

## **Commercial property offers stability in volatile markets**

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“Concerns over sub-prime mortgages in the US, and the potential knock-on effect this may have, hit global equity and bond markets last month. Such uncertainty manifests itself in increased volatility in commodity, currency, equities and bond markets, something which the derivatives markets appear to amplify. Market turbulence may not disappear quickly as the full impact of the credit squeeze unwinds but it brings some perspective on concerns over the state of the UK property market,” comments Duncan Owen, Chief Executive Officer of Invista Real Estate Investment Management.

“Recent press commentary about the UK commercial property market has been really quite alarmist in its tone,” he adds, “We believe this is being overdone and that real estate continues to offer investors a good alternative asset class especially in these more turbulent times.”

In recent years the UK property market has benefited from a high level of investor interest which has heightened understanding of the nature of the market. Between 2003 and 2006, property outperformed both the equity and gilt markets as a result of strong capital value growth. Since the start of the year the performance of the property sector has slowed from annual returns in the high teens. This is not an illustration of no growth, only slower growth. However we believe it is much more likely that performance will settle back to more sustainable long term levels.

One of the key drivers of the outperformance of UK commercial property over the last ten years has been a re-rating of the investment yields on property vis-à-vis other assets. This has largely been driven by debt-backed and overseas investors but, more recently, institutions have played a role as they have begun to realise the significant performance and diversification benefits which property can add to multi-asset portfolios.

In the short term, the moderation of property returns is largely a reflection of market expectation following rising interest rates. But the performance of property stems not just from current income but also from rental growth. Over the long term we expect rents to rise by around 2% per annum, roughly matching inflation. The IPD Quarterly Index currently shows rents rising by around 4% per annum on the back of strong occupier demand and localised shortages of available accommodation.

However, whilst rental growth does provide a significant degree of support to property performance we do expect that there will be winners and losers over the next few years. It is likely that secondary (poorer quality) properties are likely to be losers partly because of lower rental growth. But this is only part of the story as secondary properties tend to also have higher maintenance costs and higher tenant default and re-letting risk. In contrast prime (better quality) properties look better value with their stronger rental growth prospects and better quality tenants.

In today's volatile markets, an additional attraction of property is that it remains a fundamentally low volatility asset class. From 1970 to 2006, returns in the equity market were three times as volatile as those in the commercial property market. While the equity market did provide a higher average return but just 150 basis points separated the two markets. Over the more benign economic conditions since the early 1990s, equity returns have been twice as volatile as property but property has actually outperformed.

The last time we witnessed a major decline in the property market, the economic fundamentals were less attractive and stable. The last period of poor performance from property was in 1990 when unemployment and interest rates were double the current rate, inflation was 10%, house prices and domestic demand were falling and there was oversupply of accommodation. In contrast over the last 12 months the UK economy grew by 3%, earnings and employment have risen and inflation appears to be falling back toward its target. Such strong messages from the underlying drivers of occupational demand should not be ignored and support a return to long run stable returns.

#### **About Invista Real Estate Investment Management**

Invista Real Estate Investment Management is the largest UK listed real estate fund management group and was voted Property Fund Manager of the Year at the 2007 Property Awards. The Group manages both commercial and residential property across the UK and continental Europe, and has a total of £10.2 billion of assets under management as at the 30 June 2007. Invista Real Estate currently manages a total of 19 funds, some of which are for the largest UK providers of savings and investment products such as Clerical Medical, Halifax and St. James's Place. Invista Real Estate also manages a number of collective investor funds, including real estate investment trusts and open ended funds such as [Invista Foundation Property Trust](#) and [Invista European Real Estate Trust](#) which are listed on the main market of the London Stock Exchange as well as the fund of specialist funds, the Invista Property Portfolio Fund. Invista Real Estate has nearly 100 employees and in 2006 transacted over £3.5billion of real estate assets.

For more information on Invista Real Estate or the funds it manages visit [www.invistarealestate.com](http://www.invistarealestate.com).

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