IPF Investment Property Forum

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INVESTMENT PROPERTY FOCUS

Preparing for the next cycle

From the editor

Sue Forster, Executive Director, IPF

With market sentiment changing every week, this edition of Investment Property Focus looks at both the current opportunities in the market, be they in specific sectors or global regions, and where the market may be heading.

The latest **UK Consensus Forecast**, published in March, anticipates all sectors having negative capital growth and total returns for 2008. However, all sectors, bar offices, are expected to show improved performance in 2009. Over five years, the forecasts indicate real annual returns in all sectors.

The current derivatives market is considerably gloomier than the overall Consensus Forecast, anticipating a 45% capital decline between 2008-12. **Paul Kennedy** of **Invesco Real Estate** suggests that this is unduly negative and that the current market could provide profitable buying opportunities for investors. The degree to which activity in the direct market has fallen is underlined in the Property Data investment transaction tables. We are delighted that Property Data has agreed to provide such data on a regular basis.

The research team at **RREEF Alternative Investments** looks at global prospects for the different property sectors and concludes that while property performance in 2008 and 2009 will be weaker than the previous few years, the correction in market pricing could offer attractive buying opportunities ahead of the market recovery in towards the end of the decade. In addition, there are considerable structural opportunities Asia and Eastern Europe.

The hotel sector is attracting increasing interest from property investors. **Mark Wynne Smith** of **Jones Lang LaSalle** compares the investment profiles of hotels and offices and considers the rationale for the existing risk premium attached to hotels.

Can property investors achieve 'alpha' – uncorrelated superior risk-adjusted returns – systematically? **Paul Mitchell** of **Paul Mitchell Real Estate Consulting** and **Shaun Bond** of **Cambridge University** seek to establish whether this is possible and, if so, whether there is a single winning formula. They also draw attention to the potential role for property derivatives in such a strategy. The use of property derivatives in the portfolio is also discussed by **Ian Cullen** of **IPD** in his paper on where the derivatives market is heading and how it could feed back into the direct market.

The difficulty of identifying the direction in market change is exacerbated by data from different organisations not always being consistent. As **Patrick McAllister** of **Reading University** explains, "Property advisors and analysts not only disagree about future performance but also about historic and current performance".

Continuing the theme of comparability of data, **Neil Turner** of **Schroders** outlines the results of the latest INREV study of European unlisted funds' fee structures and fee levels. The study follows on from the Fee Metrics Guidelines, which are designed to facilitate comparison as property funds now measure total expense ratios (TERs).

According to **Louise Ellison** of the **IPF** and **Bill Gloyn** of **Aon**, property performance is not the only thing investors need to be thinking about at the present time. Louise outlines the role of 'green leases' in achieving sustainable property objectives and Bill looks at the implications for the investment market if the insurance industry ceases to offer the same level of cover on property assets.

IPF Education Strategy

At the end of January, the IPF Management Board approved proposals put forward by the **Education Strategy Group**, following a review of the existing education strategy. The IPF's key priorities are now to:

- Seek feedback from the IPF membership on their investment property educational needs;
- Gain recognition from the relevant regulatory organisations for the IEP, starting with Part 1 as a route to authorisation for fund managers;
- Seek exemptions for those who have completed the IEP and are interested in conversion to a masters degree;
- Develop a more international education programme through the three key routes of the IEP, CPD Programme and the IPF Research Programme;
- Extend the delivery modes of the IPF educational strategy, e.g. podcasts of CPD lectures; and
- End separate promotion of IPF events in order to provide a comprehensive overview to the membership and re-align the IPF organisational structure to ensure co-ordination between different IPF groups.

Alastair Ross Goobey

This edition of Investment Property Focus includes tributes to Alastair Ross Goobey, a former President of the IPF, who sadly died a few weeks ago. The Service of Thanksgiving for the life and work of Alastair Ross Goobey will be held at St. Mary's Church in Upper Street, Islington, N1 at 11.00am on Wednesday 30 April 2008.

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Cover photographs, clockwise from top left:

Colmore Plaza, Birmingham – developed by Abstract Land on behalf of The Carlyle Group

British Land's latest development, Ropemaker, London

Edinburgh Park, Edinburgh, Miller Development's joint venture with CEC Holdings Ltd

Grosvenor's Liverpool One and Chavasse Park, Liverpool

Alastair Ross Goobey
December 1945 – February 2008

Alastair Ross Goobey CBE, died in February 2008 aged 62. Alastair held the office of President of the IPF for 10 years between 1995 and 2005, and he will be sadly missed by all those at the IPF who were lucky enough to work with him.

Below are some tributes from past chairmen and members and friends of the IPF who had the great privilege of knowing Alastair.

Alastair was a great friend of the Royal Institution of Chartered Surveyors and an invaluable source of wisdom, shrewd advice and eclectic knowledge to me personally. As Chairman of the RICS Presidential Advisory Group, he was highly respected, gave of his time freely and stimulated innovative strategic thinking. He will be hugely missed. **Louis Armstrong, CEO, RICS**

Alastair was a rare combination of being a true captain of industry whilst being a thoroughly nice guy – he will be sorely missed. **Stuart Beevor, Grosvenor**

For around 5 years, Alastair provided a monthly column for the Estates Gazette. It always rated as the 'most respected and well read' page in every survey we carried out. Alastair was a natural writer whose erudition, common sense and great experience of the property sector made him a columnist who we will not see the like of again. **Peter Bill, Editor, Estates Gazette**

In his role as President of the IPF, Alastair was one of the most creative, challenging and inspiring individuals who gave unqualified support to every IPF Chairman. He articulated the case for property investment to be made outside the narrow confines of the property industry and played a major role in the growth and success of the Forum. He will be deeply missed.
Rob Bould, GVA Grimley Limited

By any measure Alastair Ross Goobey was an exceptional man. His passion for property and contribution to the industry over the last 20 years was extraordinary for a man whose principal focus was on the wider investment and corporate worlds. However, it was the impression he made on all those who knew him in either his business or personal life which truly differentiated him. Throughout Hermes, Alastair was well-known and loved, and his energy, intellect, enthusiasm and his engaging and engaged personality touched everyone with whom he was involved.
Rupert Clarke, Hermes Pensions Management Ltd

I met Alastair a couple of times and heard him speak on several occasions. It always struck me how much of a gentleman he was, in the best possible way, and how he always seemed to be way ahead of the rest of the industry in his thinking. I am sorry that now I work for the IPF full time that I will not have the opportunity to get to know him much better.
Sue Forster, Investment Property Forum

I knew Alastair first as a neighbour and friend of my brother's, then as a joint venture partner in the Argent Development Consortium, then as the purchaser of Argent and finally as President of the IPF. He was a remarkable man. His energy and enthusiasm for life never diminished during a seven year fight with cancer. He had a fantastic mind and the best general knowledge of anyone I have ever met. The Alpha to Omega of quiz men. Alpha for his beloved Arsenal and Omega for his equally beloved opera.

He had an opinion on everything and, quite remarkably for a man of his seniority, was always prepared to reconsider it if convincing counter arguments were put up. His views on corporate governance were from the heart and the mind and reflected his natural sense of what was right. But he was no puritan. He enjoyed a party and mixing with the young and junior every bit as much as with the great and the good of which he was a member.

Alastair has been a great friend to the property industry, whether as President of the IPF, a director of Argent, Chairman of Invista, Governor of Wellcome or a columnist in the Estates Gazette or historian of the 80s boom and bust. In everything he was motivated by the desire for best practice, thoughtfulness, innovation and fun, all of which are core values for the IPF. We will all miss him. **Peter Freeman, Argent Group PLC**

Alastair was a man of great integrity and as a leading fund manager was so important in the development of the IPF and the IPFET. He used his position to support the development of property as an asset class and promote it to the investment industry. He took a personal interest in the success of the Forum and also at Hermes he actively invested in the sector most notably with the takeover of MEPC and believed that property had its part to play in the long term returns for institutions. He spoke and wrote most eloquently and from the heart and stood out as a towering figure whom all respected and will be sadly missed by his many friends and the property industry.
Andrew Graham, Colliers CRE

I well remember when John Whalley, Philip Nelson and I were debating who we could invite to become our president – we all wanted Alastair, but we thought he was far too important to say yes to our organisation, which at that time was very much in its infancy. We were wrong; he accepted with pleasure and brought a huge boost to our profile and wisdom pool. The IPF owes Alastair a debt which most are totally unaware of. That of course was the nature of the man – always available albeit not for long – he was the supreme time manager, somehow you always knew when your meeting was ending (about 20 minutes), he was always there to give counsel together with quiet leadership. Above all he never wanted to assume – to every incoming Chairman he offered to resign – you had to be joking, no-one ever even thought about taking him up on it. In the end he was the one who said no more. Alastair's father was a great innovator being one of the first fund managers to move from bond investments to equities – Alastair was similarly a man of vision, he will be missed and remembered by many for a long time.
Edward Luker, CB Richard Ellis

I would say nobody did more than Alastair to help the property industry to be accepted at the asset allocation table. His vision and skill transcended all aspects of the investment industry. As a past chairman of the IPF I was privileged to hold office while Alastair was President. He was fundamental to the IPF achieving the profile and success it has and was always available when guidance and advice was required. A real giant of the industry and a real gentleman with time for everyone. **Ian Marcus, Credit Suisse**

Alastair's influence is everywhere in the investment world, it is a wonderful legacy. He oversaw the growth of the IPF into a world class organisation and his passion and enthusiasm for it never once dulled. I know every Chairman that worked with him found his counsel invaluable and undoubtedly we all gained just by being in his presence. We shall miss him.
Andy Martin, Strutt and Parker

At a crucial time for both the development of the UK commercial property industry and indeed the Investment Property Forum itself, Alistair played a hugely important role in bringing the ideas and disciplines existing in other markets to bear on understanding the dynamics of the property market, and in better connecting property to mainstream UK investment thinking.

Alastair was himself an excellent conceptual thinker, seeing trends and patterns where others did not. These allowed him to identify particularly those times when the property industry was fooling itself into believing all was well when it was not. It was the quality of these insights and the forthright nature with which he delivered them that earned him universal respect, not just in the property market but across the whole investment industry. The Forum and the property community at large has a great deal to thank him for. **Paul McNamara, PRUPIM**

I feel grateful and privileged to have known and worked with Alastair during his many years as president of the IPF. He was inspiring, thought provoking, challenging yet always unconditionally supportive, a great colleague and marvellous ambassador for the IPF and the wider industry. I enjoyed the times we spent reflecting on 'all things real estate' as well as the times we spent enjoying 'all things Arsenal' from our nearby seats in the North Bank. He was a great man and will be sorely missed.
Martin Moore, PRUPIM

Alastair did more than anyone else to lift the professionalism and profile of property as an asset class and we should all be eternally grateful to him. He was also a man of great wit and intellect and hugely respected. **Phillip Nelson, Trehaven Group Ltd**

As IPF President, then Governor, Investment Committee member, Estates Committee Chairman and fellow Trustee of the Wellcome Trust Pension Fund, I saw Alastair regularly. He was an exceptional man, similarly committed to other organisations, even following the highest level City career, and through illness in the last eight years. I also knew privately that some of his work was behind the scenes and 'pro bono'. He walked his talk; a lesson for us all.

For all his acknowledged greatness, he never lost the common touch. For his global multi-asset perspective, he would still spot

Alastair Ross Goobey (centre) with Nick Ritblat (r) and Steven Fogel

the punctuation error in closely worded text. For his unflinching loyalty and support, he was erudite in his criticism. For his incisive analysis and sharpness of mind, he could play the long game. For all his focus on corporate governance, he was a great investor.

I distinctly remember him correctly calling the bottom of the equity market in March 2003. Despite worsening health he recently came in to compare the 1973-74 banking crisis with the current financial situation; what he thought was likely to unfold in the years ahead, how bad it could get and yet, how there would be outstanding opportunities. Needless to say, it is happening as he articulated.

Having learned it wise to follow even his toughest advice, I have failed with the last piece. Typical of the man, 'no sentimentality required' he suggested just a few weeks ago. That, dear Alastair, was far too much to ask.
Peter Pereira Gray, The Wellcome Trust

A story that I was never able to check directly with him, but says lots about the way he approached life: on being introduced to someone in a work environment for the first time, he became utterly fed up as a young man with being asked whether he was George Ross Goobey's son. So when his own son was born, he named him George, and from then on his response to the dreaded question was, 'No, I'm George Ross Goobey's father'.
Nick Ritblat

Alastair was a great man. He was the bridge that linked property with all other investment markets. His role at the IPF was immense, and he gave the Forum great prominence and greater 'street cred'. I had the privilege of serving on the Board during his Presidency. He brought to that Board wisdom, breadth of experience and humour. He will be hugely missed. **John Story**

Alastair was a fantastic friend to the Investment Property Forum and to the property industry. He was a rare combination of huge intellect, vision, strength, integrity and pragmatism, all underpinned by warmth, approachability and a human touch. The main contribution to our industry came from his leadership and willingness to challenge but with independence.

It was a privilege to have known Alastair and he will be sorely missed. **Ian Womack, Morley**

I think we all feel genuine sadness at the loss of such a charming, intelligent and amusing man – and a gentleman too.
Adrian White, John Arkwright & Co

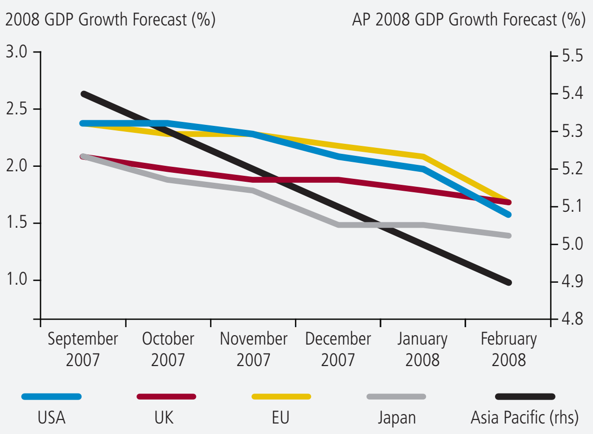
Global market outlook

Peter Hobbs, Managing Director, Global Head Real Estate Research, RREEF Alternative Investments

Economic outlook

Despite the credit crisis, global economic growth for 2007 remained robust and stronger than anticipated at the start of the year. But a global slowdown is clearly underway with growth projections for 2008 being reduced across all major economies. The sharp deterioration in the US housing market led the Fed to slash interest rates, with the Bank of England following suit albeit more modestly. Further cuts are expected in both countries over coming months and the ECB is set to follow from the middle of the year. So far, Asia remains relatively insulated from the economic slowdown but even here there are signs of weakness such as in Japan and, more recently, in Singapore. At a global level, economic growth is set to fall to below 4% in 2008 a full percentage point lower than last year. Although these global growth rates remain robust, there are increasing risks of an even sharper slowdown across global markets.

Figure 1: GDP growth forecasts over time



Source: Consensus Forecasts

The greatest risk to the global economy remains the outlook for the US where the weakness of the housing market is starting to hit consumer spending. The repricing of the debt markets (and related impacts such as the resetting of mortgage loans to higher rates) has combined with a substantially overbuilt housing market such that house prices are already declining and will continue to fall through 2008. This downward pressure on house prices coupled with the surge in the price of oil will weaken consumer spending, and the broader economy is starting to be impacted. There is an increasing probability that the US is already in a recession with greater attention being placed on the extent and severity of the slowdown. The dramatic action of the Fed suggests that growth should pick up during the second half of the year but there remain considerable risks to this relatively optimistic scenario.

