Research overview
Unique analysis of the individual holding periods and investment performance of offices throughout the UK

Holding periods

Office investments are now sold, on average, after being held for about five years

Investment risk
Trading within five years carries a high level of specifc risk

Investor performance
Property companies profit when selling City offices. Life funds appear to under-perform over both the short and longer-term

Analysis for UK office investors

February 2005

holding**periods**

Holding periods

"The length of time investors hold an asset should always be considered at both a strategic and tactical level"

Do holding periods matter?

Property is enjoying renewed interest from multi-asset investors. This means that demand is rising for accurate, comparable data to analyse the performance of each asset class.

Until now, investors have relied on the assumption that property has a much longer holding period than other asset classes, reflecting its lack of liquidity, transaction and management costs, and opportunities for active management.

In reality, the length of time investors have held or intend to hold an asset is a key issue which should be considered at both a strategic and tactical level. For example, holding periods can help investors make decisions such as:

- can we time the market and beat our competitors?
- should we adjust sector weightings?
- is now the time to buy or sell?
- what is the risk in trading now?
- can we identify assets available to buy or ready for sale?
- is there a type of property which would improve or damage performance?
- has this property delivered all the performance it can?
- how long does it take to recover transaction costs? (property vesting period)
- what holding period should we assume in purchase appraisals?

Unique research

The key to understanding holding periods is to analyse the characteristics and performance of individual properties. On our behalf, IPD created a database which does just this. We asked them, in accordance with a detailed specification, to analyse over 5000 offices purchased between 1983 and 2003, drawn from both the December and March valued databanks.

We will update our analysis regularly (the next update will be in May) to include the most recent performance statistics, and will extend our coverage to the retail and industrial sectors, enabling us to analyse the relationship between holding periods and property types which dominate the UK investment market.

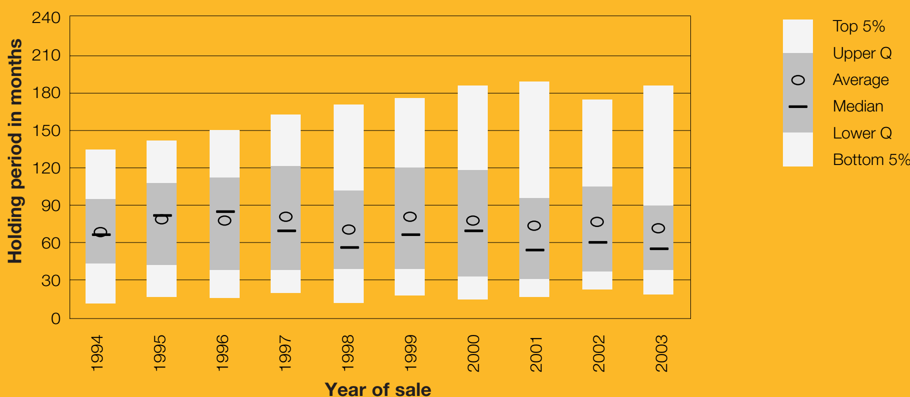
Research-led decisions

Our research enables investors to answer fundamental questions with a much greater level of confidence:

- what is the average holding period?
- has the length of holding periods changed over time?
- do holding periods vary with property types and regions?
- does the performance of individual properties have any relationship with the holding period?
- is there an optimal holding period, or a portfolio of optimal holding periods?
- how important are transaction costs and do they affect the holding period?

Fig.1 Distribution of office holding periods

Source: Gerald Eve research



Shorter holding periods

Since 1993, the median holding period of sold office properties has fallen and settled in a range between 55 and 65 months, (4.6 years to 5.4 years) suggesting turnover has been higher and properties are held for shorter periods than has been assumed previously.

A significant proportion of properties — usually 25% of disposals in any one year — are sold after being held for less than three years, demonstrating a substantial degree of active management.

279 offices were sold in 2003, 75% of which were held for 90 months or less, the lowest figure recorded over the last ten years.

Evidence suggests that median holding periods for sales fall when the market dips after a year or so of strong performance. This research study, over time, will show if successful investors are able to take profits in a falling market, or whether the number of panic sales cuts the holding period short.

If investors wait for properties to deliver in a healthy market, holding periods would lengthen. Investors in today's market face this issue as the office sector strengthens in absolute and relative terms.

