OAK INVESTMENT MANAGEMENT GROUP

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Liquidity is the word given to describing the quantity of buyers and sellers in the market. In every day parlance (especially in a post-2007 market) it is usually used as short hand for willing purchasers in a market. In equities liquidity can be measured relatively scientifically between the 'bid' (purchaser's offered price) and the 'ask' (vendor's offered price) spread (difference between the two). In real estate this bid / ask spread exists but it is hard to measure as scientifically.

Yet, understanding liquidity in real estate is one of the most important aspects of being a real estate investment manager. It goes to the heart of understanding how the market behaves, what are the driving factors and what is the changes that will affect the marketability of a certain type of real estate. Because, typically less than ten per cent of value of an asset is paid out as a coupon in real estate keeping an eye on, and assessing the risks and challenges on accessing the remaining 90 per cent is absolutely critical in real estate. It is also where the majority of 'value arbitrage' is to be found.

If one is willing to take on a relatively unloved real estate asset, and bring up its marketable credentials then there is great value to be unlocked. For example, increasing the rent, bringing down costs directly associated with rent, bringing down central administrative costs, mitigating holding taxes of one kind or another, increasing the Weighted Unexpired Lease Term (WAULT), raising the rental tone, re-designating uses on all or parts of the asset/s, creating option value are not only levers of value in themselves but that can also be variously called upon at different market moments to be of critical importance for a purchaser of a real estate asset. It is the 'art' of investment management to make sure that an asset's best characteristics are on display *at the right time* in the economic cycle. For example, in the deflationary environment in which we live most purchasers are focused on high WAULT (contracted rent going forward), but this could easily turn should an inflationary environment kick in where short WAULTs or inflation indexed leases will come much more into demand. Because of the nature of real estate leases (they typically get signed once every five years) bad decisions can take a long time to wash through the system.

From a sub-sector point of view, a successful RE liquidity strategy needs to be able to judge correctly asset allocation decisions between sub-sectors in the real estate market. Liquidity can evaporate from certain sub-sectors easily. So it is worthwhile judging the historic and current market participants. The fewer there are the more likely there is to be embedded liquidity issues. The infrastructure sub-sector for example is often touted as a low risk, low volatility sub-sector which it is. However, one needs to normalise for the fact there are not many players in this market.

From a geographical point of view a European liquidity strategy needs to appreciate some countries are more liquid than others. Germany, UK, Scandinavia and France have deep, liquid markets. Central and Eastern Europe (arguably with the exception of Poland) and Southern Europe have liquidity issues. This does not mean that successful RE investment cannot take place it means that as an investor you need to be comfortable with the coupon that is being paid and not count on a quick and / or easy sale to make the investment work.

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