



2-4 questions



## 2. Residential and Commercial Property

### Residential property

- Characteristics
  - High levels of owner occupation in the UK – psychological benefits
  - Property may be part of retirement planning – downsize to release capital
  - Buy-to-let market increased rapidly
  - Collateral for loans
  - Gearing
    - Important in the property market – can be beneficial and disastrous
      - Impact of increases in interest rates, change of circumstances

### Commercial property

- Characteristics
  - Dominated by insurance companies and pension funds
  - Longer leases
  - Retail, offices and industrial
  - Retail shopping centres are more evenly distributed across the country
  - Offices and industrial property concentrated in London and South-East

## Further information

### Summary

	Residential property	Commercial property
Direct investment	Second homes, holiday homes, buy-to-let	Large initial outlay restricts investment to institutional investors
Tenancies	Typically short renewable leases	Long term contracts
Repairs	Landlord responsible	Tenant responsible
Returns	Rent linked to house prices	Rent linked to income potential



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## 2. Residential and Commercial Property

### Features of the property market:

- Heterogeneous
  - Commercial
  - Industrial
  - Residential
  - Agricultural
- Indivisible
- High transaction costs
- Decentralised
- Maintenance
- Government regulations

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### 3. Property investment

#### Advantages and disadvantages of direct property investment

- Advantages
  - Another asset class
  - Rental yields giving real returns
  - Typically long-term appreciation in values
- Disadvantages
  - Illiquidity and transaction costs
  - Cyclical fluctuations in the housing market
    - Possible depreciating values
  - Quality of tenants
    - Maintenance costs
  - Void periods
    - Affects the yield
  - Stamp duty land tax (SDLT)

### Further information

#### *Ownership*

**Freehold** – the freeholder of a property has the right to use or dispose of the property as they wish, albeit subject to legislation, local planning laws and any covenants that specifically apply to the property.

**Leasehold** – the freeholder can create a lesser interest in the property known as a leasehold interest. The leaseholder, or tenant, to whom this interest is conferred, has the right to use the property for a specific period subject to the terms of the lease and the payment of rent. Unless prevented from doing so under the terms of the lease, the leaseholder can also create a sublease and act as the head lessee to a sub-tenant.



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### 3. Property investment

#### Returns from commercial property

- Returns
  - Factories and warehouses tend to have a greater return than shops
  - Void periods a major risk

Rental yield =  $\frac{\text{Gross rent} - \text{expenses}}{\text{All costs of buying property}}$

### Keeping on target

The gross rent from a property costing £280,000 is expected to be £1,000 per month. The agents fees are 5% p.a. of the rental income. Calculate the rental yield for the property.



### 3. Property Investment

#### Indirect property investments

- Unit trusts
  - Can invest 100% directly in property
- OEICs/ICVCs
  - Under UCITS regulation
- Investment trusts
  - Able to invest directly in property with restrictions
  - Income has to be derived from dwelling houses therefore usually not invested in commercial property
- Property company shares
  - Property development companies listed on the LSE – much more liquid
  - Influences on share price – Systemic factors vs. company specific factors
- Property bonds
- Property income certificates (PINC)s
- Real estate investment trusts
  - Tax transparent property vehicles – distribute 90% profits/no CGT or corporation tax
  - 10% max single shareholder, REITs can be held in ISAs/PEPs/Child TF

### Further information

Other indirect methods of property investment

**Fund of funds** – increased diversification

**Property company shares** – Typically highly liquid but suffer systematic risks of the equity market

**Life company bonds** – Investment product issued by insurance companies. Returns can be linked to property.

**Limited partnerships** – Direct investment vehicle in property for more wealthy investors



#### Answer to the question on the previous slide

Gross rent = £1,000 x 12 months = £12,000.

Gross rent less expenses = £12,000 x (1-0.05) = £11,400.

Rental yield = 11,400 / 280,000 = 4.07%

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### 3. Property Investment

#### Property derivatives

- Based on real estate indices
- Investment Property Database covers 15 European and 7 global property markets
- Cover retail, office, industrial and residential sectors
- Total Return
- Excludes the effects of debt, fund management fees, taxation and cash on property portfolios
- Major benefit is flexibility and cost



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## 4. Other Alternative Investments

### Chattels

- Traditional vs. alternative investments
  - Traditional investments – stocks, bonds and cash
  - Alternative investments – property, hedge funds, commodities, structured products, FX, private equity
  - Chattels/collectibles e.g. coins, stamps, jewellery, antiques, books, art, classic cars, autographs, posters, comics, toys, race horses, fine wine, precious metals, memorabilia
- Diversification benefits
  - Reduces risk in a portfolio – lower correlations with traditional assets
- Disadvantages of chattels
  - Illiquid, hard to value, fashions change, storage/insurance, no regulation, forgery, high dealers' charges, no income generated