SPR Newsletter
April 2010

Coming soon

SPR/RICS Cutting Edge Conference -13th May 2010, RICS, London

How to measure and manage real estate risk in the real world

Following what has been a turbulent period for real estate markets there has been a growing call for improvements in risk management practices across the industry. Regularly during the financial meltdown of late 2008 investors expressed confusion at their level of risk exposure. Have any lessons been learnt and are real estate professionals better placed to manage risk today?

The conference will provide a forum to present and discuss new academic and practitioner advances in all areas of risk measurement, management and controls relating to real estate. The objective is to have a balance of applied academic and industry research, thereby providing links with practical challenges and realities.

Keynote speakers:

Colin Lizieri, Cambridge University
Looking behind the asset class: time varying relationships between property and equities
Matthew Richardson, Fidelity
Modelling risk adjusted cash flows in commercial real estate investment

Other topics – see full programme (p3) for details:

Reconciling model and information uncertainty in development appraisal
The property risk premium: measurement, characteristics and influence
Driving factors in pricing European CMBS: bond, mortgage and real estate characteristics
Real options and game theoretical approaches to real estate development projects
Corporate social responsibility and risk reduction in real estate investment
Winning in the long run – a quantified approach to the risks of sustainable financial value on real estate

Cost £50 standard rate and £25 for full-time students. Cheques should be made payable to SPR and sent to St Mary's, Gandish Road, East Bergholt, Suffolk CO7 6UR, or contact Fiona Trott (ftrott@sprweb.com) for bank payment details.

In this Newsletter:
Click on titles below to reach article

Upcoming Site Visits

King's Cross

Monday 10th May 9:30am and Wednesday 12th May 9:00am: Argent Group plc will host two site visits of one of the largest developments in Central London.

Planning permission was granted in December 2006 and July 2008 for nearly 8 million sq ft of mixed use development on 67 acres of brownfield land. The permission includes up to 25 large, new office buildings totalling some 4.9 million sq ft; 20 new streets; 10 new major public spaces; the restoration and refurbishment of 20 historic buildings and structures; and some 2,000 homes and serviced apartments.

The site visits will include a short presentation by Argent in The German Gymnasium (http://www.kingscrosscentral.com/gg_location) followed by a tour along a restricted walking route around the site. The visit will last no longer than 2 hours.

Places are restricted to 10 on each day. Please note that both days are now fully booked.

Central St Giles

Tuesday 22nd June 6 pm: Legal and General will host a site visit of Central St. Giles.

Central Saint Giles is a striking new mixed-use development that provides 375,000 square feet of office space, 56 private apartments and 53 affordable homes, plus a selection of restaurant and retail units at ground level.

Central Saint Giles is designed by world-renowned Architects Renzo Piano Building Workshop and will deliver major improvements to the local area.

The site visit will include a 20 minute presentation followed by a 45 minute site tour, and will be followed by drinks. Places are restricted to 40.

One New Change

Friday 15th October 10 am: Land Securities will host a visit to their landmark mixed-use development in the City of London.

One New Change will provide the City with a vibrant retail destination. It also offers prestigious office space, creating a truly multi-purpose commercial area. Occupying 2.5 acres overlooking St Paul's Cathedral, the building has a great responsibility to its illustrious surroundings. The scheme provides 214,000 sq ft of retail and 332,000 sq ft of office space.

The visit will commence with a presentation in the One New Change marketing suite, followed by a tour of the site. The visit will be taking place less than a month before the official opening.

Please note this visit is also fully booked

Upcoming Social Event

SPR Golf Day, Monday 24th May 2010

The SPR Golf Day is an annual event open to all SPR members. It is a fantastic way to network and socialise with fellow SPR members and property professionals.

This year the golf day will be held at **The Surrey National Golf Club** in Chaldon, Surrey, on Monday 24th May 2010. http://www.surreynational.co.uk

The day is subsidised by the SPR and will cost just £27 per person to the first 32 SPR members to sign up. The package includes a bacon sandwich and coffee on arrival, 9 hole warm up competition, 2 course lunch , 18 hole competition and a refreshing drink at the bar afterwards .

