IPF Investment Property Forum

INVESTMENT PROPERTY FOCUS

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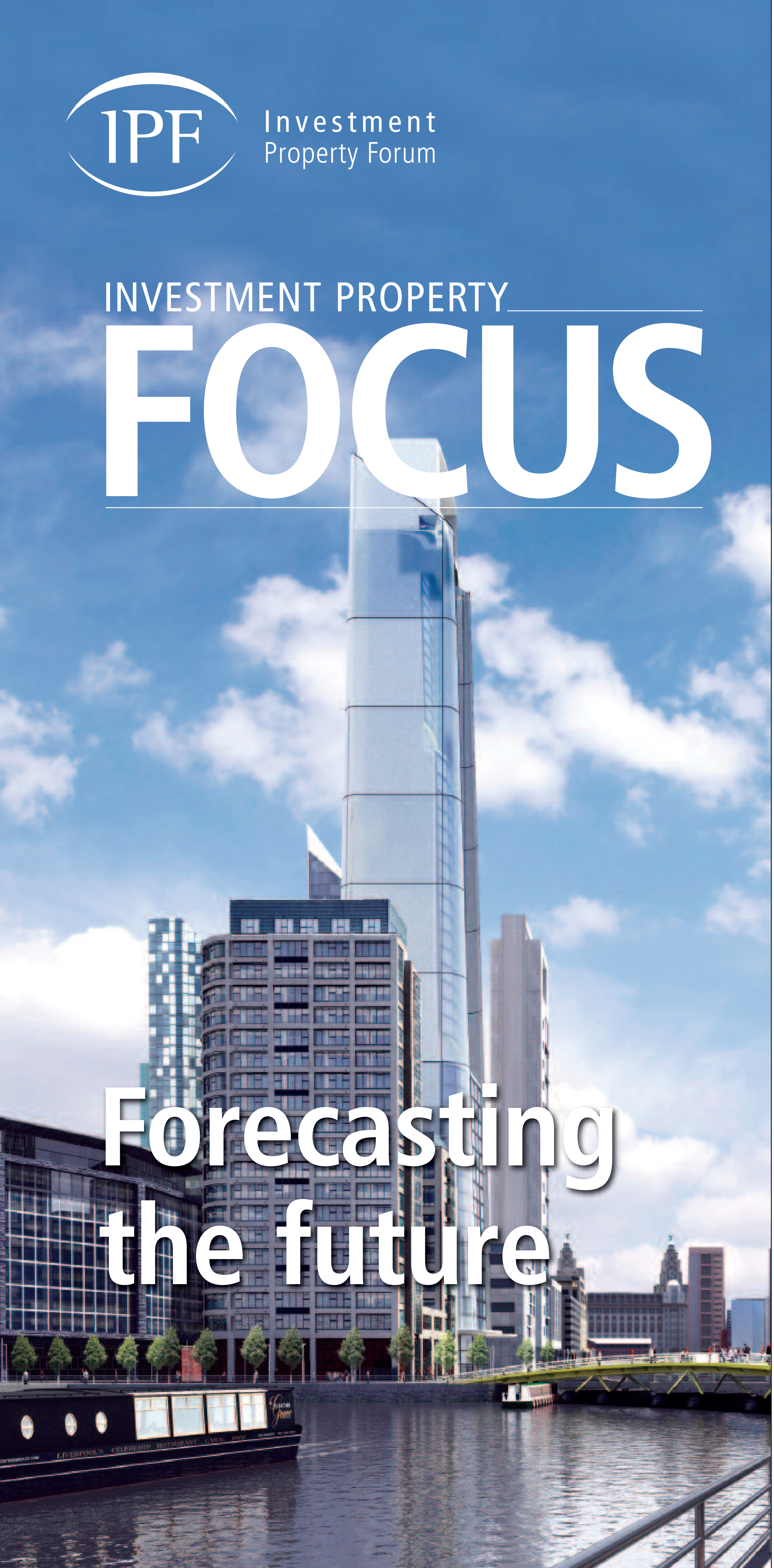
Forecasting the future



In this issue:

Image: Princes Dock, Liverpool Waters

This autumn, Peel Holdings invited IPF Northern Region members on a site visit to Liverpool Waters, a 60 hectare, 150 acres, site, which will create a new sector of the central city area within walking distance of the existing commercial core.

IPF Research Programme Sponsors

The IPF Research Programme is an important provider of high-quality, independent research focused specifically on property investment. We can only continue to fulfil this role due to the support of our 22 research sponsors. We are very grateful to this group of companies for their support of the 2011-2015 Programme.

From the editor

Sue Forster, Executive Director, IPF

As this edition of Investment Property Focus follows so soon after the annual IPD/IPF Property Investment Conference, the IPF's Research Director, Pam Craddock, took the opportunity to interview the conference chairman, Francis Salway, about his thoughts on topics as wide-ranging as changes in lease lengths, liquidity in the market, the residential sector, the importance of more capacity at Heathrow, the quality of new buildings, and regulatory proposals relating to sustainability.

Also featured at the conference were the IPF Research Programme research reports on the accuracy of current UK commercial property forecasts and how they could be improved in terms of accuracy in the future. In the article included in this edition, George Matysiak of Henley Business School University of Reading has summarised the research in respect of forecasting accuracy, which found that forecasters tend to over-estimate growth in rental levels, capital values and total returns in underperforming periods of the property market and vice versa. Michael White, of Nottingham Trent University considers the research methodologies used currently and how improvements in future forecasts might come from both the qualitative and quantitative elements of the process.

The IPF Research Programme has published several other reports recently. These include an analysis, as outlined by Malcolm Frodsham, of how the use of indirect funds alters investors' delivered return from direct property, particularly having regard to the impact of fund costs, cash, debt and fees. The programme also looked at institutional investors' attitudes towards the UK residential market, based on a survey of 42 prominent organisations. Pam Craddock, one of the researchers, summarises the findings. This survey is to be repeated in 2013 so it will be interesting to see whether there are more 'converts', particularly following the Montague Review published in August this year.

The IPF also support the Property Industry Alliance's Occupier Satisfaction Survey. This year's results are reviewed by Stuart Morley, Consultant to GVA. As in 2011, there remains a low level of satisfaction with service charge arrangements and poor level of engagement by landlords in respect of environmental issues. Perhaps there would be greater engagement if it could be demonstrated that sustainability can deliver real value. Simon Taylor of 4Front Consulting has put together a number of case studies to determine just this question and the potential financial benefits of other parts of corporate social responsibilities strategies.

REITs are also key topic in this edition of Focus. Martin Hoesli, of the University of Geneva and University of Aberdeen and Elias Oikarinen of the University of Turku, have co-authored a summary of their research into whether 'REITs are real estate'. This research was awarded the inaugural Nick Tyrrell Research Prize, sponsored by INREV, IPF and SPR. Mark Fahy of the London Stock Exchange discusses the new opportunities for REITs following the Finance Act 2012. Also featured is another prize-winner (this time from the IPF Educational Trust). Andrew Marshall, a student at the University of Aberdeen, provides an overview of his research looking at whether REITs provide an inflation hedge.

The calculation of inflation, as measured by RPI, could change. Simon Kinnie of Standard Life Investments explains the options put forward by the Office for National Statistics for "more accurately reporting changes in the overall level of price movements". Given that many property contracts make reference to RPI; this could have an adverse impact on at least some property investors.

Also included in this edition are: an article on tax planning by Alun Oliver of E³ Consulting; summaries of the IPF UK and European consensus forecasts for November 2012; and short interviews with the chairs of the IPF special interest groups, together with an overview of IPF activities.

If there are any topics you would like to see covered in the April 2013 edition, please let me know.

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Spotlight on tax planning

Alun Oliver,
E³ Consulting

UK taxation policy is under the microscope, as never before. The mainstream press highlights a 'moral' position for businesses and taxpayers to pay their 'fair share' with high profile stories including; Starbucks, Amazon, Apple and comedian Jimmy Carr. Tax avoidance (legitimate tax planning) and tax evasion (always dubious, often illegal) have been 'morphed' by many commentators into a 'single' grey, yet complex area of the law.

Property investors should always be taking account of tax in their investment strategies, whether income tax, corporation tax, capital gains tax (CGT), VAT, inheritance tax (IHT) or stamp duty land tax (SDLT) – although often those payable upfront, VAT and SDLT, are the ones that tend to get early attention! Too often in the past, tax being 'below the line' was seldom given the attention it deserves and seen as a compliance issue. In the current climate, effective tax strategies can significantly impact overall performance and turn marginal projects into successful, profit generators. Factoring capital allowances, for example, into the after-tax position on a large investment property can improve the investment yield, often by as much as 0.5% to 1.0%, occasionally more.

Paying too little tax clearly carries reputational risk; irrespective of the legality, but what is the right amount of tax? Why pay more tax than necessary? This was the sentiment of Lord Clyde in the case of Ayreshire Pullman Motor Services v IRC (1929) 14 TC 754 "No man in this country is under the smallest obligation, moral or other, so to arrange his legal relations to his business or to his property as to enable the Inland Revenue to put the largest shovel into his stores". Although an old case, the courts have repeatedly supported this view that taxpayers, should follow the tax legislation, but are within their rights to minimise the tax payable, within these complex and convoluted rules.

General anti-abuse rule

The recent National Audit Office report on HMRC highlighted "that tax avoidance is not illegal" and the Government seems finally to be correcting the misinterpretation of tax avoidance and now using the term 'anti-abuse'. Respected QC, Graham Aaronson, has been leading an independent Advisory Panel helping HM Treasury and HM Revenue & Customs with the introduction of a new general anti-abuse rule (GAAR) to clarify the boundaries of legitimate tax planning and abusive activities.

The GAAR is expected to be in Finance Bill 2013 and effective from April 2013.

Senior accounting officer requirements

Reputational risks aside, businesses also face risk management issues in tax with the senior accounting officer (SAO) requirements (the individual now taking legal responsibility for tax compliance of large corporates), which means that tax is now much more of a boardroom issue, deserving of careful consideration and corporate energy in managing effective tax strategies. Businesses must now demonstrate they have adequate procedures in place to ensure comprehensive record keeping and accurate assessment of their tax liabilities and allowances in arriving at their tax computations.

Changes to REITs?

The REIT is, of course, a tax-efficient structure and many of the larger investment landlords have opted for this structure. This does not mean they no longer consider tax as there are complicated rules that must be complied with to ensure they do not create an unintended tax liability. The forthcoming Autumn Statement is expected to announce further changes to the REIT legislation, with the aim to continue their appeal to investors and improve flexibility, whilst protecting HM Treasury from inappropriate use of tax planning.

Whilst tax can cause some to glaze over, the potential for creating value, improving yields or maximising cash flow benefits (be it from optimising the available capital allowances or safeguarding the VAT treatment on a major transaction is correct or ensuring the 'right' entities [LPs, LLPs, GPs, SARLs, SAs, PLCs] and jurisdictions are involved at the right time), is a legal duty of directors to optimise returns for shareholders – enforced through the specific and general duties set out by the Companies Act 2006.

Francis Salway interview

Ahead of his Chairmanship of the IPD/IPF Property Investment Conference in November, former CEO of Land Securities, Francis Salway, met with Pam Craddock of the IPF to share some of his thoughts on the past present and future of the UK property industry.

PC What major changes in the industry have you noticed over the past 20 years?

FS There have been many changes, but four in particular have had a significant impact. The first is the change to lease lengths – leases are generally, but not always, shorter. The important thing is that occupiers are now able to negotiate the lease length they want. Secondly, we have a far more efficient property investment market, with pricing responding much more quickly to changes in outlook. Thirdly, the boom in property research and the ability of investors to take advantage of improved market data. Finally, I would say globalisation in that, while property may be a local game, the market is international and the UK has benefitted, thanks to the transparency of its market which attracts international capital. This is demonstrated, for example, by the changes in capital investment. In the 1970s to 1990s, equity investment came largely from the UK institutions, whereas by the mid-2000s the flows of equity capital had become global.

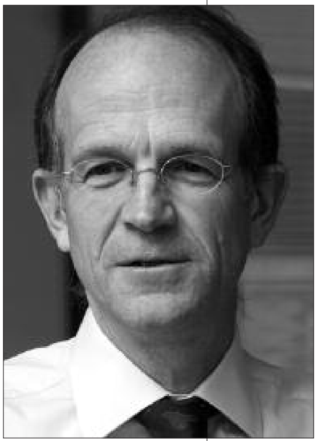
I think there is a tension between property as a service industry facilitating corporates' occupational requirements and property as an investment medium. Sometimes the two fight one another or are out of sync. This creates pricing arbitrage (positive or negative) and has a lot to do with lease lengths. The influence of the big US hi-tech multi-nationals in the 1990s led to the introduction of shorter leases. The result is that the UK is increasingly aligning itself with international leasing practises.

PC You mentioned that the market was more efficient – to what do you attribute this?

FS I am a complete fan of IPD. Performance bench-marking is the one thing that has transformed and professionalised investment in UK property.

PC Liquidity is a key issue for investors. Can property provide this?

FS Property is a less liquid form of investment than shares or gilts and I do not think there is any way around that. In the 1990s, I ran unit-linked property funds and a former colleague said, "You are purporting to offer more liquidity in the units than there is in the underlying property assets". Managing liquidity in funds is as important as getting the investment performance right. Managers need to be transparent about what liquidity is on offer and how they manage it. Investors have choice, and they have a better understanding of the pros and cons of different types of vehicle. I think there is a danger that 'in vogue' vehicles set up for the moment can leave investors 'high and dry' because of a lack of liquidity.



Francis Salway, Former CEO, Land Securities

I believe that the REIT model scores highest for liquidity and has no particular inefficiencies for investors. The UK REIT structure was stress-tested in 2008-09 and nothing in the legislation was found to be unworkable. However, having been introduced at the high point of the market (1 January 2007), this has impacted on REIT performance since that date. Going liquid in an illiquid asset class has its attractions and REITs have enabled global investors to pick experts in countries and sectors, and manage the geographical and sector allocation decisions themselves – with good liquidity in the shares.

PC What are your thoughts on discounts to NAV?

FS There are times when the return requirements of equity investors differ from the return requirements of direct property investors. So in Autumn 2011, when the Euro crisis was breaking, sovereign wealth fund investors were looking for the security of an ungeared return from direct property of 7%, compared with equity investors seeking 10% plus. This lead to a discount. However, in the medium to long-term, the correlation between share prices and NAV is very high when adjusted for debt.

PC Do you think the quality of what is built by the industry has improved?

FS I think the quality of buildings has improved hugely over the last 20 years. We are now designing better, fit-for-purpose buildings; and we are getting better at sustainability too. The industry is now recognised for delivering good regeneration programmes that will help town and city centres. Town centres may stand still or be in slow decline and they need regeneration; and this is where larger developers, such as Land Securities, are needed to turn them round. Co-ordinated initiatives can benefit a town centre hugely but it is more difficult where the high streets are in multiple ownership and not managed as a single entity.

The Portas review was good in analysing the issue but there are no easy answers to the problem – 28 recommendations are not necessarily the way forward. Whilst not having the answers, I am a fan of business improvement districts (BIDs). In terms of planning, I also see change of use as critical.

With regard to regeneration generally, I believe this is a 'tick in the box' for the industry. In the period when I was CEO at Land Securities, the company invested just under £5bn in developments. We built within yards of Canterbury, Exeter, Westminster and St. Paul's cathedrals, all of which required great sensitivity. There are lots of other examples of great commercial developments, such as Broadgate, which, of course, was recently considered for listing.

PC As the author of 'Depreciation of Commercial Property', published in the 1980s, do you think the industry has progressed very far on this issue?

FS I think the industry approach needs to be revisited/refreshed. Depreciation is a characteristic that distinguishes real estate as an asset; and the market does get it wrong from time to time. The interaction of lease length and depreciation is often mispriced. This is an area of potential opportunity, one of the largest components in a fair pricing model.

PC Sustainability issues have come to the fore – what are your thoughts on the current regulatory proposals that affect the industry?

FS The proposal to prohibit new lettings on buildings with F & G energy performance ratings will be a huge challenge. As chair of the BPF Sustainability Committee, I pressed Government to clarify how this will work as early as possible so there will be no big shocks in valuations. What is the right definition of 'new letting' so landlords cannot be penalised? What can be done where landlords cannot get possession to carry out improvements, for example, where the property is sub-let in whole or part? There are real issues with the existing building stock – these regulations on F & G are a stick but, if we really want to get existing buildings up to A & B ratings, we also need carrots.

PC The IPF has just done some research on attitudes to institutional investment in the residential sector. What are your thoughts on this sector?

FS The proportion of UK owner-occupied residential property is beginning to decrease – this is a milestone. For around 50 years, the sector experienced growth in owner-occupation. A small shift from owner-occupier to renting represents billions of pounds and it is a big market opportunity. We will get some institutional investment in residential. As the size of the market grows, so will the opportunities.

PC Do you think we will see more debt finance available in the next few years?

FS The debt/equity balance changes through the cycle and I firmly believe that we will see more debt come back into the market as we move through the cycle. The levels of leverage seen in 2006-07 may (and should) not be replicated but loosening in lending criteria will be seen as we move towards the next peak in the cycle. But lending will be scarce for a number of years. In previous cycles, it took five to six years to get back from the low point in the cycle before lending volumes started to rise again. This time it will take longer. Regulation is a crucial factor though and it is critical that any regulation is consistent with what is introduced in other countries globally.

PC Looking at the wider business environment, aside from the state of the economy itself, are there any issues you consider key to the well-being of the property market?

FS Aside from the issues directly related to the economy, I think there are three key factors: openness for trade, the benefits of immigration and infrastructure. The right environment needs to be created and supported to encourage international connectivity and access to talent. At the end of last year, I gave a talk on the future of cities. I didn't talk much about buildings, but about the benefits of immigration; the exceptional quality of London's universities; and Heathrow airport. It is absolutely critical that we address the congestion at Heathrow and the lack of capacity for growth. Heathrow is full serving developed countries and has no spare capacity to serve emerging markets. Already, other major European airports (such as Schiphol and Frankfurt) are flying three times a week to smaller Chinese cities (not Beijing or Shanghai). Similarly, we need to look at the South American markets opening up. This issue of hub airport capacity needs to be addressed urgently – whatever solution is preferred. It is positive that we now have a review commissioned under Sir Howard Davies, but disappointing that its timescale for reporting is so extended.

London arguably has more inherent potential for productivity improvement that any other city in Europe, but we are in danger of stifling this through the constraints of infrastructure rather than the built environment. I am far more confident that the commercial property industry will deliver floor space. But infrastructure takes so much longer in planning. How many years has Crossrail taken to come through?

PC Looking to the future, are there any changes that you think will have a major impact on the property market?

FS I think there will be two areas of change in the UK property market that will create opportunities and challenges: the impact of the internet on the retail sector and the decline in the proportion of owner-occupied residential properties, to be replaced by growth in the private rented residential sector.

