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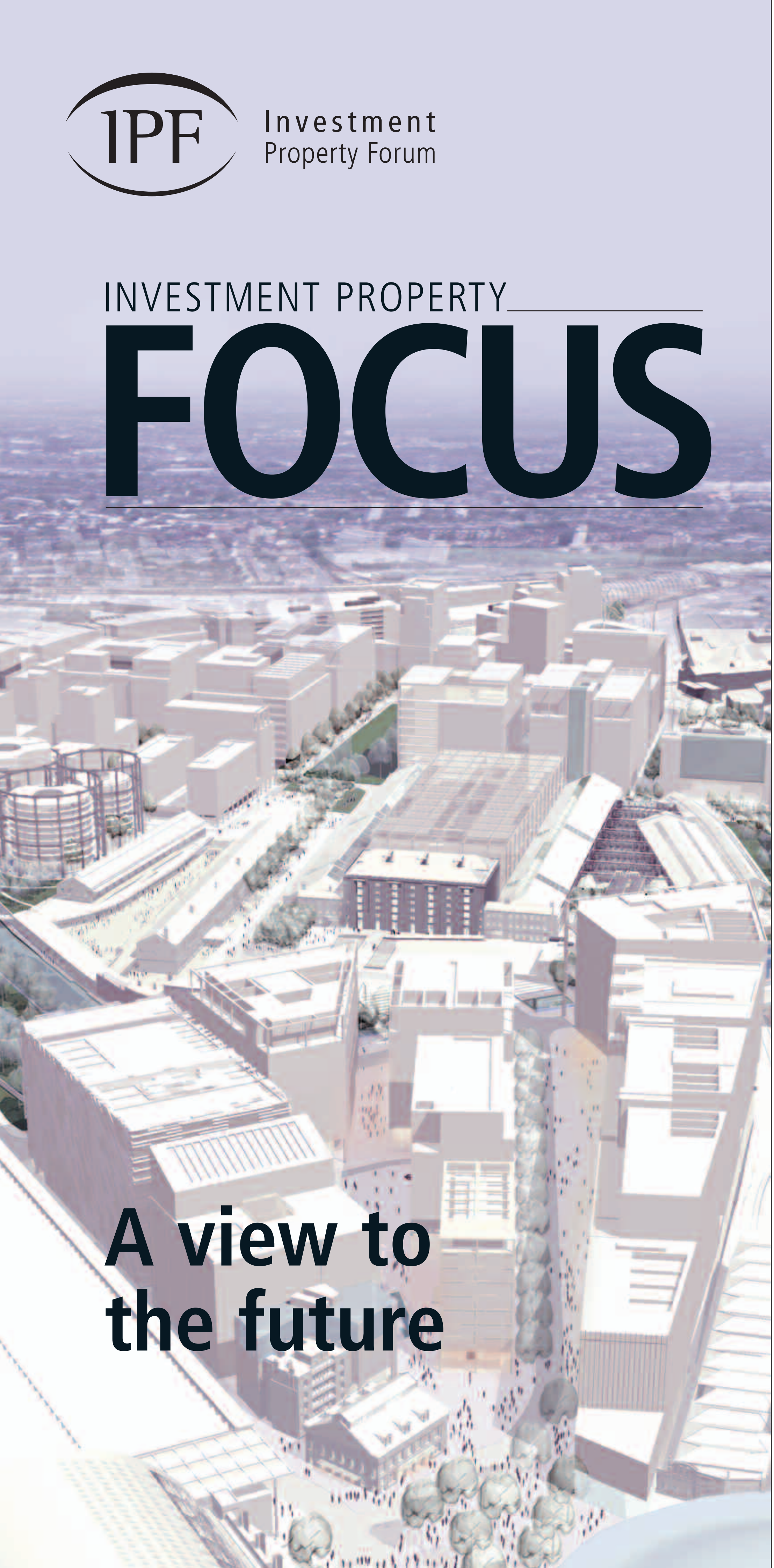
INVESTMENT PROPERTY FOCUS



A view to the future

The journal
of the Investment
Property Forum
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In this issue:

IPF Investment Property Forum

4th Annual IPF Property Investment Conference in Scotland

Thursday 13th September 2007

Radisson SAS, 80 High Street,
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Property under pressure: rise to the challenge

Industry leaders examine the four key issues currently facing the property investment market

- The Sustainability Agenda
- Building for the Future – the developer's response
- Tax – what next?
- Economic Overview and Forecast

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From the editor

This edition of Investment Property Focus highlights the details of the revised Lease Code and the new UK Occupier Satisfaction Index; takes a retrospective look at the 10 years of Labour government and, in the light of the proposed new agency, Communities England, looks at the role of land use planning in regeneration, with a complementary perspective from a leading developer.

Andy Martin of Strutt & Parker explains the background and key provisions of the new Code for Leasing Business Premises in England & Wales 2007, which embraces three elements: the Landlord Code; the Occupier Guide; and the Model Heads of Terms. He stresses the need for landlords and their advisors to sign up to the Code, not least to ensure that the government does not identify a need to legislate on commercial leases in the future.

So how healthy is the current landlord and tenant relationship? According to the new UK Occupier Satisfaction Index 2007 (OSI) there have been changes in the right direction but still room for improvement. Rob Bould, GVA Grimley, reviews the results by sector and company size and sets out some of the key challenges for the industry – any progress in addressing these will be quantifiable in subsequent editions of the OSI.

The important role played by the IPF, in respect of its membership and wider afield, is underlined by the message from the new IPF Chairman, Peter Freeman; the work undertaken by the IPF's Sustainability Special Interest Group, as described by Paul McNamara; and with the launch of the joint IPF/INREV/Cambridge University module on indirect property vehicles. The module leaders, Xavier Jongen and Philip Nell, outline the investment background to the course and details of its content.

Bill Maxted provides a review of the latest survey of the UK commercial lending market carried out by De Montfort University. Although the circumstances within the market in 2006 were similar in many respects to those of 2005, he highlights the growing amount of debt securitised in the CMBS market, the apparent continuing relaxation in some lending terms and the increased lending to development projects and outside the retail, office and industrial core property sectors.

This edition looks at a number of other topical issues: Colin Barber reviews the range of alternative ways to invest in property without acquiring a single brick; Tim Horsey reports on the recent IPF lecture 'Asset management – time to deliver?'; and the role of valuation in property investment is considered by both Neil Crosby, University of Reading, who compares valuation-based pricing in Germany and the UK, and by Tony Key, Cass Business School, and Gianluca Marcato, University of Reading, who conclude that valuation-based property indices are understating property risk.

Last, but not least, we include a brief interview with Amanda Keane, the IPF's outgoing Executive Director. After nine years with the Forum, Amanda moves on to new challenges and we wish her every success.

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Message from the Chairman

Peter Freeman, non-executive director and joint founder Argent Group PLC

The IPF is very special. For some members, it is the organiser of great lunches and dinners – entertainment, networking business development – a club. For others, it is a body which leads an enormous research programme and brings together the best academics with the most thoughtful practitioners. For others, it is a night school – constantly arranging seminars on the key issues at the heart of making property more efficient and more transparent.

It is all of these things. It is also increasingly engaged in opinion forming. The IPF took the leading role in coordinating industry wide support for REITs; it readily supports the lease code; and opposes what it considers to be unworkable new ideas like the Planning Gain Supplement. But when it speaks, it does so with objectivity and clarity. The one thing it is not is a narrow trade association, lobbying for the interests of just one business group.

People

Before setting out my aspirations for the coming year, I would like to remind members of the tremendous debt we owe Amanda Keane, the outgoing executive director of the IPF. In the nine years since she joined us, membership has tripled; the regional branches have been established; £1m raised for the research programme; and a comprehensive education programme put in place. Our budget has gone from £200,000 to £1.5m. Amanda has taken the IPF from a cottage industry to an organisation with a big vision, an important mission and the ability to deliver.

Amanda's successor is Sue Forster. Also a surveyor with a wide range of agency and consulting experience, but who has been running a publishing company, producing detailed coverage of the UK and European markets in print and on-line. I know that she will also bring new strengths to the IPF.

Our thanks also go to Charles Follows, the IPF's first research director, and Sabrina Wisner, the outgoing education officer. They both did a terrific job, and we welcome Louise Ellison as Charles's successor, and Chris Naughton, as Sabrina's.

This year, we are sadly losing three chairmen, not one. Ian Womack steps back on to the management board after a fantastic year as chairman and two ex-chairmen, Ian Marcus and Stephen Fogel, step down from the management board. Their wise counsel and good humour will be greatly missed. Next month Ian Marcus becomes President of the BPF – the fourth example of IPF thought leadership colonising the BPF!

The Property Industry Alliance

The last year saw the start of an 18-month trial period for the Alliance. It has been chaired by our President, Sir David Clementi. The IPF Management Board is very supportive of the role of the Alliance and my hope and expectation is that during my year in office, the IPF, BPF, BCO and RICS will all make a long-term commitment to its future. The protocols of the Alliance make it clear that each member retains its independence and where we are not in agreement, the Alliance will not put forward a majority view. Where we can speak unequivocally as one, I have no doubt that even government will listen – if only that was always the same as acting on our advice!

Research Programme

Due to the hard work of many, particularly John Gellatly, Paul McNamara and Charles Follows, and the generosity of our 24 sponsors, the IPF has nearly £1m to fund major research. We want to invest the money wisely. The more new research ideas members can feed back (and people outside the 'usual suspects' capable of carrying it out to the highest standards), the better the programme will be. If there is a unanswered question that will be useful to the industry let Louise Ellison know. As the first IPF chairman who is a developer at heart, I have a number of development orientated topics I would like to see explored. I am also delighted that, for the first time, the Management Board includes a planner, Stephen Brown, of GVA Grimley. In my view, planning is an essential part of the pipeline process. It has a significant impact on the supply-demand equation and thus on price and value growth for all property.

Communication

There are two areas where I hope the IPF can improve its communication role. One is in the distribution of knowledge first and foremost to members, but also to the wider property community. We should do more to disseminate both abstracts and the full text of all research reports free of charge. We should also look, possibly with the Alliance, at creating an e-library as a central reference source.

Beyond that, all of us who care passionately about our industry and believe that we do play a vital part in the economy and social wellbeing, need to do more to convince government. Its spin in seeking to abolish empty rates relief shows that we still have a long way to go before we can bury old myths like the one that we profit from keeping buildings empty!

You, the members, are all serious people doing worthwhile jobs. We, the IPF, are here to help.

The Code for Leasing Business Premises in England and Wales 2007

Andrew Martin, Head of Commercial Division, Strutt & Parker

Andy Martin looks at the thaw in landlord and tenant relations.

We cannot attribute the thaw in landlord and tenant relations to global warming, but there is indisputable evidence it is happening. This evidence comes in three quite separate initiatives; the RICS 2006 Code of Practice on Service Charges in Commercial Property; The Occupier Satisfaction Index under the auspices of The Property Industry Alliance and lastly the launch of the Code for Leasing Business Premises in England & Wales 2007.

It is not a surprise that these initiatives have occurred at roughly the same point in time. The signs have been there for some time. Leases are getting shorter, the IPD/BPF Survey of Leases tracks this decline in average lease lengths which, in its simplest statistics, puts the average length of all new leases granted as being less than 10 years. The rise of indirect vehicles and indeed quoted property companies (many now REITs) have seen increasing moves towards sector specialisation. A focus on the occupier (the customer) is a natural part of this evolution – investors talk of income management, occupiers of a fair deal. So landlords and tenants are now service provider and customer, and the thaw in traditional frosty relations starts.

It all originally started with the 1995 Lease Code, revised in 2002, and so it seems appropriate that this is also modified to encompass this new movement. The IPF was not involved in the drafting of the two predecessor codes. The initiative for those came about as a response by the industry to avert a government manifesto pledge to look at industry practices and in particular legislate against upwards only rent reviews. The second attempt was followed by a monitoring role undertaken by the University of Reading. The result of this monitoring led to a series of options for revisions to rent review terms and the issue of a consultation paper in May 2004 by the government, enabling the industry to respond with its thoughts.

At this point, the IPF utilised work already being undertaken within the Research Programme to investigate the form of rent reviews and their impact on leases. The Investment Performance and Lease Structure Change in the UK was published in full in July 2005.

The Reading University Report was submitted firstly as an interim report and the final report after a two-year monitoring period.

The combination of IPF research and the outcome of the Reading findings confirmed several areas where the industry could improve its act.

Largely these areas were as follows:

- The existing Lease Code had little penetration amongst landlords, occupiers or advisors;
- Upwards only rent reviews were not voiced as the major concern for occupiers;
- Small businesses in particular did not fully understand their contractual obligations and as a rule shunned professional advice due to costs, leaving them vulnerable;
- Leases had become shorter; and
- Alienation provisions were unsatisfactory and were more remarked upon than upwards only rent reviews.

The IPF submission to the consultation paper made several propositions:

- Better dissemination of the contractual liabilities to occupiers before lease terms were agreed;
- Lease terms were demonstrably shorter and therefore the impact of upwards only rent reviews were less relevant; and
- Alienation provisions were more important and in particular, the ability to sublet at market rent, even if less than passing rent, would remove a number of identified issues. Strangely, despite the fact that most institutional investors accepted such provisions it was not recognised within the existing Lease Code. Subsequently the BPF took on the initiative to get landlords signed up to a declaration that this was their position – most large investors immediately signed up to this declaration.

All of this was happening at the same time as REITs were moving up the agenda and this and the Lease Code initiative provided another good platform for the IPF to work with the BPF and RICS with a common goal.

So when the government announced in 2005 that having reviewed the industry and Reading submissions, it would not be proposing legislation on commercial leases this was seen as a sensible response to common sense discussion.

So why a new Lease Code? The reason is relatively simple; while many in the industry were celebrating a seeming victory on lease terms, the government statement emphasised that it would be proposing another monitoring programme and was expecting a better response from the landlord industry. Legislation had been postponed not cancelled.

The Code for Leasing Business Premises is therefore a bold attempt to produce a code that sticks.

For the first time, the IPF was invited to participate in the discussion group set up by the government for the Lease Code and subsequently the industry group set up to reconsider the Code.

This group brought together representatives of all aspects of landlord and occupier bodies, the two key professional bodies, the RICS and Law Society as well as the government itself. This group, headed by Philip Freedman of Mischcon de Reya, often had around 20 representatives sitting around the table. But first what needed to be changed? In short, the group felt the existing Code was:

- Too big, too technical and too cumbersome, therefore unlikely to be fully embraced;
- Was not specific enough and provided too many options to form a code of best practice;
- Did nothing to help dissemination to the intended audience; and
- Had no provisions enabling self monitoring by the Industry.

The result is now **The Code for Leases Business Premises in England and Wales 2007**. The IPF website has a direct link to the Code website which is www.leasingbusinesspremises.co.uk. It is worth saying at the outset that whilst the Code specifically excludes Scotland, it is the intention that the objectives of the Code are followed north of the border.

The Code embraces three individual elements.

1. The Landlord Code: Covering 10 key areas of lease negotiation with clear best practice commentary.

2. The Occupier Guide: A plain English guide for occupiers intended to act as a walk through lease negotiations and contract terms, including tips dealing with key items of the Landlord Code.

3. **Model Heads of Terms:** A checklist intended to provide those parties to the original negotiation with the details that heads of terms should cover. The intention being simply to ensure both landlord and tenant are clear on the lease bargain at the earliest stage in the lease negotiation process.

Each of the three elements are intended to be downloadable separately and therefore usable by individual practitioners, landlords and tenants.

So what is the purpose? I think the introduction to the Code neatly sets this out:

- It is authoritative and intended as a best practice guide;
- It provides a checklist;
- It requires landlords to be transparent where they do not comply;
- It is easy to use and therefore disseminate; and
- It provides simple tools by which the adoption of the Code can be monitored

The Code is intended to bring about openness at the point of negotiation of new leases and renewals, therefore preventing situations where the true terms are only available once a tenant is felt to be committed. The Code also recognises the new RICS 2006 **Code of Practice on Service Charges in Commercial Property** and as such completes a tie in with the transparency the industry is now seeking to embrace.

Key points

The full provisions of the Code are available and so there is little point in repeating them in detail here. The key elements are summarised in Figure 1. It is worth commenting that the Code sets out intent and will undoubtedly draw criticism that it should expand on certain terminology. Although that would have defeated the objective of compactness, it may be something the monitoring process picks up. The Code is intended to be a living work capable of being updated.

In my view, much of what the Code does is to spell out what is standard practice for many and makes good sense in seeking the best in landlord and tenant relations.

The Code recognises that there may be instances where landlords cannot meet all of its requirements, but does ask in these instances they explain early on why this is the case.

Where now?

Firstly this Code is endorsed by all who were party to it, landlords and tenants alike.

The industry group and, I believe, government recognise that many landlords and tenants already adopt most if not all the negotiating positions in the Code. The Reading research however emphasised the need to protect smaller businesses and get greater understanding of lease contracts in this area. It is here that the Law Society and RICS must now consider their positions as it is at the advisory level that the Code and therefore transparency can have its greatest impact.

