

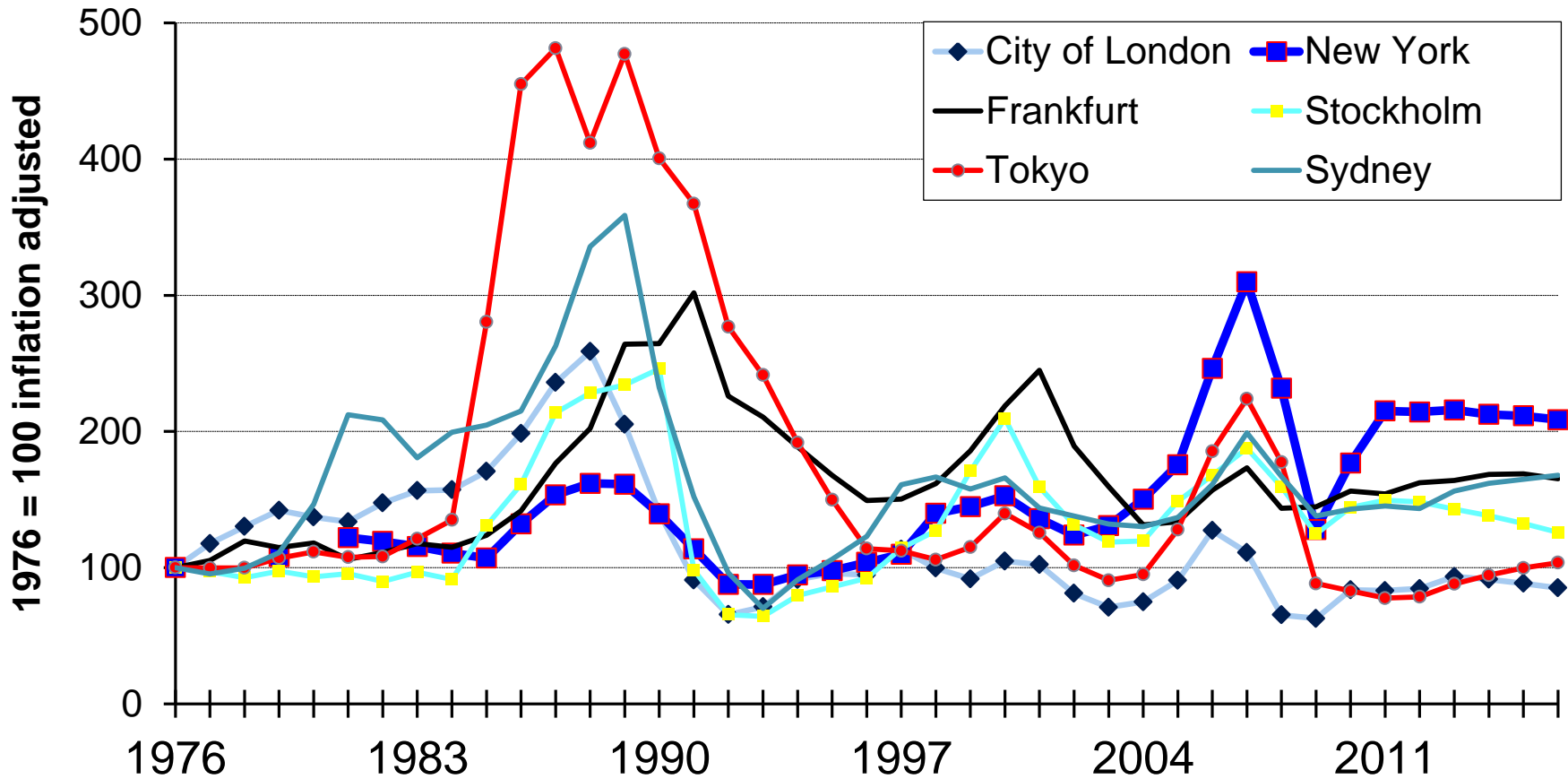
27th June 2014

How property markets work: some lessons learned over three cycles

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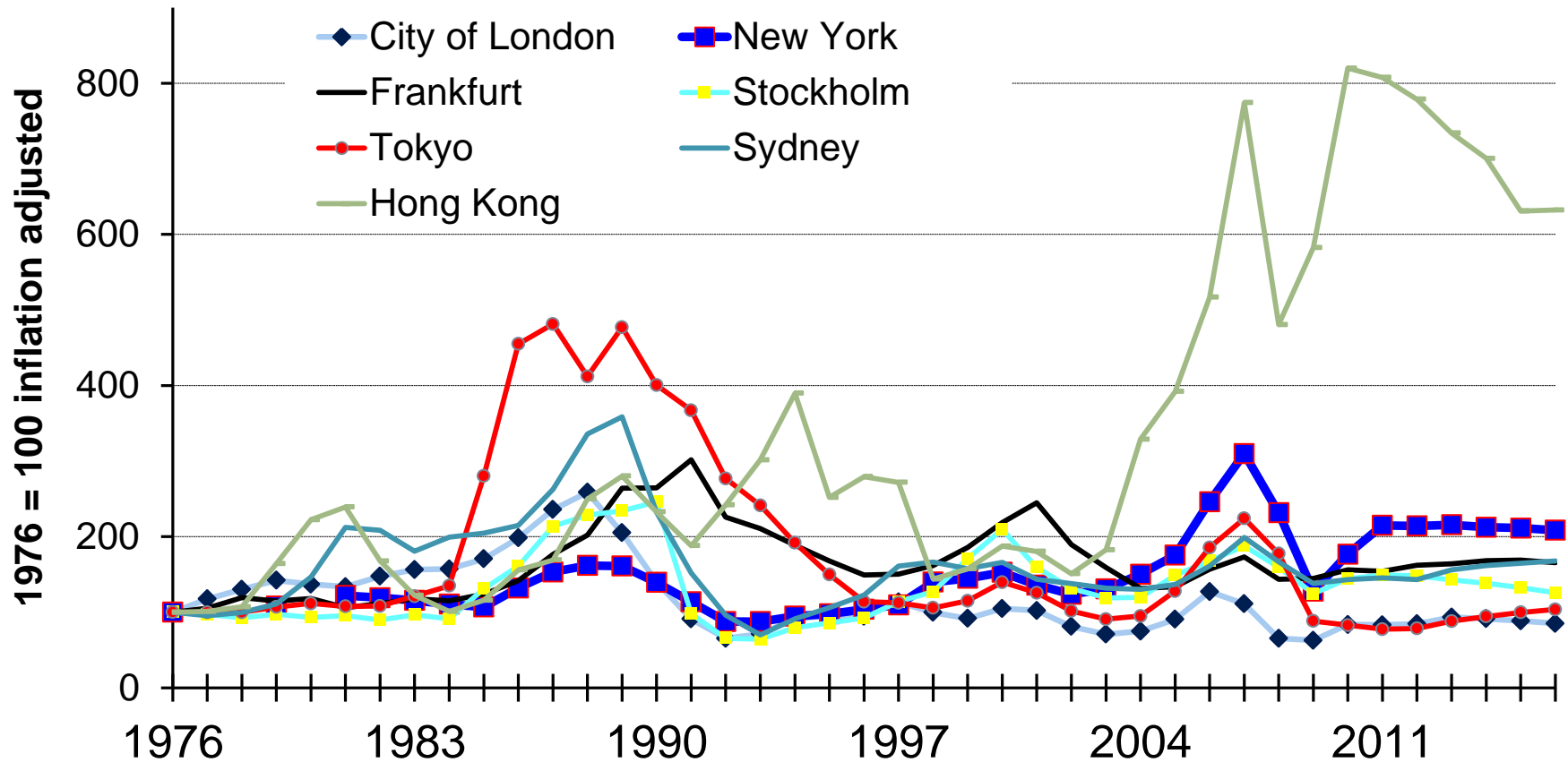
Office values in major global markets: a volatile story