Are REITs real estate? Evidence from international sector level data

The article below is a summary of the authors' research paper 'Are REITs Real Estate? Evidence from International Sector Level Data', which has been awarded the inaugural Nick Tyrrell Research Prize. The Prize, established by industry associations INREV, IPF and the SPR to commemorate Nick Tyrrell's major contribution to the industry's thought leadership, recognises innovative and high-quality, applied research in real estate investment.

Direct real estate investments have been shown to provide significant diversification benefits in a portfolio containing stocks. However, direct real estate assets have several disadvantages such as relatively low liquidity, high transaction costs, and lumpiness. The securitised real estate market circumvents these complications but does it offer the same diversification benefits as direct commercial real estate? The aim of this research is to examine whether securitised real estate returns reflect direct real estate returns or general stock market returns.

The study also considered the effects of the interdependences between asset returns and economic fundamentals, such as economic growth, economic sentiment, short-term interest rates, term structure of interest rates, default risk premia and inflation rates.

In contrast to previous research, which has generally relied on overall real estate market indices and neglected the potential long-term dynamics, this evaluation is based on sector-level data and caters for both the short-term and long-term dynamics of the assets, as well as for the lack of leverage in the direct real estate indices.

Data

Unlike nearly all earlier research, this study uses sector-level data for the US (the FTSE/NAREIT Equity REIT indices and the NCREIF TBI indices for the direct market covering apartments, offices, industrial and retail) and the UK (office and retail, based on the company-level price, dividend and market cap data provided by EPRA for REITs and the IPD indices for direct real estate) to negate the impact of any portfolio composition effects that may mask the linkages between asset classes. The study also uses the S&P/ASX 200 A-REIT index and IPD data covering the Australian REIT and direct markets as a whole as no sector data is available. All asset indices employed in the analysis are total return indices. The availability of real estate data on a quarterly basis limited the sample periods for the US and Australia to 1994-2010 and 1991-2010 for the UK.

Since the previous literature has shown that REIT performance may be more closely linked to small cap stocks than the overall stock market, the small cap indices were also considered in the analysis.

Taking account of leverage

The direct real estate indices comprise unleveraged properties, while the REITs indices include the impact of leverage, which can affect the mean and volatility of returns. To ensure comparability, leverage was 'added' to the direct real estate data, using the following formula:

Martin Hoesli, University of Geneva and University of Aberdeen

$$r_{eit} = (r_{uit} - r_{dt}LTV_{it}) / (1-LTV_{it})$$

where r_{eit} = the levered direct real estate return of sector $\mathbf{i}$ in period $\mathbf{t}$,

r_{uit} = the unlevered direct market return,

r_{dt} = the cost of debt in period $\mathbf{t}$, and

LTV_{it} = the loan-to-value ratio of sector $\mathbf{i}$ REITs in period $\mathbf{t}$.

Elias Oikarinen, University of Turku,

In the US, the average leverage of REITs during the sample period was 48% in the apartment and office sectors, 43% in the industrial sector, and 51% in the retail sector. The leverage was quite volatile, being at the lowest around 30% in the mid 1990s and, at its highest, some 70-75% in 2009. In the UK, the leverage was less volatile and 50% on average, while in Australia it varied between 9% and 50%, being 30% on average. The cost of debt used in the computations was the corporate bond middle rate for the UK and Australia and the Moody's Baa-rated corporate bond yield for the US.

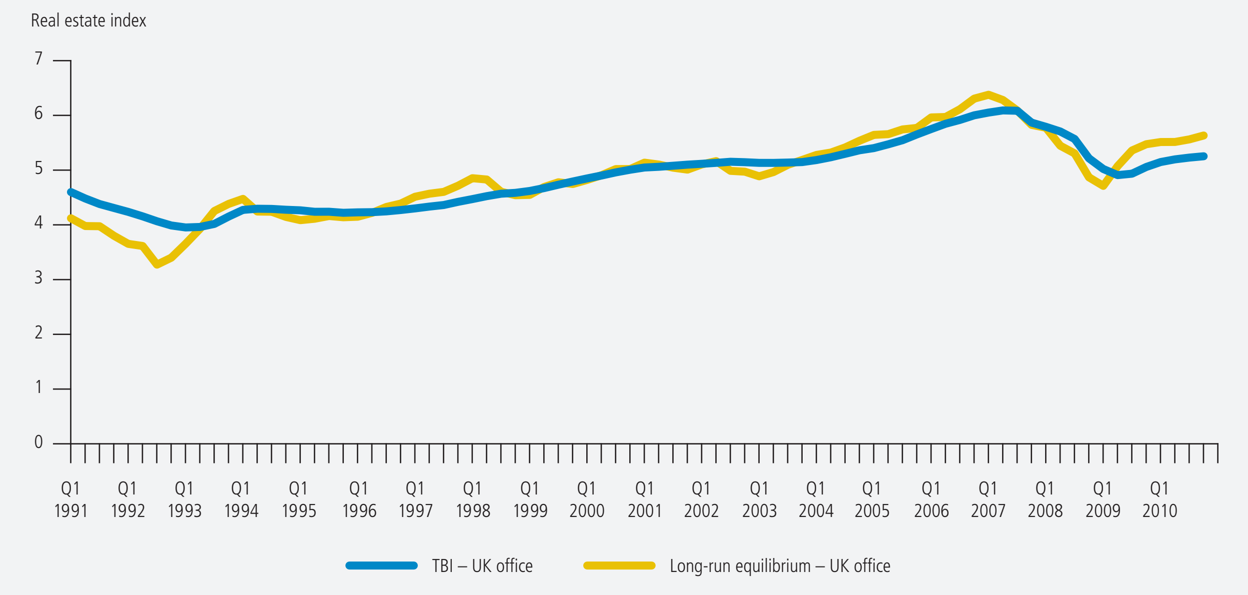
Research methodology

From earlier research undertaken by the authors and others, there are sound theoretical reasons to expect that the securitised and direct real estate markets might be cointegrated over the longer term. There may also be cointegrating relationships between the real estate and stock market return indices. Since cointegration between the variables would have important implications regarding the asset return dynamics, the research looked for the existence of such long-term relationships by employing the Johansen (1996) Trace test for cointegration. Where a stable long-run relation was not detected between the assets (this was the case only in two out of seven tests), the tests were re-run incorporating fundamentals in the cointegration analysis.

Innovation accounting

Vector error-correction models (VECMs) were estimated, using the cointegrating long-run relationships, in order to look at the dynamics of the asset returns more carefully by way of innovation accounting, based on the Choleski decomposition. If two assets are good substitutes for each other in the long horizon, their long-term reactions to shocks in various factors should be similar or, less restrictively, the relative reaction

Figure 1: Comparison of direct property indices and estimated long-run relationships (UK office)



magnitudes between the two assets should be similar regardless of the shock. So, for instance, if the change in REIT prices was twice that in direct real estate prices after any shock in the fundamentals, 50% leveraged direct real estate investments would create similar reactions to those of REITs, and REITs and direct real estate would appear to be good substitutes for one another. In contrast, if the relative reaction magnitudes notably differed between different shocks, REITs would not appear to correspond that closely to direct real estate investments.

It also follows that if the long-term accumulated responses of two markets are similar, then they are integrated in the sense that the risk premia for various factors are the same in both markets. Furthermore, if the forecast error variance decompositions show that a notable share of the long-term forecast error variance of securitised real estate returns is explained by innovations in the direct real estate market returns, and that only a small share is explained by stock market innovations, this indicates that the long-term influence of the direct real estate market on the securitised real estate market is greater than that of the general stock market. The causality can, of course, also run in the other direction.

Empirical findings

Long-term relationships

The Trace test statistics imply that cointegrating long-term relationships are present between REIT and direct real estate performance in all the markets except for the US office sector and the Australian market. The last two markets are more complicated. With respect to the US office sector, there is some evidence of long-term dynamics between the assets when the risk premia is added to the model. The inability to detect cointegration in the Australian case may be due, at least partly, to the aggregated nature of the data, i.e. lack of sector-level indices.

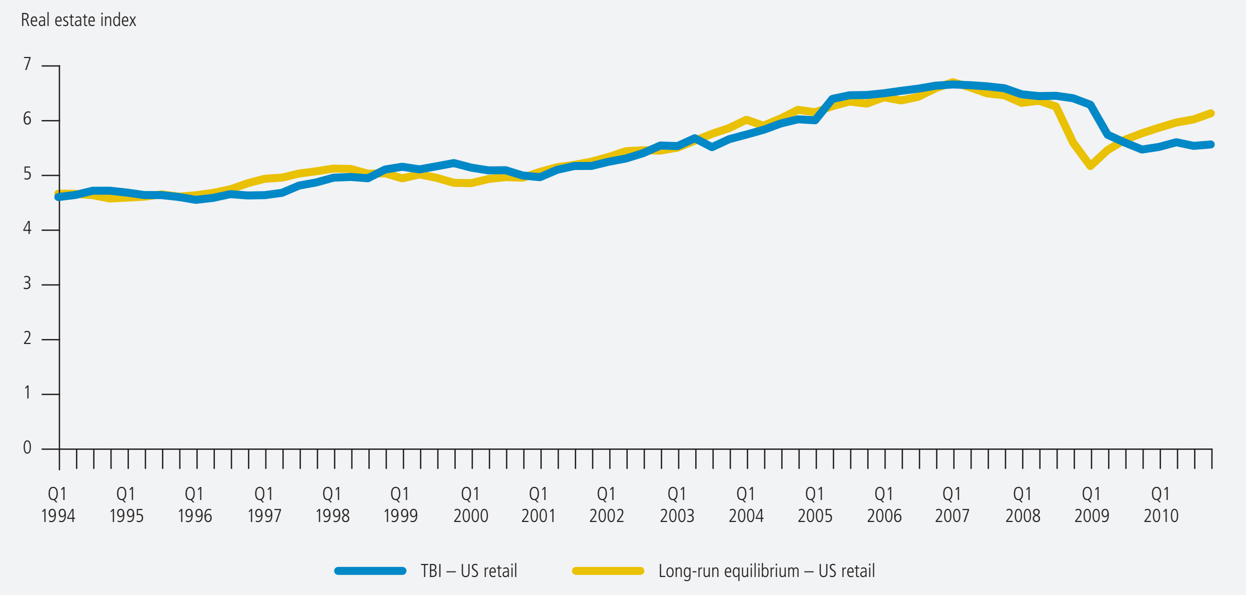
In each of the five estimated long-run relationships, all of the parameter estimates are highly statistically significant, and the estimated relationships appear generally to be stable. The indices tend to track closely the long-run equilibrium relationships. However, the apparently slow reaction of direct real estate prices to shocks in the fundamentals induced notable deviations from the long-run relationships after the outbreak of the financial crisis. Figure 1 shows the direct real estate index and estimated long-run relationship for the UK office sector and Figure 2 the same for the retail sector in the US.

Variance decompositions

The forecast error variance decompositions and impulse response functions based on separate VECMs for each of the markets and sectors were also studied. The analysis suggests that the variance decompositions converge close to the eventual long-horizon values in approximately three years. The convergence speeds vary only slightly across assets and markets.

The decompositions of the asset return indices derived from the baseline models at the 12-quarter (i.e. three-year) horizon makes it clear that direct real estate market shocks do not drive REIT market performance. Nevertheless, the linkages between the direct and securitised markets appear to be close, since a major part of the long-horizon forecast error variance of the direct real estate indices can be explained by REIT return shocks. There are no similar strong relations between shocks in the stock market and either of the real estate markets.

Figure 2: Comparison of direct property indices and estimated long-run relationships (US retail)



Impulse response analysis

The study considered the relationships between the asset market dynamics based on impulse response analysis. If securitised real estate fully reflects the underlying private real estate performance in the long run, and is thereby a close substitute for direct real estate in a long-horizon investment portfolio, it follows that the long-horizon accumulated reactions of REIT and TBI returns to various shocks should not deviate notably from one another.

Similar to the variance decompositions (above), the impulse responses converge within three to four years from the shocks. Also, not unexpectedly, in the cases where pair-wise cointegration is detected between REITs and direct real estate, the long-run accumulated responses of REITs and direct real estate closely resemble each other and the relative magnitudes of the responses are the same, regardless of the origin of the shock, even though the short-run reactions typically differ substantially.

In the Australian market and in the US office sector, where such pair-wise cointegration was not found, the relative reaction magnitudes of the assets vary substantially across different shocks. In the Australian market, it is hard to see whether REIT reactions resemble more those of stocks or direct real estate. However, in the US office case, the REIT reactions generally appear to be closer to those in the stock market than in the direct real estate market (in terms of standard deviation of the relative reaction magnitudes). This finding is not robust to the model selection (between VECM and vector autoregressive model), though.

Implications regarding the financial crisis

The outbreak of the financial crisis had a notable adverse influence on asset prices in all of the markets. In the US and the UK, the REIT market was the first to react in the early months of 2007. It is not surprising that the UK appraisal-based direct market index reacted later than REITs, but the UK stock market drop started even later than that of the IPD indices. By contrast, the US TBI drop started approximately at the same time as the stock market fall, i.e., one to two quarters later than the REIT market reaction. The decline in the TBI indices was not as steep and lasted longer than that of REITs. The patterns suggest that, especially in the UK market, real estate indices could have been used to predict the forthcoming substantial drop in stock prices.

Interestingly, the REIT and leveraged direct real estate index declines were of much greater magnitude than those of the stock market (except for the Australian direct market index, which is likely to be partly due to the appraisal-based nature of the IPD index). Therefore, it appears that the financial crisis hit the real estate sector more than the overall stock market, possibly as a result of the low market liquidity of direct real estate. Also the liquidity of REITs is typically somewhat lower than that of the overall public stock market.

With respect to portfolio allocation implications, the lesson to be learnt from the aftermath of the crisis is that an investor should not reallocate its portfolio from REITs to direct real estate after a drastic drop in REIT prices due to deteriorating market fundamentals: the direct market is likely to follow the REIT market fall, and the expected returns for REITs are therefore greater than those for direct real estate.

Conclusion

The research findings, based on sector-level REIT and direct real estate indices for the US and UK, suggest that securitised and direct real estate markets are closely linked in the long run. It appears that REIT returns are largely independent with respect to shocks in the other asset classes – neither direct real estate nor stock market shocks appear to be driving REIT market performance. However, a major part of the long-horizon forecast error variance of the direct real estate indices can be explained by REIT return shocks. This implies that 'real estate shocks' take place first in the REIT market, after which the direct market adjusts to these shocks.

The resemblance between REITs and direct real estate is substantially greater than that between REITs and the general stock market. Therefore, while the short-term co-movement between REITs and stocks is stronger typically than that between REITs and direct real estate, REITs are likely to bring a similar exposure to various risk factors as direct real estate into a long-horizon (three years or more) investment portfolio. REITs are also expected to have similar attractive diversification properties as direct real estate investments in the long horizon, at least in the US and the UK.

A copy of the full report may be downloaded from the following:

www.sciencedirect.com/science/article/pii/S0261560612001088

papers.ssrn.com/sol3/papers.cfm?abstract_id=2034377

New opportunities for REITs following the Finance Act 2012

Mark Fahy, London Stock Exchange

The UK's Finance Act 2006, which came into effect in January 2007, was the piece of legislation that set out the rules for real estate investment trusts (REITs) in the UK. The new structures were designed to allow investors a way to access the risks and rewards of holding property assets without having to buy property directly. In return, UK-REITs are required to distribute at least 90% of their taxable income, for each accounting period, into the hands of investors, where the income is treated as property rental income rather than dividends. In this way, taxation of income from property is moved from the corporate level to the investor level.

REITs enable property companies to access equity markets and to give end-investors performance related to the underlying property assets, without any tax leakage. UK-REITs therefore provide investors with wider opportunities for accessing an important alternative asset class. This also provides the opportunity for UK property companies to take advantage of the globally-recognised REIT 'brand'.

The REIT regime, combined with the traditional strengths of London's capital markets, has created opportunities for the growth of the property investment sector. The legislation that came into effect in January 2007 led a number of larger listed property groups, including five FTSE 100 members, to convert to UK-REIT status as well as a number of start-up UK-REITs being created. Five years down the line and the Finance Act 2012 has been passed with changes to the UK REIT regime. Designed to remove barriers to and increase ease of investment in REITs, there are five main ways in which it has set out to do this:

1. Abolition of the 2% conversion charge to join the regime – removing these costs should encourage more investment vehicles to change to REIT status

2. REITS can now be AIM quoted, rather than having to be listed on the Main Market – this should help smaller property investment groups to take advantage of the regime

3. A REIT now has a three-year grace period before having to comply with close company rules (close company is a company under the control of five or fewer investors) – this has been brought in to encourage larger levels of investment into residential property and to encourage private and individual investors to transfer residential property portfolios into REIT vehicles

4. A REIT will not be considered to be a close company if certain institutional investors such as pension funds, insurance providers, authorised unit trusts and open ended investment companies are holding controlling interests – this is to encourage these groups to invest more widely in UK property

5. Treating cash as a 'good' asset when it comes to assessment for the balance of business test (where 75% of a REIT's total assets must be invested in real estate) – this should help newly launched REITs, particularly as it should enable the cash raised on listing to count as a 'good' asset

In effect, this has created a wider choice of routes to market, reduced the cost of becoming a REIT and also alleviated the regulatory hurdle for businesses considering converting to REIT-status.

A Main Market listing on London Stock Exchange or a similar foreign stock exchange recognised by HMRC, has been viewed by some as a significant barrier to entry for property businesses because of the cost and regulation involved in such a listing. The new government measures to allow REITs to be AIM quoted offer significant benefits for many property investment groups.

AIM is well suited to small and growing companies from all sectors that are looking to go public. It continues to be the world's most successful growth market for small and medium enterprises (SMEs), offering a platform for companies to raise capital within a tailored and balanced regulatory framework. AIM not only offers companies good opportunities for growth at admission but also access to a unique community of investors and analysts throughout their life as a public company. The benefits, obligations and implications of a public quotation are numerous, but are well understood by an unrivalled community of advisors, each with good experience of specific sectors and geographies. This can be invaluable for an investment team looking to navigate public markets post-restructure, and AIM's system of nominated advisors (Nomads) ensures experienced professionals are at hand to support a company at all times.

AIM is a long-term destination for life as a public company for many. However, it also critically acts for some as an important step in their individual evolution as a company, acting as a gateway to the Main Market.

At London Stock Exchange, we are already seeing evidence of the impact of the changes to the Finance Bill 2012 on the REIT regime. A number of existing quoted companies have committed to conversion to REIT-status at the appropriate time. There are also a number of new REITs looking to join both AIM and the Main Market during 2013 including REITs focused on social housing, student accommodation, retail and residential. Given the increasing interest from the property sector in the 'new' REIT structure, and the demand for income from investors, this will hopefully drive further activity on both AIM and the Main Market in 2013.

