ST BRIDE'S MANAGERS

Bull and Bear

Fortune Favours the Brave

Bull and Bear look at the current pricing of the listed property company sector and conclude that there may be some bargains there, not least as current forecasts are looking much brighter, and UK cities are well positioned to avoid the level of mass office vacancies that is prevalent across the US.

Bull: Why are you all doubled-up? Are you okay?

Bear: Yes, I am fine. I am just contemplating my navel. I find it therapeutic.

Bull: Are you expecting to discover anything new whilst you are down there?

Bear: Absolutely. I already have. Look, here are the left-overs of that chocolate egg I mislaid last week.

Bull: Ugh. That's disgusting! But it does remind me that you and your bearish brethren are at serious risk of getting egg on your face!

Bear: Why is that?

Bull: Because I am officially calling the turn-around in the market. CBRE's total return for All Property in February was 0.2% and the IPF consensus forecast for 2024 has recently been released at +7.2%. That means we can expect a real bounce-back over the next six months or so.

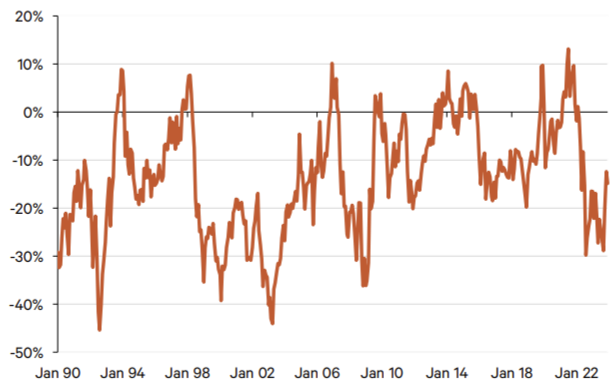
Bear: But if that is right, how come the listed property share market is still so dire? Prices have continued to retreat and the sector's average discount to NTA (Net Tangible Assets) is still around 18-20%.

Bull: I know. It's bonkers, isn't it? The listed sector is throwing off an average dividend yield of about 4.9% and bellwether companies like British Land are stumping up over 6%. When you compare those figures with the FTSE100 and 10-year gilts, both of which are yielding 4% to 4.25%, the sector looks very compelling.

Bear: Really?

Bull: Yes. Have a look at this long-term graph which has been put together by those very nice people at Berenberg. It tracks the sector's pricing relative to NTA since 1990. Other than during the dotcom crash, the time it takes for the sector to bounce back from a discount to a premium is normally between three and four years. So, by my reckoning, that should mean sometime in 2025.

Long-term sector premium/(discount) to NTA (%)



Source: Berenberg Research, Company data, Datastream

Bear: C'mon, you will have to offer a much more scientific case than that.

Bull: Okay smarty-pants, you are the one who has been doing all the contemplation recently; you tell me.

Bear: Well firstly, the issue isn't uniform across the board. The table below sets down the top four and bottom four companies covered by Berenberg with their respective exposures. Does anything particularly stand out to you?

Bull: Oh yes! I can see that the companies with the largest discounts are all heavy hitters in London offices … Helical, GPE, Derwent and British Land.

Bear: Exactly. And the companies with the smallest discounts?

Bull: They are mainly in sheds and beds?

Listed Property Companies and REITs

	Premium / Discount (%)	Dividend (%)	London Offices (%)	Retail (%)	Industrial (%)	Students (%)	Residential (%)	Other (%)
Top 4								
Unite	+4	3.8	0	0	0	100	0	0
Segro	-2	5.2	0	0	100	0	0	42
London Metric	0	3.3	0	17	41	0	0	0
Grainger	-14	2.8	0	0	0	0	100	0
Bottom 4								
British Land	-31	6.1	55	36	3	0	1	5
Derwent London	-33	3.8	99	0	0	0	0	1
GPE	-36	3.2	80	19	0	0	0	0
Helical	-46	5.7	100	0	0	0	0	0

Source: Datastream, Berenberg Research

Bear: Precisely, Bull. Which is where the growth lies. The office players will continue to be beaten up until direct asset values find their true plateau.

Bull: I get that. But pricing Derwent, for instance, at a 33% discount belies commonsense. They have a great portfolio and there is no way that West End valuations are going to slip by anywhere near the 22% implied by the discount (allowing for leverage).

Bear: I know that, but their dividend yield (3.8%) is far too skinny for investors' current liking. And GPE is tarnished with the same brush. Investors want to be able to have their cake (capital growth) and eat it (income return). And they are dubious about these guys undertaking new developments in the current climate.

Bull: You know what? I have just about had enough of all this bad-mouthing of offices. It has gone way over the top. According to CoStar, the average vacancy rate in the UK is only 7.9% and in the two major markets, London and Manchester, they are still below 10%. Moreover, some of St Bride's Key Cities, like Cambridge, have vacancy levels as a low as 4%.

