London's prime residential property investments continue to shine

Prime position

Stephen Yorke

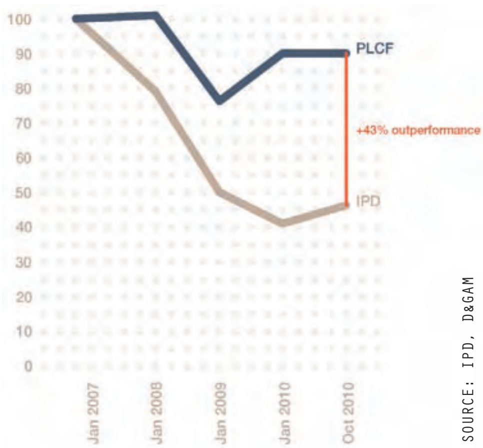
When asked what advice he had for investors the great American businessman Andrew Carnegie said 'Put all your eggs in one basket and then watch the basket'. This could not be more contrary to the advice that most wealth managers give to their clients today. For some time, the fashion has been to seek 'uncorrelated assets'; that is assets/investments that do not all behave in the same way at the same time.

There is some sense in this, but I do worry that the desire to find 'uncorrelated assets' often overrides what should be the main objective: investing in assets that make money. In the same way that it is normally a very bad idea to invest in something only because it makes tax sense, so I am always nervous when told that a certain asset has great 'diversification qualities'. Too often this is the tail wagging the dog. Surely one of the key lessons of the last couple of years is stick to what you understand and stick to simple investments with long track records of decent performance.

One-sided bet

This axiom applies to property just as much as any other investment class. During the early part of this century UK commercial property was the asset in which to invest. But did investors really understand what they were investing in? Unlike residential property, UK commercial property is dominated by institutions. This ensures the UK commercial property cycle is volatile. In the good times those institutions run successful marketing campaigns, attract inflows and then all buy the commercial property stock at the same time. When the UK economic cycle turns, those institutions are all sellers at the same time. Prices fall very fast and often investors are trapped in illiquid and poor assets.

UK commercial property has, for many years, been a highly volatile investment. According to the Investment Property Databank's IPD Index over the last three and half years the capital value of UK commercial property has fallen 34%. Over the last ten and a half years UK commercial property capital values have risen by just 5%. Total returns (including rents) for UK commercial property, over the same time period, look a bit better: minus 15% over three a and half years, but plus 69% over the last ten and a half. This demonstrates that an investment in UK commercial property is likely to be a large, one-sided bet on rents being paid.



Above: The Prime London Capital Fund (PLCF) versus the IPD All Property Capital Index, showing the PCLF's four-year outperformance

If the UK economy weakens and tenants struggle, UK commercial returns will move down in lock step with UK Plc and the UK stock market. The capital destruction that can occur when these rents disappear can be dramatic. The two biggest FTSE commercial property stocks, **British Land (BLND)** and **Land Securities (LAND)**, are still 70% down on their share price at the start of 2007.

So what investment is easy to understand, has outperformed most other asset classes in the last thirty years, has performed in an uncorrelated way to the rest of UK Plc and protected investors' wealth over the last two years? Prime London residential property.

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Prime position

Over the last twenty years the average annual rate of capital growth in 'prime London', namely high-value residential properties in areas like Chelsea and Knightsbridge, has been 13% according to research from **Savills (SVS)**. Over the last ten and a half years total return in prime London has been 94% and the split between capital growth and yield in that 94% was roughly equal, found the high-end estate agents. The reasons for this are many, but include the fact that institutions do not own it, residential property is a sought after asset by the world's richest and there is no extra supply being created.

It seems an ideal investment, yet the problem for anyone other than the very rich has always been that it is tough to buy into this highly sought-after asset class. To meet this demand we set up **The Prime London Capital Fund** four years ago. Assets under management have grown by over 400% since launch but, most importantly, we have outperformed the main IPD Index by over 40% during that period. Prime London property has historically retained and achieved high prices and, even though pockets of the UK market might be suffering, we believe that prime London will remain strong. The trick is to invest in the best properties in the best locations, improve on those assets and then make those assets sweat on modest gearing; three things that we have achieved with our fund.