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Investment Property Focus

New cycle: repeating the pattern?

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Property is one of the most pro-cyclical industries in the UK. In a paper delivered originally at the IPD/IPF conference, **Sabina Kalyan** of CBRE Global Investors considers the interaction between the classic hog cycle and credit cycle, together with the impact of government intervention in each of the three major post-war UK property cycles.

The extreme highs and lows of returns between through 2005-09 have greatly increased investors' focus on benchmarking property performance. **Matthew Abbott** of Mercer, together with **Stephen Elliott** of Royal London Asset Management, **Dan Batterton** of Legal & General Property and **Charlie Ferguson-Davie** of Moorfield, discuss changes in the industry, including whether IPD is likely to remain the key UK benchmark.

Ed Trevillion of Heriot-Watt University discusses the rationale for adding behavioural aspects to models of real estate markets, with particular reference to investor activity 2003-07.

Graeme Rutter of Schroders and **Justin Cornelius** of Berwin Leighton Paisner provide an overview of recent Asian investor activity in the UK (primarily London) market and the form of special purpose vehicles being used in order to accomplish this.

IPF, INREV and SPR sponsor the annual Nick Tyrrell Research Prize (details for 2015 submissions on inside back cover) and the third recipient, **Paul Schneider** of QIC Limited, outlines his research on, Price discovery in UK unlisted real estate funds. The results suggest that investors' view of fair value are related to REIT pricing, past fund returns, yield and leverage.

Steven Devaney of University of Reading and **David Scofield** of University of Aberdeen recently completed an extensive study of times to transact as part of the IPF Research Programme's ongoing research into liquidity. Their article here identifies the key findings including a variation in transaction times between and within sectors.

A report on 'Zombie loans' published by the Research Programme in the second half of 2014 looked at the distressed loan workout process. **Peter Clarke** of Recept Consulting, the report's author, concludes that there may be another four years before the legacy high LTV loans disappear.

After 1 April 2018, non-domestic properties that are let will need to meet a prescribed minimum energy performance standard (MEPS). The potential impact of this is considered by **Charles Woollam** of SIAM LLP, **Adam MacTavish** of Sweett Group and **Sarah Sayce**, Emeritus Professor at Kingston University who found that 19% of their sample of 400,000 buildings fell below the anticipated of MEPS' level.

Bill Bartram of Independent Risk Management Solutions provides a concise overview of EMIR's trade reporting requirements. He suggests that 2015 would be a good time for the industry to raise its concerns about complying with EMIT's requirements with the FCA.

This edition of Focus also includes the November 2014 UK and European IPF Consensus Forecasts, together with Forum Activities and Announcements

Finally, included here is a copy of the Protocol: Open Market Investment Agency. This IPF initiative is intended to increase the clarity and transparency of investment transactions. For further information regarding this please contact me.

Wishing you a prosperous 2015.

Sue Forster
Chief Executive, IPF

Has the UK property industry learnt anything from previous property cycles?

SABINA KALYAN
CBRE Global Investors

This paper is taken from a speech made by the author at the IPD/ IPF Annual Property Investment Conference in November 2014.

Property is one of the most pro-cyclical industries in the UK, ahead even of banking and finance. We all know of the lags in the development response to an increase in demand and the way in which this amplifies the business cycle. This is not something we can eliminate, although I do believe the industry has got better at judging future demand – the supply response in Central London in the mid-2000s was far lower than in the mid-1980s and that, in turn, was lower than in the 1960s and 1970s.

However, in addition to being tied to the business cycle, property is a leveraged 'bet'. It is perceived to be an ideal asset class against which to lend. This is helped by perceptions that the income streams are long (although lease lengths have shortened), and that they are hedged against inflation (although I've never seen convincing evidence on this). Accordingly, property is uniquely vulnerable to sudden shifts in interest rates.

We can see this interaction between the classic hog cycle and the credit cycle, together with the impact of government intervention, in every one of the three major post-war UK property cycles, as outlined below.

The major post-war UK property cycles

THE 1960s/1970s CYCLE

To my mind, the post-war property boom was one driven primarily by changes in legislation. Government policy was far more interventionist in those days, with wild swings from one extreme to the other all within the space of what we would think of as a property cycle. Between 1947 and 1953, the supply side was massively constrained, thanks to a 100% tax on development gain. This swung the other way when the Tory government first reduced the tax and then eliminated it altogether in 1953. This, together with an end to building controls, unleashed a development boom that lasted a decade before the pendulum swung the other way with the 'Brown Ban[1]' on office development and the reintroduction of the Betterment Levy in 1967. To give you an idea of the scale of the Brown Ban, it halted 43 schemes by British Rail alone.

"...the post-war boom was one driven primarily by changes in legislation."

1 In November 1964, the Minister for Economic Affairs, George Brown, announced a near-total ban on office development in and around London as part of government policy to encourage office employment decentralisation. During two years that followed, office development restrictions were was extended initially to Birmingham and then other major parts of southern England and the Midlands.

The Ban had consequences unforeseen by government: it so stoked land values and rents in central London that it pushed office development out along the A4 toward Heathrow and to new decentralised office locations, such as Croydon. The Ban also helped push up capital values and resulted in the perception that rents could only ever go up. This created an ever larger asset base upon which borrowers were willing to lend and the belief that the payments would, of course, be serviced by rising rental income. That belief was so strong that lenders were willing to roll up the interest payments, or defer them, until the developer had let the building at what would be even higher rents! Such was the confidence, Harry Hyams found it fantastically profitable to leave Centre Point[2] empty for years.

This perception of ever-rising rents, and the reality of rising capital values, coincided with a massive increase in the pool of lenders. Up until then, the financing of development was pretty straightforward. The developer would get a short-term bridging loan from one of the major joint stock banks at 1-2% over the bank rate. Once the asset was built and leased, the loan would be replaced by a long-term mortgage, often provided by an insurance company. But in 1967, the government allowed companies to apply for a section 123 certificate[3], making them a kind of bank; one without a deposit base and reliant entirely on short-term wholesale funding in the newly-created, inter-bank market. As a result, the broad money base increased by 73% between December 1971 and December 1973, with the section 123 banks increasing their lending from £400m to £3.4bn over the same period.

"...the party was brought to an end by a combination of sharply rising interest rates, a credit crunch and falling rents."

Then, just as in the 2000s, the party was brought to an end by a combination of sharply rising interest rates, a credit crunch and falling rents. Interest rates had been very low as a result of the government 'go for growth' policy in 1971[4] and the liberalisation of the banking system[5], creating a perfect credit boom through most of 1972 and 1973. Construction costs were rising, but the market assumed, "rents always go up don't they?" Only in this case, the government imposed a rent freeze on standing investments in November 1972. Money continued to flow into new development because perversely it was exempt from the freeze.

Then interest rates started to go up quickly as the government tried to counter the inflationary impact of the oil crisis. The Minimum Lending Rate rose from 4.5% at the beginning of 1972 to 13% by the end of 1973, and remained above 10% for the next two years. At the same time, policy confusion – from credit boom to credit crunch – continued with development gains tax (DGT) being introduced in 1974.

So here is what happened in the panic that began the secondary banking crisis in December 1973, as described by Margaret Reid[6].

"The banks had a variety of maturities and had in the past been able to renew, say, a three-month deposit, when it matured. But now, when a three-month deposit matured, the fringe could only get one month, one week or overnight money. The next day more matured and the same thing happened. Their books got shorter and shorter. And the shorter the book, the greater the demand that was seen in the market. Velocity increased enormously and this began to alarm people; the cannier lenders started to withdraw their limits. The top was spinning more dizzily but could it stay up?"

It sounds very like a description of the banks during the interbank crisis when Bear Stearns was rescued and Lehmans failed!

By the spring of 1974, the crisis had spread from the secondary banks to the heart of the property industry, where capital values fell by 25-50% under the impact of higher interest rates and the

2 Centre Point, at the corner of Oxford Street and Tottenham Court Road in central London, was completed in 1964 at a cost of around £5.5m. In 1993, the building was valued at nearly £20m, despite having been vacant since completion, because rental values were rising so rapidly.

3 Section 123, Companies Act 1967

4 Chancellor, Anthony Barber, introduced large tax cuts in the 1972 Budget.

5 Under the 'Competition and Credit Control' monetary policy operated by the Bank of England 1971-73

6 **The Secondary Banking Crisis, 1973-75: Its Causes and Course**, by Margaret Reid, published by Hindsight Books Limited; 2nd new edition October 2003.

"The solution to the crisis was ....immediate provision of liquidity and the slow patient transfer of property from the failed entities..."

introduction of DGT. When the freeze on business rents was extended, the fall in values accelerated.

The solution to the crisis was echoed in the wake of 2008 crash – immediate provision of liquidity and the slow patient transfer of property from the failed entities to new owners at market-clearing prices. The Bank of England gathered together the primary banks and argued that it was in their interests to prevent a general panic. The resulting 'lifeboat' saw the major banks providing £1bn of cash loans, effectively recycling the deposits that had been withdrawn from the secondary banks and put in the primary banks. No public funds were involved until August 1974, when the Bank of England funded the Slater and Walker bail-out.

The Bank of England actively wooed the big institutional investors, insurance groups and pension funds to acquire the property owned by the secondary banks in an operation that made it a kind of informal NAMA[7]. In the four years that followed, £4.4bn of property – or £32bn in today's terms – was transferred to the institutional investment arena. The most famous of these transfers was The Cork Dam scheme in which Sir Kenneth Cork sold off, with the Bank of England's blessing, the assets of William Stern's property empire when it collapsed in May 1974.

THE 1980s/1990s CYCLE

The early 1980s' cycle was similar to the 1970s' boom, insofar as it also coincided with a period of credit liberalisation and new entrants to the property lending field. This time it was the American, Japanese and other overseas lenders who joined the domestic banks and accounted for half of all lending to property. In the 1980s' boom, property lending was three times as high in real terms as in the 1970s, but the share in total lending (12%) was smaller than the 20% level of the earlier decade.

While the 1970s' boom had rolled-up interest and the latest boom had securitisation and subprime mortgages, the 1980s had non-recourse lending. Arguably this was first introduced to the UK market at scale by Rosehaugh Stanhope, with the financing of the Broadgate development. The other key difference was that developers no longer tended to hold onto portfolios of property financed by long-term mortgages. Rather, in an era of high real interest rates, it was more profitable to sell on the completed properties to institutional investors. However, this meant the developers no longer had a sustainable income stream.

"...the 1970s' boom had rolled-up interest, the latest boom had securitisation and subprime mortgages and the 1980s had non-recourse lending."

As usual, the boom was accentuated by government policy: the creation of enterprise zones, for example, made possible the development of the Metrocentre in Gateshead. Government policy in other countries also helped – when Swedish investors were first allowed to go offshore in 1987, they invested over £1bn in UK property over the subsequent three years. Other factors were at work too, for example, companies started buying propcos as 'counter-cyclical plays', for example, British Aerospace bought Arlington for £278m in May 1988.

On the demand side, the 'Big Bang' of November 1986 was the key event. The Stock Exchange opened itself up to foreign ownership of brokers and a wave of American banks bought British brokerage firms. Not only were they shocked at the quality of their London offices but they also needed massive trading floors. At the same time, the City of London relaxed its planning restrictions on offices.

7 The 'National Asset Management Agency' was established in December 2009 by the Irish Government.

As in the 1973 crisis, the 1980s' boom came to an end with the rise in interest rates from August 1987, which triggered the October 1987 equity market crash. 'Black Monday' did two contrary things. First, it prompted a cut in interest rates, which was helpful but temporary, as Chancellor Lawson secretly shadowed the Deutsche Mark. Second, and more damagingly, it radically reduced the demand for office space in central London. By 1989, interest rates had reached 15% and stayed there for a year. Finally, between 1987 and 1988, with the 'cult of the equity' in tatters, institutions rushed into property and, although demand was wavering, new supply had not been entirely delivered so rents were still rising.

"...between 1987 and 1988, with the 'cult of the equity' in tatters, institutions rushed into property..."

The resulting property crash did not affect mature companies to the same degree as the 1974 crash. But it did wreak havoc to any company operating at high leverage. To quote Alastair Ross Goobey[8],

"The area of the greatest self-delusion of the 1980s' property market was that the words 'non-recourse' or 'partial recourse' were a guarantee that the parent company would survive any mishap in a subsidiary. It seems to have come as a surprise to many participants that the banks took a dim view of any company that was prepared to walk away from these liabilities. The same banks would almost certainly have a relationship with some other part of the group and could prove very awkward when those facilities came up for renewal."

From my perspective, the major difference between the two cycles was the reaction of the banks and the government. In the 1970s, the banking system was more concentrated. The Governor of the Bank of England could call the lending chiefs into a room and broker a solution in the national interest. But by the 1990s, the banking system was far more diffuse and far more international. Also, the need to bring the banks together was not as great because the systemic risk was smaller. This in a way was the problem with the 1990s: the property crash was not bad enough to destabilise the economy and so the lenders were left to their own devices. Repossession, both of residential and commercial property, was therefore far more common than in the most recent crash and the banks, ill-equipped to manage property, then fire-sold assets.

"...the problem with the 1990s: the property crash was not bad enough to destabilise the economy and so the lenders were left to their own devices."

The lessons learnt from this crash are clear. When it came to the crash following Lehmans fall in 2008, valuers moved valuations far more quickly, taking in a wider set of market pricing signals, including those from the nascent derivatives market and secondary market pricing for units in pooled funds. The banks did not want to trigger fire-sales and followed more the style of the 1970s' work-out. Of course, as in the 1970s, this was a time of deep systemic risk where the Bank of England was heavily involved. One wonders whether a more limited localised credit-driven crash is still possible, and if so, whether the lenders would revert to their early 1990s' behaviour or still behave with such patience in future.

THE RECENT BOOM AND CRASH

Most of us were working in the industry during the 2000s' boom-bust cycle so I will not go over that in detail. Suffice to say that once again, UK property was caught in a wider credit bubble and suffered the consequences when the credit crunch occurred. To my mind, this really was a pure credit-driven event since there was no uncontrolled development boom or high frequency government intervention through planning laws, the taxation of development, or a rent freeze.

The response was also swift and substantial, in the US and UK at least. I suspect this was informed less by their own respective economic history and more by looking at Japan's slide into deflation after a very

8 **Bricks and Mortals: Dream of the 80s and the Nightmare of the 90s – Inside Story of the Property**, by Alastair Ross Goobey, published by Random House Business Books August 1992.

timid response to its early 1990s' crash. However, there is a UK parallel in the 'Panic of 1825'[9], when the then Governor of the Bank of England, Jeremiah Harman said,

"We lent money on behalf of the Bank of England by every means possible and in modes we had never adopted before to an immense amount and we were not on some occasions over nice. Seeing the dreadful state in which the public were, we rendered every assistance in our power."

Sounds rather like the aftermath of Northern Rock's collapse!

"...once again, UK property was caught in a wider credit bubble and suffered the consequences..."

Where are we today?

I believe that there has been a fundamental sea-change in macro-economic policy that will be with us for at least a decade to come, and with which the property industry is only just starting to grapple.

From the mid-1990s onward, most developed market central banks were given independence to set interest rates in order to achieve low and steady consumer price inflation. This created a decade of steadily falling interest rates and naturally diverted funds into commercial property. After all, what better asset class for providing similarly relatively stable income returns at a healthy premium to falling government bond yields. Not surprisingly, this premium encouraged the use of leverage.

If everyone is leveraged, and debt ratios are climbing, the system becomes incredibly vulnerable to either a rapid rise in interest rates or a fall in the price of the assets upon which the loans are based. So now governments, which originally set up the central banks to smooth the economic cycle and keep inflation stable, are trapped into keeping asset prices high and interest rates low, or run the risk of the 'house of cards' collapsing.

How should we as a property industry recalibrate our expectations of pricing in a world where interest rates will probably rise more slowly and to a lower level than most commentators and the markets are currently anticipating? On top of this, thanks to the last crash, we have realised that the pool of truly triple 'A' grade assets is much smaller than we previously thought. Plus, we live in a world where the flow of surplus savings from Asia Pacific toward the West is accelerating.

We will be faced with two choices. To accept lower implied returns on so-called prime or to move up the risk curve. I think both of those are happening today. When investors moved up the risk curve in response to hot prime pricing in the mid-2000s boom, I suspect they thought they were reacting to a cyclical upswing in the normal way. I wonder if they have truly internalised the shift in how central banks are behaving and the potential vulnerability that still exists in the UK economy, despite the recent 18 months of economic success.

From my perspective, the true price of a secure income stream is arguably higher today than in previous decades because of the increased interlinking of the global financial system, and in turn property. The system seems to be increasingly fragile and the chance of higher-frequency, higher-amplitude credit cycles has increased. Given this, does current pricing of prime property represent good value?

