



Credit crunch reduces gearing by syndicates

Global credit problems could impact on investors in commercial property syndicates

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As lenders around the globe tighten their purse strings, obtaining funding for debt-based investment could begin to get a little more difficult. Commercial property syndicates are one type of investment vehicle that are already beginning to feel the pinch due to the constriction in international financial markets.

Commercial property, which was once seen as the preserve of those with brimming wallets, has become more accessible in recent years

thanks to the advent of syndication. Property syndication means that each investor contributes a share of the total funding and supplementary funds are borrowed against this equity.

Using this mix of debt and equity, the syndicate then purchases investment properties. Taking the syndication route gives investors the chance to own a share of a high value property without having to fork out a massive sum of cash. As a result, many mid-range Irish investors can now afford a stake in a London office block or a German shopping centre.

However, with many banks taking a close look at their loan books, some property syndicates are now finding that they can not raise as much supplementary funding as they could a few months ago.

Due to the structure of commercial property syndicates, traditionally investors were able to avail of considerable gearing, which would widen the net of affordable investment properties. The level of gearing depends on the investment opportunity being considered and the level of risk involved.

Harry Cassidy, chief executive of Custom House Capital, said the level of gearing for Custom House Capital's funds had been about 80 to 85 per cent up to about four weeks ago. However, he said the level of gearing had since fallen to about 70 to 75 per cent.

"If it falls below 70 per cent, it could call into question the viability of this type of structure," Cassidy said.

At lower levels of gearing, he said the internal rate of return (IRR) would be reduced. He predicted that the level of gearing would remain somewhere "between 70 and 75 per cent for the foreseeable future".

Some syndicates concentrate on more traditional markets, while others focus on emerging markets. Most of the companies contacted by *The Sunday Business Post* listed similar criteria as key factors when choosing an investment property including location, the quality of the building, the leasing and rental situation and the region's growth potential.

The credit crunch has impacted on the type of properties that syndicates are looking at, according to Cassidy. He said that speculative projects would be "taking a back seat for a few months". However, he said there was little impact on "dry property" – in other words, properties that are already built and let.

Richard Kingston, director of the Cork-based firm CMC Capital, said the global credit crunch meant that the market was tighter in terms of sourcing funds.

"It is tough to get funded," Kingston said. "What might have previously been seen as risky deals are now seen as even riskier."

However, Kingston said the higher cost of funds was being balanced by a slight reduction in three to five-year fixed rates.

"They have notched down due to the changed outlook for medium term interest rates," he said.

CMC has recently completed a €20 million fundraising round for its latest

syndicate, CMC 5, a German commercial property fund. Kingston said this fund would have a loan to value of 80 per cent, with a total investment of €100 million.

He said the minimum investment for this fund was €100,000 and predicted an IRR of 15 per cent. This figure is pre-tax but net of fees and charges.

Cassidy said the minimum investment for Custom House Capital's property syndicates ranged from €100,000 to €250,000. He said the firm concentrated on German and French property, and also had some interest in the Spanish market.

He added that the duration of investments would probably extend somewhat due to the current climate in credit markets. "People are going to have to hold on to stuff," he said.

For people who decide to invest in commercial property syndicates, generally an initial upfront charge applies. This

Despite tightening credit conditions, commercial property syndicates are bullish on prospects for commercial property abroad

fee covers the administrative costs involved in setting up the deal and covers things like sourcing the property, legal fees, banking fees and any site surveys required.

Once you have taken the plunge and invested in commercial property, you will most likely pay an annual management fee for the duration of your investment.

Management fees for commercial property investments tend to be structured in one of two ways, with the investor either paying a percentage of the rent or a percentage of the value of the property. Investors should bear in mind that if the property rises in value, the management fees become more expensive. In general, the management fees are not capped and keep rising with the property's value.

Finally, an exit fee applies for some syndicates and funds. This tends to be structured as a type of hurdle rate, meaning that a fee kicks in if the returns on the property have exceeded a certain level of performance.

Investors in Custom House Capital's property syndicates can expect gross compound annual returns (CAR) of about 11.5 to 12 per cent, with a one-off upfront fee of 5 per cent of the value of the property.

Cassidy said an annual management fee also applies. This equates to 5 per cent of the annual rent on the property. He said no exit fees or penalties applied and investors would not face additional performance fees.

CMC Capital charges an entry fee of 3 per cent of the total investment, which Kingston said covered the cost of putting the syndicate together. An annual management fee of 1 per cent of gross assets also applies.

Eddie Hobbs's latest venture, Brendan Investments, which is structured as a public limited company, makes investing in commercial property a realistic option for

smaller investors, with a minimum investment of €5,000. Some have said that this lower entry level may lead to a host of first-time investors, still feeling flush after receiving their SSIA, dabbling in commercial property without fully understanding the risks.

While Hobbs said that this may be a risk of the lower entry level, he added that the company had to assume "an adult relationship" with its shareholders. Hobbs said Brendan Investments would open up the pan-European property

markets to investors who would be precluded from investing in other commercial syndicates due to the higher investment required. Brendan Investments charges a 1 per cent annual management fee.

