See how they run

Jane Roberts 28/10/2006 15:45

The indirect market has almost trebled in size in the past five years, thanks to both new and existing vehicles continuing to build up its value, but *Jane Roberts* questions whether the current levels of growth can be sustained. Illustrations by *Jason Ford*

It is hard to believe there has ever been a better time to be a property fund manager. Investors are flooding through the doors of big investment houses and boutiques, bringing with them the fees that feed through to bumper bonuses.

Patrick Bushnell, director of property management at Henderson Global Investors, told *Estates Gazette* last month that he had more proposals for new funds piled up on his Broadgate desk than Henderson had capacity to launch. No doubt Henderson is not the only top-tier fund manager that just cannot launch vehicles fast enough.

If growth continues next year at the same rate, the value of UK-invested indirect collective vehicles will have trebled in the five years since *Estates Gazette* began monitoring them with OPC (newly recast this week as Property Funds Research). In the first *EG*/PFR survey, which covered 2002-03, the gross asset value of the 186 funds predominantly limited partnerships was £29bn. By last year, this had shot up to £60bn in 310 funds of all kinds.

This year, it has increased again, to £76bn in 368 vehicles, as ingenious fund managers came up with wheezes for nearly 60 launches.

For the third year running, Morley is the fund manager sitting at the top of the pile, with £12.4bn of indirect funds under management and three launches since our last survey the Arena Trust, Quantum Fund and Tesco/Morley Property Fund. Ian Womack's team now manages 24 indirect vehicles, covering almost every type of asset and catering for most types of investor. In the last two years, Morley has also launched six European funds, which are not included in this UK survey.

New vehicles are not solely responsible for the indirect market's growth in value existing funds have increased in value as the whole property market has moved up, while open-ended funds have continued to attract new money. Morley's Norwich Property Trust has doubled in value to £3.3bn as cash continues to rush in at the rate of more than £100m a month.

Life funds sell out of direct property

And the property owned by indirect vehicles is not all new to the fund managers running the funds, especially in the biggest houses. Plenty of it was moved out of single client in-house funds, particularly life funds, and into collective vehicles, with the life funds typically keeping a reduced exposure to the property sold. IPD puts the total amount of direct property sold by the life funds in 2005 at £9bn.

However, the overall pool of UK property managed by the fund managers who contributed to the survey is also substantially bigger, and the growth of the indirect market is not based solely on moving existing assets around and the life funds divesting.

Fund managers and their advisers have been successful buyers this year and last, despite intense competition for stock. They have been prepared to accept lower yields and have benefited as debt-driven buyers have moved out of the UK in the search for higher yields.

Morley, for example, has not seen any fall in the value of its segregated mandates business, which involves advising single clients such as the internal Aviva funds and external pension funds on their property portfolios, as its indirect business has expanded.

Quite the contrary. This year's survey shows Morley's direct mandates have increased, from 24 to 30, while their value has soared almost doubling from £8bn to nearly £15bn. This growth just inched the fund manager past rival PRUPIM for the first time.

No surprise at growth

The dramatic growth in both sides of its fund management business makes Morley the dominant property fund manager in the UK, with an overall total of £24.7bn of assets under management. This is nearly £9bn more than second-place PRUPIM and around £13bn more than third- and fourth-place Standard Life and Legal & General.

James Darkins, global director of property at Henderson, is not surprised by the indirect market trebling in size over the last five years. Henderson, fourth in the table of indirect vehicle managers, has expanded its portfolio of indirect vehicles from two to 23, of which around half are in the UK.

He identifies two strategic shifts fuelling the growth. "First, investors have sought greater diversification to enhance returns and reduce risk. If you take a medium-sized pension fund, for example, by buying into a retail warehouse fund, it can diversify into a sector that it couldn't otherwise.

"The other shift is that the consultants advising investors on their asset class splits have become keen on property and there has been an absolute increase in the amount of demand. For an investor going from nothing in property to, say 3-5%, it is logical to go into indirect."

The number of managers competing for this money continues to increase and some of the newer managers have been the most active over the past year. Cordea Savills, which first launched indirect vehicles last year, is one of five managers to have launched three funds in the last 12 months. The others are ING, Morley, Palmer Capital Partners and Teesland.

Cordea Savills has launched the Serviced Land Fund, the Student Hall Fund and the Accommodation Investment Fund. It also has a residential land fund in the pipeline. Palmer Capital and Teesland also have forthcoming launches, both of which will be development fu nds.

There is an argument that such specialist funds will be better placed if the market cools and performance declines assuming such funds have got their timing right because investors will be more selective about the sectors they choose.

There are no definite signs that performance is declining but there are already a few straws in the wind that suggest investors and fund managers know it will.

Some existing institutional funds are in the process of refinancing. This is partly to reduce the cost of their debt, but is also to reduce their gearing in anticipation of its potential effect on returns, which is positive when values are rising, but negative when they fall.

In these circumstances, can the phenomenal growth of the past few years be sustained?

Darkins doubts it: "Will we see fewer funds launched as the UK market tails off in terms of investment performance? Absolutely, yes," he says. "I am sure we will see a slowdown in the growth of UK vehicles." The only question is: when?

HUT keeps Schroders at the top

The one area where Morley is not in top spot is as manager of the biggest indirect fund. Schroders has held this accolade since the survey started, via its role managing the Hercules Unit Trust (HUT).

HUT, which specialises in prime retail parks, is valued at £3.3bn, up from £2.6bn last year. By size, it just shades the Norwich Property Trust, managed by Morley, which has gone to second place from seventh after doubling in size in a year, to £3.27bn.

NPT's growth pushes last year's second and third funds into third and fourth places. Third is Standard Life Investment's Pooled Pension Property Fund. The fund has risen in value to £3.15bn from £2.5bn last year.

But Morley manages the fourth-placed Mall shopping centre fund, which has risen from £2.3bn to £2.9bn. And it also manages four more of the top 20: the £1.43bn Junction retail park fund (10th), the £1bn Ashtenne Industrial Fund and £1bn Airport Property Partnerships (16th and 17th), and the £990m Morley Pooled Pensions fund (19th). The balanced Schroder Exempt PUT, weighs in at eighth, valued at £1.8bn.

Click here to see the top 20 managers by value of their indirect vehicles and by value of discretionary mandates

Click here to see the top 20 by value of assets under management

Click here to see the vehicles launched over the past 14 months