A decade of fund returns

Malcolm Frodsham, Consultant

The long bull market and subsequent sharp correction in the commercial property market over the 10 years from 2001 to 2010 coincided with a dramatic growth in indirect investment vehicles. Many of the fund managers of these investment funds had to manage, firstly, substantial net in-flows at a time of a highly competitive investment market, then, subsequently, the strains of rapid disinvestment into the teeth of falling capital values.

This article is a summary of the research published as a Short Paper by the IPF Research Programme, which looks at how the use of indirect funds alters investors' delivered return from property, particularly having regard to the impact of fund costs, cash, debt and fees. The figures are constructed at a fund level so no analysis is included on the final influence of investor return: the timing of their investment into and out of funds and the prices achieved.

Pooled funds index sample

The categories of indirect vehicles analysed (using IPD figures) are outlined below. The number of sample funds in each category is shown in Figure 1.

Managed funds

Managed funds are open-ended vehicles that typically seek to give pension funds an exposure to a portfolio of direct property properties diversified across different use types and regions. These funds use no debt directly within their portfolios, although there were five funds that invested in indirect vehicles which may have injected some leverage into their overall exposure.

The GAV of managed funds grew in the sample from £2.1bn to £7.1bn.

Other balanced funds

Other balanced funds (mainly comprising property unit trusts) are typically seeking to give retail or institutional investors an exposure to a diversified portfolio of property, with a spread of properties of different types (retail, office, industrial, etc) and in different regions of the country. Debt within these funds ranged from two funds that had no leverage over the period, 11 that had utilised, on average, less than 10% debt, five funds that had averaged between 10% and 40% gearing and four that had used an average of over 40% leverage. Half of the funds in the sample invested in other indirect vehicles (which themselves may have debt or cash and carry fees) during the decade.

Most, but not all, other balanced funds are open ended.

The GAV of other balanced funds grew in the sample from £2.0bn to £8.9bn.

Specialist funds

Specialist funds typically provide investors with an exposure to property types that are difficult for investors to access due to the size of the properties or the level of specialist management skills required. These funds often use significant debt in their portfolios. Over half (18) in the sample used an average level of leverage (calculated as debt/GAV) of over 40%, eight funds had leverage of over 10%, nine had an average debt level of less than 10% and only two were completely unleveraged. In addition, 11 funds invested in other indirect vehicles, which themselves may have debt or cash and carry fees.

Most, but not all, specialist funds are closed ended.

The GAV of specialist funds grew in the sample from £1.9bn to £17.3bn.

Figure 1: Description of funds measured

	Count		Leverage?*		
	Total	Entire period	No (<10%)	Yes (>10%)	Unlisted fund holdings
Managed funds	9	6	9	0	5
Other balanced funds	22	9	13	9	11
Specialist funds	37	7	11	26	11
Total	**68**	**22**	**33**	**35**	**27**

*debt/GAV

Methodology

To quantify the impacts of each of the drivers of pooled funds performance (particularly the impacts of debt, cash, funds costs and fees), quarterly changes in NAV for each of the funds within the IPD Pooled Property Funds Index (PPFI) have been attributed to one of 12 categories, see Figure 2.

Using this breakdown of changes to fund NAVs, the evolution of fund returns can be traced from that derived from the underlying property portfolio through the impacts of other investments, cash, debt, costs and fees to the final investor return. Whilst every effort has been made to identify all the drivers of changes to NAV, it has not been possible to precisely quantify all of the data items. Therefore there is a final category for the balancing item where the change in NAV could not be fully allocated between the categories.

Figure 2: Categories of performance impacts			
Investment Portfolio	**Cash / leverage**	**Fund costs / fees**	**Bid-offer price mechanism**
Capital movements on directly-held portfolio	Interest received on cash	Fund level outgoings	Premium / discounts on net new issues
Income received from directly-held portfolio	Interest paid on debt	Annual fund level fees	
Indirect investments	Marking debt to market	Performance fees	

Direct v. indirect property returns

Over the 10 years to December 2010, the annual total return on the direct property assets in the sample funds was 7.2% per annum. The contribution of other investments, cash, debt, costs and fees reduced the return to an average fund-level return of 5.8%. The details are shown in Figure 3.

As shown in Figure 4, the different fund types experienced contrasting investment performance and also differing impacts from cash, debt and fees. Specialist funds generated by far the highest return – much of this extra performance was structural, with strong performance in the sectors in which the specialist funds concentrated, predominantly retail warehouses and high-yield industrials. The strong investment performance meant that leverage was accretive to the performance of specialist funds but not to the balanced funds.

However, fund outgoings were also highest on the specialist funds: a result that is in keeping with these funds holding stock requiring more active management than the more balanced fund types. Managed funds had the highest impact of cash but the lowest fund fees.

Impact of cash balances

Cash dilutes returns in an upswing but enhances returns in a downswing. Until the downswing began in late 2007, cash was consistently a drag on fund performance as interest earned was below the return of the real estate market. In the sharp downswing, cash offset some of the negative portfolio performance, before diluting performance once more in the sharp recovery.

Over the past 10 years, cash levels as a percentage of GAV on indirect funds have averaged 4.3%. The managed funds, which being open ended are required to keep a degree of liquidity in the fund, averaged around 10% of GAV in cash until September 2004 and after December 2008, and 6% in between these dates. Cash balances on other balanced funds averaged around

Figure 3: Impact of other investments, cash, debt, costs and fees on total returns

	Denominator	Numerator	All funds % pa
Portfolio returns	Direct portfolio value	Portfolio income + change in portfolio value	7.10
Impact of:			
Indirect, listed & derivatives investments	...plus Indirect portfolio value	...plus indirect investment returns	-0.10
Cash	...plus cash	...plus interest on cash	-0.19
Debt (including marking debt to market)	...less debt	...minus interest on debt	0.03
Fund outgoings		...minus fund costs	-0.26
Fees & performance fees		...minus fees	-0.99
Bid-offer price mechanism		...plus premia / discount on unit issues/redemptions	0.37
Other items			-0.20
Total return			**5.80**

Figure 4: Performance by fund type

	Managed funds % pa	Other balanced funds % pa	Specialist funds % pa
Portfolio returns	6.80	6.50	7.80
Impact of:			
Indirect, listed & derivatives investments	-0.09	-0.07	-0.06
Cash	-0.44	-0.19	-0.09
Debt (including marking debt to market)	0.00	-0.19	0.90
Fund outgoings	-0.17	-0.22	-0.34
Fees & performance fees	-0.49	-0.86	-1.35
Bid-offer price mechanism	0.81	0.38	0.12
Other items	-0.20	0.07	-1.85
Total return	**6.60**	**5.40**	**6.20**

4% of GAV until 2010 and then peaked at 9% in the second quarter of 2010. Most specialist funds are closed ended where cash balances are not impacted by regular investment flows and portfolio income is treated separately in the balance sheet to the NAV calculation. Cash balances on specialist funds rose significantly after June 2008, averaging 1.9% before and 4.2% afterwards. The rise in cash balances was predominantly due to a diversion of income in an effort to resolve breaches of loan-to-value covenants.

Impact of leverage

Managed funds and most other balanced funds were unleveraged, whilst two-thirds of specialist funds were leveraged, the latter at an average of 33.2%. Debt balances on other balanced funds averaged 6.7%.

In the upswing, specialist fund leverage fell to below 30% from late 2006 through 2007. Balanced funds tended to be more lowly geared prior to the upswing, only rising above an average of 9% in 2008. In the downswing, debt levels rose reaching average levels of over 40% in 2009 on specialist funds and over 10% on balanced funds.

Deleveraging by balanced funds reduced average debt levels to below 5% by the end of 2010, the lowest level since 2002. However, the deleveraging came too late to save them from the ravages of the downswing but too early to benefit from the subsequent upswing – leverage has clearly proved tricky for indirect funds to get right.

Specialist funds still had leverage of 35% at the end of the 2010. It is possible that part of the reason for this is the cost of breaking swap contracts put in place to protect them from rising interest rates (these contracts ironically created a problem when interest rates fell).

The overall impact of the 'sound and fury' of leverage through the cycle was a tiny increase in overall fund returns. Specialist funds benefitted to the tune of 90bps whilst other balanced funds lost 19bps.

Impact of fund outgoings and fees

Calculating actual fees paid within funds is complicated, particularly as different charges can be applied to different investors. Fees can also be payable on undrawn capital which we were unable to add to our calculations.

Performance fees can be also be difficult to estimate, with complex calculations and accrual provisions so that, in some instances, total fees will not be known until the fund is wound up.

The ultimate fee paid by investors and received by the operator may also depend on other fee arrangements. For example, the manager may deduct the fees payable on the unlisted funds from the fees payable on the direct property mandate.

With all these caveats, the research found that fund fees reduced average fund performance by 1% per annum, as shown in Figure 5.

Figure 5: Impact of fund outgoings and fees

	Managed funds % pa	Other balanced funds % pa	Specialist funds % pa	All funds % pa
Fund return excluding fees	6.1	5.8	8.2	6.6
Impact of fund outgoings	-0.17	-0.22	-0.34	-0.26
Impact of fees	-0.49	-0.81	-0.74	-0.70
Impact of performance fees	-0.00	-0.05	-0.61	-0.28
Plus fees & performance fees	5.6	5.0	6.9	5.6

Conclusion

Pooled funds are at a crossroads, some have argued that they are in managed retreat. The growth in these funds was dramatic over the previous decade. This growth was driven by both push and pull factors. Fund sponsors often created pooled funds as a means of providing liquidity to manage the reduction in the sizes of their life funds, whilst maintaining exposure to their prized large assets. Other investors were keen to gain exposure to these assets and multi-managers required product to give access to both return and the diversification benefits of an exposure to commercial property to their investors.

In some funds, the investor base is now fracturing with no consensus as to the future of funds. Some investors, such as sovereign wealth funds and European pension funds have increased in size and are now seeking to either go it alone or invest more through joint ventures rather than pooled funds. Many large life funds have had time to adjust their portfolio structures as they are run down in size – and indeed Solvency II may accelerate such planned reductions in direct property investment – and so the pooled fund has achieved one of its functions.

Investors understand that there are costs in running property funds. Fees should be fair and appropriate to the work involved and the performance delivery achieved so as to align the interests of investor and fund manager. Suitable benchmarks are available to compare investment performance and performance fees can be constructed that share out-performance between fund manager and investors fairly. With more transparency on these costs, it is likely that these funds will attract investor cash in future.

Potential changes to the inflation calculation methodology: Implications for property

Simon Kinnie, Standard Life Investments

The Office for National Statistics (ONS) are investigating changing the inflation statistics that it reports on the UK economy with a view to more accurately reporting changes in the overall level of price movements.

Although the Retail Prices Index (RPI) has been the main measure of inflation in the UK for many years it is now under scrutiny by the authorities as a result of its calculation methodology. There are major differences between RPI and the Consumer Prices Index (CPI), partly through composition but also, significantly, through the method of calculation. The Consumer Prices Advisory Committee (CPAC) has launched a consultation over whether to make meaningful changes to the calculation methodology.

What are the proposed changes?

One key criticism of the CPI measure of inflation, the Government's preferred measure of inflation from 2003, is that, unlike the RPI, it does not take into account housing costs. These are generally significant for consumers and account for about 10% of household expenditure. This accounts in part for the divergence between CPI and RPI (see Figure 1), with much of the remainder being as a result of the CPI measure using the geometric mean for calculating price changes, whilst the RPI measure uses the arithmetic mean.

The ONS proposes the inclusion of housing rental costs (as a proxy for the costs of home ownership) in CPI. The new measure would be called CPIH and the intention would be that this becomes the main focus of reporting, over time replacing CPI and RPI. Modelling carried out by the ONS, based on backcasting the amended data, shows that CPIH would have been lower broadly than CPI from January 2009.

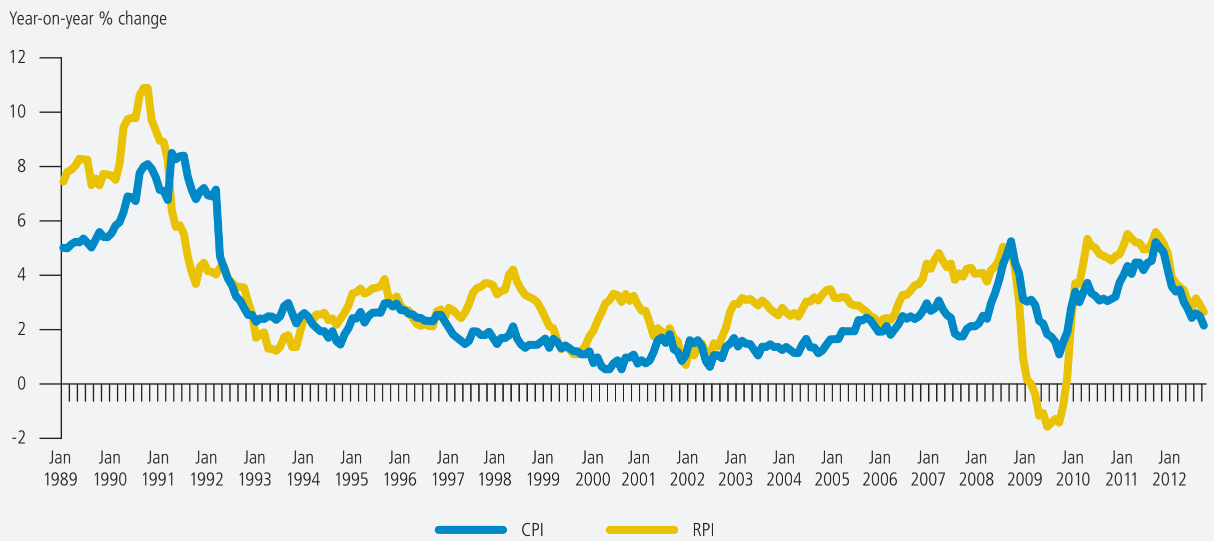
Technical background to the changes

The underlying calculation methodologies used for RPI and CPI differ significantly. There are two broad ways to calculate indices (though many variations of each exist): using arithmetic or geometric means. Avoiding overly statistical explanations, the principal difference is that geometric means 'normalise' the numeric ranges for component values within an index, and are universally regarded as the preferred method of calculation.

Arithmetic means often risk giving undue weight to high value numeric ranges. For this reason the great majority of modern indices adopt the geometric approach. The debate is not new; American economist Irving Fisher considered this in 1922, and ranked the Carli method, used for much of the RPI's calculations, as 121st out of 120 methods of index calculation. Notably though, he ranked the Dutot method, which is one of the options proposed for wider use by CPAC, as 120th, barely above Carli. However, the implications are important.

As the RPI is a relatively old index (established in 1947), most of its composition (circa 70%) is based on arithmetic means. Under discussion is a range of proposals that a number of RPI components, notably clothing and footwear, be re-calculated going forward using 'better' methodology. This will reduce the so-called 'formula effect' between RPI and CPI, which is broadly,

Figure 1: Comparison of CPI and RPI



Source: Office for National Statistics

the difference in the two inflation rates. Statistically, the use of geometric rather than arithmetic means will almost always result in a lower value. Critically, while such a decision would be intellectually robust, its impact would be to lower the overall RPI reading and, for investors, lower the nominal return earned on RPI-linked bonds and other inflation linked instruments such as RPI-linked leases.

Why is this change important for real estate?

An increasingly large number of leases have been written referencing the movement in some measure of inflation (predominantly RPI) as a cap and collar on future rental increases. In addition, several funds have been launched recently that consist predominantly of assets with these kinds of leases. These funds include the Standard Life Investments Long Lease Fund; the M&G Secured Property Income Fund; the Legal & General Limited Price Inflation Income Property Fund and the Pramerica UK Real Income Fund. Risk averse investors also place a premium on the kind of assets these funds hold because of the modest inflation link that they afford and will have factored in an estimate of what future inflation may be.

If there is a fundamental change to the reference rate or calculation methodology that means the inflation reference rate will be lower than expected then the premium that investors place on assets with these types of leases could adjust downwards accordingly. Any potential unexpected downward movement in the inflation rate will therefore cause investors to reassess the value they place on these types of assets, which may impact detrimentally the end investors in the funds. Any change to the basis of calculation for RPI may modestly impact the nominal return on these investments. Depending on the magnitude of changes made, analysis suggests RPI may be reduced by 80 basis points per year as a result. RPI has generally been used as the reference measure of inflation for real estate (and also for the index linked gilts market) because historically the CPI measure did not exist when these types of leases initially came into being.

What is the likely outcome of the ONS proposals?

This potential change remains at the consultative stage and there is likely to be significant opposition from parties that want the status quo to remain in place. In addition to the inflation-linked real estate leases, other investments where returns are linked to RPI will be adversely affected. These include the UK index-linked gilts market (sizeable at £347bn), public finance initiative (PFI) structures and infrastructure funds. Utility prices such as water are also priced on an RPI-linked structure. Furthermore, a large number of private sector pension payments are determined by movements in RPI, despite a move to CPI in other areas.

Underlying this is also questions of trust, etc. regarding, ultimately, the Government changing the inflation goal posts.

The Statistics Authority will make its firm proposals following the closing of the formal consultation at the end of November. The Bank of England will determine whether the changes are deemed both fundamental and materially detrimental, and only if the answer to both of these is "yes" will it pass to the Chancellor for a final decision. If not, the variant of the changes chosen by the Statistics Authority is likely to be made.

So, what impact is this proposed change likely to have? There is nothing concrete at the moment. and although the ONS is keen to keep pushing for further change, the changes may be resisted by a significant majority of investors, due to the potentially adverse impact on index-linked gilt holders and also real estate investors. Pensioners are also likely to be adversely affected by this change if their pension increases are linked to RPI.

For real estate at present, there is not likely to be an immediate impact but it is something to monitor closely because of the potentially adverse and far-reaching effects any changes may have.

Corporate social responsibility – proving the value

Simon Taylor, 4Front Consulting

In these current difficult economic times proving value for any business strategy is tough. Corporate social responsibility (CSR), as with any strategy, has to earn its place and demonstrate that it can deliver real value. Whilst most people accept that there are certainly intangible benefits to implementing CSR strategies, the issue holding many businesses back is the lack of evidence of tangible, measurable value. Additionally, there is often an argument that real value can only be generated over the longer term while, in the current market, most businesses are focusing on the short to medium term.

To determine whether, and how, CSR might add real value to business, 4Front Consulting interviewed three leading players in the property industry (Land Securities, Legal & General Property and Knight Frank), all of whom view CSR as core to their respective business strategy. As a result of this research, 4Front put together a series of case studies, outlined below, demonstrating the measurable benefits that have been generated through CSR practices.

The case studies are arranged under the following headers, representing the key CSR issues for the property industry:

- The environment and sustainability;
- Community and local government engagement;
- People (staff engagement and retention); and
- Winning new business through superior CSR practices.

