HOW TO MANAGE RISK IN REAL ESTATE INVESTMENT

■ Yardi and *Property Week* assembled five property investment experts to discuss low-risk ways to find value amid fierce competition for prime property. Industrial, traditional PRS, build-to-rent and student housing were seen to offer opportunities, with a tough retail climate and political risk on the downside

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Meg Brown, director of equity placement, Colliers (MB)
Howard Freedman, partner, head of real estate and construction, RSM (HF)
Jamie McCombe, partner, head of investment management, Cluttons (JM)
Kris McPhail, co-fund manager, Lime Property Fund, Aviva (KM)
David Parsley, contributing editor, *Property Week* – Chair (DP)

With prime property yields tightening and investors looking for value without too much risk, our think tank participants addressed the key issues of where funds should place their cash and what factors – both positive and negative – may affect their decisions and returns.

DP: Where are the hot sectors in real estate investment?

MB: This is something we think about a lot, as we typically advise pension funds and groups where risk really matters, as they are investing money they can't really lose. So right now we're fans of things that are not correlated to economic cycles, and that's largely mega-themes such as student housing, PRS and BTR, micro living and, to some degree, the co-working concept.

JM: We feel capital growth is going to be more muted in this market, so there has been a flight to income return. We've been looking at some of those long-term income plays, such as hotels and student accommodation.

The industrial sector has obviously been improving in the past 12 months, predicated on investors seeing some future rental growth, so yields have fallen quite significantly, but in the right areas and at right rent, there is still something to go for in terms of return.

The prime end of the market has become very competitive and the gap between prime and secondary is widening, but there is a flight to the prime end because of the kind of market we're in.

HF: We did a survey at the end of last year measuring sentiment and what investors were looking at. The areas of particular interest were industrial and distribution centres. PRS, build-to-rent and student accommodation are other popular areas that interest people.

People are moving away from traditional offices, particularly in London, as there's no value there at the moment. People are looking at offices in places like Manchester, which is particularly hot at the moment, although yields are narrowing somewhat.

People are moving away from retail, as it is considered a particularly risky area.

IB: Industrial is certainly one of the hottest asset classes and I can't see how the yields there can compress any further. Student accommodation is one area where we're seeing a lot of competition for sites, but we're quite choosey about what cities we go to. As for retail, while it is struggling, bulk goods and stores, such as Lidl and Aldi, are still doing really well.

KM: We are, to an extent, sector agnostic, but are focusing on centres where people want to live, work, learn and play. Some of the core, balanced funds are selling out of towns and cities where they may not have a lot of holdings and focusing on places such as Manchester, Birmingham and Cambridge. There's been a real focus on those areas and economies, because of the diversity of demand. We've done a fair bit in the BTR sector recently, and in offices. We're doing a few office investments in Cambridge.

DP: What are the key issues to consider when managing investment risk?

JM: We're acting for long-term investors with a long-term horizon. For them, it's all about capital preservation. We're managing endowments that

Ian Benson, Kier Property

Howard Freedman, RSM

have been with the organisations for years and want to make sure that they keep producing what they need to meet their objectives. For example, we act for an educational institution, and money from that fund supports fellows of the college to produce world-renowned academic research. So capital preservation is vital and the investments we're looking at are pretty low-risk, prime, vanilla type stocks, to minimise income voids.

IB: We manage risk by managing the amount of development stock we speculatively release. So we're looking to pre-let before commencing a development. We pre-let most of it, so we might develop around 25% of our portfolio speculatively.

But we've been doing our Trade City brand of small industrial units speculatively for a number of years, as they're less risky. We view it like houses, as people need those sort of units and they will always let, in the right area. Funds are buying them even if they are not fully let. But we wouldn't even consider retail without pre-lets.

MB: We never compromise on location and it's always a very liquid location. We always look at the asset very closely, so if you lose your tenant you know what the land value is and if you can reposition quickly. If you lose your tenants, can you look at repositioning the planning quickly and change to a use that will work in that location?

Because prime is so expensive and there's a flight to quality, there is a theme of people moving to an illiquid product in a secondary market, which is exactly what happened leading up to the global financial crisis. People went for better value, but in an illiquid property, and that is being repeated, which is a little bit shocking.

We focus on location, liquidity and not going crazy on leverage.

