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Should a client sell their freehold, or find a tenant for the property?

I have received regular requests for advice from freehold owners of restaurants, hotels and public houses who are considering what to do with their business. They no longer want to run the business themselves however; they don't necessarily need the cash that would be released from an outright sale.

There are of course benefits attached to selling the freehold and/or leasing the property, broadly speaking, they are as follows:

The obvious benefit of selling the freehold is that it releases cash immediately that can be used for either the purchase of another business or to invest. The owner has no further connections with the business i.e. it is a 'clean break'. However, for some people who do not need to fund the purchase of another business, they wonder if they could get a better return on their money by finding a tenant who would pay them rent. There is no easy answer and every situation needs to be considered on an individual basis.

The most important thing for a prospective Landlord to consider is whether or not the rent is secure and will be paid on a regular basis. Remember, the only way a tenant can pay the rent is if it is set at a realistic level. The business needs to produce sufficient profit, so that a tenant can pay part of that profit as a rent, (eg within the leisure industry it would be between 40-60%) leaving sufficient money for the tenant to earn a living at a standard they are happy with, for the amount of time and effort invested.

The obvious benefit of leasing the property is that with very little input, a regular monthly or quarterly income is received. Also, the freehold asset is retained, which, generally speaking, should increase in value (if we appreciate that historically, over the medium to long term property values generally increase).

Whilst a number of positives can be attributed to each route, there could be possible drawbacks, which need to be considered. The most obvious, is that a tenant could fall on hard times, or ruin the business. The first danger is that the tenant stops investing in the business and the general condition of the property deteriorates. Also, if a tenant is struggling, they will stop paying the rent. Therefore, the ultimate danger is that a landlord is faced with the tenant going bust or "doing a runner", and they are handed back an empty property, in poor condition, and perhaps with no inventory. They probably would also not have the profit and loss accounts from when the tenant was running the business and therefore, if they wanted to sell the property, it is likely they would receive a lower price than if they had sold it as a going concern with good profit and loss accounts at the outset. There is an option here that the owner could go back into the business, run it themselves for a number of years and try to produce profit and loss accounts which would help a sale at some point in the future. However, this could happen at a time when the owner had intended to retire and use the income as part of a pension.

If a freehold owner is considering granting a lease, I would strongly recommend they take expert advice from a licensed property agent/valuer in the first instance. This will give them a guide to a realistic rent, and in-goings, before meeting with their solicitors.

Practically, you need to contact a solicitor to draft a commercial lease with all the relevant clauses regarding rent reviews etc. You must also take up financial references on any prospective tenant and inform, even obtain permission from your insurance company, and the mortgage company (if applicable).

This is a guide, but no safety net. I have received calls from people wishing to sell a business where trade has suffered, not because the owner, operator or tenant has been incompetent but because of lifestyle circumstances such as a bereavement, serious illness or divorce. The best advice is for the client to take expert advice; this will help understand the best direction for them and their businesses.

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