

SURAJ DE SILVA

OF FAVOURITE GROUP SHARES HIS VIEWS ON COLOMBO'S COMMERCIAL REAL ESTATE



Favourite Group, commended for its divergence in operations, holds The Landmark Property as the beam of the real estate sector among all commercial, residential, warehousing and manufacturing spaces that it possesses. Suraj De Silva, a Director of Favourite Group, provides a broad overview of the impacts of the recent events on the commercial real estate segment and the part played by the Favourite Group Property sector.

The pandemic has had crumbling effects on many industries worldwide. Given your experience, how significant were the impacts on the commercial real estate market in general and on Favourite Group properties, especially The Landmark?

The COVID-19 pandemic has impacted us in several ways. Initially, we were faced with various operational challenges. As the landlord, we should provide maintenance, security, janitorial and other management services. We had to segregate management staff and operate in different teams as separate bubbles. We provided transportation as a precautionary measure during the pandemic, as we did not want our staff to use public transport and get exposed to any health hazards.

Secondly, from a client's perspective, due to the prolonged lockdowns and the stagnation in economic activities, tenants started demanding rental cutdowns ranging from 20% to 50%, depending on the type of business they were engaged in.

Despite the challenges, we were able to cope with the setbacks. Since The Landmark is a medium-sized A-grade property, we were able to cope much better with less human traffic, than the

other large A-grade properties located in the heart of Colombo. Several of our properties are located in areas slightly away from central Colombo. We had different challenges in those properties as tenants engaged in manufacturing processes, could not offer the same facilities we provided our staff during this challenging time.

Do you see a difference in enquiries for commercial space pre and post covid?

Yes. We would generally receive 10 to 15 enquiries for an advertisement placed pre-covid. However, it has now slumped down to about 2 to 3. There is a clear reduction in the number of people looking for commercial space.

As the Favourite Group had been in the market for a sustained period, what were the trends in price appreciation prior to the onset of the pandemic?

Examining the market from 2009 until 2017, showed property values and rental rates appreciating annually at a percentage ranging from 5-6%, which was very close to our inflation rate. The Return on Investment (ROI) has remained at 6-7% and 8% in certain years. Although there had been stagnant periods, very few developers were willing to lower their rental rates. However, during the last two years, with the

economy being afflicted and sluggish, people sought to sell properties at slightly lower rates than before. Therefore, we observe a diminution in their holding power and it is uncertain if this trend will continue.

In addition, due to the impacts of the Easter Sunday attacks and the unprecedented pandemic, most of the tenants have been paying the same rental rates they paid at the end of 2019. We were hopeful for things to improve by mid-2021, but unfortunately, we are presently impacted with a worse situation compared to mid-2020.

How do you ensure that your properties stay competitive with price points?

Since its inception, our key focus has been to provide novel facilities to keep abreast. Looking at what our building lacks vs a brand-new construction, it would just be the look and feel. Those aspects can be further upgraded with a little investment and we have plans to refurbish our facilities.

In terms of facilities, we have been ensuring to provide the finest and we are delighted to proclaim that we are pretty much on par with most of our competitors.

Regarding location, our most important two properties,

The Landmark and FgCity, have convenient access from Galle Road. This is the main artery that connects Colombo to the South, enabling our tenants to use public transport and thereby adding it as a competitive factor.

What typical taxes are applied to each floor space allocation to an occupier?

Before the change in the last budget, our tenants were liable for NBT (National Building Tax) of around 2% and VAT (Value Added Tax) at 15%. However, presently there is no NBT and VAT was reduced to 8%. These are significant savings for clients.

Another challenge that we as a company face, not due to COVID-19 but rather a tax policy that was implemented by the Government for companies that own residential properties. A challenging policy imposed in 2017 was that companies that were VAT registered had to charge VAT from residential clients. Thus, we had to set higher rentals for our residential tenants or absorb the tax liability within our rates.

Hence, we had to rent those spaces for VAT registered companies or find VAT exempted clients, which is not easy. Therefore, if I were asked to suggest favourable changes in policies; one would be to abolish value-added tax for

residential units.

What is the generally accepted currency for properties at Favourite Group? Have you noticed any advantages to using the USD over the LKR or vice-versa?

The company that owns The Landmark is a BOI approved company. Hence we can accept payments in USD and we do have certain clients who pay in USD. The currency accepted depends on the sources of income of our clients.

The key advantage with the USD is that fluctuations do not negatively impact us if rents are locked based on dollars. Moreover, during times of borrowing, we can borrow at a lower interest rate provided we have an income in USD to repay.

How do you think the development of the Port City will impact the commercial real estate market in Colombo?

The Port City is set to add around 1.5 million sq. ft. of commercial space. It will certainly have a drastic impact and all businesses will collectively have to be vigilant about it.

The Port City is most likely to attract a new segment of people, especially international clients who would want to enter for diversified benefits. My view is that very few local

companies would be interested in moving into such space unless they have a unique advantage. There could be openings of new business branches to capture the market at the Port City. Still, I do not think that they will close down existing branches that are currently in properties like ours, especially considering that we are situated at a considerable distance from each other.

The current pricing of commercial properties ranges from about LKR 250-400 per sq. ft. The Port City undoubtedly will not be able to market properties at those rates in the city. To cover their expenses, a new property in the Port City would have to charge around LKR 600 to 800 per sq. ft., at least. It is difficult to conclude if people would be willing to pay double or triple the rent they are paying now.

On the whole, it will take at least 2 to 3 years for us to experience the impacts. The advantage of newer buildings coming up at higher rates is that it would allow us to adjust our rates to a certain extent. People will perceive our properties to be comparatively affordable. Overall, it will generate positive benefits and enable us to increase yields by a certain percentage.

Looking ahead, is Favourite Group in the process of

any other developments?

I do not see us pursuing a massive construction, at least for another year or two. However, a glimpse of our prospective plans would firstly be the development proposed adjoining The Landmark building where we have a considerable-sized property.

We have also been gradually developing the FgCity property on the borders of Ratmalana and Moratuwa, which also has about 60,000 sq. ft. rented space. Also, we are yet to develop a plan for 1.5 acres of bare land. I believe that developing an area of that nature is much more conducive rather than developing one in Colombo, considering the current economic situation, congestion and transport issues.

An overall consideration for our properties, including The Landmark, is to make investments to upgrade available space in order to remain competitive with whoever is coming up with newer properties, rather than investing to create newer spaces in the current pandemic situation.

However, we are looking at expanding our property portfolio with newer acquisitions, especially at a time that lending rates have been reduced to considerably low rates compared to the past.