



OAK INVESTMENT MANAGEMENT GROUP



FEBRUARY (2) 2017

What is Core Real Estate?

All business activity develops nomenclature that sometimes flummoxes outsiders. Real estate should be one of the easiest businesses to comprehend but unfortunately it is no different to this general rule in this regard. Core real estate is a very important category to the investment universe of real estate.

Core real estate can be characterised as real estate that is a very safe investment which is either underpinned by an excellent location with long lease to a tenant whose covenant is indisputable. Of course, the implementation of this definition is a matter of judgement rather than self-evident empirical fact.

Selling agents can 'talk up' aspects of core in any given property and equally – invariably – there are always imperfections in a property that can 'taint' core and make it less so. Common sense and understanding of the local competition is ultimately the best judge. Typically, core real estate will be in the city centre / central business district or it will be of critical importance to a major occupier.

Observed (historical) or assumed (forward looking) yielding return, by the economic laws of risk / reward, should be lower than most other offerings. This is because rental growth prospects should weigh down the going in yield – making the investment proposition of core seem 'expensive'. Of course, proper expense can only be evaluated by an asset's subsequent performance. Core real estate is more sensitive to capital value rates because cashflows are assumed to be mature and have little scope on the upside (already being so high) and because any deviation from this assumption will have a big impact on value of the asset.

Sometimes core can have little or no yield which makes it analogous gold investing. But even in this situation the real estate needs to be maintained and protected more than other assets. From a financial point of view lease lengths need to be managed, and from a physical point of view capital expenditure needs to be spent to ward off depreciation and retain the allure for the occupier.

Another aspect of core investing is that the time horizon is usually quite long. With all costs associated with entering, exiting the ownership of a property and the low cash yield – it is unlikely for the owner to 'flip' core real estate quickly. So core is also an implicit acceptance of the high cash opportunity cost of the capital invested in this asset class in comparison to higher risk / reward propositions the safety of this investment choice lies in the fact that the principal is liquid.

Access to core real estate is very scarce in developing (high growth) countries. This is because local owners dominate the market and freeze out international capital seeking exposure. Ironically enough, therefore, there is a stampede of capital from the developing world coming to western markets for a safe, diversified harbour of core real estate. This has driven core property prices to their highest levels in relative and absolute levels for many years.

Nicholas Frankopan is Managing Director of Oak Investment Management Group pan-European real estate investment manager. To contact the author please email nfrankopan@oakadvisors.co.uk or learn more about the group at www.oakimg.com. © All rights are asserted please request permission for reproduction.