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Last updated: Saturday September 25, 2010

Funds' foundations look a bit shaky

says Tanya Powley

Residential property Experts question the wisdom of investing in the current climate, says Tanya Powley

Specialist residential property funds that seek to capitalise on the property crash by buying properties at low prices have been opening their doors to investors in the past year.

But with a strong rebound in property prices having already taken place, and an increasing nervousness over future growth, advisers question whether now is a good time to invest in the funds.

Residential property funds pool investors' money and buy a number of properties that are then let out and managed on behalf of the fund. Schemes vary from those that offer investors exposure to some of the most desirable London postcodes at a fraction of the cost, to those targeting distressed properties in the Midlands and Northern England.

Providers argue that residential property funds enable investors to gain exposure to the property market at a lower level of capital commitment, and with none of the day-to-day chores that beset private landlords.

Investors can also benefit from diversification across a portfolio of properties, reducing the risk of tenant defaults and void periods.

However, some advisers believe the funds have missed the boat.

"We saw a huge amount of people and organisations looking to set up residential property funds during the downturn," says Lucian Cook of Savills.

"However, the fact that prices rebounded so quickly and strongly in 2009 meant that few had accumulated funds in time to take advantage of the bottom of the market."

One casualty of the sharp rise in values was the proposed £100m residential property growth fund from property developers the Candy brothers. It was marketed last November but withdrawn two months later.

The fund was shelved because of the strong rebound in the market, which the company admitted had a major impact on the price and availability of stock. Other funds have managed to raise equity, but at less than their target amount and later than planned.

The Residential Property Recovery Fund, managed by Residential Property Asset Management (RPAM), targets distressed property in the Midlands and the north of England. It raised just under £3m in April, compared with a target of £25m, including gearing (borrowing). Assetz's UK Residential Recovery Fund will soon tap the markets for the second time after raising only £1m in equity in April, taking it to £2m with gearing. The fund's initial target was also £25m, including gearing.

One fund that has successfully met its £10m target is the London Central Portfolio (LCP) Residential Recovery Fund, which buys discounted one and twobedroom flats in prime areas of central London, such as Hyde Park.

Naomi Heaton, chief executive officer of LCP, claims that, in spite of the recent price recovery, the prime central London market is still below its long-term trend, having "lost" two years of growth during the credit crunch. She suggests that prices may also rise further as a result of the 2012 Olympics.

Stephen Yorke, of D&G Investment Management, which manages the Prime London Capital Fund - the only open-ended UK residential property fund - agrees. He believes that prime London residential values will be 10 per cent higher by the end of 2011.

"The demand from domestic and overseas buyers remains pretty constant, and the supply of available stock continues to diminish," he says. "In the prime London residential market, this trend of falling stock has been in place for over 10 years and there are no signs of that changing."

But not everyone shares their optimistic view of the prime London market. Philip Jeffcock of Barclays Wealth believes that the only reason prime central London residential prices are now at, or even higher than, 2007 prices is due to the inflow of international money thanks to the cheap pound. But he warns: "That money will leave just as quickly as it comes and at some stage it will."

Barney Buik of RPAM says a lot of funds are chasing what is now a non-existent discount in the prime London market. By contrast, his fund is still acquiring property at 50-55 per cent below 2007 peak levels. "Our areas - the Midlands and northern England - have not experienced the meteoric rise that central London has," he says. He argues that this leaves the fund well placed to carry on making opportunistic purchases in future. Similarly, while Law admits that the volume of property available in the market has reduced since last year, he believes Assetz's fund objectives for income and capital growth from distressed property remain "very achievable".

He says this is because distressed sales are at much lower prices than house price indices suggest, and the property market slowdown continues to deliver investment opportunities from nervous vendors.

But even if recovery opportunities can be found, advisers are often reluctant to recommend residential property funds to their clients.

Patrick Connolly of AWD Chase de Vere says most clients already have significant exposure to residential property through their main residence and any additional homes. In addition, many advisers do not like the unregulated status of these type of funds. "For many people, residential property funds will offer them the opportunity to be over-exposed to a specific asset class through an unregulated investment. That is not particularly appealing," Connolly says.

Development fund Land investment offer Hamptons is marketing a two-year development fund that it believes will appeal to investors who are concerned that house prices will fall.

The closed-ended fund will invest in land that it will develop to provide a return of 15 per cent per annum.

Matthew Tack, director of global investment at Hamptons, says it has seen a high level of interest from investors.

"Investors have been attracted by ... the fact that the fund does not rely on capital growth," explains Tack. Investors make their return from the development profit, allowing the fund to absorb a fall of approximately 10-15 per cent in residential prices before returns are affected.

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