The BPF has also sought to list publicly those parties who have signed up to the Code, being both landlords (37 so far) and advisers – the latter taking the position that they will apply the Code as default unless instructed otherwise. In addition, the BPF is to instigate an accreditation scheme. The BRC is proposing a monitoring process amongst members who sign new leases.

However, as we found out in our recent seminar at Addleshaw Goddard's offices, many who have signed up to the Code have not gone further to instruct lawyers or their leasing agents on standard form terms or to instigate internal dissemination about the Code itself. Paying lip service to the Code will not be a position that will pass the government's own monitoring process.

Figure 1: Key elements of the Code

1 Lease negotiations

This stipulates the terms which a landlord should set out in writing, including rent; alienation; rent review; repair; VAT and tenure. The Code asks for flexibility with landlords openly stating whether alternative terms are available and responding to requests for such alternative terms.

2 Rent deposits and guarantees

A simple requirement to set out clear parameters, length of arrangements, interest and release provisions.

3 Length of term, break clause and renewal rights

First and foremost be clear. The Code does break new ground by stating the conditions for exercising a break clause – up to date with rent and no continuing subleases – all the rest follows the normal provisions at expiry. This is intended to prevent breaks being challenged through technical issues which would not prevent normal expiry of a lease.

4 Rent review

The Code requires rent reviews to be clear and not contain provisions that aim to achieve a headline rent. The Code requires either party to be able to commence the rent review process. The Code requires landlords to respond to requests for alternatives to review methods, in turn, landlords should give reasons if they are unable to provide alternatives. This, of course, deflects the issue of removing upwards only rent reviews but equally it must be remembered the Reading research did not find this was the major issue for tenants.

5 Assignments and subletting

There should not be a prohibition of assignment of the whole with the exception of group companies, where a provision requiring guarantors and at least equal financial strength party would be Code compliant. More importantly, authorised guarantee agreements (AGA's) should not be a default provision and should not be required unless the assignee (and guarantor) is of lower financial standing than assignor (and guarantor) or is registered overseas. The Code does suggest smaller tenants (undefined) should be able to provide rent deposits as an alternative.

The Code also addresses the failure of the previous codes and permits subletting at the then market rent. Further sublettings excluded from the 1954 Act should not have to follow the precedent terms in the superior lease.

6 Service charges

This really tries to follow the RICS Code. Landlords have to be open, provide best estimates of charges up front, including one off items or reveal any plans for major expenditure.

7 Repairs

The Code requires repairing obligations to be appropriate for the term of the lease. This is non specific, but the wish for openness and the occupier guide hopefully will help parties to find individual solutions.

8 Alterations and changes of use

A general rule that only the overriding factor for grant would be protection of value.

9 Insurance

This goes back to the service charge provision seeking the insurance to be value for money, with reputable insurers and commission to be disclosed on request. Rent suspension is also dealt with as is the ability to terminate by either party if reinstatement works are not completed in the suspension period.

10 Ongoing management

Again really common sense for good landlord tenant relations. The key provision is for the landlord to carry out a schedule of dilapidations six months prior to expiry. Landlords should upon receiving requests from tenants give notice of information required to consider the application within five working days.

Indirect advances in education

The new IPF module on indirect property investments provides a 'Nescafé' approach to indirect investment strategies.

Indirect investment vehicles have important benefits for some investors when compared to a direct investment portfolio. First, indirect investments optimise risk and return levels by pooling assets and providing diversification benefits to investors. Second, indirect vehicles are a 'one stop shop' for expert knowledge: dedicated management as well as market, fiscal and legal expertise. Third, entrance barriers are lowered when investing in other world regions and new property sectors. In short, indirect vehicles service some investors better than they can service themselves. No surprise, therefore, that the origin of the indirect market can be traced back to the principal investor.

From its inception onwards – the 1960s in the US, the 1970s in the Netherlands, and the 1990s in the UK, the indirect market enjoyed a first quantum leap forward when Modern Finance was applied to property. This revealed the risk and return enhancements of adding property to a balanced investment portfolio. A subsequent leap forward in Europe followed the signing of the Maastricht treaty and its stability pact. This eliminated currency risks between 12 European economies and established an anti inflationist monetary policy, resulting in historically low interest rates. Both factors concurred to attract a wall of capital to the property industry.

From here onwards, the success of the indirect investment business also attracted new creative talents who had largely abandoned it since the common European property crisis of the early 1990s. Now, we see an outburst of innovation on both the debt and equity sides of indirect vehicles: new secondary debt instruments, new bond-like or inflation-hedge investment products, new sectors (such as car parks, city funds, social and road infrastructure), new regulations as well as new ways to circumvent negative externalities caused by these regulations. Arguably, the innovation with potentially the biggest impact is the new, third way, to indirect investments: derivatives. Moreover, new actors come into the market, like investment banks, and cross border strategic partnerships are on the rise, while principal investors engage in backwards integration to become investment managers; a métier they had only recently set up to better service investors.

Xavier Jongen, Bouwfonds Asset Management

New creative products, new actors and considerable market growth also spurred the need to set direction and functionality to the market. Thus, new reporting and governance principles were set up. These were partly initiated through auto-regulation by newly established multi-polar organisations, like EPRA and INREV, and partly by the public sector. The latter also introduced new fiscal and regulatory legislation, like REITs, as well as retail consumer protection regulations. Recently, EU Commissioner Charlie McGreevy called for a property expert group to be established, aiming to identify, amongst other things, the obstacles that still hinder a truly international property market to flourish.

Philip Nell, Morley

The dynamic background above illustrates the many interesting angles of the new joint IPF/INREV/Cambridge University module on indirect property investment vehicles. The course examines the three routes to indirect investments: listed, unlisted and derivatives. It explores their respective differences, similarities and the beneficial merits of their complementary use. A broad range of subjects is necessarily examined in order to provide a thorough understanding of the key elements of these structured investment vehicles. These include investor interest, investment performance and risk and return characteristics; regulations, governance and fiscal issues, as well as finance and gearing. Whilst the handbook provides a framework for academic reading, the three-day programme is heavily case-study oriented and benefits from presentations from highly-regarded academic and business leaders. Importantly, the module is structured around a roll play of various investor types to which students are allocated from the onset. The role play's objective is to stimulate an exchange of views on the motivations behind investment behaviour of the various investor types; both between students themselves and between students and presenters. At the end, groups of students present an investor specific investment strategy to a panel of industry experts. By then, it should be as simple as making a nice cup of instant Nescafé coffee!

New index for a new era

Rob Bould, IPF management board member and Chairman of GVA Grimley Capital Markets Group

Rob Bould looks at a new index and opinion survey that measures satisfaction amongst customers of the UK commercial property industry.

Two years ago, the IPF management board decided that we need to gain greater insight into the landlord and tenant relationship to demonstrate that 'customer-focused' landlords achieved better than average investment returns.

The IPF has taken a leading role in co-ordinating the engagement of the main industry bodies, culminating in the launch of the research by the Property Industry Alliance in conjunction with CoreNet Global UK on 15 May 2007.

The UK Occupier Satisfaction Index 2007 (OSI) is the first initiative of its type to have been commissioned by representative bodies from both the occupier and the property supply communities. The OSI and associated report will inform the debate about service standards within the commercial property industry and act as a catalyst for innovation and change.

The research project focuses on the hard, rather than anecdotal, evidence of what occupiers really think and provides a new benchmark, which it is hoped will be of value to the industry and its many stakeholders.

The independent research, carried out by Kingsley Lipsey Morgan and IPD Occupiers, measures how well landlords and other suppliers are meeting the needs of occupiers across the retail, office and industrial property sectors.

The results are, in part, encouraging in that they reveal that positive change is taking place. However, they undoubtedly pose a number of challenges to the industry.

Occupier Satisfaction Index 2007

The OSI is a measure of how the service provided by commercial landlords is perceived by occupiers across the retail, office and industrial property sectors.

The OSI for 2007 is 55, where total satisfaction would score 100.

Figure 1 shows the distribution of responses by the 237 organisations that contributed to the research programme by way of personal interview.

The indices for the office, industrial and retail sub-sectors are 59, 55 and 52 respectively.

Figure 2: Different levels of satisfaction

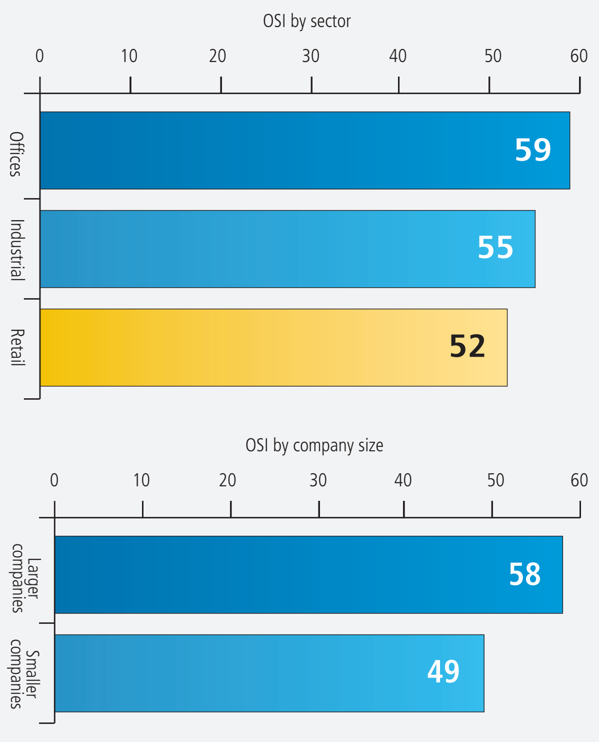


Figure 1: Responses from contributors to research programme

The research highlights significantly different levels of satisfaction between larger (OSI 58) and smaller organisations (OSI 49), and this is shown in Figure 2. Greater covenant strength, negotiating muscle and property awareness can mean that larger companies are more likely to be made to feel like valued customers of the property industry than their smaller counterparts.

The OSI for smaller organisations is strongly impacted by dissatisfaction among small retailers, where the OSI is 41; by contrast, the comparable OSI figure for small non-retail companies is 55.

Why occupier satisfaction matters financially

A number of factors combine to create a prima facie case that a higher level of customer satisfaction will help 'customer-focused' landlords achieve better than average investment returns:

- Shorter leases and higher incidences of break clauses mean that occupiers have more opportunities to exercise judgement between 'good' and 'bad' landlords when deciding whether to stay or quit.
- Landlords who can demonstrate that they provide higher levels of service and value for money are more likely to be 'landlords of first choice'.
- With greater choice and awareness, the variation in void rates between different investors could increase, thus affecting income return, a key focus for investors.

The business case for landlords to provide higher levels of service to occupiers is explored in more detail in the main report.

How the OSI is calculated

The OSI is a composite score, derived from the responses of occupiers to 14 questions, regarding their satisfaction with aspects of the service that they receive.

The responses, measured on a 1-5 point scale, where 1 is 'very poor' and 5 is 'excellent', have been weighted to give more importance to the aspects of service which are most highly correlated with high levels of satisfaction.

The responses have each been converted to a satisfaction score out of 100 (see Figure 1) and the OSI is the arithmetic mean of the 237 responses.

Defining customer satisfaction

We define customer satisfaction as the ability of the supply side of the UK commercial property industry to deliver the products and services that its occupier customers require in a way that meets, and preferably exceeds, their expectations. These products and services include the development and leasing of commercial business space, its handover and subsequent property management.

Conclusion

Many people have put in significant work to reach this stage although the real benefits will only be received by the comparison of the annual results and addressing the strengths and weaknesses identified by the associated report. The sponsor group has committed to fund the project for a three-year period.

We are fortunate to have identified John Storey, a long-standing member of the IPF to be Chair of the OSI Steering Group and under his leadership we are confident that this research will highlight the actions necessary to improve investment performance through customer satisfaction.

Key findings

The key themes and challenges are summarised opposite.

Industry challenges	Key finding	What occupiers say
Challenge 1 **FLEXIBILITY**	The majority of occupiers can secure property of a type, specification and quality that meets their needs. Occupiers perceive that flexibility has been achieved when they can match their property commitments to changing business needs. Though leases are perceived to be becoming more flexible and better suited to business needs, this can sometimes be at a price which is not perceived to represent fair value for money.	2 out of 3 occupiers say they are able to find commercial property of the right size and location. 4 out of 5 occupiers are satisfied with the specifications and build quality. 1 in 2 occupiers are dissatisfied with lease flexibility in terms of lease length and the ability to break their lease. More than 1 in 3 occupiers think that the availability of flexible lease terms at the price they are willing to pay is poor.
Challenge 2 **PARTNERSHIP**	Occupiers do not feel 'valued customers' and would like their relationship with property owners to be characterised by the term 'business partnership'. Occupiers aspire to a modern style of business relationship which is more like the style of relationship they have with their other business suppliers. Occupiers want property owners to show a greater understanding of their needs and they would like better communication generally, and, specifically, more direct contact with their landlord. Smaller occupiers feel particularly undervalued in the property market.	Nearly 1 in 2 occupiers rate the level and style of communication in the property industry as poor. 1 in 2 occupiers think the property industry's understanding of their needs is poor. 1 in 2 occupiers do not feel a 'valued customer' of the property industry.
Challenge 3 **RESPONSIVENESS**	Occupiers want the property industry to become more responsive and efficient. Some occupiers believe that they are paying for inefficiency through the service charges. Occupiers feel frustrated by the lack of responsiveness from property owners and managers. Property agents and lawyers could do more to speed up the leasing process.	Nearly 1 in 2 occupiers think that responsiveness in the property industry is poor. 2 in 3 occupiers are satisfied with the facilities and services that they receive.
Challenge 4 **SUSTAINABILITY**	Environmental issues are becoming increasingly important to occupiers. Occupiers want a more innovative approach to be taken by the property industry, and they feel strongly that property owners should at least share the costs of meeting the new standards.	More than 1 in 2 occupiers think that the property industry has made poor progress in environmental initiatives.
Challenge 5 **VALUE FOR MONEY**	Whilst many occupiers accept that rent is driven by market forces, commercial property in the UK is perceived to be expensive, particularly when compared internationally. Occupiers stress the need for the property industry to find ways to keep property costs down, and for price changes to stay in step with the rest of the economy. Occupiers place particular emphasis on accountability and transparency in relation to service charges and the cost of granting licenses for consent to assign, sublet and alter.	1 in 5 occupiers think that the UK property industry provides good value for money for the rent they pay. Nearly 2 in 5 occupiers say they think the value for money received for rent is poor. 1 in 2 occupiers think service charges represent poor value for money.
Challenge 6 **PACE OF CHANGE**	Occupiers perceive that the UK commercial property industry is becoming more customer focused, but think that the pace of change is too slow. Not all landlords are the same. Occupiers perceive that some of the larger property owners are more responsive and willing to change.	1 in 3 occupiers say that their satisfaction has improved over the last 3 years. Nearly 3 in 5 occupiers say that their business has a stronger relationship with suppliers other than property suppliers.

How was it for you?
10 years of Labour government

Three articles take a look at how the labour government helped shape the property market

The 10 years since the Labour government came to power in May 1997 have been some of the kindest to the property industry in terms of a benign macro-economic environment. It has also been a period when investors of all kinds and nationalities embraced real estate as an asset class leading to record-breaking levels of investment and values.

In the first of three articles looking back, Sabina Kalyan of IPD describes how near perfect economic conditions set the scene for a property market investment boom. In the second, Jane Roberts of EG Capital, looks at some of the highs and lows as real estate defied predictions and turned in the best performance of any asset class. And finally, Ros Rowe of PWC asks whether the tax initiatives of the UK's longest-ever serving Chancellor and now prime minister were good, or bad, for property.

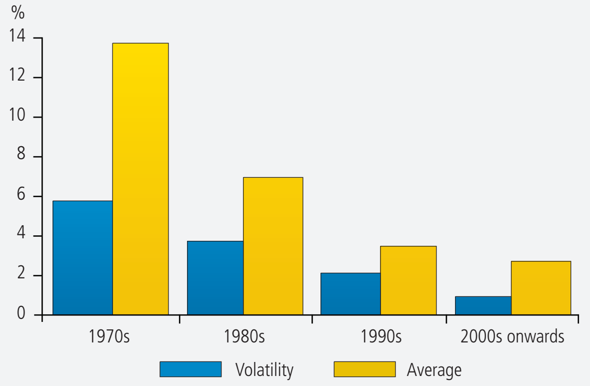
Sabina Kalyan: The NICE economy and the property investment market

It may sound odd to say that the economic climate of the last 10 years was favourable considering that we experienced one of the largest financial market crashes in history in this period, devastating terrorist attacks, a war and oil prices at historic highs. Nonetheless, the period was characterised by the combination of strong economic growth and low inflation – a combination that Mervyn King, the Governor of the Bank of England, has termed the NICE economy. That stands for, Non-Inflationary Consistent Expansion.

