ST BRIDE'S MANAGERS

Bull and Bear

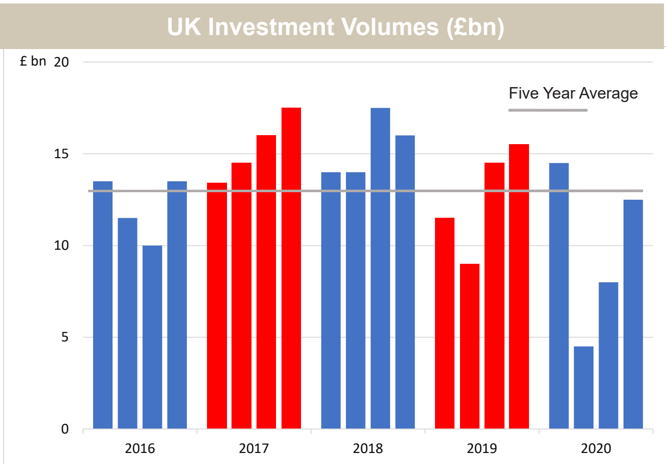
Investment Volumes

This week, Bull and Bear discuss which players will be driving UK property investment volumes in 2021... and which players will likely be spectating from the side-lines.

Bull: Right, Bear. It's time for us to earn our corn and decide what's going to happen to the UK property investment market in 2021. I've heard there is quite literally a "wall of capital" waiting to be deployed, just as soon as we get this dreaded virus under control.

Bear: Wow Bull! The PM's added an extra three weeks to the national lockdown, schools are closed until at least 8 March, and you're just as bullish as usual. Didn't you hear that investment volumes for 2020 were their lowest since 2012? That's hardly a sign of confidence in the market.

Bull: But my dear friend, just look at what happened last quarter as news of the vaccines emerged and confidence improved. Investment volumes surged, up 50% on Q3 and only 5% below the five-year quarterly average. December alone saw £5.0bn worth of deals. In the middle of a pandemic!



Source: LSH

Bear: There you go again. Spouting out the headlines, without looking at the finer detail. Take out Blackstone and your figures don't sound half as impressive. Blackstone alone invested over £1bn in Q4 with two "EPIC" portfolio acquisitions. You can't just rely on a handful of buyers in the industrial sector to support your case. That's like Manchester City relying on Sergio Aguero for all their goals. What if he gets an injury? Or the heat goes out of the industrial market?

Bull: It's a nice analogy Bear. But aren't Manchester City currently sitting top of the Premier League, with Aguero still side-lined?

Bear: Stop it, Bull. We're getting distracted. The point is that the surge in industrial investment volumes is masking big question marks over the other occupier markets. The logistics sector has clearly shown incredible resilience during the pandemic, but who is going to be ploughing your "wall of capital" into the other sectors?

Bull: You are looking at this all wrong Bear. Just look at all the reasons *to* invest. Low interest rates, a weak outlook for international bond returns, the UK's relative yield discount. If you ask me, the UK property market looks pretty attractive. Especially from the outside.

Bear: Well, I suppose the UK is better placed now that we've finally secured a Brexit trade deal, even if our businesses are having to deal with new regulations and red tape.

Bull: That's the spirit, Bear. Did I note a hint of cautious optimism from your side of the table?

Bear: Errmm....

Bull: And besides, overseas investors were investing in London offices well before the UK secured a Trade and Cooperation Agreement with our friends in Brussels. The City and West End look under-priced on a pan European basis. Just look at Sun Venture's £552m purchase of 1 & 2 New Ludgate. That's not loose change you are talking about! International buyers want a safe haven to invest in core stock. And you can't do better than London for that!

Bear: I am always reluctant to raise any red flags with you Bull (!), but I heard a rumour that the German funds won't be investing a penny in the UK until the dust settles on the Brexit deal.

Bull: You know that is not strictly the case, Mr Grizzly. Not least because St Bride's have just sold an 11-acre industrial site in Mitcham to a German-based European fund. You see, the UK has pulling power!

Bear: Pulling power??

Bull: That's right. Overseas investors ploughed £6.5bn into UK real estate in Q4 2020 and its coming from all directions. Your friends in Germany may be sounding notes of caution, but investors from Europe still ploughed in £1.8bn in Q4, which is roughly on a par with investors from the Far East (£1.9bn) and North America (£2.2bn). They all want a slice!

Q4 2020 Global Investment Flows into UK

Origin	£bn	Net £bn
North America	£2.2	£0.1
Far East	£1.9	£0.5
Middle East	£0.5	£0.4
Europe	£1.8	£1.4
Other	£0.1	£0.0

Source: LSH

Bear: Okay, Bull. I concede that the UK does have its attractions for foreign investors, but surely that is only half the story? What about our domestic investors? Last time I looked they were busy auctioning off the property equivalent of the family silver. Combined net selling among domestic investors amounted to £3.4bn in Q4. That's the highest figure for more than three years!