Time will tell whether recent investors — particularly those new to the market — intend to generate performance over the typical 55-65 month holding period. If, instead, they opt to sell at the first sign of a falling market, they are taking on the risk of making substantial losses.

Liquid city investments

Our analysis of holding periods extends to all UK regions. The graph below illustrates the length of time properties retained at December 2003 had been held in investor portfolios. This allows us to compare the liquidity of various markets and identify those where concentrations of properties are sold quickly, are not for sale, or which nobody will buy.

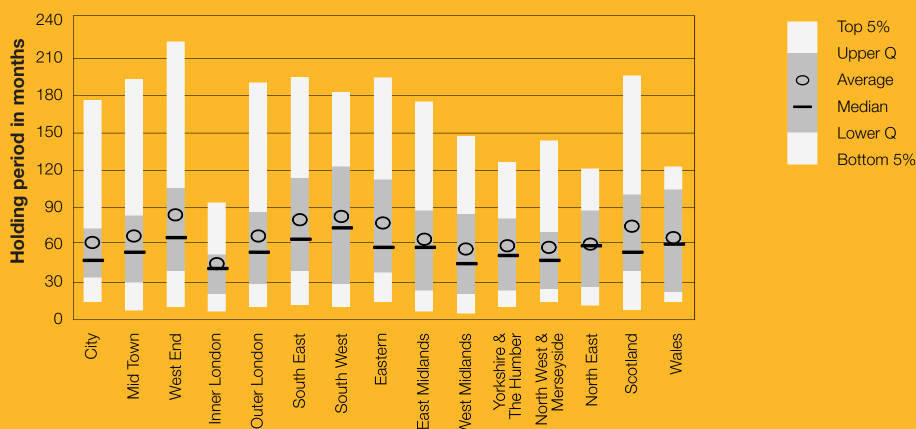
One example is the relatively short holding period in the City of London compared with the longer holding periods recorded in the West End and South East office markets. City properties had a median holding period of 46 months, the second lowest recorded (West Midlands recorded 43), contrasting with the West End (64) and the South East (62.5).

In all markets however, a significant proportion of properties had been purchased in the last three years. For example, around 25% of properties within northern England markets were purchased within the last two years.

"If new investors opt to sell at the first sign of a falling market, they are taking on the risk of making substantial losses"

Fig.2 Range of investment holding periods: properties held at December 2003

Source: Gerald Eve research



Implications for performance

Calculating returns

To understand the direct relationship between holding performance and investment performance, we sought to strip out the effects of the market cycle.

We calculated the performance from acquisition to sale (or December 2003 for retained properties) and derived an annualised holding period total return for each property. This enabled us to generate performance figures comparable over any holding period.

The performance of the office sector in the IPD December 2003 databank was calculated over each relevant holding period, and we subtracted this benchmark return to give us an excess holding period total return figure for every property.

Short hold equals high risk

Our results were quite striking. They show, for example:

- investors holding properties over a shorter period of less than five years are exposed to a much greater degree of risk, where the chance of making a profit is balanced by the possibility of incurring a substantial loss
- over a longer time horizon, say for ten years or above, volatility falls and individual property performance is more closely aligned to the market as strong and weak markets tend to smooth overall performance
- there is a massive range in the performance of individual properties and stock selection is crucial

Timing matters

Our analysis has two major implications for different types of investors.

First, the tracking qualities of properties held over the longer term may help managers establish a core portfolio which performs in line with both rising and falling markets.

Second, investors who hold an asset which has recorded strong performance over the first five years should possibly elect to take profits, as they are unlikely to sustain out-performance over the longer term.

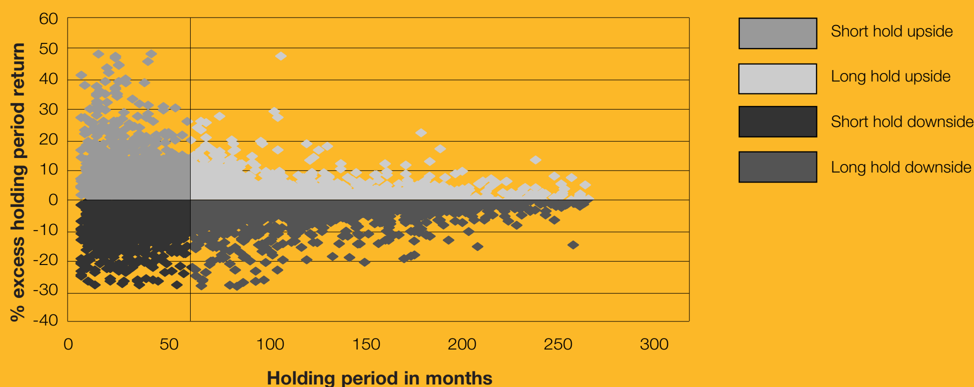
These two implications have led us to conclude that holding periods should be considered when measuring performance against the market or relevant peer groups.