Figures 1 and 2 illustrate the point. Figure 1 shows the average level of inflation and its volatility in each decade. Since the 1970s, both the level and volatility have been on a steady downward trend and today stand at benign low levels. Figure 2 shows the decade averages for economic growth (GDP). What we can see is that the volatility of GDP growth has fallen dramatically in the 1990s and in the current decade; this is Gordon Brown's much-trumpeted "end to the boom-bust economy". At the same time, the average annual rate of economic growth has been markedly higher in the current decade than in the previous 30 years.

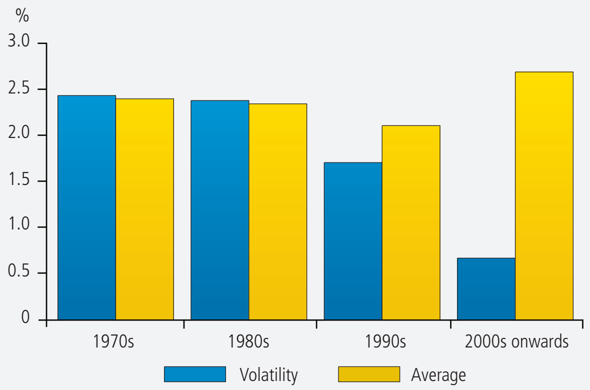
The reasons for this unprecedented combination of sustained trend economic growth and low inflation are many: a happy conflation of global structural trends and unobtrusive UK fiscal policy. On the inflationary front, the whole of the developed world has benefited from the opening up of the Chinese and Indian economies. Chinese goods and Indian services have been exported at low and falling prices and the cost-savings have been passed on to British consumers. Closer to home, labour market reforms enacted in the 1980s, coupled with rising immigration from the EU accession countries in the current decade, have kept wage inflation under control, despite the fact that the UK has been a full employment economy throughout this period. On the policy front, Gordon Brown devolved

Figure 1: Retail price inflation



Source: National Statistics & Bank of England

Figure 2: Annual real economic growth



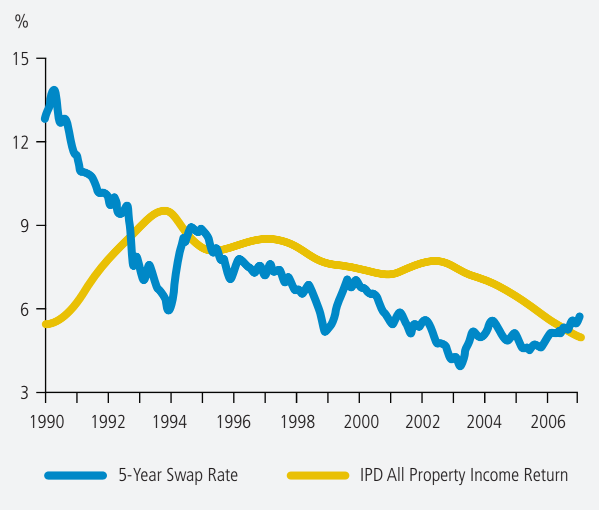
Source: National Statistics & Bank of England

monetary policy to the Bank of England in 1997, anchoring monetary policy to a 2.5% target for retail price inflation – later changed to a 2% target for consumer price inflation.

In practical terms, this meant that interest rates and bond yields fell to historic lows, helping the property investment market in two ways. First, low interest rates mean cheap financing costs for debt-backed investors. At the same time, property was still arguably under-priced after the early 1990s crash. The combination of a high income return on property coupled with cheap finance costs made debt-backed investment in property a no-brainer. By the summer of 2003 you could borrow at around 5% (the five-year swap rate plus a notional 100 basis point lender's margin) and buy a property that delivered an 8% income return. In other words, geared investment made a running profit (see Figure 3).

Low interest rates also made property more attractive to ungeared investors. We can think of the investor's 'required yield' as the risk-free rate of (the bond yield) return plus a property risk premium. As bond yields edged lower, so too did

Figure 3: Geared investment



the required property yield. Even as the investment boom heated up and property yields fell, the asset class still looked attractive.

Of course, investors in property also need to keep a close eye on the occupier market – employment growth and real economy activity rather than financial market sentiment. Gordon Brown had not so much abolished the 'boom-bust' economy as created boom and bust at the same time. The equity market crash of 2001 left the financial services industry on its back, and the slump in world trade hit the export-led manufacturing sector hard. This was reflected in the poor performance of office and industrial rents. But at the same time, lower interest rates were pump-priming the consumer sectors, not least the residential property market.

At the end of Gordon Brown's decade as Chancellor, the strong track record of the British economy is unquestioned. And it has undoubtedly helped provide near perfect conditions for the property market investment boom.

However, we are now arguably seeing the end of the NICE economy. Inflation ticked up in 2006 on the back of higher energy prices, and the Bank of England is clearly also worried that the cyclical economic recovery and strong labour market could lead to upward pressure on wages. Interest rates have been ratcheted up from 3.5% in 2003 to 5.75%. Figure 2 shows that the five-year swap rate is now running at around 5.7% – the highest level since 2001. And, for the first time since 1996, the income return delivered by property is lower than the five-year swap rate. In the occupier market, higher interest rates are starting to have an impact on consumer spending and, in an attenuated form, on retail rents. It remains to be seen whether the office market recovery will spread out from Central London to the South East and the rest of UK markets.

Nonetheless, in many ways, one would be churlish to be pessimistic about the more difficult macro-economic background now facing the UK property market. After all, the so-called problems – more expensive capital and a consumer sector slowdown – are actually symptoms of the strength of the underlying economy. Interest rates are higher because the economy is growing above trend. And after a period of extremely unbalanced growth, it is healthy to see the corporate sector start to shoulder some of the burden of economic growth in place of the stalwart British consumer. Similarly, as the pressure starts to diminish in the property investment market, we are arguably just seeing the property market return to 'normal' rather than a nasty correction: with property returns delivered largely through stable income rather than capital appreciation.

Sabina Kalyan, Chief economist at IPD

Jane Roberts: Changing sentiment establishes property's place as an asset class

"This is the first time this decade that anyone has been able to stand up in front of a conference combining property and banking people and use the words 'profit' and 'property' in the same sentence", so declared David Hunter, then managing director of Argyll Property Asset Managers, speaking in September 1997 to the Association of Property Bankers.

Jane Roberts, Editor of EG Capital

It is likely that after seven lean years, he was beaming. Everything was changing: rental levels had recovered some of their heavy losses since the boom-bust of the late 1980s and early 1990s and the prospect of a low-inflation, low-interest rate economy suggested that property might finally produce a positive, less volatile performance. In July, the new Chancellor raised stamp duty to 2%, yet property shares soared – there had been rumours that he would raise it to 7%!

DTZ reported that £18bn poured into UK property with the German open-ended funds which had been buyers since the early 1990s still the biggest group spending, just ahead of UK property companies. Total returns peaked at 16.8% – surely an unrepeatable level.

Ros Rowe, Director in real estate tax at Pricewater-houseCoopers

1998 and 1999

The investment market continued strongly through 1998, taking another stamp duty hike – to 3% – in its stride. In fact it turned out to be another record-breaking year although activity stalled in October when a stand-off between buyers and sellers left a lot of property hanging around unsold. The pause was induced by fear that prices would fall if the Asian financial crisis and the knock-on effects of Russia's default on its own government bonds spread west. But it turned out to be only temporary.

It was the period of the somewhat inelegantly titled 'debt-driven investors', the very highly-geared buyers like Rotch. In 1999 the Tchenguiz brothers were said to be assembling a £1bn portfolio of property and exploiting the huge gap between low finance costs and high property yields. They were buying central London office buildings at 8% yields.

Heavily geared Irish buyers had started what would turn out to be a sustained spree investing in UK property. Ireland seemed to have produced an unbelievably long stream of wealthy contractors, dentists and accountants who could teach the UK property industry a thing or two. The equity market was powering ahead.

2000

The FTSE 100 stood at 6,600 in early January and many analysts were predicting 7,000 by the end of the year. In the end, it slumped 10% as the dotcom bubble burst and tech stocks were sold off.

But it was another record year for property investment volumes, despite yet another stamp duty hike – to 4% – and ominous signs for the office occupation markets. The year end was a bit of a repeat of 1998, with turnover slowing and the market softening. Prices dropped below last year's valuations and for the first time fund managers started worrying about trading themselves into underperformance courtesy of the high costs of transacting. Cue the lawyers to come up with new schemes to buy and sell offshore to avoid stamp duty...

2001

This was the year everyone lost faith with equities. Although initially the stock market recovered slightly – the FTSE 100 stood at 6,334 on 1 January – it was the calm before the storm. The markets fell 16% and the FTSE ended the year at 5,217 after touching 4,433 following the September US terrorist attacks.

Interest rates were cut from 6% to 4% and swap rates fell to a 50-year low which would benefit property. But the market was relatively subdued and the institutions stayed out. IPD total returns were 7.1%.

2002

This was the third successive bear year for equities and would prove the worst yet (-25%), but it was a pivotal year for property as an investment. Everyone seemed to be talking property down: analysts recommended staying underweight in the sector and agents were predicting a grim year of low returns (and lower fees) based on income return only as vacancy rates soared in the wake of the TMT sector's collapse. Turnover in Central London office leasing fell by half.

David Rough, investment director of Legal & General and later on Land Securities board, noted that property had still outperformed equities for the last two to three years and should not be written off. Low borrowing costs and buyers fed up with the stock market gave property a boost and it began to look like a safe haven, though some funds still waited in cash for a rise in shares that never came.

Everyone else was buying retail. A record 102 shopping centres worth £4bn were sold that year – one every three or four days.

2003

The FTSE 100 opened at 4,012 and the market looked set for a record-equalling fourth year of decline. In fact it started to recover in March, at the same time as the Iraq war started. But a curious phenomenon was now established in the real estate market. Rents were still falling overall, dragged down again by offices although retail continued to be strong, but capital value growth was strong, strong enough for returns to hit 11.5% with negative rental growth. John Plender, senior editorial writer and columnist at the Financial Times, was not the only one who was perplexed: "Commercial property is suffering from a curious form of optimism. While rents have been falling, capital values across much of the market have been rising. What's afoot?"

2004

Equities might have rallied, but the small private investor was still disgusted and had found a new place to put his cash – property. "With new vehicles available to them to invest in commercial property, we suspect the money flows will remain very positive" Merrill Lynch's analysts observed with considerable prescience.

Authorised property unit trusts were just one type of indirect vehicle expanding like topsy to absorb the cash. Funds piled back into property, just as all the bargains had gone. There was another significant new trend: they started to look across the channel.

It was the year of unprecedented flows of capital into UK real estate and a record year for Central London investment. Yields fell and property shares surged, to a 46% return – the buzz phrase was 'yield shift'.

2005 & 2006

Prestbury's Nick Leslau might have called the top of the market in 2004, pointing out that values defied logic, soaring as rental values in many markets were still static. But 2005 was the year investment volumes broke all records (again) and yields were squeezed down further, to 4% in the West End and 5% in the City. And it continued into 2006. Once again, at the beginning of 2006, some analysts urged clients to take profits. Property shares went on to return 48%, with a lot of the performance in the last couple of months of the year, ahead of real estate investment trusts arrival on 1 January 2007. Property's total returns, as measured by IPD, were 19.1% and 17.9% respectively. Golden years.

Ros Rowe: How constructive were the last 10 years?

Turn back the clock to Gordon Brown's first Budget as Chancellor of the Exchequer in 1997 (the people's Budget) and, surprisingly, it looks familiar when compared to his eleventh. The corporation tax rate was cut by 2%, there were comments about fairness and anti-avoidance and a commitment to improve the environment.

At that time, any concerns about property being used to finance a 'tax and spend' government appeared to be unfounded.

However, by 2000 stamp duty land tax (SDLT) had increased from 1% to 4% and since then it has been one of the Chancellor's good earners; with the rise in house prices there has been an added bonus to the Treasury of fiscal drag bringing more properties into the 3% and 4% SDLT rate. The housing market has been fuelled by a lack of supply, by improved incomes and low interest rates. Consequently, to date, the impact of the 400% tax rate rise has been masked, but that could change if the market turns.

In the commercial sector, there has been a buoyant economy. Demand has increased for property as an alternative asset class to bonds and equities.

Furthermore, the UK remains an attractive location for non-resident investors, with a lower tax rate on income (which can be reduced by gearing) and no tax on gains.

While in this year's Budget, Gordon Brown reaffirmed his 1997 intention to be 'green', there has been no effective environmental fiscal initiative in 10 years for property investors to adopt green behaviour. We have seen the introduction of enhanced capital allowances at 100% for environmentally friendly plant. However, accessing this relief has been a big challenge for companies, with only those accredited items which appeared on a government website benefiting from the relief.

So, few claims have been made. Furthermore, it is evident that tax relief for land rectification costs has not delivered many new sites; the relief looks fairly generous with tax relief at 150% of spend but there are problems with the relief. It is complex, only businesses subject to corporation tax can claim (which has left individuals or offshore investors without relief) and many contaminants, such as Japanese Knotweed, currently do not qualify. Given that consultations have just started on improving this regime, the industry must wait to see how successful they will be.

Business premises renovation allowances (100% relief for renovation of vacant business premises) are now available but only for certain restricted areas.

The Private Finance Initiative (PFI) has been successful, even with the loss of capital allowances for roads in 2003 and the government's requirement for a share of any refinancing gain. The government consulted industry and sought to remove barriers.

Some commentators suggest that some ministers are not happy about part disposals of an equity stake, particularly where the vendor may benefit from exemption from the tax on sale of shares because they are traders. Therefore, could it be the turn of PFI to be impacted by some additional tax?

There are two areas where the Chancellor will leave a real legacy to the property industry – these are for his innovation in the development of real estate investment trusts (REITs) and property derivatives. REITs, which suffer no direct tax on rental income nor gains on the sale of related properties, are designed to replicate direct ownership. Given the tax is borne by the investor and not the REIT itself, the REIT enables investors with different tax profiles to invest alongside each other. Most major economies have had some form of REIT vehicle for many years, and there was a strong risk that the UK would no longer be pre-eminent for retail investors given various structures which could be held via the EU or the Channel Islands.

For the UK tax authorities it is a win-win situation – there is an accelerated tax take collecting the 2% entry fee and London's financial status is underpinned. The proposed Property Authorised Investment Funds, a parallel form of investment for institutions, should reinforce this position. Equally, the introduction of derivatives allows property owners to hedge some of their risk. It is early days, but the Investment Property Databank (IPD) and Investment Property Forum (IPF) have reported deals of £3bn in Q1 of 2007, with some £8bn of trades since 2004. There is an appetite for both and they are expected to lead to greater efficiency in the marketplace.

However, this year's Budget gave property investors some surprises. Capital allowances on plant are to be reduced – allowances go down from 25% to 20% with some assets (fixtures) potentially qualifying for only 10% – and allowances for industrial buildings and hotel allowances are to go. Empty rates relief for uniform business rates, which is given when property becomes vacant (eg 50% reduction after three months for an office) is to be significantly limited; consequently, liquidations may increase as businesses find they cannot meet rates and rent in a downturn.

But the biggest, most serious, issue is planning gain supplement which is due for implementation in 2009 if the regime is 'workable and effective'. This is a tax payable before development commences, at a rate unknown, on unrealised value arising from the grant of planning permission. The detail has yet to be determined but most developers remain to be convinced that the government can ensure all the funds from this levy are applied at the right time. Past attempts at some form of levy, eg development land tax, have been withdrawn because they have been overly complex and acted as a drag on development.

In summary, Gordon Brown's fiscal legacy as Chancellor will be just like his Budgets – very complex, but with a hint of green.

Property and regeneration: planning matters!

Greg Lloyd looks at the conundrum land use planning represents in the modern world.

Professor Greg Lloyd, Department of Civic Design, University of Liverpool

Land use planning forms part of the complex set of rules and regulations which guide and enforce land and property development in the wider public interest. Land and property development is essentially a profit-driven activity, and land use planning seeks to assert a broader, more holistic social value on the physical development outcomes. Why a conundrum?

On the one hand, as a society, we generally take land use planning for granted and only tend to engage with it when we are forced to. The established system is usually perceived in negative terms – having to prepare and submit a planning application; having to meet conditions laid down on the granting of planning permission and so on. At other times, individuals may feel obliged to give up time and energy to become involved in the preparation of a development plan or, horror of horrors, to become politically animated to resist a proposed development which is perceived to be inimical to their personal interest.

On the other hand, remove land use planning from the theatre of societal management and the certainty of our lives would quickly dissipate – as the property world would then likely become a very awkward lottery. Depending on locality, proximity to other activities, expected developmental potentials and a host of other circumstances, property values would likely be affected in a contrary manner. Such uncertainty would be very damaging for individual, corporate, neighbourhood, business and community well-being. Yet, notwithstanding the importance of land use planning then to the modern way of living, why does it attract such bad press? Why is planning constantly vilified – by a host of interests – property developers, landowners, home owners, communities, environmental groups and even government itself?

Historical background

One reason is that the land use planning system today is a product of a particular epoch. The initial comprehensive legislation – the Town and Country Planning Act 1947 – was introduced into a particular time and place and was intended to achieve certain things – such as slum clearance, post-war reconstruction, the provision of new housing and settlements, the inclusion of retailing and industrial facilities, the linking-up of communities through transport opportunities – and the necessary conditions for economic growth.