Economic fundamentals remain strong in Asia where growth ex-Japan is set to achieve over 8% for 2008 (closer to 5% when Japan is included). Growth is particularly strong in China and India (at around 10% and 8% respectively), where there is perhaps a greater risk of overheating given the difficulties of containing domestic inflationary pressures, particularly in China. A slowdown is occurring more immediately in Japan, with 2008 GDP likely to be as low as 1.4% compared with the 2%+ growth that Consensus Forecasts were expected six months ago.

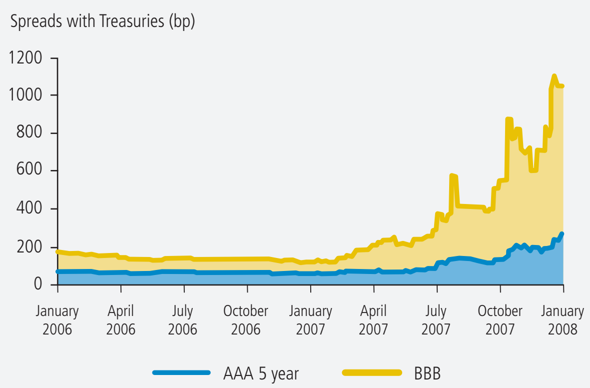
As for Asia, there are considerable variations across Europe. Economic growth is set to slow in Western Europe to below 2% in 2008 due to the weakening of the US, the high value of the euro and sluggish domestic demand. In contrast, most Eastern European economies will continue to grow strongly, with the six largest of Russia, Turkey, Poland, Czech Republic, Romania and Ukraine forecast to average around 6% GDP growth in 2008. But even within Eastern Europe there are significant variations with Hungary growing by close to 2% compared with 8% in neighbouring Slovakia.

Alan Billingsley, Director, Head of Research, North America, RREEF Alternative Investments

Office market outlook

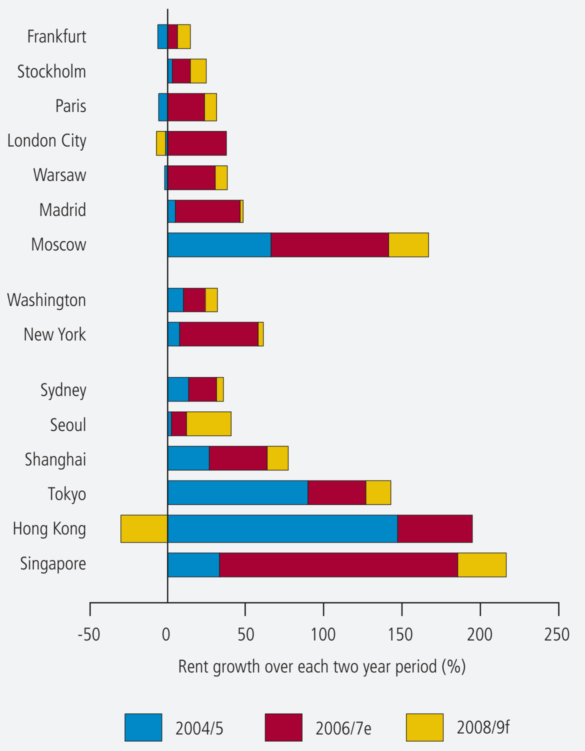
Despite the weakening economic outlook, office fundamentals remain in good shape across many markets. The strength of the corporate sector means leasing activity and net absorption remains high, and new supply remains under control across many markets. There are exceptions, with some of the US sunbelt states facing a weakening of demand and increased supply, and the ramping up of new supply means medium term prospects are weaker across many markets.

Figure 2: US conduit spreads over treasuries, January 2006-08



Source: Deutsche Bank

Figure 3: Office rent growth for major global markets, 2004-09



Note: 'e' indicates 'estimated' and 'f' indicates ' forecast'

Source: RREEF Research

In the US, office market vacancies have reached a cyclical low with year end 2007 vacancy rates of 12.5% set to rise during 2008. Office completions, at around 60m sq ft will be more than twice the level of net absorption. Markets most affected will include Central New Jersey, Orange County, Phoenix, San Diego and Washington DC. Despite this deterioration in the market, overall rent growth will be in line with inflation and a series of markets will outperform, including Boston, Los Angeles and San Francisco.

The European office markets are also experiencing a peaking of rent growth after the strong performance of 2007 when rents grew by 20% in London, Madrid and Paris, and over 40% in Warsaw. This positive rent growth will continue into 2008 but the more volatile markets that have experienced a surge of new supply will see a sharp slowing of rent that could become negative towards the end of the decade. Other markets, such as those in France, Germany and Italy, are benefiting from better fundamentals, although the relatively weak economic growth will lead to only muted rent growth for the remainder of the decade. Central and Eastern European markets are experiencing a surge of rent growth driven by strong net absorption and a desire to secure better quality space.

Ermina Topintzi, Head of Real Estate Quantitative Research, RREEF Alternative Investments

Strong rental growth is being experienced for the fourth consecutive year across Asia, and double digit-growth is likely in 2008 as well. There are some exceptions, with the surge of supply in 2007 and 2008 in suburban locations in India and in parts of China (Beijing and Guangzhou) holding down rent growth, and rents likely to turn negative in Hong Kong during the year. Despite the prospect of rising vacancies in some markets, the overall outlook remains good until towards the end of the decade when an increase in new supply will place downward pressure on further rent growth in many markets. Beyond these cyclical movements there continues to be a shortage of good quality office space across many markets due to their relative immaturity and the poor quality of much of the existing stock.

Other sectors

Yen Keng Tan, Vice President Research, Asia Pacific, RREEF Alternative Investments

While most office markets continue to experience rising rents, other sectors are further through their rental cycle, particularly in the US and Europe. But there are significant variations across global markets due to the stronger pace of growth in Asia and Eastern Europe, and due to the structural changes underway across many markets.

After several years of dramatic improvements in occupancy for the US industrial, retail and apartment sectors, vacancy rates began to stabilise and even increase modestly in 2007. This softening of market fundamentals will continue in 2008 driven by an increase in supply and the weaker economic context. Despite this deterioration, market fundamentals remain relatively healthy with new supply remaining below average historic levels across most metros. There continue to be significant regional variations and complex relationships between the drivers of vacancy change. Apartment markets, for instance, could be set to benefit from new homeowners ejected from the ownership market but the increased supply of apartment units combined with the competition from single family homes converted into rentals is likely to generate downward pressure on rents. Rent growth will also soften across most industrial markets but, as the US economy shifts from being consumer to export-driven, there will be significant variations in performance across metros with the global gateway and major tech markets performing best during the year. Although prospects are weakest for the retail sector, there remain significant variations by metro and property type. The housing-related 'big-box' market likely to be most affected by the economic slowdown, and grocery-anchored stores the least affected. As usual, it is the supply-constrained markets of the Northeastern and West Coasts that are likely to outperform.

In terms of the European retail and industrial markets, Spain, Ireland and the UK are most at risk given the slowdown in the housing market and in retail sales as well as a surge in supply. Elsewhere in Western Europe, retail markets are performing well, despite the weakness of consumer spending in many countries. The relatively poor quality of retail space, coupled with structural changes in the overall retail industry that is increasing retailer demand, is supporting rental growth across many European markets. The strong economic growth in Central and Eastern Europe together with the aggressive expansion plans from international, regional and domestic retailers, is supporting the retail and logistics markets in these locations.

The strength of economic growth is also driving very strong performance for retail, industrial and residential markets across much of Asia. The retail market is performing particularly strongly in India and Greater China, and industrial markets continue to grow in support of manufacturing activity as well the increasingly important distribution and logistics sectors.

Real estate capital markets

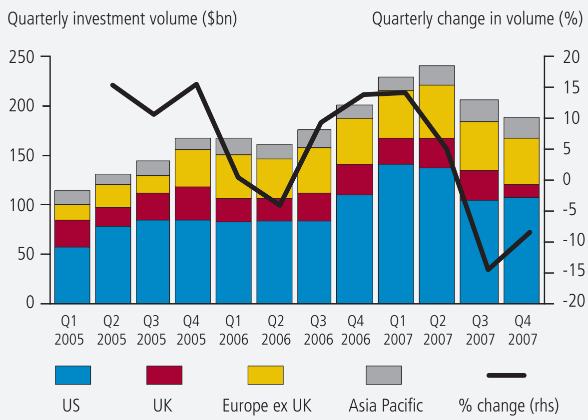
The turmoil facing financial markets during the second half of 2007 heralded the end of the bull market for real estate that has run since the early years of the decade. Despite this, there continue to be marked variations in the performance and prospects of markets by geography and by investment style.

The turnaround has been most apparent in the securities market, and in specific countries such as the UK. After experiencing annual average growth of 25% over the five years to end 2006, the global securities market posted a negative performance during 2007, with a particularly sharp deterioration in the final quarter. The UK is one of the markets that suffered worse than most with property company shares down by over 35% during the year with many commentators expecting a further deterioration over coming months. Other markets that have posted weak performance include many in Europe (such as Spain, Italy and Germany). Although many Asian markets continued to perform strongly for much of the year, there were significant reversals in the final quarter and during the start of 2008, most particularly in Australia, Japan and Singapore.

Despite the deterioration in performance, 2007 remained a record year for investment transactions, although this was driven by the very high levels of activity in the first half that continued into the third quarter. This fall-off in activity was greatest in the US and in the UK where transactions were 60% lower in Q4 than at the start of the year. The seizing up of the securitisation market has increased the cost and reduced the availability of finance, squeezing highly leveraged buyers out of the market. With the increased difficulty of raising finance and greater caution from buyers, a number of transactions have failed to complete and 2008 investment volumes are set to be well below the levels achieved in 2007.

Although there is a lag between the listed real estate markets and direct real estate, there are increasing signs of repricing across a range of markets. This repricing is most apparent in the UK, with cap rates rising by around 100 bp in the final months of 2007. This repricing will continue into 2008 with even weaker performance than in 2007. Other markets are taking longer to adjust with the US, for instance, generating a 15.8% return for the year as a whole. The fundamentals are, generally, in better shape in the US than in the UK, but cap rates are still starting to rise, and the apparently strong performance of the market is more due to the way in which it is measured by NCREIF than by the actual performance of the market. But even here, the indices will catch up with market reality, so total returns will be

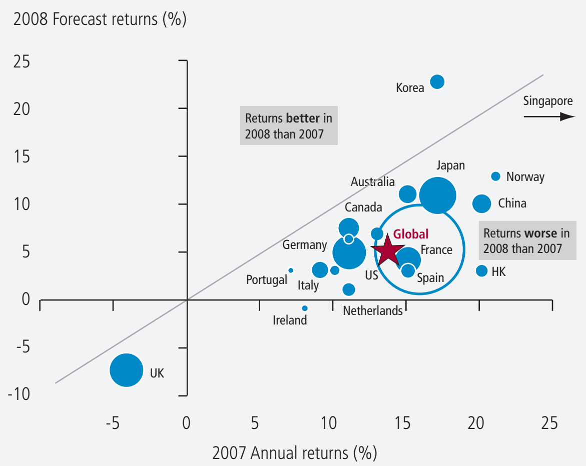
Figure 4: Real estate investment activity across global regions



Note: UK and European investment volumes converted to US$ based on constant (end 2007) exchange rates

Source: RREEF Research based on DTZ; REIS; RCA

Figure 5: Estimated all property total returns for major global direct real estate markets, 2007-08



Note: Average annual unlevered market returns for Direct Real Estate. Size of bubble indicates value of real estate market.

Source: RREEF Research; IPD; NCREIF; BulwienGesa significantly lower in 2008/9. Asian markets have been less impacted than those in Europe and North America due to the resilience of economic growth and the lower dependence on syndicated finance. Investor appetite remains strong from a range of domestic, regional and global investors, and market fundamentals remain robust. But even in these markets it is likely that returns in 2008 will be weaker than 2007.

Conclusions

After a number of years of strong performance, the global real estate market has already turned and is set to experience far weaker performance during 2008. The reduced scope for rent growth, the recent aggressive pricing of real estate, the squeezing out of leveraged buyers and increasing caution from investors will lead to weaker performance with global total returns likely to be around 5% compared with close to 14% for 2007.

Despite the deterioration in performance, there are two important messages for investors over the coming months. First, this is a cyclical slowdown that doesn't herald the end of the asset class. Performance will be weaker in 2008 and 2009 but across most markets supply remains relatively muted and the current financial turmoil reduces the prospect of greater supply at the turn of the decade. The correction in the pricing of many markets suggests there could be attractive buying opportunities over the coming two years that would benefit from the recovery of the markets towards the end of the decade. Second, although global real estate markets are entering a cyclical downturn, there remain significant structural opportunities. On the one hand, the fast pace of growth in the emerging economies of China, India and Eastern Europe coupled with the shortage of real estate means there is significant potential for residential and retail assets in these markets. On the other hand, the relatively immature (but large and wealthy) markets of Japan and the Eurozone provide significant value-added opportunities associated with the restructuring of their real estate.

Alpha...
The new grail in property?

Paul Mitchell, Paul Mitchell Real Estate Consultancy Ltd

Shaun Bond, The Pennsylvania State University and the University of Cambridge

The pursuit of 'alpha' has had profound impacts on the wider investment and fund management industries over the last 10 years. It is has become a key part of investors' strategies, no longer just the 'icing on the cake'.

This appetite for alpha – superior risk-adjusted returns, uncorrelated with other returns – has led to increased allocations and healthy fees to those asset classes and fund managers perceived to be alpha generators, away from those where consistent alpha is elusive. The shift away from active equity managers and the corresponding pressure on their fees, towards cheap, index-based forms of investment, is notable.

While these trends have been presaged by research highlighting the existence (or not) of alpha, surprisingly little analysis has been undertaken into the generation of 'alpha' in property. Anecdotally, the impression is that, in being an inefficient market, there should be relatively good potential.

This lack of authoritative evidence was the motivation for the research[1], sponsored by the IPF, into the existence of alpha in UK property fund management.

Working with IPD, we analysed the performance of all funds in its database since the early 1980s. The focus was on 3-, 5- and 10-year returns, reflecting the horizons by which investors judge their direct property strategies. Interestingly, one year returns were found to be not predictive of medium term performance, another reason (in addition to the limitations imposed illiquidity and transactions costs) for eschewing a short term focus.

The study examined funds' performances relative to the IPD Universe and also their performances after controlling for risk. The latter is the accepted approach in other asset classes where it is widely recognised that out-performance from risk is not indicative of fund manager skill. The excess return over that associated with risk (beta) is the widely accepted definition of fund manager skill and the technically correct definition of alpha.

The increased importance of controlling for risk when appraising fund performance has been amply demonstrated by the exceptionally big swings in the returns of many highly geared funds over the last 18 months. However, risk-adjustment techniques in property are less developed than elsewhere.

In the annual IPF/EG Property Investment Awards, risk-adjustment is made on the basis of tracking error (i.e. the standard deviation of relative return). While the ratio of relative performance to tracking error is an universally used performance metric, it is rarely used as a measure of alpha.

