

The Interview - James Thornton, Mayfair Capital: "Rental growth will remain elusive in most markets except central London over the next two to three years"



James Thornton, fund director at Mayfair Capital Investment Management, says investors with the specialist property fund manager have benefited from the firm's ability to time the UK market - for example in 2007, when they called the peak of the market and decided to wind up the MC Property Growth Fund early to protect investors' capital and take profits.

PFW: What is the background to your company and funds? What is your background in your targeted property market?

JT: Guy Brogden and I founded Mayfair Capital Investment Management together in 2002. Mayfair Capital remains an independent, owner-managed commercial property fund management business, and is regulated by the UK's Financial Services Authority. We have GBP165m in funds under management and advisory mandates for clients including charities, institutional investors, wealth managers and other professionals.

I have 29 years of experience in UK commercial property and Guy has been involved in commercial property transactions for 30 years. We met when working at Jones Lang Wootton, where Guy served as a partner in the investment team. Then between 1992 and 1996, Guy played an instrumental role in setting up a GBP100m UK portfolio of commercial property for a wealthy Swiss-based family.

Thereafter, he spent 12 years as senior equity partner and head of investment at Oliver Liggins a niche commercial property agency in London. At Mayfair Capital, Guy is the investment director, overseeing the acquisition and disposal of properties, as well as negotiating with banks to secure loans. He acts as compliance officer and is also responsible for fund accounting and financial reporting.

I spent the first 15 years of my career at Jones Lang Wootton, including 11 in its investment management division, JLW Fund Management. In 1996, I joined Savills as director of fund management, responsible for a team of 10 managing some GBP950m of client funds on an advisory and discretionary basis. I am fund director of Mayfair Capital, responsible for the strategy and performance of the funds and for investor relations and reporting.

Additional senior executives at Mayfair Capital include chairman David Larkin, director Catherine

Candler and James Lloyd, head of marketing and business development, who is also a director.

The GBP96m Property Income Trust for Charities (Pitch) is Mayfair Capital's flagship fund. It was the best performing fund for 2009 within the Investment Property Databank UK Balanced Pooled Funds Indices of 25 funds. Pitch returned 9.2 per cent last year, compared with an average decline of 1.8 per cent for the Balanced Funds Index. Launched in September 2004, Pitch's current yield is 8.5 per cent.

Mayfair Capital offers three other pooled funds: the GBP30m MC Income Plus Fund, launched in July 2004; the GBP15m MC UK Property Fund, launched in September 2006; and the GBP10m MC Special Opportunities Fund, launched in February 2008.

In addition, we launched the MC Property Growth Fund in 2003. In 2007 we called the peak of the property market and decided to wind up the fund early to protect our investors' capital and take profits. The fund was officially closed in March 2008 and we delivered returns of 16.59 per cent per annum to investors after performance fees. This greatly exceeded the target return on equity of 10 per cent per annum.

PFW: What is the structure of your funds?

JT: Pitch is an exempt, unauthorised unit trust, open exclusively to UK registered charities and exempt from Stamp Duty Land Tax. SDLT is currently levied at 4 per cent on all property transactions worth GBP500,000 or more, so this exemption represents a significant advantage over other property funds.

The MC Income Plus Fund is a UK limited partnership with a UK unit trust feeder fund for exempt investors. The MC Special Opportunities Fund and the MC UK Property Fund are Oeics, the former domiciled in Guernsey and the latter an experienced investor fund in the Isle of Man.

PFW: Who are your service providers?

JT: Mayfair Capital works with Nabarro, Pinsent Masons, Ogier and Cains as legal advisors; Smith and Williamson Investment Management, Royal Bank of Canada Offshore Fund Managers and Portal as administrators; Moore Stephens, BDO Novus, Cooper Parry and PKF as auditors; GVA Grimley, Drivers Jonas Deloitte and DTZ as independent valuers; and Drivers Jonas Deloitte, Chapman Petrie and CBGA Management as property managers.

PFW: How and where do you market your funds? What is the profile of your client base?

JT: We have more than 350 clients comprising private investors, charities and pension schemes, including the Berkshire Pension Fund, Merseyside Pension Fund, Oxbridge colleges and the National Trust for Scotland. We market our funds directly to institutional investors and professional clients, as well as through intermediaries such as investment managers.

PFW: What is the investment premise of your funds? What types of property do you invest in, and where?

JT: All Mayfair Capital's funds invest in UK commercial property and have absolute return objectives. Both Pitch and the MC Income Plus Fund focus on institutional-grade assets, comprising a mix of income, growth and value added opportunities. The target lot sizes are GBP3 to GBP5m, and increasing. Neither fund undertakes any speculative development.

The MC Income Plus Fund and attracted 100 private investors either directly or through a unit trust. It has the power to borrow on a non-recourse basis of up to 65 per cent loan to cost. The fund, constituted as a UK limited partnership, aims to return 9 per cent per annum to investors over its five- to seven-year life, with an annual gross income distribution of 5 per cent when fully invested.

The MC Special Opportunities Fund takes a stock-driven and opportunistic approach to investing. Mayfair Capital seeks to use its market knowledge, contacts and experience to deliver this fund's

absolute return objective through investing in weak market conditions. It invests in direct property and through joint ventures; holdings include indirect, quoted and unquoted property vehicles. The fund aims to deliver a total return on equity invested of at least 10 per cent per annum, net of fees and expenses, by acquiring properties and other property-related investments that together will provide medium-term capital growth.

