PRESS CUTTING

Lending Strategy | CROWN WESTFALEN | **1 September 2008**

lendingstrategy

Julien Holmes, managing director of Crown Mortgage Management, says that the Grim Reaper is visiting the commercial property market but not all firms are victims, so lenders must look carefully before rejecting applications

Less blunderbuss, more rifle

Tenant demand for commercial property declined at its fastest pace since the late 1990s during Q2 2008. But although certain sectors are struggling, it is not a picture of doom and gloom across the board.

Worst hit are the retail and office property sectors, especially in the financial services industry. The problem for lenders is that reports of struggling sectors can create havoc with new business and ongoing administration but in the current market, the blunderbuss needs to be replaced with the rifle.

The Bank of England recently gave a fairly upbeat review of the commercial market stating that the majority of businesses were still largely unaffected by tightening credit conditions. This was either because they had access to adequate amounts of internal finance or their committed facilities remained sufficient, particularly where investment plans had been cut back.

When looking at loan applications from pubs it is important for lenders to ask about the breadth of the menu, the quality of the chef and the trend in food sales volumes

Unsurprisingly, the BoE reported that businesses most exposed to the slowdown – particularly those in property-related sectors and retailers of big ticket homeware goods – had either scaled back their expansion plans or were looking to sell off capital assets.

The present issues in the commercial property market don't all stem from the same problems so it is important to look at each economic sector individually.

For example, manufacturing output growth is unchanged, including the production of capital goods such as commercial and military aerospace hardware, agricultural machinery and a variety of energy-related goods. Meanwhile demand has weakened in the domestic market for consumer goods and building materials.

Meanwhile construction, especially residential, has suffered a sharp decline. The commercial property construction sector has remained fairly steady but this is due more to pipeline work and I expect this sector to suffer equally in the near future.

The service sector is experiencing mixed fortunes at present, with professional and financial services firms suffering generally. But, as with every other sector, there are winners and losers. I know several repossession lawyers who are not unhappy with the current situation, but their feast may be their conveyancing colleagues' famine.

From a mortgage outsourcing point of view the market is good, but lenders are not enjoying the same good fortune.

When it comes to other business services, advertising agencies have suffered a sudden slowdown in demand from house builders and retailers. And hotels have seen reduced business spending on banqueting and conferencing facilities, which they are attributing to cost-cutting measures by their customers.

It's important not only to look at economic sectors because geography also plays an important role, especially when a sector is a large local employer.

For example, central London saw a dramatic 50% slump in commercial property transactions in the first half of this year.

The City and West End areas of the capital have seen the volume of investment transactions fall from £10.3bn in the first half of last year to £4.9bn in the first half of this year according to figures from prominent property agency Cushman & Wakefield.

The City's commercial property market has been particularly badly hit. In Q2 2008 investment volumes slumped to £1.1bn – down from £5bn in the same period last year. And nearly half of the turnover was from the sale of just one property – British Land's Willis building to Middle Eastern investors for £400m, underlining the weakness of the rest of the market.

The same is true of tertiary sectors that may not otherwise have been affected. A significant business closure or mass redundancies locally can have a dramatic impact.

Therefore, it is important to track what is going on outside of your own sector as this may have an impact on your business.

Julien Holmes

The problem with the preceding analysis is that generalisations can result in the restriction of lending to whole business communities whereas in reality there are winners and losers in the current environment – the skill lies in spotting them.

Cast your eyes around sectors that are traditionally hit hard in an economic downturn. Pubs and clubs normally feature highly so it would be easy to stop lending to all of these, especially given the statistics.

Compared with 30 years ago, some seven million fewer pints are being sold every day in pubs. And in recent months the rate of decline has hastened, with beer sales presently down 4.5% compared with this time last year.

From a lender's point of view, it would be easy to make a quick exit. But would it be fair? Recent results from M&B, owner of the Harvester chain, were good, as were those from JD Wetherspoon. But what these figures demonstrated was a move away from booze and towards food, as well as a change in customer spending patterns. For example, M&B's budget food-based Sizzling Pub chain performed best out of all its operations.

In the present environment, we are witnessing a change in consumer behaviour, whether this is a move away from restaurants towards pubs due to a lack of affordability or an increase in off-licence sales because of the smoking ban in pubs and clubs.

So when looking at applications and monitoring the loan performance of pubs it is now as important to ask about the breadth of the menu, the quality of the chef and the trend in food sales volumes as it is to enquire about all the other factors involved in traditional commercial lending.

The same is true of the retail sector, where we are seeing a move away from premium brands and towards discount retailers. Budget supermarkets such as Lidl – Europe's fastest growing store chain – and Aldi as well as retailers such as Poundstretcher are carving themselves a greater share of consumer spending while higher margin retailers are suffering.