In general terms, the land use planning system secured these immediate post-war objectives and, moreover, did so in a way that ensured orderly and well-managed patterns of property development to appropriate standards. Design and location may be controversial here – but architectural imagination would need to be another discussion. There can be little doubt that the UK became a more civilised place as houses were built, the essential infrastructure was laid down and land was allocated to allow for anticipated growth and development in a spatially co-ordinated way. Indeed, by the 1960s, land use planning had matured sufficiently to innovate – it distinguished between planning for strategic issues in terms of the allocation of industrial, commercial and residential land developments, and planning for local agendas around, particularly around siting and design, layouts and the provision of facilities. In addition, civil society was brought into the process more explicitly so as to provide a litmus-test that the technical matters of regulating land and property development reflected as far as possible the principles of public participation and a broad understanding of the public interest, mediated by governance at the most appropriate (local) level.

Subsequently, the land and property development industry has become more sophisticated and has developed positive working relations with local planning authorities. This has created a viable partnership to ensure that local and regional property markets work reasonably efficiently. Both sides of the equation – land use planning and land and property development work under difficult conditions; on the one side estimating likely demand for housing, retailing and industrial developments, and – on the other side – trying to deliver complex development schemes to the requisite standards. While there are problems, by and large the land use planning and property development relationship is a robust one.

Negativity and criticisms

So why is land use planning so exposed to negative criticism? Recently, for example through the Barker Reviews, the Treasury has taken an interest in the potential role land use planning can play in facilitating national economic growth. There are two dimensions to this interest – does land use planning inhibit growth through restrictive land allocation policies and regulation? Can it provide a more flexible supply of land? This underscores the protective and developmental capacities of the land use planning system which operates at a micro and a macro scale.

The land and property development sector may thus be critical of land use planning because at a fine-grained level, in local and regional markets, land supply for housing never seems sufficient and decision making is perceived as too slow and costly. In addition, it is argued, there is a tendency for local planning authorities to impose conditions and seek agreements on planning permissions with little reference to the financial realities of the land and property development sector.

In contrast, environmental groups and agencies become agitated with what they hold to be the pro-development bias of land use planning. Here, the argument advanced is that insufficient weight is given to non-economic factors, and that as a result the environment is rapidly being damaged, and social justice issues ignored. Think tanks then weigh in with their (politically-driven) views and advocate solutions for which they bear no democratic responsibility. Finally, individuals and communities become exercised about protecting particular qualities of defined life-styles where they perceive these as threatened by certain development proposals. Often such delaying actions can slow up the various planning processes so that the system itself attracts criticism from other quarters.

At particular places, at particular times, and from the viewpoint of particular interests, the merits of objection, concern and disagreement may hold and may be justified. The bottom line is that what was once considered and recognised as a shared public interest for the desired outcomes of a planning system has been replaced by a complex plurality of relatively more private and competitive interests. In practice, these tend to shout loudly for attention and control and assert a narrow, rather than a collective, perspective. Very rarely, it seems to me, do these particular interests calmly point to a positive alternative to a given development or policy proposal, and planning – which, after all, is only a societal tool – becomes a convenient scapegoat.

Moreover, the job facing the land use planning system – and the cadre of public, private and voluntary sector planners who principally operate it, has become more complicated and differentiated. Over time, technology has advanced and economic growth materialised so the types of developments coming forward have become more complex, such as mixed-use developments. The development of on-shore oil and gas facilities, for example, to serve the off-shore energy economy, the location of out-of-town shopping-malls and the roll-out of mobile telephony infrastructure have all brought new challenges to the land use planning system. As developments have taken place, and proximities between land uses become narrower, then trade-offs between different development types becomes more sensitive. In effect, trying to provide the democratic spaces to deliberate and to reconcile the private and public interests involved has itself become squeezed.

There is another important dimension. Economic development is not even over time or space. That truism is very powerful, yet is often overlooked. It applies equally to associated land and property developments. Simply look at the very uneven economic activity in the UK at the present time. The south of England is over-heating and there are a host of pressures on the property market, particularly with respect to housing and water infrastructure. Compare it with the north where the opposite prevails. In reality, the picture is even more layered as, at a finer scale, under-performing land and property development markets sit cheek-by-jowl with buoyant local property markets.

Here is a point well worth making. Land use planning has for some considerable time been dealing with both the positive and negative effects of modern living. Whilst then it is often characterised as simply being the regulator for land and property development and ensuring that communities continue to improve their quality of life, it has simultaneously been addressing the problems of degeneration. The causes of economic, social and environmental degeneration in certain localities are very complex and it is generally held that government action is required to turn them around. That is not to say that markets could or would not do so (so-called gentrification by groups of individuals) but this may only happen in certain limited places and circumstances. The timescales may be sufficiently long that untold damage is done to the areas, communities and individuals involved. Land use planning has played a leading role in promoting the redevelopment of neighbourhoods, ensuring the provision of appropriate retailing and community facilities and seeking to connect up areas to promote greater social inclusion and cohesion.

Recent changes

So what of the catalogue of ills? There is a familiar mantra here that the land use planning systems needs to become more efficient (and make decisions quicker, prepare development plans faster and enforce decisions more rigorously); that it needs to be more effective (and ensure that sufficient land is allocated, protected and that this takes place); and that it must become more transparent and open (so that all interested parties – indeed all of us? – have a say in the workings, deliberations and outcomes of the land use planning system).

Both the Planning and Compulsory Purchase Act 2004 in England, and the Planning etc (Scotland) Act 2006 have recently sought to address these concerns and to implement a package of reforms to enhance both the effectiveness of the land use planning system and the skills base of the profession.[1] In 2006, in England, the Barker Review took this process of critical reflection further forward. The recent White Paper **Planning for a Sustainable Future** was published by a coalition of government departments: Communities and Local Government; Environment, Food and Rural Affairs; Trade and Industry; and Transport.[2] The cross-departmental support may suggest at how important land use planning is now considered in England. The White Paper promotes major reforms which seek to speed up land use planning, address infrastructure questions, whilst improving community consultation. Its vision is for 'a planning system which supports vibrant, healthy sustainable communities, promotes the UK's international competitiveness, and enables the infrastructure which is vital to our quality of life to be provided, in a way that is integrated with the delivery of other sustainable development objectives, and ensures that local communities and members of the public can make their views heard' (para 1.3). Sixty years after that first attempt to create a comprehensive package to manage the land resource, the patent complexity of the issues in a global context and in the light of climate change is very clear.

In practical terms, the White Paper sets out proposals inter alia to provide for major infrastructure projects through improved national planning policy statements and a new Independent Planning Commission which will decide on individual projects through the use of particular experts. Second, the White Paper proposes simplifying the local planning system for householders to make it far easier to make home improvements like extensions

1 Peel, D. and Lloyd, M.G. (2007) Neo-traditional Planning. Towards a New Ethos for Land Use Planning? **Land Use Policy** 24(2), pp. 396 -403.

2 HM Government (2007) **Planning for a Sustainable Future.** London, Cm 7120, May.

and conservatories. Third, planning is expected to play a bigger role in tackling climate change, and it is suggested that householder small-scale renewable technology developments will not require planning permission. Finally, it seeks to ensure the planning system will continue to support town centres. This will involve a new test to ensure the well-being of town centres and provide protection from out-of-town developments. The White Paper also includes a new commitment to protect green belts and the overriding emphasis on brownfield development is re-asserted.

Taken individually, these ideas clearly resonate with specific concerns. There is a danger that their selected application remains piecemeal and poorly joined-up. What land use planning really needs is a collective and strategic ethos. This must be able to accommodate the different land and property development contexts across the UK, reflect the interests of the devolved administrations and be seriously resourced in terms of strategic infrastructures. Land use planning needs to be taken seriously in political circles and each of us must discharge our personal responsibilities, particularly as certain development rights become individualised.

In an elegant essay about land use planning Will Hutton, the social commentator, argued for the need for a collective debate – what he described as: **"a richer national conversation in which all the phenomena that connect – insecurity, inequality, distrust of the new, disbelief that private ambitions can have public benefits and scepticism about the effectiveness of any public action – are openly talked about and resolutions sought"**. He further asserted that this would require: **"politicians prepared to dare and citizens prepared to respond"**.[3]

As society seeks to adapt to a complex modern world, it needs to reposition land use planning, land and property development and economic regeneration rather differently. We need then to clarify how we define and articulate the public interest – at all levels – national, regional, local. We need to change behaviours. Think of the emergent crises around climate change, flooding and the collapse of basic infrastructures. Governments, think tanks, academicians, the media, single-issue groups and society at large needs to share a more rounded view of these challenges and the alternatives available. We need to revisit our established fiscal arrangements and the provision of strategic infrastructure that connects and crosses administrative boundaries. This would mean thinking on a longer term basis and jointly with the devolved administrations. At the local level, it would mean challenging the 'me, me, me' mentality which seems to have replaced the property cliché 'location, location, location'. In essence, it is time to re-assert a wider social interest and responsibility in land and property development.

What of the opportunities for investment in regeneration? The argument here is that reform of land use planning can only go so far. The major hurdle is societal. We require a more rounded, deeper, transformative overhaul of the ways in which we use land and property development for regeneration purposes. We need to explore new vehicles for 'ethical' land and property development investments, as is the case elsewhere in the financial and investment markets. Yet before these can take effect, we need a shared understanding and commitment to an appropriate articulation of land use planning and regeneration in the new millennium.

3 Hutton, W. (2005) Save the Lakes from stagnation: The Swiss have shown us how to regenerate the Lake District. **The Observer,** April 3

Regeneration – a Communities England perspective

Richard McCarthy, Director General, Communities and Local Government

Richard McCarthy looks at how the regeneration challenge is being met by government.

The regeneration challenge for government is to enable places to become more sustainable and reverse the process of economic, social and physical decay, where the market alone cannot deliver this. This means that public expenditure on regeneration needs to stimulate private investment and that public services should protect and provide opportunities for those who are vulnerable or most in need.

The focus of regeneration is to tackle failing or underperforming economies as part of a holistic approach to creating sustainable communities. This may take a range of forms, for example:

- transforming city and town centres, housing stock and strategic environments or locations;
- ensuring that those living in our most deprived neighbourhoods have access to opportunities, jobs and training, so no one is disadvantaged by where they live and we narrow the gap between the most deprived neighbourhoods and other areas;
- we improve the economic performance of our city-regions and accelerate social mobility;
- attracting private investment to locations where the market is weak or has failed.

Communities and Local Government (DCLG) currently spends over £2.3bn per annum on regeneration, covering English Partnerships, regional development agencies, Thames Gateway and Growth Areas, housing market renewal, coalfields and other programmes. This commitment is in addition to the wide range of activity undertaken by local authorities and other government programmes, for example covering community cohesion, transport, crime and policing.

In developing regeneration policy and tailoring intervention and public investment we need to support and build leadership and capacity in our regional and local institutions, have efficient frameworks for prioritising investment, and provide technical knowledge and expertise to support these functions. It is in this context that following a review of housing and regeneration the government took the decision to create a new agency, Communities England.

A new agency

Communities England is the proposed new regeneration and housing agency. It will combine English Partnerships, the Housing Corporation and key delivery functions from DCLG, including decent homes, housing market renewal, housing growth, housing PFI and urban regeneration.

The role of Communities England is to provide:

- a new partner for local authorities, regional development agencies, and regional assemblies, supporting them in strategic place-making, helping to create and shape prosperous and cohesive communities;
- take an integrated approach to regeneration and housing, providing decent places as well as decent homes;
- develop new ways of working with markets and key partners to the public, private and voluntary sectors to ensure the best outcomes from investment in these places;
- create a critical mass to harness the scarce skills needed to deliver regeneration and new homes;
- help raise standards for new buildings and homes and reduce the environmental impact of our communities.

English Partnerships and the Housing Corporation have performed well and exceeded their targets, and DCLG's delivery programmes has been successful. However, we wish to deliver a step change. This requires a streamlined delivery chain, more flexibility in the ways of working and in investment, and a one stop delivery partner for local authorities and others.

Investment partnerships

The combined budget for Communities England is expected to be in excess of £4bn of public expenditure annually, based on current budgets, with a final budget to be agreed in the Central Spending Review 2007.

The case for accelerating the pace of regeneration through a new combined agency is already evident in the innovation that is already taking place.

The highly successful Urban Regeneration Companies programme has attracted major investment in our city centres. As these partnerships have reached their completion phase they are evolving into new more complex structures, as at Sheffield One, which will deliver inward investment, physical development and economic development through a single integrated organisation.

In the area of regeneration funding, many of the RDAs are now engaged in property partnerships, linking with English Partnerships and investors such as Morley and Igloo, to form Blueprint, a regeneration fund for the East Midlands. At DCLG we have established the Urban Finance Initiative with English Partnerships to pursue new funding partnership opportunities with local authorities, as part of the next generation of regeneration investment vehicles.

We are committed to getting Communities England up and running as quickly as possible, subject to legislation. I believe that this is already creating new opportunities for the market to invest in regeneration and benefit our economy and communities. We will be consulting shortly on the new agency and look forward to receiving your views.

Creating value from regeneration

David Partridge, Joint Chief Executive, Argent Group PLC

David Partridge explains, from a developer's perspective, how a multi-tiered approach is part of a successful regeneration plan.

Creating value through the pro-active development of land involves, in a simplistic form, securing a site, achieving planning permission, building a building, attracting an occupier and then crystallising value.

However, the Argent Group also uses as fundamental to its approach the creation of new environments, or 'places', to anchor the development in the minds of the local people. We achieve this by concentrating first on establishing a new public realm at the heart of our projects. At Brindleyplace, for instance, the central square, complete with sculpture, fountains and landscaping, was laid out and constructed before a single commercial building had been commenced; a new bridge over the canal connected this space to Birmingham's International Convention Centre. Immediately, the development became part of the mental map of the city by giving people the opportunity to flow through it.

Connectivity

This theme of connectivity is the second major facet of our approach. Accessibility to public transport is becoming more and more crucial to living and working patterns in all of our cities, and there is no better opportunity to capitalise on this than at King's Cross where local, national and international travel is so highly concentrated. In the same way, our scheme at Piccadilly Place in Manchester is connected directly to Manchester Piccadilly station by a new footbridge that we have built.

These two attributes of our development approach allow previously redundant, often post-industrial, sites to be opened up to the city around them and to establish themselves as addresses in their own right. This immediately turns their value round to something comparable with (although initially at a discount to) the prime pitch. At the same time, the very fact of rendering the land more accessible increases the regeneration prospects of the surrounding area.

In order to turn those prospects into reality it is then crucial to focus on achieving a critical mass of development, to sustain a high level of public usage. This involves creating a mix of uses from commercial to residential and retail to leisure, so as to maintain the flow of people (the life blood of the city) all through the day, all through the week and, from a financial point of view, all through different economic cycles. By trying to avoid a sterile mono-culture, whether office dominated, a 'fortified' residential scheme or a self contained shopping centre, Argent's development projects have become part of the rich mix of the city, and their investment value has become more robust as a result.

Partnership approach

To further reinforce this, we try hard to think beyond the red line of our sites in themselves. This involves working in close co-operation with all of our neighbours and other investors in the surrounding area, to ensure that our individual interests provide a cohesive and comprehensive offer to the market – the whole becomes more than the sum of the parts. In Piccadilly, Manchester, we were the founding members of the Piccadilly Partnership which has been instrumental in gearing over £1bn of investment into the area and turning Piccadilly's profile round dramatically in the process. Similarly in Birmingham, Argent chairs the Broad St Business Improvement District (BID) which seeks to ensure that this popular part of the city, which is also the doorstep to our major investment at Brindleyplace, is properly maintained and promoted.

This partnership approach can only be achieved by being able to invest for the medium to long term and Argent is extremely fortunate to be able to do this through the backing of our sole shareholder, the British Telecom Pension Scheme (BTPS). Because we do not take a short term view, whereby the realisation of a quick return is paramount, we can manage our assets over time, both physically and economically, to capitalise on the uplift and growth of values which we have created. At Brindleyplace, we held over the last phases of development and injected them, together with two earlier buildings, into The Brindleyplace Limited Partnership, a co-ownership vehicle 50% owned by a consortium of private investors and 50% owned by funds advised by Hermes and by Argent. This fund has achieved over 100% return on equity since it was formed in 2004.

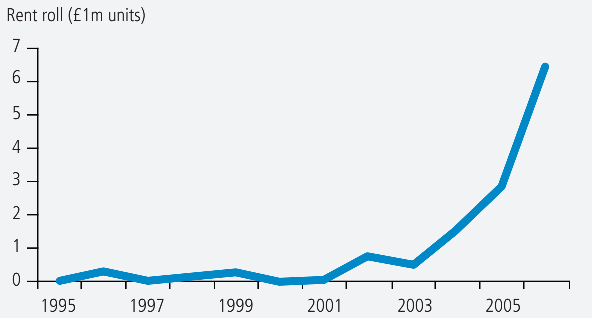
At King's Cross we will be holding the most part of the 8m sq ft estate in a similar, liquid co-investment vehicle, with the potential for conversion into a REIT once the development phases are largely complete.

