SPR Newsletter October 2012

Society of Property Researchers

In this Newsletter:

SPR 25th Anniversary Conference, 11th October 2012, 3.15pm
Does Recession Stifle or Stimulate Innovation?
Drapers' Hall, Throgmorton Avenue, London EC2

To mark the occasion of the SPR's 25th anniversary, we are hosting a conference and networking event that touches on the role of research over the past 25 years, and debates its role in the future.

Keynote papers:

Advances in Asset Allocation
Jamie Alcock and Eva Steiner, University of Cambridge

CIRS: Next Generation Sustainability
Alberto Cayuela, University of British Columbia

Social Media: Research in Real Time
Andrew Waller and Bob Thompson, Remit Consulting

Further details on p4

Technical Event Reports

Upcoming Events

SPR Seminar: Understanding UK Occupier Risk to Income, 4th October 2012

6.00 – 7.30pm, GVA, 10 Stratton Street, London W1 (registration from 5.30pm)

Sponsored by: GVA

Chair: **John Jones**, *Head of Property Management, GVA*
Speakers: **Ben Thomas**, *Assistant Director, Royal Bank of Scotland*
Simon Usher, *Associate Director – Retail, LaSalle Investment Management*
Greg Mansell, *Head of UK Research, IPD Ltd*

In the current economic climate, with limited capital growth prospects and a greater reliance on the income side for returns, threats to income streams are more relevant than ever. With this in mind, the Society of Property Researchers is organising an evening seminar focussing on occupier risk. The event will look at how investors can monitor and mitigate risk to income from potential tenant default.

SPR Scottish Seminar, 9th October 2012

Is the UK Commercial Property Market Broken?

6.30 – 8.00pm, Hotel Missoni Edinburgh, 1 George IV Bridge, Edinburgh (networking drinks from 5.45pm)

Chair: **Edward Trevillion**, *Head of Real Estate Research, Scottish Widows Investment Partnership*
Speakers: **Frances Hudson**, *Global Thematic Strategist, Standard Life Investment*
Rod Ross, *Head of Product Development for UK Property, Aberdeen Asset Management*
Fraser McPhail, *Senior Director of Real Estate Finance, Royal Bank of Scotland Plc*
Alan Gardner, *Head of Real Estate Research, Ignis Asset Management*

Commercial property is an important factor of production. Without factories, offices, shops and leisure facilities, the productive activities of business would not be possible. Over the last two hundred years commercial property has also become a significant financial asset and its value now reflects its importance as an investment medium in addition to its value as a factor of production. Inevitably, real estate performance is closely linked to the overall performance of the nation's economy – this is true for both the occupier (rental) and investment markets.

The dual susceptibility has been amply demonstrated over recent years as poorer economic performance and a lack of available credit significantly affected the performance of both the investment and occupier markets.

We ask whether this is only a short term problem, or are there fundamental structural changes taking place in global economies which have permanently affected the investment landscape? Are the traditional benefits of property investment more relevant than ever and does commercial property provide a degree of security in uncertain economic times?

SPR 25th Anniversary Conference, 11th October 2012

Does Recession Stifle or Stimulate Innovation?

Drapers' Hall, Throgmorton Avenue, London EC2

The Society of Property Researchers celebrates its 25th Anniversary in 2012. To mark the occasion we are hosting a conference and networking event that touches on the role of research over the past 25 years, and aims to look forward and debate the role of research in the future.

The collection of speakers and panellists - drawn from all aspects of real estate research - will address the question of whether recession stifles or stimulates innovation in our sector. Our three keynote papers examine the topical issues of asset allocation, sustainability and social media.

Delegates will have the opportunity to take part in the Grand Debate that closes the conference to offer their own views and experiences relating to the future of real estate research.

3.15 Registration and welcome drinks
3.45 Welcome by conference chair, Henri Vuong
3.50 Introduction by Brian Waldy, Co-founder of the SPR
4.05 Presentation of the Fellowship certificate to Bryan McGregor – Robin Goodchild

4.15 Paper 1: **Advances in Asset Allocation** – Jamie Alcock, *Lecturer in Real Estate Finance, University of Cambridge;* Eva Steiner*, University of Cambridge*

4.55 Paper 2: **CIRS: Next Generation Sustainability** – Alberto Cayuela, *Associate Director, Centre for Interactive Research on Sustainability, University of British Columbia*

5.35 Tea/Coffee break

6.05 Paper 3: **Social Media: Research in Real Time** – Andrew Waller, *Partner, Remit Consulting*; Bob Thompson, *Director, Remit Consulting*

6.45 Grand Debate: **Does Recession Stifle or Stimulate Innovation?** Moderated by Henri Vuong.

Panellists:
Andrew Smith, *Global Head of Property, Aberdeen Property Investors*
Anne Breen, *Head of Real Estate Research and Strategy, Standard Life Investments*
Bryan McGregor, *MacRobert Professor of Land Economy, Vice Principal, Head of the College of Physical Sciences, University of Aberdeen*
Alberto Cayuela, *associate director UBC Sustainability, University of British Columbia*
Kevin Mofid, *Associate Director, BNP Paribas Real Estate*

