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Malaysian funds seek yields in London real estate

BY **MAX KOH**

From mere bit players on the global property scene, Malaysian state-linked funds have emerged as some of the most high-profile investors in London real estate, and experts say they are making very sound bets.

Although late to the party, Malaysian pension and pilgrim funds have snapped up over £2 billion (RM9.8 billion) worth of London properties in the past few years.

"The London property market is seen as a safe haven for investments due to its high concentration of global headquarters, long leases and attractive rents. For Malaysian funds looking to diversify their portfolio, London property is seen as very safe investment," UK-based Gatehouse Bank CEO Richard Thomas tells *The Edge* in an exclusive interview.

Gatehouse Bank is a leading syariah-compliant investment banks in the UK, specialising in real estate. Since its inception in 2008, the group has secured 16 acquisitions in the UK worth over £640 million and six in the US worth US$636 million for clients, mainly Gulf investors.

In October, the bank clinched its first deal for a Malaysian party — Lembaga Tabung Haji (LTH) — when the latter acquired SJ Berwin's offices in London for £165 million, with a net initial yield of 5%. The deal marked the pilgrim fund's debut investment in the UK.

"Malaysian funds, such as LTH, have been looking to diversify into new asset classes beyond sukuk. While there are more exciting property markets elsewhere, such as in Asia, these are more speculative-driven assets. The London market fits the bill as it is predictable and offers stability in terms of yield, tenancy and liquidity. There is also stability in the economic, law and political climate," says Thomas.

He adds that Malaysian pension funds focus on rental income rather than capital gains when investing.

"Other funds tend to look for total returns [combination of rent and asset appreciation] but Malaysian pension funds focus solely on rental income. They want buildings with reliable tenants and long leases. Essentially, they view a building like how they view a bond — long-term investment to be held until maturity," says Thomas.

Leases for London properties usually last for at least 10 years, he adds. "Rents in London also tend to be stable as the rent is reviewed on an upward only basis for the duration of the lease. Rent for commercial properties never fall. Every major global firm is sure to have an office in London. As such, you can be assured that tenancy and liquidity is not a problem as there will always be buyers."

Given the concentration of international firms in London, Thomas says London properties are considered more of an international market than a domestic one.

Despite these attractive qualities, he says LTH was still prudent and did its due diligence. "It took LTH three years of research before it bought the property. This was very assuring for us as LTH made the decision based on knowledge and not speculation."

Another factor that helped increase London's allure is the government's new commitment to improve infrastructure. For example, the Battersea area is becoming more attractive because of initiatives to improve transport links and the building of a new bridge to connect Battersea to the north bank of River Thames, says Thomas.

"Once these infrastructures are up, the borough will be considered an extension of Chelsea and Knightsbridge."

He notes this is why S P Setia Bhd, the Employees Provident Fund (EPF) and Sime Darby Bhd were successful in clinching the £400 million Battersea Power Station project.

"The previous investors failed to see past the icon [which is Battersea Power Station] but the Malaysians saw fundamental real estate opportunities that will change the image of the whole borough. There will be more opportunities such as these across London," he adds.

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Gatehouse to tap into Asia through KL

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Since 2010, Malaysian funds have invested at least £2 billion in the UK property market. The EPF and Kumpulan Wang Persaraan (Diperbadankan) (KWAP) started the ball rolling in 2010 when they bought an office building for £156.7 million, with an initial yield of 5.75%. The EPF has since snagged another four offices and a distribution centre in Kent. Permodalan Nasional Bhd poured around £900 million into properties with initial yields of between 5% and 5.5%, while KWAP spent £200 million for an office building with a 5.2% initial yield.

"Their first preference is grade A office buildings occupied by international clients with a lease of at least 10 years. Without a doubt, central London and London sub-regions are at the top of their list," says Thomas.

They also favour properties with net initial yields of between 5% and 5.5% in central London. "These are lower than more speculative assets that are multi-tenanted as investors look for opportunities to re-lease them at higher rates," he says. In the other regions of London, properties with net initial yields of between 6.5% and 7% may also be considered.

To attract more interest from Malaysian institution funds, Gatehouse Bank has received Bank Negara Malaysia's approval to open a representative office in Kuala Lumpur.

"Malaysia is a well-regulated financial market and we are looking forward to providing the same customer service here. Just like London is the gateway to the whole of Europe, we believe we can tap into Asia through Kuala Lumpur," says Thomas.

Gatehouse is majority owned by Kuwaiti shareholders, including the Kuwait sovereign wealth fund. Its customers include Gulf sovereign funds, high net worth individuals and institutional funds.

Unlike other dealers and banks, Gatehouse Bank offers a total solution package that includes asset management services. "We also help to plan and facilitate the exit strategy of our clients," says Thomas.

To this end, the bank recently completed the sale of its first acquisition — the Procter & Gamble UK headquarter building for £33.68 million, representing a net initial yield of 7.5%.

Gatehouse Bank facilitated the purchase of the building in Dec 2009 for £31.5 million, representing a net initial yield of 8%. The client saw annual returns of 10% during the three-year holding period, and an overall 26% return on investment.

With money in the pocket to invest, Malaysian funds are also looking for similar returns. But based on the funds' mandate, it may take some time before we see an exit strategy. ■

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