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IPD/MSCI Asset Owner Survey: Real Estate Insights

ERES conference – Bucharest June 2014

Bert Teuben & Peter Hobbs, IPD research



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Agenda

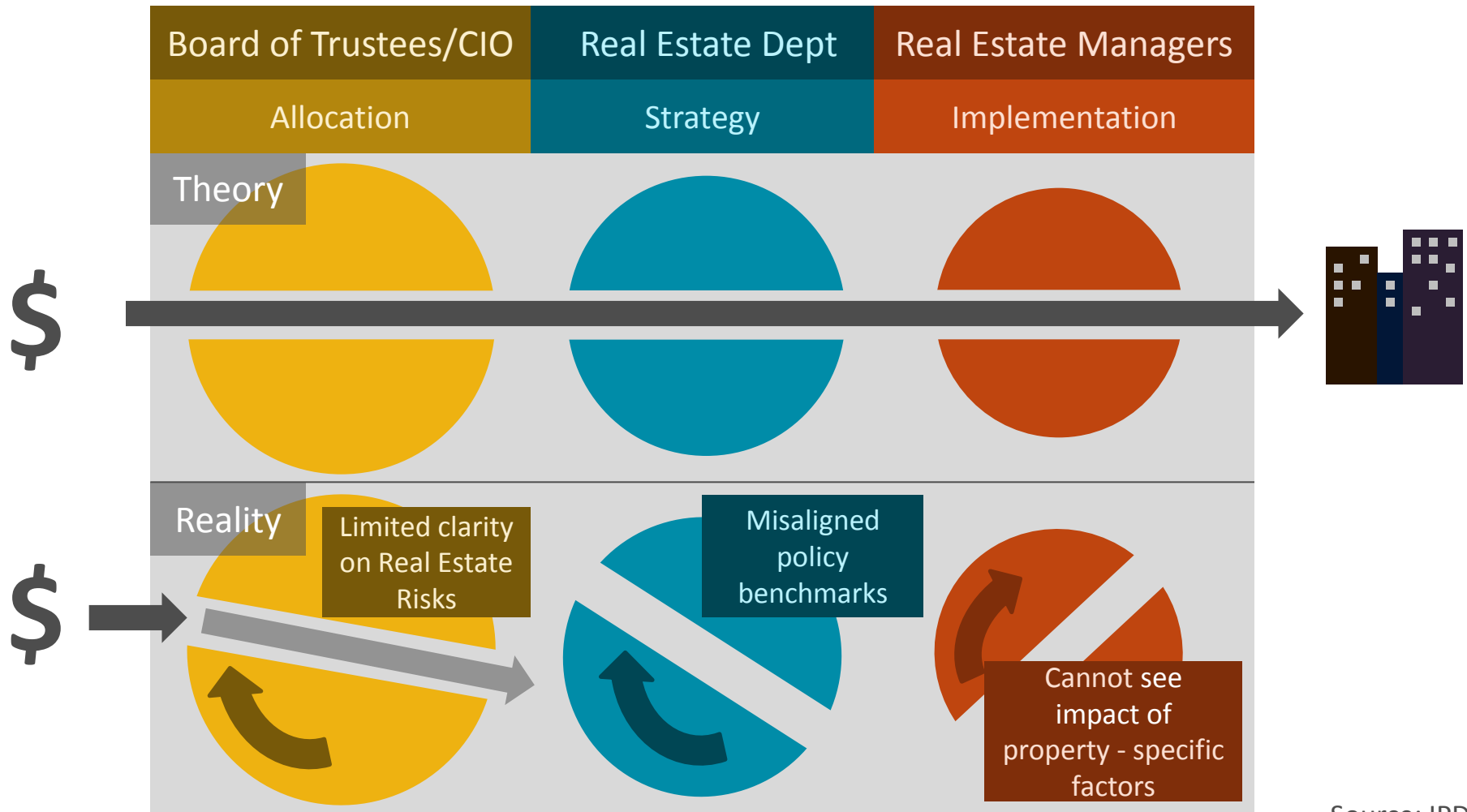
- Investment process
- Asset Owner Survey
 - Approach
 - AO Real Estate exposure
 - AO Real Estate Risk Management



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IPD/MSCI Asset Owner Survey: Shining a Light on Misalignments through the Investment Process