In addition, the UK is in for a period of political risk that may be at odds with international perceptions of it as the safe haven of Europe. The next election brings the chance of a government that will call a referendum on our EU membership. The uncertainty created by 'devo-max' will not only impact Scotland and the likelihood of a larger SNP majority in Scotland suggests that the question of independence has not been closed for a generation. All this will add uncertainty and volatility to the economy that still needs to deleverage and where its largest trading partner remains incredibly weak.

We know UK property is priced pretty fully today, and I suspect this is the high watermark of the current cycle, but ongoing cheap debt, rising political uncertainty, and currently high, but potentially 'choppy',

9 The Panic of 1825 was a London stock market crash, triggered in part by speculative investments in Latin America. This resulted in the closure of nearly 70 banks in England and affected markets in Europe, Latin America, and the United States.

international capital flows add up to a mix that is troubling to contemplate. Given our historic tendency for spectacular boom-bust cycles, we should all be especially alert.

Lessons learnt from previous cycles

It is clear that the property industry, regulators and central bankers have learnt lessons from the previous cycles and I would highlight the following:

- Only invest in a market with a clearly-defined and fast-acting lender of last resort. To quote Launcelot Holland, Governor of the Bank of England during the 1866 Overend Gurney crisis,

  "Before the Chancellor of the Exchequer was perhaps out of his bed we had advanced one half of our reserves."

  If in our modern era, the job of a central bank, self-described, is to prop up asset prices, and keep the currency cheap, then one arguably does not want to be invested in the least actively centrally banked market.
- A key lesson of the secondary banking crisis in 1973 is that because of the policy of rolled-up interest, the banks were often receiving no current interest payments on large portions of their loan books. My feeling is that we are more aware now of the importance of blending income-producing and non-income producing assets in a portfolio, highly conscious of any bunching in lease expiries or funding renewals.
- When things go wrong, they tend to go wrong together. The diversification you think you have will be nil when everything goes to hell at once and the liquidity in your open-ended fund will not be there when you want it most. Consider assumed diversification across geographies: it was the simultaneous crash in Canada, New York and London that brought the Reichmann property empire to its knees in the early 1990s.
- The best time to take on gearing is precisely when everyone else has had their fingers burned. Or more broadly, 'buy when the canon is roaring and sell when the bells are ringing'. A great example from the 1980s cycle was Sir John Ritblat buying up large assets in 1990-91, including the Finsbury Avenue development, taking on debt to do it.

So we have learnt from the mistakes of the past cycles but that is not to say that we will not commit others in future cycles.

Suggested reading (although, sadly, some are out of print)

'Property Boom', by Oliver Marriott, published by H.Hamilton, first edition November 1967, reprinted 1989

'Bricks and Mortals: Dream of the 80s and the Nightmare of the 90s – Inside Story of the Property', by Alastair Ross Goobey, published by Random House Business Books August 1992.

'The Property Masters: A history of the British commercial property sector', by P. Scott, published by Taylor & Francis April 1996.

'The Secondary Banking Crisis, 1973-75: Its Causes and Course', by Margaret Reid, published by Hindsight Books Limited; 2nd new edition October 2003

'Irrational Exuberance', by Robert J. Shiller, published by Princeton University Press, Second edition March 2005.

'The Banks and the Monetary System in the UK 1959-1971', by J E Wadsworth, published by Routledge, Reprinted edition November 2005.

'Ground-Breaking: How the commercial property market got off the ground 1950-75', by Vivian Linacre, published by Linacre Communications Limited July 2014.

Hold the Gherkin!

GRAEME RUTTER
Schroders

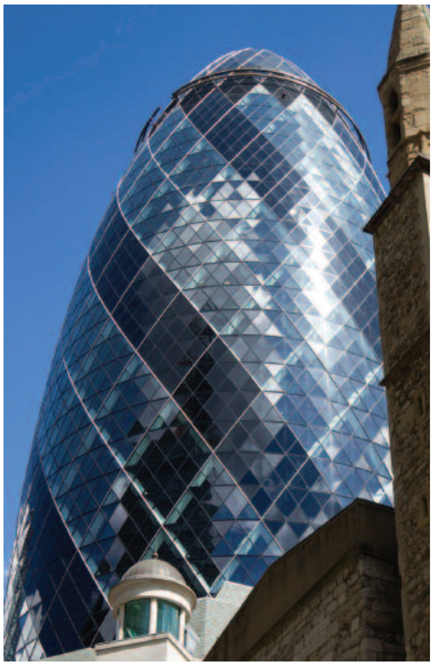
JUSTIN CORNELIUS
Berwin Leighton Paisner LLP

The recent news that 30 St Mary Axe (AKA The Gherkin) has been purchased by the Brazilian-based Safra Group came as something of a surprise, given that there had been much speculation that the buyer of the iconic City tower was likely to be a Chinese investor.

This article seeks to explore the attraction of large iconic UK property investments to Asian investors, the legal structures through which purchases are made and discuss the operational considerations for overseas landlords.

Scale of Asian investment

Overseas investment into UK property is not a new phenomenon. During the early 1990s, Japanese investors were very active in the UK property market and were then followed by waves of money from Germany and the USA. During the Global Financial Crisis, London was seen as a non-euro denominated safe haven by investors from a number of European countries, such as Greece, Italy, Spain and France. In more recent times,



St Mary Axe (The Gherkin), purchased by the Safra Group in November 2014

Recent notable London office purchases by Chinese investors

10 Upper Bank Street, Canary Wharf – In June 2014, China Life Insurance Company (70% stake) and Qatar Holdings were rumoured to have bought the headquarters building of Clifford Chance in a £780m deal. The property provides 450,000 sq. ft. over 32 floors.

Chiswick Park, west London – in January 2014, China Investment Corporation (CIC) was reported to have bought the office campus scheme for circa £780m from Blackstone. The scheme totals circa 1.8m sq. ft. Blackstone was retained as asset manager for the park.

Lloyd’s Insurance Building, London EC3 – Ping An Insurance bought the Richard Rogers-designed Lloyd’s building in the summer of 2013 for £260m/6.1% net initial yield from Commerz Real.

Winchester House, London EC3 – CIC, in partnership with Invesco Real Estate, purchased Winchester House, the City headquarters of Deutsche Bank, for £245m, equating to a net initial yield of 5.6%. The 310,000 sq. ft. building was bought in November 2012.

Drapers Gardens, London EC2 – Ginko Tree Investment, a wholly-owned unit of China’s State Administration of Foreign Exchange, was reported to have bought Evans Randall’s Drapers Gardens office scheme for circa £285m. The price on the 292,500 sq. ft. property was said to reflect a 4.5% equivalent yield on purchase in mid 2012. The property is let to fund manager BlackRock on a long lease.

London office deals have been dominated by Scandinavian and Russian investors as well as Asian investors, such as the Malaysians and, particularly, the Chinese.

The former Battersea Power Station, developed in the 1930s but empty since the early 1980s, is owned by a Malaysian consortium that is converting the site to a luxury residential and leisure scheme. The 800-plus apartment complex is rumoured to have a studio flat entry price of circa £500,000, with the price of penthouse flats only available upon request. The first homes are expected to be completed in 2016.

The Battersea Power Station Development Company is undertaking a major residential, offices, retail and leisure scheme on the former power station site.

Asian investors are now also looking beyond prime central London offices, with reports of purchases in more peripheral areas and other sectors. Offices in the Big Six UK and other major European cities have been acquired by Chinese investors and there has been activity in other markets, such as senior living and student accommodation.

Demand from China's institutional investors shows no signs of waning. According to JLL[1], investment in overseas property rose 17% in H1 2014, with residential investment rising by 84%. London has been the favoured destination for Chinese institutions, having placed circa £1.35bn in the UK in the first half of the year.

This trend towards international property investment, which looks set to continue, is, in part, due to the exponential growth in the Chinese insurance industry and the appetite for income and diversification of investments outside of domestic markets. Economic growth in China over the last 20 years has led to an equally growing affluent middle class, who not surprisingly have demand for family wealth preservation products and services such as the different forms of insurance. In particular, there is strong customer demand for accident, critical illness, juvenile and car insurance. The rapid increase in demand for insurance products has led providers to look outside their own borders for income generative investments.

1 JLL Shanghai press release, 29 July 2014

Perhaps a frivolous marker for the rise of the Chinese middle classes, but eight out of IKEA's top 10 stores are located in China and the country has become the Swedish furniture group's fastest growing market.

Investment structures

Assuming that the appetite for UK property is unlikely to fade in the medium term, how have Asian investors been building their property portfolios?

In many cases, these high value assets are already held in corporatised special purpose vehicles (SPVs), such as unit trusts, limited partnerships and companies incorporated outside the UK (Jersey and Luxembourg being two of the favoured tax efficient jurisdictions). This allows the investor to acquire and refinance the SPV, rather than buying the property directly. Since the shares in many SPVs are not subject to stamp duty or stamp duty land tax, acquiring the shares rather than the property can deliver a very significant saving in transaction costs. The saving is often shared between seller and buyer.

Acquiring a property in this way can be more complex and time consuming than a direct acquisition and may be an unfamiliar way of transacting to many of the new market entrants. It requires additional due diligence and contractual protections to ensure that the investor does not inherit unwanted or unknown liabilities associated with the SPV. In the current market, where sellers are demanding a clean break from historic liabilities and quick deal execution, many investors are relying on insurance (which is now readily available) to protect against the risks associated with buying an SPV.

Regardless of whether an Asian investor acquires a property directly or through an existing SPV, in nearly all cases the investor will invest via its own acquisition vehicle incorporated outside the UK and the investor's home territory. As with existing SPVs, favoured jurisdictions for UK assets are Jersey, Luxembourg and The Netherlands. Holding each investment in this way allows Asian investors to ring-fence liabilities in respect of their properties, crystallise investment gains on their assets on exit without incurring UK capital gains tax and affords the opportunity for the next owner to acquire the acquisition vehicle free of stamp duty.

Many of the recent Asian-backed real estate investment deals in the UK have been partially funded by debt provided by the traditional banks or new alternative lenders. The lending occurs either at the point of acquisition or, as is increasingly the case, post-acquisition where the lender refinances a portion of the investor's equity. As well as the commercial attraction of leverage, through the offshore SPVs, Asian investors are typically able to deduct the arm's length interest expense from their rental income, with the result that their effective rate of UK income tax on rent is reduced considerably.

Operational considerations

Having navigated the acquisition process and financing options available, investors turn their attention to optimising their financial returns through development and asset management initiatives. In most cases, Asian investors (and certainly first time entrants to the market) team up with a UK operating partner whose specialist knowledge and skills are combined with the investor to form a partnership, with the operating partner sometimes also taking a minority equity position in the underlying investment.

Inevitably, as Chinese and Malaysian investors build their portfolios and establish their own local presence and management teams, as many of the sovereign wealth funds have done, they will become less reliant on their partners. But for now, with no shortage of new names on the block, the need for best-in-class support from UK managers looks set to continue.

Price discovery in UK unlisted real estate funds

PAUL SCHNEIDER
QIC Limited

The first documented research of pricing in the UK secondary unlisted real estate funds market was submitted by the author to the Nick Tyrrell Research Prize[1] competition earlier this year and was awarded the Prize in September. This article is taken from the original paper, with updated analysis as at September 2014.

Unlisted real estate funds are private investment vehicles that pool capital to provide investors with direct real estate exposure. The larger capital pool enables investors to diversify geographically and across sectors, while reducing idiosyncratic property risks at costs considerably lower than direct real estate. Holdings in unlisted real estate funds – usually shares or units in limited partnerships or trusts – entitle investors access to a cash flow stream that is derived from the underlying property assets.

Net asset value (NAV)

Estimations of the market values of such holdings have historically relied on NAV methodology. NAV is an accounting definition – it is a backward-looking view of assets less an independent view of liabilities. Fund assets are valued by independent valuers or appraisers, and these valuations subsequently form part of the fund NAV, from which the NAV per unit is calculated.

However in trending markets, the inherently backward looking nature of comparison-based valuations means that NAVs do not adequately reflect the perceived spot market. Furthermore, the value of an interest in an unlisted fund might in theory (and in practice, as demonstrated later) differ significantly from the NAV of the assets, due to differences in liquidity and transparency; debt not being marked to market; performance fees not being accrued and/or assets having different valuation dates; and other issues.

NAV vs. UK secondary unlisted market transactions

The research examined the premia/discounts (price/NAV) from transactions of secondary UK unlisted real estate funds between February 2007 and September 2014 in order to:

- Examine whether there is a connection between unlisted secondary market and REIT prices;
- Investigate factors (fund and non-fund specific) that may be associated with secondary market pricing. If there is a systematic difference between fund NAVs and the prices at which investors are paying for fund interests, this may highlight the circumstances in which this occurs; and

1 The Nick Tyrrell Research Prize was established by INREV, the Investment Property Forum (IPF) and the Society of Property Researchers (SPR) to recognise innovative and high-quality, applied research in real estate investment. The Prize is in memory of the work and industry contribution of Nick Tyrrell, who sadly passed away in August 2010. Nick was Head of Research and Strategy and a Managing Director in J.P. Morgan Asset Management's European real estate division. His research work was characterised by a combination of academic rigour and practical relevance. Details for submissions to the May 2015 Prize are included on the inside back cover of this publication.

- Determine if the UK secondary unlisted funds market provides any price discovery (predictability of future fund returns) that is incremental to information from REITs. Given the sophisticated end-user investor base of unlisted funds and that the secondary market allows investors to freely demonstrate their view of fair value, it was anticipated that the market would prove to be forward looking.

UK UNLISTED SECONDARY MARKET

Facilities for orchestrating the UK secondary market for unlisted fund interests have evolved from a matched bargain service offered by some fund managers in the 1990s to more independent services led by PropertyMatch and JLL Corporate Finance. These services, which evolved from a gradual start in the mid-2000s, are most readily available for UK funds but increasingly support the pan-European market.

A liquid, transparent secondary market has three prime benefits:

- From a portfolio management perspective it allows investors to:
  - transact part or all of their interest, allowing them to better manage their real estate exposures through time;
  - reduce the cost 'J-curve' effect by investing into funds that have already absorbed establishment costs;
  - reduce the impact of the bid-offer spread in open-ended funds;
  - invest into mature, more transparent closed-ended funds, which would otherwise only have been open for investment at their launch; and
  - reduce manager risk by examining the track record of an existing fund.
- It increases the liquidity of investors' holdings in what would otherwise be highly illiquid instruments; and
- It allows incumbent unlisted fund investors to better gauge the fair value[2] of their fund equity. In facilitating the trading of previously non-transferrable interests, at current fair market value, investors may correct for any reporting lag or 'staleness'. Assuming sufficient liquidity, valuations based on the prices resulting from a transaction provide the closest approximation of fair value.

Methodology and data

Two models were used. Model 1 examined the drivers of fund premia/discounts and Model 2 whether these premia/discount contain information for future unrealised returns (changes in NAV). Correlation analysis examines the relationship between the secondary unlisted funds and the REIT market.

Before using these models, the significance of the secondary market was tested. The results show that secondary market pricing, both on an individual deal level and monthly-weighted average basis, is statistically different from zero and therefore significant. On average, secondary unlisted fund interests trade at a slight discount to their most recent NAV.

As regards data, although the UK has by far the most advanced secondary market, it is still in its infancy and so only a relatively short sample period of February 2007 to September 2014 was possible. Each of the deals examined were completed by either PropertyMatch or JLL Corporate Finance. Over the period, these deals account for almost 50% of total cumulative market liquidity (excluding private investor transactions), and over 50% in the last two years. Figure 1 shows the change in the secondary market composition (excluding private-private deals) since March 2007.

2 IFRS 13 defines fair value as, "the price that would be received to sell an asset, or paid to transfer a liability, in an orderly transaction between market participants at the measurement date".

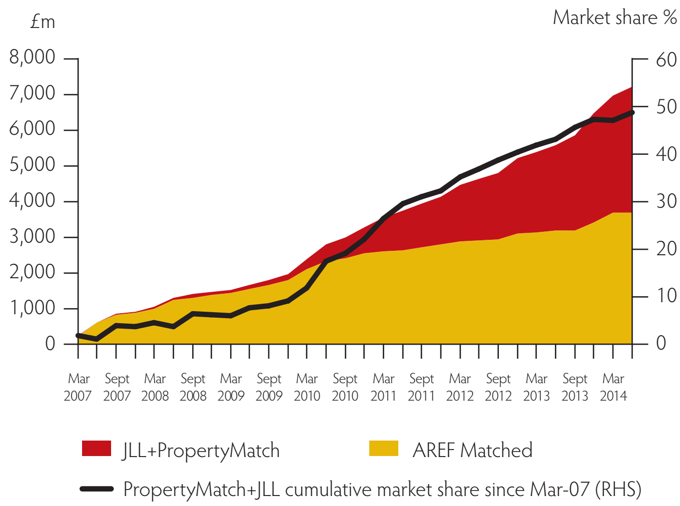
There are a couple of caveats of the data. The first is that the sample period does not capture the 2005-07 bull market and hence is not representative of a full property cycle. Second, it is possible the larger deals were being done privately during the period, as opposed to going through an official platform. Hence, there could be a selection bias in the type of funds which trade through brokers.

