THRIVING AMID THE CHAOS

You've set your investment budget, but how should you spend it amid so much economic uncertainty? Vishal Patel, a director at consultancy Prideview Group, offers his guide to the options available

Papa John's, Newport

£250,000

The wave of investors moving from residential to commercial has continued into 2018, but at this entry-level budget you generally only see messy auction lots that are unsuited to such buyers. We dealt with two quality lots recently. The first was a blue-chip dental office (Integrated Dental) in a Norfolk village (£245,000, 5.7% gross). Despite it having a break in one year, its medical use clearly took prominence given it was the only dentist in town. The second was a Papa John's pizza takeaway in Newport let for nine years (£168,000, 7.2% gross). A blue-chip investment at this yield is a rarity. It went cheap because it is a VAT property – this often (unnecessarily) puts off novice buyers.

£500,000

With many high street occupiers struggling, a higher budget widens the choice of properties let to more successful tenants. Looking again at medical use, we recently acquired an independent pharmacy with a flat above in Watford (around £300,000, 4% gross) for a medical investor who knew that this business was not going anywhere – the flat above was the icing on the cake.

Another interesting deal that was done post-auction was a housing association in Cardiff let to the local YMCA (£300,000, 7.3%). It had a short lease and the local buyer will pursue residential conversion should the tenant vacate. Believe it or not, we have even bought in central London within this budget – a small café in Islington let to an independent for 12 years (£425,000, 5% gross) bought off-market for an investor.

£1m

With a budget of £1m, a London shop and flat should not let you down – it's a diversified investment that is not subject to residential property tax rules. We recently completed on a William Hill bookmakers with three one-bedroom flats above in Shepherd's Bush (£975,000, 5.6%). Even though the tenant had a short lease, it had plenty of reletting potential and our buyer had little trouble financing it.

Those looking for pure commercial investments should consider one of the strongest subsectors of the struggling retail market – convenience stores. We acquired a Sainsbury's Local at auction in Stourbridge with a break in four years (£960,000, 7.2% gross) for a portfolio investor and a Tesco Express in Neath with a break in seven years (£800,000, 6.75%) which we bought off-market for a local SIPP investor.

Sainsbury's Local, Stourbridge

TOP TIPS FOR ASSESSING COVENANT STRENGTH

The main difference between investing in commercial and residential property is that the value of your property can be substantially influenced by who the tenant in occupation is, *writes Nilesh Patel, director at Prideview Group.*

So if it's not a AAA covenant on the hook, follow the below steps to give yourself the best chance of success:

- Find out the tenant's track record. Look at its history in that site but also more widely if it is a multiple.
- Go deeper into its finances, if accounts are available. For a smaller independent, profitability is key; for a multiple or blue-chip tenant, it's the net asset position that is your security.
- Visit the property during the tenant's busier periods and make your own judgment as to its trade. Check out the competition too.
- Talk to an expert. While we avoid some tenants like the plague, there are others we invest in over and over again. Such information can be very valuable.
- Look beyond the tenant. Have a plan B for your property should the tenant vacate. Does the unit have goodwill for a similar business to inherit? Would it suit alternative commercial uses or even residential conversion?

£2m

With a bit more in the tank one can look at convenience stores in and around London with longer leases. In the past few months we have acquired four convenience store investments let to the undisputed covenant of Co-op Food. Listed in order of distance from central London: Peterborough (15 years, £1m, 6%), Camberley (10 years, £1,2m, 5.5%), Watford (10 years, 1.2m, 5.75%) and Teddington (15 years, £2m, 4.5%). All of these deals were done off-market for fee-paying investors.

Turning back to shops with uppers, we sold a mobile phone shop and jewellers with offices above in Wood Green's High Road at auction

Co-op Food, Watford

McDonald's, Leicester

last month for £1.725m, a 5.5% yield. It was a solid investment with potential for future office-to-residential conversion, suitable for an experienced investor prepared to asset manage the property.

£4m

Now we are talking institutional-grade investments for high-net-worth buyers. Private investors at this level expect high quality, and that is what we delivered for one domestic investor who acquired a McDonald's in Leicester town centre on an 18-year lease (£2.5m, 4% gross). It's a trophy asset let to a restaurant chain that has adapted incredibly in recent times and is not feeling the heat some other restaurants are currently.

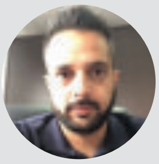
Moving back to London, we acquired a high-end kitchen showroom on a 100-year lease in Fulham for an overseas buyer for £2m, a 4.75% yield. Our client knew the business well and wanted to own it.

£4m-plus

At this level investors are moving away from big town-centre retail and all the uncertainty surrounding it. One interesting alternative we acquired for an experienced buyer was a beautiful shopping arcade in Walsall comprising more than 30 small retail and leisure units (£4.5m, 11%). Clearly it required heavy asset management, but with the loan we arranged he can expect payback within seven years.

A more hands-off investment was the Kone lifts office in west Yorkshire, let for 11 more years (£5m, 7.5%). This was not a permitted development play, but rather an investment in a successful company's regional offices with long-term rental growth potential.

How to handle a struggling tenant



Priyen Patel, director of Pride Management, Prideview Group's management arm

One of our properties in Leicester town centre was let to a struggling blue-chip tenant. The owner acquired it in auction independently and came to Prideview for help when the tenant spoke up.

Despite its national coverage, some of the tenant's high-street units had been losing money owing to high rents and strong competition. To assist its cashflow we offered monthly rather than quarterly rental payment. When this did not work, we suggested it could sublet the unit.

However, it wanted to surrender the lease, which had eight years unexpired, for a premium. We accepted on the condition that it pay full rent for six months while the unit was marketed. This minimised rental voids and saved our client from paying vacant business rates.

The proceeds of the surrender premium allowed us to let the property at a lower rent in order to attract a suitable tenant.

It is better to work with tenants rather than risk becoming embroiled in a costly administration or CVA. The priority should always be to achieve a long-term income stream rather than to chase yield.