Martin DeVarga

Property Commentary May 2009.

SORRY MR NEWTON BUT WHAT GOES DOWN MUST COME UP.

I was never very good at physics. I can remember a few things from my school days. Kinetic energy has a formula of 1/2mv2. Being a rugby fan I like to think of the potential energy to be released in the first scrum of a hard fought international – bring on the Lions tour. I also recall the story of a man who was sitting under a tree and an apple fell on his head – the discovery of gravity. Eureka, he cried, or was that the man in the bath. Newton of course redesigned the way we think about the universe. All these things got me thinking recently about the market. We all seem to be conditioned to think in terms of lack of growth. In the time I have been working in the market I have formed a conclusion that there tends to be what I call the sheep effect in that we think the bad times will continue forever and when the good times come we tend to think they will be for short time. But, I for one can see a reason why people should get back into market and now is the time. There is a lot of potential energy out there waiting to be converted into kinetic energy. I am talking here about commercial investments and commercial owner occupier properties.

The key to property returns is equity return, that enjoyed by the owner after deductions of interest payments. What determines interest rates? Answer = Base rates and today they are 0.5%. Add in a fair margin for the lender and we are looking at borrowing rates of around 2.5 – 3.0%. Today you can pick up well let commercial investments let to good covenants (yes there are some in market place) at 7.5% - 8.5%. These properties have more often than not a remaining term of between 10-15 years with regular rent reviews. I cannot recall a time when the margin was so wide. I think we all accept that we are in for periods of low interest rates but accept they may have to rise if inflation rears its head. But for at least the rest of 2009, 0.5% base rate would be a good bet. We know income or potential income drives the value of property. Hence we must accept that if it is a good time to buy investments it must be a good time to buy owner occupier properties. But of course investments usually have rental paid quarterly in advance.

Every 10 years or so the investment market goes through an evolution. In the 1970s it was the death of the 21 year lease. In the 1980s it was FRI terms in a lease. In the 1990s it was upward only rent reviews. In the 2000s I believe it will be monthly rentals or maybe turnover rents. For some years now turnover rents have been the norm in Australasia; a basis whereby the landlord receives a monthly rental and a top up every 6 months based on turnover of the business. This leads to a partnership between the landlord and the tenant and encourages more active involvement by the landlord. More potential energy to be released.

So I say get out there. There are good opportunities today for the astute investor. And don't worry about the apple falling on your head. It may turn out to be a golden delicious.

Matthew S Martin **May 2009**

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