# Is property primed for a comeback?

We discuss the merits of the asset class with several fund managers

Property has been firmly out of favour with UK investors since the EU referendum in 2016.

Panic about the effect of Brexit on the property market saw investors pull an eye-watering £1.8bn out of property funds in 2016, according to figures from the Investment Association. Meanwhile property investment trusts saw their share prices plunge by as much as 40%.

But are these fears overdone? Managers say there are plenty of opportunities in the sector if you're willing to do your homework.

### WHAT STANDS OUT?

'We do a lot of research to try and understand the supply and demand situation of any location before we buy a unit,' says Gerry Frewin, manager of **Threadneedle UK Property (BQ3G0Y0)**.

Keeping costs down is one of his top priorities so he prefers retail units on pedestrianised high streets, rather than in a shopping centre, because they attract a similar level of footfall and don't have to pay hefty service charges.

He also likes so-called retail warehouse space – the large, industrial-looking stores you find on retail parks. These tend to have a cheaper rent, which means their tenants are less likely to vacate or go bust.

In the event they do, then the cheaper rates means they are easier to replace with a new tenant. Frewin says: 'We try to look at a firm's turnover and profit and the rent it pays before we buy anything – that's how you understand if it has a future in that location.'

### REPORTS OF DEATH OF HIGH STREET EXAGGERATED

One of the major themes in the property sector at the moment is the idea that the 'high street is dead' as businesses concentrate their efforts on their online operations.

But Justin Upton, co-manager of the **M&G Property Portfolio (B89X8P6)** says the relationship between online and in-store is complementary for many businesses.

Frewin says **Dunelm (DNLM)** is a great example of a business which has tapped into this so-called omni-channel approach, allowing customers to order online but collect in-store and vice versa.

Upton adds: 'Companies once synonymous with pure online retailing, such as Amazon, are recognising this and building out their physical presence.' He says good locations, high quality buildings and long leases are key when investing in the sector.

David Wise, manager of the **Kames Property Income (BK6MJB3)** fund, has just 25% of assets in retail currently but says Brexit is not the reason for this underweight position. 'I think big shopping centre owners such as **Intu (INTU)** and **Hammerson (HMSO)** have taken tenants

Lockmeadow in Maidstone forms part of Kames Property Income's portfolio

such as House of Fraser and Debenhams for granted and now they're teetering on the brink.

'This retail space has historically been highly rated and highly priced and now it is very hard to price,' he explains.

He thinks there are better opportunities in offices, another area which has been out of favour among many property investors amid fears of an exodus of businesses to Europe after Brexit. There are concerns that if this happened, vacancy rates would soar and rents would plunge.

Wise is focusing his attentions on thriving larger, regional cities such as Bristol, Birmingham and Leeds, where he believes many companies are starting to focus their attention.

This is because businesses can attract talented, younger employees out of universities who don't want to live in London because housing is so expensive. In particular, he prefers smaller lots valued between £5m and £20m, where competition is less fierce and the prospects to improve lots and attract new tenants are greater.

But Wise still believes concerns about office space in London are overdone and the capital has 'a great future'. He adds: 'Some companies might have to move a portion of their business to Europe but the talent pool and time zone of London means it will remain an attractive location in which to do business. You can't just move a company's operations overnight.'

### INCOME RATHER THAN GROWTH

Regardless, there is a feeling that the days of easy capital growth in the property sector are over. After years of gains, some believe the market was due a correction and should now be viewed by investors as a long-term income play rather than a growth component within their portfolios.

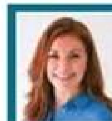
Frewin says: 'Around 75% of returns are now income after a few years of strong capital appreciation. But I think property has been heading for a correction regardless of Brexit and the asset should be viewed as an income proposition.'

And despite their optimism about the prospects for property, managers have to prepare for a swing in sentiment. In the wake of the Brexit referendum result investors panicked and flocked out of funds. Many funds had to suspend trading to avoid having to enter into a fire-sale of their assets.

Frewin has raised his cash level to around 15% of assets, and Upton too is holding more cash than the typical level of between 7.5% and 12.5%.

Having more cash on the balance sheet can act as a drag on returns. There are also difficulties in allowing holders of open-end property funds to buy and sell whenever they want when the underlying asset class doesn't work that way. After all it is not practical to sell a property in the space of a day. This has led some to argue this space is better accessed through closed-end funds (investment trusts).

Their structure and listing on the stock market means they do not have to sell assets when investors sell their holdings. The best performing UK property trust over the last five years is **Standard Life Investments Property Income (SLI)** with a five-year total return of 57.8%. It yields 5.4%.



By **Holly Black**