Source: PMA, Wheaton & Barranski, Vallis, Devaney, Turvey, RICS
Bjorklund & Soderberg

Property Market Analysis

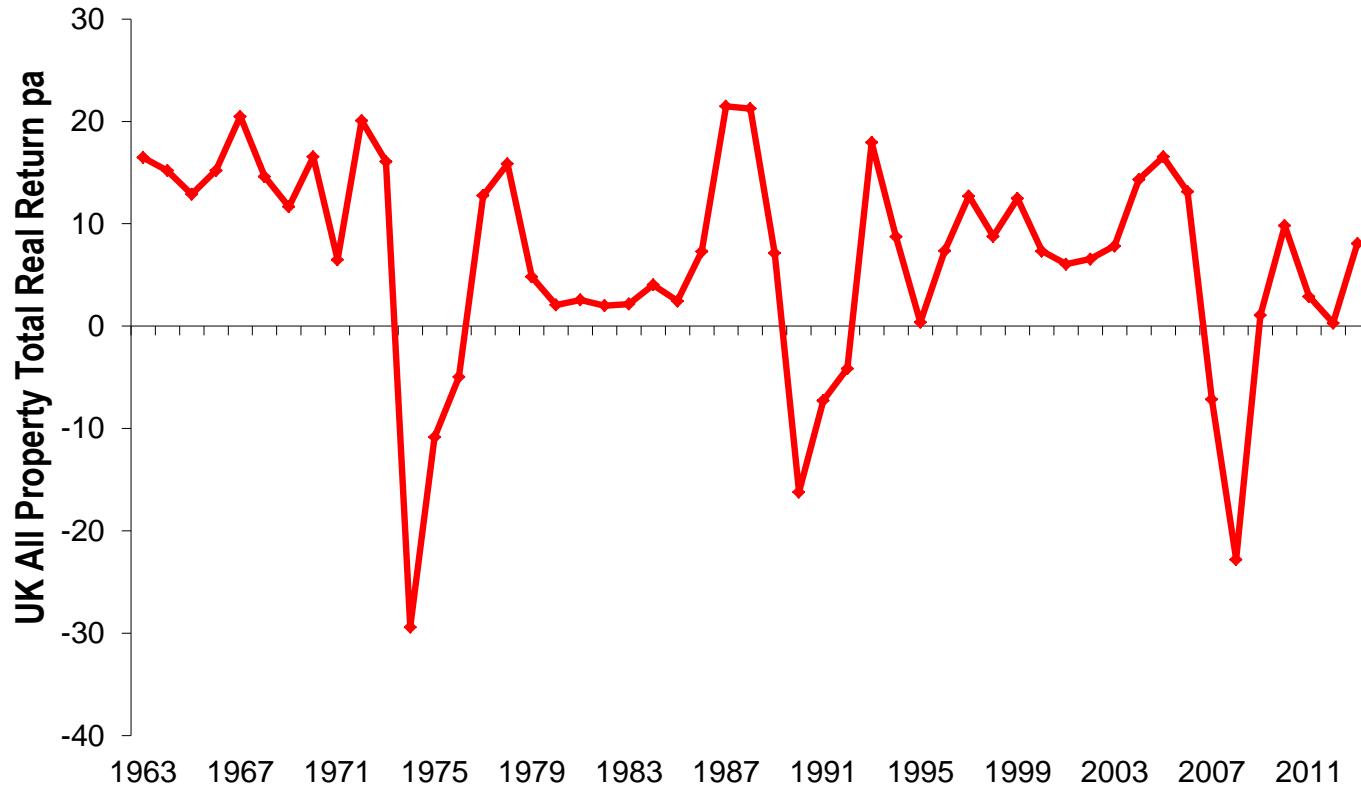
Office values in major global markets: a volatile story Especially with Hong Kong