All of the above are essential to achieving real, lasting and sustainable regeneration, but none of them would be powerful enough without a local authority with vision and a similar long term view – not least because they are often the body who control much of the land on which that regeneration can take place. At Piccadilly Place in Manchester, the city council along with the Greater Manchester Passenger Transport Executive injected the development site into a joint venture with Argent for a peppercorn, which converts to a 10% gearing on all income, once it starts to flow. Not having to pay a site price, Argent was able to dedicate its resources to putting in the infrastructure necessary to create the environment, the connectivity and the critical mass to kick-start the development. Based on current values the returns to the landowners are likely to be about 10 times that which they might have received as a land price in 2002. So all parties have benefited enormously.

Physical regeneration however, is not sufficient on its own, without real value being created through increased financial returns and it is important to understand what impact this sort of activity can have on the property market.

The graph below charts rental values of commercial space (total rent roll of lettings in each year) in the Piccadilly area of Manchester from 1995 to 2005 by plotting significant individual lettings of Grade A and B space throughout that time. It demonstrates a significant step change in 2004-5 as a result of the lettings Argent achieved at One Piccadilly Gardens (particularly to the Bank of New York). The rise in overall perception coupled with the real increase in quality engendered by our developments and the aspirations promoted by the Piccadilly Partnership, ensured that the uplift in values spread across all of the area and benefited all of our fellow investors and partners.

Figure 1: Total new lettings per year



This geographical spread, or ripple effect, is equally evident in the area around Brindleyplace in Birmingham as shown in the photographs and pie chart opposite. Catalysed by Argent's activities in the 1990s, development has accelerated and spread to the surrounding area and into alternative sectors (residential and leisure). This has had the result of cementing the values of Brindleyplace itself as part of the prime pitch of the city.

Argent's experience is that real regeneration on the ground can create real value too. We are looking forward to the opportunity to put this experience into practice at Kings Cross in the not too distant future.

Figure 2: Total areas of development (sq ft) committed in the Convention Quarter, Birmingham

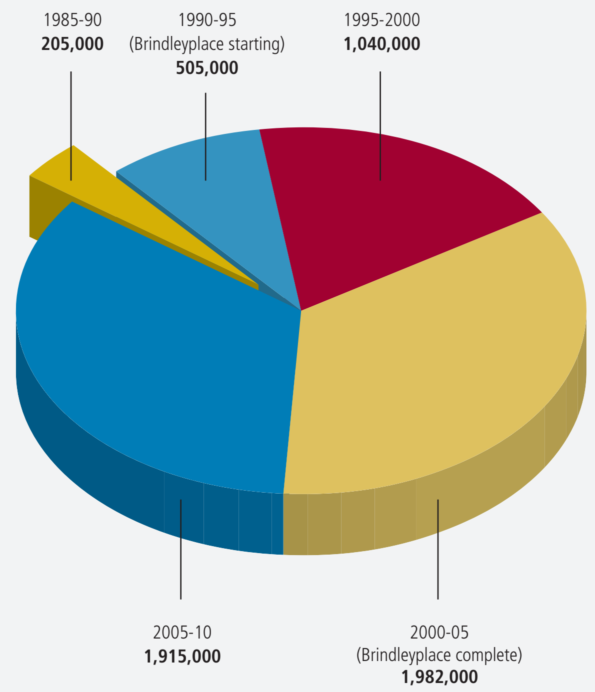


Figure 3: Before and after photographs of Brindleyplace

The UK commercial property lending market

Bill Maxted, Senior Lecturer in the Department of Strategy and Management, De Montfort University

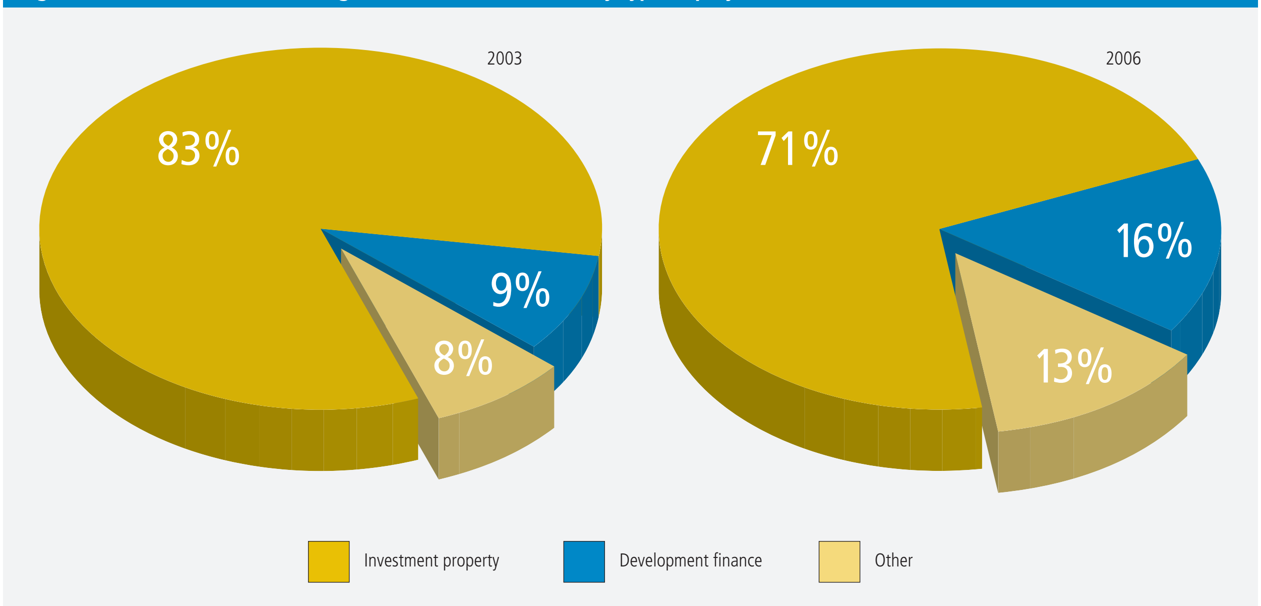
Bill Maxted reviews a recent survey on the UK commercial property lending market. De Montfort University has recently published the results of its survey of the UK commercial property lending market for year-end 2006. The findings were presented to IPF members in May. The research has been running since 1997 and this article provides a summary of the results for 2006. A full copy of the report is available, price £350 from De Montfort University.

In many respects, circumstances within the UK commercial property lending market during 2006 were very similar to those in 2005. There has been increasing downwards pressure on property yields and at the same time upwards pressure on interest rates. In these conditions lending to commercial property would appear difficult and becoming more so as the year progressed. To a certain extent this assessment is supported by the research findings which recorded a greater volume of loan originations being achieved in the first half of the year than the second. Also, the annual percentage increase in both the value of loan originations and aggregated value of outstanding debt was lower in 2006 than for 2005. However, by year-end 2006, £81.1bn of loans had been originated compared with £66.1bn in 2005 and the aggregated value of outstanding debt secured by commercial property had increased from £156bn to £172.1bn. An additional £18.2bn of debt was securitised into the CMBS market, the highest value recorded by this research in a single year.

The volumes of lending recorded during 2006 appear to have been achieved by a continued relaxation of some lending terms. Senior debt interest rate margins for loans to commercial investment properties have all declined again; more steeply for loans to prime property than for secondary. Loan-to-value ratios for different types of secondary investment properties have increased or broadly remained at their 2005 levels. Lending organisations are continuing to accept high levels of residual debt exposure and in some instance, interest only terms are available. Income-to-interest cover ratios have declined for loans to all sectors during 2006. Those for secondary property have declined more steeply than those for prime. However, average income-to-interest cover ratios for loans secured by prime retail and prime office property are at, or equal to, the lowest levels recorded by this research.

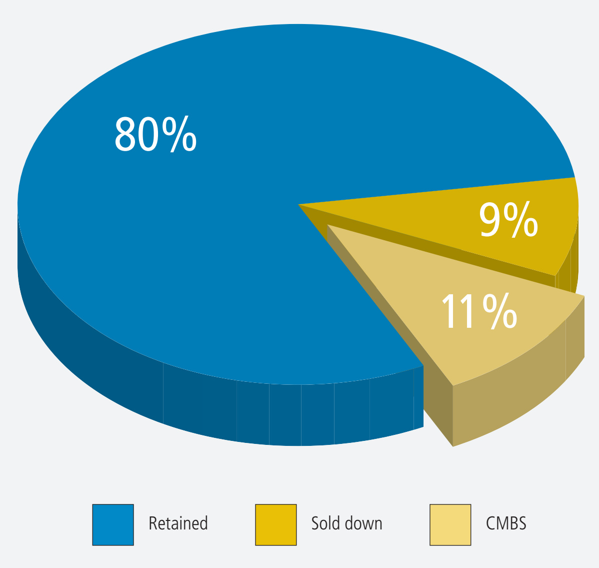
These conditions have resulted in the commercial property lending market remaining extremely competitive. In response, organisations are lending into a wider range of property sectors to generate business. During 2006 there was an increase in the value of lending to 'Other' sectors, which includes health care, trading entities, the public sector, hotels and leisure. This increase has been observed for both investment and development opportunities. The research for 2006 recorded an increase in the value of loans to all types of development project. Speculative commercial development and residential development for sale have recorded the most rapid recent increases in the volumes of lending. Interest rate margins on these sectors have declined accordingly, whilst loan-to-cost ratios have generally increased. In addition, organisations are following their borrowers in seeking investment and lending opportunities overseas. The value of outstanding debt originated in the UK but secured by commercial property located in mainland Europe increased from £15.4bn to £26.3bn during 2006.

Figure 1: Allocation of outstanding debt on loan book (£bn) by type of project



The issue in the market is whether or not lending organisations, in their desire to remain active participants, are currently exposing themselves to higher levels of risk. In response to this, the research has demonstrated that during 2006, senior debt loan-to-value ratios for loans secured by prime investment property declined for the first time since 2001-02. Greater volumes of debt are being sold down to other organisations within the investment and lending sectors. The organisations that completed CMBS issuances recorded average loan-to-value ratios below those for 'All Lenders' during 2006. These and other organisations structured loans between senior debt, junior debt and/or mezzanine finance with a differential in the pricing of each slice of debt and creating the opportunity of selling down or syndicating the higher levels of risk.

Figure 2: Allocation of outstanding debt in 2006 between retained, sold down and CMBS



For example, the volume of mezzanine finance originated during 2006 compared with that recorded in loan books suggests that much of this is either very short term or being sold to organisations outside the scope of this research. More generally, at 69%, a greater volume of outstanding debt retained in loan books has interest rate hedging in place than the 52% recorded for 2005 and loan terms have become more conservative for residential investment properties. A number of organisations that are lending outside of the UK do so on the basis that their customers enter into joint ventures with experienced local property professionals. A similar approach is also adopted in the UK where lending organisations will introduce developer and investor clients to use their joint expertise to generate business opportunities. As such, lending organisations appear to be adopting strategies to mitigate against any increased levels of risk they may be perceived to be taking.

Consequently, the lending market in 2006 was a difficult market to read. The selling down of debt reduces the exposure to risk and this research suggests that more organisations intend to participate in both syndications and CMBS issuances in the forthcoming year. Indeed, some organisations sell down their entire volume of loan originations, only retaining debt on their balance sheets for periods of up to six months. It has been observed in the comments received from respondents to the survey that, currently, it is unclear if the selling down of debt is a genuine risk management strategy or the impact of Basel II. It is believed that these regulations will impact on lending practices in a similar fashion to the criteria adopted by rating agencies. This is understood to have already had an effect on loan-to-value ratios offered by some organisations that securitised their debt into the CMBS market during 2006. It has also been suggested that organisations with a need to distribute their lending but not being able to do so, will be the first warning of more difficult conditions ahead in the market. The narrowing of loan terms between lending organisations generally may reduce the opportunities for traditional refinancing in these circumstances.

The research findings for 2006 identified a slowing down in the reported rate of 'churning' of loans between lending organisations. However, as gleaned from the comments, most organisations remain confident that the outlook for the economy remains benign and that the 'wall of equity' will continue to sustain commercial property values in the short term. Notwithstanding these comments, a greater value of loan delinquencies and loan defaults were reported during 2006 with what appears to be a concentration in the secondary commercial (based on loan size) and residential development sectors where loan terms have recently become more aggressive.

In conclusion, with the threat of increases in short-term interest rates and with just fewer than 40% of outstanding debt due to mature before the end of 2009, it could be argued that sectors of the market are sensitively balanced. Now is not the time for lending organisations to be complacent in loan criteria or lending strategies adopted.

The IPF Sustainability Special Interest Group

Paul McNamara and Chris Taite look at the IPF's climate change initiatives

As the President of the IPF, Sir David Clementi, noted in his speech to the Forum's Annual Lunch in January this year, the world of property investment is changing quickly and a key role for the IPF is to help its members navigate a path through these new waters. This is entirely consistent with the IPF Management Board's continuing desire to position the Forum as a provider of thought leadership, through education and research.

In this respect, it is increasingly clear to even the most casual observer that initiatives to combat climate change, together with long term energy supply and security concerns, are increasingly prominent on the agenda of all businesses, and particularly those of us who use and invest in property.

With this in mind, the IPF has created its second special interest group (SIG) to look at the general area of sustainability and the opportunities and costs for investment property that the subject presents. (The first SIG was launched to help foster and guide the development of the property derivatives.)

Figure 1: Terms of reference for the IPF/IIGCC Sustainability SIG

To inform and educate the property investment community on the impact of social and environmental issues, and related policy responses, on the value of property investment. This is likely to be done through:

a) the holding of educational events covering general issues and specific case study information;

b) the promotion and commissioning of research on relevant areas;

c) the development of appraisal methods; and

d) the creation of a repository of relevant information resources.

To identify and promote examples of best practice in responsible property investment.

To support IPF and IIGCC in any interaction with policymakers on the formulation and implementation of existing and new policies aimed at reducing or improving the social and environmental impacts of property investment.

To promote common standards pertaining to the definition of 'responsible property investment' (and identify those questions third parties should ask of funds with reference to their level of responsibility).

To contribute to the definition of relevant fund benchmarking measures to capture the level and progress made in responsible property investment.

To work with other interested bodies to achieve the above objectives.

Paul McNamara, Director and Head of Property Research, PRUPIM

The terms of reference for the Sustainability SIG are listed in Figure 1. Consistent with the ethos of the IPF, the focus is very much along the lines of education and research about the issues; understanding how these issues will affect investment values, creating a common language and standards by which to address these issues, establishing guidelines to help IPF members take action and helping policymakers understand potential impacts on the property investment industry when formulating new policies and regulations.

In order to increase access to expert knowledge on climate change issues and the way in which they are thought about in other investment markets, the IPF has joined forces with the Property Working Group of the Institutional Investors' Group on Climate Change (IIGCC). The IIGCC is a group organised to promote better understanding of the implications of climate change amongst fund managers and institutional (especially pension fund) investors; and to encourage those companies and markets in which its members invest to address the risks and opportunities associated with climate change and the shift to a lower carbon economy. It has 36 member organisations; many of these are household names.

Chris Taite, Business Development Manager, Grosvenor

Figure 2: Membership of IPF/IIGCC Sustainability SIG steering group

Paul McNamara	PruPIM
Brenna O'Roarty	RREEF
Louise Ellison	IPF
Chris Brigstocke	Hammonds
Chris Taite	Grosvenor
Howard Meaney	CW Investors
Graham Burnett	University Superannuation Scheme
Andy Szyman	F&C
Stephen Pyne	ING Real Estate
Miles Keeping	King Sturge
Alan Meakin	Crown Estate
Philip Parnell	Drivers Jonas
Stephanie Pfeiffer	IIGCC
Andy Schofield	Henderson

Given the propensity in the property industry to delegate green issues to technical staff, it is pleasing to note that the steering group of the IPF/IIGCC Sustainability SIG comprises investment professionals and property fund managers. Its current membership is listed in Figure 2. Clearly, given her extensive personal research history in this field, the arrival of Louise Ellison from Kingston University, as Research Director for the IPF, will boost the Sustainability SIG's knowledge base yet further.

The steering group meets four times a year and, to date, has organised two educational events, both held at IPF's new headquarters in New Broad Street and both extremely well attended (underlining the burgeoning interest in this area). It intends to hold two more in 2007. The first of these, held on 11 June 2007 reviewed the implications of the newly announced Energy Performance of Buildings Directive (EPBD) and related certification on the property market. The subject for the final meeting of the year remains under discussion. There is also active discussion about the organisation of a workshop to look at the scope and likely nature of green leases.

The SIG has also been developing some best practice environmental policies for property investment organisations, highlighting the areas in which they should be considering taking action. These are listed in Figure 3.

If you are interested in becoming a member of the IPF/IIGCC Sustainability SIG, or would simply like to contribute some ideas, please contact Suleen Syn (020 7194 7926, SSyn@ipf.org.uk) at the IPF.