SPR/APL Joint Seminar: *Assessing Real Estate Risk – new models, concepts and methods*, 17th October 2012

6.00 – 7.30pm, Taylor Wessing LLP, 5 New Street Square, London EC4 (registration and welcome drinks from 5.30pm)

Networking drinks and canapés will also be provided at the end of the evening

Sponsored by: TaylorWessing

In association with: apl The Association of Property Lenders

Chair: **Professor Andrew Baum,** *Chairman, Property Funds Research*
Keynote Speaker: **Nicole Lux,** *Senior Risk Manager, Deutsche Postbank*
Speakers: **Alex Moss,** *Founder, Consilia Capital*
Paul Ogden, *Partner, inProp Capital LLP*
Panellist: **Rodney Dukes,** *Divisional Director, Taylor Wessing LLP*

Following the onslaught of the financial crisis there has been an increased focus on assessing real estate risk. The need for more sophisticated approaches has been widely recognised across the real estate industry, with new concepts and methods being introduced across the investment spectrum in an attempt to understand the true risk of real estate exposure, both from the lender's and investor's perspective.

This seminar brings together modelling suggestions from experts across the industry, from real estate equity to real estate debt, from property derivatives to real estate securities, to give an overview of the leading risk modelling approaches.

Our keynote speaker and author of *Assessing Real Estate Risk*, Nicole Lux, will introduce the use of quantitative and qualitative risk models in the field of real estate finance, and will be joined by industry experts to discuss the complexity of the risk management function and how new techniques can improve risk management metrics for real estate investors and lenders alike.

Please note that the APB (Association of Property Bankers) has formally changed its name to the APL (The Association of Property Lenders Limited). To coincide with the name change, the Association is re-launching its website (www.the-apl.com).

SPR/CPPS Joint Seminar: *How is the Financial Crisis Impacting Investment between Asia and Europe?* 25th October 2012

6.00pm – 7.45pm, Nabarro LLP, Lacon House, 84 Theobald's Road, London, WC1
(registration and drinks from 5.30pm)

Speakers: **Junjian Albert Cao,** *Senior Lecturer in Valuation, Oxford Brookes University*
Richard Barkham, *Group Research Director, Grosvenor*
Simon Wallace, *European Research Analyst, RREEF*
Panellist: **Oliver Lovat,** *Partner, Denstone Real Estate Advisors*

The Society of Property Researchers is pleased to announce its first joint seminar with the Chinese Property Professionals Society.

The business world is changing. Against a backdrop of economic turmoil in the Eurozone, many European countries are facing significant challenges. However, in spite of tough financial conditions significant amounts of equity are still waiting to be invested. The financial crisis has driven property investors to narrow their target to prime assets, and in many cases, Grade A 'Trophy' style assets only. The foreign investor perception of core Europe, in particular London, as a "safe-haven" dominates. In the shadow of the Eurozone crisis, there are the vibrant, rapidly growing economies of the East, with the Asian markets dramatically outperforming Europe. The value of properties in London and Paris, along with other mature markets, grew on average by 32% since 2005, compared to 123% over the same period in Shanghai, Singapore, Hong Kong, Moscow and Mumbai. A shift of wealth from West to East is changing the global investment landscape.

Recent regulatory changes in China and a once in a decade change in leadership will undoubtedly alter the investment landscape in Asia and the appetite of Asian investors. Global diversification in real estate investment plays a key role, while capturing Asian capital into Europe has become a key motivation for many European fund managers. Meanwhile, European investors are seeking out opportunities in Asia.

Recent Social Events

SPR Golf Day, 11th May 2012

Surrey National Golf Club, Chaldon, near Caterham

Prizes sponsored by:

This year, the SPR golf day moved back south of the River to the Surrey National Golf Club. Although it had rained continuously for the best part of two months prior to the event, the course was in pretty good condition. In total, 28 golfers participated in the day, which kicked off with bacon rolls, coffee and a slightly soggy 9 hole warm up competition. Despite the early start and the wet rough, some decent scores were handed in before lunch, with Tom Goodwin (PMA) and Ben Martin-Henry (IPD) running out joint winners with Nick Robinson (PMA) and Joseph Kelly (RCA).

After lunch the course dried out somewhat, which added extra distance to those drives lucky enough to find the fairway. Despite having broken his driver earlier in the day, allegedly in a bag toppling incident (and not through a fit of frustration), Michael Moran picked up the prize for the longest drive with an impressive effort on the 18th, narrowly exceeding Greg Kane's earlier attempt. Marc Espinet (PMA) won closest to the pin.