Results and analysis

SECONDARY UNLISTED FUNDS MARKET AND REITS

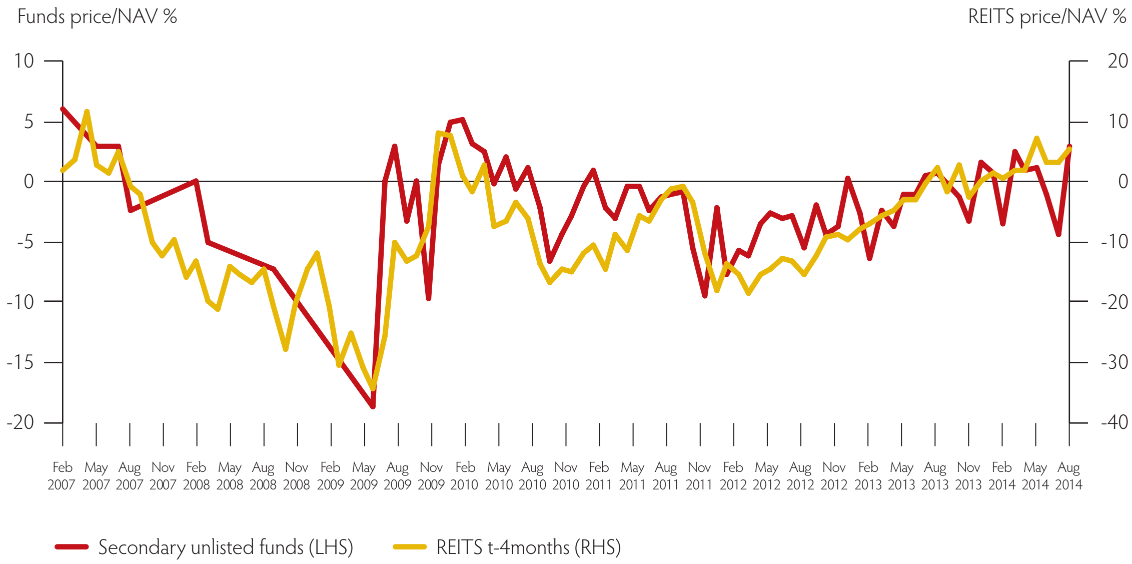
Figure 2 shows the current unlisted funds market pricing is most closely related to REITs four months prior. The lag of four months supports the notion that unlisted funds lag REITs by a period less than that observed with indices of direct property.

Figure 1: **Secondary market composition**



Source: JLL Corporate Finance; PropertyMatch; AREF: http://www.aref.org.uk/statistical-analysis-page

Figure 2: **Pricing – unlisted funds secondary market vs. UK REITs**



Source: PropertyMatch; JLL; EPRA

Despite the much lower volumes, the unlisted funds market consistently trades at lower amplitudes away from NAV (2.6% discount) than compared with REITs (11.6% discount).

FUND PRICING

Regression analysis was used to examine asset, fund, investor and macro-related factors that are associated with individual fund pricing. The results were are follows:

- **Significant**

– **Past REIT pricing (premium or discounts) for the relevant sector of the unlisted fund that traded.** This is consistent with the relationship outlined in Figure 2.

- Past fund returns – higher past fund returns lead to a higher (lower) premium (discount), suggesting that investors are extrapolating past returns. Is also possible that in an illiquid market with barriers to entry, investors are using (correctly or incorrectly) past returns as a blunt proxy for management/fund quality.
- Current income – yield was found to be positively related to secondary fund pricing. This effect is likely to be similar to past returns abut could also reflect investors' willingness to pay a premium for secure income in the recent low-yield environment.
- Leverage – this was statistically negatively associated with fund pricing, suggesting investors penalise the risk of higher leverage by discounting funds.
- BBB credit spreads – as spreads widen, risk appetite falls.

• **Not significant**

- Fund size – discussions with brokers prompted a subsequent examination by fund structure, which found that open-ended funds are 65% larger than closed-ended funds but due to their liquidity mechanism most trades are completed close to the manager's bid-offer spread. To move outside this range requires a considerable redemption (or subscription) queue. Hence, open-ended funds have less scope to produce higher premiums due to the likely bid-offer bound. It is less clear why the reverse effect for closed-ended funds is not showing up.
- Number of assets in the fund – a surprising result if one subscribes to the theory that fund investors value diversification. However discussions with brokers revealed that factors of management quality, asset performance and distribution yield are the dominant demand drivers. Also, many of the secondary market investors are multi-managers who are forming portfolios of different real estate exposures – hence they are not necessarily valuing diversification at the fund level, but rather create it themselves by acquiring a range of different fund interests.
- Income (tenant) concentration – the findings were inconsistent for the two samples. In the shorter sample period, income concentration was not found to be significant. Some investors may value a diversified (lower concentrated) income profiles while some funds with higher concentration may have a few large (credit worthy) tenants.
- Owner concentration – despite the apparent liquidity benefit of having a more diffuse unit holder registry, investors appear not to value this.
- Time between NAV reporting and trade date – given that it is difficult to pinpoint the date (possibly due to drawn out deal processes) at which the pricing reflects the investors' views of fair value, it is possible there is noise in this proxy.
- Secondary market volume – as the secondary market becomes more liquid, one might expect the relationship between volume and pricing to strengthen.

PRICE DISCOVERY

Figure 3 reports the regression results of future fund returns as a function of funds' current secondary market pricing and other fund specific and market control variables.

The key result is that current fund premium is positively associated with future (unrealised) returns. As investors price secondary market interests above (below) NAV, they are taking a view that NAV under (over) prices fair value. If investors are correct in their assessment, subsequent changes in NAV should be higher (lower).

The research suggests that the secondary market has explanatory power for future (unrealised) returns (changes in NAV) that is separate and additional to the information that investors may absorb from the REIT market. This may substantiate the claim that the secondary market due to this higher level of investor sophistication is a suitable setting to observe price discovery.

Figure 3: **Panel regression results for future fund returns**

Variable	**Group**	**Expected sign**	Sample period end **Sep-14**
Pricing of fund in secondary market pricing	Fund	(+ve)	0.34** (0.12)
Equity (REIT) markets	Macro	(+ve)	0.12* (0.05)
Past 6-month fund returns	Fund/asset	(+ve)	-0.11*** (0.03)
Current income	Fund/asset	(+ve)	3.51*** (1.18)
Leverage (Debt/NAV)	Fund/asset	(+ve)	10.79*** (2.95)
Time between NAV reporting and trade date	Fund/asset	(+ve)	-3.27 (3.47)
Borrowing conditions	Macro	(-ve)	-1.47*** (0.27)
Constant			9.24 (25.5)
R2			0.564
F-Statistics (Prob>F)			34.70 (0.00)
No. cross-sections			31
No. observations			418

*NOTE: A fixed effects model with Driscoll-Kraay standard errors was used for the sample period Feb-07 to Sep-14. Significance at the 1%, 5% and 10% levels are indicated by ***, ** and * respectively. Standard errors are in parentheses.*

Implications of this research

FOR INVESTORS

The research results indicate that investors' views of fair value are systematically related to REIT pricing, past fund returns, yield and leverage and thus may help guide future investors as to what fair value they should ascribe to their fund interests. Furthermore, these views, as reflected in investors' secondary market pricing, appear to be justified by subsequent valuation gains.

FOR INDUSTRY

This study suggest investors can use the secondary market for guidance on the fair value of their fund interests.

However, it should be noted that the benefit of increased transparency is likely to coincide with pressure from auditors for investors to marked-to-market fund interests more often. Nonetheless, even with the higher volatility that this would induce, increased transparency should help the primary funds market raise more capital as investors gain comfort in the knowledge of a liquid secondary market.

Benchmarks and measuring performance – what is changing?

MATTHEW ABBOTT
Mercer

The question of how to benchmark and measure the performance of a real estate portfolio is not a new one. However, it is a topic that is attracting increasing attention as the real estate market becomes more sophisticated and the number and type of products continue to grow. The aftermath of the Global Financial Crisis (GFC) has really focus investors' minds on this, not least what impact the use of different benchmarks may have.

To review the changes in benchmarking and the reasons for these, the author invited Stephen Elliott of Royal London Asset Management, Dan Batterton of Legal & General Property and Charlie Ferguson-Davie of Moorfield, to a round table meeting. The members of the group, therefore, cover advice to institutional investors, managing UK open-ended balanced funds, sector specialist funds and absolute return value-add/opportunistic funds. The following is a record of their discussion.

What recent trends are we seeing among investors and in what aspects of benchmarking and performance measurement are they most interested?

Abbott: If I go back to pre-GFC times, the vast majority of real estate portfolios were benchmarked against some sort of IPD index. Exactly which one would depend on the type of mandate, including its size, risk profile and structure (pooled or separate account). While it is undoubtedly the case that IPD continues to dominate the landscape, we have seen a definite increase in the number of our clients who are looking to move away from IPD to a more 'absolute' return benchmark. A lot of our clients who have separate accounts (either direct or multi-manager) are moving towards RPI+ targets in order to allow a longer-term view to be taken and to allow their managers more freedom in constructing portfolios. This approach also tends to focus the mind when it comes to investing in (or avoiding) more volatile sectors and searching for those assets which are more likely to deliver inflation-linked cash flows, either explicitly or implicitly.

Elliott: As manager of an open-ended UK balanced fund, benchmarks have always presented an unsolvable problem. Even prior to the GFC, there were questions as to the most appropriate method of performance assessment and which was best – relative or absolute. Most institutional UK investors task their fund managers with achieving a return in excess of the market, which by default is evaluated with reference to an IPD/MSCI index. In the absence of an alternative, this does remain the best assessment of balanced pooled real estate products.

> *"The period of assessment is an area that requires change..."*

The period of assessment is an area that requires change; removing the focus on short-term performance and realigning the interval of assessment more closely with the long-run nature of the asset. The target of a market return over a five-year time horizon would provide reduced volatility for investor returns.

Batterton: The cyclicality of investors' approach to property and the rationale for investment in it mirrors the underlying investment market. The GFC, low interest rates and a search for income has led to a reappraisal of what property offers as an asset class and therefore what benchmarking is appropriate. Benchmarking is not simply a way of assessing a manager's success; it helps structure the strategy of the respective fund and communicate this to investors. There can be a wide range of reasons for investing into commercial property, including diversification, inflation hedging, growth, income and capital protection. Investors must commit to funds where the strategy and benchmark aligns with their own rationale for being in the sector.

"...returns through 2005-09 have greatly increased investors' focus on benchmarking."

The extreme highs and lows of returns through 2005-09 have greatly increased investors' focus on benchmarking. The market highlighted strategy 'creep', as well as the payment of often significant performance fees where financial skills rather than property skills were delivering returns. All of this despite benchmarks being linked to the property market.

Ferguson-Davie: Moorfield manages closed-ended private equity vehicles with a value add/opportunistic strategy and our investors have typically been interested principally in absolute returns, rather than relative returns, for the purpose of measuring and rewarding performance. For most private equity vehicles this means having a hurdle IRR, which needs to be exceeded before the manager can share in the profits generated by the fund. I have seen these hurdles range from 6% to 11%, depending on the targets for the fund, the share of the excess received by the manager and whether there is a 'catch-up' or not.

There are a range of different types of investors that will invest in private equity funds and each has a different view on what the right performance measurement should be. I would say that the trend overall is away from catch-up structures and towards lower hurdles. This is perhaps due in part to a desire from many investors for lower risk and a greater focus on profit multiple, rather than just IRR. The shift is gradual though and driven to some degree by thought being given to what activity and investment strategy the performance benchmarks drive; high IRR hurdles can encourage managers to take greater risk and use higher leverage, as well as to hold investments for a shorter period of time at the expense of profit multiple.

IPD is seen as the key UK real estate benchmarking service by the majority of investors. Should this continue being the case? Does its use result in optimal portfolios or are there better ways of delivering performance for clients?

Abbott: IPD is undoubtedly changing with the increased amount of cross-border capital which is coming over to invest in the UK. I suspect this is most prevalent in central London and the proportion of this market covered by the IPD index is likely to be falling. However, it remains the best measure we have and, as such, is the go-to barometer for many of our clients. Even those clients who have RPI+ benchmarks like to see how their managers are doing relative to the IPD (which can cause issues in itself).

In terms of building optimal portfolios, whether IPD is used or not, we like to see managers who show a high level of conviction in their strategies and are effectively operating in a more unconstrained way. Risk can be measured and managed in many different ways and looking at risk relative to IPD is not necessarily all that meaningful. Real estate is a long-term asset class and using a long-term, absolute return benchmark can also lead to a lower level of transactions, reducing the negative impact of transaction costs on performance.

Elliott: Given the heterogeneous nature of real estate, trying to construct a portfolio that mirror a chosen IPD /MSCI benchmark will not produce market outperformance. The key to outperformance is individual stock selection, coupled with active asset management, particularly over a period of assessment in excess of five years. Whilst an IPD/MSCI benchmark will at a high level provide a total return (TR) assessment, investors typically will be attracted to real estate by the relatively stable income return delivered. As we witnessed during late 2007 onwards, capital values fluctuate in line with economic market forces (as in most markets) and perhaps a separate assessment on maintaining durable but increasing income stream should be undertaken outside a total return calculation.

Batterton: IPD collates information of properties and tenants for over 200 UK-focused commercial property portfolios. The majority of these funds are intended to provide unleveraged long-term exposure to the sector, designed for life and pension investors looking for market performance. IPD remains highly relevant for these funds.

Whilst the ‘benchmark tracking’ investors are likely to remain the majority, there are an increasingly significant number of private equity style investors looking to invest within, rather than throughout the cycle, and also looking for strategies focused on inflation, income or growth. These strategies often have leverage and may also allow for the use of derivatives.

Since the GFC, we have designed a number of funds with a two-tier benchmark approach. Investors are looking for fund managers to exceed market returns at a property level, but equally recognise that the end investor receives a return net of costs and the impact of leverage. Our private equity style funds have an initial hurdle of outperforming the market in an unleveraged ‘IPD’ basis. There is then a secondary hurdle, often absolute, which is a target return net to the end investor. The aim is to stop leverage being a free ride in a rising market as property skills have to be the cornerstone to the delivery of any strategy.

“...property skills have to be the cornerstone to the delivery of any strategy.”

Ferguson-Davie: We benchmark our performance against IPD as it is seen as a proxy for market performance and because we are aiming to outperform the market and deliver ‘alpha’ returns. However, IPD does not provide a perfect comparison; our investments are typically leveraged and we will incur transaction costs and tax. The IPD dataset may also not be perfectly correlated to the investment being compared and so calculating the true ‘alpha’ performance is not easy.

Investors will also look at our performance relative to that of the listed sector property companies, the funds that other private equity managers have delivered and other asset classes. Whilst performance relative to IPD is a helpful tool, I do not think it should be considered the only one and the overall track record of the manager over an extended period should be the main area of focus.

Where do you feel the industry is moving to when it comes to benchmarking? What would you like to see happen?

Abbott: I have spoken a lot about RPI+ benchmarks. Unfortunately, these are only available to investors with separate accounts. I would like to see some pooled funds adopting this approach as up until now all of them use only the IPD Pooled Property Funds Index. This would offer investors greater choice. In all likelihood these funds will have dual benchmarks (as investors will still want to see performance relative to IPD). However, I feel that a move towards more unconstrained real estate investing could have significant benefits for investors and would enable investment managers to invest in a high conviction manner. I am sure this would be welcomed by clients and managers alike.

"...RPI+ benchmarks... would like to see some pooled funds adopting this approach..."

I also think it is important for our clients to think about why they are investing in real estate as the asset class can now play different roles and, because of this, the choice of benchmark becomes less straightforward.

Elliott: We have seen the globalisation of benchmark reporting across all asset class and IPD is now incorporating this into to real estate indexes to provide a level of consistent comparison. The link between the performance of the direct UK real estate market and that of the UK economy as a whole is crucial. This is particularly so during periods of economic growth, where increases in rental levels across UK real estate will outstrip RPI or CPI measures, providing an enhanced return when assessed against an indexed-based benchmark. The best method of assessment for direct UK real estates remains a relative benchmark, as currently provided by IPD.

Batterton: Perhaps in the longer term we will see the creation of investable benchmarks. The heterogeneous nature of the asset class has always been a restriction to investors as it is not possible to buy the market – a problem for those building model portfolios. The Pooled Funds Index is a great step forward, but investable benchmarks could widen the appeal of the sector. The next step of the benchmark evolution is then smart beta.

"...investable benchmarks could widen the appeal of the sector."

Ferguson-Davie: I think investors expect greater transparency and this extends to all areas of activity – certainly track record and reporting. I would like to see investors and managers be more transparent about the performance of investments from acquisition to disposal (or current value if not yet sold).

"...like to see... more transparency about the performance of investments from acquisition to disposal..."

