Chapter 3
The REIT in Europe: History, Opportunities, Challenges

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With the years ahead promising few certainties, limited growth and challenges from every direction to the investment assumptions of old, commercial real estate is taking on a new relevance. It is has been a constant in the cycles of Europe's economy, finance and society hooked on urban living with a sustainable footprint. But listed real estate has come of age. Within the asset class, REITs and listed property companies have demonstrated over 20 years that public listing and its associated oversight leads to a superior property business in terms of management, assets and investibility.

We will look at the opportunities which REITs and Stock Exchange-listed property offer to the investor, and consider the wide-ranging contribution the sector makes to society and the economy at large.

Real estate, as a general term, describes the built environment, which plays a vital role in every aspect of the European economy, society and environment. Businesses and society cannot function without the services of commercial property, including the provision of offices, shops, factories, housing and many other forms of real estate. The commercial property sector delivers and manages the infrastructure needed for entrepreneurship to thrive. It is therefore a fundamental source of employment and economic growth, and a major contributor in addressing two critical challenges of our time such as providing liveable and functioning cities for a growing urban population and reducing the environmental footprint of the built environment.

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3.1 Contributing to the Economy and Supporting Jobs

The commercial property sector directly contributed EUR 285 billion to the pan-European economy in 2011 – about 2.5 % of the total economy and more than both the European automotive industry and telecommunications sector.[1] We believe that this figure rose significantly in 2012. The sector directly employs over four million people, which is more than not only the automotive and telecoms sector, but also greater than those employed in banking.

Most employment activity in the commercial property sector is through the construction and the repair and maintenance of buildings. The upkeep, management and care of commercial buildings are also a sizeable activity, undertaken either directly by property owners or on their behalf by a growing number of specialist contractors. All of the above activities are an essential part of maintaining and improving the quality of the accommodation services provided to businesses. Investment, fund and portfolio management is a small but disproportionately high value-added activity.

3.2 Investment: Delivering Infrastructure

Investment in new commercial property buildings and the refurbishment and development of existing buildings on average totals nearly EUR 250 billion each year – representing over 10 % of total investment in the European economy and equivalent to the GDP of Denmark. Investment in other buildings, infrastructure and housing is also substantial, totaling EUR 1 trillion, and when included with commercial property, represents almost 60 % of capital investment in the European economy.[2]

3.3 Commercial Real Estate: A Significant Role in Business, Industry and Social Life

Commercial property, other than residential, encompasses shops and retail outlets, offices, warehousing and light industrial premises, as well as hotels, leisure facilities and other forms of infrastructure. New forms of commercial property are continuously emerging playing a vital role in Europe's business, industry and social life. Its market value in 2011 was approximately EUR 5 trillion. This is comparable to the value of plant and machinery in Europe's businesses and is close

[1] "Stock Exchange Listed Property Companies – Building a Stronger Europe", EPRA 2013.

[2] "Stock Exchange Listed Property Companies – Building a Stronger Europe", EPRA 2013.

to the size of European stock and government bond markets. The total value of residential housing, at EUR 22.5 trillion, far exceeds other property sectors.[3]

Half of all commercial property – with a total market value of EUR 2.5 trillion – is held as an investment. While most families prefer to own their own homes, around half of the EU's commercial property is leased by businesses which prefer the flexibility of renting and are reluctant to commit the capital and management time required of owner-occupation. The commercial property industry meets this need by investing in commercial property and providing accommodation services to these businesses.

Listed property companies and non-listed funds are the biggest single owners, while traditional investors' (insurance companies and pension funds) directly owned share has been declining. However, the situation in Germany is revealing, partly due to the nature of its banking structure which has evolved alongside a cautious investment psychology over five decades. Of the ten largest global property markets (with the exception of Italy at 0.6 %), Germany has the lowest proportion of its underlying real estate held within the listed sector at only 1.5 %. This compares with France at 6 %, the US at 5.8 %, Australia at 16 % and a global average of 5.1 %.[4]

There has been a traditional aversion to risk which has seen German investors favouring what they perceive as safer returns as opposed to higher but riskier ones. It also explains that retail investors find it perfectly normal to immobilise their money in an illiquid investment as the price to pay for this perceived safety. It is commonly viewed that the structural distortion in the real estate investment market in Germany, which has repressed the growth of listed property vehicles in comparison with every other major economy worldwide, has led to lower returns for investors such as German pension funds and insurers and probably reduced the government's take from this major tax-generating sector.