Source: PMA, Wheaton & Barranski, Vallis, Devaney, Turvey, RICS
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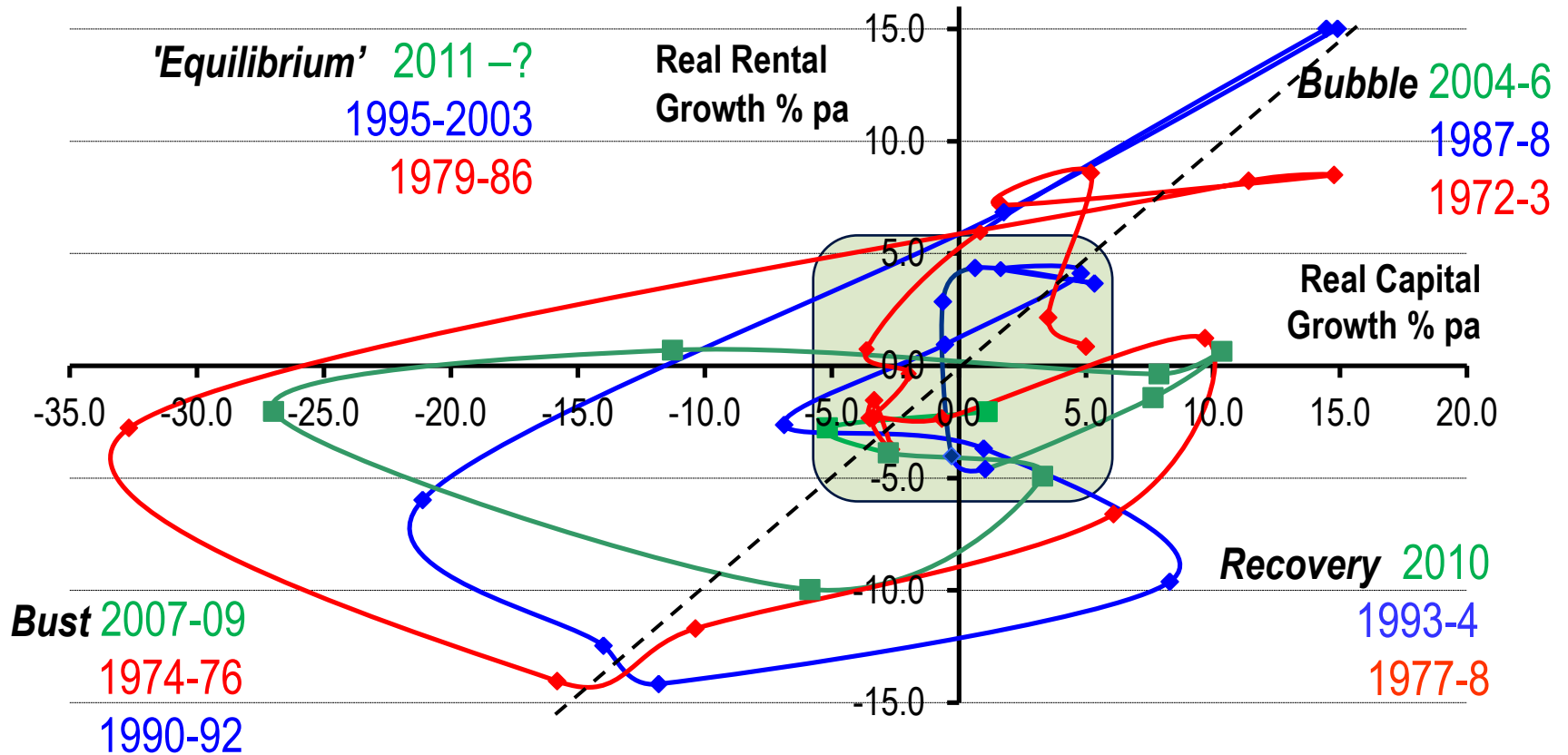
Property Market Analysis

UK Property Cycles 1963-2013: Three Big Ones



Sources: LaSalle, IPD, ONS

Example from UK: Property Cycles 1968-2013



Sources: IPD, LaSalle Investment Management

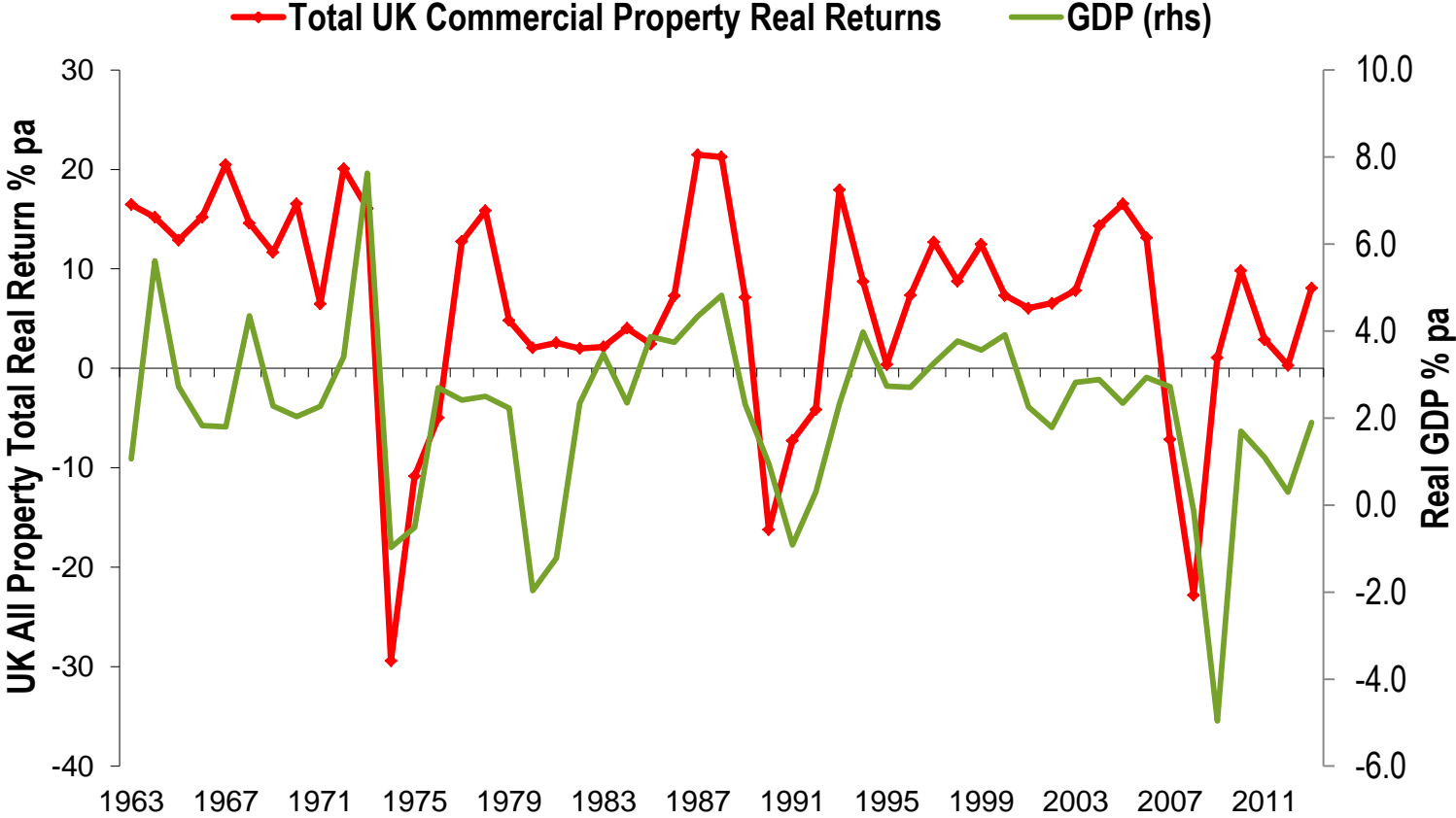
What does this tell us?

