblers may wish to take their chances on a falling market and bide their time but what is a racing certainty is the fact that leases shorten with the passage of time and as they do the premium rises which is what makes them such attractive low-cost investments.

Conclusion

Whilst business confidence remains downbeat, the market remains sluggish but it is important to appreciate that it is still functioning and an intelligent, creative, yet persistent, approach is still achieving positive results.

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