Commercial Property Professionals Buying Again

Around May this year Stenham, the property and hedge fund manager, bought a central London building for less than half of its asking price. Number 52 Grosvenor Gardens had been on the market eighteen months earlier for £57 million. Stenham purchased it from the Duke of Westminster for £25 million. The price meant an effective yield of 9.4%. Was this deal a sign that the commercial property market had reached the bottom? Is the tick up in the IPD (Investment Property Databank) UK index in August a turn in the market or an aberration?

Paul Arenson, Managing Director of Stenham Property, has been buying back into the UK market since March, in a major step change from his previous stance.

'We stopped buying in 2005 in the UK but in the last couple of months we've been buying back in. The bottom was probably the first quarter and values now look similar to 1993 levels so it looks like a repeat of that cycle, with yields moving up nicely and capital values per square foot having gone down a lot.'

Arenson, whose firm runs the Commercial Property Opportunities fund, said the real test facing the sector was tenant demand going forward. Commentators are agreed that there is likely to be further downward pressure on rents in the coming months given the large amount of free space, as well as the impact from rising unemployment.

There has been a rash of insolvencies as weaker retailers fall into administration, but Arenson said this had largely been factored in.

Arenson conceded there was not likely to be substantial capital gains in the next few years, but over 5 years he expected to make money on the initial purchase price, and it is not just property investors who are now keener on the UK market.

There are also encouraging signs that banks are not forcing property companies to offload buildings at any price while some of the property vehicles quoted on the stockmarket have raised money, not just to make their balance sheets more secure, but to buy back into the market. Other professional investors in commercial property have reduced cash weightings to buy back into the market.

Threadneedle's UK Property Trust manager, Don Jordison, has had around 55% of his £45.5 million portfolio in cash over the past two years; he has now almost halved this after snapping up a number of opportunities.

He said: 'The UK has one of the most sophisticated commercial property markets, and although some of the really distressed deals may have gone already, we are still buying across the board.'

Jordison said that compared to the yields being paid in July 2007 at the height of the property market – which equalled around 4.6% - investors were now getting paid around 8% to hold a real asset for almost half the cost.

Jordison added: 'Of all the market's you wanted to be down 44% it's the UK because of the long leases and high yields. I'd much rather buy UK commercial property as it has been properly written down by valuer's.'

Another investor now buying back in to the UK market to take advantage of recent weakness is Michael Barrie, Legal & General's UK Property Unit Trust manager.

Barrie has halved his cash position to 15%, and he expects it to fall into single digits in the next few months.

Barrie noted that a lot of the opportunities to pick up very cheap property had actually happened already.

He said: 'In the later part of the second quarter in particular there were some really good opportunities, and that has actually eased off now in terms of the number of distressed sellers.'

But he said although it was getting more competitive once more – thus pushing up prices – there were still plenty of chances to make money going forward.

'There are still liquidity constraints on some buyers, so for equity buyers there is less competition, and the rally hasn't been missed with prices still down 44%.'

A key factor to consider at present is the very high yield that can be obtained from commercial property.

Barrie said in the short term the high yield was the main reason for investing, with the average payout currently around 8%.

Better than gilts

Simon Edwards, the chief executive of fund house Midas Capital Partners which runs a range of multi-asset funds, said the commercial property market had bottomed already. He added that the yields on commercial property were attractive at present, and looked a lot more interesting than gilts or corporate bonds which have seen their yields fall back, although he said it was very important to focus on the quality of tenants.

'Weaker sterling will also attract overseas buyers and that will help stabilise the market', he added.

However while he was positive on the sector, Edwards said there was no hurry to invest since a sharp rebound in values was not expected.

He said: 'We haven't bought back in as yet, as we aren't expecting a quick recovery, so there is time to make the investment.'

While Edwards, in-line with most property fund managers, thinks the sector looks more attractive again after its dramatic correction, he warned there could be some weakness caused by sales of property held by banks. This is a key point with some in the sector believing that banks now prefer to work with property companies to create new vehicles so that they do not have to dump property on the market to repay loans.

Not everyone agrees!

Another manager who focuses on a wide variety of assets, and who is currently not buying back in, is Gartmore's head of multi-manager funds, Tony Lanning.

Lanning noted the sector had enjoyed a second consecutive month of positive returns, with yields now appearing 'quite attractive', but he warned there were a number of risks for investors to consider, in particular the hugely discounted deals being offered by some property companies desperate to attract tenants.

He said: 'There is currently a huge oversupply of units, especially within the retail and office space, which is putting downward pressure on rents.

'Huge incentives packages are being put in place to encourage would be tenants into lease agreements, an example being Nomura who recently secured a 6 year rent free lease to relocate its 4,000 staff from Canary Wharf to the City.'

Lanning said such activity would drive yields down, and when combined with the extreme lack of liquidity within many of the funds available to investors, on a risk returns basis he said there were better opportunities elsewhere. Private investors in commercial property have had a torrid time. After being inundated with fund marketing material offering daily liquidity in funds - arguably something which is wrong for such an illiquid asset - they found themselves locked in and unable to get out.

Private investors have been stung before. Thousands were locked-in to their investments as the market corrected.

New Star suspended withdrawals and other fund managers or life companies introduced queuing systems to avoid being forced to sell properties at knock down values. Trading in the former New Star International Property fund for example, now known as the Henderson International property fund, is still suspended, although the group is trying to enable investors to exit as soon as possible after starting a program to sell existing assets.

Past performance should not be used as a guide to the future

Do not act on this information alone!

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