Surviving Covid-19 - Can I use my commercial property to unlock value?

By Andrew Jefferson

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In good times, many businesses choose to own their own property and rent to themselves. In this way, being an owner-occupier is often a sound strategy as you pay your own mortgage and build up an income-generating asset. You are secure in the fact that the property is your own and thus have security of tenure.

Andrew Jefferson, a director of Annenberg Property Group

However, in more economically stressful times, such as these currently experienced, there is a significant opportunity for these individuals to release this equity to employ towards their business. A great mechanism for this is a sale and leaseback, which involves selling your property to an investor and agreeing to lease it back from them under predetermined conditions.

A major South African supermarket chain recently became a good example of this. They initially chose to develop and own many of their own shopping centres and began to generate significant rental income from these. Recently, however, they have been unlocking value from these by signing leases and selling them on to investors. In this way they control the terms of their leases for the long term, as well as unlocking significant value from their portfolio to release into their business.

Typically, a business would demand higher returns on capital than a property would. Where you may sell your property at a 10% yield, you would expect to generate a higher yield from your business. It is also crucial in these times to be able to focus entirely on your business rather than worrying about maintenance and other property-related stresses.

Lower financial risk profile

In addition, the financial risk profile as a tenant is lower than being an owner-occupier, as you can budget exactly on the costs associated with the lease, being rental and operational costs. It eliminates the extra worry of large once-off expenses like having to repaint the building, replacing rusted gutters or windows, or any unexpected large maintenance or capital replacement work.

Many leaseback arrangements can contain a Right of First Refusal clause, where the tenant has a first right to purchase back the property should the investor choose to sell it again at a later stage. Another example is an Option to Purchase clause, where the tenant has a predetermined right to purchase the property back from the landlord at a set price and under set conditions either at the end of the lease agreement, or at another agreed time. These are great mechanisms allowing the tenant to focus on their business in the medium term, but with the long-term goal of once again becoming the owner of the property should they so choose.

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Zero-rated VAT purchase

Notable benefits of a sale and leaseback to an investor include a zero-rated VAT purchase and an immediate income from a tenant who has usually meticulously looked after his/her property and who has set the property up to exactly suit his needs. The investor also doesn't have to worry about broker commissions, costs of vacancies, high tenant installation costs and the additional admin of dealing with municipalities should a new tenant require any construction work to the premises.

Annenberg Property Group has recently concluded a few such deals with large motor dealerships and are in the process of negotiating a deal on a property where the owner is looking to retire in a few years and wishes to simplify his life.

There are a few additional factors to consider before deciding on whether this route would suit you. Firstly, an owner will need to understand the achievable price and realistic monthly rental that investors are likely to purchase the property for. Consideration needs to be paid as to whether this monthly rental is affordable, as businesses may have been paying much lower rental to themselves. Secondly, you need to understand your net cash position post the sale, which would account for commission, capital gains tax and settling of the mortgage bond.

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Prices need to be realistic

Also, some owner-occupiers may have an over-inflated version of what price is achievable for their properties and the worst thing that a property agent can do is to pander to these lofty aspirations simply in order to secure a mandate. More than ever in the current environment, prices need to be realistic in order to achieve a sale. This is not to say that prices are going to be depressed - there are investors who are extremely eager to take advantage of the reduced interest rate environment. But they will not be willing to overpay for assets given the uncertain market.

With commercial real estate set to return to work under level 3 of the lockdown, they are able to advise on market-related rental levels and what value to expect to achieve for a property in this market. They can view all the details, visuals, and related market and other data regarding a property, work on the lease agreement remotely, compile an investment schedule and send the property to targeted investors who are actively looking for property even in this market.

The current crisis is almost certain to be putting financial strain on every business. A sale and a leaseback may be the solution to keeping your business running in both the short and long term.

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