The overall winner of the 18 hole competition, who took home the coveted SPR Golf Trophy and a bottle of Champagne, was Neil Chegwidden (JLL), scoring 42 points off a respectable handicap of just 11. An excellent effort and well deserved. The five runners up were Greg Kane (Pramerica), Marc Espinet (PMA), Michael Moran (MoranRAC) and Joseph Kelly (RCA). As is now becoming custom, Ben Martin-Henry picked up the last prize of the day, for wearing the most colourful pair of trousers ever worn to an SPR event – a very brave effort! The numerous prizes awarded on the day were generously sponsored by Real Capital Analytics. Thanks to all those who took part in the day. We hope you enjoyed it and look forward to seeing you back on the course next year.

Report by **Craig Wright**

SPR Summer Drinks

12th July 2012, 18.00-21.00, Balls Brothers Wine Bar, Hay's Galleria, London

Sponsored by:

This year's Summer Drinks event, once again sponsored by CoStar and Cobalt Recruitment, was held in the sheltered open-air environment of Hay's Galleria.

The event included the chance to play a game of boules, as well as a fine selection of canapés, both of which ensured that many society members remained at the event well into the evening.

Site Visit

Park Plaza Westminster Bridge Hotel, 3rd September 2012

Daniel Pedreschi, General Manager of the Park Plaza Westminster Bridge Hotel, gave a very detailed and informative tour of the hotel.

Pedreschi explained that this - the fifth London hotel from the PPHE Group - was one of the first new-build hotels in London to pioneer the buy-to-let hotel model, offering individuals the opportunity to acquire bedrooms and receive a return based on the room's revenue. This financial model allowed the development of the hotel to continue during the worst of the credit crunch in 2008.

Opened in early 2010, the £350 million hotel is situated at the foot of Westminster Bridge on London's South Bank, with uninterrupted views of Big Ben and the Houses of Parliament. The hotel was built on a site previously taken up by part of the Greater London Council's offices – a section of the former County Hall known as 'Island Block' due to its location on a traffic roundabout. The construction around a huge atrium means that all the 1,019 rooms are easily accessible along short corridors, giving the hotel something of a boutique feel. Pedreschi gave an explanation of the financial software used to adjust the pricing of the rooms so that high levels of occupancy can be assured; this was possible right through the period of the Olympics, when many other London hotels struggled to reach their normal summer levels.

Pedreschi showed us a number of the rooms, explaining the unit-based construction method used by GC Project Management, a partner organisation of the PPHE Hotel Group - which allowed bathrooms to be inserted into the building already prefabricated, thereby reducing the build time substantially and the occurrence of leaks; he also provided a viewing of the hotel's conference facilities, buried in the basement of the building, one of the largest and most flexible such spaces in the Capital.

The tour ended with complementary drinks and canapés for the SPR visitors in the Executive Lounge at the base of the hotel's atrium.

It was regrettable and embarrassing for the Society that only four of the 20 members who had originally signed up for this event attended, especially in view of the time and effort made by Daniel Pedreschi in providing such an in-depth tour.

Recent Technical Events

Meeting reports written by Tim Horsey

SPR/APB Joint Meeting: *Dynamics and Issues Facing the Senior Debt Market,* 9th May 2012

Simmons & Simmons, CityPoint, 1 Ropemaker Street, London EC2

Event sponsored by:
Simmons & Simmons

Chair: **Paul Eyre,** *Head of Structured Real Estate Finance, RBS*

Speakers:
Isabelle Scemama, *Head of Real Estate Debt, AXA Real Estate*
John Barakat, *Head of Real Estate Finance, M&G Investments*
Gregor Bamert, *Head of UK Real Estate Coverage Barclays Corporate*

Paul Eyre introduced the meeting by emphasising that the refinancing challenge remains, even though funds are trying to deleverage and outstanding debt has stopped growing. The context for lending to property continues to look difficult with weak economic growth and unpromising prospects for the sector over the next three years, while regulatory headwinds are increasing banks' costs of doing business. Debt is looking less likely to come from the traditional banking sources, but are other potential providers in a position to fill the gap?

Isabelle Scemama argued that real estate debt currently represents a good fit within insurance companies' fixed income allocations, with the premium against Eurobonds having widened to 150-200 basis points, for what is a relatively deep asset type, amounting to some €1.2 trillion across the European continent. Based on the longer US experience, benefits for insurers investing in debt include low default rates and high recovery at 70-80%; Solvency II is also favourable for the asset class. Scemama commented that the biggest risk for insurance companies lies in the possibility of early repayment of loans. The potential size of the debt market could be as large as €100-200 billion, on the basis of a conservative estimate amounting to no more than 5% of insurers' total fixed income allocation.

Pension funds could also move into the real estate debt space, according to **John Barakat**, as these assets could play a role in matching their short term liabilities, while at the same time increasing diversification due to the underlying property exposure.

However the regulatory position for pension funds is confused, even with regard to Solvency II, and real estate debt remains a category of asset where little data is available on performance track records. AXA have made a valuable contribution to initiating this market, but it needs to be deepened if institutions are to feel more comfortable.