Looking at quarterly or annual valuation movements relative to IPD, when the valuations are not necessarily perfect and neither is the correlation to the IPD Index, should only be part of the benchmarking and performance measurement practice. It should be possible to show the performance of each investment (and in aggregate) from acquisition to disposal (or current value), as well as the change in value between periods.

Benchmarking that forces institutional investors to increase or decrease exposure to a particular sector can exacerbate market movements and may risk promoting portfolio decision making at the expense of doing the right thing at the asset level. Having said that, this is often the source of opportunity for investors like Moorfield, so perhaps I should not encourage any change at all!

Time to transact: measurement and drivers

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The latest IPF study on liquidity[1] was commissioned by the IPF Research Programme in 2013. Information on deals from across the UK was collected from major institutional investors – this information included transactions from across the period 2004 to 2013. Using this data, a thorough study of transaction times and the factors that might explain variations between assets was conducted. This article summarises that research.

It is well established that buying and selling commercial real estate involves a process of exchange that occurs over an extended period and incurs risks and costs of a character and order that is different from many other investment assets. Yet, to date, there has been only limited research on the time taken to transact commercial real estate, with most studies of transaction times relating to housing markets. The IPF (2004) study was notable for outlining the different stages of commercial property transactions and measuring the time taken to transact for a sample of UK real estate investments. This found a median sale time of 190 days (circa six months) from first record on the sale file to final completion and 81 days (circa three months) from price agreement to completion but there was considerable variability around these averages. However, the research did not examine transaction times from a purchaser perspective, which has been the focus of subsequent data collection and research by Scofield (2013)[2]. Figure 1 summarises the findings from the IPF and Scofield research.

Figure 1: **Typical transaction times in days as reported in IPF (2004) and Scofield (2013)**

	Sales: IPF (2004)		Purchases: Scofield (2013)	
	Interviews	**Median from data**	**Interviews**	**Median from data**
Marketing to price	21-28	88	n/a	n/a
Introduction to price	n/a	n/a	20-30	29
Price to exchange	21-28	62	15-30	50
Exchange to completion	14-28	19	15-20	7
Total time	55-84	190	50-80	99

The new research develops and expands the existing work in three ways. First, it provides up-to-date measurements of time to transact from both buyer and seller perspectives. Second, it uses a much larger dataset than the previous studies, with data on 578 commercial real estate transactions. Third, it explores relationships between time to transact, asset characteristics, market state and other features of the transaction process using tabular and regression analysis. Currently, there is little information on whether variation in times across cases and stages is purely random or whether the nature of the asset or process adopted can explain it.

1 **Time to Transact: Measurement and Drivers** by Steven Devaney, Henley Business School, University of Reading and David Scofield, University of Aberdeen, published by the IPF Research Programme September 2014

2 **Time to Completion Liquidity in Commercial Real Estate Investment: 2000-2008** by David Scofield (2013), published in the Journal of European Real Estate Research, 6 (1): 34-47.

Data

Data collection took place during 2013. The exercise was conducted by approaching different investment organisations and asking if they would release relevant information. Data from Real Capital Analytics/Property Data (RCA/PD) was used to identify the largest buyers and sellers of investment-grade real estate in terms of the number of transactions over the last decade. This provided a sampling frame across which enquiries were made. 24 investment organisations were then approached for further data including precise dates for key transaction stages. Ultimately, seven were able to provide such data, resulting in 578 usable transactions spanning 2004 to 2013[3].

The completeness of the data varied, with less information available on the earlier stages of the transaction process. Nonetheless, it was possible to measure the average length of key stages in the purchase and sale processes. Figure 2 shows the median time in days for these as measured from the data collected.

Figure 2: **Median time for different transaction stages***

Purchases: transaction stages	Median no. days
Introduction to price agreement	31
Price to instruction of solicitors	2
Instruction to exchange of contracts	37
Exchange to completion	7
Introduction to price/solicitor	35
Price/solicitor to completion	56
Introduction to completion	**104**

Sales: transaction stages	Median no. days
Marketing to price agreement	42
Price to instruction of solicitors	0
Instruction to exchange of contracts	39
Exchange to completion	10
Marketing to price/solicitor	42
Price/solicitor to completion	64
Marketing to completion	**135**

*NOTE: * Measurements of different stages are based on differently sized samples. As a result, figures for intermediate stages will not necessarily sum to the length of longer stages*

The median time for purchase of real estate from introduction through to completion was 104 days (i.e. between three to four months) while the median time for sale from marketing through to completion was 135 days (i.e. between four to five months). There is considerable variability around the averages. In fact, the variability in time from price agreement/instruction of solicitors through to completion seems as large as that for introduction or marketing through to price.

Figures 3 and 4 report measures of central tendency and dispersion as well as the 10th and 90th percentiles of the distribution in times from price agreement/instruction of solicitors through to completion for different market states, defined with reference to turning points in price and capital value indices for UK real estate. The IPD UK quarterly capital growth index peaked in Q2 2007 and then fell before reaching a trough in Q2 2009. Similarly, the RCA/PD UK Commercial Property Price Index peaked in Q2 2007 and bottomed out in Q2 2009, though some of the sub-indices indicate an earlier peak in Q1 2007, e.g. UK Retail. Using these series, four market phases were defined; Boom (up to June 2007), Downturn (from July 2007 to June 2009), Recovery (from July 2009 to June 2011) and Recent (July 2011 onwards). Transactions were then grouped into one of those four periods based on their date of completion.

3 The data contributors were purchasers of the assets in question in 303 cases and sellers in 280 cases, with five instances where a transaction was reported twice (once by its buyer and once by its seller).

Figure 3: **Introduction date to price/solicitor date (purchases)**

	Sample	Median no. days	Mean no. days	10 pc no. days	90 pc no. days
All purchases	**127**	**35**	**63**	**10**	**143**
Boom to June 2007	58	29	36	10	64
Downturn to June 2009	21	32	53	7	48
Recovery to June 2011	17	67	80	22	174
July 2011 to mid-2013	31	51	110	21	306

Figure 4: **Price/solicitor date to completion date (purchases)**

	Sample	Median no. days	Mean no. days	10 pc no. days	90 pc no. days
All purchases	**289**	**56**	**74**	**27**	**149**
Boom to June 2007	98	55	77	29	159
Downturn to June 2009	40	60	83	31	164
Recovery to June 2011	64	50	59	26	107
July 2011 to mid-2013	87	59	78	23	158

In the full report, other tables set out transaction times by sector, sub-market, lot size, quality and nature of the counterparties. These factors were also used in multivariate regression analysis. Regression analysis was performed in order to test the significance of each factor in explaining time to transact once the impact of other aspects affecting each deal had been controlled for. A special form of regression analysis called survival analysis was used, which is designed for cases where time is a dependent variable and which is often used in studies of housing markets. Further details can be found in the full report.

Trends identified

Results from tabular and regression analysis led to a number of key findings:

- Market state correlated significantly with transaction times for both acquisitions and disposals, with slower transaction times since the UK market crash in 2007-08. The increase in time to transact was initially muted, especially in the time from introduction to price, which may reflect the capturing of some deals where price agreement was reached before the downturn. After the trough in the UK market around Q2 2009, transactions became even slower, especially from introduction to price.
- There was significant variation in times to transact both between and within sectors. Within the retail sector, shopping centres and supermarkets exhibited longer transaction times than standard retail units or individual retail warehouses, while office and industrial assets had a lower probability of reaching completion within a given interval relative to standard retail units. Portfolio deals were less likely to complete rapidly compared to deals for individual assets.
- Transaction times varied by investor type. For instance, sales involving institutional buyers and acquisitions involving institutional sellers were more likely to transact faster.

- Quality impacts the time to transact, e.g. prime offices (by price psf) were quicker to transact than other offices. Meanwhile, lower-quality assets (by price psf and yield) took longer to transact. Also interesting are tabular results that indicate Central London offices transact more rapidly than offices located elsewhere in the UK.

Most findings were not unexpected, given what is known of the UK commercial real estate market, but not all. Firstly, asset price was not found to be a significant determinant of time to transact when tested alongside other factors. This is important, as finance theory assumes liquidity to be a function of price: lower price equating to greater asset liquidity. Secondly, it was assumed that the presence and structure of brokerage would impact transaction time in a significant way. Despite testing for such a relationship, though, this research could not identify any significant effect (either positive or negative) of brokerage on the time to transact.

Further research

Although this study represents a step forward in research on time to transact, improvements in data would benefit future studies. This includes having more data on key dates and on details pertaining to leasing, financing and the methods used to sell different assets. Furthermore, more information on the number of bidders and the bids made for assets would not only shed more light on transaction times, but also liquidity and pricing in general.

A fundamental requirement for further research, though, is the continued collection of consistent and reliable data on the time taken to acquire and dispose of commercial real estate assets. Therefore, the authors recommend that the industry investigates more regular collation of statistics on time to transact.

Zombie loans: Fact or fiction?

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This article is a summary of Short Paper 20, Zombies and Beyond: A Further Update on UK Real Estate Debt, written by the author and published by the IPF Research Programme in September 2014.

Bank lending to real estate fell by over £50bn between 2009 and 2013[1] but, as predicted by IPF Short Papers published in 2009[2] and 2010[3], the distressed loan workout process has been a gradual one so there are still a significant number of 'in default' and 'high loan-to-value (LTV) loans'.

While banks have tended to concentrate on reviewing larger and more complicated loan exposures and where there are operating company issues (e.g. hotels and house builders), there has been no common approach in terms of timescale. Some banks have been reducing exposures aggressively, and looking to dispose of loans, while others have taken a longer-term approach. Generally, they have avoided both refinancing smaller loans where debt service has continued to be met and enforcement, which is perceived as a costly option. Banks have also conducted sales of portfolios of loans, driven in part by changes to bank regulation, which have increased the cost of retaining non-performing loans.

Default and high LTV loans

The year-end 2013 De Montfort University (DMU) survey, The UK Commercial Property Lending Market, identified a total of over £59bn of debt where LTV ratios were in excess of 70%, and hence considered to be a high LTV loan. While there has been a reduction of £36bn in these loans since 2011, they still represent more than one third (37%) of all the loans covered by the DMU survey, as shown in Figure 1.

Figure 1: **Current LTV ratios by proportion and value of outstanding debt**

	End-2011		End-2012		End-2013	
	%	£bn	%	£bn	%	£bn
LTV below 70%	50	96	53	93	63	99
LTV 71%-100%	30	57	24	42	18	28
LTV over 100%	20	38	23	40	19	31

Source: Survey into The UK Commercial Lending Market 2013, De Montfort University

1 Survey into The UK Commercial Lending Market 2013, De Montfort University, published June 2014

2 UK Real Estate Debt – A Problem for Borrowers and Banks, Short Paper 1, published by the IPF Research Programme August 2009.

3 An Update on Real Estate Debt, Short Paper 7, published by the IPF Research Programme February 2010.

This £36bn reduction is the result of a combination of debt restructurings, collateral value increases, loan amortisation and loan portfolio sales (circa £5bn) taking lending outside the scope of the DMU survey. Effectively, £31bn of loans have moved from high LTV to below 70% LTV in the past two years. If this rate were to continue, there is perhaps another four years before the legacy high LTV loans disappear.

Types of properties secured by high LTV loans

There is little data as to the nature of the properties secured against high LTV loans. However, using the general information and research available on the commercial property market and through discussions with banks and purchasers of loan portfolios, some insight has been gained into the type of properties that act as security for this category of loan.

ASSET TYPE

Given the time that has elapsed since the start of the banking crisis, and the fact that these would be non-income producing, there is little exposure to loans originally made against commercial developments. There may be some exposure to obsolete properties that have very low existing use values and, therefore, need to be redeveloped.

ASSET QUALITY

From anecdotal evidence and analysis undertaken by Frodsham and Gimblett[4], based on IPD data to end 2011, overall asset quality is assumed to be of lower or, indeed, poor quality. The high quality properties with larger lot sizes, security of income and yield tightening, together with the healthy property and lending markets for such assets are all factors that point to these having been early candidates for re-financing or sale.

GEOGRAPHIC BIAS

There is likely to be a bias towards the regions, given the comparative strength of central London and, to a lesser extent, the South East as against the provincial markets. This has been most evident in offices and residential assets, which form the bulk of the stock in London.

Such a regional bias has been less pronounced in prime assets in other sectors, with large shopping centres, in particular, having attracted investor interest.

SECTORIAL BIAS

It is difficult to draw conclusions about any sectorial bias without more data; sectors where occupational demand is weak are more likely to suffer income shortfalls and lower estimated rental values (ERVs), which will adversely affect valuations and, consequently, increase LTV levels. Evidence points to secondary retail, leisure, industrial and regional offices having been adversely impacted by the lack of occupational demand since the Global Financial Crisis (GFC).

What is happening?

There is thus still a long way to go before the UK returns to an entirely 'normal' real estate lending environment. Some £59bn of high LTV loans remains to be dealt with, which represents 37% of 'DMU' real estate loans. The overall face value of these loans, factoring in CMBS, may well be higher than that.

The large banks appear to have settled on a workout process, as opposed to creating a Northern Rock-type 'bad bank' to hold distressed assets.

4 **The Slotting Approach to IPRE Risk Weighted capital – A UK Simulation Study using IPD Data**, by M Frodsham and K Gimlett, published in 2012.

LOAN PORTFOLIO SALES

However, the increased regulatory burden on bank balance sheets has created an arbitrage that makes loan portfolio sales comparatively more attractive to banks than a longer-term, on-balance sheet, workout. Loan portfolio sales will continue to provide an exit route for banks, particularly as this market is now well-established and transparent.

Purchasers of these portfolios do not expect to achieve significant discounts to underlying property valuations but the lower cost of capital still provides an opportunity for good returns to be made. These purchasers also tend to have greater flexibility than the traditional banks, as they can more easily purchase assets from borrowers or provide additional capital where required. They are also more able to take a 'portfolio' view and will measure returns at a portfolio level rather than on a deal by deal basis.

A flavour of the size of this market is given by the February 2014 prospectus for the launch of Kennedy Wilson Real Estate Europe plc (KWRE) (formed to invest in "real estate and real estate loans in Europe"), which suggested that the combined amount of UK non-performing commercial real estate loans held by Lloyds Banking Group and RBS amounted to €65.2bn and KWRE expected RBS to sell £38bn of non-core assets between 2014 and 2017.

VALUATION IMPACTS

The long term over which workouts have been conducted/executed has had an impact on the property market. The lack of evidence in some sub-sectors may be attributable, in part, to the slow rate of workout and to the consequent valuation uncertainties, which are likely to result in pricing volatility over the next few years.

In addition, the continuing weakness in occupational demand in certain sectors will impact on the ability of owners to undertake capital investment in their vacant properties, which may result in accelerated depreciation. This, in turn, will lead to certain locations being unable to regenerate effectively.

INTEREST RATE MOVEMENT

The extraordinarily low interest rate environment has been a further factor in preventing more income defaults (even when additional costs are factored in), although, in some cases, the use of interest rate swaps has negated that benefit. The DMU study backed this up when stating that, "lenders continue to identify the crucial importance of low interest rates that keep historic loans profitable".

Rising interest rates are an indicator of a growing economy, which should, in theory, be a positive for property values. However, rising interest rates will make existing debt burdens for many borrowers more expensive to service. Rising rents, which should come from increased occupational demand in an improving economy, may not be seen until sometime after such interest rate rises occur.

INDIVIDUAL LOAN RESTRUCTURINGS

Loan sales accelerate write-offs but reduce the on-going administrative burden on banks. The use of such sales militates, at least in part, against banks undertaking individual loan restructurings since the ability to workout loans with borrowers is part of the attraction for purchasers of these portfolios: If the workout had already been conducted by the bank, there would be a more limited upside for loan purchasers.

However, given the amount of high LTV loans still remaining, lenders will have to continue to workout loans with borrowers on a case-by-case basis in order to spread losses and ensure that value is not eroded.

New capital will need to be introduced to facilitate such restructurings.

Conclusion

The pace of the loan workouts is inevitably linked to the health of the UK economy and, in turn, the UK property market. However, even in an improving environment, the scale of the loans left to be refinanced means that the original estimate of five to 10 years in IPF Short Paper 1[5] still appears reasonable.

The focus now is likely to move to those loans where 'blend and extend' has, to date, been sufficient to protect the lender's position. The current situation appears to dis-incentivise borrowers from properly investing in their portfolios, even when they have the capital to do so.

Whether remaining in the hands of banks or sold on to third parties, the answer lies in an increased awareness amongst borrowers that the status quo is not an acceptable situation. Borrowers will benefit from proactive engagement with lenders to extend loans against a background of specific performance targets, which may require the introduction of additional capital, asset sales, debt for equity swaps, profit sharing of upside or, even, just a fee for conducting an orderly workout.

5 See Footnote 2

Behaviour, complexity and real estate

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Over the years property researchers have produced a range of models which attempt to describe how the commercial property market works. The models have varying degrees of depth and many concentrate on describing the market in the form of time series statistically correlated equations. The latter achieve 'success' by how well the output matches the actual value of the variable of interest.