Consequently, as the financial climate adapts to more open, rewarding and liquid listed sector investments, the upside to the German listed sector is significant. Were it to match the European average of **3.5 %**, some EUR **50** billion would be added to the market cap.

3.4 Contributing Towards a Low Carbon Economy

As tenants, investors and regulators all push for a climate-friendly product, the sustainability question of buildings has become a financial as well as political touch-point.

It is no secret that buildings contribute significantly to energy use and greenhouse gas emissions; they directly and indirectly account for 40 % of the EU's

[3] "Stock Exchange Listed Property Companies – Building a Stronger Europe", EPRA 2013.

[4] EPRA figures taken from Monthly Statistical Bulletin April 2013.

consumption and a third of its emissions. Residential housing accounts for the vast majority of this with non-residential buildings – including the public sector – accounting for 12 % of the EU's energy consumption and greenhouse gas emissions.

Residential and, to a lesser extent, commercial and public sector buildings also represent one of the most important untapped potential sources of energy savings. The cost over the decade of meeting this untapped potential for residential and non-residential buildings has been estimated at almost EUR 60 billion per year – a big commitment, which emphasises the importance of Europe's commercial property sector in delivering these important energy efficiency improvements. This drive to meet EU emissions targets will further connect the real estate sector to wider economy activity.

Typically, listed property companies are already leading the way in innovating energy-savings into their assets, responding to investor expectations of green management. In a liquid market, a shareholder can instantly approve or rebuke a listed company by trading their share. This empowerment comes through the visibility of the company's performance combined with analyst research and opinion. Stock Exchange and regulatory requirements for transparent financial reporting, and the increasing adoption of consistent financial measures across the European sector, mean listed companies face constant and informed shareholder action.

The Jones Lang LaSalle Transparency Index 2012[5] reveals that listed property companies are a huge driver of transparency within a country's real estate market. Countries with larger listed sectors, relative to their overall real estate market, scored better in terms of the JLL transparency rankings. One reason for this is the high standard and frequency of reports produced by the listed property companies. This transparency does not only mean that investors are well informed when it comes to the performance of the buildings the own, but also that the management teams are under constant scrutiny from their shareholders.

Similarly, over 100 dedicated equity analysts are actively monitoring the listed property companies in Europe, leaving no 'brick' unturned when it comes to reviewing a company's performance and management decisions. This creates a close alignment between the managers and the shareholders – which ultimately ensures better long-term decision-making and performance.[6]

With accountability comes quality, so is it any wonder that listed property companies have assembled, predominantly, high quality asset portfolios in good locations? Their strategy to own quality assets with the potential to add value through active management has allowed them to enhance returns over the long run.

[5] Jones Lang Lasalle Global Transparency Index is a unique biennial survey covering 97 markets worldwide. It aims to help real estate players understand important differences when transacting, owning and operating in foreign markets.

[6] EPRA monitor the number of analysts covering the FTSE EPRA/NAREIT Global Real Estate Index. As at April 2013, there were 130 analysts covering the 85 companies in the European section of the index.

Such companies possess unique characteristics which make them ideal owners of prime properties. The tax-transparent and efficient structure of the REIT means that income from properties is exempt from tax at the company level. Instead, the dividends paid out to the shareholders are taxed. In order to qualify for REIT status, several important criteria have to be met. One of these criteria is a high pay-out ratio of net income, which guarantees the stable income return to investors and makes the combination of prime assets and REITs the ideal marriage to be embraced by income-seeking investors, including specialist real estate investors as well as general retail investors. The rapidly growing Defined Contribution (DC) pension plan market is a clear beneficiary of this structure.

