Global Matters Weekly

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(iI) Liquidity of Property

by Jackson Franks, Portfolio Analyst

Towards the end of last year, St James's Place (SJP), M&G Investments, and Canada Life all announced closures and suspensions of open-ended UK property funds. This trend isn't new; since the 2016 Brexit referendum, property funds allowing daily transactions have faced suspensions several times due to the challenge of matching liquidity with the illiquid nature of property assets. However, some firms like Legal & General Investment Management (LGIM) and other major UK fund groups have pledged to keep their open-ended property funds open, bringing back the debate on whether the UK regulator should restrict retail investors from investing in open-ended property funds.

At Momentum Global Investment Management (MGIM), we do not invest in open-ended real estate funds because of the clear liquidity mismatch of offering daily dealing on an illiquid asset such as a property. Due to the length of time it takes to sell a property, a minimum of 3 months, but in time of market stress often longer, when the sector sees an increased level of redemptions the open-ended property strategies are unable to cope with the cash demand and therefore suspend dealing. Gating the fund enables the manager to postpone redemptions for a period of time so they can raise the cash required to pay investors by selling an asset or raising further capital. This could be an uneasy time for retail investors who are wanting to reduce their exposure to the sector but are unable to do so.

Open-ended property funds are not the only way to gain direct exposure to the property market. At Momentum we gain exposure to the sector for our clients through Real Estate Investment Trusts ("REITs") and a private equity vehicle known as the Momentum Africa Real Estate Fund ("MAREF"), which are suitable for retail and qualified institutional investors respectively. A private equity style vehicle, such as MAREF, has its advantages and disadvantages for investors. Investors would be locked into the strategy for the duration of the fund's life. This gives the manager time to generate returns undistracted by the impulses of investor flows. Having said that, this style is illiquid and if the investor requires liquidity during the life of the fund (the majority are 8+ years), they cannot redeem.

REITs, similar to private equity vehicles, have a fixed pool of capital for the investment manager to invest across the sector whilst offering a similar liquidity experience to investing in publicly traded stocks. REITs are easy to understand from an investor's perspective: by leasing space and collecting rent on its acquired real estate, the company generates income which is then paid out to shareholders in the form of dividends. REITs are required to distribute 90% of their taxable income to shareholders which is significantly higher, on average, than other equities. However, because REITs are listed on the stock market, their share price is driven by two factors: (1) the valuation of their underlying assets and (2) broader market sentiment and buying/selling pressures. The manager never has to face redemptions, as investors simply sell their shares in the market if they so wish.

It is critical that any investor in the real estate sector understands and appreciates the illiquid nature of the underlying asset class. At Momentum, we manage this illiquidity risk by sizing our real estate exposure appropriately and investing in liquid REITs instead of open-ended daily investment vehicles, thus avoiding the risks arising from an asset-liability mismatch. Although the listed status of a REIT introduces an element of equity market risk and pricing volatility, which is particularly evident in these uncertain times, investors can still liquidate their holdings if so required, or indeed add to their holdings at what might prove to be heavily discounted valuations. Neither of these options are available to holders of most UK open-ended property funds at this point.

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For more information, please contact your adviser or alternatively contact:

Belvest Investment Services Limited
研富投資服務有限公司
9th Floor, Centre Mark II
305-313 Queen's Road Central
Sheung Wan, Hong Kong

Tel +852 2827 1199
Fax +852 2827 0270
belvest@bis.hk
www.bis.hk

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