However, it is questionable whether these models offer any real insight into the underlying processes at work. In this context, the article considers alternative ways of looking at the commercial property market and how a consideration of behaviour and complexity might improve the way in which we understand commercial property market dynamics.

Linear models of the market

Much of economics and many models of real estate markets continue to be based largely on neo-classical ideas of equilibrium, commonly expressed in the form of linear mathematics. Linear systems are very much simpler to analyse than non-linear systems and are also much better understood[1]. When linear differential equations have not been available, the true system of equations is linearised by, generally, discarding the non-linear parts of the description of the system.

The limitations of these models of reality are well understood, in particular their ability to understand the process of change. They hold only as long as the underlying market structure does not change because they represent an analysis of past trends. They can explain much of historic market behaviour, but cannot describe the processes of change and, famously, are not good at forecasting turning points in the market because their behavioural properties are weak.

However, where markets are structurally stable, they do offer a way of predicting market variables, particularly rental growth, albeit sometimes with spurious precision. In this context, recent work examining IPF Consensus Forecasts (Matysiak et al 2012[2]) suggests that there is no consistent or conclusive evidence that the consensus forecasts are better than those using naïve forecasting rules, such as those, for example, which assume that next year's values will be the same as this year's and are indeed often worse. Whilst rental growth forecasts can turn out to be more accurate than naïve-based forecasts, models forecasting yields have even less success, where aspects such as changes in investor sentiment and behaviour can influence performance significantly.

1 A linear equation is an algebraic equation in which each term is either a constant or the product of a constant and the first power of a single variable. Linear equations can have one or more variables. In a non- linear equation the variables are either of a degree greater than one or less than one but never one.

2 Matysiak, D. Papastamos and S. Stevenson (2012). Reassessing the Accuracy of UK Commercial Property Forecasts. Investment Property Forum.

Complex systems

For models of the market to be truly representative, we need to be able to understand and model the process of change as well as modelling the system's longer-term behaviour. Complexity theory offers a way forward particularly with regard to understanding dramatic changes in behaviour when systems become unstable. It is such behaviour that we currently find extremely difficult to model and it is such circumstances that catch us out.

Formally, a system may be considered as a set of components that interact with each other. The behaviour of complex systems can only be understood by contemplating the whole system and not individual parts in isolation. Furthermore, identifying and describing the connections between objects and events (components) is as important as identifying and describing the objects and events themselves. These connections can be quite complex. Changes in one component can induce changes in another, which in turn can induce changes in a third component. This chain of cause and effect can eventually loop back on itself in a so-called feedback loop.

Generally speaking complex systems evolve from simpler systems, rather than arriving in a fully formed state[3] and complexity will normally develop only if it confers a net adaptive advantage to the parent system, e.g. making the system more robust, and a key consideration for an adaptive system is stability. Despite being able to sustain a certain degree of stress as a result of the complex structure, however, complex systems almost invariably have thresholds. Once such systems are pushed beyond critical thresholds, for example when vital negative feedback loops are broken (price signals?), they typically undergo some sort of transition into a new state. Importantly, the speed of the transition will depend on the nature of the system and the precise circumstances of changes.

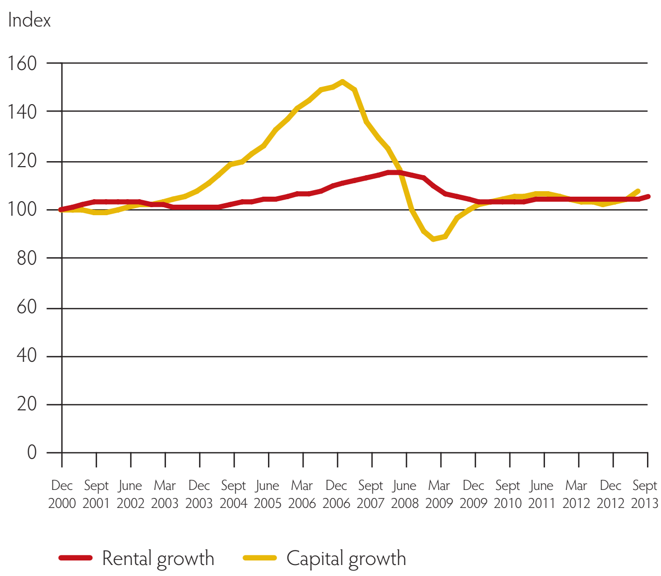
These notions of complex systems and non-linear chaotic behaviour have been known about for a long time and evolutionary theories of economic growth, in particular, have applied themselves to the process of change. They are as much concerned with the forces that displace systems from equilibrium as those that move systems towards equilibrium. They use the same models of human motivation and behaviour as the rest of the social sciences but have not been applied in any systematic way to studies of the property market.

Behaviour

Equilibrium theory makes special assumptions about individual human behaviour. It is assumed that human beings will in all circumstances act consistently, aided by perfect knowledge, in pursuit of clearly defined objectives. As consumers, people will always arrange their purchases so as to maximise their individual satisfaction – termed 'rational' behaviour. Research by Simpson[4] suggests that, while financial markets are among those where expectations play a particularly important part in the calculations of participants, it is precisely in these markets that rational behaviour is notable by its absence.

Such descriptions of reality chime with behaviour exhibited in property markets on more than one occasion over many years. The most recent example of this, of course, was over the period 2003-07 when capital value growth became

Figure 1: **All property capital value and rental value growth**



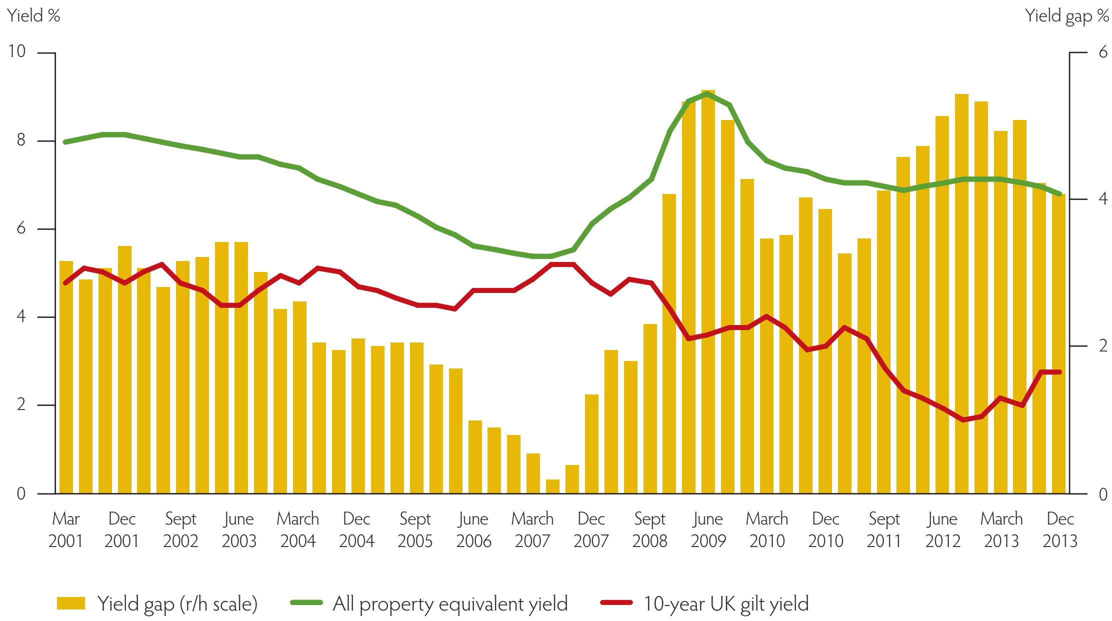
Source: IPD

3 The property market system as we know it today has taken 200 years to evolve.

4 D. Simpson (2000). **Rethinking Economic Behaviour**. Macmillan Press Ltd. London disconnected from rental value growth as a result of the weight of investment money entering the market – see Figure1.

Investors continued to put money into commercial property despite risk premia (as reflected by the gap between the All Property equivalent yield and the redemption yield on 10-year government bonds) falling, as shown in Figure 2.

Figure 2: **Yield movements and the yield gap**



Source: Oxford Economics; IPD

The reason for continued investment despite pricing signals becoming more negative was because rental growth expectations were high. At a time (June 2007) when the yield gap had fallen to just 18bps, rents were expected to grow at 2.8% pa (IPF Consensus Forecast May 2007) over the period 2007-11, resulting in the view that the risk premium attached to property was still fairly healthily positive and that capital values would continue to increase. The perception was wrong and rents actually fell on average by 1.0% pa over that same period.

There is no evidence (as yet) that the events of 2007 have led to a structural change in the property market per se. This is not totally surprising given that that the events were part of a much wider systemic response to market pressure. In this context, there is some evidence that the wider system has experienced some structural change, for example in the way that banks do business and in particular with regard to changes in the relationship between investment and retail banking. Notwithstanding this, changes in property values over the period were clearly indicative of the behavioural response of a market under pressure.

The kind of behaviour experienced in the property market in the run up to 2007 reflects the 'irrational exuberance' described by Alan Greenspan, then chairman of the US Federal Reserve Board, in December 1996. Shiller[5] notes that,

"...this term has become a useful name for the kind of social phenomenon... that has happened again and again in history, when markets have been bid up to unusually high and unsustainable levels under the influence of market psychology."

5 R. J. Shiller (2005). **Irrational Exuberance.** 2nd Edition. Broadway Books. New York and has undertaken a detailed analysis of such behaviour in the context of the US stock market. But the recognition that behaviour is massively important in the operation of markets was recognised as long ago as 1841 when the Scottish journalist Charles Mackay reflected that,

"Men, it has been well said, think in herds… they go mad in herds, while they only recover their senses slowly, and one by one."

The vision of equilibrium with individuals and organisations having clear responses to events that are perceived with absolute clarity is not one that normal people would recognise as corresponding to reality. This type of behaviour is more readily understood in terms of complex, adaptive systems[6].

Conclusions

Economic systems such as the property market are imbued by cultural values and underpinned by social and psychological customs that influence the way in which people understand their options and make their choices. Treating property markets as a complex system can address and integrate this diversity and offers a multi-dimensional framework for analysis.

While the consequences of non-linear/chaotic behaviour are known in this regard, they have not been widely used for modelling purposes by property professionals because they are ultimately difficult to model. Nonetheless, they probably describe the behaviour of investment markets (investors) better than linear econometric models but we use the latter because, basically, they are simpler. However, as Albert Einstein noted (credited), everything should be made as simple as possible but not simpler. All models of the world are ultimately reductionist and information loss is generally accepted as an aid to simplicity and clarity. However, notions of complexity offer a unified view of the property market system and one that can be used to focus current models of property market behaviour.

As a first step, we need to use such notions as an aid to intelligent and sophisticated reductionism and further research ought to review the drivers we use for our models and examine the potential for adding behavioural aspects on to them (for example by including short-term market indicators such as the weight of money as additional drivers in our models). Such an approach would offer a multi-dimensional framework for analysis and strengthen current modelling approaches.

MEPS: What will be their impact?

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Under the Energy Act 2011, it will become unlawful to let properties after 1 April 2018 that fall below a prescribed minimum energy performance standard (MEPS). The government is still working out the fine details of the detailed regulations following extension industry consultation but expects that these will be put in place before Parliament is dissolved for the General Election. It is already certain that energy performance certificates (EPCs) will be used to determine whether buildings meet the prescribed minimum standard, which is widely expected to be set as an E rating.

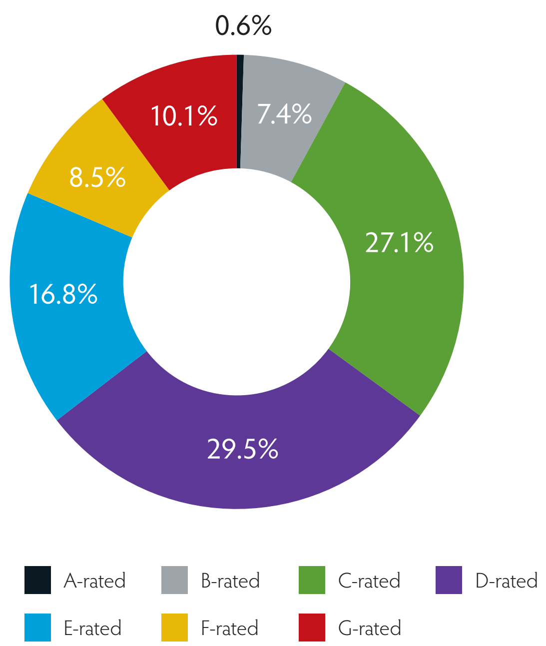
Concerns had been expressed over potential negative impacts on the property investment market and as yet it is unknown whether the regulations will apply to existing tenancies and lease renewals as well as new lettings.

Sweett Group, in conjunction with Sustainable Investment & Asset Management (SIAM) and Kingston University, was commissioned by the Green Construction Board to identify how many non-domestic buildings were likely to be subject to mandatory improvements under the new regulations and whether any particular segment of the market (by region and by sector) or types of building would be unduly affected. The research team was also asked to explore the potential impact of the MEPS regulations on the value of poor-rated buildings for investment purposes.

> *"The obligation to make improvements is limited only to those works that pass an affordability test..."*

Although it has been widely-reported that all F- and G-rated buildings will become 'unlettable' after April 2018, this is incorrect as the restriction on lettings will only apply until qualifying improvements have been carried out. The obligation to make improvements is limited only to those works that pass an affordability test, i.e. where the cost can be justified by the projected energy saving. It will remain lawful to let F- and G-rated buildings if the minimum standard has not been reached once all these works have been done and, indeed, if there are no works which would pass the affordability test.

Figure 1: **Analysis of sample certified units by EPC rating**



Nearly 400,000 certified units were analysed. A breakdown by EPC ratings is shown in Figure 1. Of the total sample, 19% units are F- and G-rated and a further 17% are E-rated. Some E-rated buildings are likely to be affected by the regulations because the rating may fall on re-certification due to periodic changes to the basis of assessment and because the government has said that the minimum standard will be raised to D at some, as yet, unknown future date.

Figure 2: **Distribution of EPC ratings by property sector**

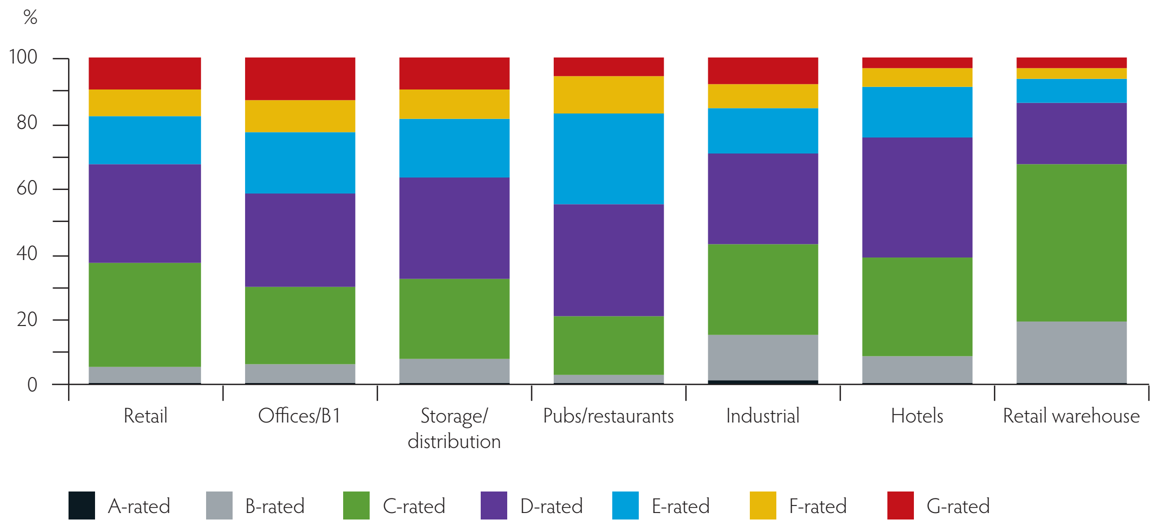
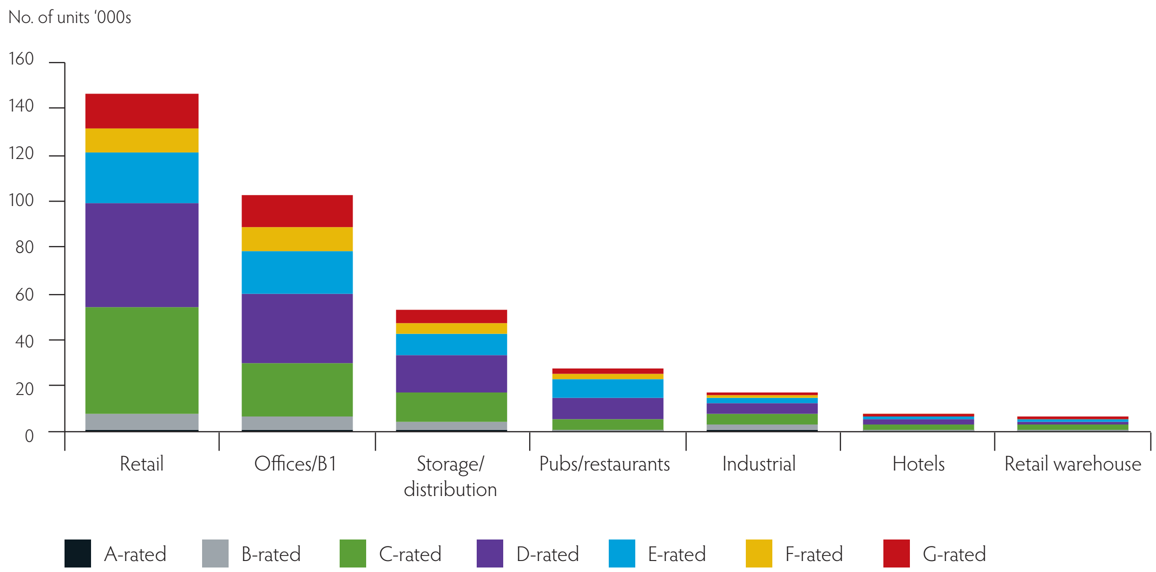


Figure 2 shows the distribution of EPC ratings for each of the principal asset classes and Figure 3 shows the total number of certified units in each sector. Whilst pubs and restaurants have the highest proportion of E-, F- and G-rated certificates, the sample size is small. The retail sector has the largest number of poor-rated certificates but the office sector has a greater proportion by far.

