Real estate's safe house for 'bond refugees'

Cast your mind back to the 2008 crisis. It seemed, the only thing outpacing the unsecured mortgages being underwritten was the speed at which they were being re packaged and issued back to Wall Street. Out of the ashes of this turbulent time in global economics has grown an asset class that while watched with a cautionary eye is starting to show signs of stability, growth and, most of all, a source of yield that today's fixed income markets are struggling to deliver.

Abdallah Nauphal, CEO of Insight Investment, argues that the mainstream market landscape has changed so much that it has heralded a new era for the investment industry. Yield hunters being forced out of their comfort zone in the search of superior returns.

The commercial property sector is positioned to provide that alternative. As investors shrug off the ratings agencies and wade into high yielding corporate debt, the commercial property markets are also positioned to benefit as 'bond refugees' move up the risk curve.

Looking out of my window at the Square Mile, I see numerous cranes towering over the City, all building the structures of tomorrow. Green buildings, sustainable properties each commanding rental premiums with slower balance sheet depreciation, longer leases, and higher capital values not to mention some very quirky designs. I often wonder what piece of household equipment is going to be built next to rival the cheese grater and the walkie talkie.

Michael Morris CEO of Picton Capital believes the commercial property sector is still valued at a 26% discount to the heady days of 2007 and, as such, is still seen as a comparatively cheap asset class versus the more conventional equity and fixed income sectors.

Schroders has seen commercial rental income growing uninterrupted for the past 68 months and expect it to continue to yield double digit returns into 2015.

With growth metrics such as falling unemployment, rising GDP, low borrowing costs and moderate wage inflation, the UK economy is now in the top six developed economies. In 2014, and into 2015, we have seen this growth story playing out in commercial rental yields. TAM invest with real estate fund managers who are seeking to diversify their property portfolios. Investments into industrial, office, logistics and retail markets with varying rental yields are made, not only to fully capture this broad growth in the rental market, but to provide the investor with an actively managed, secure investment, resulting in a blend of increasing rental yields with underlying capital appreciation.

Indeed, we can see this story playing out over the cobbled streets of the City with London positioning itself as a global player in accountancy, law, media and technology. London has seen a rise in the professional talent pool applying to work in the capital as a result. What makes commercial real estate an attractive market is that demand is outstripping supply. With banks drip feeding their property portfolios onto the market whilst holding back on future project funding because of more stringent capital adequacy requirements the City landlords are holding all the cards, or should I say keys!

This growth is not confined to London, it can be seen in most of the major UK business hubs, where a large portion of our funds are invested. Government initiatives aimed at increased competition between UK cities has helped to develop commercial and retail markets that attract some of the market leaders in commercial business. With low, regulated supply from banks unwinding their property portfolios, combined with rising demand for commercial rental space, the property market outside of London has also seen a substantial rise in yields and asset appreciation.

We are seeing a similar story developing in Europe with property performance in 2015 predicted to increase its 2014 gains. This is widely being attributed to two factors. One being the introduction of QE acting as a ‘rising tide that lifts all boats’ driving commercial rental demand up as businesses expand. Secondly, with the German 10yr yield at less than 0.1%, the German 5yr at 0.08% and with Netherlands, Austria and Finland issuance of negative debt all becoming common place, investors searching for yield in these markets are eyeing up the alternative. That being the prospect of commercial property funds yielding around 4% without the added risk of having to dance near the door in the fixed income ball room. Knight Frank predicts commercial retail sales in Europe to reach up to EUR 180 billion in 2015.

TAM has been increasing investment in UK and European property funds through 2014 and into 2015. This strategy has proven a reliable and diversified approach for our client portfolios. For an asset manager with the belief the fixed income market is carrying a level of risk not seen before, the property market has given us an opportunity to provide our clients with equivalent yields while diversifying portfolios into another asset class.

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