- 2008/09 was not exceptional in real estate terms (at least in the UK)
- 16-18 years between cycles – is that just a coincidence?
- Types of economic cycles:
 - Kitchin: 3-5 years – inventories
 - Juglar: 7-11 years – fixed investment (business cycle)
 - Kuznets: 15-25 years – infrastructure investment
(18 year US property cycle - Hanke 2010)
 - Kondratiev Waves: 45-60 years – technological changes / financial manias?

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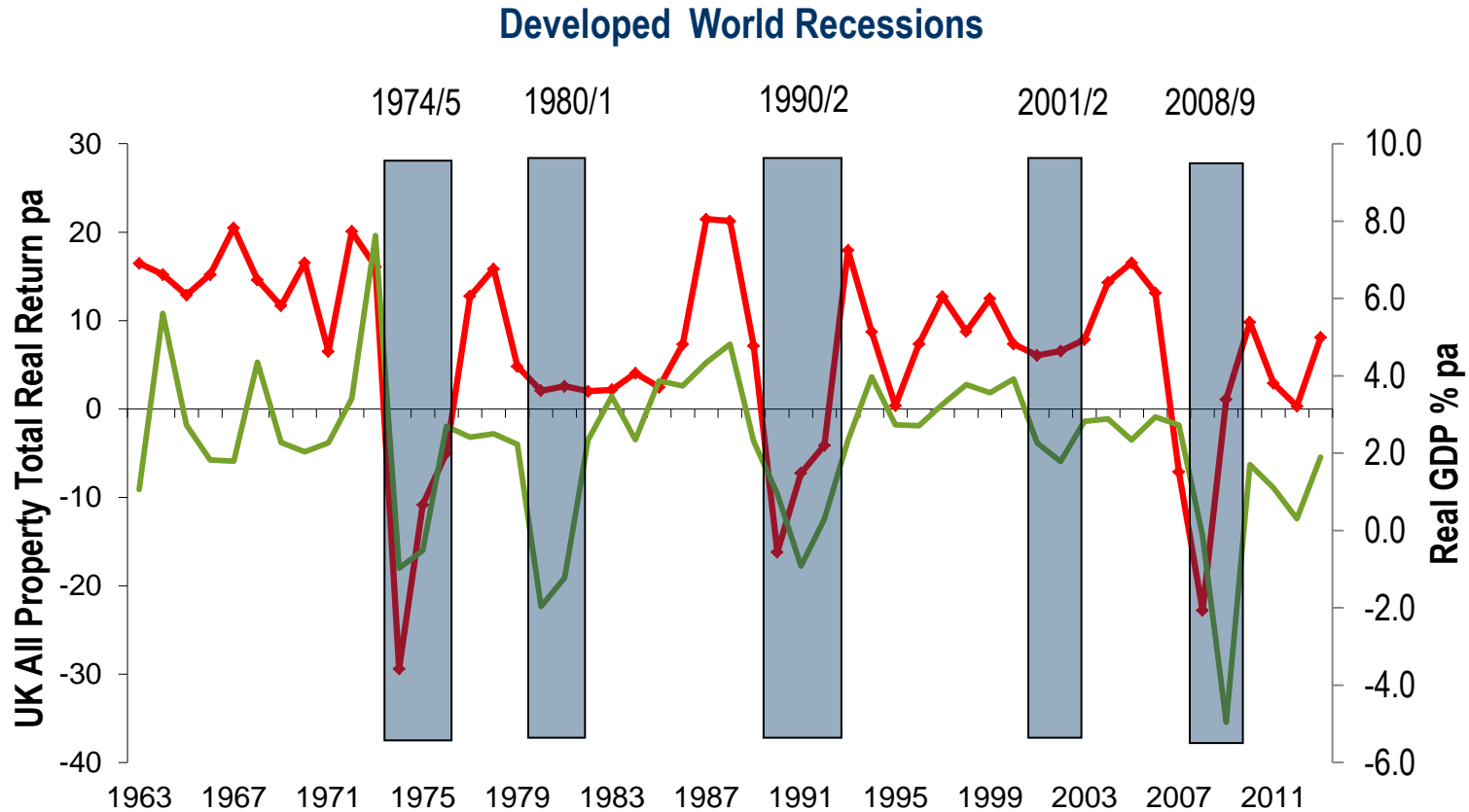
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- Explanations:
 - GDP growth
 - Behavioural economics – balance of *Greed & Fear*
 - The role of memory