Figure 3: **Total number of certified units by property sector**



Locational analysis reveals that poor-rated certificates are more or less evenly distributed around the towns and cities of England and Wales, although large centres of commercial activity tend to have greater concentrations of poor-rated buildings than smaller towns. In nearly every post code area, investors and occupiers appear to have a wide choice of buildings that already meet the proposed minimum standard, but in historic town centres, relatively large numbers of shops and offices are poor-rated, not all of which will be exempt from MEPS through being listed buildings.

> *"...poor-rated certificates are more or less evenly distributed around ...England and Wales..."*

Improving poor-rated buildings

The cost of improving poor-rated buildings to the required standard varies considerably by type of building. For many industrial buildings and for most retail units, qualifying works will generally improve the EPC rating to the minimum standard and many buildings will be improved as part of tenant fit out or during planned refurbishment. However, there is likely to be a large number of offices – particularly older air-conditioned units – that will retain an F or G rating when all qualifying works have been undertaken. In such cases, they are able to be re-let but may appear less attractive in the market place.

> *"...likely to be a large number of offices that will retain an F or G rating when all qualifying works have been undertaken."*

Although in many cases improvements are likely to fail the affordability test (as the projected energy savings are insufficient to justify the cost of improvements), the cost of achieving the minimum standard equates to only a few months' rent. Despite the fact that these units technically can be re-let with their residual F or G rating, it is anticipated that some landlords will wish to incur the additional costs voluntarily to prevent any possibility of rental or capital values being compromised.

Conversely, there is a large number of industrial buildings where the cost of improvements meets the affordability test (as the energy savings potential is high) but where the cost is disproportionate to rental value. It is considered likely that, in these circumstances, investment value may be adversely affected unless the cost of the mandatory improvements either improves cashflow or a contribution towards the cost can be recovered from the tenant as beneficiary of the resultant energy savings.

In nearly every case, regardless of property type, it may prove better to incur the additional cost of achieving a D rating, rather than an E as this not only future-proofs buildings against later changes to the minimum standard but also provides an opportunity to generate more significant energy savings per pound of capital expenditure.

The full report is available to download from the Green Construction Board's website at http://www.greenconstructionboard.org/index.php/working-groups/valuation-and-demand.

UK Consensus Forecasts November 2014

PAM CRADDOCK
IPF

The last quarter has seen a further strengthening of forecasts for 2014, with the mean All Property total return figure rising to 18.9% (from 17.0% in August and 13.7% in May). Rental and capital value growth average projections have risen to 3.1% and 12.6% respectively (from 2.8% and 10.9% three months ago), the latter driven by double-digit growth for offices (17.0%), industrials (14.9%)and standard retail (up to 10.0% from 8.9% in August), in parallel with increased rental growth projections in each of these sectors for the current year.

However, this buoyant outlook is short-lived as forecasts moderate considerably over the remaining years of the survey.

Rental value growth forecasts

Rental value growth projections for 2014 and 2015 have improved again since the August survey. Expectations for 2015 to be the best performing year within the forecast period are maintained.

Thereafter, sentiment weakens and the average growth rate forecasts in the final two years have fallen (from 2.4% and 2.1% respectively in August). Notwithstanding this, the earlier projections continue to impact the five-year average, taking it above the 2.6% annual rate recorded three months ago.

Figure 1: **All Property rental value growth forecasts**

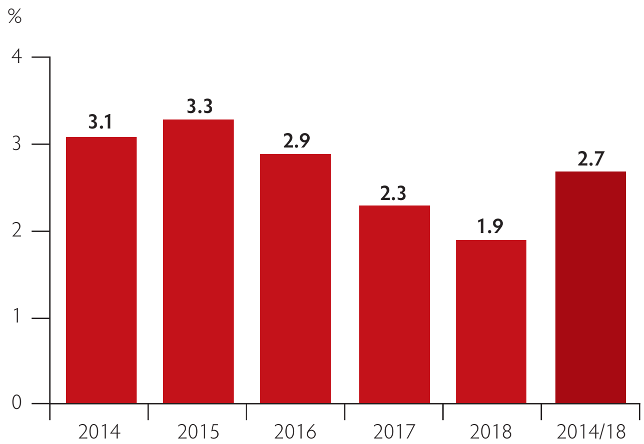
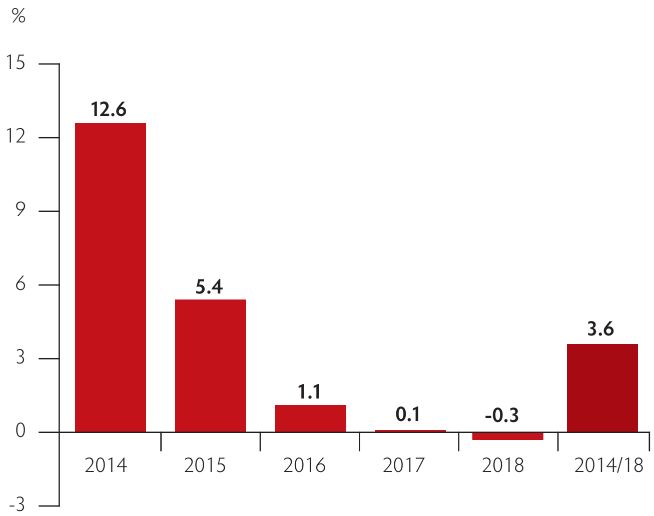


Figure 2: **All Property average capital value growth forecasts**



Capital value growth forecasts

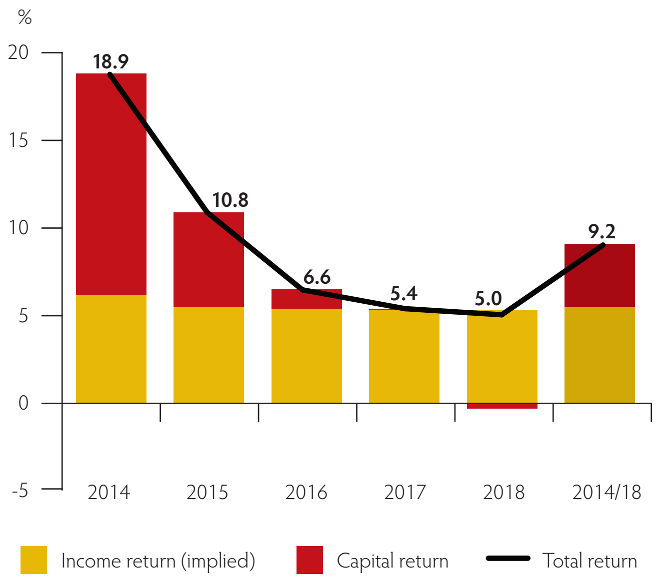
The principal drivers of strong investment flows and growth in the UK economy have again impacted on the All Property capital value growth forecast for the current year. A further significant increase has been recorded over the quarter, with the average rising from 10.9% in August (7.7% in May).

The subsequent fall back in growth rates in 2015 is particularly marked, although contributors are more positive in their expectations than three months ago, when the reported average was 4.8%. However, the weakening outlook for 2016 and beyond is evidenced by lower averages for that and subsequent years (from 1.5%, 0.3% and 0.0% in August). Nonetheless, the strong influence of 2014 serves to increase the five-year average to 3.6% per annum (from 3.4% in August).

Total returns forecasts

The significant contribution of capital value growth to a 2014 total return forecast approaching 19% contrasts with the remainder of the survey period. Despite lower growth prospects in 2015 (albeit an improvement on August's 4.8%), the current average indicates it is likely to fall below the implied income return, whilst, in the final years of the forecast, total return is expected to be wholly reliant on income.

Figure 3: **All Property total return forecasts**



Following a significant fall in the implied income return in 2015, in parallel with very weak capital growth, this element should remain relatively static for the rest of the survey period.

Despite declining capital growth expectations in later years, the five-year total return average has increased, from 9.0% in August and 8.3% in May, driven by improved 2014 and 2015 projections.

Figure 4: **Property advisors and research consultancies**

	Rental value growth %			Capital value growth %			Total return %		
12 (13) contributors	2014	2015	2014/18	2014	2015	2014/18	2014	2015	2014/18
Maximum	3.6 (3.6)	6.0 (3.8)	4.3 (3.0)	14.2 (12.8)	7.6 (8.0)	5.6 (7.9)	21.1 (19.3)	13.3 (14.5)	11.2 (14.1)
Minimum	2.3 (2.2)	2.3 (2.2)	2.2 (2.0)	9.6 (7.1)	2.5 (1.0)	1.2 (2.0)	15.6 (13.2)	8.0 (6.4)	6.3 (8.0)
Range	1.2 (1.4)	3.7 (1.5)	2.1 (1.0)	4.6 (5.7)	5.1 (7.0)	4.3 (5.9)	5.5 (6.1)	5.3 (8.1)	4.9 (6.1)
Median	3.1 (2.8)	3.3 (3.0)	3.0 (2.8)	12.7 (12.0)	4.9 (4.5)	4.3 (3.8)	18.7 (18.0)	10.4 (10.0)	9.6 (9.3)
Mean	3.1 (2.8)	3.5 (2.9)	2.9 (2.6)	12.5 (11.0)	5.2 (4.5)	3.9 (3.9)	18.6 (17.2)	10.7 (10.2)	9.4 (9.6)

Figure 5: **Fund managers**

	Rental value growth %			Capital value growth %			Total return %		
16 (15) contributors	2014	2015	2014/18	2014	2015	2014/18	2014	2015	2014/18
Maximum	3.7 (3.8)	4.7 (4.7)	3.7 (3.9)	15.1 (14.7)	11.9 (9.1)	5.9 (5.7)	21.2 (19.6)	17.7 (14.0)	11.1 (10.9)
Minimum	2.7 (1.6)	2.0 (2.1)	1.4 (1.6)	8.0 (4.0)	1.0 (0.7)	0.5 (0.3)	17.6 (11.0)	6.3 (5.9)	6.2 (5.9)
Range	1.0 (2.2)	2.7 (2.6)	2.3 (2.3)	7.1 (10.7)	10.9 (8.4)	5.4 (5.3)	3.6 (8.6)	11.4 (8.1)	4.9 (5.0)
Median	3.0 (2.8)	3.2 (3.1)	2.6 (2.7)	12.7 (11.7)	5.8 (4.8)	2.8 (2.8)	18.9 (17.0)	10.9 (10.6)	8.6 (8.4)
Mean	3.1 (2.9)	3.2 (3.2)	2.5 (2.7)	12.7 (10.8)	5.4 (4.9)	3.2 (2.9)	19.0 (16.7)	10.7 (10.3)	8.7 (8.3)

Figure 6: **All forecasters**

30 (30) contributors	Rental value growth %			Capital value growth %			Total return %		
	2014	2015	2014/18	2014	2015	2014/18	2014	2015	2014/18
Maximum	3.7 (3.8)	6.0 (4.7)	4.3 (3.9)	15.1 (14.7)	11.9 (9.1)	5.9 (7.9)	21.2 (19.6)	17.7 (14.5)	11.8 (14.1)
Minimum	2.3 (1.6)	2.0 (2.1)	1.4 (1.6)	8.0 (4.0)	1.0 (0.7)	0.5 (0.3)	15.6 (11.0)	6.3 (5.9)	6.2 (5.9)
Range	1.4 (2.2)	4.0 (2.6)	2.9 (2.3)	7.1 (10.7)	10.9 (8.4)	5.4 (7.6)	5.6 (8.6)	11.4 (8.6)	5.6 (8.2)
Std. Dev.	0.3 (0.5)	0.8 (0.6)	0.6 (0.5)	1.5 (1.9)	2.7 (2.2)	1.5 (1.4)	1.3 (2.0)	2.6 (2.1)	1.3 (1.5)
Median	3.0 (2.8)	3.3 (3.0)	2.7 (2.7)	12.8 (11.9)	5.7 (4.8)	4.0 (3.6)	19.0 (17.6)	10.9 (10.3)	9.3 (9.0)
Mean	3.1 (2.8)	3.3 (3.1)	2.7 (2.6)	12.6 (10.9)	5.4 (4.8)	3.6 (3.4)	18.9 (17.0)	10.8 (10.3)	9.2 (9.0)

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 12 weeks prior to the survey date. **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 forecaster' level only. **9.** The sector figures are not analysed by contributor type; all figures are shown at the 'All forecaster' level. **10.** In the charts and tables, 'All Property' figures are for 30 contributors, while the sector forecasts are for reduced samples (25/27) of contributors.

ACKNOWLEDGEMENTS

The Investment Property Forum (IPF) would like to thank all those organisations who contributed to the IPF UK Consensus Forecasts for Q4 2014, including the following:

Property advisors (including research consultancies): BNP Paribas Real Estate, Capital Economics, CBRE, Cluttons LLP, Cushman & Wakefield, DTZ, Fletcher King, GVA, JLL, Paul Mitchell Real Estate Consultancy Limited, Real Estate Forecasting Limited, The Lazarus Partnership.

Fund managers: Aberdeen Asset Management, Aviva Investors, AXA Real Estate, CBRE Global Investors, Cordea Savills, Cornerstone Real Estate Advisors, Deutsche Asset & Wealth Management, F&C REIT Asset Management, HSBC Global Investors, Keills, Knight Frank Investment Management, LaSalle Investment Management, Legal & General Property, M&G Real Estate, Standard Life Investments, TIAA Henderson Real Estate.

Equity Brokers: Kempen & Co.

Note Consensus forecasts further the objective of the IPF to enhance the efficiency of the real estate investment market. The IPF is extremely grateful for the continuing support of the contributors as noted above. This publication is only possible thanks to the provision of these individual forecasts.

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

IPF European Consensus Forecasts November 2014

PAM CRADDOCK
IPF

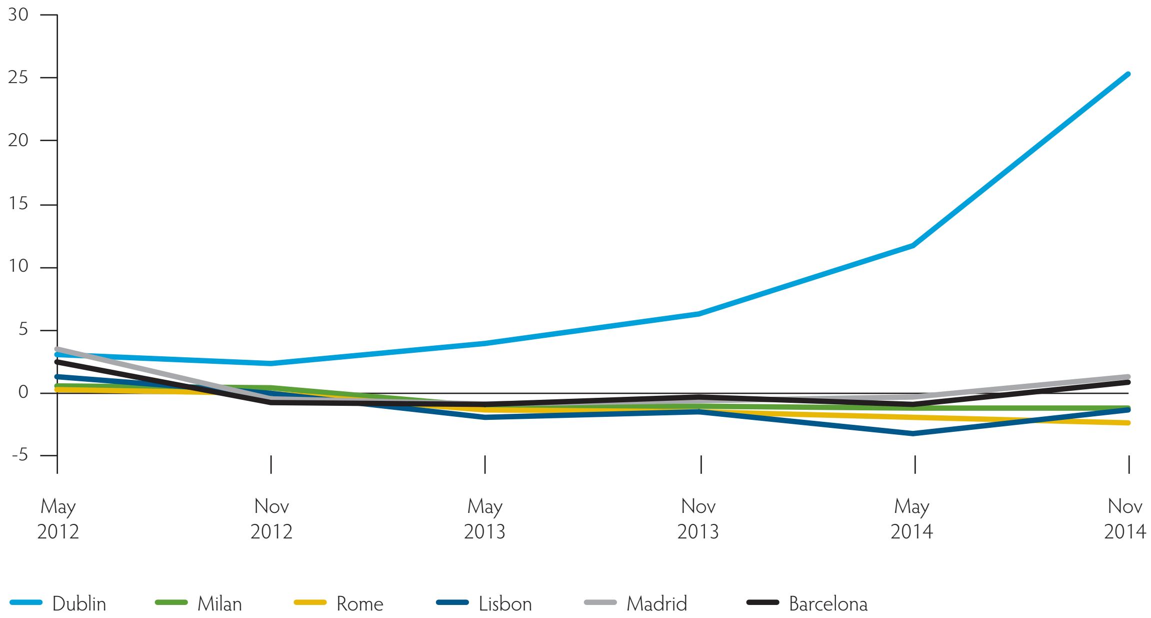
The range of forecasts for 2014 across the 29 locations recorded indicates mixed performance expectations, with some extreme positive and negative projections reflected in the figures presented for the Dublin and Moscow markets.