There are a number of reasons for this. First, it is only meaningful when the fund's objective is to 'track' the index. Not every fund in IPD seeks to do this; there were clear examples in our research of some funds explicitly following different strategies to their peers.

Second, the presumption is that tracking error is incurred in the pursuit of higher returns; this makes it an asymmetric measure. There are many other reasons why tracking error might be generated, most fundamentally where a fund departs from the index in order to incur lower absolute risk. Such a fund would be penalised on account of its low (relative) returns and high tracking error, even though it might have a very successful manager who is adding alpha.

Instead, the risk-adjustment techniques used in our study corresponded to those typically used in other asset classes. We used regression-based models which associate a fund's performance over time with one or more explanatory risk factors (the simplest being the IPD Universe return).

Alpha in these models is the 'residual' in excess of that accounted for by the explanatory factors. In the same way as we did for simple relative performance, funds were ranked on the basis of their alpha and then again in the following period to check if there was any persistence in their alpha over the two periods.

The results from the analysis of relative performance are presented in Table 1 and for alpha in Table 2. Drawing on the approaches adopted in other asset classes, the figures opposite show the likelihood of a fund remaining in (for example) the top or bottom quartile over two successive periods. The point is that we cannot be certain if the initial performance is due to skill or just random, a 'lucky' deal and so on. However, if the performance is repeated in the following period, such persistence might be indicative of skill.

Table 1: Proportion of funds remaining in top rankings over consecutive 10-, 5- and 3-year horizons – relative performance

Group	10 years (%)	5 years (%)	3 years (%)	Expected proportion, if random (%)
Top 50%	48	53	54	50
Top quartile	35	36	34	25
Top decile	29	19	17	10

In particular, random luck would point to 50% of the funds remaining in the top 50%, 25% in the top quartile, and 10% remaining in the top decile. By contrast, statistically significant proportions higher than these would point to 'skill'.

In terms of relative performance, the proportions tended not to be statistically different to the expected values. The very best, top decile, performers, however, stand out. The proportion of funds consistently in this group tended to be 2 to 3 times higher than expected. Persistent out-performance, therefore, seems to be limited to an elite group of funds. It is also clear that the way to achieve this is to play a long game – the likelihood of a fund

1 The report Alpha and Persistence in UK Fund Management is available from the IPF.

Table 2: Proportion of funds remaining in top rankings over consecutive 10-, 5- and 3-year horizons – alpha

Group	10 years (%)	5 years (%)	Expected proportion, if random (%)
Top 50%	60	53	50
Top quartile	35	31	25
Top decile	17	12	10

consistently delivering this elite, top decile performance was much higher over 10-year horizons.

Controlling for risk and thereby focusing on alpha, Table 2 shows that, for the 5-year horizons, the proportions remaining in the top rankings are typically lower than for simple relative performance. This suggests that some of the good relative performances were a reward for risk rather than being due to skill.

However, for the 10-year horizon, the proportions tend to be higher, thereby indicating greater persistence in performance over this longer duration. From the more detailed examination of the data, our overall conclusions were that evidence of systematic out-performance in UK property funds is tentative, focused on the elite performers and partly associated with risk.

Consistent with these findings, our analysis revealed that previously top performing funds (and, conversely, poor performing funds) tended to show returns and alpha much closer to the average in the subsequent period.

We also looked at the features influencing funds' relative performances and their alpha, and similarly those which were predictive of the future.

The most consistent and important factor was having good assets (represented by the IPD 'property score'). However, this advantage did not carry through into the following period (i.e. good stock was not predictive of future fund performance): there is a finite period over which a fund is likely to out- (or under-) perform on account of its stock.

A high-yielding strategy also contributed positively to performance and alpha up to the beginning of this decade since when its contribution has reversed. It was consistently a characteristic predictive of future performance. A relatively high exposure to development almost always undermined performance and alpha.

Good asset allocation (to segments of market such as shopping centres, City offices etc) made a positive contribution to medium-term performance and alpha up to the mid-1990s since when its contribution has vanished. In the same way as stock, good asset allocation was not predictive of future performance.

These observations highlight that there is no simple winning formula to delivering alpha in property fund management. This is not surprising as only an elite few have managed to do it systematically. From the more detailed analysis of the data and the interviews held with investors, the few that have achieved it have done it not by being 'better' than their peers but, rather, doing something 'different' well and being prepared to play a long game – avoiding markets which perform poorly over the longer term such as City offices and developments, investing outside the mainstream, focusing on yield and cashflow, buying only when the prospective return is above a well-defined hurdle etc. Alpha was a key part of their property strategy.

Such investors nevertheless represented the minority with most seeing property, like equities, as a beta asset class where superior performance was secondary to avoiding significant below-par returns.

Does this mean that property may go the way of equities, with a big shift towards cheap index-tracking strategies on the cards? The feedback from the interviews with investors was that this was unlikely in the foreseeable future.

First, their property strategies were continuing to evolve. In particular, alternative property sectors and international property appealed because their low correlations with traditional UK property provided much valued diversification for their multi-asset portfolios. There was also potential for alpha, given the perception that some alternative sectors and overseas markets were undeveloped and hence would deliver a premium return on account of their illiquidity and the specialised skills and managers needed to harvest the returns.

Second, investors were yet to be convinced about derivatives as a strategic alternative to the underlying asset class. There was a lack of confidence and understanding of the market's pricing of property derivatives, and concern about illiquidity and over basis risk. This highlights the need for the property industry and others involved in property derivatives to direct their educational efforts towards the primary investors.

Similarly, there was scepticism over the potential for portable alpha – whereby exposures to alpha in the underlying asset class are increased and a short derivatives position taken in order to neutralise the market (beta) exposure. This scepticism was not only because of concerns about property derivatives but also because it was felt that any alpha in property was small in relation to the much bigger potential elsewhere.

Finally, there was little concern over the level of property fund management fees – at least for balanced mandates.

In conclusion, property fund managers should view the results of the research with pragmatic satisfaction. By and large, they are meeting the requirements of investors for little more than a market return whilst limiting the risk of not achieving this. It is difficult to consistently 'shoot the lights out' without taking risks which most investors would be uncomfortable with. Longer-term out-performance typically requires a fundamentally different approach and the support and patience of the investor. Innovation is important. Property also can compare itself favourably with equity fund managers and has less to fear from the major changes in investment strategies since the 1990s.

Shooting the past: Contested histories of commercial property market performance

Patrick McAllister, Reading University

Without apologies to Jane Austen, it is a truth universally acknowledged that whenever two or more property analysts get together, they will bemoan the quality of the data that they have to work with. We only have to look at the IPF Consensus Survey to appreciate that there is a wide range of expectations among market analysts about the prospects for future performance of the commercial property sector. This is normal and to be expected in any market. But, possibly uniquely, property advisors and analysts disagree not only about future performance but also about historic and current performance. To put it bluntly, property advisors not only disagree about where they are going, but they also disagree about where they are and where they have been. This issue is relatively unique to property markets. Is it a serious problem?

Borrowing another quotation, the past is not a package one can lay away. Although we tried to avoid putting the 'd' word in the title, market data provides the raw material for analysing markets – position in the cycle, supply/demand shifts, turning points etc. Further, given that forecasters use what has happened in the past to forecast the future, disagreements about what actually happened in the past may affect what forecasters expect to happen to rental and capital values in the future. This issue seems to be almost unique to property market analysis. Although there are often revisions to GDP, trade figures etc, many macro-economic data (e.g. exchange rates, interest rates and commodity prices) are easily available and not subject to any measurement error. In contrast, property analysts are faced with, what is called, hindsight uncertainty.

We agree that they should disagree

The fundamental reasons that property advisors disagree about the past relate to the nature of property markets. Estimates of market levels of rents are produced by professionals who, because of well-known qualities of commercial property as an asset class – heterogeneity, thin trading, inducements and confidentiality issues, etc. – must decode 'fuzzy' signals from the market. Rental appraisers are faced with the problem of interpreting pricing signals from actual buildings when applying them to hypothetical assets. As a result, most reasonable commentators would agree that some disagreement between the organisations recording market levels is, therefore, largely unavoidable. Given this inevitability of uncertainty and disagreement in property appraisals, the most interesting questions relate to the quantity and patterns of disagreement and uncertainty, rather than their existence.

A little harmony could help

Reasonable commentators would also point out that there are institutional problems in the configuration of the property industry that tend to exacerbate these problems of intrinsic data uncertainty associated with property markets. There are definitional problems so that organisations disagree about:

- What geographical area is being measured?
- How are centres/districts defined?
- What is the quality of the hypothetical building being measured?
- Does the data reflect prime or average quality stock?
- Are rents and yields reported net or gross?
- How are net and gross defined?
- Are rental values effective or headline rents? How have effective rents been calculated?
- Has the rental estimate been observed or is it a pure estimate?

Sources of data uncertainty due to these inconsistencies are avoidable.

So there are both preventable and inescapable sources of data uncertainty. The former are caused by differences in market and corporate practices and can be reduced by a combination of co-operation and harmonisation. The latter are due to intrinsic attributes of property markets which tend to provide 'noisy' signals of market prices which are then subjectively applied to the valuation of hypothetical assets. There may be benefits then from data pooling. This is essentially a 'wisdom of crowds' argument. It is well established that the average of all estimates can be the best estimate.

So what?

The question that academics dread! Well, we see three main negative consequences of data uncertainty. Firstly, data differences may make it more difficult to understand what is happening in a market. Put formally, data differences affect the ability of property analysts to characterise markets and produce forecasts. But is this a major problem? Secondly, linked to the previous point, data differences may also lead to enhanced perceptions of risk by investors. Finally, data inconsistencies have led to resource duplication at both the advisor and investor levels. Collecting and analysing data costs money – the more data, the greater the costs.

A flavour of the evidence

Working with Paul Kennedy at Invesco and Stephen Lee from Cass Business School, we compared data on the European property office market provided by three of the main property advisors. For confidentiality, they are labelled A, B and C. We looked at market rental data for 13 European cities provided by three leading pan-European property advisors. There are a number of ways of assessing the degree of disagreement. We focused on whether the recording organisations agree on market performance in terms of returns, risk and timing and also investigated whether there is any evidence to suggest that any

Table 1: Indicators of disagreement between major data providers

	Dispersion Mean MAPE+		Rental performance Mean Rental Growth (%) p.a.				Market timing Correlation coefficients	
	1990-2006 (%)	1996-2006 (%)	A	B	C	A-B	A-C	B-C
Vienna	6.3	5.3	-1.35	0.60	-0.50	0.60	0.49*	0.59
Brussels	2.8	2.6	2.68	2.39	2.01	0.64	0.44*	0.69
Milan	7.9	4.0	1.79	1.81	-0.01	0.75	0.84	0.87
Madrid	5.6	3.8	1.36	0.29	0.04	0.88	0.89	0.89
Berlin	5.1	5.0	0.66	-1.22	-0.50	0.86	0.75	0.72
Copenhagen	8.3	5.1	0.91	0.54	4.78	0.70	0.62	0.37*
Athens	6.5	6.1	0.90	1.72	1.12	0.53	0.46*	0.42*
Dublin	4.3	3.1	7.19	7.12	7.06	0.80	0.86	0.79
Amsterdam	3.5	3.4	3.01	3.60	4.10	0.84	0.69	0.72
Lisbon	2.5	1.9	-2.13	-2.80	-3.13	0.80	0.91	0.84
Stockholm	6.8	7.2	2.13	1.54	0.74	0.96	0.85	0.88
London	4.6	4.6	4.19	4.26	4.05	0.95	0.95	0.91
Paris	2.4	2.5	0.80	0.60	1.14	0.97	0.92	0.94
Europe	5.1	4.2	1.70	1.57	1.61	0.79	0.74	0.74

+ Mean Absolute Percentage Error – a measure of the spread around the average of the three firms
* Not significantly different from zero at the 95% significance test

organisations were systematically optimistic or pessimistic in their measurements. In addition we attempted to assess the extent to which the different data sets generated different forecasts.

At the city level, there were wide variations in terms of the level of agreement about historic rental performance. At one end of the scale were Dublin and London where there was little variation amongst the three organisations. At the other end were Berlin, Stockholm and Copenhagen. In a number of cases, the organisations disagreed about whether the average rate of rental value growth has been negative or positive (Vienna, Milan and Berlin). At first sight, this suggests that the effects of data uncertainty may vary between markets. There are three cities where the gap between firms is consistently below average – Paris, Lisbon and Brussels. Five cities are close to the average – Amsterdam, Milan, Madrid, Dublin and London and five are well above the average – Vienna, Berlin, Copenhagen, Athens and Stockholm. Not surprisingly, we found that there was a fairly strong relationship between the level of disagreement and the transparency of a market.

In terms of agreement about market direction, the correlation coefficients between the three organisations provide a measure of disagreement about timing. The coefficients are presented in Table 1. A similar pattern can be observed. At the individual city level, there are marked differences. Although we need to be careful about statistical significance given the sample size, there is strong correlation (>0.8) for only 16 of the 49 possible combinations. Generally for cities with low levels of disagreement about rental growth e.g. Paris, London and Dublin, there is strong correlation (Brussels is a notable exception here). Similarly for cities with high levels of disagreement, there tends to be weak correlation (again with Stockholm as a notable exception).

In terms of modelling past relationships and understanding what is happening in markets, agreement on the direction of change seems fundamental. In order to investigate further, we simply examined whether there was consensus among the three data collection organisations on the direction of market movement in a given period. Three possible outcomes were stipulated – market rise, market fall and no change. Where at least one organisation differed from the other two, disagreement was recorded. One-year and three-year horizons were examined. Over the sample period, in 32% of total observations, there was disagreement. In 1996 for over 60% of the cities, at least one data collection organisation disagreed on the direction of market change in that year. In contrast, in 1998, 1999 and 2000 there was disagreement on the direction of change for only one city (Lisbon, Stockholm and Copenhagen respectively). For some periods and for some cities, the extent of disagreement about the direction of market rental change seems to be providing inconsistent and/or incorrect signals of market conditions and the effects of causal variables on rental levels.

Clearly, some of the specific examples of hindsight uncertainty could undermine users' confidence in the value of historic data as a basis for forecasting and analysing markets. In order to assess the extent to which the different data sets produce similar forecasts, the different data sets were used in a relatively simple explanatory model. We assessed the extent to which the different data sets 'selected' the same explanatory variables, had similar explanatory power and produced similar forecasts. We also generated three-year forecasts for the individual markets using the same model but different firm's historic rental series. This was done in May 2006 – so they may look a bit optimistic.