The listed 'wrapper' also provides significant liquidity benefits to the otherwise illiquid real estate market (including for prime assets) and its investors. The possibility to increase and drop exposure to the real estate market at any given moment allows for unmatched ability to jump at opportunities as soon as they emerge.

On average, a significant proportion of the shares of listed property companies change hands every single year (based on FTSE EPRA/NAREIT Developed Europe Index). This is significantly higher than the liquidity of direct assets, where transactions take much longer to complete as well. On top of that, transaction costs are much lower when acquiring shares as compared to acquiring a direct property.

The quality of the underlying assets in combination with a relative high security of income reduces the risk of Interest Cover Ratio breaches, and as such are the key ingredients in successful real estate financing. New lenders tend only to select the best assets to enter this space in order to minimise risk. The ownership of high quality assets has allowed listed property companies to secure long-term capital from a variety of sources, including equity, corporate bonds and traditional bank debt, facilitating the diversification of their capital structure.

On the public debt market, bond issuances by listed property companies have increased in numbers and size over the past years. The vast majority of issuances have been oversubscribed multiple times and received attractive ratings from the agencies. Demand for this product from investors is strong, as is the long-term trust in the companies and management teams which issue them. Once again, the advantage of being backed by stable and secure income streams generated by high quality assets plays its hand.

As an example, Unibail-Rodamco, Europe's largest listed property company based in France, owning a large portfolio of retail assets across continental Europe, issued a 6-year EUR 750 million bond at a fixed coupon of 2.25 % which was four-times oversubscribed in 2012. At the same time, the 10-year French Government Bond yield stood at 2.28 %. Property companies and REITs' ability to raise debt from multiple sources at low interest rates throughout the cycle suggests inherently strong income fundamentals of the asset class.

3.5 Pension Funds and Long-Term Listed

A recent study into pension fund investment in real estate by Andonov, Eicholtz and Kok of Maastricht University[7] found that larger pension funds are more likely to invest in REITs, whereas smaller funds allocate more assets to fund-of-funds in direct real estate. Investing through fund-of-funds resulted in substantial underperformance compared to other investment approaches. They believe this is at least partly due to multiple layers of fees, but in addition, neither do the fund-of-funds managers seem to have good skills in selecting investment managers, since their gross benchmark-adjusted returns are significantly negative. Smaller pension funds do not seem to recognise that REITs provide exposure to property returns comparable to external managers that invest in direct real estate, and much better than fund-of-funds managers, but with much lower investment costs. Fund-of-funds in direct real estate performed worse than REIT mutual funds and funds investing in hedge funds.

The Andonov et al. paper has some implications for institutional investors investing in real estate. Pension funds should consider the full range of potential investment approaches and avoid extended investment chains. Particularly, smaller funds should consider using more REITs and should re-evaluate their extensive use of fund-of-funds to gain exposure to direct real estate. Smaller pension funds can also implement more passive strategies in REIT investments in order to remain cost-competitive with larger funds.

The long-term cash flows generated from property investment provide an important source of diversified income in the portfolios of European savers and pensioners. Property in its various forms represents EUR 715 billion – over 6 %[8] – of European pension funds and insurance companies' total investments. Direct ownership is their most common form of property investment, but indirect forms of investment – either through non-listed funds or listed property companies and REITs – are becomingly increasingly important. EPRA has work to do to educate this broad group of pension fund investors of the opportunities within the listed real estate sector.

3.6 Blending Direct and Listed: Relative Returns

For a long time now, we have seen the potential role of listed real estate in a blended portfolio. In practical terms, many of Europe's large pension funds such as APG & PGGM have taken this "blended" approach. The fundamental reasons for investing in real estate remian – exposure to quality assets, in quality locations operated and

[7] Value Added from Money Managers in Private Markets – An examination of Pension Fund Investments in Real Estate. Andonov, Eichholtz and Kok, June 2012.

