



Middle Eastern Appetite Shifts from Residential to Commercial

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A slowdown in the UK residential market has led to a shift in demand from private Middle Eastern investors, says John Collier-Wright, founder and chief executive of JR Capital.

“We have been active in both the residential and commercial markets for the past 12 years or so, co-investing alongside our predominately Middle East-based private and institutional clients, in deals ranging in size from £1m to £100m and more.

“Since the slowdown in the residential market, we have seen a huge shift in focus from Middle East investors to the commercial sector.

Private Middle Eastern investors that would have previously bought a handful of flats priced around the £1m to £2m mark to rent out and hold for investment purposes or put equity into development deals are now buying income-producing commercial properties instead.

“Although we could clearly see two to three years ago that the central London residential market was looking very frothy, the last straw was the high SDLT charges and the complex tax changes that were introduced by the UK government. The main beneficiary of these changes have been the lawyers and tax advisers who are reaping the rewards from hundreds of overseas clients that now need advice on restructuring their existing holdings.

“Despite the downturn in the residential market, the appetite to invest in the UK has remained stronger than ever and that momentum has moved on to the commercial sector.

“Since the financial downturn in 2008, Middle East private investors continue to move away from financial investments in favour of tangible assets and direct investments. All our clients have substantial land and real estate holdings in their local markets, so it is only natural when investing overseas that they will choose to look at asset classes that they know and understand.



“Traditionally, it’s been the larger merchant families that invest here. Recently we have started to see an increasing number of investment firms based in the Middle East that are attracted to UK commercial property as a way of generating income products for funds managed on behalf of their local retail and mid-market private clients. There is a growing middle class in the Middle East and investors with \$1m to \$2m to invest are looking for a home for it outside of the region.

“Income is still very much flavour of the month as Middle East investors look for yield in the current record low interest rate environment, coupled with the cheap sterling and increasing need to diversify away from local markets owing to the political and economic uncertainties at home.

“What attracts our clients to the UK commercial property sector is the quality of income on offer. Back home they don’t have FRI leases, as do most markets in Europe and around the world, where a tenant is responsible for the upkeep of a building. The idea of buying a building let to a blue-chip company for 20 years and not having any responsibility as a landlord other than collecting four cheques a year is attractive.

“RPI reviews are another big selling point that our clients like. They see it as an inflation hedge and a natural way to increase the value of an asset.

“We started investing in the regional commercial markets shortly after the last downturn, when yields drifted out by 100 to 200 basis points and we were able to buy high-quality commercial assets off net initial yields around the 7% mark. At the same time interest rates dropped, with long-term debt available at less than 3% all in. This provided an attractive positive carry with cash-on-cash returns of circa 10% and more. Coupled with the increase in capital values, our all-in returns over the past five years or so have been in the mid 20’s IRR.

“Many of our clients like to keep it simple and are attracted to single-tenanted freehold assets, secured on long 10 year-plus FRI leases, preferably with the benefit of RPI reviews. They are attracted to covenants that they know and understand; blue-chip names in our current portfolio include the UK government, British Telecom, HSBC, Virgin, Tesco, and others.

“We have just recently exchanged contracts on a 22-year Travelodge investment on Guildford Street in Chertsey Surrey, which benefits from open RPI reviews, for £7.5m. The asset was



acquired from a pension fund managed by Colliers. This is typical of the sort of long-income deals we are doing.

“Despite the fact that much of the yield compression has already taken place and rental growth will slow, we think it is still a good time for our clients to invest.

“There are a number of key factors why UK commercial property will remain attractive to Middle East and other overseas investors:

- long-term low borrowing costs;
- weak sterling;
- high-yielding assets, relative to bonds/gilts and some other global real estate markets;
- institutional-quality leases;
- no capital gain tax; and
- UK’s status as a preferred safe haven for overseas capital.

“We had some concerns about how our clients would perceive Brexit; however, if anything, it has increased demand. The softening of the market leading up to and immediately post Brexit coupled with the fall in sterling created some very attractive buying opportunities. This was triggered by the UK and European institutions putting the brakes on investing and liquidating assets.

“We were able to capitalise on this by investing in Thavies Inn House, EC1, a 50,000 sq ft, a multi-let office building in Midtown at a price of £33m, down from the circa £40m the vendor was originally asking. An almost island site, next to Goldman Sachs new circa 1m sq ft European HQ, it has fantastic potential to be repositioned to a Grade A office of more than 80,000 sq ft with a GDV in excess of £100m.

“The reality is that Brexit is a fairly minor matter compared to the instability in the Middle East and some other parts of the world. Most of our clients support the view that London will remain the top financial centre. As they often say, ‘London is London and it’s not going anywhere’. They’ve all done extremely well investing here over the past 20 years and they take



comfort in the quality of our legal and professional systems, transparency and the diversity and openness of our economy.

“Historically, our main partners in the Gulf have been heads of merchant families who are now in their 70s and 80s and they have started to pass the baton down to the next generation. They are even more bullish on the UK and are open to investing into more alternative asset classes around the UK.

“They share a common view with their fathers that ‘UK real estate sometimes gets ill but it never dies’!

“We think the stars are still aligned and capital from the Middle East will continue to flow into the UK, with much of it finding a home in commercial property. We expect to remain active and deploy a further £100m-plus of equity in the next six to 12 months.”