

CRELA MEETING – 24TH FEBRUARY 2011

NOTES OF THE PRESENTATIONS

MARTIN MOORE - Managing Director and Head of Fund Management at PRUPIM

PRUPIM is part of the M&G group and offers expertise in Real Estate Fund Management on a global basis. The UK team comprises 282 people across 2 sites, and they manage assets in UK and Europe. There is a newer team of 20 based in Singapore, looking after the assets in Asia and Australasia. M&G has assets of £200bn in UK and Europe.

Currently PRUPIM is in the Global Top 20 by reference to the *size* of funds it manages, and holds second position (behind Aviva) for the *range* of funds run.

The performance of property as an asset class over the last 10 years has been volatile. 2010 figures suggest that there has been a reduction of about 30% from peak values during that period, and capital values are back to where they were in 2003. However, if you look at the relative performance of property as an asset class, over different periods, it has held up well against equities.

The PRUPIM strategy is to

- Grow the number and value of the assets that it manages
- Diversify the funds and assets that it manages – both by geography and by channel

Whilst in 2000 its business concentrated on UK properties for the two life funds (Prudential and Scottish Amicable, who together had around £7.5 bn assets under management), by 2010 the portfolio was far more balanced. In addition to the life funds, PRUPIM was now advising international funds, institutional funds, retail funds and annuity funds, so the share represented by the life funds was now smaller. It is true that the retail fund area can be a challenge, because the volatility in that market, and their need for liquidity, means that properties have to be kept in a perpetual state of readiness for disposal.

PRUPIM has some flagship developments – for example, Bluewater, Cribbs Causeway, and the Holborn Bars site (the Prudential headquarters prior to the move to Governor House). However, they were not limiting their assets to retail and office. There is a productive joint venture with Berkeley Homes (called St Edward Homes) which is investing in development of high class residential flat developments. This JV is likely to figure in the Top 10 housebuilders in 2011. Their development in Kensington has been very successful, particularly when marketed off plan in the Far East. Even in the current market, buyers there are happy to pay good prices and a 25% deposit for well positioned flats (which deposits help to reduce the required borrowing to complete construction).

PRUPIM is developing its international business (either under its own name, or in appropriate markets, under the M&G brand). They are also developing innovative products, designed to capture interest in more secure income streams. Martin explained the thinking behind the M&G Secured Property Income Fund, where the secure income stream from high quality, well-let property is used as a proxy for corporate bonds or similar instruments. Where the leases on these properties have index linked rent increases, this type of investment can prove a good hedge against inflation.

The European fund has not suffered quite so much from the swings and roundabouts of the economic cycle as the UK fund (partly because the fund avoided investment in properties in Southern Europe), and is seeing revived interest. The Asia funds are spread widely, but there is an emerging business in Vietnam (investment in residential property), although political circumstances in this area may prove a temporary setback.

PETER BEST - Head of UK Asset Management at PRUPIM.

Peter chairs the BPF Commercial sub-committee, which, despite having been initially convened for a limited remit (for responding to the then Government plans to abolish upwards only rent reviews), remains very active. He wanted to give a snapshot of the issues they felt would be topical in 2011.

Improving Landlord and Tenant relationships

Peter felt that, in contrast to when he had started on the BPF committee, there was a marked improvement in the health of L/T relations, certainly at the upper end of the market. Landlords now recognised their tenants as customers, held regular reviews of the service being provided, understood the need to consult with tenants and to assess performance against agreed criteria. This may be a reflection of the improved strength of tenants in the market, but also of enlightened attitudes amongst the bigger landlords. Perhaps this was not so well represented at the smaller landlord end of the market.

Insolvency regimes and the potential abuse of CVAs

Peter felt that Landlords can justifiably object to the use of CVAs to disadvantage them as a particular class of creditors (for example, the landlords of “failing” stores) as has been criticised in the recent JJB CVAs. The challenge to the insolvency practitioner’s decisions in the Miss Sixty case were to be welcomed. The Insolvency Service is consulting on potential reforms and he thought landlords would welcome enhanced oversight of insolvency practitioners in this area.

