Syndicates inch back to life

As commercial property prices bottom, interest rates rise and vacancy levels stabilise, the sector is slowly finding favour

JACQUIE HAYES

INVESTORS are being lured back into the unlisted property syndicate market as it prepares for a recovery after being smashed during the financial crisis.

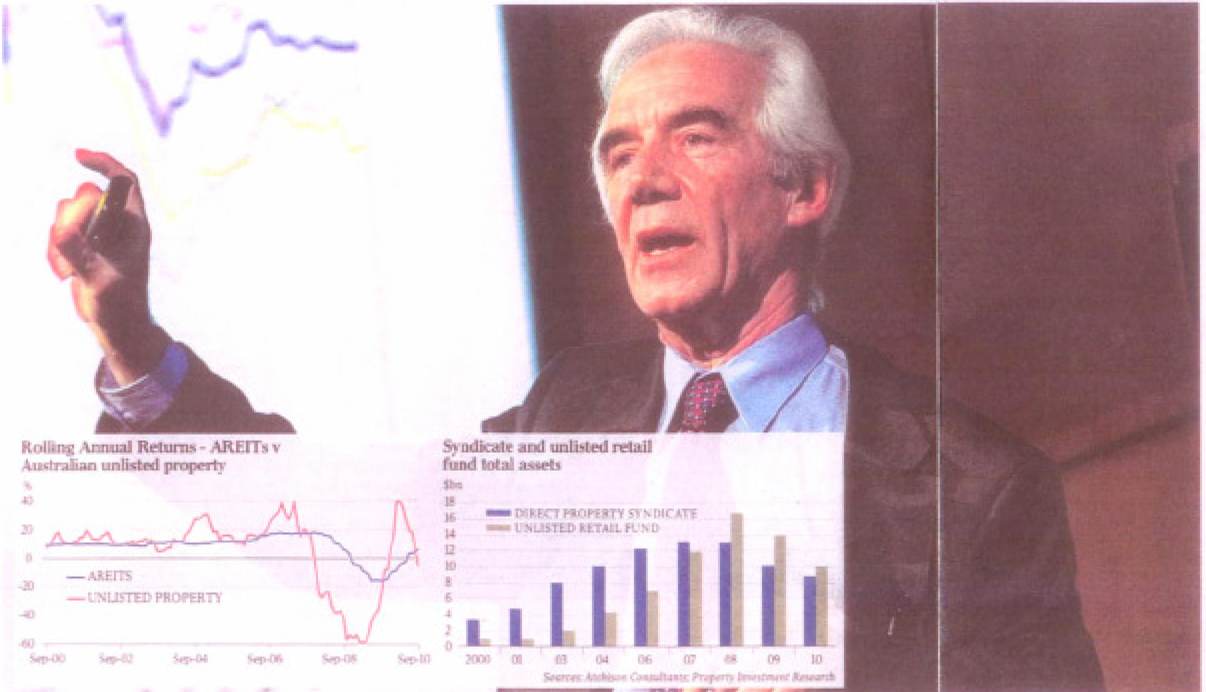
High yields, low property prices and the return of solid income streams are being promised as property-focused investors consider whether these vehicles might be more cost-effective and less high-maintenance than buying bricks and mortar in a rising interest rate environment.

Syndicate providers are set to offer low barriers to entry, simpler and more transparent investment vehicles and lower, less-convoluted fee structures as proof that the sector has learnt from the excesses of the past.

The unlisted property sector, which ranges from single-asset syndicates with fixed terms to open-ended funds, attracted solid and steadily increasing investment in the years leading up to the GFC, peaking at about $30 billion under management, according to Property Investment Research.

When the financial crisis hit full force and underlying property valuations plummeted, high gearing levels blew out, putting them in breach of banking covenants. Investors tried to flee, forcing managers to suspend redemptions. Retail investors have been left with their funds locked up for uncertain timeframes.

Today the sector still has billions of investors' funds on ice, with hopes of attracting a necessary equity injection remaining more wishful thinking than a real prospect.



Ken Atchison of Atchison Consultancy says funds will have to be very different to survive
BOB FINLAYSON

It's an uncomfortable place for investors to be while indebted banks circle for the money they're owed.

With this background, new investors are unlikely to rush back in to unlisted funds or illiquid syndicate options, Winston Sammut, managing director of Maxim Asset Management, says.

He cites 17 funds or syndicates that have tried to raise $1bn in additional capital in the past 18 months to bring them back within their loan-to-value-ratio agreements, so they can recommence business.

"If investors were queuing up, they'd be able to raise (that money), but that's not happening," Sammut says. "That situation's unlikely to change unless the sector experiences a period where values will stabilise and people get back to getting a regular income stream."

Many industry players and analysts, however, believe the market has reached the bottom and that a recovery, albeit slow, has begun.

This may be good news for investors who like property syndicates because of the much higher income returns they have traditionally offered — about 8 per cent compared with residential property's offering of about 3 per cent.

Syndicates may also contain tax-deferred components, which allow investors to delay paying tax on a portion of their income until the asset is sold.

This could mean, for example, that if an investor bought the asset in a superannuation fund and delayed selling it until retirement within an allocated pension, they might effectively pay no tax.

What's more, syndicates are cheaper to buy into — requiring an investment in the thousands of dollars compared with hundreds of thousands of dollars for, say, an apartment — and they offer greater diversification.

Another particularly valuable benefit, according to AXA Financial Planning Advice Network's head of research, Robert Thomas, is the access point they provide to types of property that investors cannot normally get into.

"Apartments can be built anywhere, so there's not a lot of uniqueness about them," Thomas says.

"There's also the risk of overpaying for them and going into too much debt to do so."

Syndicates and funds can provide access to more reliable tenants without the management hassle.

"You could buy a great apartment in a great location, but you've still got issues of property management, strata fees and vacancies," Thomas says.

"Those risks are removed in these types of things."

But if investors wanted to avoid repeating the mistakes of the past, they will need to watch for some telltale signs, says Assyat David, director of financial planning advisory group Strategy Steps.

These include factors that contributed to syndicate closures during the global financial crisis, such as the level and structure of gearing that could make returns more volatile.

"Property syndicate investors need to be aware that even though they've got the perceived security of the underlying asset they also need to recognise the financial risk that they're taking on with gearing," David says.

"Gearing really does change the risk-return dynamics of property investments."

The quality and diversification of the underlying property and tenants were critical, too, AXA's Thomas says.

"Fees also need to be reasonable, as do the payback periods," he added, citing poor examples, pre-GFC, where payback periods of four to five years were not uncommon after underlying asset sales commenced.

It is clear that new unlisted property syndicates and funds will have to be very different from those of the past if they were to survive, Ken Atchison, managing director of property and business consultancy firm Atchison Consultancy, says.

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> ATCHISON CONSULTANCY MD

"The vehicles to look for in the immediate future will reflect the failures of the last five years," Atchison says.

"So fees — acquisition fees, disposal fees, financing fees, continuing management fees, performance fees, the list goes on, sometimes amounting to 10-20 per cent of an investor's contribution — they have to be materially reduced."

Gearing levels should remain at about 40 per cent, he said.

If these can be achieved, Atchison says, he is positive about the unlisted property sector.

"Cap rates, or yields, are at a high point, commercial property prices have reached their lows and vacancy rates in properties have largely stabilised, (which means) you're looking also at prospective rent growth coming through," he says.