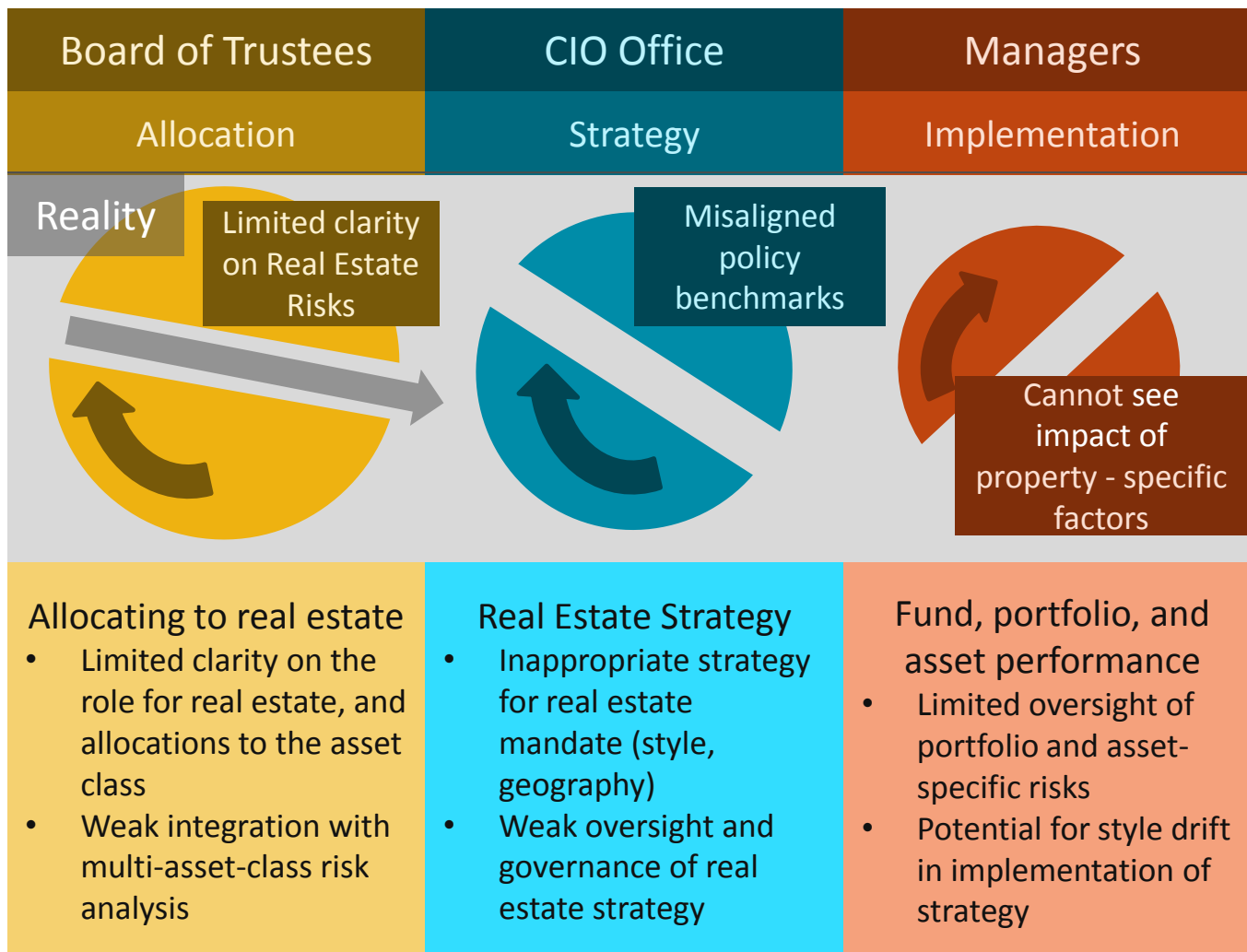
Objectives and execution options can create a disjointed investment process



Source: IPD

Challenges Exist Through the Real Estate Investment Process

Investment Process:





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Agenda

- Investment process
- Asset Owner Survey
 - Approach
 - AO Real Estate exposure
 - AO Real Estate Risk Management



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Survey Approach

- **MSCI conduct AO surveys every 18 months** or so. On this occasion, the survey focused on Multi-Asset-Class Allocation issues, and Real Estate
- Three main **data sources**:
 - **40 in-person interviews** during Q4 2013 with Risk Managers/CIO's at organizations with **\$3.2 T** in assets
 - Supplemented by 44 responses to an online version, with another \$0.7 T in assets
 - Data from the annual reports and public sources of **138 organizations**, with **combined assets of \$10.3 T**
- **Conducted jointly by**:
 - MSCI – Neil Gilfedder, Zita Marossy, Thomas Verbraken
 - IPD – Peter Hobbs, Bert Teuben, Bridget Bruss