Twenty of the 29 average forecasts have strengthened since the last survey (11 by 1.0% or more), including five of the 11 centres that are expected to show negative growth in the current year. Of those markets where sentiment has weakened, four are in locations previously expected to provide sub-zero growth.

Eurozone offices

Figure 1 shows current forecasts for locations in economies that have been under greatest strain during the eurozone crisis. Disregarding Dublin, these again appear to be around or slightly better than previous forecasts. Lisbon's modest declined in May appears to have been reversed (to -1.3% from -3.2). Once again, there were insufficient forecasts for Athens offices to permit an analysis of this market.

Figure 1: **Weighted rental growth forecasts 2014 – peripheral eurozone economies**



In eastern Europe, the average outlooks for Warsaw and Prague have worsened slightly (from -2.7% to -3.5% for Warsaw and from -1.3% to -2.9% for Prague), whereas the Budapest market is improving (to 1.0% from -0.6%).

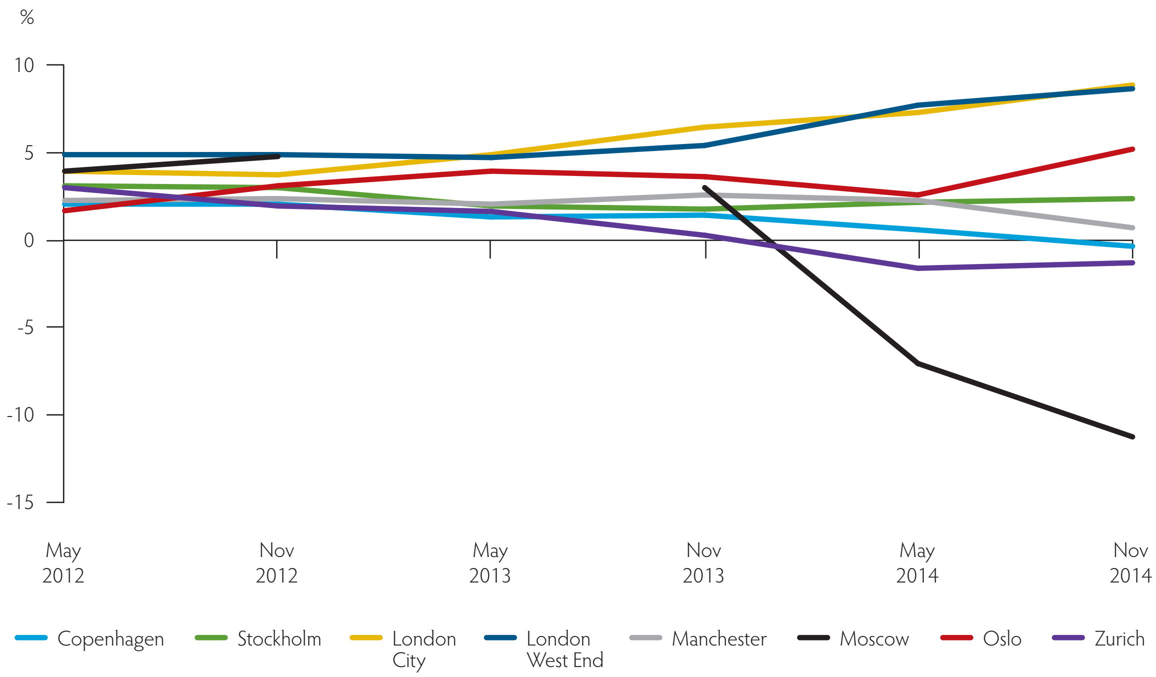
Remaining eurozone locations expected to deliver negative growth in 2014 comprise the three French office markets monitored: Paris la Defense, -3.3%, Paris CBD, -0.2% and Lyon at just under 0.0%, although there is a relatively high degree of volatility around these forecasts.

Turning to those centres predicted to deliver positive returns, after Dublin, the strongest growth expectations lie within Germany markets, ranging from 3.6% (2.5%) for Munich to 1.5% (1.1%) for Hamburg. Luxembourg, Amsterdam, Helsinki, Vienna and Brussels make up the remaining locations, with all but Brussels expected to exceed 1.0% growth.

Non-eurozone markets

Outside the eurozone, prospects for growth have continued to weaken in a number of locations, with Moscow expected to show a further significant decline (see Figure 2) as some local agents report lower rents, coupled with high vacancy rates and currency weakness. Manchester's prospects have weakened further to 0.7% (from 2.3% six months ago), whilst the only other centre that has weakened over the last six months is Copenhagen, which has fallen into negative growth (-0.4% from 0.6%). Zurich has firmed slightly, to -1.2% from -1.6% previously.

Figure 2: **Weighted average rental growth forecasts 2014 – Non-eurozone centres**

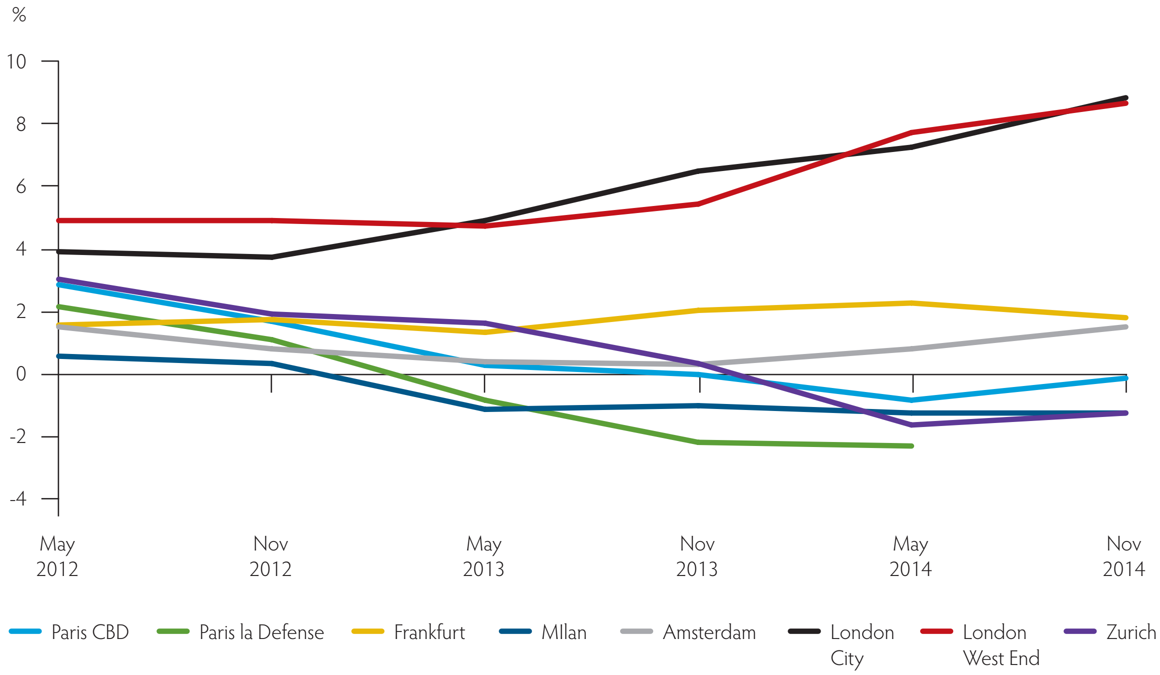


Positive sentiment for the two central London markets is maintained, with both expected to deliver increased growth of up to 8.9% (7.3%) in the City and 8.7% (7.7%) in the West End. The predicted growth rate in Oslo has risen to 5.2% (2.6%), whilst for Stockholm it has risen to 2.4% (2.2% in May).

Financial markets

Within the loose grouping of financial centres, London, Frankfurt and Amsterdam are projected to achieve growth in excess of 1.0%, the latter being projected at 1.5% (see Figure 3).

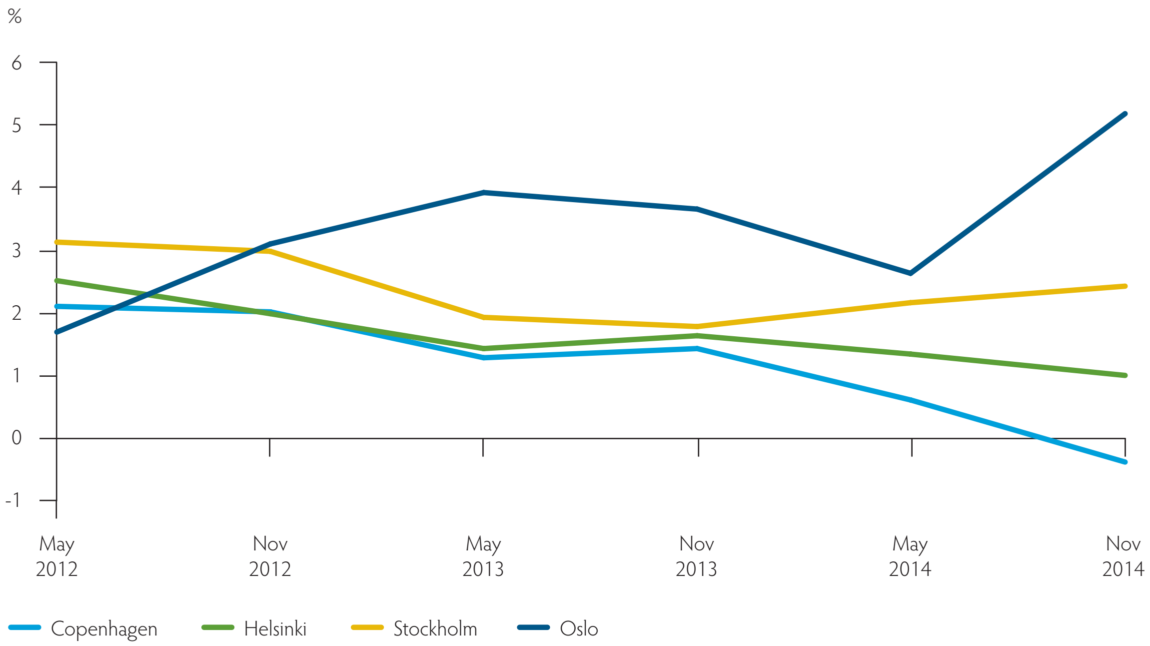
Figure 3: **Rental growth forecasts for year 2014 – Financial centres**



Nordics

In the Nordic region, individual growth projections for Oslo have resulted in a notable rise in average forecasts, although expectations of a weakening of the Copenhagen market have continued to drive the average forecast down.

Figure 4: **Rental growth forecasts for year 2014 – Scandinavian centres**



2015 and 2016 outlook

Whilst 24 of the 29 centres are projected to deliver growth in 2015, forecasts have softened for almost half of these centres (14) over the last six months, with Moscow down by 4.6%, to -4.2%, and Warsaw falling by 2.8% to -1.7%. Of the remainder, Prague and Zurich may be weakly negative, whilst the Paris la Defense forecast, the only other market expected to show negative growth next year, at -0.7%, has firmed since May (-1.2%).

Whilst contributors believe the spectacular growth of the current year will not be repeated, Dublin, at 10.5%, and London City (8.5%) are likely to be the leading centres in 2015, followed by London's West End and Madrid (6.2% and 4.7% respectively). A further eight centres are expected to deliver better than 2.0% annual growth in the next 12 months.

By 2016, whilst all centres are anticipated to deliver positive rental growth, the spread of growth rates is expected to tighten (from 0.3% in Warsaw to 5.6% in Dublin).

Three and five-year average forecasts

The rolling average growth rates point to a recovery to positive growth in most markets in the near term, although six of the three-year average forecasts indicate negative rates, compared to four in May. Moscow and Warsaw may prove to be the weakest of these, at average annualised rates of -5.0% and -1.6% respectively. In the 12 month period since November 2013, 12 forecasts have improved by more than 1.0%, including Madrid and Barcelona (rising by 3.5% and 2.8% to potential annualised growth rates of 3.3% and 2.1% in these markets).

In absolute terms, of the 23 markets averaging positive projections, only three (Lisbon, Milan and Lyon) may produced sub-1.0% growth, with a further eight expected to grow by between 1.0% and 2.0% annually over the three years. Of the remaining 12 locations, annualised rates of between 2.1% (Manchester) and 13.5% (Dublin) are predicted.

With the exception of Moscow (at -2.0%), the five-year forecasts are positive for all centres. Average growth rates in 23 markets have strengthened over the last 12 months, eight by more than 1.0%. Of the 16 locations where average forecasts exceed 2.0% per annum, Madrid (averaging 5.0%) and Barcelona (3.7%) maintain their presence towards the upper end of the range in this group, together with Zurich (which, at 3.0%, indicates a recovery in the later years of the forecast period) and the two central London markets (3.3% West End and 4.0% City), although the latter are anticipated to deliver slower growth in the later years of the decade. Dublin continues to be the premier market with an average expected growth rate of 9.0% per annum.

ACKNOWLEDGEMENTS

IPF thanks all participants in the survey for contributing rental data to the November 2014 European Consensus Forecasts, including the following organisations:

Aberdeen Asset Management, AXA Real Estate, CBRE, CBRE Global Investors, CoStar Portfolio Strategy, Cushman & Wakefield, Danish Property Federation, DTZ, Invesco, JLL, LaSalle Investment Management, Paul Mitchell Real Estate Consultancy Limited, Rockspring, Standard Life Investments and TIAA Henderson Real Estate.

Notes At present the IPF European Consensus Forecasts survey focuses on office rental value growth in major cities. It is not possible currently to assemble sufficient forecasts of all sectors across all European countries to produce a meaningful consensus of views, although our ambition is to extend and improve the scope of the survey.

In addition to the rental value forecasts, we run a consensus survey of forecast IPD European total returns by sector. The samples provided for this survey were once again insufficient to permit publication, as fewer than five forecasts were received for each sector/territory. We aim to produce a full release of this data at a future date, once the number of responses has grown to five or more.

The data This latest survey collected prime office rental forecasts for 30 centres for the calendar years 2014, 2015 and 2016. We request a three-year average forecast for 2014-2016 where individual years are not available, as well as a five-year average for 2014-2018. The survey requested both the percentage annual rental growth rates and also the year-end rent levels. The growth forecasts provided by each organisation are analysed to provide weighted average ('consensus') figures for each market. Figures are only aggregated and reported for office markets for which a minimum of five contributions are received.

The definition of market rent used in the survey is "achievable prime rental values for city centre offices, based on buildings of representative size with representative lease terms for modern structures in the best location." Prime in this case does not mean headline rents taken from individual buildings but, rather, rental levels based on market evidence, which can be replicated. All figures included in the survey are required to have been generated by formal forecasting models. This report is based on contributions from 16 different organisations (fund/investment management houses and property advisors).

Consensus forecasts further the objective of the Investment Property Forum to enhance the understanding and efficiency of the property market. The IPF is extremely grateful for the support those organisations that contribute to this publication, which is only possible thanks to the provision of individual forecasts.

The IPF welcomes new contributors for future surveys, so that the coverage of the market can be widened. If your organisation wishes to contribute to future surveys, please contact Pam Craddock, IPF Research Director at pcraddock@ipf.org.uk, tel. +44 (0)20 7194 7925.

Contributors receive a more detailed set of statistical outputs than those shown in Appendix 1 – for each office centre, the sample size, median and range of rental values are also provided.

EMIR – Can you (should you) sleep at night?

BILL BARTRAM
Independent Risk Management Solutions

The European Markets Infrastructure Regulation (EMIR) caused a lot of commotion in Q1 2014 as the mandatory trade reporting date came and went. Nobody, seemingly, was ready despite the regulation coming into force in August 2012! There was a deluge of paperwork issued by the banks regarding classifications, portfolio reconciliations and delegated reporting agreements. Thankfully, for the most part, things have now quietened down. For non-financial counterparties (which encompasses the majority of real estate deals), EMIR has introduced some additional bureaucracy but is manageable, if a little tedious.

Trade reporting requirements

One of EMIR's requirements is that the details of all OTC derivatives traded by EU entities are reported to a central trade repository. The objectives behind this are very noble. EMIR is designed to not only force more of the derivatives market into central clearing (more collateral/less market risk), but also to provide transparency to regulators so that, in the future, they are quickly able to see the size of the market and the exposure of its participants. When Lehman Brothers collapsed nobody had a clue!