UK Property Cycles 1963-2013: Three Big Ones



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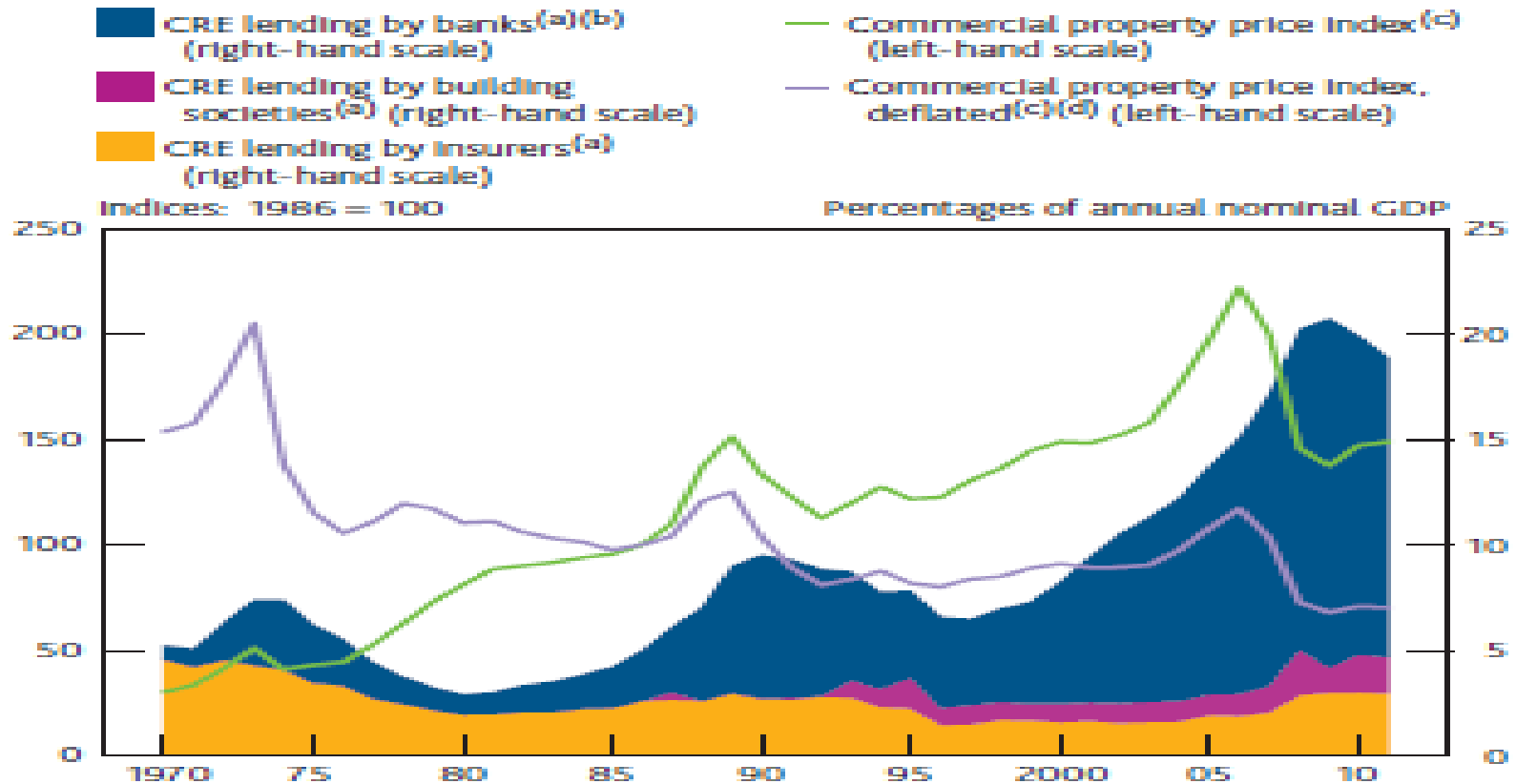
Economic Downturn doesn't have to cause a Property Crash



Sources: LaSalle, IPD, ONS

UK Lending to Corporate Real Estate

Highly correlated with the 3 Cyclical Peaks

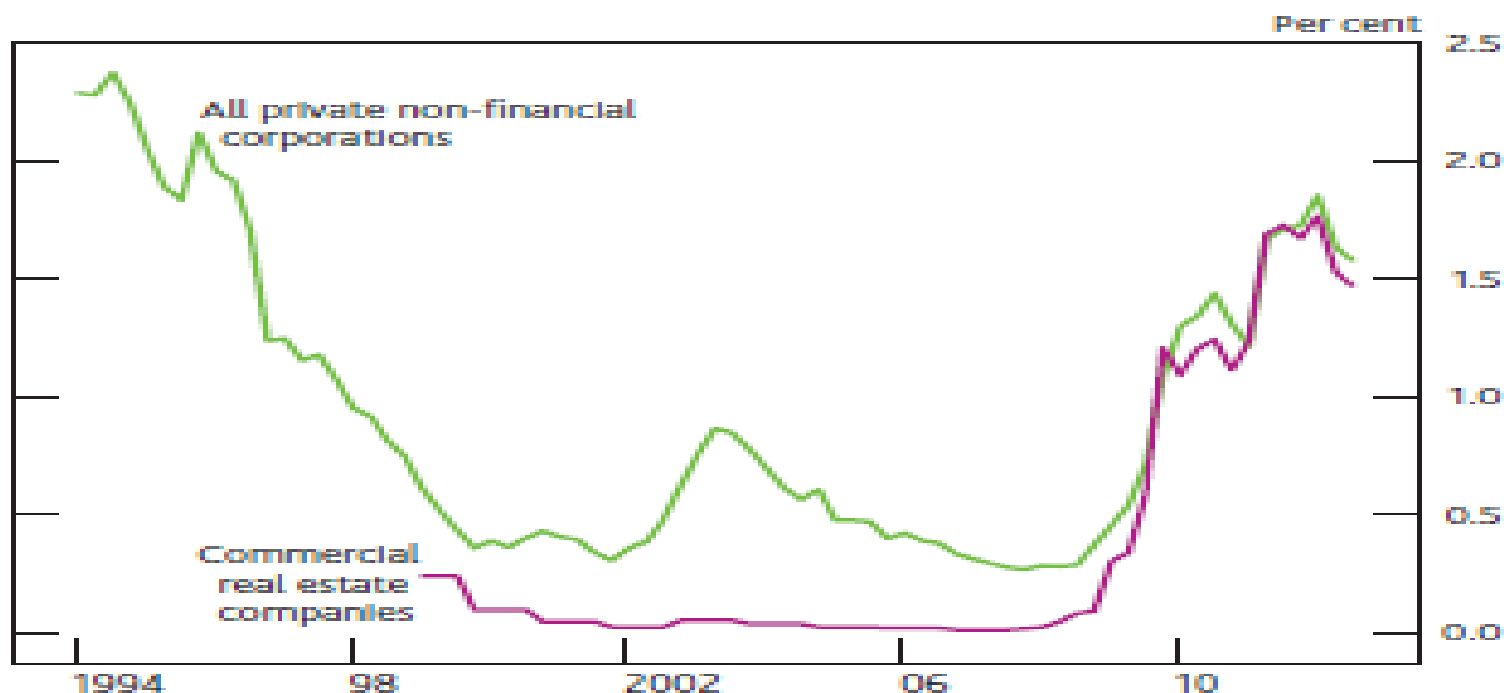


Sources: Association of British Insurers, Bank of England, Building Societies Association, Investment Property Databank, ONS and Bank calculations.

- (a) End-year stock of outstanding lending.
- (b) In 2010 and 2011 this includes an adjustment to include CRE loans transferred to the Irish National Asset Management Agency.
- (c) Based on end-year data.
- (d) Deflated using GDP deflator.

Why is CRE lending so cyclical?

