

Currency play draws in overseas investors, but fluctuations remain a risk

# Turnaround built on foreign wealth



The pound's decline, plus a near 45% drop in property values, means that overseas investors can buy UK real estate at prices 60% lower than in 2007

## Mike Phillips

The IPD all property index ticked up last month – a modest 0.2% – for the first time in 26 months. In general, anecdotal evidence suggests that, for the primest of prime UK property, values have risen considerably in the past three months.

One factor has been vital in this stabilisation of values – the return of foreign money to the UK. Whether it is Middle Eastern sovereign wealth buying into Canary Wharf, German open-ended funds investing in the City, or European opportunity funds buying logistics, cross-border capital is heading back to the UK.

This is partly due to the effects of volatile currency movements over the past six months. Although the pound has recovered from earlier lows – for instance, against the US dollar it hit a nadir of \$1.50 to £1 – it still stands at around \$1.65 compared with \$2 last summer.

For dollar and euro investors, this means that the general market decline has been exacerbated by currency movements. Property that is 40% cheaper now than two years ago for a UK investor is as much as 60% cheaper for overseas buyers.

As Ezra Nahome, head of investment at Lambert Smith

## Dollars to the pound

The fluctuating exchange rate



Source: Thomson Reuters

Hampton, which tracks investment into UK property, says: “The 20% decline in sterling’s value since the start of the credit crunch, coupled with an almost 45% decline in property values, means that overseas investors are effectively buying UK property for one-third of its mid-2007 value.”

The influx of foreign money is set to continue in the form of investment by institutions into funds. According to one corporate finance director at a top UK agency, at the moment, 21 opportunity funds are raising equity to buy in the UK, and more are launching every week.

But for these investors, currency factors can present a

risk as well as an opportunity.

James Stretton, director at financial risk consultant JC Rathbone, says that adverse currency movements, such as a sudden weakening of the pound against the dollar or euro, could wipe out a lot of the gains foreign investors stand to make in the UK.

“Most funds don’t offer hedging for investors at the fund level, which means investors run the risk of their investment depreciating as currencies fluctuate.

“Also, some investors might not have put hedging in place at the start of deals, anticipating that they could use some of their credit facilities to put forward hedging at a later date. But the increased cost of credit, or the fact that loan-to-value covenants might now be stretched, means that this is, in many cases, no longer possible.”

Stretton says that investors are increasingly looking to put in place foreign exchange options, which allow them to hedge currency risk for an upfront premium.

Investors have the right to sell a certain amount of sterling at a prearranged price, say \$1.60 to £1. If the value of sterling falls, they can then exercise the option, selling the pound at the strike rate of the option, and

mitigating the fact that the fall in sterling has reduced the value of their property investment in dollar terms.

Stretton adds: “Previously, investors might have shied away from options because of the price of the premium, but now, with the cost of credit increasing, they are looking at this option more and more.”

However, some feel that the moment might have passed for the great influx of foreign investment in the UK.

One reason for the sharp rise in prices is a lack of prime stock with long-dated income to satisfy investor demand. (See News, p44). Investors cannot buy property one step down the ladder, because banks are not yet willing to finance anything but the least risky property.

“We speak to investors – from Europe and the Far East – who have never bought in the UK, and they would love to buy now,” says Mark Titcomb, head of the London office of Deka Bank. “But the stock just isn’t there, and with the value of sterling not as low as it was and yields hardening, some may feel they have missed the bottom and choose to look elsewhere.”

You certainly get more bang for your buck in UK property at the moment, but probably not for much longer.