Liquid property investments that keep on delivering

Alex Ross, Fund Manager:
Premier Pan European Property Share Fund

The Premier Pan European Property Share Fund invests in real estate securities, rather than physical real estate. Listed securities offer liquidity and flexibility, and the fund aims to use this flexibility to target those areas of the listed property market across the UK and Continental Europe where the fundamentals and/or equity pricing are most attractive.

The closed-ended structure of the underlying investments matters in real estate. It means that underlying management teams don't have to go and buy property when they have inflows, or try and sell it when they have outflows. The management teams are able to buy and sell real estate on fundamentals rather than the weight of money.

Fund manager Alex Ross principally looks for active management teams that create value by improving real estate. If property isn't actively managed, it typically depreciates and this is becoming ever more important in today's rapidly evolving tenant requirements. Alex is searching for those management teams that are actively positioning real estate for tomorrow's tenants. These assets are expected to deliver superior rental growth, which Alex believes will be the key driver of value with the tailwind of yield compression having largely run its course.

The investment team look for balance sheets with appropriate leverage. In sectors where underlying values screen as conservative, such as the German residential market, they will consider investments with higher leverage. In contrast, sectors that are more vulnerable, such as the London office market, are preferred with lower levels of gearing.

The UK is currently about a third of the portfolio. Of this, about two-thirds is in the UK regions and only about one-third is in London. The team like the UK regions, which are seeing a limited impact from Brexit. Tenant demand is rising and they are comfortable with the rental cycle, where rents have only recently started to improve after a number of years of stagnation. The team expect rental weakness in certain areas of the London office market, such as the City and very prime West End, whilst niche fringe areas are expected to prove more resilient. However, the Fund holds companies exposed to London offices, as the uncertainty to London is well known to the equity market and therefore trade at discounts to their asset values. Furthermore, these companies have very strong balance sheets and are therefore well positioned to take advantage if values were to weaken, particularly on opportunity assets which require re-development expertise.

German residential property is approximately 20% of the portfolio. The investment team continue to see good rental growth in this market. As most German residential is still valued below its replacement cost, there is limited new supply of housing, leading to higher rental tension. This is thus driving the Germans towards home ownership, with resulting house price inflation. It is pertinent to note the German population, which has traditionally rented property, are increasing their home ownership in an affordable housing market, whilst the UK is rapidly moving away from home ownership towards renting. We expect the UK private rented sector to become a significant asset class ahead.

The fund also has fairly substantial holdings in France and Spain. The Paris office market is seeing stronger growth from President Macron's reforms and there is greater confidence in the retail property market as well. The Spanish office and hotel markets are attractive and the fund holds a number of destination shopping centres across Europe, including in Stockholm, Paris, and other major cities across Europe.

The industrial sub-sector is also well-represented in the fund. Logistics and warehousing is an important growth area across the UK and Europe, benefiting from structural changes in retailing. This includes larger logistics warehouses, but also 'last mile' logistics, which are necessary to meet the consumers increasing desire for immediate delivery from online orders.

There are some market concerns about the impact of interest rate rises on the property sector. However, European REITs have been very successful at locking in today's low interest rates for the long-term, as many of the fund's core holdings in Europe have managed to fix or hedge their long-term borrowing costs. Therefore, if rates do increase, they will likely have relatively little impact on interest costs. At the same time, as the economy improves, the investment team believe there should be greater rental and revenue growth. With limited rises in interest costs, this scenario should drive earnings and dividend growth.

While sentiment towards some of these companies may be relatively volatile in the short-term, because of the prospect of rate rises, Alex Ross remains constructive on the sector principally due to the current stage of the rental cycle and the potential for earnings growth.

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