[8] Value Added from Money Managers in Private Markets – An examination of Pension Fund Investments in Real Estate. Andonov, Eichholtz and Kok, June 2012. P. 30.

managed by professional management team with a clear strategy, but there are short-term performance differentials between listed and direct real estate offering numerous arbitrage opportunities for investors to exploit.

Investors have for a while now had many options in which to obtain real estate exposure. However, there are two specific catalysts which have stimulated a surge in interest in combining a more liquid, listed element with direct exposure. Firstly, the inevitable move from Defined Benefit to Defined Contribution Pensions schemes which have a greater liquidity requirement, and require a form of real estate allocation that can provide exposure to the asset class in a more easily tradeable form. Secondly, the redemption issues which many Property Funds faced has led to product developers seeking to capture fund flows by creating a more liquid product.

For example, perhaps the best way of explaining this is to examine the issue of blending real estate vehicles, or the four quadrants, is to select one country and blend just two options initially. We would also emphasis the key point that we are not suggesting that is necessary to combine all four quadrants across all regions to provide effective solutions to specific product liquidity requirements. At its simplest, listed exposure can be added to enhance liquidity of a product to meet investor requirements, or a trading strategy can be developed to arbitrage between the two areas. As a first step, we look at the UK direct market – represented by the IPD All Property Index and the UK listed market – represented by the FTSE EPRA/NAREIT UK Index.

The UK has the longest time series on both the direct and listed side. In addition, the data sets are widely regarded as most representative of each market. Figure 3.1 outlines the straightforward rolling 10-year performance of the UK direct and listed sector, unlagged[9] – both capital and total returns. This provides an initial overview of returns, unadjusted for either risk, management costs, or liquidity. The FTSE EPRA/NAREIT UK Index outperforms IPD UK for a significant period of the analysis – 2000–2010. On the other hand, IPD UK total return outperforms the FTSE EPRA/NAREIT UK total return. The listed sector trades within the boundaries of the direct benchmark.

3.7 Mixing the Blend: A Rules-Based Trading Strategy

While Fig. 3.1 shows the ‘raw returns’ historically and the stages of the cycle where listed and direct generate superior and inferior performance, the next step is to examine how a simple rules based strategy can arbitrage between the two markets.

[9] Yunus, Hansz and Kennedy (2010) – Short-run analyses also reveal significant causal relationships between private and public markets of all countries under consideration. As expected, it was found that price discovery occurred in the public real estate market in that it leads but is not led by its private real estate market counterpart.

Fig. 3.1 Annualised rolling 10 year performance (Source: IPD, EPRA)

At a strategic level, we use a simple portfolio comprising 50 % direct property and 50 % listed property as starting point. A series of thresholds is calculated around the long term average discount to NAV (−18 %) over the entire period.[10] This can of course be recalibrated throughout the course of the strategy.

An upper and lower threshold is set at two thirds of one standard deviation – approximately 9 %, either side of the long term average discount. The weighting to listed property is adjusted 150 bps for each month that listed property trades below (or above) the thresholds. For example, if the discount to NAV trades at 20 % for a cumulative 5 months period, 7.5 % extra is allocated to the listed allocation. Once discounts to NAV trades within the upper and lower band, weights revert to 50/50.[11]

By combining the direct and listed market over the period and employing the trading strategy,[12] it is possible to outperform both the direct and listed markets by some margin. In Fig. 3.2 we display the results of the strategy, clearly showing that the blended portfolio generates significantly better cumulative total returns than

[10] The long term average NAV discount figure includes data both pre and post REIT introductions in Europe. The current figure is 8 %.

[11] This analysis was first published in issue 34 of the *EPRA Newsletter* – May 2010. The article was written by Martin Allen, now at Deutsche Bank Property Research.

[12] This simulation did not allow for transaction costs, and full allowance for these would reduce the return premium generated. On the other hand, it should also be possible to come up with a more sophisticated algorithm that generates a higher return premium.