Service Charges in commercial property

There is no doubt that landlords recognise the need to deliver good value for money. They can no longer expect tenants to pay up, regardless of the cost or the level of service. Alongside this, most landlords will be looking of ways to economise on cost and there is much room for improvement in this (Peter cited the example of the Prupim/DTZ collaboration in developing a procurement agency (Buying Force). Many managers now used the model which Prupim does, of a global provider of services to a particular building, with financial incentives for reducing overall cost of services. He felt that the changes to the commercial service charge code were well meaning, but the implementation of some of these would be very difficult (for example the mandatory use of standard cost codes and crediting of interest earned on service charges).

Upward only rent reviews

The original focus on this by tenants as a source of discontent had largely dissipated, and with it the Government focus on reforming it. This is partly because lease lengths have dropped (according to BPF/IPD research from an average of 14+ years in 1999 to 5+ years in 2009), so there is at worst only one review. The planned changes to the Accounting Standards will encourage shorter leases. Improved relations between landlords and tenants also encourage more balanced clauses. However the Government does not believe this is reflected in the smaller markets, and is unlikely to abandon its desire to make sure that small tenants are not disadvantaged. The recent abolition (both prospective, and, possibly, retrospective) of upwards only rent reviews in the Republic of Ireland may encourage this attitude. So we should not assume this issue is now dead.

Flexible terms of leases

This was originally part of the debate on upward only rent reviews. The idea was that landlords should offer different packages of terms (and matching “prices” – whether rent levels or other terms) to tenants. This was happening more amongst the larger landlords. For example, Philip Green of Arcadia had pushed hard for monthly payment of rents to encourage cash flow. Many landlords (including PRUPIM) now offer this as a

matter of course. However, tenants should not lose sight of the fact that such flexibility in terms may result in an *increase* in rent levels, to compensate for the resultant drop in capital value.

Reform of the LTA 1954

There is growing support amongst landlords for the view that this Act has run its course, and that with the other protections available for tenants (flexible terms, range of rent systems, shorter leases, service charge protection) the landlords should no longer be fixed with the obligation to offer tenants a new lease, or constrained as to the terms of that lease. Particularly where a tenant has not been performing well, the landlord should have flexibility to drop them, and maintain capital value by reletting the premises. The Government is not keen on the idea of reform. It thinks the Act works well enough and has been unenthusiastic when faced with requests for abolition.

CRC/Sustainability issues

Despite the current uncertainty over the future of CRC (and whether it will be replaced by something more like a carbon tax) there is no doubt that the property industry (and improvements it can make to the green credentials of buildings and their emissions) must expect to continue its efforts in this area. There is much to be gained, and the Government may decide to encourage this by incentives, rather than punish failure with financial penalties. The CRC is likely to cause tension in the commercial property sector. Those landlords who did all the preparatory work to deal with the CRC in its original guise have already invested a lot of money. PRUPIM had established some standard clauses ready for new leases, though it had not yet used these.

The Green Property Alliance has presented its thinking to DECC (as part of the current informal seeking of views on possible changes to CRC). It has commented on the tax implications, alternative ways to incentivise landlords and using public reporting as a lever to encourage improvement.

CRC is not the only area of focus – landlords will increasingly need to focus on other areas such as waste, water and energy consumption.

Keeping costs down

Everyone is under pressure on costs. Peter would encourage lawyers to think of ways to reduce the overall costs of doing property deals. Is there mileage in any of the following?

- Standardising documents more than is done at present (to cut time in negotiation). This has been much talked of but little progress has been made.
- Landlords certifying title to and/or the permitted use of the property rather than each tenant clocking up legal costs investigating it
- Developing cross industry IT standards that allow the management information for a property to be entered once, and then transmissible to all players in that building's history – new owners, new tenants, new managers etc. There was much to hope for in the OSCRE project on this front. Peter would encourage lawyers to engage with this – at the moment the major players in the project are large landowners/landlords.

Notes taken by Sue Highmore, Practical Law Company