Figure 3: Environmental best practice investment management policies

Energy

Measure electricity, oil and gas consumption in Kw/h: CO_2 emissions

Target annual reductions in energy consumption: landlord and tenant

Target annual increases in renewable energy sourcing

Seek to ensure 'best of class' Energy Performance Certification in 2008.

Benchmark energy performance for specific types of buildings and occupiers

Process of identifying poor energy performers and targets for improvement

Develop and implement procedures for working with occupiers to target carbon emissions reductions

Consider renewable energy option

Figure 3: continued

Waste (incl. recycling)

Measurement of performance data for waste and recycling across the portfolio

Develop and implement formal waste management policies

Develop initiatives to assist tenants in waste reduction and improved recycling

Develop and implement building specific waste management plans

Transport

Operating specific green/ sustainable travel plans

Policy of investment in public transport and reductions in car dependency

Active promotion of transport alternatives to tenants and employees

General management

Support environmental standards and action plans for managing agents (ISO 14001)

Develop sustainability guide for property acquisitions, lettings and disposals

Staff awareness and training programmes

Environmental procedures manual

Standard sustainability briefs for refurbishment design and construction including use of materials from sustainable sources

Ensure sustainability is incorporated within planned programme of maintenance

Annual reports that are fully integrated with company reporting process

Policy of public reporting of historic performance and disclosed targets

Ensure investment manager delivers best practice in its own occupied premises

Supply chain

Ensuring suppliers have, or are committed to achieving, ISO 14001

Biodiversity

Action plans to enhance biodiversity

Water

Collate water consumption data to inform management plans, with annual reduction targets

Policies on grey water recycling, rainwater harvesting and sustainable urban drainage where appropriate

Asset management – time to deliver?

Freelance journalist, Tim Horsey, looks at the emergence of specialist asset management organisations. This lecture was delivered by Mark Bowden (Teesland iOG), Alastair Evans (Hermes) and James Salmon (Protego Real Estate Investors).

Asset management has always been part of the work of property owners and investors, but only in the last 10 years have specialist organisations in this field begun to emerge.

Ashley Blake of Lathe Investments introduced this IPF meeting by emphasising that now is the right time to be talking about asset management. On the one hand, there have never been so many funds, funds of funds, REITs, AIM listing, all promising to deliver superior returns based on strong asset management. And on the other, the UK investment market is becoming ever more challenging, with yield-shifts now largely in the past and gearing likely to start acting as drag on performance. Poor asset management will no longer be able to hide behind the fig leaf of positive market sentiment.

James Salmon, Head of Asset Management at Protego, defined asset management as "the creation and extraction of value from real estate in addition to that passively derived from market movement." Salmon however believes the performance impact of asset management is difficult to measure. "One possibility might be asset ERV growth in excess of IPD ERV growth," he suggested, "although this could be as much due to stock selection as asset management."

Salmon also believes that greater specialisation is now emerging in the asset management business. "This is becoming more necessary," he says, "as nowadays performance can be closely measured, making poor asset management harder to disguise. Good asset management means being as responsive as possible to tenants' changing needs, and executing those decisions effectively and quickly. Sometimes this can mean working with tenants as a group, for example to refurbish an industrial estate which is partially let."

He explained that, at Protego, investment, management and asset management are recognised to be separate disciplines and are therefore handled within separate teams, but that these teams work together on each property. For example, the asset management team makes an input to the stock selection process, considering the asset management potential of an investment prior to its acquisition. Has asset management delivered in recent years? Salmon says yes, citing an example from Donaldsons' Shopping Centre Commentary for 2006, which shows that specialist managers outperformed their competitors by more than 2% per annum over the 2002–2005 period.

Alasdair Evans, Corporate Finance Director at Hermes and also a member of INREV's corporate governance committee, sees asset management from the investor perspective. Hermes uses specialist asset managers for each of the six sub-sectors of its direct portfolio, explained Evans. "These handle all tenant liaison, lease management, business planning issues, and are aligned with the investor through performance fees, based on IPD benchmarks in their relevant sub-sectors. The cost has generally been low because the firms concerned often see asset management as a loss-leader into other parts of their business. However this may be a problem if the asset management fee is being reduced so that fees can be creamed off by the investment department, which is likely to result in limits on the resources such firms will make available."

Evans believes that for indirect funds targeting specialist sectors, like leisure and student accommodation, it is crucial to have managers who understand their businesses. "It is essential to be aware of the specific needs of the tenants operating there," he commented, "and it is also very valuable to have working relationships with the major occupiers. In addition specialist managers may have good access to stock, perhaps through a development pipeline. It is also important not to forget the technical expertise that is required for lease engineering – this is the backbone of asset management."

"In assessing the performance impact of asset management on indirect vehicles, it is crucial to eliminate the impact of gearing," emphasised Evans. "Gearing may have the effect of distorting the impact of asset management on the performance fee, unless this has been specifically broken out."

Mark Bowden of Teesland iOG, specialist fund managers, has a continental European angle on asset management issues. Bowden set the scene by reminding the audience that European property funds are now estimated to be worth more than €300bn, and are growing ever more rapidly. "But," he believes, "the market is likely to get more difficult in the medium term, as the low interest rate environment may change and many closed funds will terminate around 2010, bringing a lot of properties to the market."

Bowden explained that Teesland began by specialising in multi-let industrial portfolios in the UK and then exported this expertise to Europe. "The concept of asset management has only existed in the UK over the last 20 years," he says, "and in Europe it is even newer. When working in Europe it is crucial to recognise the differences between each national market, and this is likely to mean tapping into local expertise – working with others who share the view that it is essential to manage the whole asset."

"There is no single definition of asset management that would be recognised right around Europe," continues Bowden, "and those involved in what we understand by asset management have a diverse range of skills..." The discussion which concluded the meeting emphasised that asset management is not just about adding value, but also about managing risk – of the tenant leaving or defaulting, of environmental policy impacts, and so on. This may also include increasing adherence to the objectives of corporate social responsibility, according to Alasdair Evans.

Investing in property – a growing menu of choices

Colin Barber
Director,
Capital
Markets,
Costar Group
UK

Colin Barber looks at the growing range of alternative ways to invest in property without acquiring the actual bricks and mortar.

Imagine for a moment that a property fund manager believes West End offices are this year's must-have asset. Traditionally, he would join the rush to buy the few buildings that are coming up but now he could look to buy units in Welput, the West End of London Offices fund run by Schroders, through the growing secondary market. Alternatively, he could talk to a derivatives trader and take out a total return swap on the IPD West End Office Index. Today there are many more ways to achieve his objective.

Derivatives

The market in property derivatives goes from strength to strength. The latest volumes report by IPD and the IPF reported trades in Q1 2007 totalling £2.9bn from 125 trades – the highest number ever reported in one three-month period.

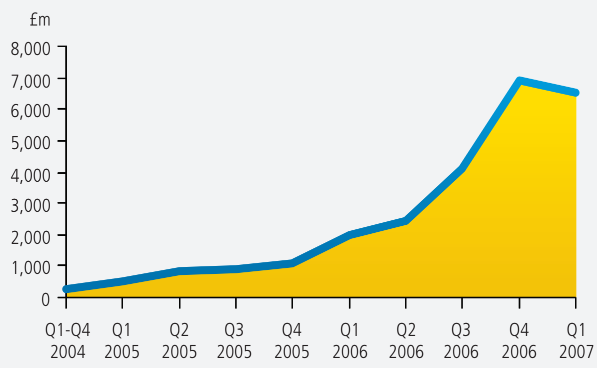
This equates to about 10% of the total IPD record of direct property investment trading in the UK throughout 2006 – itself the second busiest year on record.

For 2006 as a whole the total volume was over £5.7bn. This dwarfs the predictions made in a poll of the attendees at the IPF/IPD Forum at the start of 2006. Here, the market players predicted a volume of some £2bn for 2006, double the observed volume in 2005.

In aggregate, at the end of Q1, the total cumulative notional value of commercial property derivative trades since the beginning of 2005 stood at £6.5bn coming from 407 trades. Note that the total value of outstanding trades at the end of Q1 fell for the first time, indicating that a substantial amount of trades matured at the end of 2006. The average size of live trades now stands at £16m.

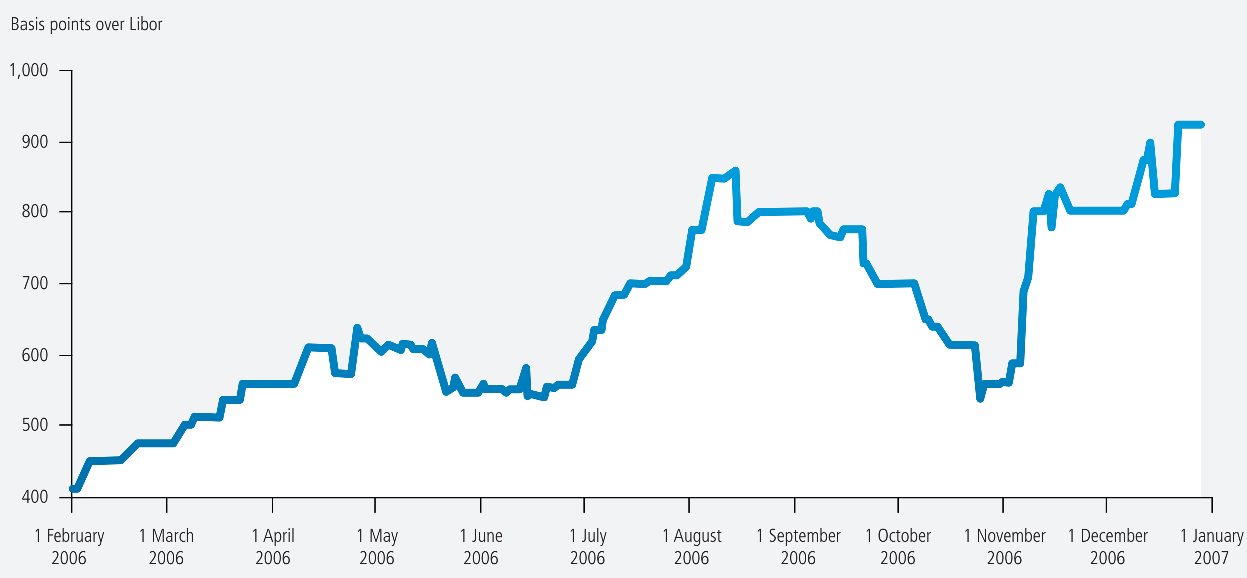
The number of banks licensed to trade UK IPD property derivatives has increased to 17 and currently four banks in the USA are licensed to trade the NCREIF. To date, in the UK, trades have been carried out at all property, sector and sub-sector level.

Figure 1: Total cumulative notional value of contracts (£m)



Iain Reid, Chairman of the IPF Property Derivatives Interest Group, comments: "At each Property Derivatives Trading Forum we hold we see increasing numbers of leading property companies and financial institutions not just interested in, but also prepared to transact, property derivatives."

Figure 2: Mid price of UK All Property Dec 2006 swap



Source: Tullett Prebon Information / DTZ

As you would expect in an active market, prices for property derivatives are changing all the time; live pricing can be found on Bloombergs, Reuters and Propex. Figure 2 shows the mid price of the December 2006 total return swap throughout the course of last year.

Prices started the year at 400 basis points over LIBOR and have ranged around to upwards of 900 during the year. Gary McNamara of DTZ comments that "these changes are a function of both technical and market factors. Prices move due to the shortening of the contract as the year goes by and the known return to date at the contract start. The contracts start at the most recently published monthly estimate of the IPD Annual Index i.e. on a January-December, February-December, March-December, April-December (and so on) basis."

"The market factors include the rise in interest rates in August and November along with the rising expectation of property performance in that year. In February 2006 the IPD Consensus forecast was 11.2%, this was increased to 13.4% in May, 16.5% in August and again to 18.1% in November. The actual outcome was 18.1%. This showed both that buying a December 2006 contract in January 2006 would have been a good short-term play and also that pricing in the derivatives market is a good indicator for performance in the physical market."

Indirect property vehicles

In the indirect market, primary issues of new funds continue apace but the focus is shifting away from UK-orientated funds to those invested in Europe and beyond. At the end of 2006, the market value of UK and European funds stood at €330bn according to INREV, the European association for investors in non-listed real estate vehicles.

The majority of money flows in the market to date have been through investment into new fund launches or further investment into the open-ended funds that are capable of accepting new money after their initial launch. For example, in 2006 the 57 member funds of The Association of Real Estate Funds (AREF) raised more than £4.5bn of net new money in the year. Substantially more would have been invested across the wider INREV database.

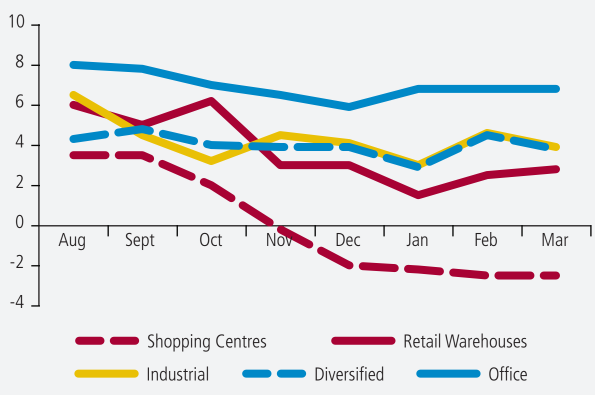
But excitingly, the year saw a doubling in the secondary activity in these funds. The value of units traded in these AREF funds on the growing secondary market increased from £0.57bn to £1.24bn during the year but this is still equivalent to only 3.8% of the net asset value. Estimates suggest that there was nearer £3bn in total secondary trades across all funds during the year.

This activity is being driven by diverging views of the likely performance of particular funds driving portfolio reallocations and the continued growth of fund-of-funds needing to manage their holdings to produce superior returns.

In June, a new industry initiative, Indirex.co.uk was launched. It aims to be a community hub for the unlisted real estate community and will provide a fund database along with access to research and listings of primary and secondary opportunities. The initiative, supported by CoStar, was the brainchild of Julian Schiller, Head of Indirect at Jones Lang LaSalle who developed it with collective insight from leading industry participants including Standard Life, Rockspring, Wellcome Trust and Penningtons.

Whilst the value of the indirect vehicles is largely pinned to the underlying property valuations, the increase in activity has highlighted that trades are happening at both premiums and discounts to their net asset value depending on investors' views of the prospects for the vehicle. Jones Lang LaSalle have produced the table below (Figure 3) showing that office funds are currently trading, on average, at a 7% premium to NAV while shopping centre funds are proving unpopular and trades are occurring at a 2% to 3% discount to current property valuations.

Figure 3: Secondary trading premiums (discounts) in the UK private closed funds



Source: Jones Lang LaSalle

With this increasing choice of ways to achieve investment in to a particular sector, investors are now keeping an eye on the arbitrage between vehicles. Julian Schiller notes that "investors seeking three year exposure to IPD All Property returns will pay a premium of 1% through the derivatives market but as much as 4% via indirect funds. Conversely, it is still cheaper to gain exposure to Central London offices through the fund route at a premium of 8%, as the cost through a derivative is currently at a premium of between 11%-13%". There are many factors other than simple price to take into account but clearly there are now opportunities to gain exposure to markets without being forced to own the bricks and mortar.

Valuation based unit pricing

Neil Crosby, Department of Real Estate & Planning, University of Reading Business School

Neil Crosby asks if we should we be worried by what happened in Germany?

Valuations in the UK have been put under the microscope during the last 15 to 20 years and we now know much more about the process and the methods. Because of this scrutiny we can make investment decisions knowing the strengths and weaknesses of the information provided by valuations and weight it accordingly. I believe there is circumstantial evidence that the German open ended fund crisis at the beginning of 2006 may have had a valuation component and until the valuation process there is subjected to similar scrutiny, it constitutes an additional institutional risk to investors.

Valuations have played an important role in UK property investment and are still the cornerstone of all performance measurement systems, despite attempts to generate transaction-based indices. They also play a very important role in price setting, nowhere more so than in the unit trust sector where no real secondary market in units exists. So last year's crisis in the German open-ended funds was not just a cause for concern to the German funds and their investors, it also raised questions about other funds which traded at prices based on valuations. This was because there were suspicions that the German crisis was partly due to valuations which did not accurately identify the true underlying exchange price. If they did not accurately reflect exchange price, and this was perceived to be an over-valuation, then it is not surprising if unit holders seek to redeem over-priced units.

If valuation was an issue in Germany, and the suspicions mentioned above have not been established as fact in the last year of commentary, then is there any evidence to suggest it is solely a German internal problem? If not, then any suspicions concerning valuation based unit trust pricing should attach equally to the UK market. This paper sets out the reasons why the suspicions over Germany exist and the UK market does not attract the same level of concern.

The circumstantial case to be answered

As indicated above, there is a strong denial of any valuation problem from both the German open-ended fund and representative bodies and the German valuation profession.