One of the nuances of the trade reporting requirements is that both counterparties must report the trade independently. Thankfully, it is possible to delegate your reporting requirement to your counterparty, which is what most people have done. However, even if you do this, you remain legally liable for any errors or omissions. Legal liability is, of course, a moot point if delegated reporting works. Unfortunately this is not always the case. In one instance that we have observed, more than 50% of the trades that were reported on behalf of our client were reported incorrectly and in some cases not at all! This client is, however, in a fortunate position compared to most because at least it knows what data has been reported on its behalf. The same could not be said for most people.

The reason that most people are in the dark is that it is very difficult to get access to the raw data that has been reported on their behalf. Most banks are reticent to provide excerpts from their own reports and it is not freely available from the trade repositories. This means that most people are currently liable, under European law, for data that they have never seen, approved or have any control over!

What next?

Given the problems that have plagued trade reporting since its introduction it seems unlikely that the regulator will address these issues with a heavy hand. However the regulator will not extend leniency indefinitely. Taking into account our experiences and the pure number of errors that we have observed, we are now of the opinion that property companies should start reporting their own trades.

2015 may present an opportunity to discuss some of these issues with the regulator. By August 2015, the European Securities and Markets Authority (ESMA) must conduct a wide-reaching review of EMIR and issue a report on its findings to the EC. We, therefore, think it is a good time for us, as an industry, to raise our concerns with the FCA. The reality is that, particularly for many smaller firms, the cost and complexity of complying with the legal requirements imposed by EMIR is far over and above what can be expected of many businesses.

Forum Activities and Announcements

New IPF website

The IPF Executive has been working with website and database providers to develop a new platform for IPF news, events, research and other services. The new website is due for launch in the New Year– watch out for announcements!

Many thanks to Frankie Clay for project managing the implementation.

The Glasgow Commonwealth Games – Seminar and Dinner

The IPF Board in Scotland organised a seminar on 3 September, chaired by Jason Baggeley of Standard Life, which looked at the potential property development and legacy of the Commonwealth Games. The speakers were Neale Coleman of London Legacy Development Corporation, Francesca Osowska from the Scottish Government and Fionna Kell of Clyde Gateway. Both the seminar and the dinner that followed it were held at the Crowne Plaza in Edinburgh.

Chairman and speakers at the Scottish Seminar and Dinner

Many thanks to the sponsors; CMS Cameron McKenna and Miller Developments.

IPF Midlands Dinner

Hugh Dennis, guest speaker at the Midlands Dinner

Hugh Dennis, guest speaker at the Midlands Dinner

The IPF Midlands Dinner took place on 16 October at the ICC, Birmingham. The event was sponsored by BNP Paribas Real Estate, Lloyds Bank, Lockton Real Estate and Construction, and Rider Levett Bucknall. The 600+ guests attending were treated to amusing anecdotes from after-dinner speaker, Hugh Dennis.

IPF Northern Dinner

The Lowry Hotel in Manchester once again hosted the IPF Northern Dinner. Held on 13 November, the event attracted over 250 guests, an increase of nearly 100 on last year. The after-dinner speaker was Dave Spikey, co-writer and star of Phoenix Nights. The event was sponsored by Argent, Grant Thornton, Pochin and Santander.

Members of the IPF Northern Board with Sue Forster and Chris Ireland

IPD/IPF Conference

The 24th IPD/IPF Property Investment Conference took place on 20-21 November in the Grand, Brighton. Themed, 'Riding the new wave – risk, return and regulation in the latest real estate cycle, the conference had a number of high-profile speakers including Gerard Lyons, the up-beat Chief Economic Advisor to Mayor of London, Boris Johnson.

The Grand Hotel, Brighton – venue for the IPD/IPF Conference

IPF session at MIPIM UK

IPF was invited to organise a session at the inaugural MIPIM UK. Chaired by Andrew Smith of the Mill Group on 16 November, the session entitled, 'A new property cycle: The same again?', was discussed by Paul Clark of PMA, Alan Patterson of AXA Investment Managers and Graham Parry of Grosvenor Group.

Nick Tyrrell Research Prize

Paul Schneider of QIC, winner of the third Nick Tyrrell Research Prize, presented his paper 'Price Discovery in UK unlisted real estate funds' at a seminar hosted by Dechert on 27 November. A synopsis of his paper is to be found on pages 12-16 of this edition of Focus

The Prize is sponsored by IPF, INREV and SPR and submissions are invited for the 2015 prize – for further details see inside back cover.

IPF co-sponsors Brussels event

The European Real Estate Forum (EREF), an informal alliance of 27 European real estate organisations including the IPF, hosted a successful event in Brussels on 4 November focused on the role of real estate as a long-term investment. The event, attended by MEPs and officials from the EC, is intended to be the first in a series highlighting the importance of real estate to the European economy.

IPF co-sponsors EREF event

'Cheesegrater' site visit

Lego model of the 'Cheesegrater'

British Land and Oxford Properties hosted two IPF site visits on 21 and 24 October to the newly-completed Leadenhall Building. Those attending enjoyed fantastic views over London from the marketing suite on the 40th floor.

Next Generation Networking Evening

Over 100 people attended the informal Networking Evening held at King & Wood Mallesons SJ Berwin's offices on 28 October. Max Sinclair of Wells Fargo was the guest speaker.

To find out more about the Next Generation Group, please contact Cormac Watters, email: cwatters@ipf.org.uk.

Investment Education Programme (IEP)

The next two IEP modules will be 'Property Investment Appraisal' on 26-28 January and 'Property Finance and Funding' on 23-25 March 2015.

To find out more about these and the IEP as a whole, go to the University of Cambridge Institute of Continuing Education website: www.ice.ac.uk/investment

Protocol: Open Market Investment Agency

The IPF published this 'Protocol' at the end of November 2014. Developed by a cross-industry working group, chaired by Martin Moore, the aim is to establish clear guidance around good practice relating to open market property investment sales and acquisitions in the UK, in order to address potential conflicts of interest.

A number of major investment agency firms, fund managers and investors have already agreed to sign up to the Protocol and the IPF would like to encourage others to do so in order to provide greater clarity and transparency to investment transactions for the benefit of both Principals and Agents.

The Protocol is set out below and is also available to download, with an example of issues to be addressed in Agency Barrier Policies, from the IPF website: www.ipf.org.uk.

The two scenarios covered by the Protocol are how agents should deal with instances where they are instructed to act by more than one Principal in the potential acquisition of a property/ies and instances of 'dual agency' when they are approached to act on a proposed acquisition where they are already instructed by the Vendor.

Intentionally, the guidance is high-level, recognising the danger of going into too much detail in areas where it would not be unreasonable to expect individual organisations to approach the detail differently.

The terms 'Agent' and 'Principal' refer in all cases to the respective organisation, not individuals and where communication between Agent and Principal is proposed, it is recommended that key subject matter is always confirmed in writing or by email.

In all circumstances, Principals should be provided with terms of engagement that are fair and clear, including reference to complaints-handling procedures and, where it exists, an appropriate redress scheme.

This Protocol accords with RICS ethical standards and the RICS Real Estate Agency and Brokerage Guidance, 2nd edition, which contains mandatory requirements for RICS Members and RICS Regulated Firms.

Multiple introductions

1. An Agent may elect to make multiple introductions of an investment property/ies acquisition opportunity.

2. Principals should have a written 'Introductions Policy' so Agents are clear how any introduction will be treated. Agents wanting to make an introduction should be aware of the Principal's Introductions Policy, which should be available on request.

3. Where the Principal does not have an Introductions Policy, the Agent should agree at the outset the basis of engagement with the Principal in writing.

4. Agents should have a clear and robust 'Barrier Policy' to deal with potential conflicts of interest that is proactively managed and reviewed on a regular basis, with compliance enforced across its entire organisation. A copy of the Barrier Policy should be available to Principals on request.

5. Where a Principal chooses to progress a particular investment opportunity with an introducing Agent, the terms of engagement should be confirmed in writing or by email as soon as practicably possible at the outset of the engagement.

6. As part of the formalisation of engagement terms, there should be clear agreement that:

a. The Agent is appointed and will act on an exclusive basis, or

b. The Agent is appointed on a non-exclusive basis and it is accepted by the Principal that the Agent may act for more than one Principal but confidentiality will be maintained at all times by activating the Agent's Barrier Policy.

7. Where section 1.6.b. applies, the Agent must clearly identify and record internally, all individuals (across all services lines) nominated to represent each Principal in connection with formulating their respective offer (the Deal Teams), in accordance with the Agent's Barrier Policy.

8. In the absence of a clear and robust Barrier Policy, an Agent should not represent more than one Principal on any given transaction.

9. Following engagement, the Agent should ensure the basis of its agreed appointment, either exclusive or not, is made clear to the Vendor's Agent. Where the Vendor is unrepresented, then the Vendor should be advised directly.

10. As soon as an Agent agrees to accept an exclusive appointment, all other Prospective Principals with whom there was an ongoing dialogue concerning the same opportunity need to be notified that the Agent is now unable to represent them.

11. During the period of an exclusive or non-exclusive appointment, should the Agent be approached to provide specific 'incremental advice' related to the investment transaction (e.g., planning, building surveying, valuation), this additional work can be accepted/undertaken but only in accordance with the Agent's Barrier Policy to ensure clear segregation of the individuals providing this incremental advice from the already nominated Deal Team(s). Where an 'incremental instruction' is to be accepted, the Agent will need to advise a Principal with whom the Agent has an exclusive buy-side engagement and obtain the Principal's consent unless this circumstance has been covered in the terms of engagement, as per section 1.5. above.

Dual agency

Dual agency arises where an Agent, acting on behalf of the Vendor in the sale of an investment property/ies, then acts for another Principal, or wishes to approach a Principal to act on its behalf, in respect of the proposed acquisition of the same property/ies.

The default position is that an Agent retained to sell a property should avoid acting for another Principal on the buy-side.

1. There should be formal written terms of engagement regarding the sales instruction between the Vendor and the Agent. Before these are concluded, the Agent should declare any pre-existing, sole buying mandates that the Agent has that are likely to result in a Prospective Purchaser for the property/ies in question.

2. Where the Agent is instructed to sell, it should only approach Prospective Purchasers in its capacity as retained selling Agent. Under no circumstances should it also seek to introduce the transaction in order to create a buy-side position.

3. On receiving instructions from the Vendor, the Agent must clearly identify and record internally individuals across all service lines nominated to represent the Vendor on the sale (the Deal Team), in accordance with the Agent's Barrier Policy.

4. Only in exceptional circumstances, e.g. the Agent has a pre-existing sole buying mandate, should the retained selling Agent also represent a Prospective Purchaser. In this instance, the terms of engagement need to be reconfirmed in writing with both Principals (Vendor and Prospective Purchaser), including specific acknowledgement that the Agent is acting for both the Vendor and a Prospective Purchaser and the Agent's Barrier Policy has been activated. The Agent will identify and record internally individuals across all service lines nominated to represent the Prospective Purchaser, all of whom (in accordance with the Barrier Policy) will be independent from the selling Deal Team.

5. During the period of a sale mandate, should the Agent be approached to provide specific 'incremental advice' by a Prospective Purchaser (e.g., planning, building surveying, valuation), this additional incremental work can be accepted/undertaken but only in accordance with the Agent's Barrier Policy to ensure clear segregation of the individuals providing this incremental advice from the already nominated Deal Team(s). The Vendor should be notified of the details accordingly but the Vendor's consent is not required.

6. In the interest of transparency to the wider market, in the exceptional circumstances where the retained selling Agent also has a retained buy-side instruction (over and above giving incremental advice), then the Vendor's Deal Team should ensure all other Prospective Purchasers and their Agents are made aware of this (along with confirmation of the invocation of the Agent's Barrier Policy).

7. Where an Agent is acting in this dual agency capacity, all bids should go directly to a Third Party, such as the Vendor, Vendor's Solicitors or a joint selling agent.

For further information, please contact Sue Forster: email sforster@ipf.org.uk

NOTE: The IPF and the members of the Working Group accept no liability whatsoever for any direct or consequential loss of any kind arising from the use of this Protocol or any part of its contents.

About the Nick Tyrrell Research Prize

The Nick Tyrrell Research Prize has been established by INREV, the Investment Property Forum (IPF) and the Society of Property Researchers (SPR) to recognise innovative and high-quality, applied research in real estate investment.

The Prize is in memory of the work and industry contribution of Nick Tyrrell, who sadly passed away in August 2010. Nick was Head of Research and Strategy and a Managing Director in J.P. Morgan Asset Management's European real estate division. His research work was characterised by a combination of academic rigour and practical relevance.

1. The Prize

- The Prize includes the following elements:
  - an award of £2,000;
  - an award presentation (which may be held at one of the conferences / dinners organised by one of the sponsoring organisations);
  - the opportunity to present the paper at a seminar organised by the sponsoring organisations; and
  - the inclusion of the article (or a summary thereof) in one or more of the sponsoring organisations' publications;

All of the above elements may be changed at the discretion of the three sponsoring organisations and the IPF Educational Trust.

2. Prize criteria

- Papers should represent, in the opinion of the Judges (listed below), high-quality research that is:
  - innovative, original and timely;
  - relevant to the real estate investment industry (listed/unlisted, direct/indirect, equity/debt);
  - of academic rigour; and
  - typically between 5,000 and 10,000 words.
- Both single author and joint author submissions are permitted.
- Preference will be given to those papers where one or more of the authors is associated with a real estate investment management organisation or similar, by way of a full-time or part-time position.

3. Submission of papers

- Papers should be submitted directly by email to the Secretary, as nominated by INREV, the IPF and the SPR, stating any involvement or sponsorship by third parties and/or whether the paper has been submitted for other prizes.
- **The deadline for submission of papers is 31 May each year.**
- Papers that have been submitted for other prizes may only be considered with the explicit consent of one of the Judges.
- Sponsored pieces may be submitted with the written consent of the sponsor. A copy of this consent should be included with the submission.
- Only completed research papers will be considered by the Judging Panel. Proposals for papers may be discussed with the Secretary.
- Ideally, the Prize will be awarded to an unpublished paper, but papers may be considered that:
  - have been published in the academic or professional press no longer than one year before submission;
  - presented to a conference no longer than one year before submission; or
  - are being considered for publication at the time of submission.
- The Secretary will distribute the papers to the Judges. The Judges will not correspond on any submissions directly.
- The Judges are under no obligation to award the Prize.

4. Management of the Prize

- INREV, the IPF and the SPR will be responsible collectively for the administration of the Prize and will appoint a Secretary to liaise with the Judges and the IPF Educational Trust.
- The Prize will be funded by monies from the Nick Tyrrell Memorial Fund, which is administered by the IPF Educational Trust, an independent charitable body.
- Monies for the Prize will be raised by the three sponsoring organisations on an as-and-when basis. The three organisations will each be responsible for publicising the Prize and for all aspects of management.
- The three sponsoring organisations will each appoint one Judge to sit on the Judging Panel. A fourth Judge will be appointed collectively to act as Chairman. Further Judges may be appointed, providing all three organisations are in agreement. All Judges will serve a two-year term and may serve a maximum of two consecutive terms.
- The Judging Panel should comprise individuals with broad and substantial experience from both academia and practice. At least one member of the Judging Panel will have experience of non-UK real estate markets.

5. Other issues

- Should the Fund be unable to award the Prize due to insufficient funds and the three sponsoring organisations choose not to seek additional funds, the remaining monies in the Memorial Fund would be merged with those of the IPF Educational Trust, to be used at the discretion of the Trustees.
- Similarly, should all three sponsoring organisations choose to cease awarding the Prize, the remaining monies in the Memorial Fund would be merged with those of the IPF Educational Trust, to be used at the discretion of the Trustees.
- Should the Prize not to be awarded at any time during a four-year period, for whatever reason, the Prize would terminate automatically unless the three sponsoring organisations all agree otherwise.

Judging Panel (2015)

Dr Paul McNamara (chair)
Professor Martin Hoesli
Dr Brenna O'Roarty
Dr Neil Turner

Secretaries (2015)

Dr Paul Kennedy email: paul@pjkennedy.co.uk
Henri Vuong email: henri.vuong@inrev.org

Investment Property Forum

Annual Lunch 2015

Guest Speaker: Tim Harford

Award-winning Financial Times columnist and author of "The Undercover Economist"

Friday 30 January 2015

The London Hilton on Park Lane
Park Lane, London W1

11:45 – 12:30	Pre-lunch drinks
12:30 – 15:00	Lunch
15:00	Post-lunch bar opens

Lounge suit

For more information or to book, please contact Barbara Hobbs on 020 7194 7924 or email bhobbs@ipf.org.uk

Ticket price: £117.50 +VAT

(£141 inclusive of VAT @ 20% per person)

The ticket price excludes wine and other beverages.

This event is kindly sponsored by:

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