PRESS RELEASE

Property stocks outperforming direct real estate on all fronts, first global pensions study shows

Berlin, September 06 – Pension funds worldwide are on average getting poorer performance, higher costs, less transparency and liquidity by investing directly in bricks and mortar or using funds to do so, than by opting for property stocks and particularly the efficient listed Real Estate Investment Trust (REIT) structure, groundbreaking new research suggests.

In the first study of how pension funds invest in real estate across the globe, three researchers from Maastricht University in the Netherlands highlighted a key finding that the longer the investment chain in real estate the less sense it made for institutional investors to use it, with multi-layered funds of funds the least attractive.

Philip Charls, CEO of the European Public Real Estate Association (EPRA) said: "This is the first conclusive study on a global scale that confirms what the listed real estate industry has been saying for a long time – pension funds have been potentially losing hundreds of millions of dollars and euros in returns for their members by not choosing the most transparent, liquid, low cost and best performing form of property investment over the long term. The research should also be a wake-up call to governments that if they do not create the right regulatory conditions for REITs to thrive, they may be depriving retirees of a high yielding source of income, backed by hard assets, that is in desperately short supply in the current investment environment."

In their study: *Value Added From Money Managers in Private Markets? An Examination of Pension Fund Investments in Real Estate,* the researchers, Aleksandar Andonov, Piet Eicholtz and Nils Kok, used the CEM dataset, the broadest global database on pension fund investment. This comprised of a total of 884 US, Canadian, European and Australian/New Zealand pension funds for the period 1990-2009. Overall assets under management (AUM) of these retirement plans exceeded USD 4.6 trillion in 2009.

The Maastricht University researchers conclude in their report: "Pension funds should consider the full range of potential investment approaches and avoid extended investment chains. Small funds, in particular, should consider using more REITs and seriously re-evaluate their growing use of funds-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."

Real estate is the most significant alternative asset class for pension funds, ahead of both private equity and hedge funds in portfolio allocations, and represents more than 5% of total holdings on average globally.

According to EPRA data, the total listed market capitalisation of the FTSE EPRA/NAREIT Global Real Estate Index is approximately USD 1.0 trillion (holding gross assets, including leverage, of USD 2.0 trillion) and the total global gross assets held by private equity real estate funds is USD 3.0 trillion.

The University of Maastricht research showed that larger pension funds are more likely to invest in real estate internally and have accompanying lower costs and higher net returns. In contrast, smaller retirement plans are more prone to invest in direct real estate through external managers and funds of funds, but largely ignore REITs. The additional investment layers significantly increase costs and disproportionally reduce returns.

Moreover, US pension funds' investment costs are twice as high as those of their European and Asian peers, and both gross and net performances are lower. The underperformance of US pension funds in real estate investments is most striking in the last two years of the study's 1990-2009 sample period, which may be due to the "irrational exuberance" of investment managers in adopting excessive use of leverage and opportunistic investment behaviour in the real estate boom than preceded the credit crisis and the subsequent slump in returns as values crashed. Overall though, US pension fund costs are still 41 basis points higher compared with institutional investors from other regions, which can be mainly attributed to their higher costs for external investment mandates in direct real estate.

Key findings of the study include:

- The average gross total returns of pension funds globally between 1990-2009 was about 7%. REITs delivered a higher return (10.92%) compared with direct real estate (6.7%). Gross returns on internally managed real estate assets (7.7%) are higher than the returns on external mandates (6.82%).
- Certain pension funds are persistently more likely to outperform their direct real estate benchmarks, while this is not the case for REIT investors. This may be explained by the fact that direct real estate markets are illiquid and not very transparent, which may give insiders an edge.
- Although listed REITs provide liquid and scalable property exposure, which should make these vehicles attractive to smaller investors, large pension funds are actually more likely in invest in the listed vehicles – which they largely as complementary investments to direct real estate holdings.
- Even among the largest quintile of pension funds (AUM over USD 33 billion), only 42% manage property or REITs internally, whereas for the smallest quintile (AUM USD 336 million) this is 13%.
- Switching from internal real estate management to complete external management results in a 21 bps increase in investment costs. A complete switch to fund-of-funds would increase costs by 122 bps.
- The average cost globally of pension funds investing in real estate is 76 basis points, but more than double for direct real estate (83 bps) than for REITs (41 bps). Overall real estate investing carries significantly lower costs than private equity or hedge funds.
- Larger pension funds obtain higher returns. A one unit log in real estate holdings increases annual returns by 32 basis points. These economies of scale are present in both REIT and direct real estate investments.
- The listing of REITs on stock exchanges increases liquidity, lowers investment costs and also reduces potential agency conflicts (in the multitude of layers between investor and underlying properties), for example, due to mandatory dividend distribution.
- European pension funds are on average more likely to invest in REITs than their US counterparts.

About EPRA

The European Public Real Estate Association – is the voice of the publicly traded European real estate sector. With more than 200 active members, EPRA represents over EUR 250 billion of real estate assets and 90% of the market capitalisation of the FTSE EPRA/NAREIT Europe Index. Through the provision of better information to investors, improvement of the general operating environment, encouragement of best practices and the cohesion and strengthening of the industry, EPRA works to encourage greater investment in listed real estate companies in Europe.

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