Table 2: Rental growth forecasts 2007-09

City	A % p.a.	B % p.a.	C % p.a.	A Rank	B Rank	C Rank
Vienna	-0.64	-0.65	0.21	9	10	11
Brussels	5.14	3.84	4.04	6	8	9
Milan	12.36	10.33	15.25	1	1	1
Madrid	-7.31	-5.81	-11.85	13	13	13
Berlin	-2.22	-1.42	1.09	11	11	10
Copenhagen	1.79	4.31	4.68	8	7	7
Athens	-0.69	5.93	4.31	10	5	8
Dublin	5.22	-0.55	4.97	5	9	5
Amsterdam	3.49	4.77	4.95	7	6	6
Lisbon	-4.52	-3.51	-4.02	12	12	12
Stockholm	7.85	7.24	6.15	3	3	4
London (WE)	10.68	9.35	10.74	2	2	2
Paris (CW)	6.30	7.04	9.60	4	4	3

Many forecasters consider that their ability to add value in the investment process does not lie in the absolute accuracy of their outputs (ability to predict absolute performance) but in their ability to identify 'winners' (ability to predict relative performance). Nevertheless, it is also clear that forecasts are used both in the pricing of individual assets and in decisions about where and when to invest. At the asset level, the absolute accuracy of forecasts is important, whilst at the tactical or strategic level identify the best relative performance is much more important. One unequivocal finding of our work was that, using an identical model, the three different data sets produced a substantial degree of agreement about the relative performance of individual cities. Both A and B 'pick' Milan, London (WE), Stockholm and Paris as numbers 1, 2, 3 and 4 respectively whilst C 'picks' the same cities but reverses the rankings of Stockholm and Paris. The only cities about which there is notable disagreement on relative performance are Dublin and Athens.

This disagreement is also reflected in the marked differences in the actual rental growth forecasts. Apart from the stark disagreements in absolute performance for Athens, Dublin and possibly Copenhagen, it was difficult to assign much significance to the relatively small differences in the forecasted absolute performance. An element of forecast uncertainty is normal and, in addition, 'raw' numbers produced by models are likely to be amended within forecasting organisations compared to predictions of relative performance.

Conclusion

Whilst the quality, range, depth and consistency of European real estate market data has improved dramatically over the last decade, real estate forecasters and analysts are faced with a large degree of hindsight uncertainty compared to many other categories of economic forecaster. The issue has practical consequences for the production of market analyses and forecasts.

The data suggests that at the aggregate level and for many markets, there is substantial agreement on direction, quantity and timing of market change. However, there is substantial variability in the level of agreement among cities. Probably the most concerning finding is that the extent of disagreement on the direction of market change was high for many markets. This can provide confusing signals to investors and analysts. However, despite the notable levels of disagreement on the direction of market change, the findings suggest that there are no strong effects on forecast outputs. Whilst it is possible to point to a small number of exceptions, the data sets generated similar expectations of relative and absolute performance.

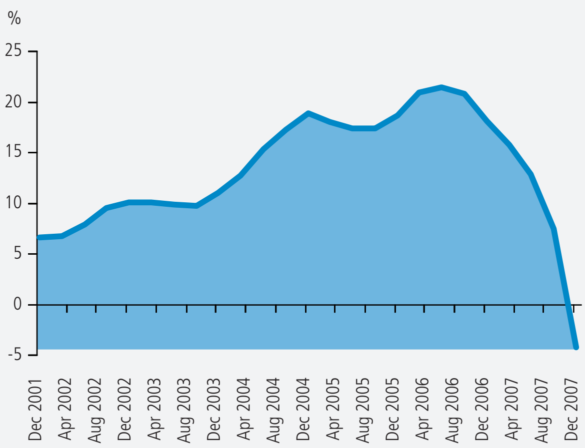
A fuller version of this paper can be downloaded from http://www.reading.ac.uk/rep/wp/wp1007.html

UK Real Estate: Is it time to be a contrarian?

Dr Paul Kennedy, Head of European Research, Invesco Real Estate

The UK real estate market is undergoing a sharp reversal of fortune. Total returns on the IPD quarterly index peaked at over 21% in the middle of 2006, since then they have fallen to -4.4% for the 12 months to the end of Q4 2007 (Figure 1). Information from the IPD monthly index and the CBRE monthly index suggests that performance for 2007 as a whole will be around -4%, implying capital decline of over 10%. As valuations typically lag prices, it is likely that actual capital decline will be greater than that implied by the IPD index. In addition, secondary properties are likely to have suffered sharper declines than core or prime stock.

Figure 1: IPD quarterly index – annual all property total return



Source: IPD (December 2007)

This change has been driven by a number of related factors. First, after falling from just under 7% at the end of 2001 to around 4.5% by the middle of last year, initial yields rose by between 50 and 100 basis points over the second half of 2007. The capital decline associated with this change offset the income return and led to the first negative return on the UK IPD index since 1992, and the worst performance since 1990.

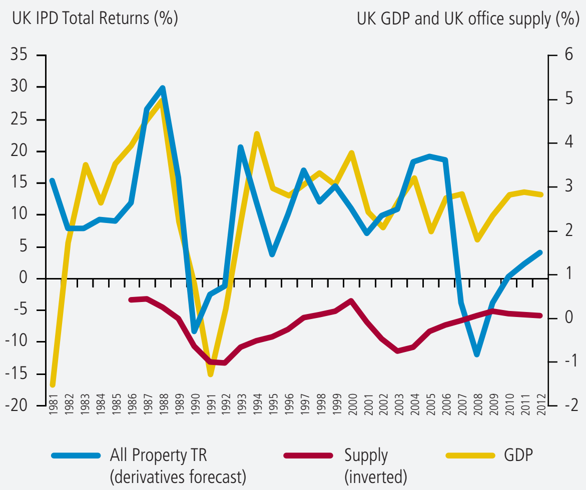
Second, deteriorating confidence in the UK's economic prospects has led to more conservative rental growth and other underwriting assumptions (e.g. breaks, void periods etc.). Importantly, although most investors have adopted more conservative views on expected GDP growth and, therefore, occupier demand, supply side projections appear to have only moderated slightly, thus accentuating the impact of expected economic weakness on prospects for rental appreciation. This change is particularly important for supply driven markets such as the City of London, Manchester and Glasgow office markets and parts of the retail market, particularly in-town space.

Third, investors have assumed that the reassessment of general investment risk premia triggered by the sub-prime crisis will lead to higher real estate required returns and, therefore, a partial or even total reversal of the yield compression experienced over the last few years. As a result, exit yield assumptions have become increasingly conservative.

Finally, credit market problems associated with the sub-prime crisis have increased the cost, reduced the availability and tightened available terms for debt capital. In addition to reducing the flexibility of all investor groups, these changes have limited the competitiveness of debt backed investors and, therefore, reduced market activity levels and helped to force price levels downwards.

The negativity of current market sentiment can be illustrated by looking at the UK derivatives market. February 2008 data from DTZ Tullett Prebon implies a total return for the IPD UK all property annual index for 2008 of -12% and capital decline of just under 18%. Looking further forward the same data implies a further negative return of around 4% for 2009 and an average return of 0.6% per annum over 2010 to 2012. Over the period 2008 to 2012 the total capital decline anticipated by derivative pricing is in excess of 45%.

Figure 2: IPD annual index – UK real GDP growth and UK office supply



Note: the expected IPD total returns have been calculated based on the mid-point of Tullett Prebon's December swap prices. The GDP growth forecasts are based on Experian Business Strategies projections, updated to reflect the December 2007 concensus. Finally, the supply side measure is an inverted average office vacancy measure reflecting both Central London and regional markets.

Source: Invesco Real Estate calculations; Tullett Prebon (22nd February 2008); IPD; DTZ Research; Experian Business Strategies.

Before we consider the rationality of this projection, it is worth highlighting a note of caution. The UK derivatives market is relatively immature, which may limit the reliability of implied return expectations. Perhaps more importantly, the use of derivatives to hedge real estate exposure may lead to the exaggeration of market cycles. Despite this it is probably reasonable to assume that derivatives pricing provides a good indication of current market sentiment and expectations. Investors are clearly cautious and expect returns to deteriorate further.

Figure 2 compares historic and forecast IPD total returns with GDP data and a supply side measure. The IPD total return forecasts are based on the February 2008 derivative prices reported overleaf. The GDP growth and supply side forecasts reflect our current view. The supply measure is the inverted unweighted average of historic and expected vacancy rates for all the main UK office markets, including central London and the main regional centres. In each case a low line is negative (weak demand, excessive supply and low total returns) and a higher line is positive (strong demand, limited supply and high total returns).

In the last significant market downturn between 1990 and 1992 negative total returns from the IPD annual index were associated with a clear and significant economic recession with real GDP falling by over 1% year on year in 1991. At the same time, the supply side position was very weak as development activity failed to respond to the slowdown in the demand side. Given these conditions it is not surprising that the capital value of the IPD annual index fell by a cumulative 35% over the period.

Compared to 1989-1992 the outlook for the next five years looks a lot more attractive. On the demand side GDP growth is expected to fall markedly below 2% in 2008, but should remain above 1% and recover to trend levels of between 2% and 3% per annum from 2009 onwards. Amongst other factors, these projections are supported by our expectation that while the US economy will slow sharply in 2008, the downturn is likely to be relatively short as emerging market demand and US dollar depreciation support US exports. On the supply side while vacancy is likely to rise in some parts of the UK office and retail markets (e.g., City of London offices) our calculations suggest that the magnitude of the expected change should be relatively limited.

Given the above, the 45% capital decline over 2008-2012 anticipated by the UK derivatives market appears to be unduly negative. One argument against this conclusion is that the change in capital values will be driven by risk premium expansion rather than demand side weakness or excess supply. However, while some risk premium expansion is required, particularly for secondary quality space, the capital decline anticipated by the derivatives market would require a reversion to an average risk premium markedly higher than that suggested by our analysis of appropriate real estate pricing relative to bonds and equities, or that suggested by history.

While this could happen, particularly given the negative sentiment that currently dominates the UK market, the resultant increase in the available income return would probably lead to higher allocations from investors seeking to profit from leverage or to maximise their income returns. This excess demand would lead to the erosion of the available yield premium and, therefore, capital appreciation from yield compression. Interestingly, the change in yields over the second half of 2007 has already led to increased interest from income-focused German investors as well as from opportunistic UK and overseas investors.

The arguments outlined above suggest that UK real estate market sentiment is currently too pessimistic. In addition to derivatives trades, investors should be able to profit from this situation through selective purchases of high quality properties. While there remains a risk of further short-term price reductions, the separation of sentiment from economic, supply side and capital market fundamentals, suggests that at least some of the recent price falls will be reversed over the medium term. Our analysis suggests that opportunities are likely to exist across the sectors and regions, as investors are either forced to sell properties to meet fund redemptions, or choose to do so in order to take profits or de-risk their portfolios.

Have hotels finally become mainstream?

Mark Wynne Smith, CEO Europe, Middle East & Africa, Jones Lang LaSalle Hotels

In recent years, the ownership base in hotels has diversified considerably. It was not that long ago that one of the nation's leading fund managers was speaking out against hotels saying that he never invested in any real estate that had a bed.

Fortunately for those of us who derive our livings from providing hotel investment advice, there seem to be an increasing number of investors who have not abided by this maxim. What has drawn them to this sector and how have they fared against, in particular, the office sector? Furthermore, there was a general view that hotels were inherently cheap and it was the lack of knowledge in the market that kept them priced well above other forms of real estate. Is that still the case?

What we have seen in the recent past is a massive shift in ownership. Five years ago, several leading hotel companies, many of them UK public companies held large portfolios of assets. They may have sold the odd non-core property but ownership was the model with no deviation. Companies grew mainly through acquisitions of portfolios that meant increasing their real estate holdings. Marriott led the way by splitting itself between a propco and opco which retained management of the hotels. Having watched what happened to Marriot's share price, most other operators – Intercontinental, Hilton being the two largest, followed either with asset light or asset right strategies which mean monetising the real estate whilst retaining long term management contracts. As a result, a large amount of hotel real estate entered the property owning domain with private equity being the most active participant in the fevered sell off but they have been joined by high net worth individuals, sovereign wealth funds, property companies and some institutions, the latter being mainly focused on leases but some are now venturing into the management contract arena.

2007 saw a 56% increase in the volume of global hotel transactions to nearly $113bn, compared to $72.5bn in 2006. Meanwhile, in Europe, the Middle East and Africa region ('EMEA') transactions were down 13% to $24.5bn compared to the previous year, which had been driven by unprecedented portfolio transactions.

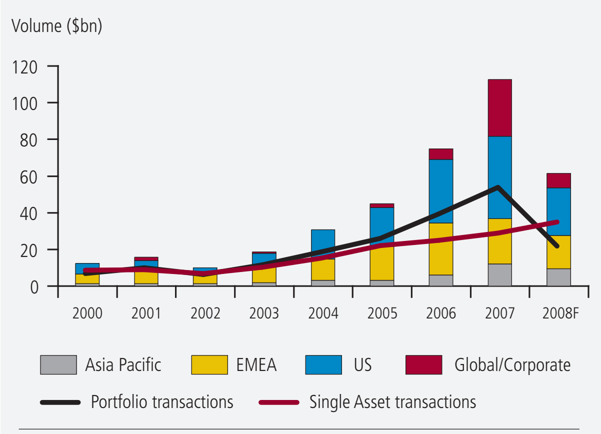
We are now in an interesting position of the operators having effectively sold most of what they own and what they haven't sold, they are likely to hold for some years as the assets are important for their brand development.

Supply and demand

The greatest threats to hotel income growth are frequently cited as being new supply and under-investment in refurbishment. Jones Lang LaSalle established some years ago that hotel and office occupancies generally move in the same pattern but hotels experience greater peaks and troughs – frequently brought on by demand shocks but often by too many hotels opening in a market at one time. The famous 'daily rent review' also leaves hotels more susceptible to reduction in demand as the office market with its longer lease structure has a greater lag.

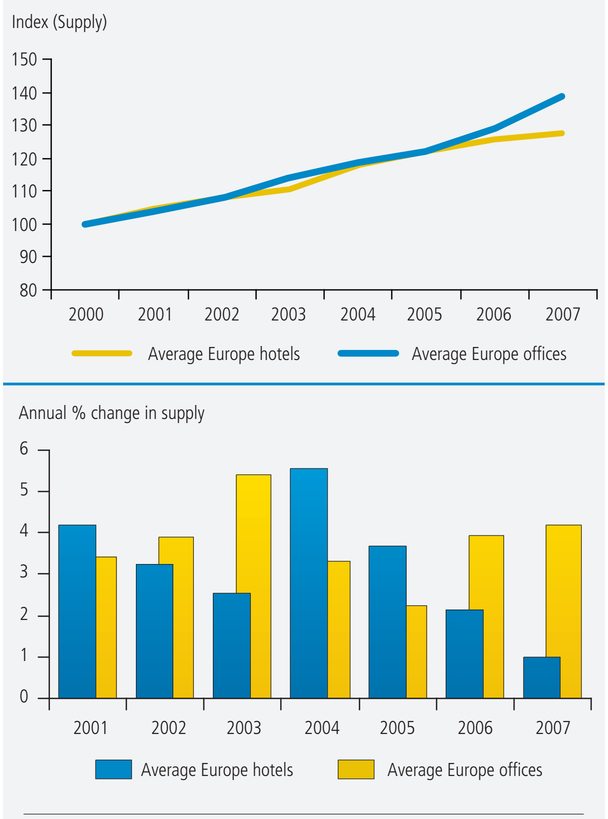
As can be seen from Figure 2, supply growth between offices and hotels has generally increased at the same rate since 2000, it would appear that whilst a gap has opened up that would favour the hotel market where supply growth has been at a lower rate.

