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Property funds face fresh battering from Brexit headwinds

Liquidity fears resurface as investors step up withdrawals ahead of March deadline

Fresh liquidity crunch fears have given more ammunition to critics of the funds, who have question whether the open-ended format is compatible with property © Bloomberg

Kate Beioley and Judith Evans FEBRUARY 8, 2019

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Fears over property funds have resurfaced in recent months as investors step up withdrawals ahead of the Brexit deadline.

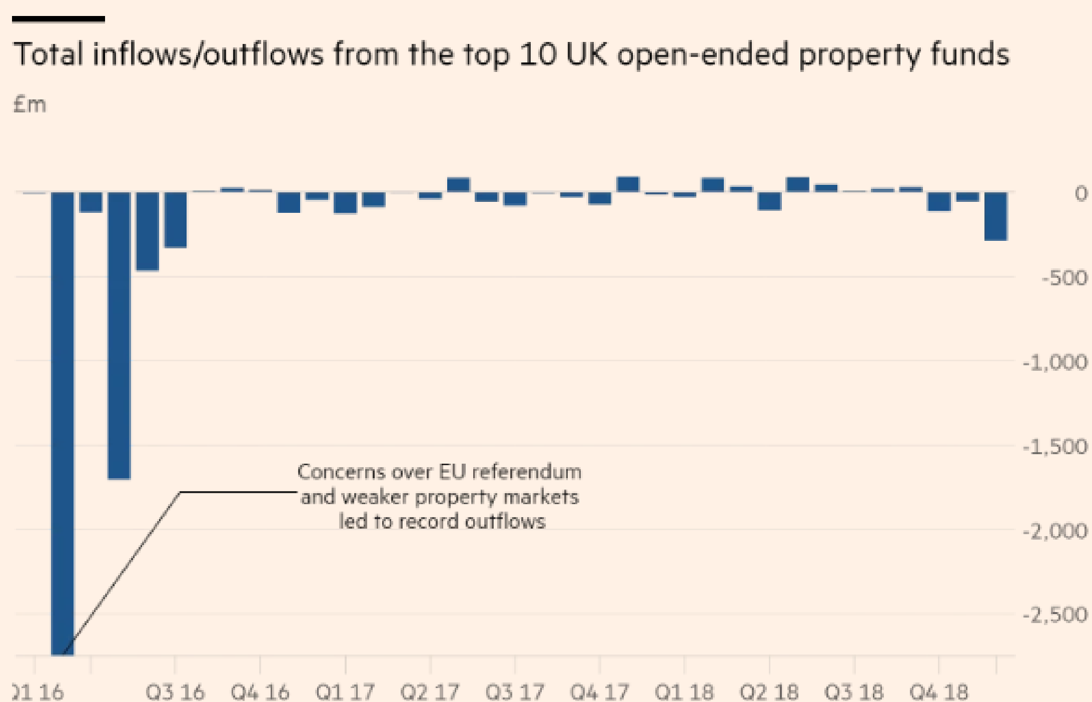
But many of these funds — once a firm investor favourite — never fully recovered from a 2016 exodus from the sector immediately after the EU vote.

Among the largest nine UK property funds, the average size is now £1.4bn, down from £1.8bn at the time of the Brexit referendum, according to Morningstar.

M&G Property Portfolio shed more than £1bn in assets between June 2016 and the end of last year, ending 2018 with £3.7bn in assets. Janus Henderson UK Property PAIF suffered almost £100m in outflows in December alone, and stood at £2.8bn at the end of that month, compared with the more than £3.5bn in assets it had in June 2016.

A recent pick-up in withdrawals — retail investors pulled £315m from property funds in December, nearing the level of redemptions reached in the two months after the Brexit vote — has prompted the UK financial regulator to demand daily updates on outflows.

The recent fears of a fresh liquidity crunch have given more ammunition to critics of the funds, who have questioned whether the open-ended format — unlisted funds that grow or shrink as investors move money in and out — is compatible with property. Not only are the holdings illiquid, but fees are higher than in equity and bond funds, because of the management that buildings require. And higher — and less predictable outflows — mean many of the funds have had to increase their cash buffers so they can quickly satisfy redemptions.



Source: Morningstar
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Some fund managers said property funds faced an intractable problem by offering daily trading to investors in an asset class that is time-consuming, difficult and expensive to sell.

“Illiquid assets just aren’t suited to the open-ended structure,” said Ryan Hughes, head of fund selection at broker AJ Bell. “When you go into buying commercial property funds you have to go in with your eyes open that they may suspend and you might not get your money back when you want.”

