Martin DeVarga

DeVarga Commentary – November 2017

We All Knew It Was Coming – It Was Simply a Matter of When

I bought an interesting book the other day. It is written by David Smith, an economist who writes for The Sunday Times. You may recall I referred to him in our July 2012 Commentary. Back to the book – it is called 'Free Lunch'. I am about 20% of the way through it. If the 'appetizer' on economics which David has fed me so far is anything to go by, I am looking forward to digesting the main course.

Another 'dining experience' was enjoyed by reading a new book on the block, by a new author to the world of business. Rod Cooke, a former Banking supremo, has written a book entitled 'Visionary Leadership and Emotional Management for the Digital Age'. I admit a degree of self-interest here, as Rod is a good friend and mentor. His book does, however, carry a very important message. I pause and add, yes I must declare there is a conflict here. Rod, as discussed, you can give me the £100 later for this free plug!

But the big news on everyone's lips is the rise in interest rates. It is now 0.5% base rate - still cheap money. We were having a debate in the office on the impact on the commercial property market given the likely rise in rates. We came to the unanimous decision the impact will be seen in shorter commercial Leases. Lessees will be less inclined to enter into longer Leases. Most Leases today are for a 10-year term, with upward-only rent reviews at the 5th year, even if they are from the Freeholder to their associated trading Company. That upward provision is important for lenders. They can, with some degree of certainty, programme the mortgage payments that are being fed by rental income, for at least 10 years. But how should Landlords and, for that matter, commercial lenders react to this possibility of a 5-year term?

The answer is, in either one of two ways. Either a 10-year term, but with that wonderful tool called a break clause, in Year 5. But it is important this break be such that 6 months' written notice is required before the expiry of the 5th year, the timing of which must be of the essence. Any Solicitor will inform you what that means.

The alternative is a rental geared to a percentage of the Tenant's turnover. Ask any international property developer from 'down under' and they will tell you they are relatively normal. It is important, however, that there always be a base rental payable with a top-up based on audited Accounts. I suggest that base rental should be at about 60% to 65% of the fair market rental value. Always look at the math; make sure the rental payments are sufficient to cover the principal reducing mortgage payments; factor in possible annual increases in interest rates. Given the reduced annual rental, then it makes it somewhat difficult for the Tenant to argue for a shorter Lease. If argued, the response from the Landlord is simple - *I am standing side-by-side with you in that risk by taking less annual rental on account, in the hope future times will be good for you and, if so, good for me.* That's called a partnership; commercial trust. A Landlord who cannot trust their Tenants (in the commercial sense) is in a dangerous position.

PS: Interesting Budget. Stamp Duty change welcomed. It could have the effect of pushing up prices due to limited supply. Supply was the same the day before and the day after the Budget. I was waiting for something to increase the supply of new houses. Unfortunately, I did not see it. Maybe next year.

Please note: Our offices will be closed from the evening of 22nd December, reopening on the morning of Monday, 8th January 2018. Wishing you all a very happy Christmas and a prosperous New Year!

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