The environment and sustainability

At a basic level of environmental measures, it is generally accepted that short-term value benefits can be generated through the reduction in energy, water and waste consumption. With forecast increases in the prices of these core resources (as well as the constant threat of further environmental legislation), the financial savings that can result will only increase over time.

Figure 1: Land Securities' carbon offset programme

	Cost £	Estimated annual utilities cost savings £	Lifetime savings, tonnes CO_2 £
2010-11	134,000	36,000	19,000
2009-10	60,000	50,000	9,000
2008-09	152,000	107,000	5,000
TOTAL	**346,000**	**193,000**	**33,000**

Estimated lifetime cost savings £1,578,000

Source: Land Securities

Land Securities has already delivered on bold targets set around the environmental credentials of its portfolio of new and existing buildings, the latter being far more challenging in terms of making them sustainable in a cost effective manner that will enhance value. Land Securities' commitment to reduce CO_2 emissions by 15% by 2020 is expected to generate savings of £3m a year (based on today's prices).

The company also developed its own carbon offset programme. Originally, the programme was essentially a carbon offset fund for the energy used in the common parts of shopping centres. The money was used to buy carbon credits to enable the centre to be described as 'carbon neutral'. In 2008, the decision was made to redirect these monies into real-life initiatives in the centres to reduce energy and water use. Centre teams were encouraged to put forward projects such as rainwater harvesting and low-energy lighting; those with a good business case received the funding. Figure 1 summarises the costs and estimated annual savings to date. Approximately £350,000 has been spent on these locally-generated initiatives. They have already seen savings of £200,000 and estimate total savings will be over £1.5m, assuming a reasonable lifetime for the improvements made.

Other practical initiatives include the commitment to increase the amount of waste diverted from landfill from 70% to 90% (by 2015), which the company estimates will generate savings of around £600,000 a year.

Implementing measures to reduce the service charge is a relatively 'easy win' for all owners of multi-let properties. Particularly in the current market where there continues to be downward pressure on rents, creating savings in a tenants total rental cost can only enhance the building's rental appeal.

Between 2008-09 and 2009-10, Legal & General Property implemented a strategy to review and enhance energy efficiency at its Midsummer Place Shopping Centre in Milton Keynes. This incorporated many 'common sense' items such as:

- Mall lighting to be switched off one hour after centre close down
- Boulevard lighting to be reduced to 25% one hour after close down
- Car park lighting to be switched off after close down and only switched on when being cleaned and patrolled
- Car park security checks to be undertaken at same time as cleaning, one level at a time
- Building management system (BMS) to be re-programmed and upgraded
- Night cleaning regime changed to early morning to avoid unnecessary lighting of the building

- Delay the start time of escalators
- Liaise with staff to remind them to switch lights off in areas not being used

As shown in Figure 2, the financial impact of these measures was emphatic.

Figure 2: Impact of energy efficiency measures at Midsummer Place Shopping Centre

Category	2008-09 cost £	2009-10 cost £	Savings £
Electricity	220,000	147,000	73,000
Gas	143,000	75,000	68,000
Cleaning	480,000	395,000	85,000
Total savings			**226,000**

Source: Legal & General Property

Legal & General Property has also demonstrated that environmental efficiency savings can be generated in office buildings. 50 Pall Mall was one of its most energy-demanding buildings and so, when the opportunity for a partial refurbishment arose in 2008, Legal & General saw an opportunity to improve efficiency by addressing issues such as:

- Reconfiguring the reception and fitting new double doors to improve light and heat retention;
- Introducing light sensors in certain zones;
- Replacing the boilers with 30% more efficient ones; and
- Installing more energy-efficient lamps

The reductions in energy use ranged from a 20% fall in electricity consumption in the common parts to a fall of 54% in gas consumption. While some of these savings were fairly small in money terms, they start to offer significant financial benefits when extrapolated across an entire portfolio, particularly against a future landscape of rapidly increasing energy prices. When passed through to the service charge, these savings also benefit the company in terms of creating buildings with competitive advantage in terms of attracting tenants.

The impact of Energy Performance Certificates (EPCs)

The arrival of EPCs, despite some valid criticism, has brought in a simple and effective tool that is understood by all. With the recent Energy Act making it unlawful to let any building below an E rating after April 2018, this has created a necessary focus on enhancing the rating of any building that falls below that threshold. It also raises the very real threat that these buildings will not only drop in value but could become obsolete.

Legal & General Property took back possession recently of an office building in Fleet. Built in the 1990s, its original EPC rating was an E. The fund instigated a complete upgrade programme focused around improving the energy efficiency of the building. This was funded largely through the dilapidations and the break penalty monies received. As a result of the work carried out the EPC rating is now a C, and the future value should be protected.

With a similar objective in mind, Land Securities has set itself a target to ensure that all buildings available to lease have an EPC rating of E or better by March 2017, one year earlier than the Government requirement.

Property valuation

The industry is still waiting to see what measurable impact the sustainability credentials of properties impact has on their rental and capital values. According to Rupert Johnson, Head of Valuations at Knight Frank, "Whilst there is currently no market evidence of a 'green premium', there is certainly a fair amount of discussion about the 'brown discount'. A few years ago, we would not have raised a question on this subject. Now, as a matter of course, we always collate relevant information on environmental performance of a building (where it is available), and we are monitoring the subject very closely."

Community and local government engagement

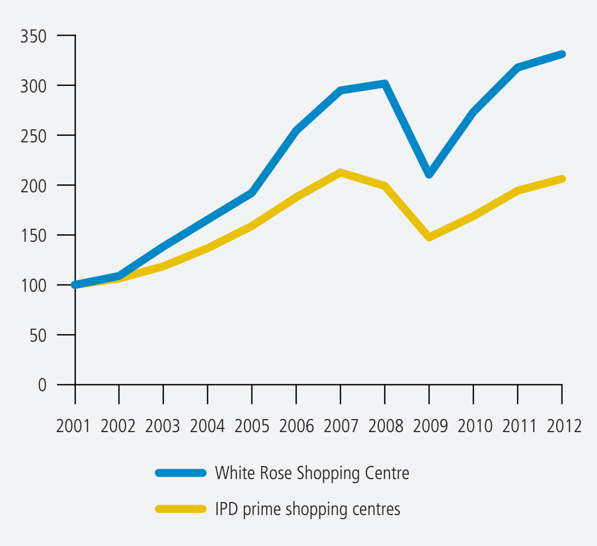
Community engagement strategies are one of the hardest areas of CSR in which to quantify a real and tangible value, although it is an area that has one of the biggest influences on a property company or fund's success and performance. Most responsible developers and land owners have long recognised that it is much easier to do business with an organisation where you have a strong and trusting relationship. Common sense says this applies to any business relationship and local government and communities are no different.

One example of effective community engagement has been at the White Rose Shopping Centre in Leeds, which was developed by Land Securities in 1994. Initially, this was opposed by the local community, who had not wanted another shopping centre, but Land Securities has worked extremely hard to engage with the local authority and the relevant community stakeholders. As a result, the company has implemented strategies targeted at adding value to the local economy.

While it is not possible to separate fully the impact of the specific community engagement strategies from the rest of the asset management programme on the Centre, Figure 3 shows that Land Securities' 'holistic' approach has led to the Centre outperforming the IPD index quite substantially.

Another example of the benefits of investing in positive stakeholder interactions is in Westminster, where Land Securities is a major land owner. In such an important location for Land

Figure 3: Comparative performance of the White Rose Shopping Centre



Shopping Centre Source: Land Securities

Securities, creating a strong and trusting working relationship with the council is vital. Land Securities engaged proactively with Westminster Council, with a view to identifying the 'big' issues on the Council's social agenda (primarily housing, homelessness, employment and education) and looking to see whether there were opportunities to team up to work towards tackling these issues. The result was the launch of the Westminster Fund; an endowment fund to which Land Securities provided the initial funding, and continues to contribute annually, and are now working to raise additional funding from other organisations. This money is be used to benefit a range of those identified local social issues, enabling Land Securities to make a positive social contribution itself, whilst assisting the Council in achieving its own objectives – effectively aligning the interests of both organisations and strengthening their working relationship. More recently, their London-wide Employment Strategy has further enhanced this relationship.

A company such as Land Securities has sought to embed this approach to enhancing its community and local government relationships into one of the core values of the business. As Robert Noel, Chief Executive of Land Securities says, "Being a responsible business is not just a nice thing to do, but a necessity as it makes complete commercial sense. Local people recognise efforts to engage with, and give back to, the communities in which we operate. In turn they will support us in our commercial endeavour as they see it will bring more benefits".

People

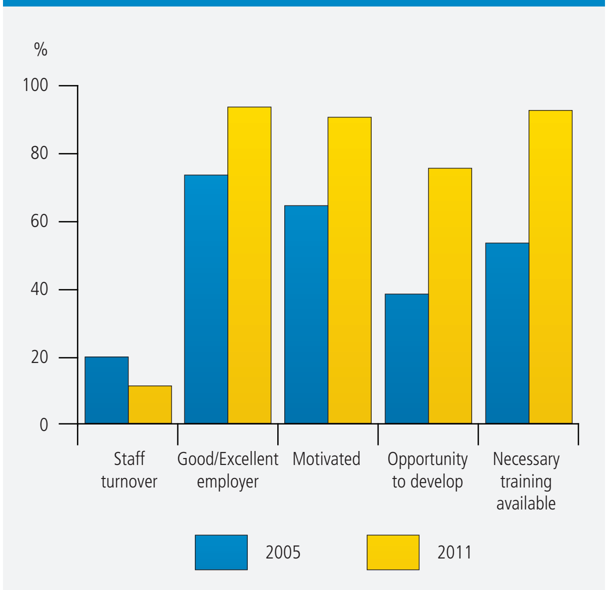
For the large advisory firms, their staff are their most important asset and, consequently, the way they engage, motivate and ensure retention of their employees is vital to the future success and value of their business.

Most people want more out of work than just earning their salary; according to the Guardian's 'Grad Facts': 73% of final-year university students stated they would have to feel happy with a prospective employer's ethical record to work for them. The challenge is how to demonstrate a tangible value to the business from CSR and employee engagement strategies. Intuitively it seems common sense that the more motivated, engaged and 'happy' the workforce are the more productive they will be. The 'flipside' of this is that the costs of, and time spent on, recruitment are typically high, so retaining and motivating employees is therefore essential to maximising value.

Key metrics for measuring the value of employee engagement strategies include staff turnover and staff satisfaction levels. Knight Frank has recognised this and, following his appointment as Senior Partner in 2004, Nick Thomlinson has focused on making the firm "an even better employer" by giving its staff the opportunity to develop both in terms of their career, through the necessary training and development and career opportunities, and responsibility through the firm's environmental community and charity programmes.

The value benefits are clearly demonstrated by comparing the staff engagement score measures from 2005 to 2011, as shown in Figure 4. Knight Frank's staff turnover figures are now down

Figure 4: Knight Frank staff turnover and satisfaction levels



Source: Knight Frank

to 10% and therefore compare very favourably to the accepted industry average of around 15%, and the various scoring measures largely around the 90% level are very high by most industry standards. Knight Frank estimates that this is creating savings of up to £500,000 a year.

It is also telling that these values and strategies have been driven and inspired from the 'top' of the business. Companies that simply make statements about valuing their employees but where the leadership team do not 'practise what they preach' are usually found out in the end.

Winning new business

As CSR becomes the norm for all major businesses so these organisations are starting to impose their CSR values and principles down their supply chains. Their suppliers now have to ensure that their own CSR values are aligned. Those advisers and suppliers that can comply and show leadership on CSR will win business.

Ignoring this new reality means businesses will start to lose clients and fail to get onto tender lists. To date, many companies have been able to get away with simply 'ticking boxes' when it comes to questions regarding their CSR principles and activities. The mood is changing however. One major firm of lawyers recently confirmed that it had its CSR responses audited by a potential client as part of a business pitch to check that it was actually delivering on all of the things it claimed to be; this amounted to a full two-day inspection and review. The beneficial outcome for the law firm was that the client was sufficiently impressed with their practises that the two organisations are now sharing CSR programmes.

Legal & General Property, which uses a large range of advisors, is very clear on this issue – the 'box tickers' will start to lose out. Bill Hughes, Managing Director of Legal & General Property, speaking at the recent Better Buildings Partnership Conference said, "Whenever we re-tender contracts for any sort of service provision to Legal & General Property, we look for excellence in a range of areas, including a full understanding of sustainability and associated implications. Organisations without an appropriate level of knowledge in this area will simply not win business with us".

Conversely, Legal & General Property's own CSR credentials were a vital part in securing the successful closure of its UK Property Income Fund (UK PIF) last year – raising £300m from 14 major international institutional investors. One particular investor spent considerable due diligence time on the sustainability credentials of Legal & General Property, and even added some wording to the investment management agreement to reflect this stance.

Conclusion

The property industry needs to take CSR issues seriously. We are all affected by 'short termism' in every aspect of our lives, and this inevitably drives investment and financial decisions. The case studies above show that there are now short-term tangible benefits from CSR that have enhanced the 'bottom' line already. The tools are now in place and businesses such as Land Securities, Legal & General Property and Knight Frank, amongst others, are showing leadership and are firm in their vision for where they want their business to be. Where the leaders go, others eventually have to follow.

Occupier Satisfaction Survey 2012

Stuart Morley, consultant to GVA

The sixth Property Industry Alliance (PIA) Occupier Satisfaction Survey was released on 21 November. The survey collected the views of a wide range of occupiers about their relationships with landlords over the past 12 months. The questionnaire was based on the Code for Leasing Business Premises in England & Wales, 2007, as it was last year and the year before, and the survey will hopefully continue to be a useful tool for the industry, helping to identify key areas for improvement and good practice where it is happening.

There were 182 usable responses representing the views of well over 500 companies, covering 26,000 properties across the three main property sectors. Some respondents were, therefore, giving average views covering a number of different landlords and properties.

A steering group from the PIA devised the questionnaire and was responsible for emailing it to occupiers, with help from Capita, DTZ, GVA, JLL, Knight Frank, Savills and Tenant Assistance Programme. Results were collated, analysed and presented by GVA, a member of the steering group.

Headline findings

An average weighted score of 5.1 out of 10 for occupiers' overall satisfaction with their landlords (where 1 is extremely dissatisfied and 10 is extremely satisfied) suggests that, on the whole, commercial occupiers feel that UK landlords provide a fair level of service, but with room for improvement. This score is slightly worse than last year's score of 5.4, but better than 2010's score of 4.9.

Occupiers from the industrial and retail sectors are less satisfied than those from the office sector. The retail sector's level of satisfaction with landlords is weaker than in 2011 and 2010, and retail is marginally the weakest commercial sector this year, perhaps reflecting the economic battering the retail sector is experiencing.

Smaller occupiers (small and medium enterprises [SMEs] with 250 employees or fewer) are, overall, much less content with their landlords than larger occupiers, although this is not true for all issues. The overall gap is wider than it was last year but much the same as it was in 2010.

Although the overall weighted average score is 5.1 the responses were not distributed evenly. Overall, 21% of occupiers were very dissatisfied (with scores of 1-3 out of 10). For SMEs the figure was over 40%, but only 10% for larger occupiers. 12% gave scores of 8-10 (with similar scores for SMEs and larger occupiers), indicating a high level of satisfaction. Two thirds of respondents, on average, gave scores of 4-7, but there was a large disparity between smaller and larger occupiers. 80% of larger occupiers, but fewer than 40% of smaller occupiers, gave scores of 4-7.

Main issues

As Figure 1 shows, in general, occupiers are displaying similar levels of satisfaction with their landlords on many issues, but on a few issues there are high or low scores. On average, there has been a small decline in scores this year from 2011. This may reflect the fact that occupiers gave a below average score of 4.4 out of 10 when asked to assess their landlords' understanding of their business needs, compared to a score of 5.1 for their overall satisfaction with their landlords. The scores from SMEs were 4.1 and 4.4 respectively, compared to 4.6 and 5.5 respectively for larger occupiers. In a weak economy the relatively low understanding by landlords of their tenants' business needs is clearly a cause for concern for occupiers.

Figure 1: Summary of the survey results

All occupiers' satisfaction with…	Weighted average score (all sizes of company & sectors)		
	2012	2011	2010
Overall relationship with landlord	**5.1**	**5.4**	**4.9**
Leasing process	6.1	6.2	5.5
Rent review process	5.3	5.1	5.4
Communication with landlord	5.0	5.3	4.7
Negotiating dilapidations	4.4	5.2	4.6
Service charge arrangements	4.7	4.3	4.2
Application for consent process	4.7	5.3	4.0
Interaction on environmental issues	3.8	4.0	3.5
Importance of sustainability issues	6.5	6.5	7.1

Service charge arrangements have seen the greatest continuous improvement in satisfaction levels over the last three years, with a score of 4.2 in 2010 increasing to 4.7 in 2012. Despite this improvement, nearly half (47%) of all occupiers reported a score between 1 and 4 when asked about the value for money they receive for their service charges, and the average score was a relatively low 4.6. Larger occupiers and SMEs gave similar scores.

The leasing process yielded one of the highest satisfaction scores from occupiers, with an average of 6.1, a large improvement on the 2010 figure of 5.5. Yet there was a marked difference between the scores given by retail and office occupiers (6.4 and 6.2 respectively) compared with industrial occupiers who scored 5.2. However, SMEs and larger occupiers gave almost identical scores. The rent review process was given a lower, but still above average, score of 5.3, with larger occupiers (scoring 5.5) more satisfied than smaller occupiers (scoring 4.7).

Respondents appeared reasonably well satisfied with the length of their leases, giving an average score of 6.9 out of 10 (the highest score in the survey), with retail occupiers the most satisfied and industrial occupiers the least. SMEs were less satisfied than larger occupiers.

Occupiers were most dissatisfied with their landlords' interaction on environmental issues, as in previous surveys. Overall, this area scored 3.8 out of 10. Whilst retail and office occupiers both gave a score of 3.9, industrial tenants gave a lower score of 3.3 but this is an improvement on the 2011 figure of 2.6. SMEs and larger occupiers gave almost identically low scores.

In contrast to the low score occupiers gave their landlords on sustainability issues, these remain important to occupiers (an average score of 6.5). Larger companies placed greater importance on them, with a score of 7.0, compared to SMEs' score of 5.7.

The only area which scored lower results in 2012 than in 2011 and 2010 was the negotiation of dilapidations. Although this improved in 2011, (from 4.6 in 2010 to 5.2), occupiers in the 2012 survey gave a score of 4.4 out of 10. Of these, SMEs gave a very low score of 2.6, compared with large companies who gave a score of 5.1. Office occupiers were noticeably more positive than industrial occupiers.

Conclusions

The results for this year's survey are similar to the results last year and the year before. Occupiers' overall relationship with their landlords scored 5.1 this year, slightly lower than the score of 5.4 last year, but slightly higher than the score of 4.9 the year before. This consistency is, perhaps, not surprising over a relatively short space of time. It would be a little odd if there had been a dramatic improvement or worsening in the space of just two years.