Hobbs said Brendan Investments would have a gearing rate of 75 per cent. Hugh O'Neill, portfolio acquisitions director with Brendan Investments, said this was not an aggressive level of gearing.

O'Neill said there were two types of bank: those with an exposure to the interbank lending market and those without. He said that the degree of leveraging on offer from bank's without an exposure to interbank lending was unlikely to be impacted by the current credit crunch.

Syndicator Farrelly and Mitchell manages a property and development portfolio of €250 million.

"The company's strategy of identifying a variety of niche projects to meet different investment objectives means that the structure of the investment is very much deal specific, particularly dependent on the market and asset type, with investment returns ranging between 15 and 30 per cent," said a spokesman for the company.

"Similarly, the level of gearing, set-up fees and the investment term is project dependent and subject to identifying the most attractive structure for each opportunity."

The company has interests in Germany, the United States and most recently in Lithuania.

It recently secured a 54.3 acre development site in Lithuania on the outskirts of Vilnius. The company has also acquired three Belfast properties so far this year, worth a total of €30 million.

If you invest in a commercial property syndicate, you also need to consider the tax implications of your investment.

In some syndicates, investors are in receipt of a taxable income stream during the course of their investment, such as rental income or a dividend.

Capital gains tax is also payable at the end of the investment on any profit generated from the disposal of the assets. The first €1,270 of net gains are exempt from tax and the remainder is taxed at 20 per cent.

Tim O'Rahilly, a partner in tax department of PricewaterhouseCoopers, said that ultimately the main tax event for commercial property syndicates occurs at the end of the investment's lifetime. He said that investors also needed to be aware of the tax charges that may apply abroad, such as the foreign equivalent of stamp duty at the time of purchase of the property.

Despite tightening credit conditions, commercial property syndicates are still bullish on the prospects for commercial property abroad.

France continues to offer good opportunities for property investors, according to Cassidy. He said the influence of the recently elected French president, Nicolas Sarkozy, was a positive force for investors, with a "huge infrastructural shift" underway.

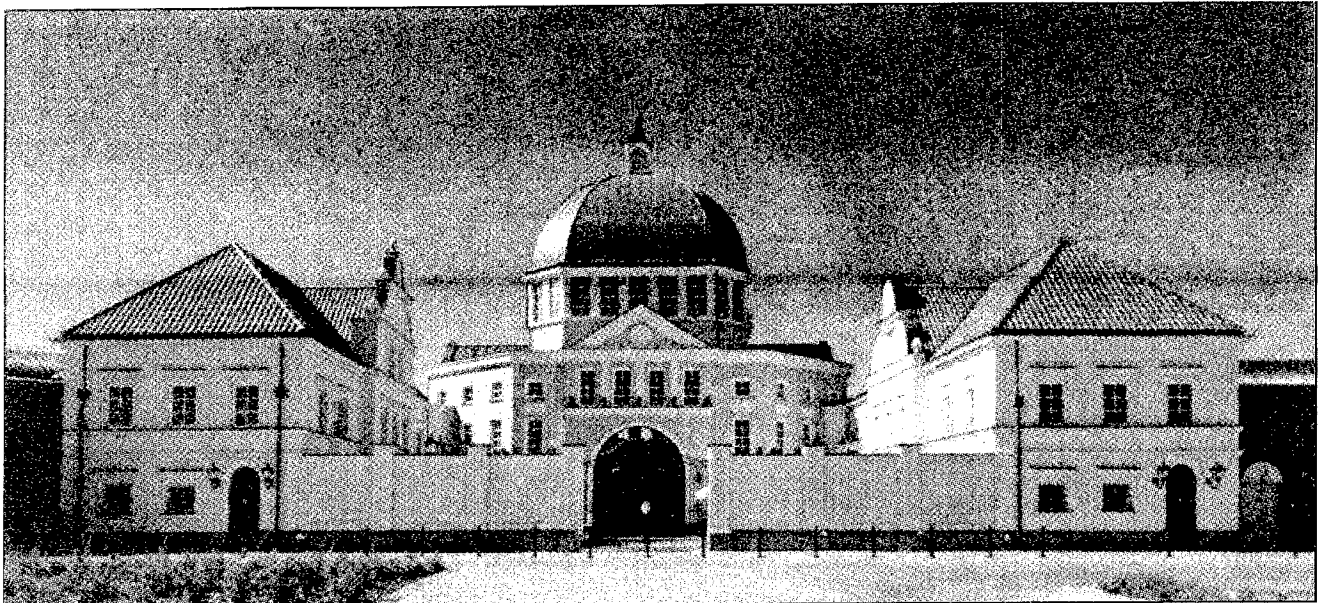
New roads, new TGV stations and other developments are breathing new life into a host of French cities such as Marseille, Le Havre and Bordeaux and, according to Cassidy, France "has a huge amount to offer investors".

Kingston said there was a lot of potential for increased value in the German market. He said CMC Capital would still invest in the British market but only on a "selective basis",

since the current interest rate climate there made it "more challenging".



The Schloss Strassen Center in Berlin was bought by CMC Capital for €100 million last month



Fashion House Outlet Centre, Warsaw: AIB Capital Markets' Polonia II fund bought it for €45 million last month