The German Investment and Asset Management Association (BVI) in its 24/01/06 Press statement commented:

"The BVI is confident that the current use of a committee of experts results in realistic valuations. Property sales completed in recent months confirm this view. The Association therefore regards public criticism around valuation as unjustified" (BVI, 2006).

Unfortunately, it appears from most other comments that there is perceived to be a problem and these comments are not all based on hindsight. Bruhl (2001) in his address to RICS Europe drew attention to valuation problems with German open-ended funds and at a similar time Crosby et al (2000) were suggesting that the use of sustainable value concepts in lending valuations were not grounded in theory and were a dangerous practice. While the rest of the world was refining market valuation definitions within the International Valuation Standards Committee, The European Group of Valuers (TeGOVA) was convincing the Basel II committee of the arguable benefits of mortgage lending value. It may seem that sustainable value concepts in bank lending have little to do with the valuation of assets within open-ended funds but the same valuers were undertaking both financial statement and lending valuations.

Bruhl (2001) suggests that in 2001 the German valuation profession was a heterogeneous group of mainly self-employed and locally operating individuals. Their background was technical and based in the built environment paradigm and frequently they were practising architects and engineers. Their status ranged from self-appointed freelance valuers to publicly certified and sworn-in valuation experts with regulation and appointment mainly through Chambers of Industry & Commerce. Professional bodies had a lower level of organisation by comparison with the UK, there was a fragmentation of professional associations and a lack of generally agreed standards of education and qualification. TeGOVA has tried to introduce an approval process but this has been resisted by RICS, the leading valuers' organisation in the UK, which believes that the levels of qualification fall below that provided by its own RICS membership.

Not only is the approach to education, professional qualification and practice organisation different in the UK and Germany, the valuation methods used also appear differ. Friedrich (2003) in his Master's thesis suggests that survey work confirms there are systematic differences identified between the German investment method and relevant international approaches. The main German specialities in this regard are separation of value for land and building, consideration of only one income (sustainable long-term rent) and arriving at gross values. Kilbinger (2006) in her Wall Street Journal article concluded that the feeling in the market is that the future of the funds will be less bleak if the valuations of funds' real-estate holdings are overhauled. She suggested that at the heart of the problem is the way real estate owned by the funds is valued.

Other issues include rules within the German open-ended funds including a prohibition to sell at less than the appraised value (or within 3%), the non-use of international firms of valuers on the valuation committees and the allowing of a significant amount of a valuer's business to come from one client. Even if two funds are within the same stable, the valuer can count both funds as separate entities. The majority of their business could be based on fees from basically one client. In the UK, the Baum, et al (2000) paper caused a major professional debate concerning client influence issues leading to the Carsberg Report (2002) and an overhaul of conflicts and other valuation process issues in the latest edition of the Red Book (RICS, 2003). Germany has had no such review and the moral hazard implications are huge. However, there is no actual evidence of any client pressure even though the fund policy statements would not allay fears in this respect.

The organisation and objectives of open-ended funds are set out in the BVI (undated) sales brochure. Fund units are priced by the fund managers based on asset values of the properties in the funds. The main selling platform of those units is based on a clear commitment to offer a product that has very low risk and volatility. The BVI sales document is sub titled "An investment in solid value" and is packed full of statements like "a low volatility alternative", "steady growth in value at a low risk" and "stable profitability and the absence of wrenching moves in market price". How is that low volatility policy delivered within a property fund?

One way is to use valuations to smooth the real movements. If a fund wished to hide the true market value of its assets or to change the nature of its performance through time for any reason, it would have all the necessary levers to exert undue influence.

There is evidence that the volatility of property in Germany is less than other markets in the world. Investment Property Databank produces worldwide indices and Table 1 illustrates the last 17 years annual performance and volatility of seven world markets including the UK and Germany. It shows that German office markets have had a very different profile to all of the other countries with very low volatility. The next least volatile country is the Netherlands, which has double the volatility of returns of Germany, while the UK has four times the volatility of Germany.

Figure 1: Annualised performance and volatility of office markets 1989-2005

Country	Annual performance (%) 1989-2005	Annual volatility (%) 1989-2005
Germany	4.69	2.45
UK	7.48	9.8
France	6.51	9.43
Sweden	4.86	13.27
Netherlands	7.96	5.00
USA	6.34	9.24
Canada	6.98	9.42

Source : Kurzrock (2006)

Research in the UK concerning the performance of valuations during both bear and bull markets suggests that valuers are naturally conservative when following markets up and down. In a fast rising market they tend to fall further and further behind. When markets turn, they are adrift but the turn in the market brings the prices back to the valuations as they also fall faster than the valuations. After a few years of a falling market they catch up. In the UK in the early 1990s, valuation accuracy data suggests valuations caught back up with prices in 1994 and 1995 but then prices rose gain and valuations started to fall behind again (RICS/IPD, 2005). This analysis is limited by the fact that valuations can affect which properties are actually sold and at what price. So some evidence of valuations lower than prices would be expected (undervalued properties are more likely to be sold than overvalued ones).

But if we accept the shape of the analysis then it raises further questions for Germany. If after a five-year recession in the UK, recorded valuations started to exceed prices what would have happened if the bear market had continued for 10 years, as it has in Germany? Over the last three years, capital values of offices have fallen by over 12% and in the last 10 years by over 16%. Would valuations start to significantly exceed prices in these circumstances?

There is evidence that this was the case in an attempt by the DEGI fund to sell a portfolio of German offices in July 2005. The portfolio was held in the fund at a book value of €350m. The highest offer that could be obtained was €250m. The Estates Gazette reported that this was the third German fund that had tried to offload a domestic property portfolio with much higher book values and reported that "many funds are saddled with properties at higher book values than the market is prepared to pay". This is despite the BVI reporting that German property fund values had been lowered by 2.6%, 2.3% and 3% in 2002, 2003 and 2004 respectively (Estates Gazette, 2005).

So there is a circumstantial case to answer and this should not be avoided just because the current boom in investment markets may well have enabled any over-valuation to be reversed.

Should we be worried in the UK?

This discussion raises a number of issues for UK funds, for example are valuation processes more transparent and objective in the UK and therefore trusted? There are different issues for funds whose units are priced by share markets (REITs and investment companies), funds priced by periodic valuations (property unit trusts), funds valued less regularly (closed end PUTs and limited partnerships) and derivative contracts based on valuation based indexes.

There are grounds for considering that any valuation issues raised by the German approach could be replicated in the UK. There are suggestions that the German valuers adopt a different interpretation of value, have a different educational and practical background, use different applications of methods and are more vulnerable to coercion from clients. Despite the protestations of the client's representative body, the aims and objectives of the German funds, the method of appointment of valuers and the appraisal based performance measures of the German investment market also provide motive and some element of empirical backing respectively for these suspicions. Coupled with a vehicle that allows instant withdrawal, valuation based unit pricing and a small margin of liquidity, a prolonged bear market was going to put the vehicle under pressure. The accident waiting to happen duly arrived at the end of 2005.

In the UK there are no major suspicions concerning the valuation process and the education, training and approach of valuers. The basis of valuation is not subject to different interpretations and valuers are all aiming at the same target, the identification of the price if a transaction took place at the date of valuation. Client influence does exist and it is important that motives are reduced to a minimum. This author has argued that bonus payments to fund managers based on performance targets set by reference to valuation-based indices should be outlawed, no doubt a fairly unpopular suggestion to this particular readership! However, responses in the UK to valuation issues have largely been the domain of valuers rather than clients, with the RICS at the forefront of introducing more information, guidance and enforcement of standards. This is despite the fact that there was no evidence that client influence was endemic or was introducing a serious problem into the pricing of commercial property, or vehicles based on commercial property.

However, there is an issue of accuracy of valuations and the smoothing, lagging and accuracy literature and data analysis does suggest that valuers lag the market and generally this means that prices are more than valuations. However, it has been suggested that in a long bear market the situation could reverse and valuations systematically exceed prices. The most significant bear market in UK property markets commenced in 1990 but did not last long enough to produce evidence of that phenomenon. This was not the case in Germany. So, if the UK was subjected to a very long falling market then there is some reason to suppose a systematic over-valuation of assets could occur. Where secondary markets exist and units are traded at prices which have significant discounts or premiums to net asset value, the reasons for these differences need to be researched. It may be that some element of the differences relates to investors making assumptions about any systematic bias in the valuations of the underlying properties.

Even where units are traded on a secondary market, valuations are an important part of the information base but are only part of it. Research on valuations is in the public domain and investors are able to take a view of the veracity of valuation information and the research, and price units accordingly. The real issue is investments priced by direct reference to the asset valuation, or by reference to indices based on asset valuations. Germany open-ended funds and UK PUTs are such investments. Although this paper suggests there is circumstantial evidence to suggest that loss of confidence in German valuations may have been a rational response and that many of those issues do not exist in the UK, there is still evidence that valuations vary by a significant extent and that variation is not always random. These valuations should be particularly well policed by the RICS and there may be some grounds for biasing the random samples adopted by the RICS compliance unit towards this group of regulated purpose valuations. Derivative contracts are also part of this process with the indices on which they are based heavily dependent upon valuations.

A similar event in the UK is concluded to be much less likely to occur even in a long bear market as long as the valuation regime for those property investment types at risk continues to be transparent and objective and is closely observed, researched and regulated. If German valuation processes were subject to the same level of scrutiny as in the UK, trust would be increased and institutional risks to investment reduced.

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Index smoothing and the volatility of UK property

Recent research from Tony Key and Gianluca Marcato addresses whether property indices understate property risk.

The property industry relies on valuation-based property indices – like IPD's – for forecasting, benchmarking and, these days, as the basis for derivatives markets. Academic researchers are unanimous that while indices may offer robust measures of period rates of return, they understate true property investment risk. So it is surprising to find that there is still no widely publicised or generally accepted measure of what the 'true' level of risk of property investment actually is – perhaps a disturbing omission now that property investment is being marketed to a much wider range of non-specialist investors.

That gap is not due to any shortage of analysis or suggested techniques to adjust property risk. A mass of academic articles do that, though they lack consistency in their estimates of what property risk really is because they use a variety of methods on data from different countries, index sources and time periods. Industry reports and fund prospectuses, on the other hand, frequently note that historic index results may understate investment risk, but tend to be coy about exactly how much, or the methods they used to tinker with risk figures.

Against that background, the IPF study had four main elements:

- First, from the academic literature, to revisit briefly the basis for the belief that valuation-based property indices are 'smoothed' and understate risk.
- Secondly, to identify techniques available to desmooth indices, and apply those methods to the standard UK index series to demonstrate how much estimates of property risk vary with choice of method and data used.
- Third, to explore how much desmoothing, which cranks up property risk, affects the weighting of property indicated by asset allocation models, in short whether desmoothing destroys the conventional risk reduction and diversification case for property.
- And finally, from an industry survey, to find out what desmoothing methods are used by leading fund managers and investment advisors, and whether there is in fact already an unrevealed consensus on the corrected, or true risk of property investment.

Our overall objective is to provide a basis for a broad industry consensus on the representation of property risk, not to devise new methods for adjusting risk, or even to recommend the use of any one method. Any estimate of true or adjusted property risk remains in part a matter of judgement, and leaves room for alternative views. In that spirit, the Desmoothing Project Spreadsheet available alongside the final report includes all the property data sets and formulae used in the work, with tools which allow the user to apply assumptions different from our own.

Tony Key, Cass Business School

Gianluca Marcato, Reading Business School

Why do we think property indices understate risk?

The idea that valuation indices understate risk rests on several, mutually supporting, sources of evidence.

For individual properties, we know that the valuations rely on backward-looking comparables, often surrounded by a large measure of uncertainty. Blundell and Ward (1987) were among the first to suggest that this makes valuations 'sticky'. They can be represented as a weighted average of the last valuation estimate and new market evidence, with the weights depending on the volume and quality of new evidence. In the language of behavioural finance, current valuations are partially 'anchored' on past valuations, and will therefore tend to smooth out shifts in the true market price.

On top of that pure valuation smoothing, constructing an index is done by adding up results for many individual properties. If those valuations are done at dates spread around the notional valuation date, and by different valuers who respond to the same market information with varying lags, the resultant index will again smooth out fluctuations in market prices (Matysiak and Brown, 2000). In effect, any shift in the underlying market is spread over a period of time in the valuation index.

So, from a mainly theoretical standpoint, it is likely that a valuation index will dampen shifts the prices which would be achieved on transactions, and therefore smooth out some of the true property risk. Since we have very little robust information on general movements in transactions prices, however, we cannot see directly how much risk may be understated.

But there is indirect evidence on that point in the behaviour of the index results. In an efficient market, financial theory suggests (Fama, 1965), it is impossible to predict changes in asset prices or total returns purely from their past performance – because traders would already have built that evidence into current prices. Returns will be a random walk, with no statistical relationship (serial correlation) between returns in one period and any previous period. Which is, broadly, what we see in equity and bond returns, but do not see in property returns (Figure 1).

Property index results in fact show a simple statistical linkage – serial correlation – between returns in successive periods. UK monthly and quarterly returns show very high serial correlation (as do annual returns for non-UK countries), which suggest returns measured at a high frequency are very heavily smoothed. This is, of course, unsurprising if we believe that rather little new

Figure 1: Serial correlation in IPD returns

	Annual 1971-2005	Annual 1981-2005	Monthly 1987-2005	Quarterly 1987-2005
Serial correlation	0.28	0.42	0.87	0.85
T statistic	1.66	2.17	25.93	13.60
P value	0.06	0.02	0.00	0.00

market evidence arrives each month and therefore that monthly valuations are often carried over. For annual returns in the UK, however, the results suggest a rather weaker smoothing effect, with a low level of statistical significance over the longest available runs of history.

A further, more practical, pointer that property indices understate risk comes from the comparison with other asset classes. The fundamental nature of property cash flows, with mix of fixed-income and equity characteristics, and the fact that returns on property run between those on gilts and equities, suggest that property risk should also be above gilts but below equities. Index results, however, show UK property risk little more than two-thirds that on gilts – an implausibly low figure.

Finally, because property risk seems to have been very low in relation to its return, many studies (for example, Lee 2003) have demonstrated that asset allocation models run with index figures produce implausibly high weights of property in optimal asset portfolios. On our calculations, using unadjusted index figures on return and risk, the optimum historic portfolio of UK assets (defined by the maximum Sharpe ratio) should have held a minimum a property weighting from 30%, and up to 80%, depending on the period over which the exercise is estimated.

So, overall, there is a strong theoretical, empirical and practical case that valuation indices understate property risk, with a consistent picture from varying perspectives. The evidence leaves the analyst faced with a choice. Either the standard financial theories applied to all other asset classes cannot be applied to property, or index results have to adjusted to fall in with financial theory, or more importantly with the asset allocation models used by investment practioners.

Desmoothing methods and their results

Over 20 years, a string of academic articles have proposed a wide range of methods to correct for index smoothing (see, for example, Geltner, Macgregor and Swann, 2002). From this range, we have selected five which form a mainstream of the most widely used, and readily reproducible, desmoothing methods. They are all rooted in the basic proposition that a smoothed index is, like a valuation, the weighted average of past values and new market evidence. On this view, a desmoothed estimate of returns can be recovered from a series of valuation based by the formula:

$$\text{True return}_t = \frac{(\text{Valuation return}_t - k \times \text{Valuation return}_{t-1})}{(1 - k)}$$

Where k is a desmoothing coefficient taking a value between 0 and 1, which represents the weighting in current valuations of old market evidence. The set of five desmoothing methods, described in detail in our full report, elaborate on this basic theme, using alternative lags or calibration methods.

Our tests applied the five methods to UK indices over varying frequencies and time periods to tease out how far estimates of risk are sensitive to choice of method, or how long a run of history is used in the estimation, or to the criteria were used in the calibration of the desmoothing models. We were looking for a preferred method which was least likely to produce extreme and implausible results when applied to different data sets, and also preferably demand the least subjective judgement from the analyst. And we were looking for the most robust figure for long-run historic property risk, taken as the central estimate which emerged from the variety of methods and data sets.

These tests show a simple technical desmoothing solution. With what look like reasonable assumptions, the estimates of adjusted property risk run from less than that observed in the original index to three times that figure. Often, it is the more sophisticated methods which are more likely to produce extreme results, and often demand more judgemental input. We therefore regard the simplest Lag 1 autoregressive desmoothing technique, based on the formula above, as the most robust.

At the end of the day, our central, or preferred, estimate of property's long-run historic standard deviation in annual total returns is 13% to 15%, or 1.3 to 1.5 times that observed in the unadjusted index results.

The impacts of desmoothing on asset allocation

The dominant practical application of desmoothing property returns is to offer a more credible comparison of property with other asset classes, and to make property a better fit in standard asset allocation models. We have tested the impacts of varying desmoothing assumptions on the property weights indicated by models based on mean variance portfolio theory (MVPT) and asset liability modelling (ALM). Our preferred estimate of property risk is a base case for these exercises, but we also show the results of much more extreme desmoothing which doubles the observed risk.

