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Trophy Assets in Real Estate

The real estate industry refers to 'Trophy assets' as real estate that bestows a certain glamour on the owner of them. Implied in the characterisation is that their purchase might not make economic sense. This assumption might or might not be correct as there is a certain economic logic that might not immediately be apparent.

Almost by definition a small proportion of the real estate is 'trophy' quality. Indeed the ideal trophy property is an in-demand, unique and non-replicable one. Such assets might have certain characteristics beyond financial return that might make them appealing i.e. they may be of historical, cultural or popular interest. But there are also ways in which this interest outside financial return might indeed feed back into the value proposition surrounding an investment in the first place.

Typically, the purchase of a trophy asset requires an incredibly low – maybe zero and even negative – yield for a period of time. This period of time might even last for the entirety of the time of ownership of the asset. But, also typically, this minimal or lack of yield comes with a hope / aspiration that the increase in capital value will compensate for the lack of coupon return during the period of ownership from an economic point of view. Capital appreciation can be assured if an asset is indeed an in-demand, unique and non-replicable asset.

The vagueries of life mean that assuming an asset is and always will be of a trophy quality can be a risky calculation. Even in property fashions change, nothing is ever completely unique or unchanging and a competitive landscape means that analogous assets can always be created anew. Nonetheless, from an empirical point of view, the proven appetite for investment in trophy assets is such that if an investor is happy making the investment in the first place, good returns can become a self-fulfilling prophecy. Deep wealth – or capital value – can create heightened returns, as an investor can bet against the market, when the market is down and sell out when the market has recovered. This is especially the case if a particular asset comes into fashion on the market at the same time as the market moves in the right direction, or heightened leverage becomes available. Interest in lower yielding or more prime assets is always higher in a good market as the arbitrage between income secondary and prime assets is less.

Finally, there is a limited field of investors who have the wherewithall and the cash to invest in trophy assets and this means that the market can be very erratic, spontaneous and driven by individuals. Liquidity can be an issue in times of severe market stress but this can be counter-veiled by the rarity value of individual assets (for which there should always be a buyer). Investment in trophy assets can be lucrative but it requires a fundamental understanding of what makes the asset special or unique. Such analysis can be intuitive or it can be intellectually rigorous. Either way it exists and, if right, will always succeed in outperforming the general market.

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