HF: Because there's so much capital around and some of the funds are under pressure to invest, I wonder whether they're having to look at stock other than prime assets?

KM: We still have to look at the tenant's credit rating, so the first port of call is research and credit reports, and then looking at the underlying real estate values and the fundamentals in the markets we invest in. But you've got to look at the portfolio and it comes back to portfolio management. Diversification is still one of the best ways to manage risk: not having any over-exposure to any asset or particular tenant

Our think tank experts discussed the challenges and opportunities for real estate investors

Jamie McCombe, Cluttons

Meg Brown, Colliers

Kris McPhail, Aviva

or particular sector, and being disciplined in what you're buying, making sure anything you buy is accretive to the fund's portfolio returns.

DP: How has reporting on assets changed and is real-time reporting something investors are looking for?

KM: There is definitely a shift in the frequency of reporting, with a need for quick, real-time reporting. Typically, we try and get back to clients in 24 to 48 hours. But also, in your investment decision making, you want up-to-date, real-time reporting on the portfolio, so you can make a decision with conviction. We've taken on Yardi [products] because of the ability it gives us to extrapolate data that we can provide to clients, and the accuracy of the data it holds.

MB: On the private equity side we are seeing a huge push in technology in terms of internal reporting. So we now have asset managers who go and see sites and they input data on an app – say, this needs doing, or tenants are saying x, y, or z – and that feeds into an internal system and uploads a cashflow. This means we don't have analysts spending time on cashflow modelling, so the efficiency and connectivity internally is super-powerful now.

DP: If the core London office market is not offering value, where is – and what do investors want?

HF: Bristol is very hot and Edinburgh is also becoming increasingly popular. There's a wider discussion to be had around offices, demographics and what's happening. People are working a lot more flexibly and the shared office and co-working trend is taking up some of that demand – companies like WeWork are really plugging into this.

JM: In London, we're seeing younger people want to settle down, buy a house, start a family and that's proving more and more expensive to do, so they are looking to go elsewhere. So companies can attract talented young people who don't want to live in London and that's one of the drivers for firms to look at other cities.

Wellness is also a big office market theme at the moment. The days of going to work every day and sitting in a boring office on an office park outside Birmingham are probably dying. There's definitely a move towards more flexible working.

KM: We've identified places around the UK where fundamental demand is diversified and not reliant on any particular sector. In the regions, it's Birmingham, Manchester and Cambridge where we're focusing.

DP: What are your positive and negative points on the health of real asset investment now?

MB: I think capital flow will continue and it's the strongest it's been in a long time. Equities are extremely volatile at the moment and overpriced, while with fixed-income, you're lucky if you get a 2% return these days. So real assets are very attractive. Even if things are getting pricey, you still get a better return. On the negative side, there's probably more geo-political risk now. There are also economic challenges, but you can still find value if you work hard.

JM: On the optimistic side, the consequences of Brexit will be more muted and less disastrous than many people predicted. I think the economy will fare better than everyone expects. For the property market, a lot of it has been priced-in. On the pessimistic side, it's difficult to see how the UK retail sector is ever going to recover. I think the structural changes in retail are here to stay.

HF: Looking at the real estate market generally, I think it's still very good as a long-term play. If you look at how it has recovered since the financial crisis, it's proven to be pretty good. On the pessimistic side, I am concerned about a potential change in government.

IB: I think the BTR sector will continue to get stronger. Demographic changes have shown people are more geared up for renting, whether in retirement or during their working life. So I think that sector will continue to go from strength to strength. Also, one thing the past 10 years have proved is that the sector is very resilient and proved to be very attractive to investment. On the downside, retail is in pain, and there's the uncertainty around political issues – whether it's another referendum or a general election, they're more likely to cause a shock than anything else.

KM: I'm optimistic about real estate demand from investors and the return arbitrage it offers over fixed-income investments, and the consistency of return versus the volatility you're seeing in the bond and gilt markets. But I'm pessimistic about retail and leisure; the changing demand landscape and consumers being more demanding; geo-political risks worldwide; and a possible change in government.

Yardi is thrilled to have brought together a dynamic group of panellists for our Investment Think Tank, the latest in our ongoing series of industry thought leadership sessions in association with Property Week. In this session, we see how the need to manage risk is prevalent in every real estate asset class and how the industry uses risk management tools such as real-time reporting to help preserve capital and maximise returns to satisfy investors.