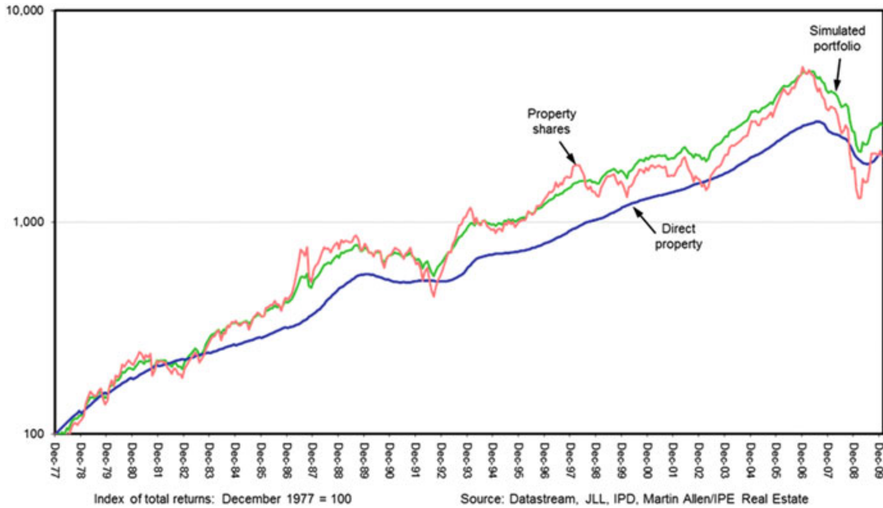

Fig. 3.2 Total returns from simulated portfolio compared with those from direct property and property shares

either direct property or property shares. This approach generates – an average annual return premium of over 100 basis points over that on direct property over this 32-year period.

As might be expected, the volatility of the returns generated by the simulated portfolio sits between that on direct property[13] and that on listed property.[14] Yunus, Hansz and Kennedy (2010) analysed the long-run relationships and short-run linkages between the private and listed real estate markets of Australia, Netherlands, United Kingdom and the United States. Results indicate the existence of long-run relationships between the public and private real estate markets of each of the countries under consideration.

We are now seeing products developed that seek to combine underlying real estate exposure with the investor requirement for liquidity. Given the importance of liquidity in DC schemes and their expected growth, we also believe that attention is firmly focussed on providing a (more) liquid real estate solution for this market, and that the listed sector will play an important role in providing this liquidity.

[13] Volatility using the valuation based methodology – we estimate that ‘real volatility’ is significantly higher when taking into account significant economic events and low transactions or lack of liquidity.

[14] The market movements experienced by stocks provide an opportunity to buy into property at levels that could never be achieved in the direct market.

3.8 Long-Term Outlook

Good quality real estate can offer long-term capital appreciation and offer attractive cash-flow or income when managed and structured well. So what are the dividend and yield characteristics of listed real estate, and REITs in particular, that give a clear picture of their income-distributing qualities?

The total return on an investment is a factor of both capital return and income returns. Different types of investors have different investment objectives and horizons to which they will try to match their allocations and investment decisions. For example, one investor might need to make regular distributions (e.g. pension funds), whereas others might be more focused on long-term wealth preservation (e.g. sovereign wealth funds).

Real estate offers a distinct set of characteristics when it comes to sourcing income and growing value, which can differ from other asset classes. In combination with the wide variety and heterogeneity of buildings, the right holding structure and management focus can provide attractive returns to investors in terms of income and capital.

3.9 Reliable Income

A distinguishing feature of real estate investment compared against other investments is the way in which income is sourced, generated and secured. Income return on real estate investments is predominately derived from regular rental cash-flow or income. Contractually agreed tenant obligations such as a minimum duration of the term, termination penalties, and rent review structures all lead to a higher level of visibility and predictability of (future) income. These unique features, not often seen in other industries on this scale, are natural to the real estate industry.

To maintain healthy cash flows, and ultimately to distribute income, a stable stream of rental income is required. In order to achieve this, the underlying assets must be of sufficient quality to attract and retain the required levels of rental income. On the whole, the majority of REIT portfolios are composed of good-quality assets in prime locations, you only need to look at the annual reports of largest companies in Europe – Unibail-Rodomco, Land Securities and British Land to see examples of the level of assets they own. It is these assets which attract the better quality (and as such more desirable) tenants, who are less likely to default on their rental payments, particularly when the broader economy is in decline.