Figure 1: Global hotel investment activity 2000-2008f



Source: Jones Lang LaSalle Hotels

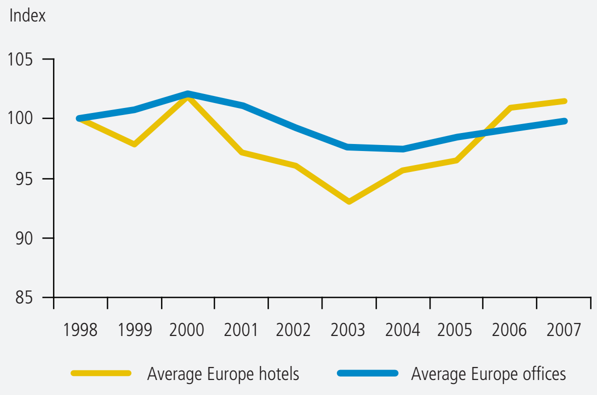
Figure 2: Average supply growth – major European markets

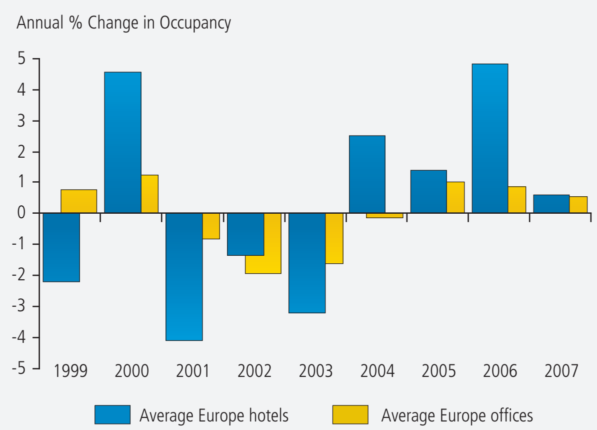


Source: Jones Lang LaSalle Hotels

This is borne out by the strong income growth that the hotel market has experienced in recent years where many markets have achieved nominal income growth in excess of 10% per annum. We are now moving from uniform growth to a multi-speed market where some markets still have strong growth potential whereas others, such as regional UK, are likely to see less buoyant conditions although they should still keep pace with inflation.

Figure 3: Average occupancy growth – major European markets

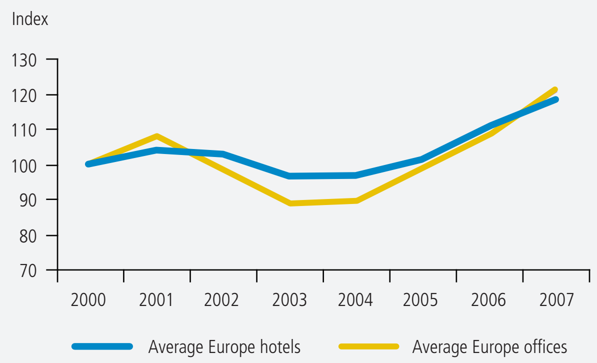


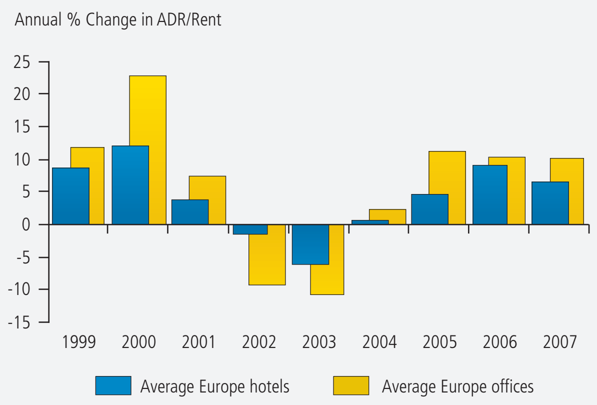


Source: Jones Lang LaSalle Hotels

It would seem that with less supply growth in the market and the fact that hotel average daily rates have not grown much more than office rentals, the prospects for a major downturn in the hotel market when compared to offices is relatively small. There are certain statistics floating about the market which would suggest over 100,000 new keys under development through the year. If they were all built, this would mean that new supply would start to be a threat to the prospects for hotel income growth in the near future. However, the lack of debt generally for any new project, be it hotel or office project, could be the saviour of the performance profile as it will naturally slow the pace of new openings to a point where demand may be increasing again.

Figure 4: Average office rent/hotel average daily rates (ADR) growth – major European markets





Source: Jones Lang LaSalle Hotels

Are hotels underpriced?

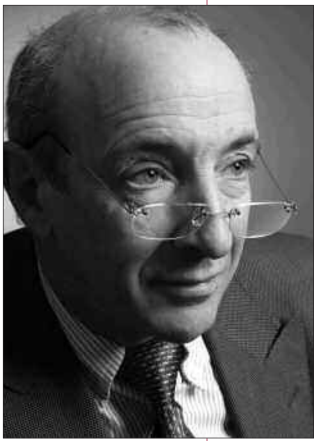
Given the income profile, should yields match other forms of real estate or should there be a risk premium?

Looking at leases first, I am not aware of a well maintained hotel that has not been re-let within a short space of time. Although there are fewer potential tenants in the market, the expectation is that you will find a willing taker at lease expiry, providing the rent is at market level. It is therefore down to covenant and rent cover (i.e. profit over rent) and providing they are in line with the market, I would argue that there would seem to be little inherent risk in leased hotel investment. For this reason yields have shifted much closer to mainstream property but they never quite match. A gap of 25 to 50 bps often seems to be the norm.

For management contracts, with exposure to the daily rent review and all of the issues involved in running a trading business. Five years ago, 200 bps from office yields was the often quoted range but as understanding of the sector has improved, this has closed to 150 bps.

Finally, it is often forgotten that hotels are transacted by way of share deals – frequently with embedded capital gains – so be careful about making direct comparisons between transactions.

Index linked derivatives for property investors



Dr Ian Cullen, Head of Systems and Information Standards, IPD

Derivative markets are so called because they are derived from the asset, commodity or other direct market from which they are priced. This tautology is no less true in the case of real estate even though the pricing in this case has to be linked to an index rather than a liquid underlying asset market.

The UK indices have been traded synthetically to a far greater extent than those for any other property market since the re-emergence of a derivatives market at the back end of 2004. Thereafter the UK property market rose continuously to a peak value at around July of last year, and then collapsed at an unprecedented rate. This collapse was exclusively yield driven (rent levels have yet to start to fall), fuelled by a reversal of investor confidence. This reversal resulted in forced selling from, and the subsequent redemption closure of, several open ended funds, and more generally it lead to a big reduction in turnover levels as the managers of long and medium term funds began to batten down the hatches against the storm of the sharpest cyclical downturn on record.

How is the property derivatives market responding?

After a relatively slow start in the first few months of 2005, there were some very significant large derivative trades undertaken by major institutions and property companies, including the Prudential and British Land. These participants took significant long/short positions on the IPD UK total return Index through over-the-counter contracts intermediated by major investment banks.

The pattern of activity began to change through the back end of 2005 and well into 2006. During this period many more participants entered the market and many more banks were granted licences by IPD to trade the UK indices. The deals quite rapidly increased in number and reduced in average lot size – from around £35m in the early months of 2005 down to closer to £10m at the back end of 2007. The accumulated notional value of all trading to date on the UK indices is now up to £12bn, with trading on the French and German IPD indices pushing the total to £13.3bn. In addition to this activity there have been a small number of test trades on four other IPD indices – Italian, Swiss, Japanese and Australian – as well as around $500m notional traded on the NCREIF Index in the USA.

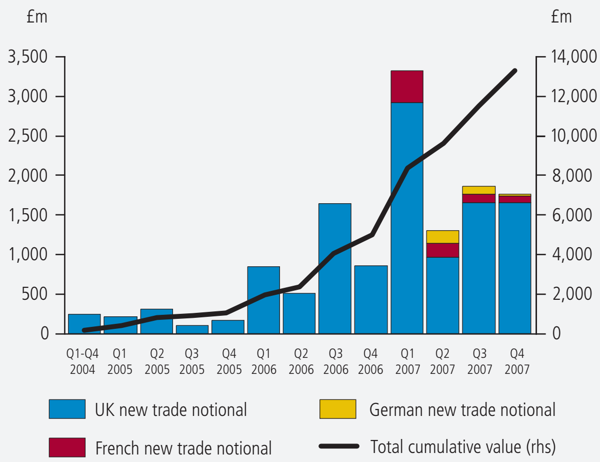
There is also a much smaller but quite active market trading the Halifax House Price Index in the UK and equivalent residential indices in the USA. Total notional value is, however, low and not documented.

Although, as 10% was wiped off the value of the commercial property investment market in the UK in the second half of last year, and as investment managers reacted by reducing their activity levels in the direct market, no similar trend was observed in the derivatives market. Since the end of June last year a total of 310 separate trades were conducted, to a total value of just over £3.3bn. Adding these numbers to the volumes accumulated in earlier quarters and across all of the IPD indices, there have to date been just over 1,000 separate trades conducted, representing the cumulative total volume of £13.3bn noted above.

How does the property derivatives market work and what is it used for?

The real estate index linked derivatives market which has emerged in London over the past three years still takes an essentially simple form. Contracts are traded 'over the counter' and thus there is (in Europe at least) no exchange traded derivative market on a real estate index. These OTC contracts all the take the form of deals intermediated by investment banks, each of which has been granted a licence to trade the indices by IPD (now 23 in total). This licence is free at the outset and attracts a licence payment to IPD only when the market becomes active and then at a rate which is linked to the level of business undertaken by the banks.

Figure 1: The growing volume of derivative trading on IPD Indices



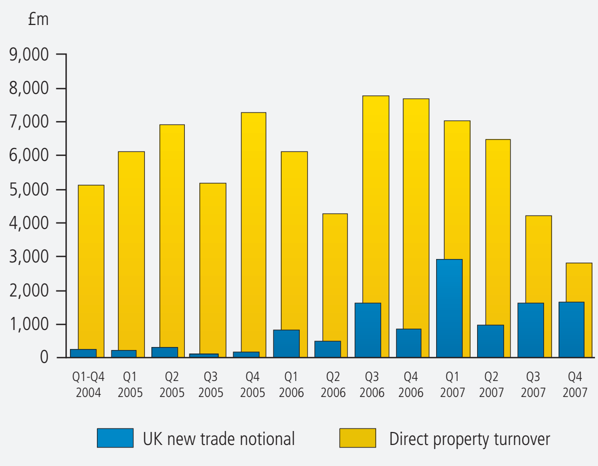
In addition structured products have been constructed for this market, including Barclay's Property Index Certificates, which were amongst the earliest offerings of a synthetic route to index linked investment. These are all typically cash settled in advance, and take the form of a bond linked to an underlying total return swap. The swap contract thus forms the basis of virtually all activity in the property derivatives market to date.

In its simplest form a contract is constructed by a bank which matches long and short positions taken by two counterparties with opposing views and requirements. The counterparty with a long position receives the IPD total return over the agreed period, and pays to the other counterparty an amount linked to the inter-bank lending rate (LIBOR), plus or minus a spread. There is no exchange of capital up front (unless there is a structured product overlaid upon the swap) and so positions are simply adjusted quarterly during the lifetime of the contract in line with index movements.

More than 90% of all of the activity to date has been linked to the IPD all property total return index. This suggests that the overwhelming pattern of usage so far has been either for broad medium to short term asset allocation (in favour of or against real estate) or for asset class hedging of risk. Only a relatively small number of sector or segment trades have been conducted and in the very recent past the volume of activity at sector level has declined virtually to nothing.

Will the market continue to grow?

Figure 2: The converging trends of direct and derivative trading volumes



There can be no guarantee of the long term future of synthetic trading on real estate indices. However, the market seems very unlikely to continue to tick over at or below current quarterly volumes which are in the region of £1.5bn. Compared with mature derivatives markets this is a very low level of activity and one which seems likely to be unsustainable in the long run. The market will either grow to a level which exceeds by some multiple the volume of activity in the direct market, or it will disappear as current contracts unwind and new ones are not signed.

A casual observation of the trends of the last few quarters, however, suggests that there is at least a possibility of a cross over in activity levels between the direct and synthetic markets in the near future. IPD recorded turnover levels in the direct market have been falling continuously since Q4 2006. Over the same period, whilst the activity in the derivatives market has been erratic, it has nonetheless shown no signs of decline, and if these two trends continue, a cross over seems likely sometime this year.

How might the derivative market develop in the near future?

It is hard to predict the way in which such a novel investment technology will be assimilated further into the real estate investment sector. However, it does seem probable that growth in liquidity in the OTC market will spread soon to the sector level. This will permit the use of derivatives for the short and medium term management of portfolio structure and risk, and thus encourage more real estate investors into the market. It will also permit more precise and focused liquidity management for those real estate investors who wish to use derivatives to help cope with the sometimes long drawn out process of identifying and acquiring direct assets. There has also been some very modest early interest shown in trading options on IPD indices, and it seems likely that if the current swap market continues to grow then an options market will develop in parallel.

Will changes in the derivatives market feed back into the direct market?

No direct asset market remains unaffected by a highly liquid synthetic market linked to its performance. Short term impacts may well include a quicker responsiveness on the part of the direct market to circumstantial changes, and possibly also to higher short term volatility as the sentiment which instantaneously drives the synthetic market feeds back to the pricing of the direct market.

Such short term impacts upon the direct market will clearly not represent the end of the story. In the medium and long term, if the market deepens and becomes an integral feature of the investment infrastructure available to the real estate sector, then we should anticipate many and possibly more profound changes. The conversion of real estate investors over the past 10 or 15 years to the use of indirect means of accessing property investment (through open ended funds, listed vehicles and other close ended structures) has had very major impacts upon the shape of the market. Now small pension funds with no more than £20 or £30m to invest in real estate can have shares in some of the largest lot size assets in the land. There is no reason to believe that derivatives will have any lesser impact upon the shapes of portfolios and the way in which the market operates over the next 10 to 15 years.

Where may derivatives take the direct property market in the near future?

The derivatives market that has emerged to date may have already helped to de-couple the UK real estate investment market from many of the slower moving and less transparent markets in Europe and further afield. It is tempting to conclude that the pace of the reversal in the UK market observed over the past 6-9 months has had something to do with the availability on a daily basis of prices of 1-, 2- and 3-year total return contracts flowing from banks and derivative brokers. A deep and liquid derivatives market may also facilitate a quicker recovery in the UK (perhaps after a pricing overshoot) through a reversal of the above mentioned mechanisms.

However, the role of a derivatives market should not be over stated. It cannot change the underlying fundamentals which drive the long cyclical structure within any direct market. So if current investor uncertainty translates now into consumer and employer uncertainty occupier markets will be impacted and the cyclical downswing will be prolonged. Derivative pricing and activity will then reflect rather than cause the trends.

Increasing transparency: Fund management fees

Neil Turner, Head of Property Investment, Schroder Property Investment Management Limited

The European Association for Investors in Non-Listed Real Estate Vehicles (INREV) published its fourth Management Fees and Terms Study. This study provides analysis of the fee structures and fee levels of non-listed European funds, thereby increasing their transparency and comparability.

The study follows on from the Fee Metrics Guidelines which were published by INREV. These metrics are designed to facilitate comparisons between property funds as they now measure total expense ratio (TER) – annual operating costs as a proportion of assets – along with the real estate expense ratio – which measures fund-level expenses and other property-specific costs – and 'leakage' from the gross internal rate of return.

These new metrics are the result of a two-year project. INREV engaged in lengthy and widespread consultation with investors, fund managers and service providers on the Fee Metrics Guidelines and there has been overwhelming support for the initiative.

