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Property Investment – A Square Peg in a Round Hole

On Wednesday, 4th December, it was announced that dealing is suspended in the M&G Property Portfolio, one of the leading names in property investing. This fund has been struggling with significant outflows, with its assets under management falling by around £1bn over the past year. In order to avoid having to sell properties at fire-sale valuations, M&G has blocked investor withdrawals, allowing the fund managers time to raise sufficient liquidity to eventually fund these client redemption requests.

This move will likely be distressing to investors of the M&G fund, but it is not without precedent. A spate of similar suspensions happened following the global financial crisis of 2008 and following the EU referendum of 2016. In these cases many funds remained closed to withdrawals for a number of months.

Open-ended, physical property, funds, such as these, in normal times offer the opportunity to buy or sell shares of the property portfolio on a daily basis, with these inflows or outflows being absorbed or raised from the fund's cash holdings, which acts as a liquidity buffer and which typically accounts for around 10% or 20% of a fund's total assets. When a fund is suffering from sustained large withdrawals, however, this buffer may be used up, forcing the fund managers to sell properties to raise the necessary cash.

While such dynamics of redemptions leading to sales are also true of open-ended funds of different asset classes, such as equities or bonds, in these, their underlying assets are typically much more liquid. While one equity share or bond typically costs a few pence or pounds, the smallest unit a property fund trades in is typically a commercial building, likely worth at least a few million pounds. As such, finding a buyer and completing a transaction for a property often takes many months and incurs high transactions costs. This inevitably leads to a mismatch in liquidity between the daily dealing demands of investors and the protracted trading process of physical property.

This dichotomy in the open-ended property sector is an issue that industry participants are increasingly concerned about and so too are the regulators. The Financial Conduct Authority is attempting to bridge the liquidity gap with new rules to be implemented in September 2020 that will force property funds to suspend trading if they are uncertain about achievable valuations in 20% of their assets. While increasing the frequency of property suspensions may seem counterintuitive at first, this is an effective way of ensuring client's valuations are not supressed by forced selling.

Physical property investment has historically been seen as an attractive way of building diversification into an investment portfolio. Part of this comes from the seemingly robust valuations of property at times of difficulty for equity markets. However, a major factor in these 'robust' valuations is that given the lack of liquidity in the market, published valuations do not reflect the true nature of the achievable sale prices on any given day. Without these true valuations being known, published prices of property funds can look artificially high at times of market stress. This can lead to 'smoother' portfolio performance and can therefore give property the appearance of being relatively low risk. Yet, when digging a little deeper, the true risk of property investment can be found in two forms: either, heavily discounted prices must be used to allow client redemptions at times of market stress; or, property funds must be suspended to stop client redemptions.

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At Future Money, we manage a range of multi-asset investment portfolios that each has the ability to invest in property funds. However, a core tenet of our investment philosophy is to provide investment solutions that are highly liquid in nature, seeking to minimise the risk of clients being unable to access their money at a time of their choosing. An assessment of a potential investment's liquidity profile is therefore an important part of our research process. Consequently, we have chosen not to invest in property at the current time given our long standing concern that events, such as we are seeing with the M&G Property Portfolio, could occur.

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Important Information

Please note that the contents are based on the author's opinion and are not intended as investment advice. This information is aimed at professional advisers and should not be relied upon by any other persons.

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It remains the responsibility of the financial adviser to verify the accuracy of the information and assess whether the fund is suitable and appropriate for their customer.

Past performance is not a reliable indicator of future performance. The value of investments and the income derived from them can fall as well as rise and investors may get back less than they invested.

Important information about the funds can be found in the Supplementary Information Document and NURS-KII Document which are available on our website or on request.

For any information about the Future Money funds please contact the authorised corporate director, Margetts Fund Management Ltd, on 0121 236 2380, admin@margetts.com or at 1 Sovereign Court, Graham Street, Birmingham B1 3JR. A copy of their Terms of Business which relates to investments into the funds can also be obtained using these contact details.

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Future Money Ltd

Henry Wood House · 2 Riding House Street · London · W1W 7FA

0203 4570 387

www.futuremoney.co.uk