The MC UK Property Fund was designed to achieve capital growth through investing in UK property via a mixture of opportunistic and value added strategies. It has an absolute return objective of 8 per cent per annum.

PFW: How do you make investments for the funds?

JT: Our investment process lies at the heart of all decision-making and is derived from a combination of top-down and bottom-up analysis. Mayfair Capital subscribes to external forecast organisations such as Capital Economics. Changing trends in the economy are analysed on an ongoing basis and applied to specific market sub-sectors. For example, the penetration of high-speed broadband is significantly impacting retail trading patterns, with online retail sales now accounting for close to 8 per cent of all sales. Such a fundamental shift has implications for property strategies.

This type of macroeconomic analysis forms the basis of our asset allocation recommendations. We start by defining sectors we wish to invest in and then decide on geographical allocations within the UK that we feel are appropriate for these sectors. Technically, this produces 'tilts' - a set of neutral, over- and underweight recommendations for all the main property sectors relative to a benchmark or return objective.

Our bottom-up research focuses closely on individual stocks with forecast IRR analysis for each asset and its impact on the overall portfolio.

It is from a reconciliation of these two approaches that we derive our sector allocation and property recommendations for individual portfolios. Our investment process is founded on a strategic and analytical view of the market, tempered by performance expectations for individual portfolios and holdings. We aim to bring together rigorous economic analysis with individual stock projections.

In each of our funds, an external board or investor committee must approve every transaction. Board paper recommendations describe the rationale for the action proposed and will include a financial analysis of both the asset and the impact on the portfolio of each acquisition or disposal. Investor committees and external boards have the final say on activity.

PFW: What is your approach to managing risk?

JT: There are two types of risk: systemic market risk and stock-specific risk. Systematic risk analysis involves looking at property as an asset class in a wide context. We do not have any control over this type of market risk.

Stock-specific risk, however, is controllable and requires analysis of the quality of income, length of income, risk of voids, sector, regional and development risk, all of which are explicit in our investment process. We place limits on what percentage of a portfolio is comprised of large rental incomes. We also set a maximum lot size for a single asset as a percentage of a fund. We continue to monitor our exposure to sectors and geographical areas, as compared with the benchmark.

PFW: What opportunities are you currently looking at?

JT: We are reviewing a number of investment opportunities in both Pitch and the MC Income Plus Fund. There is approximately GBP10m of cash to invest in each fund. Each opportunity is consistent with our house view in that with the exception of central London and selected assets in the south-east, we are bearish about rental growth prospects in the regions. Accordingly we are targeting either properties let on long leases with fixed increases or inflation-linked rent review provisions. In addition, added value situations are pursued where performance can be extracted through lease management or other initiatives.

We recently signed a joint venture agreement with L&B Realty Advisors, a US real estate investment business, to advise their clients on diversifying into UK commercial property. L&B Realty estimates that its clients have around USD250m to invest in the UK over the next 24 months.

PFW: What developments do you expect to see in the real estate sector in your target market over the year ahead, and in other political and economic areas that may impact it?

JT: The pound may be affected further if real action is not taken to tackle the financial deficit by increasing taxes and cutting spending and public services. Investor confidence that the deficit is being addressed is a key issue for the property market, given the pricing relationship between benchmark gilt yields and property yields. There are risks to property pricing if gilt yields rise and property yields compress too quickly.

UK GDP growth, although positive, remains weak. It is only when the economy starts to gather strength that occupational demand will increase and start to erode over-supply in a number of markets. With the exception of central London, rental growth will therefore remain elusive in most markets over the next two to three years.

This year, GBP35bn of the GBP200bn in loans outstanding to commercial property are set to be refinanced. Of these, 13 per cent are estimated to be in breach or in default of a key lending agreement. However, wholesale bank-induced selling is unlikely become a feature of the market in 2010.

PFW: How will these developments affect your portfolios?

JT: We are focusing our purchase activity on retail and open consent retail parks in London and a few other selected cities, the West End and south east offices, and south east single and multi-let industrials. We favour assets let on long leases to strong tenants with inflation-linked rent reviews or minimum increases built into the terms.

We expect income to provide the dominant component of total returns until 2013, when we hope rental growth will resume. Value-added strategies will be difficult to implement while occupational markets are weak, but opportunities do exist to exploit market imperfections. Cash flow is paramount and the UK convention of leasing properties for 10 years-plus, with upward-only rent reviews, marks it out as a unique property investment market.

PFW: What differentiates you from other managers in your sector?

JT: Five key areas differentiate Mayfair Capital from its peers: the expertise of Mayfair Capital's team, strong track record, innovation, dedication to clients and personal service, and alignment of interests.

Guy and I possess complementary skill sets. With almost 60 years of combined experience and a wide-reaching book of contacts, we have been able to access 'off the market' buying opportunities.

Mayfair Capital has a strong track record and has proved its ability to time the market - as when we called the peak of the market in early 2007 and took profits from the MC Property Growth Fund.

The firm is an innovative business leader. For instance, we founded Pitch as the first and only exempt, unauthorised unit trust open to all UK charities whose purchases are exempt from Stamp Duty Land Tax.

We strive to place our clients first in everything that we do. Clients have direct access to the co-founders and other investment managers. We also organise seminars and educational events for clients. Co-investment by the management team and performance incentives ensure alignment of interest with our investors.

PFW: Do you have any plans for further acquisitions or for product launches in the near

future?

JT: We are in discussions with a third party with a view to launching a new fund in the next two to three months.

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