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Investors face refurbishment headache

Refurbishment required: the former Bank of Ireland headquarters at Baggot Street, Dublin 2, will have to undergo an extensive refurbishment before it can be re-let. The complex was bought by a group of investors for more than €200 million in 2006 and is currently in receivership.

Standards and regulations have evolved to reflect current needs, resulting in buildings which are outdated becoming redundant unless they are refurbished

Very few investment properties have been constructed over the past five or so years. Additionally, the market has moved from being a landlords' market where tenants took what they were offered, to being very much a tenants' market requiring higher standards of finishes and services – usually for lower rents.

Existing properties reflect the standards and statutory requirements of the period in which they were built. However, those same standards and regulations have continued to evolve and reflect current needs, resulting in buildings which are outdated becoming redundant unless refurbished.

While existing buildings generally don't have to immediately conform to the new standards, it is a different matter when it comes to refurbishment or fitting out older buildings and bringing their floor space up to the standards expected by both the law and also discerning tenants.

For example, if the windows need replacement as part of a refurbishment, then new ones have to meet energy standards often requiring triple glazing. Three layers of glass will add significant additional weight to the structure, and strengthening may be required in some cases.

The higher insulation values demanded now may result in a reduction of floor area if the additional material has to be fixed to the internal walls of the building.

New partitioning layouts may require full compliance with new fire escape requirements and so on.

Access and egress requirements combined with the provision of adequate facilities to address the needs of the disabled can create serious issues for the refurbishment of older buildings, in many cases challenging the architects' ingenuity to provide a cost-effective solution.

Heating, lighting and lift systems have changed significantly in the way each delivers its respective service. In an era when everything seems to be produced as a microchip, the sheer volume of additional mechanical and electrical features needed to service and operate a modern building

results in additional space requirements for these services. There is also often a requirement to make significant structural alterations to provide the accommodation.

It gets particularly complicated if the building is on the list of protected structures in a Development Plan where the building regulations say one thing and the conservationists often say something else.

There are two serious consequences for the existing or new property investor.

Firstly, the costs and difficulties of carrying out a refurbishment have increased significantly, and a refurbishing project which might have cost €30 per sq ft five years ago can now cost double or treble that figure.

Secondly, the value of unrefurbished buildings has fallen as new investors factor in the increased costs of meeting tenants' requirements.

Many institutional and private property portfolios now hold properties dating from the 1970s, 1980s and 1990s. Most of these buildings face large refurbishment costs. Many investors have on the close horizon a double whammy of expiring leases as well as big refurbishment bills. Some of these older buildings may, due to design or other factors, be more valuable as redevelopment sites than as cases for heavy refurbishment.

Whether to spend big money or demolish and rebuild is often a hard call by property asset managers because if you spend large sums on an obsolete building frame it can be money down the drain in the long term.

But in addition to the changes in building standards, there has been a noticeable shift in tenant standards which may make simple refurbishment uneconomic. For example, industrial and warehouse tenants demand changed specifications – greater floor-to-ceiling height, fewer columns, super-strong floors plus loading docks and ample truck parking. Consequently, many of the vacant industrial buildings now gracing our 1970s, 80s and 90s industrial estates are effectively slums waiting for full site clearance.

It is the same for office buildings with obsolete air conditioning systems, inefficient floor space, low ceilings or bad glazing systems. The one thing that these older buildings have is lots of car space in big basements, but this is often no longer in high demand as workers transfer to public transport, bicycles etc.

Retail and the high street have not escaped locational obsolescence because of changes in consumer demand and spending patterns, and also greater competition resulting from the oversupply. Many shops that were once prosperous have lost footfall and either closed altogether or are producing lower and less reliable rents from lower calibre occupiers.

Keeping a property portfolio up to date is challenging and does not happen by accident. Apart from regular reinvestment, professional asset managers are aware of the continuously changing technical and market environment, and strive to keep their portfolios in top condition by taking action on a property-by-property basis – with a business plan for every property.

Such action may be by selling a particular building, by accumulating sinking funds for vacancy and refurbishment or securing planning permission for redevelopment. The fact that we are in the middle of a property recession does not stop this ongoing work. Indeed, sometimes it is easier to implement portfolio changes in a recession than in the teeth of a boom as tenants are more accommodating and amenable to change and building costs are lower.

Many inexperienced investors bought property in the good times and had no appreciation of the ongoing asset management work necessary. Many such holdings are now approaching lease expiry events and refurbishment challenges, and the owners don't realise that running a property portfolio is a business not a sinecure.

Unfortunately, many of the armchair self-appointed property asset managers of the boom era failed their clients not only by bad timing and overleveraging but by a failure to diversify clients holdings by concentrating all assets in a single building and not anticipating obsolescence. Experienced property asset managers strive to have at least 10 differentiated properties in a balanced portfolio, so that if one or two properties turn out to have problems the other ones will make up for the deficiency, and the expense of refurbishment is spread over a broader rent roll and a broader time scale.

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