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Time for real values on commercial property

One of the major transparency problems in the commercial property market is the use of inducements and the openness (or not) with which they are disclosed, writes Lorcan Sirr

The recent letting by Shelbourne Development to Dolmen Stockbrokers of space in the newly refurbished 75 St Stephen's Green was apparently one of the first lettings in several years to happen without the use of inducements.

Whether this is entirely true depends on whether or not a landlord paying for a fit-out of space for a tenant is considered an inducement.

But the disagreement over whether or not the yields being quoted for the sale of the building were accurate or not highlighted some ongoing issues in the commercial property market as a whole. In particular, it brought home the question of transparency in the market.

The Irish commercial real estate market is, in reality, fairly transparent. According to Jones Lang LaSalle's Global Real Estate Transparency Index 2006, Ireland is joint 15th (with Austria) out of the 56 countries mentioned.

That puts us in the second tier out of five, behind such countries as Australia, the United States, Sweden, and even South Africa. (Vietnam came last, in case you were wondering.)

Not too bad, all-in-all, but when yields are so low and the sums of money involved so huge, any improvement on 15th could well be financially advantageous to all concerned in the long term, and commercial property investment is all about the long term.

A new question on Jones Lang LaSalle's Global Real Estate Transparency Index 2006 concerned the availability of information regarding properties for sale or lease, on which we could undoubtedly do better.

And that's the point, for one of the major transparency problems in the commercial property market is the use of inducements, and the openness (or not) with which they are disclosed.
As inducements have a direct impact on the amount of net income generated by a property, the disclosure or lack of disclosure – in other words, transparency – can have a significant impact on the true value of a property. This is particularly pertinent when the building in question is being used as a comparable to value other property.

Inducements are prevalent in the Irish commercial property market and, being designed to fit the individual tenant, can take many forms.

They are often to be found as rent-free periods, periods of staggered or stepped rents, premium payments to tenants, break clauses, contributions by landlords to the costs of any fit-out for tenants, or indeed the acquisition by the landlord of new tenants’ existing lease on another property.

All very well then, and when inducements encourage a struggling market, or indeed simply fill empty space, they are very welcome.

After all, buying one tin of beans in your local supermarket only to receive another one free is a form of inducement, and we happily live with them every day.

The problem is, if your local supermarket was for sale, the inventory will describe in detail all remaining stock after the buy-one, get-one-free offer. It’s possible to work out the net cost of the customer inducement.

In the commercial property market, these inducements are very rarely disclosed, nearly always being the subject of confidentiality agreements, and as they have an intrinsic financial value – a year’s rent-free is, on the face of it, a year without rent for a landlord – not disclosing them is effectively masking their existence to interested parties.

A potential purchaser or a valuer arrives on the scene and has to second-guess the real financial value of the income stream based upon nothing more than personal knowledge, experience and contacts or those of his or her surveyor.

As the value of the income stream will be a major determinant of the capital value of the property, then it is vital that accurate financial information is acquired and analysed.

The problem lies in the sourcing of this information.

Valuers look at similar recent deals and
analyse the rents and prices quoted, but
again accuracy is difficult as alongside the
inevitable confidentiality clauses, many
leases are structured to protect the
landlord's long-term and reversionary
interest by keeping the headline rent as
high as possible.

Information is garnered from other
valuers, but eventually everybody is a
competitor, and many agents are
landlord-oriented, and are also unwilling
to create a situation where they reveal
information only to have this used as
evidence against them at some later date in
a rent review or arbitration.

Valuers, of course, are aware of the
prevalence of these inducements and the
ever-enthusiastic use of rental figures, and
make very competent attempts to
incorporate them into their valuations. But
they are only attempts, and their success at
analysing the hidden element of a
commercial property transaction truly is
partly science and partly art. Inter-firm
competition, client confidentiality and a
paucity of real evidence makes accurate
valuation difficult.

A large degree of the reliability of
complicable information is dependent on
having faith that the figures being acquired

are indeed true and accurate. In many
instances the comparables are to an extent
"true", but are they always accurate? And
when so much money is at stake surely
there is a better way of ensuring more
accurate values are determined?

What is really needed is more
transparency in the market.

The so-called "free market" is not really
free in the world of commercial property
due to the lack of reliable and accurate
information.

One system to improve transparency is
by means of a central commercial property
transactions databank. This could be
established on a statutory footing, but
there are already successful private sector
examples in places, such as Scotland and
Connecticut.

In this the true and accurate details of
each and every commercial property
transaction would be compulsorily
recorded.

Inducements would be acknowledged
and accounted for in each and every
transaction.

Figures would be broken down into the
essentials, such as true price per square
metre, recording and value of any
inducements, and capital value and hence
yields derived. Details, such as location,
would be necessary in order to be able to
track yields and rents in specific areas, but
access could be restricted to specific groups.
This would not be a tool to enable the Revenue Commissioners to chase the occasional forgetful investor, but an instrument that would aid valuers – and the market in general – to come to terms with reassessing the valuation, and potential overvaluation, of commercial property in Ireland. This would initially create a two-tier system of accounted-for and non-accounted-for valuations.
But, coupled with modern valuation techniques over a period of, say five years, when most commercial properties would have had a rent review, this would bring about a gradual realignment of market values, creating in the meantime a more sound economic basis for the market. Many interests would – in some ways, understandably – be natural objectors to this, but thinking strategically, transparency ultimately makes everybody a winner, including the market itself. And as the world of real estate becomes increasingly global, it is especially important not to deter international funds through opaque habits.

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Transparency ultimately makes everybody a winner, including the market itself. And as the world of real estate becomes increasingly global, it is especially important not to deter international funds through opaque habits.
75 St Stephen’s Green, Dublin 2: the 9,412sq m (99,695sq ft) building has seven floors ranging from 596sq m (6,425sq ft) and was refurbished by Skolbourne Development. The recent letting of space in the modern office block to Denise Stockdale was one of the first Dublin lettings in several years to happen without the use of inducements.