Legal and General UK Property fund

An overview of the bid-offer spread

The Legal and General UK Property fund is dual-priced, meaning there is an 'offer price' to buy into the fund and a 'bid price' to sell out of the fund. This is in contrast to a 'swinging price' model, where a fund swings between a bid basis and offer basis depending on the volume of net inflows or outflows.

WHY IS THERE A BID/OFFER SPREAD?

The existence of a bid/offer spread is due to the difference between the buying and selling price of the underlying holdings (in this case, mostly commercial properties). All funds regardless of their asset class incur these expenses to some degree, but for commercial property funds these costs can be significant.

A physical property transaction is far more complex and therefore expensive than placing a trade for equity on a listed exchange. A property transaction can take many weeks to complete and involves several professional parties such as agents, lawyers and surveyors.

Additionally there is Stamp Duty Land Tax (SDLT) that must be paid and, since commercial property funds usually buy properties worth over £250,000, this will generally be at 5% of the price paid for the property.

WHY USE A DUAL-PRICED METHOD FOR A COMMERCIAL PROPERTY FUND?

We believe the bid/offer spread treats investors fairly and equally in this fund. Dual pricing protects existing fund holders from being disadvantaged by the actions of other investors entering or exiting the fund. As an illustrative example, the estimated costs generally break down as follows.

Buying a property	
Agent fees (for advising on the property)	**1.00%**
Legal fees	**0.75%**
Stamp Duty Land Tax	**5.00%**

Selling a property	
Agent fees (for finding a buyer)	**1.00%**
Legal fees	**0.75%**

Note that a couple of the costs are incurred when the property is sold. When the fund buys a new property it has to pay fees described above (approximately 6.75% of the value of that property). This transaction cost is borne by the existing investors in the fund on that day and effectively reduces the value of each share. Using a dualpriced method therefore means that anyone who invests in the fund pays their fair share of the transactional expenses inherent to owning a commercial property investment.

In a swinging price model the fund will be priced on an offer basis if it is receiving significant inflows, whereas it could move to a bid basis (which will be a 5-7% drop) suddenly if the fund is in net outflow.

The bid/offer spread encourages long-term investment discipline

The cost involved in the 'round-trip' of selling a dualpriced fund helps create a community of investors who recognise the importance of investing for the long term.

Having long-term investors is crucial for a property fund, due to the naturally low liquidity of the property market in comparison to other asset classes such as equities. If investors are constantly entering or exiting a fund, then unnecessary transactions can be a drag on performance. As we said earlier, however, a commercial property fund manager simply cannot buy or sell a property overnight.

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INVESTMENT MANAGEMENT

Dual pricing also reduces daily volatility, or in other words it increases the stability of the value of the fund's shares. This is because the price of the fund does not unexpectedly swing from a bid basis to an offer basis and back again. This means daily performance is driven by the success or failure of the underlying investments, not unexpected price swings.

Total spread on the fund

The full cost to buy and then to sell a property is typically around 8.5%. You will notice the spread on the fund is less than 8.5%, though – this is because physical property does not make up 100% of the assets in the fund. The fund also holds other assets such as listed securities, derivatives and cash which do not incur the same level of transaction costs. The spread is therefore reduced by the proportion of non-property assets which have much lower transaction costs associated with them.

If the physical property portfolio makes up a large proportion of the fund then the spread will tend to be larger, and vice versa. A recent spread figure is available on the KIID and Factsheet which can be found on our website.

CHANGES TO STAMP DUTY (MARCH 2016)

As of 17 March 2016, the stamp duty on the value of commercial property above £250,000 in England and Wales was increased to 5%. This was effectively a 1% increase in stamp duty and translated into a 1% decrease in capital values of the English and Welsh properties held within the fund.

- This had no impact on the Scottish properties in the fund as they were already subject to a 5% stamp duty
- This only applied to physical properties in the fund, not to the cash allocation
- At the fund level the overall impact was less than 1%

What this meant for clients

- The spread on the fund increased from 5.04% as at 17 March 2016 to approx. 5.74% as at 18 March 2016
- The bid price (and bid-to-bid performance) dropped by approx. 0.70%
- The offer price was only marginally impacted

Although this was unexpected, the impact was mitigated by our approx. 18% holding in cash at the time.

Technical details of the spread and price drop:

- Capital values for the English and Welsh physical properties were reduced by 1%
- This brought down the 'NAV' or 'mid' price of the fund (impact at fund level was approx. 0.70%)
- The spread on the 'offer side' for the English and Welsh properties was increased by 1% (approx. 0.70% at fund level)
- The result was a lower bid price and a wider spread

PAIF conversion

The fund converted from a Unit Trust to a Property Authorised Investment fund (PAIF) in May 2014. This structure allows eligible investors in the fund to receive a more tax-efficient income. The fund's underlying holdings remained the same, however, and there was no impact on its pricing model or the spread.

Looking at the complete picture

Of course, the pricing structure of a property fund is just one aspect that investors need to consider. The overall level of charges are important too, but here also the key point is getting value for money rather than necessarily the cheapest. Ultimately it is the experience, expertise and resources of the fund management team that will have the greatest impact on relative returns.

CONTACT US

For further information about our UK Property fund, please contact us:

0345 070 8684* fundsales@lgim.com lgim.com

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