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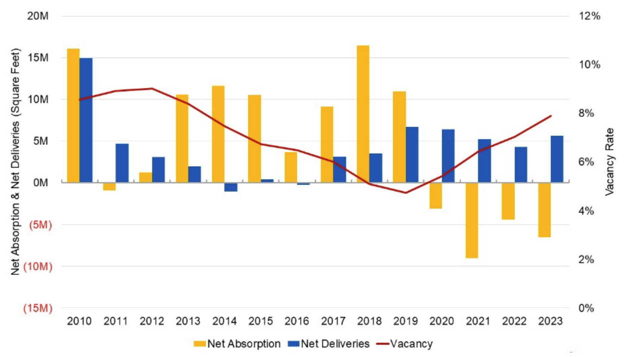
Bear: You are missing the point, Bull. We live in a global market nowadays and investors have been spooked by what has been happening across the Pond. There, according to Moody's Analytics, the national average office vacancy is 19.6%. The fear is that somehow, we will be infected by the same sort of levels being endured in Manhattan (16.5%), Washington DC (17.1%), Seattle (23.0%) and San Francisco (23.7%). But you and I know that it is never going to be anywhere near as bad as that here. Just look at the historic stats.

UK Office Vacancy Rate Reached 7.9% at the End of 2023



Source: CoStar Group, January 2024

Bull: Well said, Bear. So, what do you think is going to happen?

Bear: What? Do you really want me to do your job for you?

Bull: Go on. I dare you! You love a challenge. Give our readers just two reasons why the UK market is pivoted for a turnaround and why they should dive in now. And cut out the gobbledegook so that they have a chance of understanding what you are saying.

Bear: Okay. I'll start with the denominator effect.

Bull: What? I thought we were going to keep it simple.

Bear: It is simple. Think of it like this. Investors usually aim to keep a balanced portfolio between equities, fixed income and alternatives, of which property is one. To avoid excessive positions, weightings are usually constrained to certain upper and lower parameters. With the rocketing US equity market having been such a popular destination recently, this will have automatically nudged their other asset classes into an underweight position. As a result, in due course, their portfolios will need to be re-set, and hopefully property, where values have been heading in the other direction, will be a net beneficiary again.

Bull: Are you saying that property will get fresh allocations because it has done so poorly recently? That all sounds rather bizarre to me, but hey ho! And your second point?

Bear: The economy, inflation and employment growth are all heading in the right direction. So, it is reasonable to expect that The Bank of England will clip interest rates later this year. This will have a positive impact of cash flow and project viability, and in turn, prime property yields should start to compress.

This will generate capital growth … and bingo … the upward cycle will begin all over again.

Bull: Wow! I couldn't have put that better myself.

Bear: There is more.

Bull: What? Are you offering us three for the price of two? I love it.

Bear: Yes. You may think that you are a lone voice in calling the market, Bull, but the IPF consensus reveals a generally bright sentiment across the market. The nineteen contributors are predicting capital growth in every sector, except shopping centres, which come in just below par at minus 0.5%.

And overall rental growth is expected to be in positive territory (+1.0%) too, albeit largely as a result of industrials which are expected to deliver 2.1%.

IPF Consensus Forecasts - 2024

	Income Return (%)	Rental Growth (%)	Capital Growth (%)	Total Return (%)
Offices	4.8	0.0	0.6	5.4
Industrials	4.9	2.1	3.8	8.7
Standard Retail	5.5	-0.4	1.3	6.8
Shopping Centres	7.4	-1.0	-0.5	6.9
Retail Warehouses	6.5	0.6	2.6	9.1
West End Offices	3.8	0.3	2.4	6.2
City Offices	4.3	-0.6	0.6	4.9
All Property	5.0	1.0	2.2	7.2

Source: IPF Consensus Forecasts (19 contributors)

Bull: Talking of 'par', Bear … with the volume of new investment activity being so low at present, I have organised a few golfing trips over the next couple of months. But now I am a little concerned that the market may take off while I am away. I certainly don't want to miss out on any of the fun. What do you reckon? Will I be okay?

Bear: You very well know that it won't matter a toffee what I say. You are going to play your wretched golf anyway. But if it makes you feel any better, the action probably won't start until the second half of the year. Meanwhile it is only the Brave that are striking now. And it wouldn't surprise me if they don't turn their focus onto the listed sector first where the recovery in prices can be much more immediate.

Bull: Yes. And we all know what happens to the Brave, don't we? Fortune favours them.

Bear: So, is that it for this week? Can I get back to my contemplations? I am sure that I lost a couple of Rolos down there somewhere.