Many of the funds have been running with at least 25 per cent in cash, as opposed to the nearer 10 per cent levels seen prior to the EU referendum, causing a drag on performance. L&G Property Portfolio, one of the biggest funds, holds around 24 per cent in cash and cash equivalent.

“Funds have been holding much higher cash balances than in the run-up to the referendum,” said David Wise, manager of Kames Income Fund.

Another senior fund house executive said: “It can take four weeks to two months to sell an asset and you need to hold cash to cover what might happen in two months.

“Of course this impacts performance but these funds are designed to do two things: give people access to real estate and give them daily liquidity. You can’t square that without having a higher degree of cash now.”

The average UK property fund returned almost 30 per cent to investors in the 10 years to the beginning of June 2016, according to data provider FE Trustnet. L&G UK Property returned almost 50 per cent in that time while M&G Property Portfolio returned just under 15 per cent.

In 2015, L&G UK Property, Kames Property Income and Threadneedle UK Property all generated returns of around 10 per cent in a single year. That has now slowed.

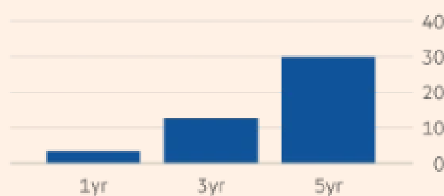
The Threadneedle and Kames funds both returned negative performance in 2018, according to FE Trustnet. Both of these funds late last year switched to “bid” pricing — lower pricing that reflects the cost of asset sales when redemptions outweigh inflows, resulting in a 5.7 per cent hit to investors in Kames’ fund.

Even the higher cash buffers have not been enough to withstand redemptions in recent months. Managers have been forced to place buildings on sale. A crisis on the high street has cut into the values of their retail holdings — but because there is little appetite for retail property, they have been forced to sell more desirable buildings, such as offices and warehouses.

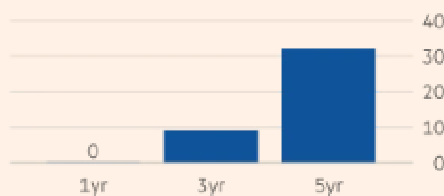
Top five UK property funds' performance

Total returns (%)

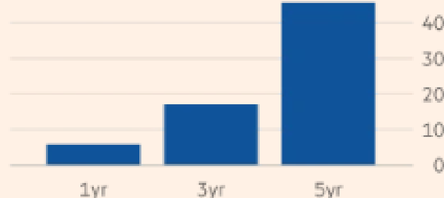
BMO UK Property



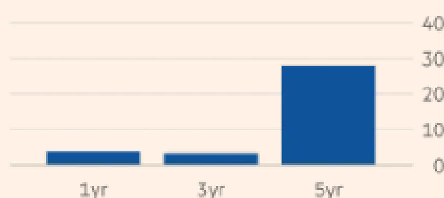
Janus Henderson UK Property PAIF



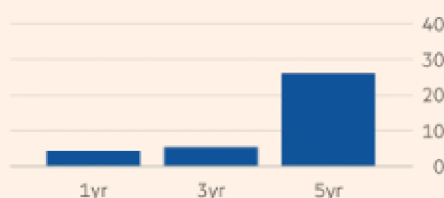
L&G UK Property



M&G Property Portfolio



Standard Life Investments UK Real Estate



Last month Janus Henderson UK Property put top-10 holding 169 Union St on the market for £95m, according to one person close to the deal. The manager of another fund admitted being forced to sell properties but said they had been able to hold off "selling the family silver". The manager said "£30m to £40m is the average lot size [for sale]".

Henderson said the fund was "recycling the proceeds from the sale [of Union St] towards south-east industrial, where we have strong asset management opportunities."

Analysts also feared that sliding capital values have yet to feed into portfolios, meaning many could face drops in the value of their assets this year.

Adrian Benedict, investment director for real estate at Fidelity International, said forced sales of liquid assets would weigh on performance. "Their portfolios are going to have even higher weightings to retail if they are going to have to sell assets to fund redemptions," he said.

The regulator has indicated it was happy with fund suspensions after the Brexit vote — investors' money was trapped for several months but funds avoided fire sale selling and the impact on the wider market was contained, unlike during the 2008 financial crisis.

The FCA is considering new rules for property funds that could require them to suspend trading if there was uncertainty around the value of at least 20 per cent of the portfolio.