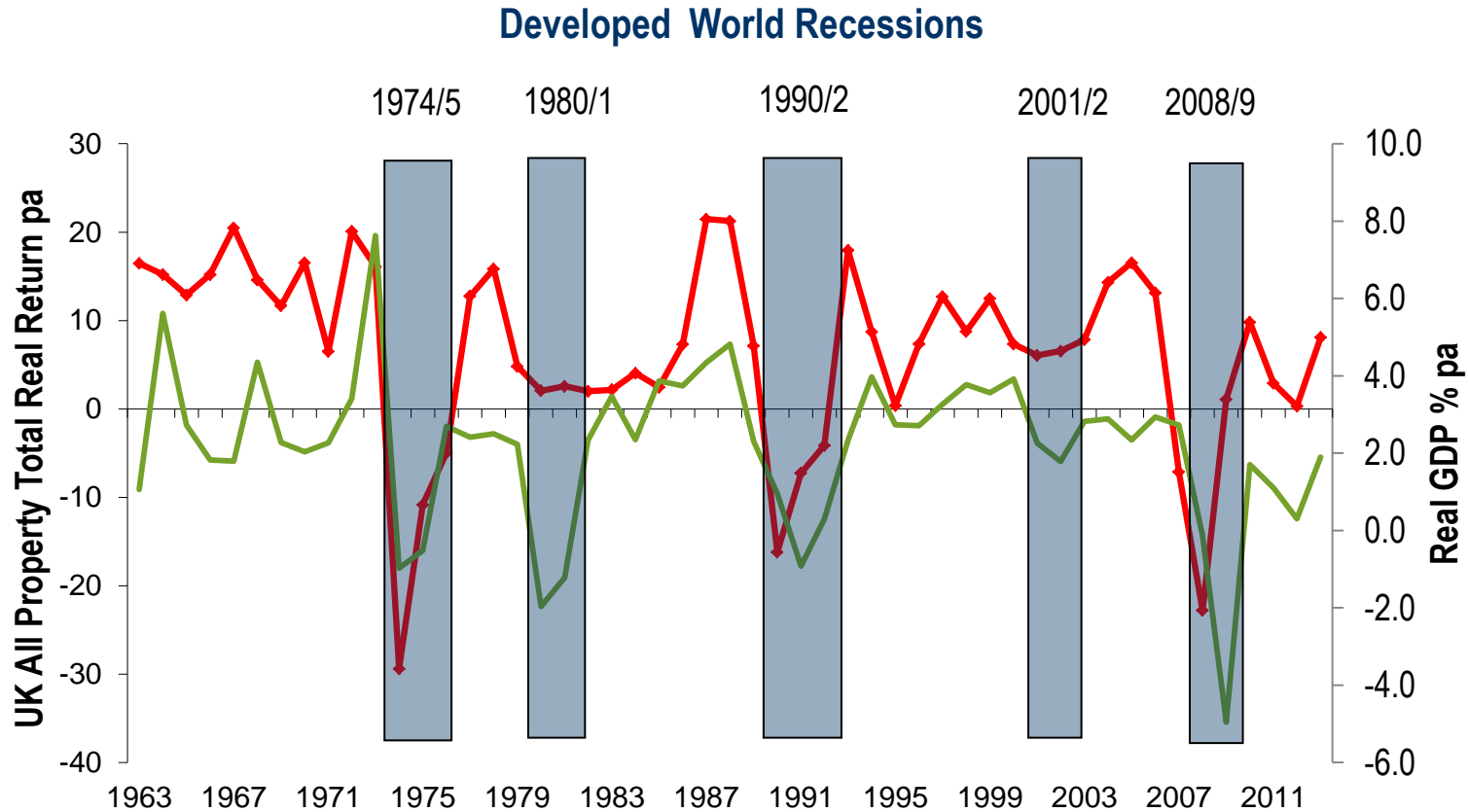
Write-off rates on lending to UK businesses



Sources: Bank of England and Bank calculations.

(a) Lending by UK monetary financial institutions. The series are calculated as annualised quarterly write-offs divided by the corresponding loans outstanding at the end of the previous quarter. The data are presented as four-quarter moving averages and are non seasonally adjusted. Lending in both sterling and foreign currency, expressed in sterling terms.