Gregor Barnert stressed that banks are now working in a much more difficult lending environment than before the credit crisis began. Return on equity, the financial rationale of the business, is under strain due to the need for an expanded capital base, chiefly as a result of strengthening regulation. 23% of UK real estate loans are on assets valued below their level of borrowing, and while banks' business reputation in the country at large remains under considerable strain. In this environment banks are having to be very cautious about the new loans they are making, with the success of borrowers' own businesses together with the security of the income flowing from their assets paramount.

In response to a question from the audience, Isabelle Scemama said that she believes that a greater allocation to property lending is likely to be a long term trend for insurance investors. John Barakat however argued that investors still need to be persuaded of the long-term viability of this market before it can really take off.

SPR Research Briefing – *London Office Occupier Trends and Outlook*, 29th May 2012

90 High Holborn, London W1

Event sponsored by:

Chair: **Matthew Flood,** *DTZ*

Speakers:
Sandra Jones, *Ramidus Consulting*
Kevin McCauley, *CBRE*
Nick Searle, *Argent*
Richard Cole, *Canada Pension Plan Investment Board*

Sandra Jones described the way Central London's office market is changing, using information from the EGi London office database. London is now polycentric, with the biggest growth in occupation over the last 15 years taking place in the peripheral markets: in Docklands, and to the north, south and west of the central core.

Large occupiers made the earliest moves to these locations, to be followed by smaller firms. Mega-schemes have changed the character of the office stock in these areas, and as a result professional services are now much more widely distributed around Central London than previously. GLA's forecast for office jobs shows financial service employment declining by around 10% over the next 20 years, and services including TMT growing to offset this. It is therefore perhaps surprising to note that around Old St and Shoreditch – 'silicon roundabout' – there is still the same amount of TMT occupation as before the Dotcom bubble began in 1995.

Kevin McCauley focused on the role of transport in the development of London office market geography. The widening of the Central London market has been strongly influenced by structural change in financial services, with the five largest investment banks requiring a new scale of office space. This has been accompanied by a desire to move to more cost-effective buildings and locations. Meanwhile the City's planning regime has become more flexible while the West End has remained relatively rigid.

At the same time transport improvements have played a key role by making fringe locations more accessible – eg the Jubilee Line opening up the South Bank for office development. Now mainline hubs like Waterloo, Victoria and King's Cross are likely to be a focus of future growth as these areas are currently undeveloped.

CENTRAL LONDON CROSSRAIL ROUTE

Crossrail is the most important new scheme set to redefine the market structure: Canary Wharf will get a 20% boost to its transport capacity, while Paddington and Tottenham Court Road should also see their potential unlocked. Meanwhile the Thameslink programme will reinforce north-south connectivity, with particular benefits for the Blackfriars and Farringdon areas. These areas are most likely to see a mix of user types, as has been the case around Paddington. These developments should benefit London's role as a world financial centre, but this might be further enhanced if there were more joined-up thinking between government and the property industry on transport development.

The King's Cross project provides one of the most important case studies for these trends, explained **Nick Searle**. St Pancras station has provided a lot of the momentum behind the project with the coming of Eurostar, while King's Cross has also been redeveloped, but the project also aims to attract occupiers on its own merits. This is an overwhelmingly mixed-use project, with not just retail but also residential and university uses, and its attractiveness as a destination is enhanced by its strong heritage aspect. By 2016 there should be 30,000 people working in this area, including BNP Paribas who have already agreed to take space. Costs in terms of rents, business rates and service charges should be lower than in most of Central London.

Speaking from an investor viewpoint, **Richard Cole** emphasised that his organisation is very much focused on core markets. CPPIB like to invest in large scale assets with real growth prospects for the long term. In London timing is very important, and it is also difficult to buy outside the City; they have chosen Victoria Circle in a joint venture with Land Securities, which is a mixed use project with large retail and residential elements. This is essentially a sub-market of the West End with an improving transport infrastructure and office environment; and being an estate investment, the project will provide a large measure of control for the investor.

SPR Global Outlook Meeting, 12th June 2012

Jones Lang LaSalle, 22 Hanover Square, London W1

Chair: **Rosemary Feenan**, *Director of Global Research Programmes, Jones Lang LaSalle*

Speakers**:**
Anthony Light, *Head of International Regional Services, Oxford Economics*
Peter Hobbs, *Senior Director, Group Business Development, IPD*
Andrew Burrell, *Director, Head of Forecasting, Jones Lang LaSalle*

The meeting began with a tribute to **Andy Paine**, who tragically died in a road accident in May, from his former PRUPIM colleague **Paul McNamara** with input from ex-colleagues at IPD. Paul reflected on the loss of a wonderful and supportive team member, whose career had held so much potential for the future; not just as a result of his technical wizardry, which had already become evident during his spell working for IPD, but also in his ability and keenness to teach others.