Another aspect of REITs which is likely to provide a more stable stream of income is the relatively large size of REIT portfolios. This allows diversification in terms of both assets as well as tenants, and as such delivers more stable occupancy levels by avoiding dependency on a small number of income sources and assuring that lease expiry schedules are well spread over a long time period. These maturity

schedules are transparently featured in most Annual Reports as breakdowns of the percentage of total rental income which could potentially expire in the near future.

Within the real estate sector, the focus on cash flows has increased since the downturn due to the large amount of debt in the market. One of the largest expenses of a real estate investment vehicle will be the cost of debt. When interest rates are increasing, bearing in mind the capital intensive nature of the real estate sector and a relatively high average LTV, it is clear how rising interest costs can threaten otherwise healthy cash flows, dividend returns, and ultimately ICR covenants.

Covenant breaches did not occur however in the listed real estate sector (bar a few exceptions) where average LTV levels were lower (around 50 % in Europe) and cash flows were healthier. The listed real estate companies were able to refinance before debt maturities were reached, not only with equity raisings but also with the banks through renegotiations; meanwhile other vehicles struggled to get access to finance as the debt market virtually locked up.

REITs' ability to do this suggests inherently strong income fundamentals. This solid underpinning is also reflected through the high appetite for bond issues by property companies at relatively low yields, and with good ratings from the well-known rating agencies. The quality of the underlying assets in combination with a relative high security of income reduces the risk of ICR breaches, and as such are the key ingredients in successful real estate financing. Secondary, the vast majority of listed real estate companies' debt has fixed interest rates or is hedged otherwise. In combination with multiple financing options available to listed property companies, a well structured and balanced debt maturity schedule can be achieved. Companies provide a clear picture of interest payment obligations – as well as refinancing needs – to the end-investors by reporting their debt maturity schedules in their Annual Reports.

The income-producing capabilities of REITs will ultimately be reflected in the form of distributed dividends to the end-investor. The next paragraph will look at the dividend distribution levels of REITs.

3.10 Stable Dividends

As indicated previously, one of the key features of real estate investments is their ability to generate a steady stream of income. If managed and structured correctly, this in turn should lead to more stable income returns towards the end-investors. Figure 3.3 displays the long-term dividend growth of European property companies. Annual compounded growth since 1999 stands at 3.8 %, well above the annual compounded inflation of 2.0 % over the same period. As expected, dividend growth will be more volatile when compared to inflation due to lease renegotiations next to agreed annual increases. The data however suggest that over the long-term it will out-perform inflation, illustrating the ability of well managed property companies to offer stable growing income returns to investors.