Figure 1: Current reporting of TERs

Fund style	Funds %
Core	23
Value added	18
Opportunity	11
Not reported but calculated	36
Sample	21

Source: INREV

Research methodology

Data on fees and expenses was gathered through a survey questionnaire sent to fund managers in September 2007. Completed questionnaires were received from 52 fund managers representing 160 non-listed funds and a total GAV of €87.2bn. Of these funds, 81 funds were already included in the INREV Management Fees database, with the remainder providing information for the study for the first time. Overall, the returns represented a response rate of 36% compared to the study universe by number of funds and a rate of 37% measured by current GAV.

Structure of reporting fees

The study seeks to standardise reporting of fees by categorising the different fees and costs related to fund management into five categories:

- initial charges
- management fees
- performance fees
- fund expenses
- property-specific costs

Initial charges

Some funds charge initial fees, typically as either a subscription fee or a placement fee.

Subscription fee

In the sample, 31 funds (19%) reported having a subscription fee. These fees are applied mainly by core and value added funds and are most commonly based on NAV. The average rate for all funds is 3.25% but there is great spread in rates due to a small number of funds applying much higher subscription fees.

Placement fee

Some 16 funds (10%) charge a placement fee. These fees are most common for value added funds (16%), which frequently base the charge on fee on commitment, whereas core funds are more likely to use another basis, such as drawn commitment or GAV.

Management fees

Different management fee structures are often applied during the fund's commitment and investment periods.

Commitment period

The length of the commitment period varies between 1-10 years, the average being 4.3 years. Management fees during this period are most often based on commitment (48% of the sample), with 36% using GAV – the latter being more commonly used by the value added funds. 2008 average management fee levels are higher than in the 2006 sample, particularly for GAV-based fees, which were 0.58% for core funds and 0.63% for value added funds in 2006 compared with 0.70% in 2007. Additional fees are rarely applied during the commitment period, with the exception of acquisition fees that are charged by 11 funds.

Annual management fees

Out of the 160 funds in the study, 143 funds (89%) reported an annual management fee. The most common basis for annual management fees is GAV (57%), with 15% of the funds using NAV. The spread of fees based on commitment, drawn commitment and GAV are significantly smaller than those based on NAV, due to the differing levels of gearing affecting the NAV-based fees. The inter-quartile range for fees based on GAV is 30 basis points compared with 79 basis points for NAV.

The average management fee levels in the current sample are very similar to those of the 2006 sample, except for NAV-based fees, which have seen an increase from 0.89% to 1.02% of NAV. Average annual management fees based on drawn commitment have risen marginally from 1.49% to 1.50% and for GAV-based from 0.58% to 0.61%.

Country allocations

Not surprisingly, the average fee levels are higher for funds investing in several geographical markets than for single country funds, 0.67% and 0.58% of GAV respectively. The single country funds investing in the UK and the Netherlands charge lower annual management fees based on GAV than 'other' single country funds.

Sector allocations

The expectation is that the number of sectors a fund invests in will affect the fee level. This is borne out by the value added funds but for core funds, the average annual management fee levels appear to be the same regardless of whether the fund is a single sector or a multi-sector fund.

Fund size

The analysis shows that management fees do tend to decrease when the fund size increases, with the highest management fees are found in the size category of €100-299m.

Domicile

The average GAV-based annual management fees of funds domiciled in Luxembourg and 'other domiciles' are higher than the average annual management fees of all funds. However this may be due to the fact that funds domiciled in Luxembourg are mainly multi-country and multi-sector.

Other management fees

In addition to the fund management fee, 48 funds (30%) charge acquisition fees and 28 funds (18%) charge disposal fees. Other management fees are rarely used. The study could find no obvious relationship between annual management fees and the number of other fee items.

Performance fees

Some 79% of the funds in the sample apply either periodic performance fees (35%) or performance fees at termination (27%) or both (17%). Not surprisingly, periodic performance fees are more frequently applied by infinite life (58% of funds) than finite life funds (48% of funds). Some 63% of finite life funds, however, apply performance fees at termination and 23% of finite life funds report both types of performance fees.

Periodic performance fees

The most frequent basis for calculating periodic performance fees is an absolute total return or IRR, used by 49% of the sample. 38% use a hurdle rate relative to a benchmark like IPD/KTI . Income return is used as basis by 5% of funds. For funds using a benchmark, the most common first hurdle is an IPD sector index plus an average of one percentage point. The difference between target IRR and hurdle rates is highest for opportunity funds, highlighting the fact that fee structures of opportunity funds are much more performance driven than those of core and value added funds.

Performance fees at termination

In total, 70 funds (44%) report applying a performance fee at termination, most commonly based on a total return measure . These fees are most common for value-added and opportunity funds, 57% and 58% respectively, compared with only 33% of core funds. This, however, is explained through the larger percentage of infinite life funds amongst the core funds, some 51%, compared with 16% of value added and 5% of opportunity funds.

Fund expenses

In addition to initial fees, management fees and performance fees, the INREV Fee Metrics Guidelines list 20 categories of fund expenses that may be charged to the investor. Some of these expenses are paid to the manager and others are pass-through items that are paid to third parties such as service providers. Over 50% of funds in the sample charge at least an audit fee, valuation fee and bank charges. The basis of charging varies, effectively preventing the reporting and comparisons of fee rates.

Property-specific costs

INREV identifies 11 types of property specific costs. The most commonly applied are property management fees (65% of funds in the sample), acquisition/disposal related costs (63%) and letting and renewal fees (59%). As with fund expenses, property-specific costs are charged on varying bases, making it difficult to make any meaningful comparison.

Bringing insurance into focus

Bill Gloyn, Chairman Real Estate Europe, Aon Mergers & Acquisitions Group and Vice President, City Property Association

Last summer did not just presage the credit crunch, it brought devastating flooding to several parts of the UK and wider Europe. The two events seemed to be basically unexpected by most of those affected, with disastrous consequences for many. They brought sharply into focus the real fragility of some of the models on which the property markets – commercial and residential – were based. While much has been written about the credit crunch and its aftermath, there has been little commentary about the problems of flooding and the resultant insurance issues which should now be receiving serious attention from the investment property world.

There were two major flood events last year, one in the North of England and the other in the Severn Valley. The estimates of the insurance claims likely to be settled amount to around £3bn, possibly triple the total to be expected in an average year. Of the reported 165,000 insurance claims, the vast majority were obviously in respect of damage to residential properties and motor vehicles. However, there were also some high profile examples of commercial property damage including Meadowhall shopping centre, parts of which were not able to re-open until several months after the event. There were many others that did not hit the property press but nevertheless contribute to the overall statistics.

Insurance industry dialogue with government

So what are the implications for insurance? Well, first consider the position of the insurance companies. For a decade or so the Association of British Insurers (ABI) has been in regular dialogue with the Government to try and establish a regime of adequate investment in flood defences and drainage, together with a change in the planning system, which would reduce the likelihood of widespread flood events. After many years of procrastination, an agreement was reached between the two parties and a Statement of Principles was published in 2002 representing the relative undertakings of both sides to continue the provision of insurance.

That Statement of Principles was reviewed in 2006, due mainly to the ABI's perception that the Government was not fully meeting its side of the bargain. The revised statement sets clear requirements on the Government for investment and change, in exchange for which insurers agree that they will provide insurance based on the likelihood of a once-in-75 year event happening. If that event is not predicted, there will be no restriction on cover and premiums will be based on normal underwriting criteria. If, however, the flood risk is more than once in 75 years but improvements are planned, the cover will be maintained with a 5-year review. If no improvements are planned the insurers give no guarantee of providing cover but have agreed to work with policyholders to find risk improvements that might make the property insurable. It should be noted that the Statement of Principles only applies to residential property.

The fundamental objective of insurance is to protect against the consequences of an accidental, unexpected or fortuitous event, not a racing certainty. With the experience of the past eight months, it is not surprising that the ABI has now announced that the Statement of Principles is again under review – "to ensure that it is fit for purpose". The ABI has also commented that "The Government has failed to grasp the importance of the situation", which is borne out by a refusal to increase the amount allocated for flood defence expenditure in the October 2007 Comprehensive Spending Review despite the National Audit Office reporting that some 46% of flood defences were inadequate.

Reliance on re-insurance

There is no doubt in my mind that the ABI has demonstrated a strong resolve in attempting to continue to provide flood insurance in the UK – incidentally one of the few countries in Europe where the cover comes as a standard part of the insurance package. However, the front-line insurers are not totally masters of their own destiny. Behind almost all insurance policies there sits a degree of re-insurance. For the larger risks it is specific and for the smaller risks it is more on a portfolio basis – designed to protect against any single event proving catastrophic for the insurer. In whichever way it applies, the primary insurer is very unlikely to be able to continue to offer cover for any contingency if the re-insurers withdraw their own backup protection.

That was dramatically illustrated in the aftermath of 9/11 when the global re-insurance market withdrew all terrorism insurance protection leaving the actual insurers with no option but to also cease providing the cover. In the UK, at least, we had the benefit of the Pool Re, a mutual insurance company set up by the Government in the aftermath of a partial withdrawal of cover following the terrorism atrocities in the City of London and elsewhere in 1992. As a result, after several months of delay, the Pool Re was able to fill the gap that the complete withdrawal of cover created, leaving the UK with still the best terrorism insurance in the world. The Pool Re may be needed again if there is a widespread withdrawal of flood cover. It did not happen, as feared by many, when the last round of re-insurance renewals took place at the end of 2007 but the future rests on a knife edge. More serious events this year in Europe, or just in the UK, could tip the balance.

Similar state provision against the consequences of natural catastrophes is not without precedent in the EU. In particular, France and Spain provide such cover with the premium being recovered by means of a levy or tax on the insurance premium for the main policy. In the UK insurance premium tax is currently running at 5% but in other countries it is closer to 20%, often depending on the type and size of risk.

Implications of lack of insurance cover

So there is a chance for insurance not to be completely lost, but what would be the implications for the investment property world if it were? One is obvious. If there was damage, it would not be insured and someone would have to pay for reinstatement from their own funds. Under the terms of many leases, there could be an argument whether that someone should be the tenant or the landlord, although the 2007 Lease Code makes it quite clear that the risk for uninsured and uninsurable damage should rest with the landlord.

With the interruption in income stream, which would occur if the tenant exercised its rent cesser rights under the lease, it might be questionable whether the owner would have the ability to continue servicing any debt. In those circumstances, the risk would fall on the banks. Of course, if the property were owned in an investment fund of some kind that exposure would fall upon many private or institutional investors and be reflected in reduced or even zero returns.

Before any property suffered actual damage, there could be other serious commercial consequences of the unavailability of insurance. The party responsible for arranging it would be in breach of a number of contractual obligations – under leases or finance agreements. Managers might also find themselves in breach of their obligations to arrange insurance in accordance with those underlying contractual obligations if no let-out clause applied, as it certainly did not in leases until the relatively recent past. There are undoubtedly a number of contracts in place at present that one or other party would like to get out of, or at least renegotiate and the breach of a fundamental insurance requirement could provide the opportunity to do that.

One of the fundamental shortcomings of insurance when considered in an investment context is that it is designed to cover against the cost of repairs and subsequent consequential losses and not against the loss or diminution in investment value. There is often a misconception by banks that it is, and they often have to be reminded of the objective of insurance when believing that a serious claim would result in a payment that would settle the debt. To change the scope of cover would be a fundamental alteration to current arrangements. It would result in additional premium costs and there is no certainty that those could be recovered from the tenant as the insurance envisaged under the lease only relates to rebuilding and repairing damaged property. Therefore, in these difficult times, it is unlikely that a property owner or investor would be keen to incur non-recoverable costs for enhanced insurance protection.

There also needs to be a radical rethink about responsibility and control of insurance. In many cases, this is delegated by the ultimate investor to managers or joint venture partners. Because of the volume of deal flows and the general lack of importance assigned to insurance issues, many investment houses have not given any real thought to controlling and monitoring those delegated insurance arrangements. There is often no centralised and consolidated record of the cover on assets, income and liabilities; something that could be used to demonstrate compliance with fiduciary obligations to investors.

With asset performance under pressure from other market influences, investors cannot afford to suffer an uninsured loss that damages performance even further. Professional investors, such as fund managers, can hardly afford the reputational damage that would result from such a fundamental breach of duty to investors, who are already shocked by the closure of funds to withdrawals.

Now is the time to focus on insurance in as much detail as the other risks in property investment. The time has never been more appropriate and the circumstances never more compelling.

Achieving sustainable property objectives: The role of green leases

Louise Ellison, Research Director, Investment Property Forum

In September 2007, the IPF organised a workshop, hosted by DLA Piper, focusing on the concept of green leases. Fundamentally, a green lease is a lease for a commercial property that includes provisions to encourage the landlord, tenant or both to carry out their roles in a more sustainable way. The details of the provisions and incentives are negotiated between the parties, but typically relate to the achievement of specific targets for energy and water use and waste management. Such leases have been successfully adopted by some landlords and tenants in Australia where a number of occupiers, notably public sector occupiers, will now only take a building on the basis of a green lease.

What is driving the issue and why is it happening now?

Government policy, regulation and legislation are the major drivers of the requirement to own, manage and occupy buildings in a more sustainable way. In particular the introduction of energy performance certificates (EPCs) across much of the EU in 2008 has focused attention on energy efficiency. As ethical investment and corporate responsibility policies have filtered through to the property investment arena, investor pressure has emerged as a driver behind the requirement for more sustainable commercial property assets. However, in relation to green leases, tenant pressure has been an extremely strong force.

Why now is driven in part by the desire of some to be 'ahead of the game', given the focus of legislation and regulation – i.e. first mover advantage. But it is also driven by the heightened awareness within the market of sustainability issues and a search for mechanisms through which sustainability can be delivered by both the investor and occupier side of the property industry.

What actions in terms of good management might be involved?

Typically, green leases are concerned with issues of energy, water, waste, carbon and sustainable construction/refit materials. In terms of the operational use of the building, simple measures might be encouraged by mutual agreement, for example:

- Energy efficiency: for landlords and their FM teams, reducing consumption by simple actions such as the installation of low energy light bulbs; efficient use of air-conditioning systems and monitoring energy use during hours of low-level activity such as weekends and over night. For tenants, switching off monitors and other small electrical equipment, providing information and awareness raising campaigns to support carbon reduction programmes. At the next available refurbishment the installation of energy saving plant and machinery might also be agreed such as movement-sensitive lights and smaller lighting circuits.
- Waste: landlords can provide recycling opportunities through building management and encourage the use of recycled materials (e.g. paper). Installation of mains supplied water fountains in place of bottled water coolers reduces the use of bottles and transportation. Consideration might also be given to the reduction in use of resources as well as recycling.
- Water: reducing consumption by monitoring and repairing leakages; installation of water efficient plant and machinery including spray taps and six litre flushes at first available opportunity.
- Pollution and contaminants: A commitment to ensure FM teams use environmentally friendly cleaning products and that materials used in refurbishment and maintenance work are similarly specified. Monitoring of leaks from air-conditioning systems would also be agreed as a standard requirement.

Where sustainability is a key element of an occupier or landlord's business or investment strategy, adherence to the green lease targets and service levels is likely to be strictly enforced. Where it is not, aspirational targets that enable the parties to measure performance and seek, but not be bound by, annual improvements might be more appropriate.