If you would like to participate please send a cheque for £27 made payable to Surrey National Golf Club Ltd to:

Craig Wright
Aberdeen Asset Management
Bow Bells House
Bread Street
London
EC4M 9HH

Or contact either Michael Moran or Craig Wright for further details:
craig.wright@aberdeen-asset.com
michael.moran@moranrac.com

Upcoming Technical Events

SPR Research Briefing on the UK Office Market

Wednesday 5 May 2010, 6.00-8.00pm (registration from 5.45pm)
CoStar, 40 Portman Square, London, W1H 6LT

Chair: Adelaide Gray, Legal & General Property
Speakers: Stephanie McMahon, JLL,
Hugh Mulcahey, Cyril Sweett
Developer, TBC

With the green shoots of recovery struggling upwards what will be the impact on the UK office market. As employment improves will space requirements move in line, or will other factors come into play? Will occupiers feel they have the better hand in this fragile market? And how are developers viewing these green shoots?

Three presentations will respectively cover: the market and how demand will evolve over the near term; the occupiers' satisfaction with the current stock; and developer decision making. The presentations will give thought provoking insights into the short and longer term factors that will drive office market performance.

Please contact Fiona Trott ftrott@sprweb.com to reserve your place

SPR/RICS Cutting Edge Conference

13th May 2010. RICS, 12 Great George Street, London SW1P 3AD.

How to measure and manage real estate risk in the real world – full programme

0915 Welcome
0930 Key-note paper: Looking behind the asset class: time varying relationships between property and equities.
Colin Lizieri, Cambridge University
1015 Estimation of dynamic correlations across REIT sub-sectors. Simon Stevenson, Cass Business School
1045 Are securitised real estate indices good predictors for the direct market? Sotiris Tsolacos, PPR

1115 Coffee break

1130 Real options and game theoretical approaches to real estate development projects: multiple equilibria and the implications of different tie-breaking rules. Tommaso Gabrieli and Gianluca Marcato, University of Reading
1200 Reconciling model and information uncertainty in development appraisal.
Peter Byrne, Pat McAllister and Peter Wyatt, University of Reading
1230 Panel debate

1245 Lunch

1340 Key-note paper: Modelling risk adjusted cash flows in commercial real estate investment
Matthew Richardson and Chris Arnold, Fidelity
1425 Driving factors in pricing European CMBS: bond, mortgage and real estate characteristics
Gianluca Marcato and Giovanni Alberto Tira, University of Reading
1455 The property risk premium: measurement, characteristics and influence
Paul Mitchell, Paul Mitchell Real Estate Consultancy
1525 Scoring risk factors as a measure of overall risk exposure in real estate portfolios
Malcolm Frodsham, IPD

1555 Coffee break

1610 Corporate social responsibility and risk reduction in real estate investment
Richard Grover, Oxford Brookes University
1640 Winning in the long run – a quantified approach to the risks of sustainable financial value on real estate
Juerg Bernet, Danube Krems University, and Sarah Sayce, Kingston University
1710 Panel debate

1745 Conclusion and reception

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Recent Social Events

SPR AGM and Annual Dinner, 12th November 2009

Gerald Blundell was honoured for his contribution to property research with the award of an SPR fellowship. In the after dinner speech Rupert Nabarro of IPD paid tribute to his work, together with that of Blundell's former Jones Lang Wootton colleague Honor Chapman, who died in 2009.

The raffle held during the dinner raised £1,077 in total, which will be split, with half going to Acorns Children's Hospice and half to The Brooke Hospital for Animals, in memory of Honor Chapman. Remarkably, we raised over £100 more than last year, despite far fewer people attending.

Ice Skating at the Tower of London, 6th Jan 2010

Report by Henri Vuong

Unfortunately this event was hit very hard by the severe winter weather. Around 40 members had signed up for the event, with more than 30 paying to ice-skate. It was hoped everyone would to meet at the Hung, Drawn and Quartered pub for a glass of mulled wine and some hot buffet food afterwards.

However by late afternoon about 20 people had sent their apologies, and only 10 were able to confirm their attendance. The continuous snowfalls resulted in only these few surviving to skate in the icy winds, joined by two more drinkers in the pub. However those that made it said that they had a very enjoyable evening, and there was certainly plenty of food and wine to go round. All enjoyed the historical Tower of London setting, and the warm ambience of a good old fashioned city pub.

In true Apprentice-style we managed to sell a few of the spare tickets under the noses of the ticket office!

SPR Quiz Night, 11th March 2010

The City Flogger, Fen Court, London EC3.

