

PRESS INFORMATION

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What are the dangers of investing in unlisted property?

Controversy continues to bedevil the property syndication industry, with several poorly structured (from an investor's point of view) and inappropriate syndications on offer. Perhaps one of the most critical adverse aspects is their lack of liquidity.

Property syndication is essentially an unlisted investment scheme that enables a group of investors to buy property and become part owners of it, either directly or indirectly. Such schemes can be structured in different ways, with different cost layers attached to them. Although schemes vary widely, many do not give investors direct ownership of the property, keeping them a long distance from actual ownership and some do not provide ownership in perpetuity.

In general, a scheme promoter will establish and market the property syndicate. Mostly this is done through setting up an unlisted company which owns the property. The syndicator then creates a holding company in which shares are sold or debentures issued to investors.

The syndicators charge management and admin fees and they are levied for each legal entity. So if there are two companies in the holding structure, there will be a double layer of fees. These fees can vary between 3% and 8% of the property value and may escalate at unreasonable rates over time.

In a property bull market, such as that experienced in South Africa over the past five years, the costs associated with property syndicates can be hidden with relative ease. However, when the market is not rising at the same rapid pace, the overpricing becomes more apparent.

There is no formal market for property syndications. This leads to liquidity constraints for investors, who may not be able to realise their investment, should they require their capital. There may be difficulties in finding a buyer and then, even once the shares have been sold, it can take up to two months for the investor to receive his cash. It will depend greatly on the nature of the scheme promoter as to whether or not funds can be readily available. There have even been cases where a moratorium of up to six months has been placed on sales and investors are thus locked in to the investment.

Says Craig Hallows, spokesperson for the Association of Property Unit Trusts, "There are some excellent property syndicates, in which investors are able to gain sound property exposure and where the promoters are highly principled. However, not all are in the same league and investors must do their homework prior to investing. Liquidity is a great concern: if investors have made a mistake, can they extricate themselves easily?"

The degree to which the syndicator creates a secondary market for the schemes is also important. Some promoters will ensure that investors are able to realise their asset, others not. In addition, most will charge the same commission that an estate agent may charge, namely 7.5%.

Valuing the properties may be open to manipulation. There is often a large discrepancy between what the syndicator paid for the property and the value placed on it when it is sold to investors. In addition, the valuation is not truly tested until an investor opts to sell his interest. At that point, depending on the extent of buyer interest, the bid-offer spread could open up markedly, to the detriment of sellers.

“This is in contrast to listed real estate where there may be more volatility as a result of demand-supply dynamics, but the companies are highly regulated by the domiciled exchange and the market prices the stock every moment of everyday and liquidity is extremely high. There are also collective investment schemes, available to individuals, which invest in international listed real estate companies or REITs,” remarks Hallowes.

Another aspect of property syndication is that there is little or no diversification – in many instances, a new company is established for each property. This significantly increases the risks for investors as the success of the syndication investment will depend solely on the quality of the specific property.

“It is vital that prospective investors are fully aware of what they are buying,” advises Hallowes. “They need to assess the quality of the syndicate management, the quality of the portfolio itself, the tenants and leases, the projected yields as well as what demand would be like for the syndication shares in the resale market. This applies particularly in the case of a market event, such as a significant correction as we have seen recently. It really is a case of *caveat emptor*.”

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