Desmoothing does produce a significant change in the relationship between property and competing asset classes. Thus our preferred estimate of property standard deviation at 13% to 15% puts property risk in its expected position between equities and gilts (though still closer to the latter), and also results in higher correlations between property returns and those on equities and gilts returns. The increase in correlations with equities and gilts however tends toward upper limits well below 1, so that property retains substantial diversification benefits even at extreme levels of desmoothing.

Even with reasonable levels of desmoothing, therefore, property remains an asset with moderate (rather than low) risk, and only mildly diluted diversification benefits. So asset allocation models using the standard MVPT methods continue to indicate high property weights with all but the most extreme desmoothing assumptions. When our preferred 13% to 15% estimate of property risk is used, indicated optimum property weight in historic portfolios remains in the range of 20% to 65% (depending on time period covered). And the weight of property falls below 10% only if property risk is assumed to be over 20%, more than double that shown by index figures.

Similarly, runs of ALM models show that with property risk adjusted to our preferred level, the indicated property weight falls in the range of 12% to 20%, and again the property weight falls below 10% only if the assumed property risk is more than doubled. Overall the property weights indicated by ALM methods are below those produced by MVPT models when run over the same period, but still well above the typical weights of institutional investors.

Industry practice in desmoothing and asset allocation

A survey of 13 leading fund managers, asset allocators and advisors was undertaken to gather opinions on the importance of desmoothing, use of desmoothing methods and the implications of desmoothing for their advice on property weightings in multi-asset portfolios.

There was general agreement that historic property risk is understated by valuation indices, and should be adjusted. A majority of firms use their own estimates of risk, mostly produced by the simplest Lag 1 autoregressive desmoothing method. Their estimates of true property risk averaged 13.8%, with almost all in the range 13% to 15%, falling in line with our own preferred estimate of risk.

The forward-looking assumptions used in asset allocation modelling reflected this view. Over a five to 10 year horizon, property returns were on average expected to run just under 7%, with an expected standard deviation a little over 13%, slightly higher correlations between property and other assets from those observed historically.

Run with these expected return profiles, quantitative asset allocation models indicated property weights in from 15% to as high as 50%. The typical advice to clients offered by respondents was, however, a recommended property weight in the range 10% to 15%.

Findings and conclusions

There is an overwhelming case that property valuation-based indices are smoothed, and property risk should be adjusted. We believe that the most robust estimate of long-run historic property risk is 13% to 15%, or 1.3 to 1.5 times that observed in the valuation index. And we find a fairly strong agreement among fund managers and investment advisors that expected property risk for the future lies in the same range.

Aside from those interested in the technical details, the most general point of interest is how far reasonable assumptions on desmoothing change the conventional case for property as a strong portfolio diversifier. As our full report discusses at length, the precise answer to that question depends on what period of history you choose to take as typical, and the details of your desmoothing method. But the general answer has two parts.

First, you have to combine very extreme desmoothing assumptions (more than doubling property risk to 20% or more) and use the worst available period of relative property performance (1980 to 2005) to cut away the historic case for property to a weighting below 10%.

And second, assuming property risk in future at our desmoothed estimate of 13% to 15%, alongside consensus expectations of returns across asset classes, quantitative asset allocation models continue to indicate optimum property weights above 15%, and often much higher.

Forum News

New Executive Director

We are delighted to announce that Sue Forster has joined the IPF as Executive Director. Sue has long been involved in the work of the IPF as consultant editor of this journal and is relishing the challenges which lie ahead. Of her appointment Sue said:

"I am really looking forward to joining the IPF Executive. Since becoming a member in 1989, I have watched the Forum grow from its primarily networking roots to a leading industry body – yet still retains its focus on the membership. I shall be working with the Management Board to develop the Forum's role still further, drawing on its proactive and influential membership, combined with the expanding education and research programmes."

Investment Education Programme

Relaunched a year ago, this post-graduate programme continues to attract a wide range of property investment professionals who are looking for a high level of flexibility in the way that they study. The course comprises of a series of modules which may be taken as one-off courses or a part of the overall programme which, on successful completion, leads to the award of the IPF Diploma.

A full outline of all the modules can be found on the IPF website

Timetable 2007/08

Part I	Part II
Property as an Asset Class – e-learning module Available online (15 hours) IPF Members £350 Non-Members £400	**Property Investment Appraisal** 28, 29, 30 January 2008 IPF Member £1,095 Non-Member £1,440
Introduction to Investment Valuation & Portfolio Theory 9,10,11 October 2007 IPF Member £1,095 Non-Member £1,440	**Property Finance & Funding** 4, 5, 6 March 2008 IPF Member £1,095 Non-Member £1,440
Financial Instruments & Investment Markets 26, 27, 28 November 2007 IPF Member £1,095 Non-Member £1,440	**Indirect Property Investment** 22, 23, 24 April 2008 IPF Member £1,095 Non-Member £1,440
	International Property Investment 3, 4, 5 June 2008 IPF Member £1,095 Non-Member £1,440
	Portfolio Management 2, 3, 4 September 2008 IPF Member £1,095 Non-Member £1,440

For further information on the Investment Education Programme, please contact the programme office at Cambridge International Land Institute tel 01223 477150 email cili@fitz.cam.ac.uk.

IPF Midlands Lunch 2007

A highly successful lunch took place at the Burlington Hotel in Birmingham at which 380 members and their guests heard from former IPF Chairman and Chief Executive of Quintain Estates and Development on his vision for sustainable construction and the implications for property investment. At the event, tribute was paid to Hapri Yorke Brooks who was integral in the formation of the region and who has now stepped down from the Regional Board. Many thanks to Abstract Land, GBR Property Consultants and Lloyds TSB Corporate Markets for supporting this event.

Estates Gazette Property Investment Awards Lunch 2007

This annual event, supported by the IPF and IPD, took place at the London Stock Exchange and was supported by Eurohypo. The winners were as follows:

Insurance Company Life Funds (above £1000m, Dec 06)
Manager: Scottish Widows Investment Partnership
Winning Fund: Scottish Widows PLC

Insurance Company Life Funds (above £50m and below £1000m, Dec 06)
Manager: Threadneedle Property Investments
Winning Fund: Zurich Assurance Ltd Zurich EW WP 90/10 Prop Fund

Segregated Pension Funds (above £200m, Dec 06)
Manager: Cordea Savills
Winning Fund: Diageo Pension Scheme

Segregated Pension Funds (above £50m and below £200m, Dec 06)
Manager: LaSalle Investment Management
Winning Fund: Kodak Pension Plan

Balanced Pooled Funds & Traditional Institutions (above £200m, Dec 06)
Award not made

Balanced Pooled Funds & Traditional Institutions (above £50m and below £200m, Dec 06)
Manager: Canada Life Ltd
Winning Fund: Canada Life UK Life Fund

Small Funds (below £50m, Dec 06)
Manager: Henderson Global Investors
Winning Fund: VV Real Estate Fund

Specialist Pooled Funds and Traditional Estates (above £50m, Dec 06) Highest 3 year annualised return margin relative to IPD sector/segment weighted average
Manager: Drivers Jonas
Winning Fund: Pollen Estate Trustee Company Ltd

Risk Adjusted Return: All funds with a full ten year IPD performance track record Highest ratio of 10 year annualised relative return vs standard deviation of relative return
Manager: DTZ Investment Management
Winning Fund: Imperial Tobacco Pension Fund

Forthcoming events

4th Annual IPF Property Investment Conference in Scotland: Property Under Pressure: Rise to the Challenge
Thursday 13 September 2007, Radisson SAS, Edinburgh

This conference will examine:
- The Sustainability Agenda
- Building for the Future – the developer's response
- Tax – what next?
- Economic Overview and Forecast

Speakers:
- **Peter Freeman**, IPF Chairman and Non-Executive Director at Argent Group.
- **Jim Hillan**, Tax Partner at Dundas & Wilson LLP
- **Sabina Kalyan**, Chief Economist at IPD
- **Phil Miller**, Chief Executive of Miller Developments
- **Fiona Morton**, Managing Partner at Ryden
- **Martin Moore**, MD at PRUPIM

Many thanks to Lloyds TSB Corporate Markets, Miller Developments and CoStar Group for supporting this event.

To reserve your place at this event, please contact Chris Naughton, Education Director on tel 020 7194 7928 or email cnaughton@ipf.org.uk

Midlands Dinner 2007

This sell-out event takes place on 18 October at the ICC. This year's speaker is former British Lions and England International Martin Bayfield (due to speak last year but due to filming commitments had to withdraw). To reserve a table at this event, please contact Ingrid Styles, Events Manager on tel 020 7194 7923 or email istyles@ipf.org.uk

IPD/IPF Property Investment Conference 2007: Your property investment in their hands... the rise of the alpha manager

The Grand Hotel, Brighton, 22-23 November 2007

Featuring leading speakers including:
- **Gerald Parkes**, Lehman Brothers Europe
- **Alec Emmott**, Société Foncière Lyonnaise
- **Ian Cullen**, IPD
- **Julian Schiller**, Jones Lang LaSalle
- **Simon Stevenson**, Cass Business School
- **Malcolm Frodsham**, IPD
- **Martin Moore**, PRUPIM
- **Paul Mitchell**, Paul Mitchell Real Estate Consultancy
- **James Clifton-Brown**, CBRE

For further information on the conference, please contact the IPD events team: +44(0)20 7336 9255 or melissa.manchon@ipdglobal.com.

Surveys

The latest versions of the UK Consensus Forecast and European Office Consensus Forecasts were published May and can be downloaded from the IPF website.

Research projects

Two new research projects have recently been published:
- Asset allocation issues in the modern world
- Tax status of authorised investment funds

We have changed the dissemination strategy for our research projects. Members will now be able to download the full report from the IPF website. Non-members can still purchase the full report from each project from IPF.

Two other projects are nearing completion:
- Risk perceptions – an update to the previous work in this area carried by IPF and IPD
- Energy Performance of Buildings Directive – a situation review

We have had a positive response to the latest invitation for research proposals and are looking to let a range of projects over the next few months.

Research events

A successful event chaired by Paul McNamara of PRUPIM was held to present the findings of the Energy Performance of Buildings Directive research. The findings were presented by Oxford Brooks University and King Sturge. Martin Russell-Courcher of RICS responded to the research and gave an outline of the RICS position on EPBD and energy certificates at the current time. Matt Smith of BPF gave a presentation of the Les-ter initiative that has been developed by BPF and funded by the Carbon Trust. A summary report from the research is available on our website along with the presentations. Material is also available on Les-ter along with a link to the Les-ter website: www.les-ter.org.

IPF also sponsored a session at the European Real Estate Society Conference held at Cass Business School in June. Papers were presented based on research IPF has supported on diversification, risk and derivatives pricing.

Future dates for your diary

Annual half-day conference 2007
13 September 2007: Edinburgh (Radisson SAS)

Midlands Region Annual Dinner 2007
18 October 2007: Birmingham (ICC)

Northern Region Inaugural Dinner 2007
14 November 2007: Manchester (The Lowry Hotel)

IPD/IPF Annual Conference 2007
29-30 November 2007: Brighton (The Grand)

IPF Annual Lunch 2008
6 February 2008: London (Grosvenor House)

New members

New IPF members since April 2007:

Mr Kevin Adams	Property Broker	TFS
Mrs Mary Anderson	Partner	Clarke Willmott
Mr George Andreoglou	Financial Analyst	Global Finance Real Estate
Mr Stephen Brown	National Head of Planning	GVA Grimley LLP
Mr Ross Burns	Associate Director	Jones Lang LaSalle
Mr Edward Cable	Associate	ING Real Estate Investment Management
Mr Alan Collett	Partner	Allsop LLP
Mr Spencer Davies	Director	CB Richard Ellis Ltd
Mr Heraclis Economides	Managing Director	Bridgewell Ltd
Mr Edward Gamble	Head of Investment	Jones Lang LaSalle
Mr Paulo Gomes	Senior Broker	TFS
Mr Paul Goward	Partner	Druces & Attlee
Mr David Hayes	Partner	Clarke Willmott
Mr Paul Hillier	Associate Director	Atisreal
Mr Tim Horsey		
Miss Victoria Jack	Student	Macquarie Global Property Advisors
Mr Jason Jackson	Partner	Shoosmiths
Mrs Jane Kemp	Partner	Clarke Willmott
Mr Kultar Khangura	Partner	Pinsent Masons
Mr Peter McKeown	Senior Surveyor	DTZ
Mr Paul Mellor	Director of Valuation	Atisreal
Mr Graham Powell	Snr Commercial Finance Manager	Northern Rock Commercial Banking
Mr Mark Rooke	Associate Director	CB Richard Ellis Ltd
Mr Paul Royston	Senior Lecturer	Nottingham Trent University
Mr Tony Smedley	Head of European Funds	Invista Real Estate Management Ltd
Ms Juliet Thomas	Senior Associate	Berwin Leighton Paisner LLP
Mr Duncan White	Associate/Asset Manager	ING Real Estate Investment Management
Mrs Anna Wohlthat	Student	KGE Kommunalgrund

Interview with Amanda Keane

Amanda Keane

After 9 years at the Investment Property Forum, the outgoing executive director takes some time out for a quick interview...

What got you involved in property? Why did you want to be a Chartered Surveyor?

I wanted to come out of higher education with a vocational qualification, perhaps somewhat naively. Not being very imaginative, I only considered Law, Accounting and Surveying. As I made my career decisions in the mid 80's, the built environment appeared really exciting and I had friends already making money in the sector (£4,000 per was mega bucks to me in those days) so the decision was made!

Any high or low points worthy note in your 9 years at the IPF?

There are too may highs to mention and never a low point at the IPF! If I was to pick one high though, it would have to be REITs. My first introduction to the work of the IPF was when it made the case for securitisation back in the mid 90s. It's great to see the hard work of so many over the years actually come to fruition.

How do you manage to motivate people so well?

Do I? I just ask nicely!

How do you think the IPF will change over the next 5 years?

Well that will be in the hands of the new Executive Director and her Board! Change is however inevitable and I think the influences of the global market place and on a domestic level the role of the Property Industry Alliance will shape the IPF of the future.

Where do you see things moving for you over the next 5 years?

I plan to take life at a slightly slower pace than I have done so far in my career and spend more time with Dominic my son. Saying that, I have been lured by some very exiting new opportunities which have come my way since my resignation was announced. So, I will be staying pretty busy just in a more 'family friendly' way!

You've worked with a number of IPF Chairmen over the years. Which one has stood out as particularly memorable?

Every single one of them! What an unfair question.

What's the most important lesson this post has taught you?

To have confidence in my abilities.

Your son, Dominic, is approaching his 1st birthday. What line of work would you like to see him getting into when he's older?

The clichéd answer would be to say whatever makes him happy! However, as I always wanted to go on the stage as a child, it would be great if he pursued a more artistic path than I managed.

Who's the most famous person you've met over the last 9 years?

Oh, Ian Marcus definitely.

Who was the best after dinner speaker you've heard and why?

Ian Hislop. He consistently makes me laugh.

What do you consider your greatest achievements to date?

Fitting into size ten jeans (once) oh and producing Dom.

If you could edit your past, what would you change?

That tattoo...

However, Amanda is not departing from the industry completely and will be working on a freelance basis in future.

Her new contact details are:

Mobile 07973 653841
Email ak@lindfield58.freeserve.co.uk

IPD/IPF Property Investment Conference 2007

22-23 November 2007, The Grand Hotel, Brighton

The **IPD/IPF Property Investment Conference** is an annual fixture in the UK property investment calendar. It leads the field in strategic thinking, investment analysis and informed debate.

It is also the UK's premier networking event for leading property investment professionals. Over its 17-year history the line-up of opinion formers has consistently attracted a demanding and sophisticated audience.

Your property in their hands... the rise of the alpha manager

The theme of this year's event reflects the ever-growing role of indirect funds in the UK market, and the increasing specialisation of vehicles. As the market becomes more challenging, those managers who can deliver alpha will be more and more highly valued.

The conference sessions will focus on:

- **Beyond direct investment strategies**: how can investors exploit the vast array of routes into property?
- **Trading indirects**: how can these vehicles contribute to an actively managed strategy through time?
- **Risk and return**: do specialists do it better?
- **Long-live the assets**: why buildings and their occupiers are still crucial
- **From assets to alpha**: how can alpha be generated strategically and tactically?

Book now – secure your room at the Grand!

To register for the conference, contact IPD on +44 (0)20 7336 9255, email conferences@ipdglobal.com or visit www.ipdglobal.com

For more information, or to register, contact:

Melissa Manchon, IPD
+44 (0)20 7336 9255
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For information on sponsorship opportunities, contact:

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Vivienne Wootten, IPF
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vwootten@ipf.org.uk

Confirmed speakers include:

Richard Barkham, Grosvenor
James Clifton-Brown, CB Richard Ellis Investors
Paul Clark, Church Commissioners
Ian Cullen, IPD
Alec Emmott, Europroperty Consulting
Malcolm Frodsham, IPD
Paul Mitchell, Paul Mitchell Real Estate Consultancy
Gerald Parkes, Lehman Brothers Europe
Matthew Richardson, Fidelity Investments
Nick Ritblat
Julian Schiller, JLL
Simon Stevenson, Cass Business School

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