The fact that the economic situation has not improved over these two years gives further grounds of support for the results being similar this year to previous years. With such a weak economy a key issue is that the score for landlords' understanding of occupiers' business needs is a relatively low 4.4, well below occupiers' overall satisfaction score for landlords of 5.1. Hopefully, as the economic climate slowly improves over the next few years, occupiers' business needs will change and landlords will gain a better understanding of them, thus improving the overall the landlord and tenant relationship.

Assessing the accuracy of UK commercial property forecasts

George Matysiak, Henley Business School, University of Reading

George Matysiak, Dimitrios Papastamos and Simon Stevenson of Henley Business School, University of Reading have updated the research, published by the IPF Research Programme in 2006[1], into the accuracy of property forecasts that are provided to the IPF UK Consensus Forecast. While the earlier report covered the period 1999–2004, this update extends the period of analysis to 2011.

The new study adopts broadly the same methodological framework as used in the previous work, in order to facilitate comparison, and provides some additional analysis, particularly forecast accuracy on two-year-ahead forecasts. The earlier analysis found there was strong evidence of consensus amongst forecasters. It is therefore of particular interest as to whether this degree of agreement was maintained during the far more volatile market conditions observed after 2004.

Data

The data used in this report consists of forecasts for rental growth, capital growth and total returns for the UK commercial property sector. The data, provided by the IPF, is quarterly in nature, with up to two-year out forecast horizons, covering the period 1999-2011. In total, 69 forecasters are included in the dataset, comprising 22 property advisors, 26 fund managers and 21 property equity brokers. However, continuous data for all 69 firms is not available from each firm in every period and for each of the forecast variables. Therefore, the samples adopted in the report can vary considerably from period-to-period. For example, for one-year ahead rental forecasts the number of forecasts in any individual year ranges from 18 to 29. In particular, it should be noted that the sample for equity brokers is particularly small, especially towards the end of the sample period. Whilst brokerage firms total 21, the sample size in any one year ranges from seven to one.

For the quarterly IPF UK Consensus Forecast, contributors are asked to provide forecasts of rental growth, capital growth and total returns in respect of seven 'sectors' and for All Property. The forecasts include the current year, two years out and an average figure over the next five years. The benchmark reference in each case is the respective IPD annual index. In this study, both the one- and the two-year-ahead forecasts for All Property were considered. This expands upon the analysis in the McAllister et al. (2008) study, which looked at the accuracy of one-year-ahead forecasts.

The descriptive analysis was conducted on the entire sample (i.e. 69 forecasters). However, for the regression analyses that were undertaken only 30 out of 69 forecasters were used. The criterion employed was that firms should provide a minimum of four forecasts over the entire 12-year sample period. As a consequence, the sample was constrained to 14 property advisors, 13 fund managers and 3 equity brokers.

Methodology

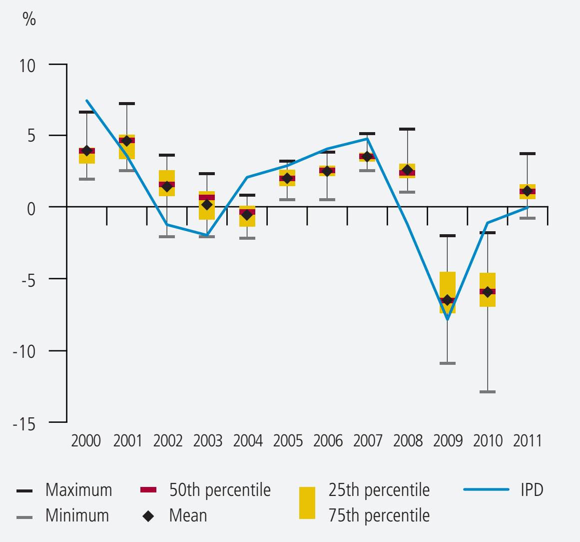
The researchers used a Theil's U2 statistic to assess the relative performance of the actual forecasts compared with two alternative naïve forecasts: forecast 1 assumes no change in the previous year's value, at the time the forecast was made; and forecast 2 was based on the long-term average of the respective IPD values, up to the point at which the forecast was made. For example, for forecasts made in 2002, the long-term average growth rates of the appropriate IPD index up to and including 2001 were used. This approach avoids the potential bias that subsequent data is incorporated into the average figures utilised. As the naïve forecasts are used as the respective divisors, a Theil U2 in excess of one implies underperformance of the consensus, whilst a statistic less than one indicates outperformance of the consensus.

The study also sought to evaluate the forecasting accuracy of the different categories of forecasters (i.e. property advisors, equity brokers and fund managers) by applying the Diebold & Mariano (1995) test.

Initial analysis

Figures 1-3 show the extent to which there was disagreement between individual forecasters in each November prior to the indicated year by showing the range between the minimum and the maximum forecasts, the mean and median forecasts for each period. The box surrounding the mean denotes the interquartile range from the 25th to 75th percentile. The actual outcome (IPD index) is also shown.

Figure 1: Distribution of rental growth one-year ahead forecasts



1 Analysing UK Real Estate Market Forecast Disagreement', McAllister, Newell and Matysiak (2006)

Figure 2: Distribution of capital growth one-year ahead forecasts

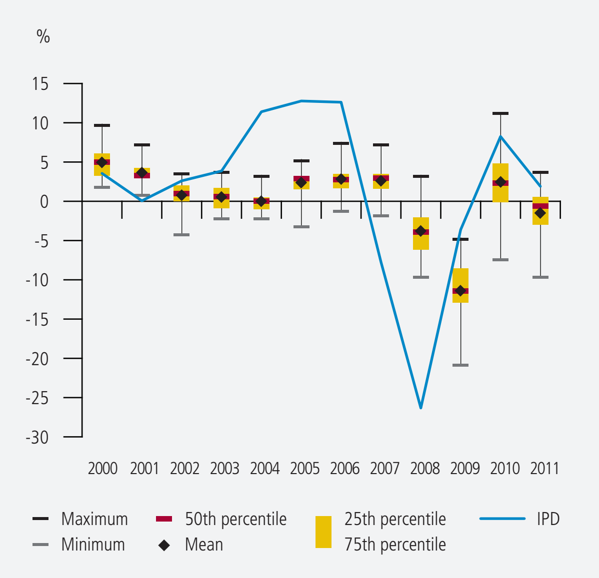
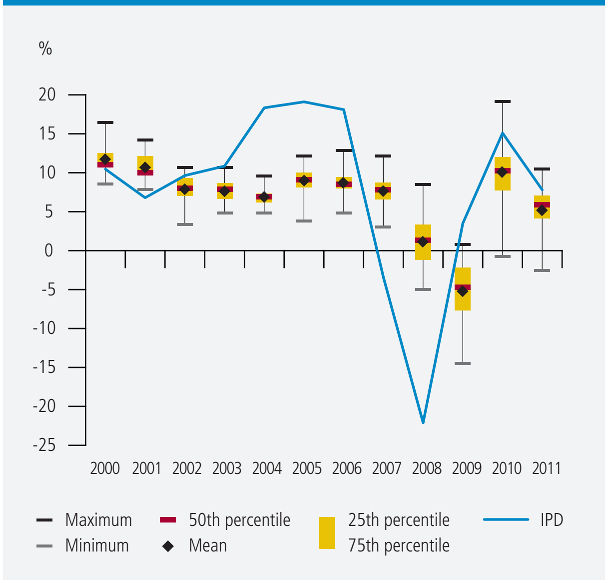


Figure 3: Distribution total returns one-year ahead forecasts



As can be seen from Figures 1-3, broadly, rental growth forecasts more closely track the rental growth outcome than do either the capital value growth or total return forecasts for each of these. To some degree, this is not particularly surprising, given the strength in capital value growth predominantly driven by the downward movement in yields in the latter half of 2006 and the first half of 2007. This period of 'yield compression' saw the IPD Monthly All Property initial yield series reach a low of 4.6% in both December 2006 and in the summer of 2007. Initial yields had 'compressed' from over 7.0% in 2002. In contrast, rental growth during this period had been generally quite sluggish.

Furthermore, if one considers the monthly IPD series, it will be seen that, whereas capital values increased by 49.0% from December 2002 to August 2007, the corresponding increase in the All Property rental value index was only 9.3%. The importance of increased funds entering the UK market during this period is well known and established. However, it is often forgotten that the non-linear nature of the relationship between yield and present value means that as the yields come down to low levels, the percentage increase in capital values accelerates. The non-linear characteristic also works in reverse; when yields rose from very low levels in 2007 and 2008, the extent of the falls in capital values and, therefore, total returns, was extremely high.

The research found distinct patterns in the forecasts of capital value growth. In the 2004 to 2006 period, capital values rose by more than the highest individual forecast provided. This is true for both one- and two-year-ahead forecasts. By contrast, as capital values fell following the market reversal, capital value growth fell by more than the most pessimistic forecaster anticipated for both 2007 and 2008. Therefore, it would appear that some behavioural aspects do come to the fore, in that forecasts tended to provide more conservative forecasts in the case of capital, and therefore, total returns during the extremes of the last cycle.

Level of forecasting accuracy – key findings

a) Below average and above average growth periods

Forecasters tend to overestimate growth in rental levels, capital values and total returns in underperforming periods of the property market and vice versa. They also have a tendency to avoid the 'big numbers' in their forecasts. In the broader forecasting literature, it has been suggested that forecasters seek to avoid sudden and large adjustments in order to try and maintain their reputation and credibility. The result of such behaviour is the phenomenon of so-called 'forecast smoothing'.

With respect to the one-year-ahead forecasts, the largest deviation from the actual outcome is observed in 2007 (i.e. 2008 target year) for capital growth and total returns. The mean forecast for capital growth in 2007 was -3.8% with a standard deviation 2.9% and a maximum of value of 3.0%. The extent of the deviation was -26.3%. Additionally, the mean for the one-year-ahead total returns' forecasts in 2007 (i.e. 2008 target year) was 1.15% with a standard deviation of 3.1% and a maximum of 8.0%. This results in a high deviation in comparison with the actual value for 2008 which was -22.1%.

It should be noted that given the substantial fall in capital values and total returns in 2008, forecasters continued to forecast a downward trend for 2009, missing the turning point in that year. Clearly, the recent year's experience had an influential impact on

Figure 4: Correlations between forecasts and actual values

Variables	Forecast	Correlation coefficient	t-stat	Conclusion
Rental growth	1-year ahead	0.74	3.48	Significant
	2-year ahead	0.09	0.28	Insignificant
Capital growth	1-year ahead	0.42	1.47	Insignificant
	2-year ahead	0.24	0.75	Insignificant
Total return	1-year ahead	0.50	1.81	Insignificant
	2-year ahead	0.50	1.73	Insignificant

Note: t-stat greater than 2 indicates significance of the coefficient

the forecast for the following year. For rental growth, the largest consensus one-year-ahead forecast deviation is observed for the target year 2010. The mean forecast was -6.1% with a standard deviation 2.3% and maximum of -1.9%, whereas the actual value recorded was -0.5%. Again, the worst recorded annual rental growth over the 12-year period, in 2009, had a significant influence on the forecast for 2010, thereby missing the 2010 turning point.

Another characteristic noted from the one-year-ahead analysis is that the forecasts of rental growth seem to have less 'uncertainty' in comparison with the corresponding estimates for capital growth and total returns. As shown in Figure 4, there is a strong correlation (0.74) between the one-year-ahead forecast and actual rental growth. In contrast, there is no significant correlation reported with respect to either capital growth or total returns, with the corresponding coefficients being 0.4 and 0.5 respectively. In no instance was there a significant correlation found in the two-year-ahead forecasts.

Looking at the one-year-ahead capital growth and total return figures, it appears that the distribution of under- and over-forecasts seem to follow a systematic pattern. Four years of under-forecasts, 2003-06, were followed by two years of over-forecasts, 2007-08. In fact, over the period 2003-09 all of the forecasts for any given year did not encompass the outcome for that year. The forecasts were wide of the mark in anticipating the exceptionally good performance years of 2004 to 2006. The average under-forecasts for one-year-ahead capital growth and total return for 2011 were higher in value than the over-forecasts, which were very close to the mark: the pessimists were more wrong than the optimists. The largest recorded absolute forecast errors for capital growth and total returns were made in 2008, where property total return was the lowest recorded value in 30 years, being -22.1%. Given the severity of the downturn in the market in 2008, it is not surprising that the forecast errors were of this magnitude.

In summary, it is clear that forecasters, on average, are unable to anticipate particularly good or particularly bad years.

b) Comparison of the consensus forecasts against the two naïve forecasts

The results of the comparison are summarised in Figures 5 and 6. The main conclusions from this analysis are:

On balance, consensus rental growth forecasts tend to be more accurate than naïve rental growth forecasts. Conversely, for one-year-ahead capital growth and total return forecasts, naïve 2 forecasts do a better job than consensus forecasts 80% of the time, and in the case of two-year-ahead forecasts, almost 75% of the time.

Figure 5: Number of years (out of 12) naïve forecasts were more accurate than the consensus for one-year-ahead

Variable	Naïve forecast 1	Naïve forecast 2
Rental growth	5	6
Capital growth	7	10
Total return	6	10

Figure 6: Number of years (out of 11) naïve forecasts were more accurate than the consensus for two-year-ahead

Variable	Naïve forecast 1	Naïve forecast 2
Rental growth	2	5
Capital growth	5	8
Total return	4	8

However, for the two-year-ahead forecast period, there is an improvement in consensus forecasts, in that the naïve forecasts do less well compared to the one-year-ahead forecasts, particularly in the case of rental growth. It may be that for a two-year rental growth forecast horizon, (conditional) information on the outlook for the property market is more accurately captured.

In the majority of cases, the naïve 2 specification, the long-term average figure, tends to do a better job than naïve 1, last year's value.

These findings are based on the 'average', that is, the consensus. This does not necessarily mean that individual forecasters may not be doing a better job than the consensus.

c) Comparative accuracy of different forecasters

Equity brokers outperformed both property advisors and fund managers in the case of one-year forecasts (at a significance level of 10%). On the basis of a mean absolute errors anaylsis, the accuracy of property advisor forecasts are significantly better than those of fund managers, although equity brokers significantly outperform both. For the two-year periods, equity brokers outperform in each case, except when based on the mean square error criterion.

It should be noted, however, that individual forecasters move between organisations and new forecasters replace previous forecasters and, so, the interpretation of these findings needs to be viewed in this context. Furthermore, as noted previously, the sample size of equity brokers was considerably smaller than for the other categories. Additionally, the majority of property advisors and fund managers contributed to the whole sample period (i.e. 1999-2011), whereas there are few cases of equity brokers producing one- and two-year-ahead forecasts for the whole period. This means that the results obtained may purely reflect forecasting accuracy relating to a small number of organisations. Despite these caveats, it is of interest that, in marked contrast to the rental growth findings, no single significant result was found with respect to either capital growth or total return forecasts with no group dominating in terms of accuracy.

d) Analysis of bias in the one- and the two-year-ahead forecasts

The study looked at whether there was bias in the forecasts of 30 forecasters for whom there was a minimum of five observations over the course of the sample period. In the case of rental growth, the majority of the forecasters tended to make unbiased one-year-ahead forecasts (i.e. November forecasts), with only seven exceptions. This finding is broadly similar for capital growth and total return, with significant evidence of bias in only five and seven cases respectively. However, of interest is that when the two-year forecasts are considered, a higher number of significant findings are reported, especially in the case of rental growth. In this case, there is evidence that 15 forecasters produce significantly biased rental growth forecasts. This does not, however, carry through to the capital growth and total return forecasts, where only six and seven significant results emerge respectively.

In the case of the one-year-ahead rental growth forecasts, variation in the beta coefficients is in a range of 0.13% to 2.76%. In comparison, the corresponding values for the capital growth and total returns lie within the ranges -1.66% to 5.62% and -1.86% to 5.19% respectively. The range of the beta coefficients also helps explain the lack of accuracy in predicting the variation in capital growth and total returns, which can be implied from the significance or otherwise of the beta. This supports the previous evidence that forecasters tend to predict more accurately the trend in rent than capital value and total returns.

Overall, the analysis found that forecasters tended to make unbiased one- and two-year-ahead forecasts for rental growth, capital growth and total returns during the period 1999-2011.

Conclusions

The study found that forecasters tend to exhibit optimistic behaviour, leading to over-estimation of growth rates during periods of market underperformance. However, this finding needs to be placed in the context of the severity of the 2008 downturn. Forecasters tend to make unbiased one- and two-year forecasts for the three property variables but the rental growth forecasts are more accurate in comparison with the corresponding capital growth and total returns forecasts, exhibiting smaller forecasting errors for all periods.

However, whilst models attempt to capture the broad systematic influences driving the property variables analysed in the research, a host of other (model-omitted) factors will at any point be impacting on rental growth, capital growth and total returns. The authors of the report suspect that many 'pure' model-generated property forecasts are adjusted, as is the case with macroeconomic forecasts, but information as to which individual forecasts were purely model-generated and which were subject to adjustments is not available. Judgemental adjustments do not necessarily result in value-added by way of more accurate forecasts and, indeed, biases can be (are) introduced, thus rendering the forecasts less accurate than may otherwise have been the case. Looking to identify the market environments and conditions where property forecasts are biased is an area for further research.

The future of property forecasting

This article is a summary of the report by Craig Watkins and Berna Keskin of the University of Sheffield and Michael White of Nottingham Trent University on current forecasting practice adopted in the UK property market and suggestions as to possible improvements that should be considered. This work was funded by the IPF Research Programme and a copy of the full report, published in November 2012, is available to download from the IPF website.

Current forecasting practice

Property professionals have long been involved in developing implicit forecasts of market values. Until the1980s, this was based largely on intuition but since the 1990s' market collapse there has been greater emphasis on quantitative methods and formal modelling techniques. The rise of quantification has led to some convergence in views, not least because forecasters tend to use similar models, the same datasets and a standard set of statistical procedures. This means, of course, that most forecasts will be subject to similar sources of systemic bias. These techniques, of course, are not used in isolation. Most property forecasts are generated by combining econometric predictions, with a more subjective market overlay process.

There are a large number of ways that errors might enter the forecasting processes including: the modelling process because the data used are inaccurate; the limited variables included do not cover all of the key drivers of the market; the statistical methods used to estimate relationships are not sufficiently sophisticated to deal with the complexity of the market; and the assumptions made about future trends in key property and economic drivers are erroneous.

Errors might also be introduced through the market overlay process. The research found that IPF Consensus forecasters use this to capture the influence of mood and sentiment in these predictions. They also highlight that mood is difficult to assess and can be inaccurate; and that there is no systematic basis for quantifying the way in which mood has influenced forecasts in the past. This raises the possibility that there might be considerable inconsistency in the way in which qualitative assessments of market conditions might impact on any particular 'house' forecast.