As usual the Quiz Night attracted an impressive turn-out of knowledgeable property researchers, forming 18 company teams. Andrew Marston of Land Securities capably took over the question master duties from Mark Charlton of Colliers CRE, with a challenging array of questions ranging from the name of the prequel to *Only Fools and Horses* to the missing link in the Standard Model of particle physics.

L'equipe sans nom

At the end of a gruelling evening *L'equipe sans nom* from BNP Paribas and *the Sturgettes* from King Sturge stood neck and neck on 134 points, with *the Costars* third on 127. A tense tie-break saw the BNP team of Kevin Mofid, David Speers, Irene Fawkes, Keith Steventon and Tim Horsey (last minute ringer), come away with the SPR Quiz Trophy.

The Sturgettes

£365.92 was raised for charity at the quiz and donated to Habitat for Humanity, specifically for their Haiti fund (www.habitatforhumanity.org.uk).

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Recent Technical Events

Unless stated otherwise, all meeting reports written by Tim Horsey

SPR Peer Review on the Price Impact of Designer Buildings, 23rd Nov 2009

DTZ, 125 Old Broad Street London EC2

Patrick McAllister the University of Reading, co-author of the research report entitled "Designer Buildings: An Evaluation of the Economic Value of Signature Architecture" presented its findings to the meeting. The other report authors were Franz Fuerst and Claudia Murray of the University of Reading. The full report is available on the SPR website.

The research looked at US office buildings which had won either the Pritzker Prize or the Gold Medal awarded by the American Institute of Architects, and asked whether they achieved rental premiums compared to offices designed by non-signature architects. This question sprang from the intuitive belief that such buildings ought to have functional and ascetic qualities which would bring utility and image benefits to their occupiers.

The research used CoStar rental data on 500 properties of comparable location, age and height to the signature architect designed buildings.

Using a hedonic regression model, it was concluded that office buildings designed by signature architects had rents that were 5-7% higher, and sale prices that were 17% higher than other comparable buildings in the same sub-markets. There also appeared to be a strong positive relationship with the involvement of the major US architect practice, SOM. However McAllister stressed that the results were very messy and left many questions unanswered.

Rob Wilson of the RIBA reflected on the result from an architect's viewpoint, emphasizing the rather arbitrary nature of the process of awarding architects. He pointed out that the quality of the client and the client relationship was likely to be an important element in the building that was eventually achieved.

Matt Hall of DTZ commented that the functionality of the space was not accounted for in the research model – for example the Gherkin building in London is perhaps difficult to occupy due to the nature of the floor plates. He suggested that this issue could be addressed through analyzing the costs of the building to the occupier, and that the effect of signature architecture needs to be separated from the effect of new building.

Dominic Smith of Land Securities praised the paper for highlighting the flexibility and individuality of property, especially in the development process. He felt that the results derived on the rental side didn't look surprising. Remaining questions remained however around occupational costs and the liquidity of this kind of asset, which might mean that they only tend to be transacted at particular moments in the market cycle. The effect of timing the development also hadn't been stripped out and this could have had a major impact on profitability.

Peter Damesick of CBRE, chairing the meeting, wondered whether all those buildings designed by SOM would justify being viewed as signature buildings, given that this is a very large practice. There may be a difference in looking at specific architects' work as against purely focusing on architecture built by them. Even great architects have off days.

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SPR/IPF Joint Meeting on the Outlook for UK Property, 14th Jan 2010

Allen & Overy, One Bishops Square, London E1 6AO

2009 was a year of recession, rising unemployment and severe restrictions on the availability of bank debt, yet the IPD UK Monthly Index in November showed the largest rise in commercial property values for 15 years. So what did the next 12 months have in store for property?

In 2010 investors in all asset classes will have a very difficult job, in the opinion of **Peter Pereira Gray**, Managing Director of the Investment Division at The Wellcome Trust, who opened and chaired the meeting. This is because, he believes, levels of investment yield across the board do not reflect the true risks facing future market returns. Investors would do well to remember that the stock market crash of 1929 was followed by a rise of 50% in the short term, but the worst period for this market was still to come. Though he was not predicting a return to conditions similar to the 1930s, another 'black swan' event could not necessarily be ruled out.