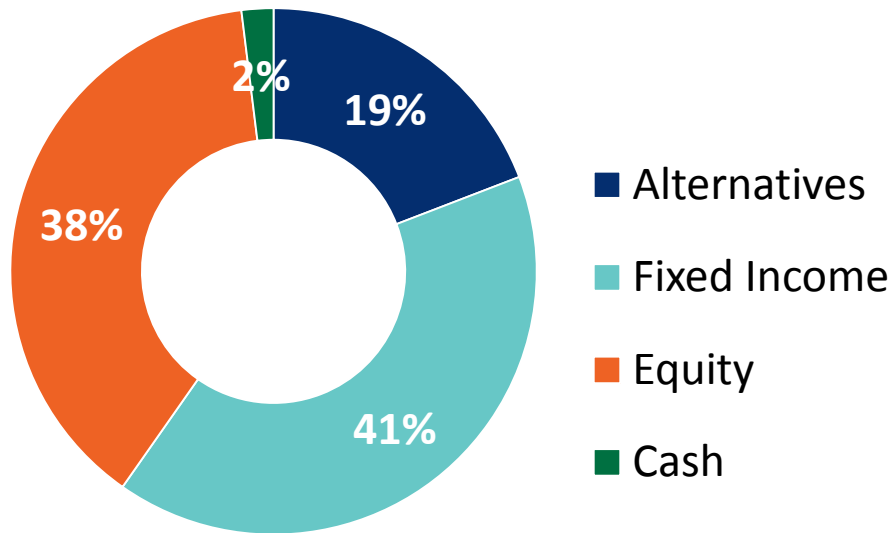


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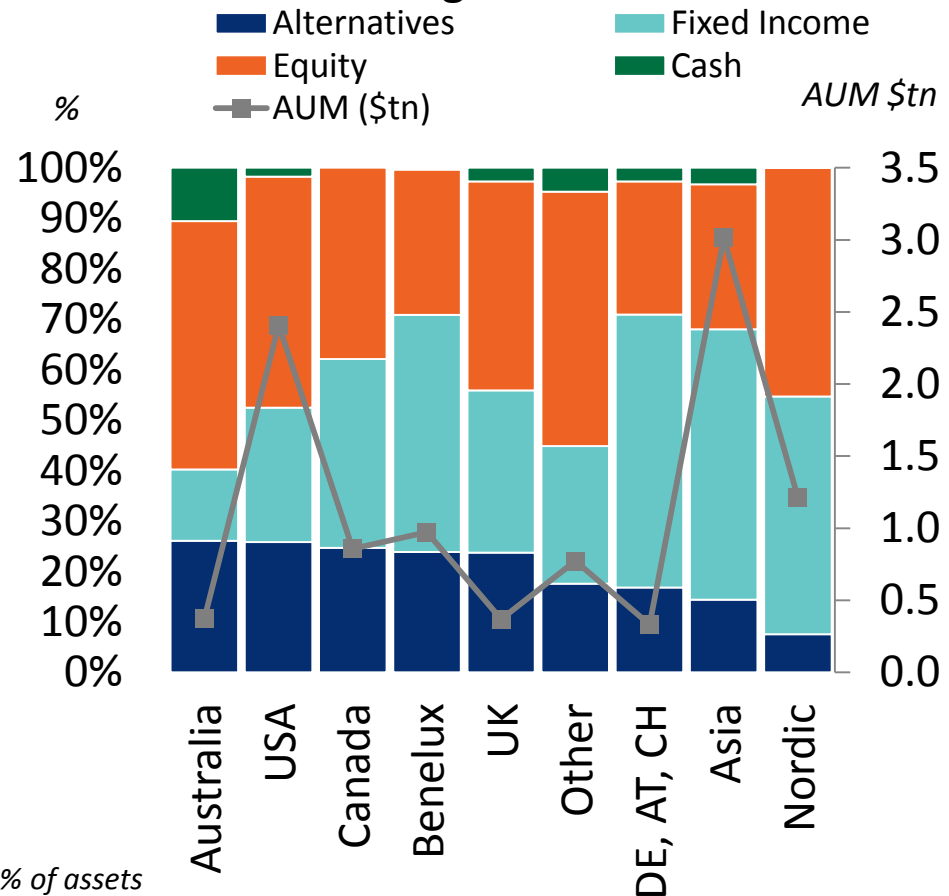
Multi-asset-class Allocations: 40:40:20 has Replaced 60:40, but Wide Variations Across Markets

Asset Class Allocations Across Regions

Global



Regional



Note: Based on 138 asset owners in Survey Universe. Calculated on % of assets in each category, not number of asset owners.