The researchers found that there was a tendency for property models to be a little slow in accommodating new econometric advancements. The survey of forecasters suggests that few of the models used in practice use the very latest methods for capturing cyclical effects and/or structural changes. Given that simpler model forecasts tend to be robust over only very short periods, this may be one of the weaknesses of IPF members' forecasts. The commonalities in modelling approaches used are also a source of forecast convergence.

Empirical study

Michael White, Nottingham Trent University

It was the view of the project team and the IPF project steering group that exploring how best to forecast the most challenging case is potentially more instructive than focusing on markets driven by a less extreme set of influences. The City market/sub-market presents a particular challenge for forecasters in that it is generally influenced significantly by those investment flows that have been difficult to capture in the past. This means that the market overlay process tends to be quite prominent in shaping views about future prospects. The City market is also highly liquid and transparent and data availability makes it attractive for the purposes of econometric analysis.

ARIMA and ECM

Two different types of econometric models were used in the study: autoregressive integrated moving average (ARIMA); and error correction mechanism (ECM). These have been used to demonstrate the sensitivity of forecasts to changes in model structure, methods of estimation, data used and variables measured. Figure 1 shows the results from the best-fitting ARIMA model, explaining over 93% of the variation in rent. However, when this model was applied in a forecasting context (2010–15), its predictive performance was very poor and within-sample forecasts diverged from actual economic outcomes.

Figure 1: ARIMA model for City of London

Sample (adjusted): 1982-2009
Included observations: 28 after adjustments
Convergence achieved after 9 iterations
MA Backcast: 1981

Variable	Coefficient	Std. error	t-statistic	Probability
Constant	4.26	0.2219.13	0.00	
AR(1)	1.43	0.20	6.99	0.00
AR(2)	-0.57	0.21	-2.74	0.01
MA(1)	0.61	0.19	3.26	0.00

R-squared	0.94	Mean dependent var	4.36
Adjusted R-squared	0.93	SD dependent var	0.37
S.E. of regression	0.10	Akaike info criterion	-1.72
Sum squared resid	0.22	Schwarz criterion	-1.53
Log likelihood	28.04	Hannan-Quinn criterion	-1.66
F-statistic	124.94	Durbin-Watson stat	1.89
Prob(F-statistic)	0.00		

The theoretical benefit of using ECM is that it highlights explicitly the market's role to remove demand and supply imbalances resulting in market equilibrium. The variables used in the rent model for the City of London were the finance and business services (FBS) output to capture demand, and stock to reflect supply. While it is possible to use gross value added (GVA) or local gross domestic product (GDP) as alternative demand side variables, FBS performs better statistically. Figure 2 presents the results for the long-run model. The coefficients have the expected signs a priori the model performs reasonably well in terms of explanatory power. The forecasting performance of this model was better than the ARIMA model. However, the ECM does require forecasts of the future values of the exogenous demand and supply side variables. This was done by using the Hodrick-Prescott filter that separates short- and long-run influences on variables.

Figure 2: ECM model for City of London office rents

Sample (adjusted): 1984-2009
Included observations: 26 after adjustments

Variable	Coefficient	Std. error	t-statistic	Probability
Constant	49.32	5.359.22	0.00	
Finance & Business Services Output	0.40	0.16	2.47	0.02
Stock	-4.54	0.62	-7.33	0.00

R-squared	0.804	Mean dependent var	4.34
Adjusted R-squared	0.784	S.D. dependent var	0.38
S.E. of regression	0.18	Akaike info criterion	-0.53
Sum squared resid	0.71	Schwarz criterion	-0.38
Log likelihood	9.89	Hannan-Quinn criterion	-0.49
F-statistic	46.24	Durbin-Watson stat	0.51
Prob (F-statistic)	0.00		

Scenario forecasting exercise

The researchers then looked at a more qualitative, judgement-based 'experiment' (scenario forecasting exercise) that invites forecasters to estimate future outcomes under different circumstances.

The scenario exercise serves to illustrate the way in which a market overlay process introduces differences in views about macroeconomic and market-specific prospects, including investment flows. The exercise highlights the potential variation in the scale of overlay and demonstrates the difficulties associated with trying to avoid further distortions being introduced by the ways in which individual views enter the process. The analysis shows, perhaps unsurprisingly given the similarities in inputs and model structures, that most of the variation in forecasts is derived from differences in the overlay process.

The overlay process

The degree to which overlay is taken into account in developing forecasts is rarely a source of reflection or debate and that the precise impact of the overlay process is not well understood. The researchers therefore looked at two issues: in what way and to what extent does the overlay process introduce differences/ variations in forecasts; and how might that overlay improve forecasts consistently. This element of the project was based on a short questionnaire to IPF consensus forecasters asking them to share, in confidence, information about how their forecasts are derived, and in-depth interviews with six volunteers from the Consensus forecasting community, who were asked to engage in a scenario exercise.

Participants were asked to provide details of their assumptions about a range of macroeconomic variables and to provide forecasts for City office rents and yields. The data requested covered the next three years. The macroeconomic variables selected by the researchers were not those shown statistically to be the most likely to drive office market models (such as FBS employment). Rather they were national level indicators of the general health of the economy: GDP; unemployment; interest rates; the sterling index; and inflation. The intention was to gauge the respective institution's view of the health of wider UK economy. GDP, unemployment and inflation were seen as standard general indicators of the strength and direction of travel of the economy, while interest rates (specifically the inter-bank lending rate) were included to provide some opportunity to reflect on relative potential of bonds. The sterling index was intended to provide a guide to views about the relative strength of the UK with respect to international markets.

Most respondents reported that their economic view was shaped by externally sourced forecasts. When comparing these with each other, and with the overview of economic forecasts provided by the Treasury[1], it was clear that there was considerable convergence (in fact three responses were identical) and that most views were very close on all indicators. As expected, there was rather more variation in the property forecasts (see Figure 3). These results would appear to confirm the sense that the differences enter not from divergence in opinion about wider economic prospects but from slight variations in either the property-specific models (data, model structure or statistical methods) and/or the market overlay process.

The second part of the exercise was designed to explore to what extent the forecasters might adjust their views when faced with a change in economic circumstance. The exercise confronted the participants with circumstances that are either worse (the 'pessimistic scenario') or better (the 'optimistic scenario') than their initial assumptions. It was anticipated that the respondents would all consider both the facts (they were given identical information about general macroeconomic conditions) and the 'mood' in the market (as conveyed by the terms 'optimistic' and 'pessimistic'). The variables chosen allowed reflection on the

1 HM Treasury (2012) Forecasts for the UK Economy: a Comparison of Independent Forecasts, HM Treasury.

Figure 3: Scenario forecast change in macroeconomic and City office outcomes

	Mean %	Minimum %	Maximum %
2013			
GDP	1.4	1.3	1.5
Office rents	0.7	-1.0	1.6
Office yields	6.2	5.25	6.6
2014			
GDP	2.1	2.0	2.1
Office rents	0.5	-1.5	1.6
Office yields	6.1	5.25	6.6
2015			
GDP	2.25	2.2	2.3
Office rents	1.2	0.5	1.6
Office yields	6.2	5.0	6.6

economic circumstances, the relative position of property versus other assets, and the relative position of the UK economy. The economic scenarios were intended to be plausible and internally consistent. These were based on the most optimistic and pessimistic views reported by the Treasury[2] in its comparison of independent economic forecasts.

This revealed some interesting tendencies. First, the best case is close to the Treasury view but forecasters do not appear to place much faith in the most bullish messages emerging from official sources. Second, the tendency to locate property market outcomes near the bottom, even in moderate circumstances, might be interpreted as an indication that mood or sentiment has led forecasters to tend to downgrade their views and to break the link between economic fundamentals and predicted property market outcomes. The fact that this emerges most strongly for predictions two and three years ahead might imply an innate risk aversion (possibly conditioned heavily by recent experience). This impression is reinforced by the need to upgrade significantly when confronted with rather better economic conditions.

There was more variation revealed in the extent to which adjustments were made under different scenarios than there had been in the analysis of assumptions about the economy or in the initial forecasts of rents and yields provided. This suggests that the sorts of judgement calls that enter the overlay process provide a far greater source of adjustment, and arguably error, than any other input. It is also the largest source of differentiation between forecasts than any other element of current practice.

3-year forecasts

As a by-product of the research process, a range of forecasts for the next three years were derived using a variety of techniques. It would have been interesting to have tested all of these on historic data but it is impossible to explore the 'softer' influences of market overlay processes, given that everyone knows what has actually happened during past three years. Figures 4 and 5 summarise the City office rent and yield forecasts for the next three years generated by different methods.

Figure 4: City office rental growth forecasts 2013-15

Forecasting approach	2013 % pa	2014 % pa	2015 % pa
ARIMA	1.0	0.5	0.3
ECM	2.0	1.5	1.5
Scenario exercise (variable inputs)	0.7	0.5	1.2
Pessimistic economic scenario	-2.0	0.2	1.0
Optimistic economic scenario	3.8	3.9	3.8

Figure 5: City office yield forecasts 2013-15

Forecasting approach	2013 %	2014 %	2015 %
ARIMA	5.5	5.6	5.6
ECM	5.25	5.3	5.3
Scenario exercise (variable inputs)	6.2	6.1	6.2
Pessimistic economic scenario	6.5	6.3	6.4
Optimistic economic scenario	6.0	5.9	6.0

The model-based rental estimates are calibrated using the ARIMA and ECM econometric techniques. The rental ECM forecasts are different from the mean scenario forecasts but are within the optimistic and pessimistic values. The yield model presented here also follows the form of an ECM. In the yield forecasts, the econometric models produce quite different results from those forecasts that accommodate an overlay. There is no evidence of either strong upward or downward yield movements in any of the forecasts.

The scenario-based estimates are based on the arithmetic mean of the survey responses. The model estimates are actually quite close to those produced in practice by the widely-used econometric models. They overlap with some of the final forecasts produced in the scenario exercise. Most forecasters, however, use overlay processes to move away from the central model estimates, citing mood and sentiment as the main reasons

2 HM Treasury (2012)

for making adjustments. It is interesting to note that, even when presented with optimistic and pessimistic scenarios, there is still considerable clustering in forecast values. It seems that forecasters, perhaps as a result of a strong 'mood' effect, tend to be very conservative. The overlay appears to introduce an 'anchoring' effect which reinforces the tendency towards grouping.

How might forecasts be improved?

Taken together, the two elements of this project suggest that potential improvements in future forecasts could come from both the qualitative and quantitative elements of the process. Modelling improvements might include:

- adopting more innovative econometric methods, including investing in techniques that better capture structural breaks; and
- exploring new variables that might proxy changes in sentiment and mood in both rental and yield forecasts.

These might be combined with qualitative enhancements by:

- considering developing methods that allow greater appreciation of the different drivers of market overlay processes and provide a more systematic basis to capture the influence of this aspect of this process. The scenario exercise used here is intended to act as a simple exemplar of how this might be done;
- enhancing the feedback between overlay and modelling processes, for example, by using qualitative discussions as a basis to adapt model inputs; and
- using qualitative insights, including 'mood' adjustments as proxy measures for market sentiment, as inputs into formal models. This might help overcome the limitations of some of the existing measures.

There are several other process improvements that might be made. These include:

- engaging in greater reflection about the effectiveness of current practices. Considerable benefits might be gained from recording formal outputs, the size and direction of overlay influences, and final outputs with a view to revisiting these on a regular basis. This would provide a clearer sense of the conditions under which current methods produce the best results and possibly suggest simple changes in approach that would yield improvements in accuracy and/or consistency; and
- moving away from reliance on point estimates and towards the development of forecasts that offer a range of possible outcomes (that may even have probabilities assigned to them).

No compelling evidence was found to suggest that techniques such as neural networks, cellular automata or evolutionary models help overcome the inherent weaknesses of existing methods. The paucity of property data also limits the effectiveness of these approaches, possibly even more than it constrains econometric model development. These techniques have also been constrained by the tendency of the underlying models to be under-specified and therefore unable to capture adequately the complex drivers of the market. In this context, an overlay process seems to be an appropriate response to the challenges associated with capturing difficult-to-quantify behavioural influences on the market.

Undoubtedly, the most appropriate forecasting approach will come from reflective practice and from a mixed-method design that draws together what the models can explain with deep market knowledge that seeks to systematically explore the 'softer', (non-rational) behavioural influences that cannot be statistically modelled. At present, the relative weight different forecasters place on qualitative versus quantitative inputs varies and so do the ways in which they seek to ensure consistency of approach and to minimise errors.

Most forecasters are broadly satisfied with the way in which the approach they use has evolved and feel better equipped, even in a very uncertain market, to take a position than they have been historically. Views vary on whether this reflects a degree of inappropriate complacency or whether it suggests that forecasts play such a limited part in decision-making that these processes do not merit any more investment (in terms of finance, time or research effort) than the current level.

Institutional investment in UK residential property

Pam Craddock, Research Director, IPF

In February 2012, Sir Adrian Montague issued a call for evidence of how to encourage greater investment in privately rented properties, being part of the Government's housing strategy. The Montague Review sought to address two key questions: would the changes, e.g. the level of SDLT on the acquisition of multiple residential properties, that the Government had introduced go far enough to generate significant new flows of investment? If not, what could be done to accelerate things?

In order to inform its response to this review, the IPF undertook a survey of institutional investors in property. Participants were primarily UK pension funds, life assurance companies, property companies/REITs, fund managers and other financial institutions, as well as some consulting actuaries who advise many public and corporate pension funds. Interviews (the majority conducted by telephone) were carried out during March 2012 and 42 entities contributed data or shared their views on those issues they consider impact on institutional investors' appetite for residential investment. The principal findings of the survey are outlined below.

Current investment in residential property

The 42 respondents to the survey currently invest in excess of £180bn in global property assets. Of these, the exposure of 28 investors amounts to a headline total of almost £7.6bn of residential property within their portfolios. The average exposure of those investing directly is £271m (just under 6% of their total property investment) but, of these, 16 of the 28 hold less than a combined total of £1bn. At the other end of the scale, seven have investments worth in excess of £4.3bn in residential property, representing some 16% of their property investment on average.

To put the above totals in context, however, private 'buy-to-let' investors have committed over £200bn to the residential sector since 2000.

The investors in residential property hold their assets directly or in a combination of direct and indirect ownership via private funds. No respondent identified listed vehicles as a means of exposure to residential, which may be as a result of listed stocks being classified or managed as equity investments. A more detailed description of investment method, by reference to value or proportion per investment type, was not recorded.

Figure 1 summarises the 28 respondents' current investment in the residential sector by category, both as a percentage of respondents and by value. This shows that 75% of these investors have some exposure to market rents/assured shorthold tenancies (MR/ASTs) and over half are invested in residential development land, although it should be noted that at least some of this is earmarked for build-to-sell rather than to rent.

Rationale for investing in residential property

Respondents already invested in the residential sector were invited to select from four criteria for investment and rank these, as well as to provide additional reasons for holding UK residential property. The majority (23 out of 28) identified the returns profile as being a major consideration and, of those who provided rankings, 13 considered it to be the prime driver. Stability of income, low correlation with other asset classes (including commercial property) and capital value stability were also identified as important characteristics. Figure 2 summarises these responses.

Figure 1: Current investment in the residential sector

	MR/ASTs	Devt. land	Student hsg	Ground rents	Reg. tenancies	Other	Social hsg	Total
No. respondents	21	15	11	10	7	6	5	–
Proportion	75%	54%	39%	36%	25%	21%	18%	–
Value (£m)	3,176	822	1,178	139	179	885	1,214	7,593
% of total	42%	11%	16%	2%	2%	12%	16%	100%

Figure 2: Why do existing investors hold residential property?

		Ranking					
Reason to invest	No. responses	1	2	3	4	5	Not ranked
Returns profile	23	13	7	1	1	0	1
Stability of income	19	3	5	6	2	1	2
Low correlation with other asset classes	18	2	5	6	4	1	0
Stability of capital values	17	0	3	5	8	0	1

Other reasons for investing included the defensive qualities provided by the very different characteristics of each sub-sector of residential property. Several respondents identified their exposure as a default position, resulting from acquisition of residential property ancillary to commercial investments, as a condition of planning in development situations or to maximise value from mixed-use development; the latter was especially the case in central London.

Reasons for not investing in residential property

Fourteen of the 42 survey participants (33%) do not currently have any investment in residential property. Six factors were suggested as being deterrents to investing in the sector and the responses to these are shown in Figure 3.

Figure 3: Reasons given for not investing in residential property

Factor	No. responses
Just too difficult/management issues	12
Income yield too low	9
Lack of liquidity/insufficient market scale	9
Pricing not right	6
Reputational risk	5
Political risk	4
Other	3

Other reasons mentioned were the current economic background and speciality of the asset class. One REIT mentioned that it would not invest as the income yield is too low and would have a too dilutive affect on distributable income if a meaningful position were to be built up.

Contributors were asked if their lack of investment in residential property was because their organisation invests in other assets as proxies or substitutes for the sector (such as house builders, nursing homes or residential mortgages but not student housing). With the exception of one respondent, whose organisation invested in a listed house builder, the answer was "no".

Future investing intentions

All respondents were asked whether they intend to commence or increase investment in residential property over the next year and three years.

Of the existing investors, 19 anticipate investing further over the next 12 months and 23 over the next three years. The extent of their investment could be around £2.6bn, the majority coming from the fund management sector. The type of residential property that may attract this level of investment was not specified in many instances. However, those investors that did indicate a preference favoured the private rented sector, development and student housing. A number of respondents commented that their approach would be opportunistic and responsive to market conditions at the time.

Up to 60% of the current 'non-investors' may enter the residential market within the next three years, although the total volume of funds is relatively small – estimated to be between £350m and £840m. The most favoured types of investment under consideration are MR/ASTs, student housing and ground rents.

Investment in student housing

The Montague Review asked for comments on whether anything could be learnt from the recent large-scale investment in student housing and the IPF survey therefore sought the views of respondents on this point.

A total of 20 respondents (48%) have an exposure to student accommodation, some using more than one investment method. Eleven have invested directly in the sector, whilst investment via private funds proved almost equally popular (nine respondents). Only two investors hold listed company shares for student exposure.

The reasons for investing in this sector are summarised in Figure 4. In addition to these, respondents cited such features as

Figure 4: Reasons given for investing in student housing

		Ranking						
Reason to invest	No. responses	1	2	3	4	5	6	Not ranked
Returns profile	17	9	4	1	2	0	0	1
Stability of income	18	5	6	5	1	1	0	0
FRI leases with RPI indexation	16	4	5	3	3	1	0	0
Stability of capital values	15	1	4	1	5	2	1	1
Low correlation with other asset classes	12	0	1	4	3	2	2	0
Similarity to commercial property management-wise	11	0	1	1	3	2	4	0

'scalability' and occupier demand as supportive of their investment, as well as the high income return when compared to other types of residential property.