Robert Barrie, Chief European Economist at Credit Suisse, the first of the event's main speakers, was much more upbeat about economic prospects, and indicated that his organization was forecasting global growth of 4% in 2010, with non-Japan Asia leading the way and the US close behind. Barrie suggested that corporate spending may be higher than average and that US employment, for example, could well come through stronger than many expect. But much will depend, he believes, on whether the recent stimulus packages are unwound gradually enough, a question about which there is huge uncertainty amongst observers.

Mike Turner, Head of Global Strategy and Asset Allocation at Aberdeen Asset Managers, was positive about the part property could now play in the multi-asset portfolio, suggesting that for defined benefit pension schemes its weighting might well rise to 10% given current assessments of risk and return. At present the yield gap between long gilts and property is at its widest ever, while the exit strategies for budget deficits may well threaten equities' apparent strength. As long as concerns about property's liquidity, which have come to the fore in recent years, can be overcome, demand for property, particularly that which is well-let, is likely to remain strong amongst investors, Turner believes.

Ian Mason, Head of UK Fund Management at Schroders, agreed that the positive yield gap was one of the factors behind the "bonkers market" of late 2009, when a wide variety of investor types – overseas, institutional and listed companies – had been chasing the relatively small amount of stock matching their quality requirements.

Mason identified five distinct themes likely to have an impact on property investments in 2010: government austerity, alternative sectors (with healthcare looking positive), corporate cost control – which should favour newer offices in cheaper locations, sustainability, and retail saturation. In terms of UK market performance, Mason suggested that yields should continue to tighten through the first half of 2010, while rental values continue to fall, even though occupier demand should strengthen. But beyond that, he commented that Schroders sees the UK economy set for a "bumpier ride" than is being predicted by many other forecasters.

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Research briefing: another look at the London office market. 10th Feb 2010

Report by Ruth Hollies and Anne Koeman

Legal & General Investment Management, 1 Coleman Street, London EC2

Colin Lizieri, Professor of Real Estate Finance at Cambridge University, presented the results from the paper that he co-authored with Patric Hendershott and Bryan MacGregor. The paper won the prize for Best Paper for Real Estate Market Analysis at the 2008 ERES conference.

Colin Lizieri and **Sotiris Tsolacos**

Lizieri began by setting the background for rental modelling globally, explaining some of the options available and used in the US, Europe and the UK. In the US the concept of an equilibrium rent and vacancy are often employed, in Europe often deduced form supply-demand models. However, more recently Error Correction Modelling has become prevalent, incorporating deviations around a long-run equilibrium.

The City office market has been modelled extensively and Lizieri explained how this piece of research built on previous work. Now, a longer time series was available which covered two property cycles, and thus enabled a richer analysis. Also, an analysis of two cycles made it possible to incorporate asymmetric adjustments in the dynamic equation thus making the results more robust. The new model consists of a rental equation derived from a long-run equilibrium relationship and a dynamic rental adjustment equation. The analysis links the demand for office space, real rents and office-based employment levels.

Lizieri talked through the difference impacts that positive and negative changes to explanatory variables were found to have and their magnitude, depending where in the cycle the market was; for example, positive employment shocks combined with negative supply shocks have a greater impact when initial vacancy rates are low.

The results from this modelling exercise will help to improve our understanding of rental adjustment processes in major office markets. In particular, the model emphasises the importance of the direction of supply and demand shocks - and the timing of those shocks relative to the rental cycle – in determining the speed and strength of the impact on rental adjustment. The key results were found to be that rent and vacancy always move oppositely and then oscillate back to a new equilibrium. That symmetric adjustment is the result of positive and negative shocks that are near mirror images of each other. However, an asymmetric adjustment to positive shock would have a larger coefficient, so the response would be quicker. An asymmetric adjustment to a negative shock shows the largest difference with rental declines for four years and the oscillation is both shorter and shallower.

Kieran Farelly of CBRE Investors commented on the paper, saying that it added to the understanding of the dynamics of the City office market, but he wondered if non-linear dynamic models may work better. **Alexandra Krystalogianni** of Schroders thought it was a useful piece of work and would be keen to see the methodology applied to other markets. However, she noted that data constraints may make it hard to model in other markets and so use of the parameters from this model might be usefully employed in other markets where data was not so prevalent. **Sotiris Tsolacos** of PPR said that academic research of this type was useful to those in business as they could take the methodologies and employ them in their own modelling and forecasting.