In the coming months, we will be modelling the three main property types with holding periods to simulate 'efficient' portfolio pay-offs.

> "Investors are exposed to a high level of specific risk when holding property for five years or less"

Fig.3 UK office market: excess returns of individual properties

Source: Gerald Eve research



Case study

Applied research: City office market

We applied our methodology to the City of London, a major office market. The City has proved to be the UK's most volatile market over the past 20 years after two major booms and serious downturns.

We analysed the City by investor type, to see if any patterns had emerged in the 20 years to December 2003.

Ready to sell?

As expected, pension funds have a longer median holding period for sold properties than short term, unit linked funds, Unregulated Property Unit Trusts (PUTs) or property companies.

The picture is slightly different when looking at properties retained in December 2003. Property companies had a higher median holding period than pension funds.

We would therefore expect property companies to sell in the short term and initial evidence suggests that this was indeed the case over 2004. We will be able to illustrate later in the year whether they managed to continue to out-perform the market.

After calculating the holding period returns for individual properties, we derived the equivalent returns for all City offices to generate excess holding period returns. The range of individual excess holding period returns for all City offices by fund type is displayed in Fig.4 below.

Winners and losers

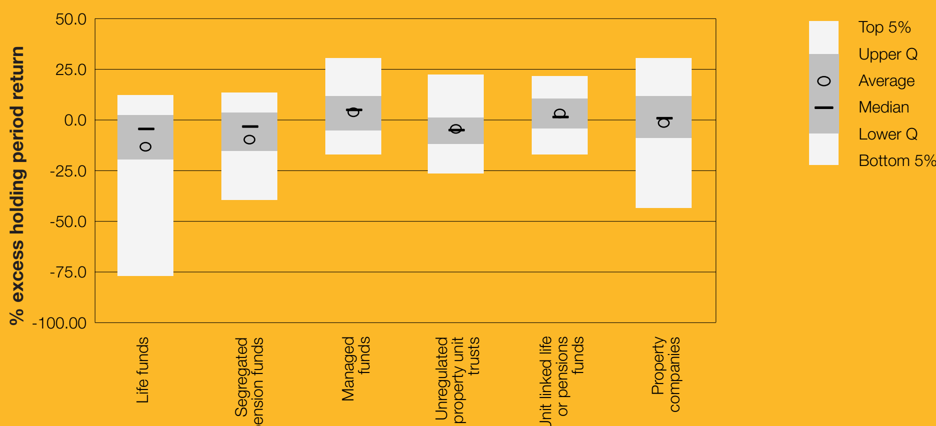
The results show:

- life funds have under-performed by a large margin in the 20 years to December 2003; the median excess return recorded was -4.6%
- segregated pension funds also under-performed and recorded a median excess return of -3.8%
- unregulated PUTs, unlikely to have exposure to the largest City lot sizes, under-performed and recorded a median excess return of -5.3%
- unit-linked funds (1.1%) and property companies (0.6%) have out-performed the market
- property companies have proved particularly good sellers, recording a median excess return of 6.9% on those sales
- properties purchased since 1983 have under-performed the City market as a whole; suggesting that the 'Crown Jewels' held within portfolios prior to 1983 never make it to market

Given the distribution of individual property returns, knowledge of the inherent risk of individual properties and market prospects is crucial. Investors should, therefore, seek specialist advice.

"Life and pension funds have consistently under-performed the market across the full range of holding periods"

Fig.4 City office market: excess returns by investor type
Source: Gerald Eve research



Gerald Eve's UK office network

Gerald Eve is an independent firm of chartered surveyors and property consultants, employing more than 310 staff across the UK.

We provide a comprehensive range of services to our private and public sector clients covering consultancy, asset management and transaction advice.

Our philosophy is to serve clients by identifying opportunities and solving problems relating to property through the provision of high quality, thoroughly researched, cost effective advice.

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