Economic Downturn doesn't have to cause a Property Crash

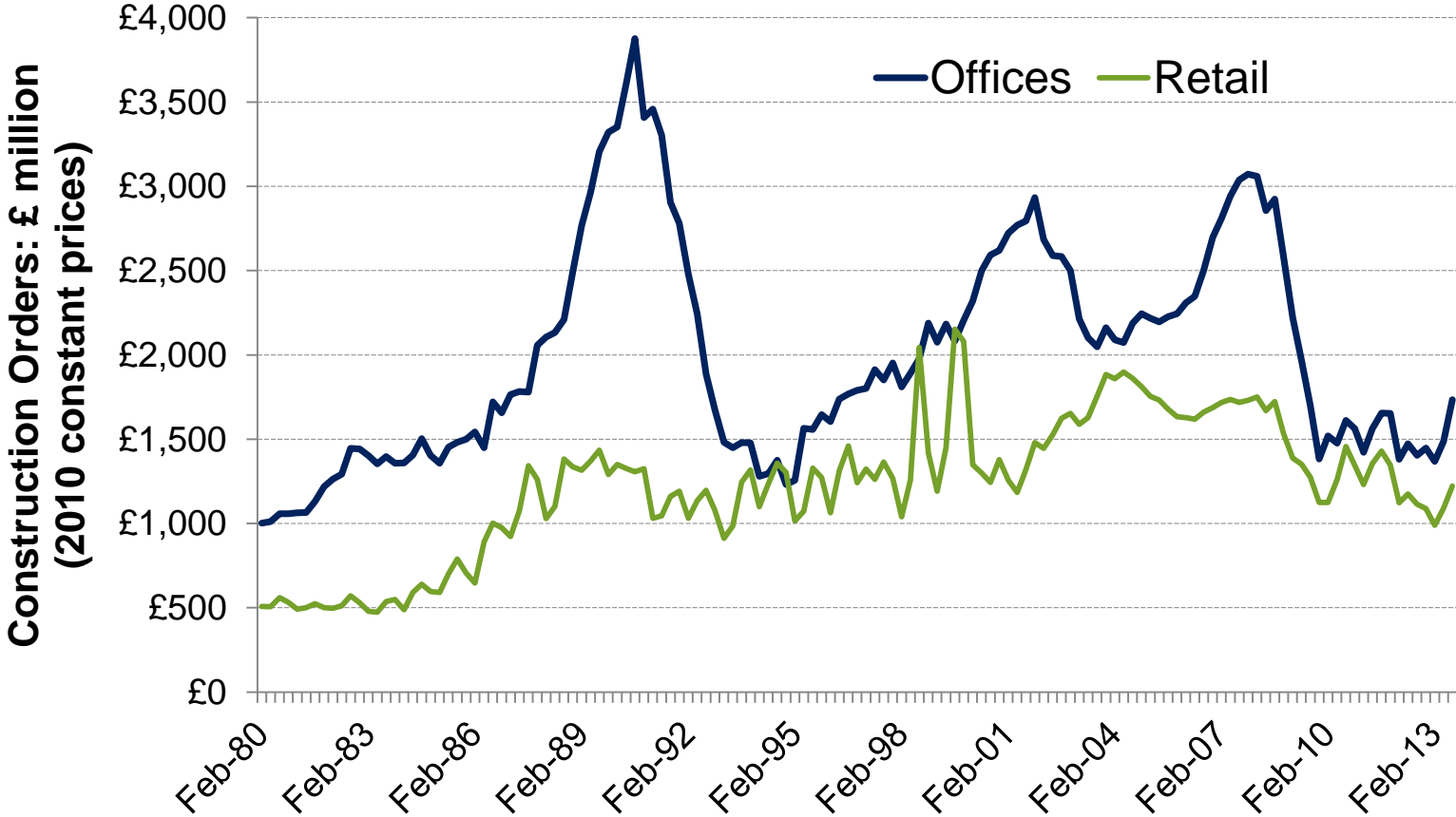


Bankers learn a new way to lose money every other recession

Sources: LaSalle, IPD, ONS

Too much office development can also be problematic

Much more so in 1989/90 than in 2007

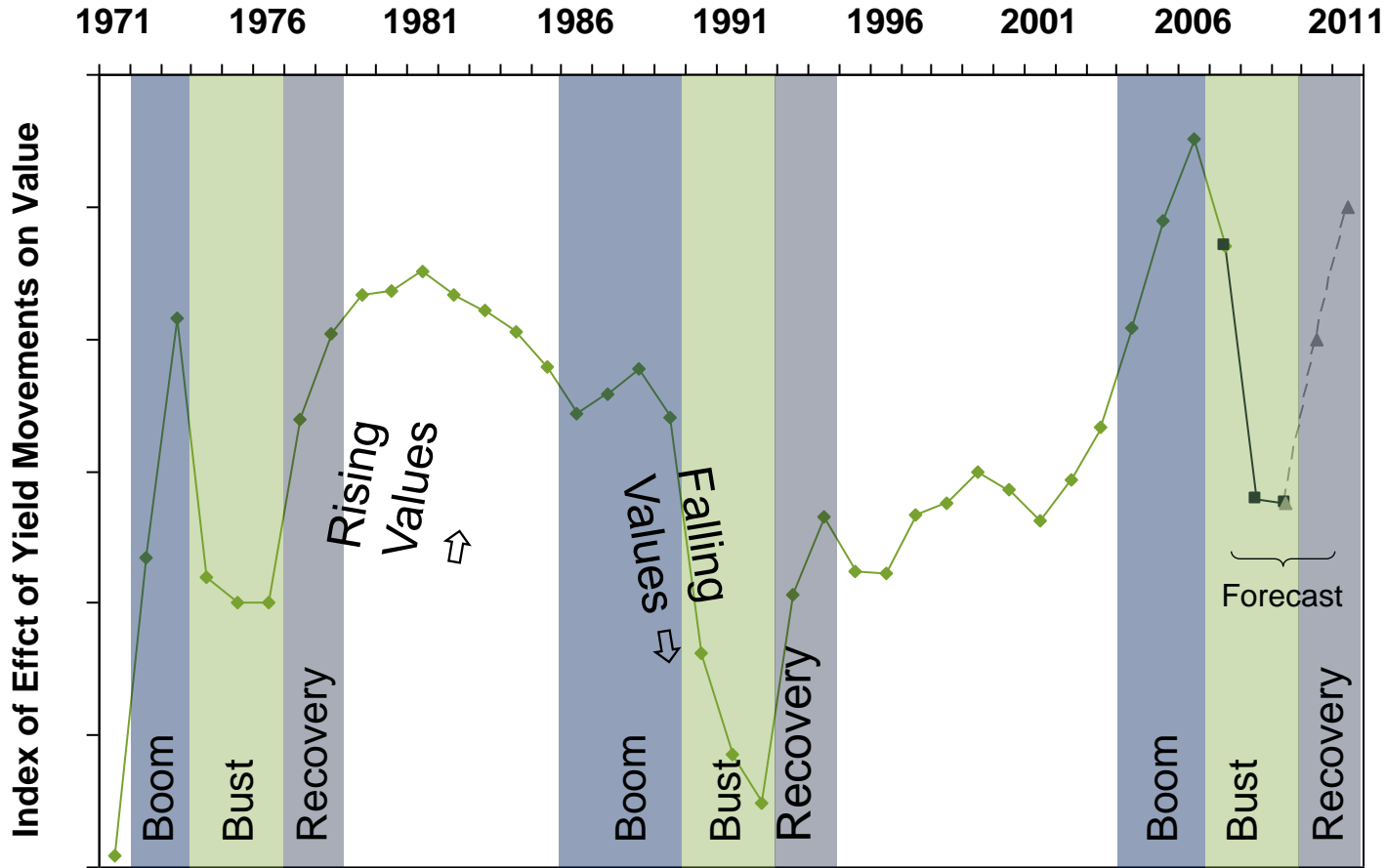


Sources: LaSalle, BCIS, ONS

Some lessons from three big Property Cycles

- Debt is the principal fuel that drives real estate markets
- Contradiction between prudent lending and building a market leading banking business in commercial real estate
- Too much development is also dangerous
- ‘Greed and Fear’ rule - pay attention to Behavioural Economics
- Property looks a very easy business in a Boom
- Beware managers in senior positions who have not experienced a big cycle
- Commercial property values should not increase by over 5-6% real pa (This may vary by market. Numbers quoted are for the UK)
- Ways to exploit property cycles
 - ‘Catching the falling knife’ - buy in the Bust to exploit the Recovery bounce