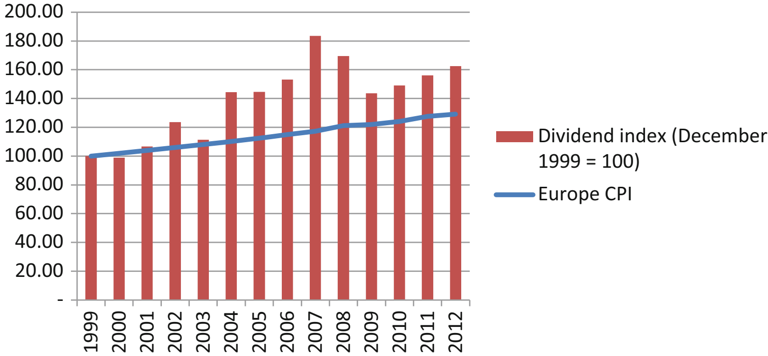

Fig. 3.3 A stable source of income

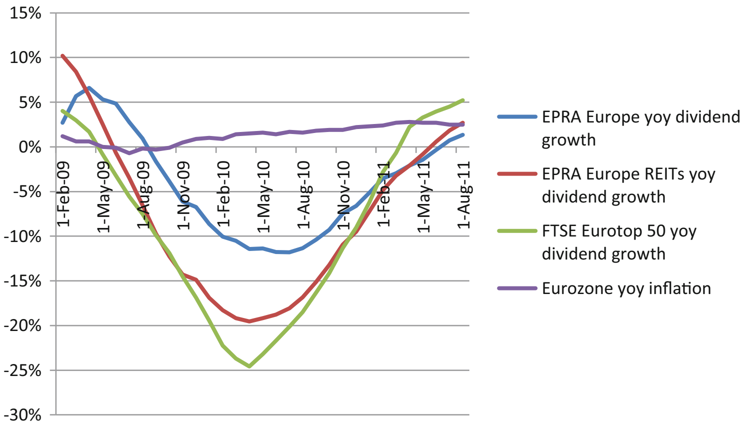

Fig. 3.4 YOY growth

Figure 3.4 illustrates the year-on-year dividend growth for listed property companies and REITs during the recent downturn. Although there was a clear drop in distributed income during 2009, the majority of companies were able to pay out dividends. This indicates the generally healthy cash flows of these companies. The year-on-year drop in dividends paid out by listed property companies bottomed out at around −20.0 %, whereas REITs bottomed out at −11.8 %. In comparison, general equities showed a maximum decline of 25.0 %. As the graph reveals, dividend distributions are growing again, showing the strong long-term income fundamentals of these companies.

In general, REITs pay out higher dividends as compared to non-REITs. Built into European REIT regimes is the obligation to distribute the vast majority (up to 100 %) of their earnings to their shareholders. This is in line with most REITs' income-oriented strategy of offering stable income growth through active asset

management and asset rotation. In some cases this may lower the organic growth potential of the companies as retained earnings are limited. Most companies however possess sufficient levels of firepower due to recent equity raisings, bond issues and available granted credit lines. Likewise, property acquisitions in exchange for shares can be a good way to expand their business. Besides, more countries are starting to allow stock-dividends which do allow REITs to retain earnings.

3.11 Attractive Yields

As indicated above, dividend payouts of REITs are relatively stable when compared to other asset classes. On top of that, REITs tend to trade at higher yields when compared to these other investments. REITs have consistently traded at higher dividend yields when compared to bonds and general equities.

Over a 5-year period, the average dividend yield of European REITs was 5.1 %, whereas European Governments Bonds yielded 3.4 % on average. General equities had an average yield of 4.1 % compared to an average annual inflation of the Eurozone of 1.9 %. Table 3.1[15] highlights the annualised total returns of the main asset classes over a variety of holding periods. Global listed stands out over significant number of periods.

It is however difficult for investors to get access to high quality assets at high yields. This could be seen during the latest downturn when the direct real estate market was basically locked, as the bid/ask spread was too high. Therefore, the number of transactions on the direct real estate market was very limited.

In a way, the expected amount of good-quality assets coming to the market at discounted prices due to distressed selling has not materialised. On the other hand, REITs did offer investors access to prime assets at attractive entry levels. A key feature of REITs in comparison to other real estate investment vehicles is their ability to change hands continuously, even during the downturn, providing exceptional and much desired high levels of liquidity within the real estate market. This meant that investors could obtain exposure to high quality real estate at discounts to NAV coupled with relatively high and attractive yields. These relatively high yields caught the attention of investors, in a low interest rate climate. Similarly, the lower economic growth outlook meant generalist investors re-focussed on income as well.

Real estate, because of its fundamental characteristics, can provide healthy income returns when structured and managed in the right way. REITs have the distinct characteristic that income return, i.e. dividends, are more predictable as compared to some other vehicles due to tenant agreements and standards of reporting. The prime quality assets they tend to own are most likely to offer long-term *reliable income* leading to healthy cash flows.

[15] Source: FTSE EPRA/NAREIT Global Real Estate Index, IPD Global, FTSE World & JP Morgan Global Bonds.

