Time to say goodbye to open-ended property funds?

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St James's Place's decision to suspend dealing in its £825.9m property unit trust is the latest in a series of gatings that have led experts to fear such funds have hit "the point of no return".

SJP's move, which will also include deferring redemption requests for its £563.2m Property Life and £838.2m Property Pension funds, came swiftly after M&G set out plans to wind down its £565m Property Portfolio fund.

In addition, Canada Life Asset Management suspended withdrawals from its WS Canlife UK Property ACS fund last week, after its assets declined to £102m from £254m following a spate of redemptions.

The suspensions mirror a long-running "fundamental mismatch" between investor demands and the liquidity of the underlying assets, according to many industry figures.

Buyers in pole position

For Ryan Hughes, head of investment partnerships at AJ Bell, "the writing has been on the wall for open-ended property funds since they suspended again in the depths of the Covid crisis".

"Offering a daily dealing structure for an asset that can take months to sell was an accident that happened all too often and one that ultimately undermined investor confidence," he said.

Hughes said the challenge for M&G will be to "sell at a sensible price while not rushing", and that potential buyers are in "pole position" knowing that M&G will seek to offload more than £500m of real estate into a market that is "not exactly buoyant".

The largest individual assets in M&G's fund, as of its most recent annual report, include Parc Trostre Retail Park in Wales, which has a September 2022 book value of £73m, and several units at the Junction 6 Industrial Estate in Birmingham, valued at a combined £76m.

The SJP Property Unit Trust consists mainly of offices, warehouses, leisure and retail parks. Its properties include the West Thurrock industrial site, on Motherwell Way, and Altrincham Retail Park.

Following a raft of fund suspensions in 2016 post-referendum, the FCA began a number of consultations and proposed legislative changes around open-ended funds.

Seven years on, the outcomes are still awaited. Consultant John Forbes said the affected funds are the latest victims “of the malaise”.

Withering away without FCA clarity

Forbes, who led an independent report for the Association of Real Estate Funds in 2017 after a raft of fund suspensions in the prior year, maintains there is a role for open-ended funds when it comes to retail investors.

“There are well-recognised impediments to reforming open-ended funds. In particular, the architecture of retail investment platforms needs to change, which will require significant investment,” he said.

“Platform operators will not make this investment until there is clarity as to the outcome of the FCA’s regulatory cogitations. As the funds wither away while waiting, the likelihood of any investment in the infrastructure diminishes.”

Forbes noted investors have been restricted to a limited, daily-traded, “one-size-fits-all” choice, which the FCA is keen to reform by introducing mandatory notice periods.

However, he said more choice should be available to investors, including a model that allows redemptions to be deferred up to six months to enable asset sales, while also enabling earlier payouts if there is available cash, other investors wishing to subscribe, or if assets are sold sooner.

“All that has been achieved by the prevaricating since 2017 has been a diminished choice for retail investors,” said Forbes. “We may have reached the point of no return for property funds.”

Good night, and good luck

Richard Peacock, European head of equity for real assets at Aegon Asset Management, said more suspensions are possible, “based on the nature of investor behaviour”.

He added that “unfortunately the long-term solution seems a long way off” since the FCA and HM Treasury have not got to grips with the issue.

Peacock noted that the Aegon Property Income Fund, Canlife’s and M&G’s open-ended property funds were “undone” by the discord of holding illiquid assets in a product offering daily liquidity.

“I’ve spent 18 years running open-ended daily dealt property funds so I feel that I have some experience here,” said Peacock. “Sadly, I do not think they are fit for purpose anymore and do not deliver acceptable outcomes to investors.”

He added that unless the industry devises structures that can work, pointing to the new long-term asset fund structure as a potential solution, the industry risks “missing an opportunity to harness the weight of defined contribution pension saving”.

“To all those fund managers still fighting the good fight with their open-ended funds, I wish you good luck,” said Peacock.

"It is a sign of how dysfunctional these products can be, that the greatest risk of outflows is always in the days after another manager has suspended or announced their closure."

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