It should be noted that respondents, with one exception, do not consider this sector as a proxy for residential per se.

What more can Government do?

All respondents were invited to give their views on what more Government could do to make residential more attractive or to increase existing investors' commitment to the sector.

The most favoured ideas for helpful Government interventions focus principally on tax incentives, e.g. the removal of, or material reduction in, VAT on repairs & management fees, as well as changes to the planning system, notably in connection with affordable housing requirements. These changes are viewed as ways to improve the net yield and increase the size of the investible market, both currently important barriers to investment.

A copy of the IPF Short Paper 'Institutional Attitudes to Investment in UK Residential Property', published June 2012, can be downloaded from the IPF Website. This includes a copy of the joint response by AREF, BPF and IPF to the Montague Review.

NOTE:

The IPF intends to repeat this survey of institutional investors in 2013. If you are interested in participating, please contact Pam Craddock, Research Director, IPF: pcraddock@ipf.org.uk

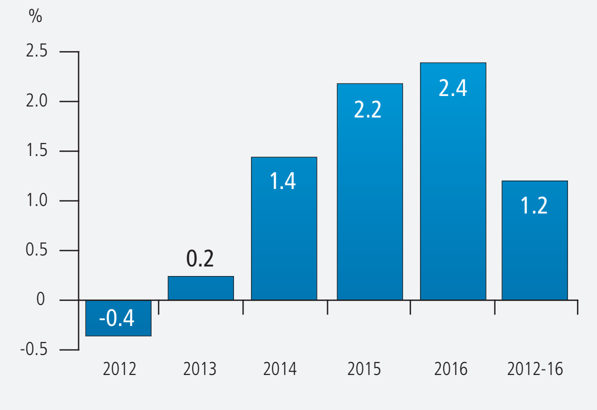
UK Consensus Forecasts
November 2012

All Property annual rental value growth forecasts

Concerns remain over the occupational market as the economy struggles to grow.

However, the All Property rental value growth forecast for 2012 has continued to strengthen and now stands at -0.4% (from -0.8% in August and -0.9% in May). Confidence has also increased slightly over the remaining years of the survey, although the five-year average (up from 1.0% in the last quarter) is still well below the long-run average of over 3.0% per annum.

Figure 1: All Property rental value growth forecasts

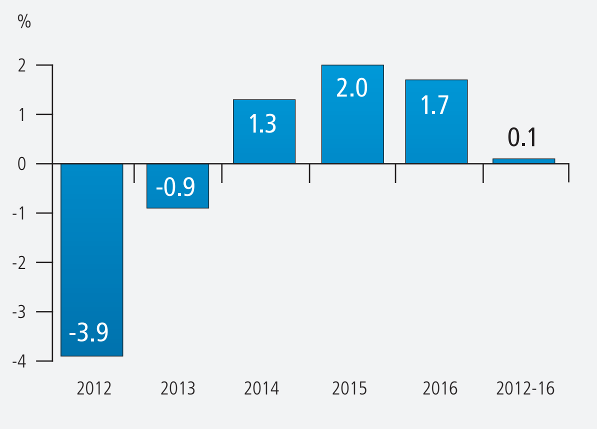


All Property annual capital value growth forecasts

The pattern of anticipated capital value growth remains the same as for the last two rounds of the forecasts, with some recovery in 2013 although growth is still expected to be below zero. Whilst there is increased optimism in the last two years of the forecast, these projections continue to be lower than the long-run average of 2.5% per annum.

The influence of the negative growth forecasts of 2012 and 2013 on the five-year average is demonstrated by the expectation of virtually nil growth in nominal terms.

Figure 2: All Property capital value growth forecasts

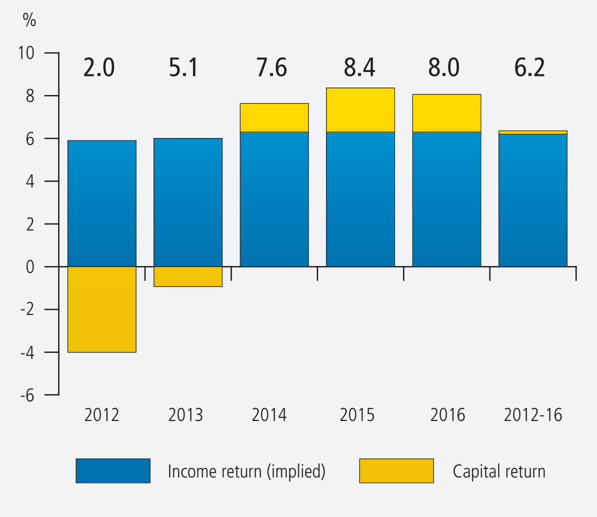


All Property annual total return forecasts

The average All Property total return forecast for 2012 has strengthened since the last report, reversing the last two quarters' declines (1.1% in August and 1.4% in May). The likely return for 2013 has increased to 5.1%, although this is still below expectations earlier in the year (6.0% in May).

The implied income return for 2012 has risen to 5.9% and is anticipated to rise to 6.3% in 2014. Assuming an average of 6.2% per annum for the period 2012-16, this shows that income remains the key driver of real estate performance over the next five years.

Figure 3: All Property total return forecasts



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. **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.** There was one 'other' (non-equity broker) contributor this quarter, whose data is incorporated at the 'All forecaster' level only. **10.** The sector figures are not analysed by contributor type; all figures are shown at the 'All forecaster' level. **11.** In the charts and tables, 'All Property' figures are for all 31 contributors, while sector forecasts are for reduced samples (27/29) of contributors.

Acknowledgements

The Investment Property Forum would like to thank all those organisations who contributed to the IPF UK Consensus Forecasts for Q4 2012, including the following: **Property advisors (including research consultancies):** BNP Paribas Real Estate, Capital Economics, CBRE, Cluttons, Colliers International, Drivers Jonas Deloitte, DTZ, Fletcher King, GVA, Jones Lang LaSalle, Knight Frank, Paul Mitchell Real Estate Consultancy Limited, Real Estate Forecasting Limited, Strutt & Parker. **Fund managers:** Aberdeen Asset Management, Aviva Investors, AXA Real Estate, CBRE Global Investors, Cordea Savills, Cornerstone Real Estate Investors, F&C REIT Asset Management, Henderson Global Investors, HSBC Global Asset Management, Ignis.

All Property survey results by contributor type

(Forecasts in brackets are August 2012 comparisons)

Figure 4: Property advisors and research consultancies (16 contributors)

	Rental value growth %			Capital value growth %			Total return %		
	2012	2013	2012-16	2012	2013	2012-16	2012	2013	2012-16
Maximum	1.4 (0.0)	1.4 (2.1)	3.3 (3.8)	-1.2 (0.5)	3.4 (2.7)	1.9 (3.8)	4.4 (6.2)	9.5 (8.7)	7.5 (10.2)
Minimum	-1.2 (-2.0)	-1.0 (-1.6)	0.3 (0.0)	-5.0 (-6.4)	-2.6 (-3.0)	-0.8 (-1.1)	0.6 (-1.0)	3.3 (2.9)	5.3 (5.3)
Range	2.6 (2.0)	2.3 (3.7)	3.0 (3.7)	3.7 (6.9)	6.1 (5.7)	2.8 (5.0)	3.8 (7.2)	6.3 (5.8)	2.2 (4.9)
Median	-0.4 (-0.7)	0.6 (0.5)	1.4 (1.4)	-3.9 (-4.4)	-0.3 (-0.4)	0.6 (0.2)	2.2 (1.6)	5.7 (5.5)	6.7 (6.4)
Mean	**-0.3 (-0.7)**	**0.4 (0.4)**	**1.5 (1.4)**	**-3.4 (-4.2)**	**-0.2 (0.5)**	**0.5 (0.4)**	**2.4 (1.6)**	**5.7 (5.6)**	**6.6 (6.6)**

Figure 5: Fund managers (15 contributors)

	Rental value growth %			Capital value growth %			Total return %		
	2012	2013	2012-16	2012	2013	2012-16	2012	2013	2012-16
Maximum	0.2 (0.3)	1.5 (1.6)	2.2 (2.3)	-3.1 (-2.8)	2.4 (1.8)	1.8 (1.6)	3.0 (3.4)	7.2 (6.6)	7.7 (7.6)
Minimum	-1.8 (-1.9)	-2.2 (-3.0)	-0.7 (-1.3)	-5.5 (-7.5)	-4.1 (-4.7)	-1.9 (-2.3)	0.6 (-2.0)	1.9 (1.2)	4.3 (3.6)
Range	2.0 (2.1)	3.7 (4.6)	2.9 (3.7)	2.4 (4.7)	6.5 (6.5)	3.7 (4.0)	2.4 (5.4)	5.3 (5.4)	3.4 (4.0)
Median	-0.3 (-0.8)	0.3 (0.2)	1.0 (0.8)	-3.9 (-5.5)	-1.7 (-1.4)	-0.2 (-0.5)	1.9 (0.3)	4.7 (4.5)	5.9 (5.7)
Mean	**-0.4 (-0.7)**	**0.1 (0.2)**	**0.9 (0.6)**	**-4.2 (-5.4)**	**-1.5 (-1.7)**	**-0.3 (-0.6)**	**1.7 (0.4)**	**4.6 (4.4)**	**5.9 (5.6)**

Figure 6: All forecasters (31 contributors)

	Rental value growth %			Capital value growth %			Total return %		
	2012	2013	2012-16	2012	2013	2012-16	2012	2013	2012-16
Maximum	1.4 (0.3)	1.5 (2.1)	3.3 (3.8)	-1.2 (0.5)	3.4 (2.7)	1.9 (3.8)	4.4 (6.2)	9.5 (8.7)	7.7 (10.2)
Minimum	-1.8 (-2.0)	-2.2 (-3.0)	-0.7 (-1.3)	-5.5 (-7.5)	-4.1 (-4.7)	-1.9 (-2.3)	0.6 (-2.0)	1.9 (1.2)	4.3 (3.6)
Range	3.2 (2.3)	3.7 (5.1)	4.0 (5.1)	4.2 (8.0)	7.5 (7.4)	3.8 (6.2)	3.8 (8.2)	7.6 (7.5)	3.4 (6.6)
Std. Dev.	0.6 (0.9)	0.9 (1.2)	0.9 (1.0)	1.1 (1.7)	1.6 (1.6)	0.9 (1.2)	1.0 (1.8)	1.5 (1.5)	0.8 (1.2)
Median	-0.3 (-0.8)	0.5 (0.3)	1.2 (1.1)	-3.9 (-4.8)	-1.0 (-1.2)	-0.1 (-0.1)	2.0 (0.8)	5.1 (4.8)	6.1 (6.0)
Mean	**-0.4 (-0.8)**	**0.2 (0.0)**	**1.2 (1.0)**	**-3.9 (-4.7)**	**-0.9 (-1.1)**	**0.1 (0.1)**	**2.0 (1.1)**	**5.1 (5.0)**	**6.2 (6.1)**

Note
Consensus forecasts further the objective of the Investment Property Forum 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.

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European Consensus Forecasts
November 2012

2012 expectations improve but fall back in 2013

The differences between the May and November 2012 projections for the current year suggest some strengthening of sentiment by contributors, as only six forecasts have weakened by more than 1.0% in this period, compared to 22 between November 2011 and May 2012. The outlook for 19 markets has picked up over the last six months, with 12 showing a greater than 1.0% improvement in forecast growth rates. The changes in the two surveys are detailed in the Appendix to the report.

Notwithstanding this more upbeat theme, 12 markets are still expected to deliver negative growth over the year with most office markets in the PIIGS states continuing to weaken, the exceptions being Lisbon and Barcelona. The latter locations both show marginal improvement, albeit substantially lower than their original forecasts of 30 months ago, when the economic outlook was perceived to be considerably better. This is illustrated in Figure 1.

In the case of the Madrid market, it has experienced the biggest fall in the six months since the last survey, as prime rents are expected to have fallen by over 6.0% (to -6.9%) by year end. Dublin and Barcelona remain the other weakest markets, at -6.5% and -5.3% respectively, whilst Paris La Defense is anticipated to fall by over 4.0% for the year as a whole (counter-balancing an improvement in fortunes for Paris CBD). As in previous surveys, there were insufficient returns for Athens to permit any analysis.

Of the remaining centres that are expected to produce negative growth, weaker performances compared to May are predicted for Paris la Defense (-4.1%), Brussels (-1.8%) and Zurich (-0.6%), whilst Budapest (-1.1%), Prague (-0.3%) and Copenhagen, at just below 0.0%, are slightly better than six months ago.

In the UK, the London office market forecasts have reversed over the half year to show improved outturns for 2012, with the City now anticipated to produce 2.8% growth (as against a mere 0.1% in May).

The spread in growth rates between centres has increased further since the last survey, to 14.6% (from 12.9%), demonstrating the diverging strengths of the different economies and, potentially due to the 'safe haven' status ascribed to certain markets.

The theme for 2013 is for a softening of rents in most markets, as forecasts have been reined back in 27 centres since May. Negative rental growth is anticipated within 15 of the 29 centres reported and only four markets are currently anticipated to deliver more than 3.0% positive annual growth (London City and West End, Oslo and Moscow). The poorest performers are all located within PIIGS states, ranging from -5.8% for Madrid to -1.4% for Dublin (the latter forecast being a significant reversal from the May forecast average of 2.8%).

The range of growth forecasts for 2013 has widened since the last survey, to 9.6% (5.9% previously), reflecting a widening

Figure 1: Weighted rental growth forecasts for year 2012 – Peripheral (PIIGS) economies

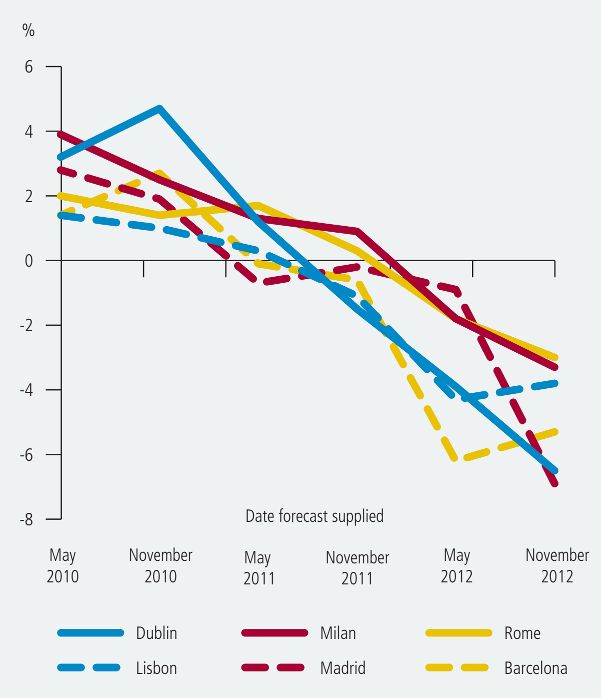
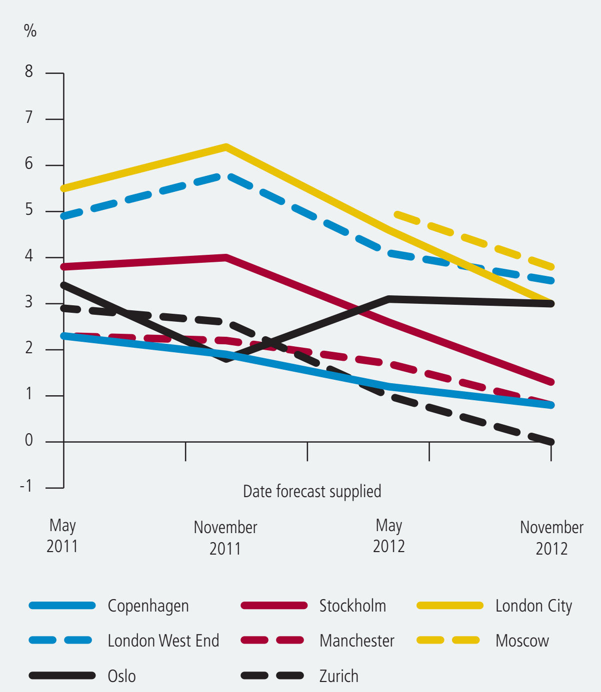


Figure 2: Weighted average rental growth forecasts 2013 – Non-euro centres



scope of opinion between contributors. This is even more apparent within individual markets, where the differing forecaster views record substantial ranges in growth forecasts over most timeframes.

Abstracting non-eurozone locations, 2013 is also anticipated to deliver weaker growth within these markets (with most demonstrating similar rates of decline), reflecting the poorer economic outlook, the only exception being Oslo where the rental growth rate is anticipated to remain relatively stable. This is illustrated in Figure 2.

Three- & five-year averages weaken

Over the longer term, predictions remain diverse, although the majority of forecasts (18 of the 29 reported) have risen in the six months since the last survey. The lowest three-year average growth forecasts are all populated by PIIGS centres, ranging from -4.4% for Madrid to -1.7% for Rome.

In total, 10 locations are forecast to deliver negative growth and a further six only weakly positive growth (less than 1.0%). At the other end of the spectrum are the four centres that lead over the shorter-term – Moscow, London (City and West End) and Oslo, ranging from 3.1% to 4.6%.

The five-year outlook is more encouraging, as 26 locations are forecast to produce positive growth, although, compared to the last survey, three centres may now to deliver weakly negative average growth (Lisbon, Rome and Milan). As was forecast in May, six locations may produce lower than 1.0% growth (Amsterdam and Prague being present in both surveys' groups). Disappointingly, contributors on average have made downward adjustments to 17 of their forecasts for this period.

The most exceptional movement predicted within the three- and five-year averages is for Dublin, where a significant improvement is predicted, based on a presumption of strong performance over the latter years of the period: the three-year average of -1.9% translating to +1.9% for the five-year average.

Of the eight forecasts that predict 2.0% or more growth over five years, all have either matched or exceeded their previous (May 2012) projection – a broad reversal of the trend between November 2011 and May 2012. Those recording an improved five-year outlook comprise Helsinki at 2.0% per annum (from 1.7%), Munich (2.6% from 1.8%), Moscow (3.4% from 2.9%), London City (3.6% from 3.1%), Oslo, (3.8% from 2.2%) and London West End (4.1% from 3.1%).

Conclusions

The lack of any clear resolution to the prevailing sovereign debt problems has undoubtedly caused forecasters to adopt a very cautious stance to the peripheral eurozone economies, which continue to populate the lowest positions within the ranking of rental growth prospects for the 29 office centres being monitored by this survey (Athens continues to attract too few forecast to be capable of inclusion within this analysis).

Non-eurozone locations broadly demonstrate the best performance prospects over all time periods, although these markets are not immune to the issues affecting their neighbours, as illustrated by weakening performance prospects in 2013.

