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INVESTMENT NOTE

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Hermes: There's no such thing as a free lunch

There may be little novelty in this observation, but it's one that property investors would do well to remember, says Hermes Real Estate Chief Executive, Chris Taylor. Tapering and the threat of rising rates mean that the bill for the banquet is on its way.

Beware gatecrashers: Long-term yields are ultimately driven by how occupiers assess property and the level of rent they can afford to pay. However, yields are currently being driven by flows of capital from other asset classes. Real estate has been gatecrashed by short-term investors who don't necessarily look closely at the underlying fundamentals. While in the UK this has been highlighted with regard to London, it is a general problem: an influx of capital has pushed up prices beyond fundamental value in many areas. Sometime over the next couple of years we expect to see a withdrawal of capital, as relative yields fall, causing valuations in many areas to drop.

Risk reduction: It's because of our concerns over there being too much froth in the market that we have taken the opportunity to sell selectively, thus taking some risk off the table. Strategically, there are two main ways in which we look to reduce risk in this environment:

- **Fundamentals:** we refuse to follow the herd into what we see as overvalued areas of the market. Indeed, we will look to sell into this, in order to take advantage of valuation distortion. Our focus remains wedded to occupier fundamentals as the best indicator of where to find long-term value. This underpinned our recent South Bank Tower joint venture with the Canada Pension Plan Investment Board, in an area where we see increasing long-term demand.
- **Diversify:** we are developing a diversified range of quality, well-valued assets throughout the UK and internationally. This also includes a diversification of assets within real estate, including increasing residential exposure, such as the Gotham platform of New York affordable private rental residential assets, and by other opportunities arising nationally and internationally.

London pride: It would be a mistake to ascribe all of real estate's problems to the London bubble. London occupational fundamentals are actually strong – so long as you avoid the over-priced trophy assets. With the UK's capital, it was ever thus given its global appeal. We are experiencing 14% annualised rental growth in the West End, and there is particular scope for further phases of infrastructure related development, such as Crossrail and its successor Crossrail 2, running north to south. London remains a truly global financial gateway on a par with New York, and this will continue to further underpin market demand.

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Notes to Editors:

Hermes Fund Managers

Hermes is focused on delivering superior, sustainable, risk adjusted returns for our clients – responsibly.

We believe in **Excellence, Responsibility** and **Innovation**

- **Excellence:** We aspire to excellence in everything we do. This manifests itself most visibly in our investment performance. We will only offer products to our clients where we believe there is a strong investment thesis and where we can deliver sustainable alpha.
- **Responsibility:** We believe it is our responsibility to lead discussion and debate about the fiduciary responsibilities of fund managers to our clients, their stakeholders and, ultimately, society at large. We have always sought positive engagement with the firms in which we invest.
- **Innovation:** We have the entrepreneurial culture to identify forward-looking products that meet those needs, along with the resources and speed-to-market mentality to develop them rapidly.

Our structure provides wholesale, institutional and pension fund clients globally the benefit of access to a broad range of specialist, high conviction investment teams operating within an established and robust operating platform.

Hermes' investment solutions include:

- **Fixed Income:** Inflation-Linked, Government Bonds, Investment Grade, High Yield
- **Alternatives:** Commodities, Hedge Fund Solutions, Infrastructure, Private Equity
- **Equities:** Global, Emerging Markets, Small & Mid Cap, Europe, Asia Ex Japan
- **Real Estate:** Segregated, Unitised, Debt, UK, US Residential, European

Hermes manages assets on behalf of more than 200 clients* across these investment areas with £26.9 billion* assets under management. In Hermes Equity Ownership Services, we have one of the largest engagement resources in the industry, advising on more than £103 billion* of assets.

*Please note the total AuM figure includes £3.5bn of assets managed or under an advisory agreement by Hermes GPE LLP ("HGPE"), a joint venture between Hermes Fund Managers ("HFM") and GPE Partner Limited. HGPE is an independent entity and not part of the Hermes group. £0.5bn of total group AuM figure represents HFM mandates under advice. Source: Hermes as at 31 March 2014.