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Opinions sharply divided over property fund reform

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The industry is divided on what lessons should be drawn from the spate of fund suspensions that occurred after the EU referendum.

Source: Shutterstock/Sheff

Two key papers have been published seeking to frame the debate. The Financial Conduct Authority (FCA) was first up, producing a discussion paper in early February, and now, the Association of Real Estate Funds (AREF) has published a draft report produced independently by consultant John Forbes.

They both seek to assess what changes should be made to prevent a repeat of last summer, when the majority of property funds for retail investors were forced to temporarily suspend trading in order to cope with mass redemptions following the EU referendum.

At the time, many commentators called for sweeping reform. For example, Richard Tice, chief executive of Quidnet Capital Partners, argued that retail funds were "fundamentally flawed" in their existing form because although they offered daily liquidity, the assets they invested in could take months to sell.

Both the FCA and AREF papers attempt to address this issue, but neither calls for a ban on open-ended property funds.

"We do not intend to ban open-ended funds holding illiquid assets or prevent retail investors from acquiring units in open-ended property funds," said the FCA, which instead set out a range of potential reforms to improve the way funds operate.

355-361 Oxford Street was sold by Aberdeen Asset Management last year to meet redemptions - Source: Chris Gascoigne/Artiflex/Fletcher Priest Architects

AREF's draft report goes further. Whereas the FCA says funds should be allowed to continue to offer "regular dealing", the AREF report says "daily dealing" should be maintained and argues that "there is nothing to suggest that the concept of a daily traded fund is wrong".

To improve the status quo, it calls for better communication from fund managers and the creation of a broader range of products for retail investors.

Neither report has done much to satisfy critics of retail funds. "The simple fact is that no real lessons have been learned from the 2008 crash and the 2012 AREF report," says Tice. "This saga brought the reputation of the UK real estate industry into global disrepute due to vested interests and incompetence."

Tice goes so far as to describe the AREF paper as "complacent" and contends it protects the vested interests of the trade body that commissioned it.

Recognising the limitations

However, others are more supportive. For example, David Paine, head of real estate at Standard Life Investments, whose UK Real Estate Fund was one of the funds that suspended trading, agrees with the AREF paper's point that many investors want the liquidity that retail funds offer and do not want the exposure to the vagaries of the stock market that comes with investing in listed alternatives.

"My view has not changed, in the sense that I do believe preserving and enhancing choice for investors is important," he says. "There is a need to recognise the limitations of differing approaches and explore whether they can be mitigated at best, or clearly and consistently communicated as an alternative."

Phil Clark, head of property investment at Kames Capital, which runs a retail fund called the Kames Property Income Fund, is also generally positive about the findings of the reports. He says the FCA in particular "deserves a lot of credit" for its intervention and the way it is seeking to work with the industry.

However, he also argues that the debate around the future of retail funds should consider whether redemption periods for daily dealing retail funds could, or indeed should, be extended. Pointing to the scale of the redemptions after the EU referendum and attributing them mainly to "fear and panic", he argues:

"The risk is that this is going to happen each time there are economic and political shocks. Logically, we should be thinking about creating longer-term redemption windows and other retail fund models with longer redemption windows such as those in Germany."

Such change is only likely to come with the support of the regulator. All eyes will be on the FCA, which is accepting comments on its paper until 8 May, ahead of a response later in 2017. It will publish a consultation paper if it decides to propose new or amended rules.