Peter Hobbs opened the Global Outlook discussion, emphasizing that forecasting markets was always difficult, but this was especially the case now given the high level of uncertainty in regional economic prospects. The variation in recent property investment performance has been highlighted by IPD's work comparing global city returns, which shows that there can be big differences not just between countries, but between individual cities within national markets. This also applies to sectors within cities, with retail generally doing best over recent years and offices performing least. The forecaster's problem is underscored by the big changes in the ranking of cities from year to year. US markets have now had two good years, so does this mean that they are now due for a fall?

Even before the Euro crisis took hold, European city economies had been growing much slower than their developing world counterparts. **Anthony Light** suggested this trend was likely to continue over the next ten years, but that those mature cities with open economies and strong financial and business services were still likely to do well. For emerging cities, those with expanding manufacturing and natural resources look most promising, as long as they have enough public spending to develop good infrastructure. If the Eurozone breaks up, those cities in exiting nations are bound to be most exposed to declines in GDP; not just Athens, but also Madrid, Barcelona, Rome and even Paris could be hard-hit, according to Light, with office-based employment falling dramatically as a consequence.

Andrew Burrell proposed that global real estate prospects look weak for the next five years, even assuming a best-case scenario for the Eurozone. Demand from occupiers is set to remain feeble, and although the supply of space is restricted, markets are also suffering from considerable polarization between prime and other locations. Prime rents are forecast to be stable but unexciting, with yields similarly flat, in contrast to previous years; any growth is likely to be rental-driven, with European rents set to grow near the middle of the global range.

But Burrell emphasized that this JLL 'central forecast' might be on the optimistic side given current Eurozone upheavals. If a worst-case break-up occurs, then Paris could see rents 50% lower than now forecast, with Madrid and London 40% and 20% lower respectively. Does this mean that we should give up on Europe? Burrell argued that growth may not be everything when investing in real estate; scale, openness and liquidity can be as important. And furthermore, medium and smaller scale cities in developed economies may do better in the longer run.

In a wide-ranging audience-led debate which followed, there was consensus that the high degree of market uncertainty made it difficult to take decisions at present. Peter Hobbs however stressed that real estate was likely to keep progressing as a globalizing asset class in investors' eyes, but that market maturity was no guarantee of stability. All speakers agreed that London was relatively well placed in the Eurozone, with its financial services increasingly required by the developing world.

SPR Research Briefing: *Attracting Institutional Investors to Social Housing*, 21st June 2012

DTZ, 125 Old Broad Street, London EC2

Chair: **Tony McGough**, *DTZ*

Speakers:
Robin Caven
Richard Donnell, *Hometrack*
Graham Priddle, *Jones Lang LaSalle*
Ed Warrick, *Affinity Sutton Housing Association*

Richard Donnell opened the session by stressing the continued interest among investors in the UK residential sector as a whole. With just under 5 million social housing dwellings in the stock, half owned by local authorities and half by housing associations, this segment looks ripe for attracting greater attention from UK investing institutions.

Graham Priddle emphasised the diversity of social housing assets, as there are more than 1500 Registered Providers active in the sector – though the sector is dominated by 64 organisations, each of which is responsible for over 10,000 individual housing units. As an investment it benefits from steady index-linked rents guaranteed by the government. But restricted development supply and difficulties in raising long-term debt are currently posing substantial challenges to progress. Nevertheless, £15bn of investment in new stock will be required for the Registered Providers ('RPs') to meet their commitment to the government; this will require them to be more entrepreneurial, perhaps opening up possibilities for institutions to enter into partnerships with them.

Robin Caven, who has acted as an independent consultant on social housing for many years, confirmed that the sector may well become increasingly important for investors. Social housing is likely to be seen more as a liabilities match than a growth opportunity by institutions; reflected in the fact that the main sphere of activity so far has been in providing debt at fixed rates – a bond-type investment which has fallen under the fixed income heading rather than property. But there may be an increasing tendency to go down the joint venture route, sharing equity with the RPs; in which case some of the growth characteristics of social housing could also come to the fore.

The presentations ended with a view from a leading social housing provider. **Ed Warrick** explained that Affinity Sutton see themselves as an asset holding business, albeit one with a social purpose. He emphasised that RPs are continuing to go through a period of rapid change, with an acceleration of the movement from subsidy-based finance to a structure based on rental income. The business model is now a debt-hungry one, but it is unclear how this need for credit will now be met.

Warrick suggested that institutional investment finance could be part of the solution to this potential capital shortfall. The sector's attractions include its financial strength and profitability, in particular due to the low risk income stream flowing from a secure customer base, still supported to a degree by government. For the future however he believes that the business will see significant consolidation, as there are currently too many small organisations involved. And longer term there may well be more joint ventures with house-builders, mirroring the recent collaboration between Barratt and L&Q.