Relevant lease terms

The lease terms most relevant to the negotiation of a green lease are: repair; user; outgoings; alienation/assignment; service charges; rent reviews and reinstatement.

Repair

Under most commercial property leases granted in the UK the tenant has responsibility for some, if not all, repairs. A green lease might require such repairs to be undertaken to specific standards and/or using sustainably-sourced materials. Imposing more onerous repairing obligations was seen as potentially unrealistic as it could drive down rents or dissuade tenants from signing the lease unless the supply of suitable property was limited. Conversely it is also argued that some tenants might actually want such a clause as a demonstration of their corporate responsibility credentials. This has been the Australian experience, particularly from the public sector occupiers.

There is an argument that landlords should start granting inclusive leases under which they retain the repairing liability. With the shortening of lease terms, the life expectancy of even M&E plant and equipment is often longer than a single lease term and whilst is clearly in the landlord's interest to ensure the equipment is well maintained, ready for the next letting, the tenant has no similar incentive.

User Clause

Within the user clause it could be possible to require tenants to undertake activities such as recycling, efficient energy usage and water management. However, the industry has experience of the difficulty in implementing clauses that require particular behaviour, e.g. keep open clauses. Some suggestions that have been put forward for energy efficiency, e.g. reduced use of lifts, are difficult to enforce.

Outgoings

The outgoings on a building, i.e. energy, water and local property tax bills, are an obvious target for green lease provisions. However, to place any restrictions or obligations on the tenant in relation to outgoings is considered difficult to enforce. Nevertheless, transparency with regards to outgoings is important to monitor performance effectively in terms of energy and water efficiency for both parties. This should perhaps be an area where attention is focused.

Alienation

The insertion of a restriction on alienation in relation to a proposed assignee's ethical or environmental performance and/or policy was discussed at the workshop and largely discounted as unworkable on the basis of negative value impact. Furthermore it was felt that for some landlords, engagement with poor environmental performers as a means of improving performance could be a positive strategy.

Rent review

Rent abatement at review is one of the means by which financial incentives can be incorporated into a green lease. This could be linked, for example, to benchmarks for energy and water usage and waste reduction and/or recycling. Both the landlord's service provision and tenant's operational activity would have to be monitored. Where the landlord fails to perform by providing services according to the lease provisions or the EPC Asset Rating falls below an agreed rating, a reduction in rent might be the penalty. The latter arrangement represents a substantial risk to the landlord as it is highly likely that over the course of a lease, the building will have to improve its performance to retain the same rating, as newer buildings come on stream and raise the level of the overall stock. Achieving the required performance level will therefore require expenditure on both active management and improvements to the building. A landlord is likely to require additional rent to take on this risk.

Alternatively, a landlord may require the EPC Operational Energy Rating to be no lower than say a 'C'. Continued achievement of a 'C' rating would require active management of the building and possibly behaviour change amongst tenants to ensure, for example, that lighting and climate control systems are used efficiently. If the building fails to achieve this rating, recompense could be through a premium on the rent.

One of the major difficulties with using rent abatement as a means of incentivising specified levels of performance is the potential it has to compromise the value of a commercial building. Where the requirement is tenant driven, the tenant is willing to share the additional burden through a rental premium and the strategy complies with the landlord's investment policy, both parties may see it as a positive arrangement. However, sufficient flexibility would need to be incorporated within the terms of the green lease to ensure it did not restrict the potential to market the property to alternative tenants.

Where the green leasing arrangement is landlord driven and related to a particular investment fund strategy or investor policy, the potential impact on value is equally significant since the property is likely to have to be offered at a lower rent that reflects the extra requirements placed upon the tenant. The extent of that reduction might be a product of the benefit to the investor of achieving the benchmark and the perceived additional 'cost' to the tenant in management and monitoring.

Rent abatement has negative value implications and could lead to over-rented properties and their attendant problems. However, it is also the most powerful means of incentivising both landlord and tenant to achieve the objectives of the green lease.

Service charge

Service charge provisions can provide a further or alternative mechanism for incorporating financial incentives since any savings arising through waste management, reduced water costs or energy efficient behaviour on the part of the occupier can be passed back through the service charge. This is particularly pertinent in retail centres where management of packaging waste can be a substantial element of service charges.

General issues relating to lease drafting

Enforceability by both parties is a key issue for green leases. It is important therefore that elements that might undermine enforceability are clearly established, including the means to demonstrate compliance, penalties for non-compliance and, crucially, what recourse is available to each party.

Are green leases the answer?

To achieve sustainable property objectives requires a fundamental change in the landlord and tenant relationship and green leases could be part of this by achieving more sustainable commercial property management and operation. It is unlikely that a single green lease model will be adopted, but a system for tailoring different types of targets, responsibilities and obligations into an agreement which may or may not have financial incentives and penalties attached, could be a fruitful way forward.

There are issues to resolve with the regards the potential impact on rental and capital values and the willingness and/or ability of different types of occupier to accept such a lease. But the fact that the debate is happening shows very clearly how far the commercial property sector has moved on in terms of sustainability in the past five years, and how seriously it is taking this issue.

UK Consensus Forecasts March 2008

This quarterly survey looks at property investment market forecasts and offers an insight into the range of forecasts of future property performance gathered from over 30 companies including fund managers, property advisors and equity brokers. The survey has become a key indicator of the UK commercial property markets performance expectations.

The latest IPF Consensus Forecast shows a continuation of last quarter's downward revision of commercial property returns. The consensus total return forecast for 2008 at the all property level is -2.6%, down from 0.9% last quarter. This is the first negative all property total return forecast produced since the survey was first published in 1999. This negative return is replicated across all sectors for 2008 and is driven by further reductions in capital and rental value growth expectations. The sharp correction predicted for 2008 at the end of 2007 is now predicted to be sharper still.

The City and West End office markets are the two worst affected sectors. They have moved from being the drivers of strong performance in the office sector 12 months ago to the laggards holding performance back. Where recovery is forecast in rental value and capital value growth in all other sectors for 2009, the City of London office market is forecast negative rental value growth throughout the three- and five-year view in this quarter's forecast. Capital value growth is forecast to turn positive in 2010 but the five year view remains negative for this sub-sector.

The forecast recovery shown for 2009 in the last survey is reflected again here but is stronger this time. Total return forecasts for each sector have improved for 2009 with the exception of the London office sub-sectors. The forecast spread has also reduced this time with a greater consensus of views for 2008 and 2009. The first 2010 forecasts show a continuation of this recovery with these two years driving a five-year mean forecast clustered around 6% total return for all sectors.

The commercial property forecasts remain redolent of a short-term market correction in line with a re-pricing of risk and weaker occupier demand emanating from a slow-down in the UK economy. They do not however appear to reflect expectations of a recession in the wider UK economy. Economic data[1] supports this view. Service sector output fell from 1.7% in Q3 to 0.5% in Q4 of 2007 but UK GDP was 3.1% in 2007. GDP is forecast to fall to 1.8% in 2008, recovering to 2% in 2009. Employment figures remain robust. The three months to December saw the highest number of people in employment since records began in 1971. Unemployment fell again and the claimant count fell by 128,500 over the year to 794,600; the lowest figure since 1975. The number of job vacancies has increased.

Growing concerns regarding the level of consumer demand and the stalling of the housing market led to two quarter point cuts in the Bank of England base rate to 5.25% since the last forecast was published. According to ONS data, retail sales volumes rose in January 2008. Total sales volume in the three months to January saw a 4.1% increase on the previous year. Household goods stores and non-store retailing and repair enjoyed the largest increase in sales volumes over this period.

In light of the robust consumer spending data, concerns about inflation remain with CPI reaching 2.2% in January. As might be expected, rising fuel and food prices were largely behind this increase. The latest HM Treasury economic consensus forecasts for 2008[2] forecast CPI at 2.3% for 2008 and 2% for 2009. However the potential for oil prices to rise further remains a key risk within this scenario.

Key points

The consensus forecast for all property total return in 2008 has moved down again this quarter, from 0.9% to -2.6%. This is the first time the IPF consensus forecast has produced a negative mean total return forecast for the all property classification since it was first published in 1999. It is reflected across all the sectors with each one showing a negative mean total return for 2008.

- This shift is driven by further significant reductions in capital value growth expectations, i.e. yield shift, and reduced rental value growth forecasts across each sector.
- The City and West End office sub-sectors have seen the most significant reductions in both rental and capital growth forecasts. The consensus shows negative rental value growth for City offices throughout the three- and five-year views, with a return to positive capital value growth anticipated in 2010 (0.8%)
- On a more positive note, there remains a clear expectation of improved performance across other sectors in 2009 and 2010. The five year view continues to show real annual returns for each sector, perhaps underlining the long term characteristic of property as an asset class.

The substantial downward revisions in forecasts for all sectors in last quarter's survey are reinforced this quarter, albeit with less dramatic reductions.

- All sectors are showing negative capital value growth and total return forecasts for 2008. Rental value growth has also been revised downwards for all sectors with the sharpest reductions in City and West End office sectors.
- City offices shows the poorest expected total return performance for 2008 at -4.8% driven by substantial falls in expected capital value growth and rental value growth forecasts, both showing negative mean forecasts for 2008.
- Retail rental value growth forecasts have fallen further for 2008 and remain below inflation for the three- and five-year forecast views. Improved total return figures for 2009 and 2010 reflect capital value growth forecasts as yields are expected to strengthen.

2 Source: HM Treasury, **Forecasts for the UK Economy**, February 20, 2008

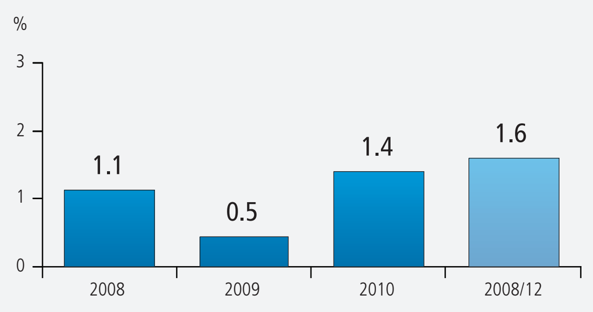
1 Economic data source: **National Statistics, February 2008**

- In contrast to the 2008 figures, the strong total returns forecasts for 2009 produced in last quarter's survey have improved further, with all sectors bar offices showing an up-tick in performance for 2009.
- Given the context of very poor performance forecast for 2008 and further falls in rental value growth forecast for 2009, these positive 2009 total return forecasts suggest wide expectation of a strong recovery in investor demand.
- The West End, City and all office sector forecasts are less encouraging and remain dogged by falling rental and capital value growth figures for 2008 and 2009.
- The first forecasts for 2010 reflect expectations of a continuing trend of recovery from 2009 onwards. This is supported by stronger rental and capital value growth across each sector.
- The five-year view is positive with all sectors showing above inflation total returns.

All Property rental value growth forecasts

The All Property mean rental growth forecast for 2008 and 2009 fell back this quarter. The forecast spread for both years has narrowed as those at the higher end of the scale have fallen. The forecasts at the lowest end of the scale are also less extreme this quarter but the change is more limited.

Figure 1: All Property rental value growth forecasts

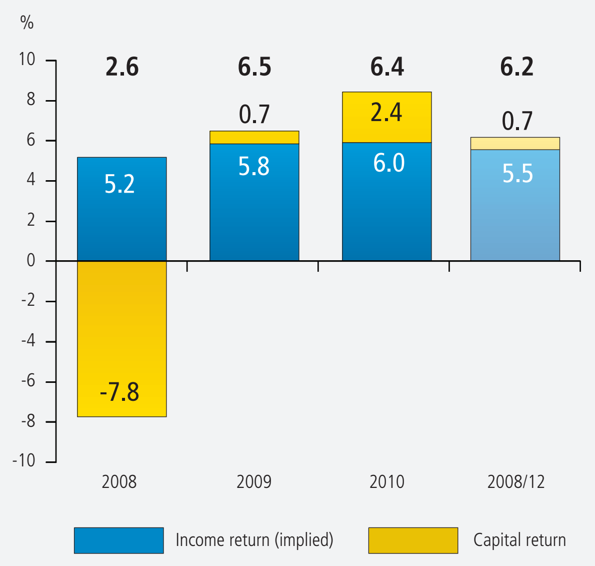


Whilst the 2010 figures show signs of an improvement in performance, there is no expectation of a return to above inflation rental growth for the five-year view at this point.

All Property total return forecasts

The consensus all property total return forecasts have fallen again this quarter with the first negative total return forecast as the mean for 2008. This is driven by falling capital and rental value growth expectations.

Figure 2: All Property total return forecasts



The forecasts for 2009 continue to show expectations of a relatively strong recovery and have moved up marginally on last quarter. The first total return forecast for 2010 shows further positive expectations of yield shift underpinning a return to above inflation total returns, similarly the five-year view shows buoyant expectations as the annual return over five years is expected to even out the poor short-term returns expected in 2008.

All Property survey results by contributor type (Forecasts in brackets are November 2007 comparisons)

Figure 3: Property advisors and research consultancies (15 contributors)

	Rental value growth %			Capital value growth %			Total return %		
	2008	2009	2010	2008	2009	2010	2008	2009	2010
Maximum	3.7 (5.3)	2.0 (5.3)	2.9	-3.8 (3.0)	6.9 (5.2)	5.0	1.5 (8.3)	13.1 (10.0)	11.1
Minimum	-1.7 (1.5)	-3.5 (1.0)	-0.5	-12.5 (-7.5)	-5.5 (-3.6)	-0.2	-8.1 (-2.5)	0.1 (1.3)	6.2
Range	5.4 (3.8)	5.5 (4.3)	3.4	8.7 (10.5)	12.4 (8.8)	5.2	9.6 (10.8)	13.0 (8.7)	4.9
Median	1.5 (2.6)	1.0 (2.5)	2.0	-6.5 (-3.2)	1.6 (1.9)	3.1	-1.0 (1.8)	7.3 (7.2)	9.1
Mean	1.3 (2.8)	0.6 (2.5)	1.7	-7.3 (-2.8)	1.5 (1.4)	3.0	-2.3 (2.1)	7.3 (6.7)	8.9

Figure 4: Fund managers (15 contributors)

	Rental value growth %			Capital value growth %			Total return %		
	2008	2009	2010	2008	2009	2010	2008	2009	2010
Maximum	2.4 (4.8)	2.0 (3.9)	2.3	-4.9 (-1.2)	4.4 (2.5)	6.2	0.4 (3.9)	10.4 (8.1)	12.8
Minimum	0.4 (1.1)	0.0 (-0.1)	0.2	-11.0 (-9.4)	-1.6 (-1.0)	-0.3	-5.7 (-4.8)	4.2 (2.7)	5.9
Range	2.0 (3.7)	2.0 (4.0)	2.1	6.1 (8.2)	6.0 (3.5)	6.5	6.1 (8.7)	6.2 (5.4)	6.9
Median	1.3 (2.4)	0.9 (1.8)	1.6	-8.1 (-4.7)	1.0 (0.8)	2.0	-3.1 (0.7)	6.1 (6.3)	7.8
Mean	1.4 (2.6)	0.9 (1.7)	1.4	-7.9 (-4.6)	0.8 (0.8)	2.3	-2.6 (0.3)	6.7 (6.1)	8.3

Figure 5: Equity brokers (4 contributors)