Bull: You can't blame them for cashing in occasionally Bear. Domestic investors have been able to crystallise some very substantial gains from some equally willing overseas buyers. I think you're just reinforcing my point!

Bear: You are rather blinkered sometimes, Bull. Maybe it has something to do with those enormous neck muscles you keep flexing....?

Bull: I'll take that as a compliment!

Bear: But aren't you conveniently forgetting that many of the open-ended retail funds - such as M&G's, Aviva's and Janus Henderson's - remain suspended? They had an excuse back in March 2020 when the pandemic initially struck, and all RICS valuations were subject to a material uncertainty declaration, but that provision was lifted in September! The funds are hardly likely to be net investors if they are still worried about redemptions and getting their own house in order.

Bull: I beg to disagree.

Bear: Now why does that not surprise me?!

Bull: Institutions invested £2.0bn last quarter. That's only 7% below average and pretty robust considering some of the funds remain suspended. Who else do you think has been driving record investment volumes in the Build-to-Rent market? L&G's recent £100m forward funding deal at Hockley Mills in Birmingham is hardly a sign of institutions turning their back on UK property, is it?

Bear: You are missing the point Bull. The FCA and the Bank of England are actively reviewing the liquidity mismatch between assets held by these open-ended funds and their redemption terms. How do you align investors' expectations of daily redemptions with the illiquid nature of property? Fund managers can't just suspend daily dealing every time the market receives a shock.

Bull: Let's keep this in perspective, my dear Bear. The fund industry has faced some unprecedented circumstances in recent years, but the underlying demand for property exposure from savers and investors won't disappear. I have every faith that the FCA, Bank of England and our friends at AREF will come up with an innovative solution, even if that spells the end for daily dealing.

Bear: Let's hope so! But what about the other domestic investors? Local Authorities, for example, have just had their wallets confiscated by Rishi and are no longer allowed to borrow from the Public Works Loan Board (PWLB). You'll recall Grant Thornton even accused Croydon Council of "putting future generations of taxpayers at significant financial risk" after splurging £545m. I think we can safely assume there won't be anymore taxpayer money searching out property for a while.

Bull: You're right, Bear. The PWLB tap has been turned off, but let's be honest Local Authorities only ever made up a small fraction of the market. A record 3.5% in 2018!

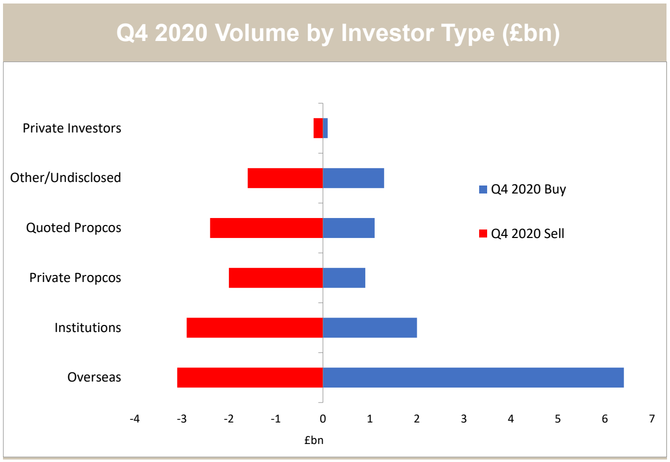
Bear: You want to talk about bigger fish? What about the REITs?

Bull: What about them?

Bear: Quoted property companies were the largest net sellers in Q4 2020, with total sales of £2.3bn. That's 61% higher than the five-year quarterly average. The pure-play retail REITs (Hammerson and Capital & Regional) are trading at an average 73% discount to their Net Asset Values! Hammerson alone have £43.7m in outstanding rent still to collect. How much of that will ever actually be paid? I would have included Intu on the list too, but they've already gone into administration!

Bull: Another convenient distortion of the market, my Bearish companion. The UK REIT sector as a whole is trading at a 1% premium overall. The long-income REITS (+16%) and Operational REITS (+18%) make up a healthy proportion of the market and they are trading at significant premiums. I'll admit that the retail REITS are taking a battering and the London specialists have also taken a hit (-21%), but 2021 will see plenty of purchasing activity among REITS focused on Build-to-Rent, supermarkets and distribution.

Bear: What about property companies and private buyers then? Are they really going to put their hands in their pockets when there is so much perceived risk? My money is staying firmly under my mattress, even if the banks are still willing to lend me money.



Source: LSH

Bull: But that's just the point, Bear. For those investors willing to take on some risk, 2021 represents an enormous window of opportunity. There'll be rich pickings for all those investors prepared to take on distressed assets and reposition them.

Bear: I must concede, Bull, that your Boris-strength optimism is rather catching, but the reality is that much of our retail stock needs repurposing and the jury is still out on the future role of the office in the wake of this pandemic.

Bull: Now that, my dear friend, is a topic for another time! I think I may have convinced you that the pent-up demand is there. We just need to determine where this will be deployed. And I promise you, it's not just going to be in bed and sheds!

Same time next week?