SPR/RICS Cutting Edge Conference, 27th June

Befriending the elephant in the room - The scale and size of UK debt, and its role in the UK commercial property market

RICS Headquarters, Parliament Square, London, SW1

The opening keynote paper was presented by **Bill Maxted** of **De Montfort University**, under the title *The Size and Scale of UK Commercial Real Estate Senior Debt*. Maxted described the latest findings of the annual survey of the UK Commercial Property Lending Market. Outstanding loans have continued to diminish through 2011, to a total of just over £200m, but there is a dangerous overhang of loans, about half of the total, which cannot be refinanced at currently available LTVs. The survey suggests that the lending intentions of the main players appear to have weakened through the year, in large part due to the uncertain economic outlook in the UK and Eurozone, but the increasing regulation of banks has also been a major factor.

Alex Moss, Founder, Consilia Capital followed with a paper on *Optimum Gearing Levels for Listed Companies throughout the Cycle - what are they, and can they be actively managed*?

After breaking for coffee, the conference resumed with a second wide-ranging keynote view of the lending landscape, looking at the driving forces behind changes in the availability of debt. In this presentation **William Newsom, UK Head of Valuation at Savills Commercial**, asked 'Who's in charge? The borrowers, the lenders or the politicians?' His answer was the regulators, meaning ultimately the politicians, but he also implied that no-one was yet really in control of a difficult situation. However, from his recent research among lending and borrowing organisations, he has found conflicting views on whether the situation is getting brighter or gloomier. While one borrower with more than 40 years experience believes "this is the worst time ever to raise finance," there are still 16 organisations in a position to write cheques of £100m or more.

This reflects a lending market in transition from old to new sources of capital, Newsom suggested. Lenders are in a strong position, with interest rates low, particularly those outside the banking sector which is now likely to be strongly constrained by the 'slotting' requirements of Basel III – regulations which will mean they will need to hold more capital. The new players are mainly foreign banks - particularly American ones - who are not constrained by Basel regulations; as well as investment institutions from the insurance and pensions sectors, who are being pushed more in this direction by the influence of Solvency II.

Tony Key, Professor of Real Estate Finance at Cass Business School, then considered the evidence on the impact of debt on property investment performance, and the importance of timing in getting a positive effect from leverage. Key concluded that the use of leverage without good timing did not generally pay for investors, whilst taking an overall perspective, leverage does not appear to have boosted fund returns. He also suggested that diversification could mitigate some of the risk associated with leverage, but not all of it.

The presentation began with a review of the history of real estate lending since the 1970s, showing that these issues are not new, though the scale in terms of LTVs has become much more acute in the latest cycle. Through this period debt was used by opportunistic funds in an attempt to meet ambitious performance targets of, but Key's worked examples suggested this needed to be allied with high performing assets and good timing to succeed – a tall order.

The afternoon session opened with an examination of the debt funding gap predicted for 2013, based on recent research by **DTZ**, looking at the difference between loans due to be repaid and the potential new debt that looks likely to be available. **Nigel Almond** suggested

that the funding gap for Europe was likely to be just shy of $200bn, and had been substantially increased by the effects of new regulation, which are making banks less inclined to lend on commercial real estate. Within Europe, the UK has the largest funding gap, despite the fact that it is less exposed to new regulation than some core European markets, whose funding gaps have recently increased as a result of greater capital requirements. Non-bank lending, particularly from institutional investors, could reduce the European funding gap by almost half, according to DTZ, but there will also be increasing pressure on equity investors to bridge the gap. Almond proposed that there should be enough equity out there to meet this need.

Possible consequences of this funding gap could be a continuation of the practice of 'extend and pretend' or fire sales of existing assets, unless more junior debt provision and equity finance – for example through REITs – emerge in the near future. This view was expounded by **Thalia Kounini** as the background for her work in collaboration with **Anish Goorah** on developing a hybrid financing instrument for real estate combining debt and equity. Kounini proposed that the so-called DEquity would have the benefit of being easier and quicker to arrange than traditional junior debt. There should also be better alignment between the lender and real estate owner, achieved by pricing-in a reverse call option, which would be paid by the owner at the end of the loan period under certain conditions.

Nicole Lux of **Deutsche Postbank** completed the day's formal presentations with the bank lender's perspective, predicting that European banks' ongoing process of deleveraging over the next 3-5 years will release €300-600bn of debt into the market place. Higher capital requirements – resulting in part from regulation – will mean that loan margins are likely to continue to rise, while those banks with more secondary stock on their books – known as Tier 2 and Tier 3 under the Basel slotting framework – will find new lending especially difficult as a result of their higher funding costs. Meanwhile those banks with more prime exposure are likely to resort more to Pfandbrief (covered bonds) issues, as a way of reducing their funding costs.