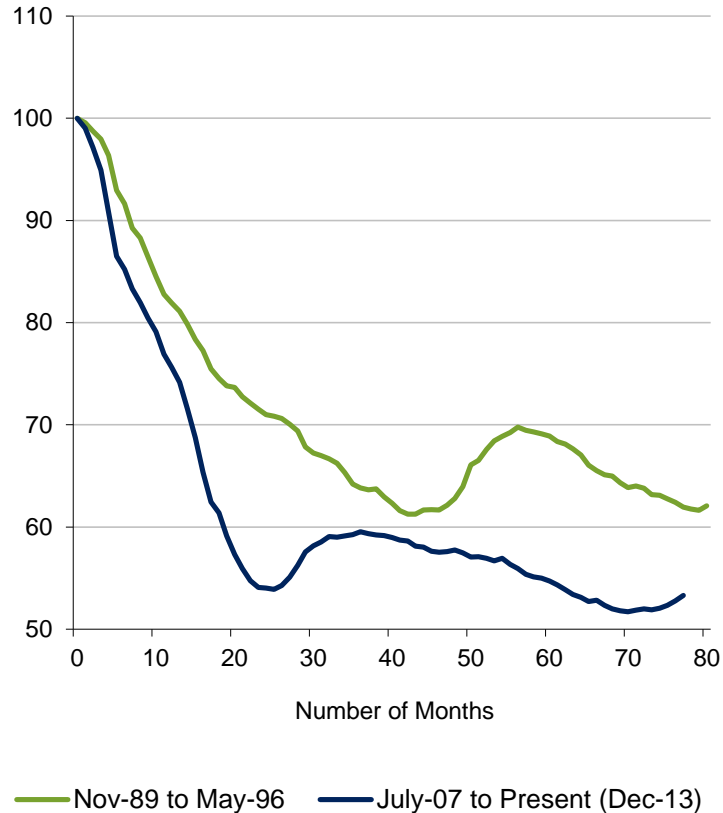
Yield Levels – Anatomy of Boom, Bust & Recovery



History shows that pricing recovery has been rapid: buy in 2009 for 2010/11 recovery as equity in the wings re-enters market *(written in October 2008)*

UK property market: boom, bust & recovery

Real estate downturns compared (inflation adjusted)



Source: IPD Monthly Index



Example:

Retail warehouse purchased in March 2009

Distressed seller (property unit trust)

Yield at purchase 10%+

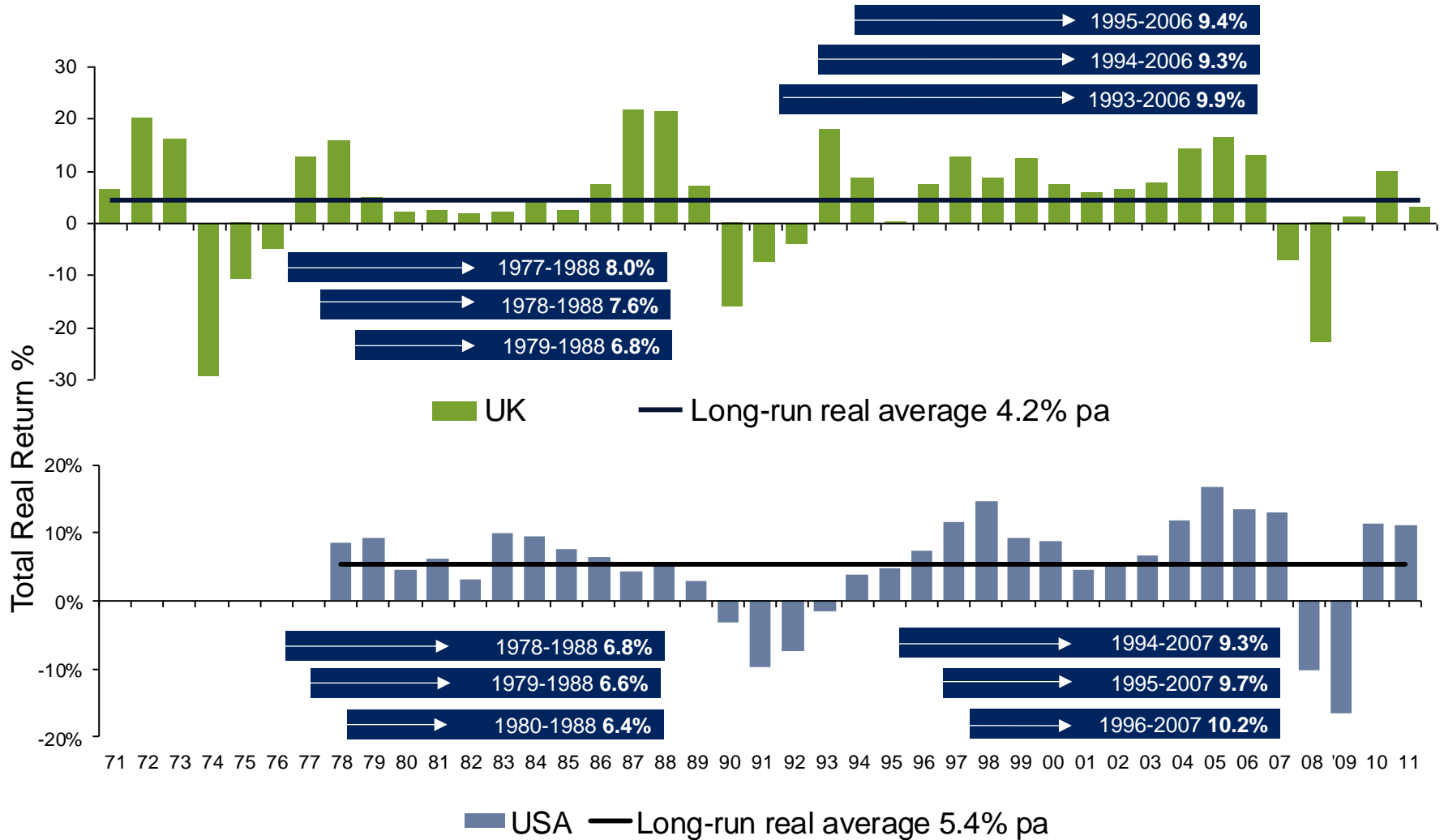
Income increased during ownership

Sold December 2009 at yield <7%:
70% capital gain in 9 months

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- Property looks a very easy business in a Boom
- Beware managers in senior positions who have not experienced a big cycle
- Commercial property values should not increase by over 5% real pa (This may vary by market. Numbers quoted are for the UK)
- Ways to exploit property cycles
 - ‘Catching the falling knife’ - buy in the Bust to exploit the Recovery bounce
 - Long term investing between big cycles selling into the next Boom

Benefit of investing between big cycles in US & UK



Source: IPD, NCREIF, LaSalle Investment Management

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References:

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