Issue three hundred and sixty-four

Did "Generalist" Property Funds Hinder the Unitised Property Market Recovery?

Many property funds have been suspended for approaching a year. One of the largest (M&G) has been shuttered for even longer and this is not good for the property sector, and also, in reality, the whole of the fund management industry.

This piece is not about whether a daily traded vehicle is the correct structure (enough has been written about this already) and the regulator is presently reading through the responses to its recent paper CP20/15 surrounding the illiquid nature of the asset incorporated into a liquid structure (UT / PAIF).

Last year, in the midst of the Coronavirus market sell-off, all asset classes were hit – it made no difference if you invested in large cap, small cap, value, growth, short or long duration, investment grade or high yield, commodities or property. Pretty much all markets were affected, and without intervention from central banks it does make you wonder where global economies would be today. Although there are still lots of issues emanating from the fall-out of the global pandemic, and there will be for decades to come, at least capital markets seem to be functioning much better now.

But (and we all knew there was going to be a but) the liquidity in the property sector continues to struggle even though there are signs of improvement coming through. Of course, there will be uncertainty – the high street is unlikely to ever recover to pre-pandemic levels due to the shift to online transactions. Will offices ever see occupancy levels back to where they once were? Will hotels that traditionally serviced business travel be forced to change their business model and many other questions certainly keep a negative spotlight on good old bricks and mortar.

When the unitised property market as a whole suspended last year it was due to rules of the individual trusts being breached. A collective investment fund can be suspended if an independent valuer cannot accurately price 20% or more of the underlying properties, and in the midst of the pandemic, it was a no-brainer to suspend. It protected and continues to protect the integrity of the long-term investor, the fund manager and the illiquid nature of the asset class.

Over the next few months, as more information emerged and more property transactions went through, the independent valuer started to lift suspensions on different sectors of the property market. Valuing a property is not a simple calculation – square footage is good measure, but age of building, location, use, tenant, length of lease and many other factors are taken into consideration. For instance, building A could be priced differently if it were leased to company A with a 10-year lease versus a 20-year lease. Alternatively, building A could be priced differently if it were leased for 5 years to company A or company B.

All the way through the pandemic, supermarkets remained open, and if you wanted to sell a supermarket in March, April or May 2020 (at a realistic price), you could have done so very easily. But, if you wanted to sell a high street shopping parade, think again. 12 months on, and it's still easier to sell the former rather than the latter.

Property, as an asset class is not homogenous. Industrial units are in huge demand as the shift to online continues to gather pace, and they have fared pretty well all things considered, but many other sectors have struggled. Without government intervention I do feel the property market would be in much worse shape that it is today. The intervention, relating to landlords not being able to force tenants out for non-payment of rents, and for business rates deferrals must be seen as a good thing.

As the asset class is quite diverse, so are the risks and return profiles of different properties, yet when you look at of the property funds within the IA UK Direct Property sector (26 as at the end of February) they are all generalist property funds. If you looked at the Investment Trust offerings, you would see dedicated funds looking at sector specifics such as student accommodation, healthcare, logistics, supermarkets and so on. Maybe if the open-ended world had specialised the damage might have been more limiting. I'm fairly sure an open-ended supermarket fund wouldn't have suspended due to material uncertainty surrounding the pricing of its underlying assets.

I know many would come back and suggest that the diversified nature of a generalist property fund is one of the main reasons to own it in the first place. Knowing the nuances of the office market versus the leisure market, retail and industrial for instance is very specialist in nature and by outsourcing to a fund manager who has the ability to add value by allocating across these sub asset classes gives access to the sector, with the potential to outperform the wider market sounds appealing – and it is, but I do wonder that in a sector where everybody is a generalist, maybe there is a need for specialists – it might not have tarnished the sector as much.

Market Snapshot (05.03.21 – 12.03.21)

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FTSE 100	6761.47	↑1.97%	UK	0.82	↑7.89%	£/$	1.3930	↑0.63%	Brent Crude	$69.23	↓0.66%
S&P 500	3943.34	↑2.64%	US	1.62	↑0.62%	£/€	1.1650	↑0.29%	Gold	$1722.50	↑1.53%
NIKKEI 225	29717.83	↑2.96%	Germany	-0.29	↑3.29%	€/$	1.1950	↑0.27%			
DAX 30	14502.39	↑4.18%	Japan	0.11	↓8.33%	£/¥	151.8000	↑1.19%			
CAC 40	6045.55	↑4.56%									

Figures quoted are in local currency.
Source: FE Analytics & Financial Times

Week Ahead

Monday –
Tuesday – US: Core Retail Sales (MoM) (Feb)
Wednesday – Eurozone: CPI (YoY) (Feb)
Thursday – UK: BoE Interest Rate Decision
Friday –

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