Commercia Real Estate Investment

2nd Edition

Andrew Baum



Commercial Real Estate Investment

A Strategic Approach

Second edition

Andrew Baum

2009



A division of Reed Business Information

Estates Gazette 1 Procter Street, London WC1V 6EU © Andrew Baum, 2009

ISBN 978 0 7282 0567 3

Apart from any fair dealing for the purposes of research or private study, or criticism or review, as permitted under the UK Copyright Designs and Patents Act 1988, this publication may not be reproduced, stored, or transmitted, in any form or by any means, without the prior written permission of the Publishers, or in the case of reprographic reproduction, only in accordance with the terms of the licences issued by the Copyright Licensing Agency in the UK, or in accordance with the terms of licences issued by the appropriate Reproduction Rights Organisation outside the UK. Enquiries concerning reproduction outside the terms stated here should be sent to the Publishers.

The Publishers make no representation, express or implied, with regard to the accuracy of the information contained in this publication and cannot accept any legal responsibility or liability for any errors or omissions.

The material contained in this publication constitutes general guidelines only and does not represent to be advice on any particular matter. No reader or purchaser should act on the basis of material contained in this publication without first taking professional advice appropriate to their particular circumstances. The Publishers expressly disclaim any liability to any person who acts in reliance on the contents of this publication. Readers of this publication should be aware that only Acts of Parliament and Statutory Instruments have the force of law and that only courts can authoritatively interpret the law.

Copying in any form (including all hard copy and electronic formats) is strictly forbidden without written permission from the Publishers, Estates Gazette, a division of Reed Business Information.

Typeset in Palatino 10/12 by Amy Boyle, Rochester Cover design by Rebecca Caro Printed by Short Run Press, Exeter © Andrew Baum, 2009

ISBN 978 0 7282 0567 3

Apart from any fair dealing for the purposes of research or private study, or criticism or review, as permitted under the UK Copyright Designs and Patents criticism or review, as permitted under the UK Copyright Designs and Patents Act 1988, this publication may not be reproduced, stored, or transmitted, in any form or by any means, without the prior written permission of the Publishers, or in the case of reprographic reproduction, only in accordance with the terms of the licences issued by the Copyright Licensing Agency in the UK, or in accordance with the terms of licences issued by the appropriate Reproduction Rights Organisation outside the UK. Enquiries concerning reproduction outside the terms stated here should be sent to the Publishers. The Publishers make no representation, express or implied, with regard to the accuracy of the information contained in this publication and cannot accord any legal responsibility or liability for any errors or omissions

accept any legal responsibility or liability for any errors or omissions. The material contained in this publication constitutes general guidelines only and does not represent to be advice on any particular matter. No reader only and does not represent to be advice on any particular matter. No reader or purchaser should act on the basis of material contained in this publication without first taking professional advice appropriate to their particular circumstances. The Publishers expressly disclaim any liability to any person who acts in reliance on the contents of this publication. Readers of this publication should be aware that only Acts of Parliament and Statutory Instruments have the force of law and that only courts can authoritatively interpret the law.

Copying in any form (including all hard copy and electronic formats) is strictly forbidden without written permission from the Publishers, Estates Gazette, a division of Reed Business Information.

Typeset in Palatino 10/12 by Amy Boyle, Rochester Cover design by Rebecca Caro Printed by Short Run Press, Exeter

Contents

Foreword to the first edition Preface to the first edition Preface to the second edition

Part 1 Introduction to the market

1	Commercial real estate — the asset class					
	1.1	Property — a global asset class?				
	1.2	What makes property different?				
	1.3	Property depreciates				
	Box 1: Depreciation and its impact					
	1.4	Lease contracts control cash flows				
	1.5	The supply side is inelastic				
	1.6	Valuations influence performance				
		1.6.1 Valuation accuracy				
		1.6.2 Client influence				
	1.7	Property is not liquid				
	1.8	Large lot sizes produce specific risk				
	1.9	Leverage is commonly used in real				
		estate investment				
	1.10	Is property an inflation hedge?				
	1.11	Volatility and risk appear to be low				
		Real estate cycles control returns				
		1.12.1 Developments				
		1.12.2 Rents				
		1.12.3 Yields and capital values				
		1.12.4 Returns				
		1.12.5 Cycles: the result of market inefficiency?				
	1.13	Diversification — the evidence				

iii

	1.14		enges
		1.14.2	Securitisation and globalisation
2	The	marke	et — and who makes it
	2.1	The g	lobal property investment universe
	2.2	The v	alue of the UK real estate market
	Box	2: The	UK property market sectors
	2.3	Mark	et players
		2.3.1	
		2.3.2	Fund managers
		2.3.3	Advisors
		2.3.4	Funds and vehicles
	2.4	A pro	perty performance history — the UK64
		2.4.1	1950–73: from low inflation to a boom
		2.4.2	1974–81: a small cycle, high inflation
		2.4.3	1981–89: high inflation, another boom
		2.4.4	1990–99: deep recession, low inflation
			and globalisation70
		2.4.5	2000–06: boom
	Box	3: A b	ubble in UK property prices?
			2007–09: bust
	2.5	Conc	lusions

Part 2 The investment process

3	Building the portfolio		
	3.1	Introduction to portfolio management	
	3.2	Absolute and relative return objectives	
	3.3	The top-down portfolio construction process	
		3.3.1 The relative return target	
		3.3.2 The absolute return target	
	3.4	Setting investment objectives	
		3.4.1 Criteria for investment objectives	
		3.4.2 Return and risk	
		3.4.3 Benchmarks	
		3.4.4 Time horizons	
	3.5	Strengths, weaknesses, constraints: portfolio analysis 105	
		3.5.1 Recent performance	