The conference concluded with a panel discussion around the issue of whether the problem facing the property business is really a debt funding gap or an equity funding gap. **Peter Bullock, Senior Director of Real Estate Finance, the Royal Bank of Scotland**, chaired the panel, which comprised **Mark Waghorn, Banking Partner at Simmons & Simmons; Joe Pitt, Head of Recovery and Restructuring at BNP Paribas Real Estate Finance; Nigel Chapman, Director of Secondary Markets at Deutsche Pfandbriefbank; and Zachary Latif, Director, TLG Capital.**

Zachary Latif proposed that no 'new normal' had emerged in lending markets, and that no alternative source of finance has yet come through to fill the funding gap left by the banks - which remain the principal providers of lending. The context for this gloomy scenario is that the global economy is continuing to deleverage while economic growth is proving elusive.

Nigel Chapman, on the other hand, was on balance more optimistic, stressing that there are a variety of different new players in the market. Deals are being done, albeit in a thin market, and borrowers are generally realistic about their return prospects.

Joe Pitt however emphasized that the real funding gap is for properties that are secondary and tertiary – poor quality underlying real estate, whether in terms of location or depreciation. A few deals are being done in this area if the price can be made realistic, but in general the banks are managing these situations very carefully. Mark Waghorn echoed this view, characterizing the market as one of distortion and obstruction, making it difficult to value assets; but he did suggest this might provide some buying opportunities. But Chapman proposed that prices for this quality of asset were not falling enough to attract equity buyers; Latif agreed, saying that there was still a need for big write-downs within financial institutions; which was mainly a question of political will or at least scope for manoeuvre in the UK.

Chapman concluded that people have got used to the current difficult situation, but the continuing uncertainty on how regulation will turn out is unhelpful. But regulation can be helpful if it forces people to work out how they will be able to make enough money to sustain their businesses in the long run.

SPR Seminar: *Sustainable Investment in Real Estate*, 2nd July 2012

K&L Gates LLP, One New Change, London, EC4

Event partners: K&L GATES

PEI Alternative Insight PERE

Chairs:
Steven Cox, *Of Counsel, K&L Gates LLP*
Bonny Hedderly, *Senior Associate Real Estate, K&L Gates LLP*

Speakers:
Paul McNamara, *Head of Property Research, PRUPIM*
Louise Ellison, *Head of Sustainability, Quintain Estates and Development*
Christina Cudworth, *Global Head of Sustainability, IPD*
Tatiana Bosteels, *Head of Responsible Property Investment, Hermes Real Estate*

This seminar, hosted by K&L Gates in their impressive new offices overlooking St Paul's, featured four short presentations from contributors to the recently published PERE book *Sustainable Investment in Real Estate – a guide to green value creation and risk management* **Paul McNamara**, who has been championing UK property investors' efforts in this field for a number of years, introduced the topic as both a moral and a 'fiduciary' issue for the industry: while responsible investors will strive to 'do well by doing good', intelligent investors will also focus on the sustainability agenda if they expect it to have a positive impact on their performance.

Louise Ellison spoke from the practitioner's perspective, giving examples of buildings where Quintain has been able to add value by improving their sustainability. She emphasised that her organisation sees sustainability not just as a risk issue – as a result of the ever tighter regulatory environment, but also a business opportunity providing the chance to gain a competitive edge over rival investors.

As the level of risk associated with environmental issues increases, so does the need for investors to have a tool that can measure this risk within their portfolios. This, argued **Christina Cudworth**, is why IPD is now working to provide improved measurement and a better understanding of the relationship between environmental and investment performance – in particular through the IPD UK Sustainable Performance Indicator (ISPI) and its environmental portfolio analysis service (EcoPAS).

Focusing on the regulatory environment for UK property investment, **Tatiana Bosteels** noted that those building regulations relating to sustainability are often less well enforced than those with other objectives, and that this needs to be tightened up. As for the policy framework itself, she argued that there needs to be a better appreciation of, and a more nuanced response to, the structure of the real estate market; this particularly applies because of the heterogeneous nature of the building sector.

SPR/IPF Joint Seminar on the *Outlook for Central and Eastern European Property*, 18th September 2012

Freshfield Bruckhaus Deringer, 65 Fleet Street, London EC4

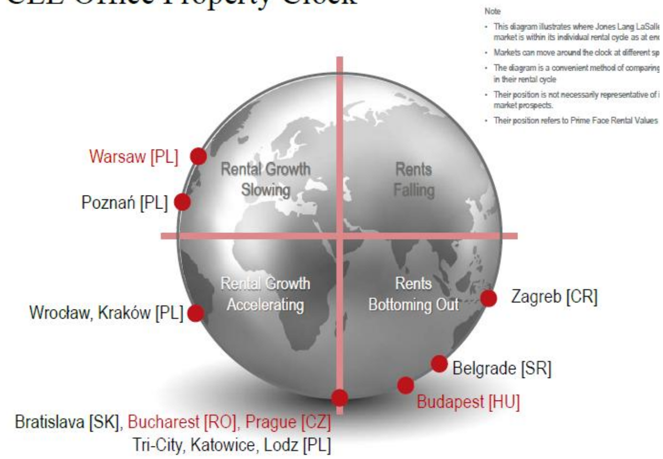
Chair: **John Forbes**, *Partner, Real Estate Investment Management, PwC*