Tony McGough of DTZ chaired the lively debate that followed with a number of questions from the audience.

Lizieri was asked about the use of prime rents and whether they would be considered as representative of the entire market and how the net effective rent had been calculated. He explained that they had used rent free information to create net effective rents. He agreed that the relationship between prime and secondary rents may vary over the cycle but that often decision making, particularly for development, was based on the prime rental data.

The geographical boundaries were questioned in respect of the change in demand for alternative markets, for example Docklands, but Lizieri explained that the City market is a very distinct area and that he had tested in previous work for any causality between the two markets.

The correlation between demand and supply shocks was raised with Lizieri explaining that in conceptualising the model availability was used because the relevant event is the construction start and not completion. Some behavioural components would also suggest that the rental negotiation process today may be influenced by knowledge on the future pipeline in terms of excesses or shortages.

In summing up it was declared that this piece developed the existing body of work although there are still numerous questions about how the City office market works. Others are working on different questions that relate to this work, such as what is meant by vacancy. For example, hidden vacancy is not yet being quantified in respect of under occupying existing space or planning for future expansion as part of current requirements. With the abundance of data for the City market it is unlikely that this will be the final piece of research on how the market works.

SPR/IPF Joint Meeting on Depreciation
4th Mar 2010

DTZ, 125 Old Broad Street, London EC2

Professor **Neil Crosby** of the University of Reading presented the results of this research on the Depreciation of Office Investment Property in Europe. This research was undertaken jointly with Steven Devaney (University of Aberdeen), Malcolm Frodsham, Rebecca Graham (IPD) and Claudia Murray (University of Reading). The research was funded by the Investment Property Forum and the IPF Educational Trust.

Neil Crosby explained that the research extended the methodology which had been developed in the 2005 study on UK commercial markets to cover six European office markets. The UK study had shown that office rents depreciate by about 1% per year, standard shops do not depreciate, and that offices come somewhere between. These results had been produced using the definitions and measurement processes developed by Vicky Law in 2004.

The European study applied an identical longitudinal process to assess depreciation in six European office centres, using rental values on individual properties from IPD and benchmark rents for theoretical new buildings from CBRE and BNP Paribas. The results were very varied, ranging from strong positive depreciation for Frankfurt (4.9% pa) to significant negative depreciation for Stockholm (-2.0%). There was seen to be a negative relationship between property expenditure and depreciation.

Crosby indicated that because of this unexpectedly wide range of results, it was decided to further segment the results by sub-markets and by age within each centre. But once again different patterns were seen, perhaps suggesting a timing issue, with greater depreciation occurring in the strongest performing markets, or else a valuation issue, particularly for the Frankfurt and Paris markets.

Keith Steventon of BNP Paribas, one of the providers of the benchmark data for the Frankfurt analysis, commented that the research raised many interesting questions. He noted that the 'sustainable rent' which was used for the IPD market rent input was in practice defined differently to the rental value applied in other markets, with valuers marking to market on vacant properties but applying current rent on let properties.

Malcolm Frodsham of IPD stressed that finding a wide range of depreciation rates for different European markets was not necessarily a surprising outcome, especially given that the samples of individual properties were relatively small for each centre. He noted that there is always considerable uncertainty surrounding the rental values of properties that are not being marketed, and therefore even more in reaching an estimate of the rent that would be achieved by a theoretical new property as required for the benchmark data in this analysis.

Andrew Smith of Aberdeen Property Investors, the third respondent at the meeting, wondered whether the contradictory nature of the results suggested some issues with the methodology being used. In particular the likelihood that individual buildings would be altered through time and that their location dynamics could also shift, might make a cross-sectional approach more appropriate.

Thanks are due to DTZ for hosting the event and to Hans Vrensen for chairing.

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JUST ANNOUNCED: Upcoming Technical Event

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Industrials / Logistics Occupier Briefing

Tuesday 8 June 8 2010, 6.00-8.00pm
BNP Paribas Real Estate, 5 Aldermanbury Square, London EC2

Chair: **Bob Thompson, RETRI Group**

Speakers:

Sally Bruer, Gerald Eve: multi-let industrial estates

Kevin Mofid, BNP Paribas Real Estate: real estate impacts of waste and recycling

Anna Behan, King Sturge: update on the big shed market

Further details to follow by email