Psst, looking for a bargain?

Colm Fagan **Diary of a Private Investor** **Update 16** **14 August 2019**

This month's update tells of an opportunity to buy into property at close to half-price, but buyer beware: I'm trying to sell the same property!

I've never bought an investment property. For a start, even one (small) purchase would tie up a sizeable portion of my savings. I'm also put off by the high cost of buying and selling a property; by the time it takes to complete a transaction; and by the impossibility of selling a portion of a property to meet income needs in retirement. In contrast, shares can be bought and sold in seconds, at low cost, and in small lots.

A unit-linked property fund, consisting of a selection of properties owned by an insurance company, packaged and put into a pooled fund, and divided into units of equal value for allocation to policyholders, surmounts some of these problems. The value of each unit equals the total value of the fund divided by the number of units. If there are net inflows, new units are created, and more properties are added to the fund. If there are net outflows, units are extinguished, with the outflow being met in the first place from cash in the fund, but properties must eventually be sold if outflows continue. There are problems if there's not enough cash in the fund to meet requested outgo, but that's a story for another day.

Nineteen years ago, I decided to invest in property, but I steered clear of unit-linked property funds, opting instead for shares in a quoted property company.

A property company is a very different animal from a unit-linked property fund. A key difference is that a property company's share price is driven by supply and demand rather than by the value of the underlying properties. If there are more buyers than sellers, the price rises; if there are more sellers than buyers, it falls. Changes in the share price may bear no relation to movements in the values of the underlying properties. Also, unlike a unit-linked property fund, a rise or fall in the demand for its shares has no impact on a property company's own cash flows. It's purely a transaction between shareholders.

As noted above, the price per unit of a unit-linked property fund equals the fund's asset value divided by the number of units, while the share price of a property company could be more or less than the Net Asset Value (NAV), normally less – an important part of this story.

I bought my first shares in Town Centre Securities, a Leeds-based property company, in 2000, at 87p a share. It is my second-longest-standing investment.

In 2014, I decided to add to my holding, buying at £2.35 a share. I reckoned I'd got myself a bargain: the price was 17% below the net asset value (NAV) of £2.83 a share at the time. I would have had to pay the full £2.83 to acquire the same assets through a unit-linked property fund – probably more, because new investors in a unit-linked fund are normally required to pay a share of the stamp duty and legal costs of buying the underlying properties.

Now, five years later, the boot is on the other foot. I recently considered selling my shares in Town Centre Securities. The net asset value has increased to £3.61 a share (at 31 December 2018), but the share price has fallen to under £1.90, a massive 47% discount to the current NAV. This compares to a 17% discount five years ago. If I thought the shares were cheap then, they're even cheaper now. That's great news if you're a buyer, but now I'm a seller, not a buyer.

I have decided that I won't sell at such a low price, especially with sterling also on the ropes. By holding on, though, I'm running some risks. One is that the discount from NAV could widen further: some property companies are trading at even lower percentages of NAV. The NAV could also fall some more (it has already fallen, from £3.84 at 30 June 2018 to £3.61 by 31 December).

Thanks to Amazon, property companies with significant exposure to shopping malls are at greatest risk of falling NAV's. Some retailers have gone into CVA's (Company Voluntary Arrangements), a type of insolvency protection. This results in lower rent receipts for owners of the malls and properties from which they operate. Town Centre Securities is making valiant efforts to cut its exposure to retail: the proportion was 52% at end 2018, down from 70% in 2016. It also has limited exposure to retailers that have gone into CVA's.

My decision to hold on is motivated primarily by the dividend, now 11.75p (gross)[1] a share, which equates to a dividend yield of more than 6% at the current share price. The dividend has never been cut in the 19 years I've held the shares, not even in the depths of the last big recession, now over a decade ago. It has increased steadily from 4.75p gross in 2001 to its current level, an increase of almost 150%. There was also a special once-off dividend of 20p a share in 2007. I don't expect a dividend increase in the next few years, but nor do I expect it to be cut.

Finally, I can always dream of a white knight life insurer buying out current shareholders at (say) a 50% premium to the current valuation. This would imply a take-out price of less than 80% of NAV. In my dream, the insurer stuffs the acquired properties into a unit-linked fund, offers them to policyholders at 100% of NAV, and its shareholders pocket the other 20% of NAV. Sadly, it's a pipedream – I think.

1 The tax treatment of dividends from UK property companies differs from that of ordinary dividends. There is a withholding tax of 20% on a portion of the dividend, which may or may not be recoverable.