Acknowledgements

Forecast Contributors

IPF would like to thank all participants in the survey for contributing rental data to the November 2012 European Consensus Forecasts, including the following organisations:

Aberdeen Asset Management, Aviva Investors, AXA Real Estate, CBRE, CBRE Global Investors, Cushman & Wakefield, DTZ, Grosvenor, Invesco, Jones Lang LaSalle, Paul Mitchell Real Estate Consultancy Limited, PPR, SWIP, Standard Life Investments.

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. We hope to be able to produce a full release of this data at some time in the future, once the number of responses has grown sufficiently.

The Data

This latest survey collected prime office rental forecasts for 29 centres for the calendar years 2012, 2013 and 2014. We request a three-year average forecast for 2012-2014 where individual years are not available, as well as a five-year average for 2012-2016. The survey requests both the percentage annual rental growth rates and the preceding (i.e. 2011) 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 that 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 15 different organisations (fund 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 of 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.

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

Figure 3: European office market prime rent forecasts, November 2012

	Year rental growth forecast % pa 2012	2013	2014	3-year forecast 2012-14 % pa	5-year forecast 2012-16 % pa
Vienna	3.9	0.3	0.9	1.7	1.2
Brussels	-1.8	-0.5	0.3	-0.7	0.7
Prague	-0.3	0.0	0.9	0.2	1.1
Copenhagen	0.0	0.8	2.0	0.9	1.7
Helsinki	5.2	0.8	2.0	2.7	2.0
Lyon	1.8	-0.3	0.0	0.5	1.5
Paris CBD	0.3	-0.1	1.7	0.6	2.2
Paris la Defense	-4.1	-0.3	1.1	-1.1	0.7
Berlin	1.6	2.0	2.5	2.0	1.8
Frankfurt	1.1	1.5	1.7	1.4	1.7
Hamburg	2.2	1.7	1.1	1.6	1.7
Munich	3.0	2.3	3.0	2.8	2.6
Athens	na	na	na	na	na
Budapest	-1.1	-0.7	0.5	-0.4	1.5
Dublin	-6.5	-1.4	2.3	-1.9	1.9
Milan	-3.3	-2.4	0.3	-1.8	0.1
Rome	-3.0	-2.2	0.0	-1.7	-0.1
Luxembourg	2.7	0.6	3.2	2.1	1.9
Amsterdam	0.1	-0.4	0.8	0.2	0.7
Oslo	7.8	3.0	3.1	4.6	3.8
Warsaw	1.5	-0.5	0.8	0.6	1.3
Lisbon	-3.8	-3.3	0.0	-2.4	-0.3
Moscow	0.6	3.8	4.8	3.1	3.4
Madrid	-6.9	-5.8	-0.4	-4.4	0.4
Barcelona	-5.3	-4.0	-0.8	-3.4	0.2
Stockholm	2.5	1.3	3.0	2.3	2.3
Zurich	-0.6	0.0	1.9	0.4	1.2
London:City	2.8	3.0	3.7	3.2	3.6
London: West End	2.7	3.5	4.9	3.7	4.1
Manchester	1.1	0.8	2.4	1.4	1.7

Who's Who at the IPF

Robin Goodchild, European Director, LaSalle Investment Management

What brought you into the property industry?
I'm a third generation chartered surveyor – my father so obviously enjoyed his work that it was an easy career choice.

How has the property industry changed for you since you joined?
Massively with a much greater emphasis on investment (I was very interested in planning when I first started) as well as globalisation, but the chasm between the public/listed market and the private/direct market remains wide.

How do you feel about the future of the industry?
Very positive because the asset class is a natural investment providing both income and potential for capital gain, with some inflation-hedging qualities; but I don't expect boom conditions to return during the current decade so you need to be in the industry for the long haul.

If you weren't doing the job you are, what would you be doing instead?
Teaching

What was the first record you ever bought?
'Handed Down' but I've not idea who sung it.

Robin is Chair of the Residential Interest Group

What book is on your bedside table?
I've two – Hilary Mantel's 'Bring up the Bodies', her sequel to the extraordinary 'Wolf Hall', and 'Matthew for Everyone' one of Tom Wright's guides to the books of the New Testament.

How do you spend your free time?
Watching sport – principally cricket, rugby and hockey (+ the Olympics and Paralympics but sadly not until 2016), being with family and church activities.

What's on your iPod?
I don't have one.

What keeps you awake at night?
Suburban foxes.

Max Sinclair, Head of UK Division, Hypothekenbank Frankfurt AG

What brought you into the property industry?
When I joined National Westminster, as it then was, some 30 years ago, life was far less sophisticated than today. So it was more or less a question of standing in the line with all of the other graduate recruits and seeing where I would go as my name was pulled out of the hat. However I have never looked back, and working as I was in a bank that at that time was still recovering from the mid-1970's secondary banking and property crisis was one of the best apprenticeships ever!!

How has the property industry changed for you since you joined?
The industry is so much more sophisticated in so many ways – and so much more global.

How do you feel about the future of the industry?
Until we can face up to the realities of the crisis in the UK banking system, very nervous!! It will take some years for the market to recover and during this time, we should make sure that we do everything we can to put more safeguards in place to help ensure that the next time there is a financial crisis, the market is better protected.

If you weren't doing the job you are, what would you be doing instead?
Keeping bees!

What was the first record you ever bought?
Beach Boys Greatest Hits – I still have it!

Max is a member of the Management Board and Chair of the Property Finance Forum

What book is on your bedside table?
One of the most beautiful novels I have had the pleasure to read – 'Shantaram'. I hope that the author, Gregory David Roberts is reading this as I would like him to know that I have given it as a gift at least 20 times!! Can I have a signed copy please?

How do you spend your free time?
I do much of the usual things that we all do – golf; cycling; family; music; and reading etc. However, for the last few years my passion has been the restoration of an old property in southern France. We have been at it for 5 years already and are only half way through.

What's on your iPod?
Tom Waits, David Bowie, Santana and so much more. One of my great pleasures is discovering new music from all around the world. And my children have all developed a great love for music so it is fun to share artists with them.

What keeps you awake at night?
There could be all sorts of ways to answer this question!!

Miles Keeping, Partner and Head of Responsible Property Investment, Drivers Jonas Deloitte

What brought you into the property industry?
My father was an agent so I probably always thought it was on the cards – I briefly dallied with becoming a lawyer but thankfully saw sense.

How has the property industry changed for you since you joined?
Hugely. It's become a whole lot more sophisticated and transparent (although there's still a long way to go in that regard). Thankfully, we're continuing to learn that dealing with property issues needs more than just property thinking.

How do you feel about the future of the industry?
In the short and medium terms there's clearly a desperate need for the industry to come to terms with a new landscape in investment thinking. I do worry that there aren't enough people in the industry who are responding to this and other challenges quickly enough.

If you weren't doing the job you are, what would you be doing instead?
Scoring centuries and taking wickets for Somerset & England.

What was the first record you ever bought?
'New Boots And Panties!!' by Ian Dury & The Blockheads... timeless quality.

Miles is Chair of the Sustainability Special Interest Group

What book is on your bedside table?
'Vanity Fair' by William Thackeray, which I have read countless times; a better study of the pitfalls of selfishness has never been written.

How do you spend your free time?
At the moment helping with GCSEs & other homework, trying to tame an allotment into a productive purpose and occasionally treading the boards with a local drama group.

What's on your iPod?
Hendrix and Beethoven.

What keeps you awake at night?
The window rattling and the rapidity of climate change.

Paul Ogden, Partner, InProp Capital

What brought you into the property industry?
In the mid-2000s as head of new product development at inter-dealer broker Prebon Marshall Yamane I became aware that real estate, the largest asset class in the world, was only just waking up to derivatives. Given that all of the commodities, energy, shipping and insurance markets had embraced derivatives it seemed like such an amazing opportunity so I moved to GFI and helped to establish their derivatives JV with CB Richard Ellis.

How has the property industry changed for you since you joined?
Pre-crisis property was all about how to maximise gearing without too much thought for risks. These days the converse is true, risk is now foremost on everybody's mind.

How do you feel about the future of the industry?
I think that the future will be very exciting if the industry is willing to embrace innovation. I'm very excited by the opportunity to bring techniques from other asset classes and to apply them to real estate. There's even a whole new investable asset-class to look forward to: real estate debt.

Paul is Chair of the IPF Property Derivatives Special Interest Group (PDIG)

If you weren't doing the job you are, what would you be doing instead?
I have a, so far unused, snowboard instructor's qualification, that wouldn't be a bad alternative to the City.

What was the first record you ever bought?
Blue Oyster Cult's Agents of Fortune, a mildly obscure US 1970s/80s rock band.

What book is on your bedside table?
Two books: 'Thinking Fast and Slow' by Daniel Kahneman, set to be as influential as Black Swan but not recommended for forecasters. 'Fixing Your Feet', a technical read about how to avoid the horrible things that can happen to your feet if you choose to run a long way in the Sahara.

How do you spend your free time?
Training to run a long way in the Sahara: I'm running in next year's Marathon des Sables which is a 6 day, 250km jaunt in up to 50C heat carrying a pack. I also try to balance that physical exercise with some mental exercise at the Royal Institution and Royal Geographical Society when possible.

What's on your iPod?
Widely varied: e.g. Alabama Shakes, Ethiopian Jazz, Led Zeppelin, Grateful Dead, Cafe del Mar and a whole lot more.

What keeps you awake at night?
Sore ankles from all that running and excitement at the opportunities in real estate right now.

Graeme Rutter, Co-Head Property Multi Manager, Schroder Property Investment Management

What brought you into the property industry?
A career in property was a natural progression from a degree in Geography from Bristol University which I followed up with a Diploma in Land Economy from Aberdeen University.

How has the property industry changed for you since you joined?
Massively. I started my career with the partnership Weatherall Green and Smith, getting a broad range of experience of direct commercial property before moving to Savills to mainly specialise in retail warehouse investment agency. I've focussed on indirect property for the last eight years with Morley (now Aviva) and for the latter six years with Schroders.

How do you feel about the future of the industry?
Cautiously optimistic. The income return from property still makes the asset class attractive to investors despite capital side volatility and uncertain economic environment.

If you weren't doing the job you are, what would you be doing instead?
I'm pretty handy with a hammer and screwdriver, so probably DIY related.

Graeme is Chair of the IPF Indirect Funds Group

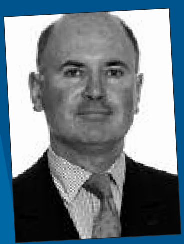
What was the first record you ever bought?
'Kids in America' by Kym Wilde. It seemed like a good idea back in 1981.

What book is on your bedside table?
I've got two on the go at the moment: 'I'm Not Really Here' by Paul Lake – the former Manchester City hero and best football captain England never had – and 'Trampled Under Foot: The Power and Excess of Led Zeppelin' by Barney Hoskyns.

How do you spend your free time?
Either fixing or decorating things around the house, watching my older boys playing a variety of sports (much better than I ever did) or preventing my toddler from getting into trouble.

What's on your iPod?
A variety of sports related podcasts and a fairly eclectic collection of music, heavily influenced by the Manchester (pre-Madchester) scene.

What keeps you awake at night?
Not a lot, although a glis glis / edible dormouse was a recent unwanted visitor in our bedroom for a couple of nights.



Michael Stancombe, Partner, Hogan Lovells

What brought you into the property industry?
I was press ganged! On qualification I had other ideas about my preferred area of specialism but our then senior partner (and my mentor) Alan Parsons was convinced that I was destined for a career in property. As ever, he was right.

How has the property industry changed for you since you joined?
When I joined the industry, it was dominated by the UK institutions and the listed sector. The investment process was much more straightforward and rather leisurely. We now have a very sophisticated industry with complex investment structures, regulatory frameworks and financing techniques. We are also part of a global market.

How do you feel about the future of the industry?
I am very positive about the future of the industry. I can see huge opportunities for the brave and equity rich. Inevitably there will be a consolidation and this will impact on advisers – including lawyers.

If you weren't doing the job you are, what would you be doing instead?
Assuming we are looking at options after qualifying as a lawyer, I would probably have moved into property development (an avenue I thought seriously about at an early point in my career).

Michael is a member of the Management Board and Chair of the International Group

What was the first record you ever bought?
'Bad Moon Rising'. Creedence Clearwater Revival Band.

What book is on your bedside table?
'Bring up the Bodies' by Hilary Mantel.

How do you spend your free time?
Catching up with the family and enjoying good wine and food – preferably in rural Dorset.

What's on your iPod?
A huge range from Velvet Underground to Bruce Springsteen.

What keeps you awake at night?
I normally sleep like a log – unless I've drunk coffee beyond mid afternoon or over-indulged on cheese!

Forum activities and announcements

Annual Lunch

The Annual Lunch will be taking place on Friday 25 January 2013 at the Hilton Park Lane, London W1. **Allister Heath** will be the after Lunch speaker this year, and there will also be presentations to the IPF Diploma Award winners. To book a table, contact Barbara Hobbs, bhobbs@ipf.org.uk

IPF Northern Dinner 2012

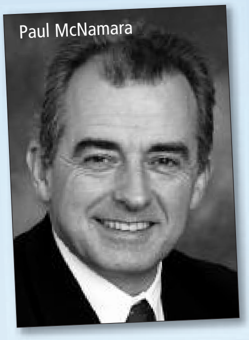
The IPF Northern Dinner took place in Leeds on Wednesday 17 October with over 70 attendees. After the Dinner, **Tom Riordan**, Chief Executive of Leeds City Council spoke about the opportunities for the property sector in the Leeds city region and beyond.

IPF Midlands Dinner 2012

Thursday 18 October saw over 600 people attend the IPF Midlands Dinner at the ICC in Birmingham. This was a fantastic turnout and shows that this event deserves its place as the foremost property networking function in the Midlands. **John Prescott** was the after Dinner speaker – and he provided plenty of fodder for conversations in the bar afterwards!

Paul McNamara joins the IPF as a Consultant

Paul McNamara, formerly Director: Head of Research at PRUPIM, has been appointed as a consultant to the Investment Property Forum (IPF) to assist in identifying emerging issues and proposed regulatory and legislative changes that are likely to impact the transparency and efficiency of the property investment market. Paul will work alongside Sue Forster, Executive Director, and Pam Craddock, Director of Research, at the IPF.


Paul McNamara

Paul, a life member and former Chairman of the IPF, commented:

"The context within which property investment takes place is being influenced materially by, amongst other things, financial regulation and the burgeoning green agenda. I look forward to working with thought leaders in the IPF to ensure sensible and practical measures are developed in these and other areas."

Amanda Howard, current Chairman of the IPF, commented:

"Paul's appointment comes at a key time for the IPF. The wave of proposed regulatory and legislative changes by the UK government, EU and global institutions is likely to have a major impact on the property sector. The IPF's role is to enhance the understanding and efficiency of property as an investment. Paul will be playing a valuable role assisting us effectively to identify and address issues as they emerge."


Midlands Dinner 2012


Tim Hurdiss, Chair of IPF Midlands Board

John Prescott, Amanda Howard and Tim Hurdiss

New Chair of the Research Steering Group


Alan Patterson

Alan Patterson of Axa Real Estate Has taken over from Andrew Smith of Aberdeen Asset Managers as Chair of the Research Steering Group. Alan brings a wealth of experience, and we are delighted that he has accepted this role. Andrew has stepped down in advance of him becoming the Chair of the IPF in 2013. We would like to thank Andrew for his invaluable contribution to and recent leadership of the Group.

Does the level of inflation affect returns in UK REITs?

Andrew Marshall, a student at the University of Aberdeen, was awarded the IPF Educational Trust (IPFET) dissertation prize in 2012 for the best MSc dissertation on a topic in real estate investment and finance. His dissertation is summarised below.

This article is a summary of the author's MSc dissertation paper, which looks at the return characteristics of several UK REITs and, in particular, how inflation rates affect REIT returns. Do securitised real estate investments provide an inflation hedge or do they act more like equities, with evidence suggesting that these are impacted detrimentally by inflation? To try and establish this, the research looked at four major UK REITs, with emphasis on the effects that the global financial crisis played on the returns of such companies and whether sector-specified REITs and/or diversified REITs reacted differently to the changes felt in the macro economy during the time of crisis.

Data

The research considered four different REITs with differing diversification characteristics in order to establish whether different sectors of real estate reacted differently to the changes level of inflation. These were: British Land (a diversified portfolio); Capital Shopping Centres Group, (retail-specific portfolio); Great Portland Estates (predominantly office-based portfolio); and finally SEGRO (main focus being industrial property). As these REITS were real estate operating companies (REOCs) before REITs were introduced to the UK on 1 January 2007, the company return data prior to that date was used in the analysis, providing a sufficiently long time series to carry out a regression analysis.

Monthly data for opening share prices from as far back as 1990 has been found for British Land (BL), Great Portland Estate (GPE), and SEGRO. Unfortunately data for Capital Shopping Centres Group plc (CSCG) could only be found as far back as July 1992; however this still provides 20 years of data and 265 observations. All this data was sourced from Thomson Reuters Eikon.

The inflation measure used is the Consumer Prices Index (CPI), being the official method of calculating inflation in the UK.

Patron: John Ritblat

Methodology

The research used a vector autoregressive model (VAR) to examine the relationship between the variables by taking each one and relating its variation to its own past history and the past values of all the other variables in the system. By using an unrestricted VAR model, it does not enforce any restrictions about which of the variables in the system affects the others. Also researchers do not need to specify whether the variables are endogenous or exogenous, they are all described as endogenous (generated within the model). This means that only lagged variables are used on the right-hand side, therefore all future outcomes and values of the dependent variables can be calculated using only information from within the system.

Results of the analysis

The study produced results that support the argument that securitised real estate is an effective hedge against inflation. Inflation was shown to have no significant affect on the company returns for BL, GPE and SEGRO.

The only REIT where there was a very slightly significant relationship with the level of CPI was CSCG, which has a retail-specific portfolio. This would suggest that increases in the prices of goods reflected in the CPI could have a more direct impact on the retail sector as a whole and therefore any company that has is invested in retail property. The connection could be investigated in future research to obtain a more detailed understanding of the relationship.

For further information and/or to obtain a copy of Andrew's dissertation, please email him: andrew.james.marshall.07@aberdeen.ac.uk

IPF Investment Property Forum

Annual Lunch 2013

London Hilton on Park Lane, London W1

Friday, 25 January

Pre-lunch drinks: 11.45 – 12.45

Lunch: 12.45 – 14.50

Post-lunch bar opens: 14.50

Dress code: Lounge Suit

Guest Speaker:

Allister Heath

Editor of City A.M. and regular economic, business and political commentator on TV and radio.

This event is kindly sponsored by:

CHASE & PARTNERS C&P

LanghamHall
real estate fund administration

VALAD

Ticket price: £110 + VAT

£132 inclusive of VAT @ 20% per person. The ticket price excludes wine and other beverages.

For more information or to book, contact Barbara Hobbs on 020 7194 7920 or email bhobbs@ipf.org.uk