	Rental value growth %			Capital value growth %			Total return %		
	2008	2009	2010	2008	2009	2010	2008	2009	2010
Maximum	1.0 (2.0)	1.0 (2.0)	2.0	-4.0 (-2.0)	-1.0 (-2.0)	2.0	1.0 (3.0)	5.2 (3.0)	7.0
Minimum	-2.5 (-2.8)	-6.1 (-6.9)	-1.7	-12.0 (-12.6)	-5.7 (-9.0)	-0.2	-6.7 (-7.9)	0.2 (-3.5)	6.1
Range	3.5 (4.8)	7.1 (8.9)	3.7	8.0 (10.6)	4.7 (7.0)	2.2	7.7 (10.9)	5.0 (6.5)	0.9
Median	-0.3 (1.6)	-1.2 (1.4)	0.5	-10.4 (-6.9)	-2.0 (-4.0)	1.0	-5.1 (-1.6)	3.0 (1.6)	6.7
Mean	-0.5 (0.6)	-1.9 (-0.6)	0.3	-9.2 (-7.1)	-2.7 (-4.7)	1.0	-4.0 (-2.0)	2.9 (0.7)	6.6

Figure 6: All forecasters (34 contributors)

	Rental value growth %			Capital value growth %			Total return %		
	2008	2009	2010	2008	2009	2010	2008	2009	2010
Maximum	3.7 (5.3)	2.0 (5.3)	2.9	-3.8 (3.0)	6.9 (5.2)	6.2	1.5 (8.3)	13.1 (10.0)	12.8
Minimum	-2.5 (-2.8)	-6.1 (-6.9)	-1.7	-12.5 (-12.6)	-5.7 (-9.0)	-0.3	-8.1 (-7.9)	0.1 (-3.5)	5.9
Range	6.2 (8.1)	8.1 (12.2)	4.6	8.7 (15.6)	12.6 (14.2)	6.5	9.6 (16.2)	13.0 (13.5)	6.9
Std. dev.	1.2 (1.4)	1.6 (2.0)	1.0	2.6 (3.3)	2.4 (2.9)	1.7	2.7 (3.4)	2.5 (2.8)	1.7
Median	1.2 (2.3)	0.9 (2.0)	1.6	-8.0 (-4.0)	1.2 (0.9)	2.2	-2.8 (1.0)	6.8 (6.2)	8.0
Mean	1.1 (2.4)	0.5 (1.8)	1.4	-7.8 (-4.1)	0.7 (0.4)	2.4	-2.6 (0.9)	6.5 (5.7)	8.4

Notes

1. Figures are subject to rounding, and are forecasts of All Property or relevant segment Annual Index measures published by the Investment Property Databank. These measures relate to standing investments only, meaning that the effects of transaction activity, developments and certain active management initiatives are specifically excluded.

2. To qualify, all forecasts were produced no more than three months prior to the survey.

3. Maximum: The strongest growth or return forecast in the survey under each heading.

4. Minimum: The weakest growth or return forecast in the survey under each heading.

5. Range: The difference between the maximum and minimum figures in the survey.

6. Median: The middle forecast when all observations are ranked in order. The average of the middle two forecasts is taken where there is an even number of observations.

7. Mean: The arithmetic mean of all forecasts in the survey under each heading. All views carry equal weight.

8. Standard deviation: A statistical measure of the spread of forecasts around the mean. Calculated at the 'all forecasters' level only.

Survey summary results by sector

Figure 7: Sector summary

	Rental value growth %				Capital value growth %				Total return %			
	2008	2009	2010	2008-12	2008	2009	2010	2008-12	2008	2009	2010	2008-12
Office	2.0	-0.3	0.8	1.4	-7.4	0.0	2.3	0.1	-2.2	5.9	8.4	5.9
Industrial	0.6	0.6	1.2	1.2	-7.7	0.8	2.1	0.1	-1.8	7.3	8.8	6.5
Standard shops	0.8	0.8	1.4	1.4	-7.5	1.3	2.7	0.3	-2.4	6.9	8.4	5.9
Shopping centres	1.1	1.2	2.0	1.9	-7.7	1.1	2.4	0.4	-2.5	6.9	8.4	6.0
Retail warehouses	0.6	1.4	2.3	2.2	-8.3	1.7	3.6	0.9	-3.6	7.0	9.0	6.1
All Property	**1.1**	**0.5**	**1.4**	**1.6**	**-7.8**	**0.7**	**2.4**	**0.7**	**-2.6**	**6.5**	**8.4**	**6.2**
West End offices	4.0	0.7	1.3	2.3	-6.1	1.4	3.2	1.1	-1.9	6.4	8.5	6.1
City offices	-0.4	-5.0	-1.3	-0.8	-9.6	-3.2	0.8	-1.7	-4.8	2.4	6.9	4.1
Office (all)	2.0	-0.3	0.8	1.4	-7.4	0.0	2.3	0.1	-2.2	5.9	8.4	5.9

The 34 contributors to this quarter's forecasts at the All Property level included 15 property advisors, 15 fund managers and 4 equity brokers. Of these, 30 provided sector forecasts. In addition, 25 contributors provided West End office segment forecast and 26 City office segment forecasts, (12 property advisors, 12 fund managers and 2 equity brokers). Out of the 34 forecasts 7 were updated in December 2007, 11 in January 2008 and 16 in February 2008.

Notes

Consensus forecasts further the objective of the Investment Property Forum to improve the efficiency of the market. The IPF is extremely grateful for the continuing support of the contributors as noted on the last page of this publication. This publication is only possible thanks to the provision of the individual forecasts. The IPF welcomes a number of new contributors for this edition, widening the coverage of the market participants.

If your organisation wishes to contribute to future surveys please contact the IPF Research Director at lellison@ipf.org.uk.

The sector figures are not analysed by contributor type, with all figures shown at the all-forecaster level.

In the charts and tables 'All Property' figures are for the full 34 contributors while the sector forecasts are for the reduced sample (30) of contributors.

Acknowledgements

The Investment Property Forum wishes to thank the following organisations for contributing to the IPF UK Consensus Forecasts during 2007:

Property advisors (includes research consultancies): Atisreal, Capital Economics, CBRE, Cluttons, Colliers CRE, Cushman and Wakefield, Experian BSL, Fletcher King, GVA Grimley, IPD, Jones Lang LaSalle, King Sturge, Knight Frank, Paul Mitchell Real Estate Consultancy, Real Estate Forecasting.

Fund managers: Cordea Savills, F & C Property Asset Management, Goodman Property Investors, Henderson Global Investors, HSBC Specialist Fund Management Ltd, ING REIM (UK) Ltd, Invista REIM, La Salle Investment Management, Legal and General, Morley Fund Management, Protego, Prudential Property Investment Managers, Schroder Property Investment Management, Standard Life, SWIP.

Equity brokers: Exane BNP Paribas, Merrill Lynch, Morgan Stanley and one that wishes to remain anonymous.

Disclaimer

The IPF Survey of Independent Forecasts UK Property Investment is for information purposes only. The information therein is believed to be correct, but cannot be guaranteed, and the opinions expressed in it constitute our judgment as of the date of publication but are subject to change. Reliance should not be placed on the information and opinions set out therein for the purposes of any particular transaction or advice. The IPF cannot accept any liability arising from any use of the publication.

Forum activities and announcements

Executive team

We are delighted to welcome a new addition to the team. Frankie Clay joined us in January and replaces Chris Naughton. She will work with Sue Forster on education and also assist Louise Ellison with the IPF Research Programme 2006-09.

We also welcome back Jenny Hooper from maternity leave and who will now be dealing solely with our accounts.

IPF executive

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Education

Investment Education Programme (IEP) – the IPF's formal postgraduate programme of modules

The course comprises a series of modules which may be taken as one-off courses or a part of the overall programme which, on successful completion, leads to the award of the IPF Diploma. A full outline of all the modules can be found on the IPF website: www.ipf.org.uk

Upcoming modules:

Indirect Property Investment 22-24 April 2008
Teaches participants how to evaluate the risk/return profiles of indirect real estate investment vehicles.

International Property Investment 3-5 June 2008
Aims to provide an understanding of how the core skills in property investment can be applied in an international context.

For further details on these courses, please contact Frankie Clay, Education and Research Manager on 020 7194 7928

Diplomas 2007

We are pleased to announce that the IPF Diploma has been awarded to the following people:

Richard Apfelbacher	Colliers Capital UK
David Austin	Land Securities
Jennifer Conway	Standard Life Investment
Drew de Wynter	ING Real Estate Investment Management
Fergus Egan	Legal and General Investments
Andrew Funnell	Watson Wyatt
Vaughan Griffiths	Griffconsult
Catherine Haughey	Rynda Property Investors
Simon Kinnie	Standard Life Investment
Nicki Marco Weber	UBS AG
Timothy Reade	Grosvenor
Cynthia Parpa	Grosvenor
Anna Starczewska	CB Richard Ellis
Alan Thompson	Scottish Widows Investment

Prize Winners

Andrew Funnell **Watson Wyatt**
For best performance in a single module

Catherine Haughey **Rynda Property Investors**
For outstanding performance in the Diploma

New module leaders

We welcome two new module leaders to the Investment Education Programme. Werner Bäumker has succeeded Dr Shaun Bond as leader of the Portfolio Management module and Nick Tyrrell has taken over from Ben Sanderson as leader of the International Property Investment module. We thank the two outgoing module leaders for their dedication and expertise.

IPF Educational Trust

The main aim of the IPF Educational Trust (IPFET) is the advancement of education in connection with the financing, development, management, valuation and ownership and marketing of property. In furtherance of this aim, the IPFET has launched a new grant scheme to support academic institutions in the delivery of post graduate property investment education. Accordingly, the IPFET is making £100,000 per annum available for its Universities & Business School Programme. The Trust plans to help academic institutions:

- Recruit top flight students at a post graduate level;
- Encourage new and retain existing staff; and
- Develop and enhance property investment courses.

As Andrew Graham, Chairman of the Trustees explained, "This new scheme concentrates the IPFET's efforts in an often overlooked area and will, we hope, provide valuable additional funding for property academia and at the same time enhance the links between academia and industry".

Special Interest Groups

Property Derivatives Interest Group (PDIG)

Nick Scarles of Grosvenor has taken over from Iain Reid of Protego as Chairman of PDIG.

The increasingly popular PDIG breakfasts continue to raise awareness of property derivatives trading and keep the market up-to-date on the level of trading activity. The next breakfast is scheduled for Thursday 1 May and will be a joint IPF/IPD event where the Q1 derivatives trading volumes will be announced alongside the IPD Quarterly Index.

Sustainability Interest Group

Chris Taite of Grosvenor has taken over from Paul McNamara of PRUPIM) as Chairman of the Sustainability Interest Group.

The group is planning two events for 2008, the first on 14 May. This will focus on ways in which the property investment sector have started responding to the sustainability agenda through improvements to standing portfolios, or setting up new green investment funds.

Events

Recent events

IPF Annual Lunch, The Grosvenor House Hotel, London
6 February 2008

Over 1,300 IPF members and their guests attended this superb event at the Grosvenor House Hotel.

Peter Freeman, IPF Chairman, paid tribute to the late Alastair Ross Goobey who had sadly passed away a few days earlier. In addition, Peter announced the award of two life members:

Adrian Wyatt, CEO of Quintain Estates and Development PLC who was the founder of the IPF and Rob Bould, a past Chairman, who has been extremely active in the internal affairs of the IPF and also spearheaded the Occupiers Satisfaction Index.

At the lunch, John Story, Academic Faculty Chairman, also presented two prizes for outstanding achievement in the IPF's post graduate qualification, the Investment Education Programme. The prizes were awarded to Andrew Funnell, Watson Wyatt, for best performance in a single module and Catherine Haughey, Rynda Property Investors, for outstanding performance in the Diploma. Unfortunately, Catherine was unwell and unable to attend the event and so the award was collected on her behalf by Michael Walton, Chief Executive of Rynda Property Investors.

Future dates for your diary

Half-day conference in Scotland, Radisson SAS, Glasgow
12 June 2008

IPF Annual Dinner, The Grosvenor House Hotel, London
25 June 2008

IPF Midlands Regional Dinner, The ICC, Birmingham
16 October 2008

IPF Northern Regional Dinner, The Lowry, Manchester
19 November 2008

Lectures and workshops in London

Sliding Doors: Money in and out of property
Hammonds, Devonshire Square, Cutlers Gardens 7 May, 6-8pm

The UK commercial property lending market 22 May, 6-8pm

Where are the tenants? 3 June, 6-8pm

Reading property company accounts 23 April, 9am-4.30pm

For venue details and booking, please email Suleen Syn
ssyn@ipf.org.uk

Research

The IPF Research Programme 2006-09 has published two reports:

- Large-scale investor Opportunities in Residential Property: An Overview
- Risk Management in UK Property Portfolios: A survey of current practice

Both reports are available to members to download for free from the IPF website.

We are expecting to publish the following reports in the next few weeks:

- Alpha and Persistence in UK Property Fund Management
- Implications for the Strategic Development of UK REITs from the Experience of LPTs in Australia.

Publication will be announced on the website.

In February 2008 we published our first IPF Research Newsletter. This is planned as a six-monthly publication designed to keep the industry up-to-date on the activities of the research programme. The newsletter has links to all our downloadable reports.

DLA Piper (one of the IPF Research Programme sponsors) hosted an IPF Research event at MIPIM 2008. The programme featured presentations on US and Australian REITs, looking at potential lessons to be learned from these mature REIT markets; the IPF European Consensus forecast of office rents providing an overview of the outputs of this six-monthly survey, and one of our latest research projects, looking at depreciation in European Office market rents.

IPF Investment Property Forum

20 YEARS OF THE IPF 1988-2008

Annual Dinner 2008

Guest Speaker **Ian Hislop**

The 2008 Annual Dinner will be even more special than usual as it sees the start of our 20th Anniversary year celebrations. We are delighted to announce that Ian Hislop will entertain us following the dinner.

Wednesday 25 June 2008 18:30 Pre-dinner drinks | 19:30 Dinner

Grosvenor House Hotel, Park Lane, London W1

Ticket Price £128.00 (inclusive of VAT) per person (excluding wine and liqueurs)

Ian Hislop has edited Private Eye since 1986, taking over the helm from Richard Ingrams and steering it to ever greater commercial and satirical success.

He is also known to millions as team captain on Have I Got News for You?, which has won numerous awards including a BAFTA for Best Light Entertainment. Ian has made countless television and radio appearances, as panellist, essayist and presenter. Credits range from Newsnight Review, Question Time and University Challenge ('The Professionals'), to a Radio 4 series on the history of tax, the Victorians and church architecture.

Ian Hislop was honoured to receive the British Society of Magazine Editors' highest award, The Editors' Editor.

Please reserve tables for the Annual Dinner by completing a booking form and returning it with payment, as soon as possible. Tables will be for ten or twelve (limited availability of larger tables). Individual bookings can be made and, in this case, please indicate if you wish to join a table with specific people. All business associates and colleagues are welcome.

Please note that wine orders, hosted bars and special dietary requirements must be arranged directly with The Grosvenor House, contact details will be supplied on confirmation of your booking together with tickets and place cards.

For more information or to book, contact Ingrid Styles on 020 7194 7920 or email Ingrid on istyles@ipf.org.uk

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