Speakers:
Kevin Turpin, *Head of CEE research, Jones Lang LaSalle*
Dr Walter Hampel, *Head of Origination CEE, Deutsche Pfandbriefbank*
Otis Spencer, *Co-Head/Managing Director, KSP Real Estate Investment Management*

Kevin Turpin opened the meeting, stressing that the CEE region is made up of many distinct national property markets, which should each be considered on their own merits. Therefore, although most CEE economies have stronger growth prospects than the West, issues like transparency and legal conditions should also play a part in investment decisions. On this basis Poland, the Czech Republic and Hungary have proved most popular with West investors, and Poland now has the additional advantage of the most buoyant economy in the region.

CEE markets have, like most regions, seen a fall in investment through 2012, but Turpin stressed that these locations are seeing a bigger share of overall European flows than previously. Most investment has been into Poland and the Czech Republic, and the year to date has been notable for the fact that office investment has overtaken retail for the first time.

CEE Office Property Clock



Source: Jones Lang LaSalle , Q2 2012

Poland and the Czech Republic have also been the only two markets that have consistently attracted significant levels of real estate lending, according to **Walter Hampel**. Although at the height of the last boom rising values across the region saw lending stretch beyond these core markets, the German banks which dominate the area have now retrenched to focus their attention here once again. Hampel characterised CEE markets – seen from a Pfandbrief lender's perspective like his – as either good, bad or ugly. If the Polish and Czech markets are good, Russia, the Ukraine, the Balkans and Turkey are bad, since they are outside the EU and therefore not eligible for Pfandbrief banks. Meanwhile he sees Hungary, Romania and Bulgaria as 'ugly' due to their political unpredictability.

The views of the Pfandbrief banks are crucial for the region's property markets, since they are the only lenders who have weathered the financial crisis and are still active in the region, even if only in Poland and the Czech Republic. As elsewhere in Europe, Pfandbrief banks take a cautious approach, only investing in quality assets at LTVs which are effectively below 50%. Beyond the two favoured markets Hampel noted the additional problem of pricing: adjustments over recent years are yet to truly reflect the decline in investment prospects that has occurred through the downturn.

Otis Spencer spoke from KSP's viewpoint as a value add investor. He stressed the importance of focusing on income and strength of covenant; if this rule is followed it is possible to find competitively priced assets with prime cash flow qualities, he believes. Furthermore, he proposed that the regulatory and legal environment in Poland and the Czech Republic is comparable to that found elsewhere on the Continent. KSP favour these markets because of their low labour costs, proximity to Western Europe, flexible exchange rates and expanding middle classes.

Nevertheless, Spencer accepted that there were considerable challenges to be overcome in investing in CEE markets at present, in particular the length of time required to complete transactions and the likely lack of liquidity at the point of sale. It is also increasingly unclear what forces will be driving markets in future – for example most major infrastructure projects have now been completed – while it is difficult to assess the success of investments with the lack of well established benchmarks for these countries, even though IPD and INREV have made some progress.

In the Q&A discussion which brought the seminar to a close, Spencer projected that investors could expect an annual return of 14-16%, based on 50% leverage, if they invested with KSP. This would however require some yield compression to take place.

Research Prize

INREV, IPF and SPR announce the first winner of the Nick Tyrrell Research Prize

The judging panel established by INREV, IPF and the SPR has named Martin Hoesli and Elias Oikarinen's research paper entitled '*Are REITs Real Estate?*' Evidence from International Sector Level Data' as the first winner of the Nick Tyrrell Research Prize. EPRA provided financial support for the winning piece of research from Hoesli and Oikarinen.

The organisations have established the Nick Tyrrell Research Prize to acknowledge innovative and high-quality applied research in real estate investment and to commemorate Tyrrell's major contribution to the industry's thought leadership.

The prize is funded by the Nick Tyrrell Memorial Fund and was first launched at a memorial event for Tyrrell last October in London. The accolade's first round of submissions attracted 18 research papers from around the globe. The prize is open to researchers and focuses on the application of academic excellence to practical problems in real estate investment. In addition to a cash prize of £2,000, winners are invited to present at a major industry conference.

The judging panel comprised Dr Robin Goodchild (LaSalle Investment Management), Professor Colin Lizieri (University of Cambridge), Dr Brenna O'Roarty (RHL Strategic Solutions) and Dr Neil Turner (Schroders), who reported that the overall quality of submissions was of a very high standard. Robin Goodchild commented: "Nick himself would have been both intrigued and impressed; the awarded paper differentiates itself through original, thorough and insightful analysis and direct implications for investment practice".

The next deadline for submissions for the Prize is 30 November 2012

If you would like to discuss a possible submission or have a paper that meets the criteria, please email the Secretary of the Nick Tyrrell Prize, Anne.Koeman@gmail.com