Table 3.1 Global Asset Classes – "Annualised performance over variety of holding periods"

Number of Years–Holding Periods	Listed Real Estate	Global Real Estate	Global Bonds	Globel Equities
1	16.7%		3.4%	12.8%
2	8.3%	4.8%	5.5%	5.9%
3	13.5%	6.3%	4.4%	9.7%
5	2.0%	1.0%	4.4%	2.6%
8	5.5%	5.3%	4.1%	5.3%
10	10.4%	6.0%	3.8%	8.7%
15	7.4%	7.0%	4.6%	4.4%
20	9.3%	7.7%	5.5%	7.3%

Combined with appropriate debt management, *stable dividends* should be achieved when managed correctly. On top of this, the liquid nature of REITs can offer access and exposure to quality real estate at *attractive yields* when other ways of achieving this are blocked. In combination with long-term capital appreciation out-performing inflation and growing dividend distribution, the REIT vehicle can contribute to the stability and return demands of a wide range of investors (Fig. 3.5).

3.12 Market and Research Developments

Investor attitudes have changed over time, for example and has there been relevant recent research looking at blending listed real estate into total portfolio allocations.[16] In addition, impacts of regulatory change at a national and EU level have changed the way we do business in many respects. One of the key developments in the period has been the increased urgency in examining the role of listed real estate securities within defined contribution pension schemes.

3.13 Real Asset Portfolios

In addition to listed real estate as part of the real estate allocation there has been a trend towards looking at real estate as part of a grouping of 'real assets' for pension funds purposes. Russell Investments[17] produced a paper which looked at "real assets for the defined contribution menu", which explored the impact of adding assets such as commodities, real estate and listed infrastructure as a way to help participants achieve their long-term goals. Their conclusions were that target date

[16] "The use of listed real estate securities in asset management" EPRA publication by Alex Moss and Andrew Baum, April 2013.

[17] "Real Assets for the defined contribution menu" Russell Investments by Joshua Cohen and Mark Teborek.

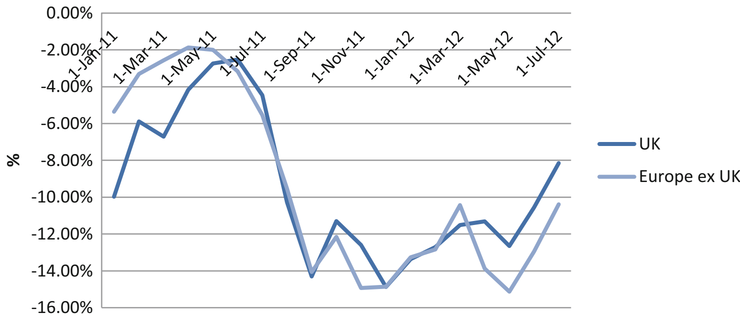

Fig. 3.5 Implied capital value changes (Source: EPRA, Bloomberg, Consilia Capital)

funds should include an allocation to real assets in the early working years, and that real assets provide exposure to compelling long-term global trends.

3.14 Summary

It is clear that listed real estate and REITs are a fundamental part of any serious real estate allocation. We can view this in both practical and theoretical terms. At a practical level, the large Dutch pension funds have been using listed real estate and REITs as a major part of their overall real estate allocation, which in itself trends above the global average of approximately 8 %. APG, the largest Dutch pension fund and the second largest in Europe has held as much as 15 % in real estate, with approximately 50 % of that held in listed real estate or REITs. They have gone on record as stating that their investment strategy 'looks through' investment vehicles and focuses on the asset exposure, quality of management and strategy.

The academic theory makes a strong case to include listed real estate or REITs: the examination of the benefits of diversifaction, risk-adjusted total returns, fees, inflation hedging capabilities, liquidity and transparency all point in a favourable direction. We strongly believe that this environment sets the conditions for expansion and growth in the European listed real estate market over the medium to long-term.

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Yunus, N., Hansz, J. A., & Kennedy P. J. (2010). Dynamic interactions between private and public real estate markets: Some international evidence. *Journal of Real Estate Finance and Economics, 45*(4), 1021–1040.