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Helping clients transition from residential buy to let to commercial

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I think it's fair to say that residential buy to let landlords over the past couple of years have had the proverbial kitchen sink thrown at them. Stamp duty surcharge on second homes, changes to mortgage underwriting standards, and the ever-reducing mortgage interest tax relief coupled with Bank of England challenges and geopolitical impacts on our sticky economy, it seems there has been a conspiracy to help dampen buy to let purchase activity.

Against such a backdrop, we're seeing investors diversifying beyond 'vanilla' buy to let to maximise profits and spread risk, which includes looking at commercial as an alternative. The reasons for this are understandable. The main attraction of commercial property comes in its exemption from the major tax changes that have hit residential buy to let including the phasing out of mortgage tax relief. Commercial property stamp duty rates are capped at 5% over £250,000, while residential Stamp Duty Land Tax (SDLT) rates can reach 12% (on properties over £1,500,000).

Even so, investing in commercial property is not risk-free and potential investors should do their homework. The commercial property market is all about valuing the income stream, its certainty, regularity and security.



The checklist for anyone looking to invest

Estimating the value of a commercial property is harder than in buy to let because of the greater range of factors that can affect it. A valuation is therefore a little more complicated than a residential property, which should affect both the investor's decision-making, and that of a lender. The following three considerations will help decide whether a property is a sensible investment.

Firstly, investors should look at physical aspects such as location, size, condition, how the property is configured, and whether it has parking, or is close to good transport links. Make sure that your client has a reputable, independent surveyor to call upon to ensure that the necessary checks have been

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done. Equally, encourage them to do their own due diligence – spend time in the area, ask questions and read up as much as they can.

Secondly, there are legal concerns such as the nature of the lease, its length, break clauses, opportunity for rent reviews and business rates liability.

Finally, there are economic factors to consider such as occupancy rates elsewhere along the street. This includes anything from how long other places are staying on the market to whether it's an affluent area. This also applies to the tenants they accept – it's better to have a stronger covenant that's more likely to remain in place even after a difficult phase of business.

What do prospective investors and brokers need to know?

For those thinking about making the move over to commercial buy to let from residential, there are a number of differences between the leases that landlords should be aware of.

In general, business tenants tend to sign up for longer leases – some of which can be decades long. However, break clauses are common, with tenants often needing to adapt to rapid expansion or decline.

There are additional responsibilities for health and safety that would not apply to a residential property. Fire, electricity, gas, fixtures and fittings, and asbestos all have different regulations that a commercial landlord should consider. The Code for Leasing Business Premises in England and Wales was published in 2007 outlining the responsibilities of commercial landlords and tenants. While not a legal requirement, it's worth knowing about to see what tenants may expect of their landlord, and what competitors might be offering.

In short, there are a range of hoops that face a client looking to take a leap into commercial buy to let, but there are good reasons to do so. These decisions are only made more complex by the current economic environment. However, this emphasises the valuable role of the broker in these circumstances, helping inform clients, and navigate through the myriad of decisions they have to make. For brokers looking to diversify into commercial, not only will this additional expertise be a value add for current clients, but as more landlords look into this route it could also be an alternative source for new business going forward.