Sources: IPD; MSCI

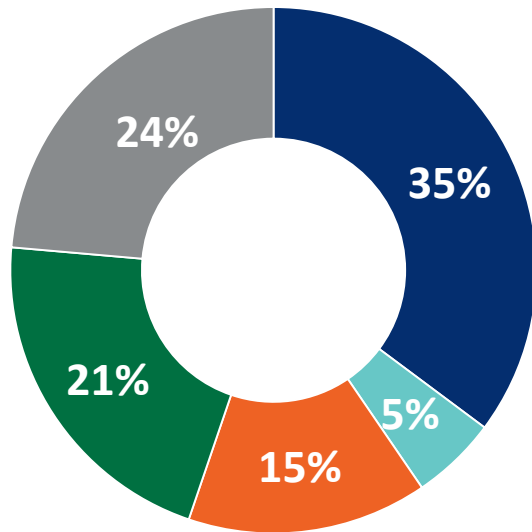


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Real Estate is the Favoured “Alternative” Asset Class, Globally and in all Markets Except USA

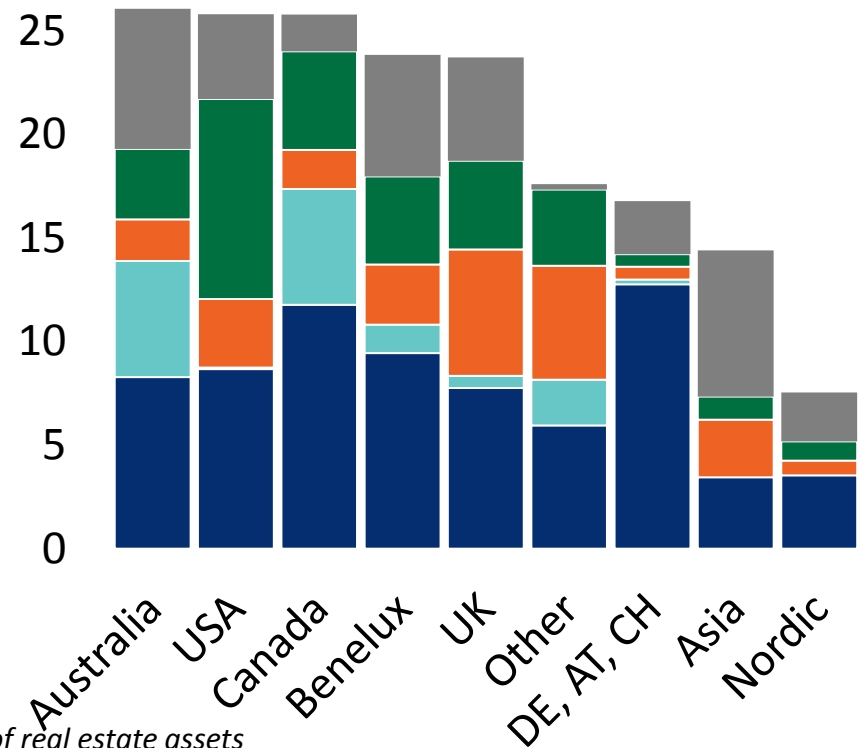
Alternative Allocations Across Regions

Global



- Real Estate
- Infrastructure
- Hedge Funds
- Private Equity
- Other

Regional



Note: Based on 138 asset owners in Survey Universe. Calculated on % of real estate assets in each category, not number of asset owners.

Sources: IPD; MSCI



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Survey was based on 138 AO's with over \$10tn assets and \$696bn in Real Estate

127

AOs with real estate

\$8.8 tn

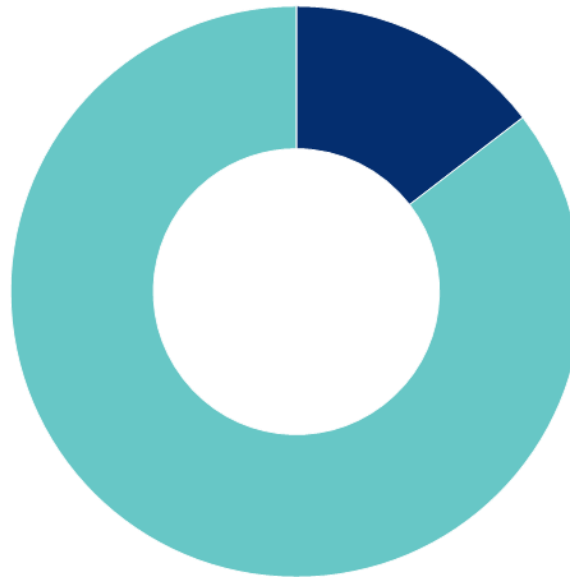
Total assets under management

\$696 bn

Total real estate assets

8%

average real estate allocation



9

AOs without real estate

\$1.5 tn

Total assets under management

Note: Asset Owners included in the survey including Pension Funds and SWFs, but excluding Insurance companies and HNWI
Source: IPD; MSCI

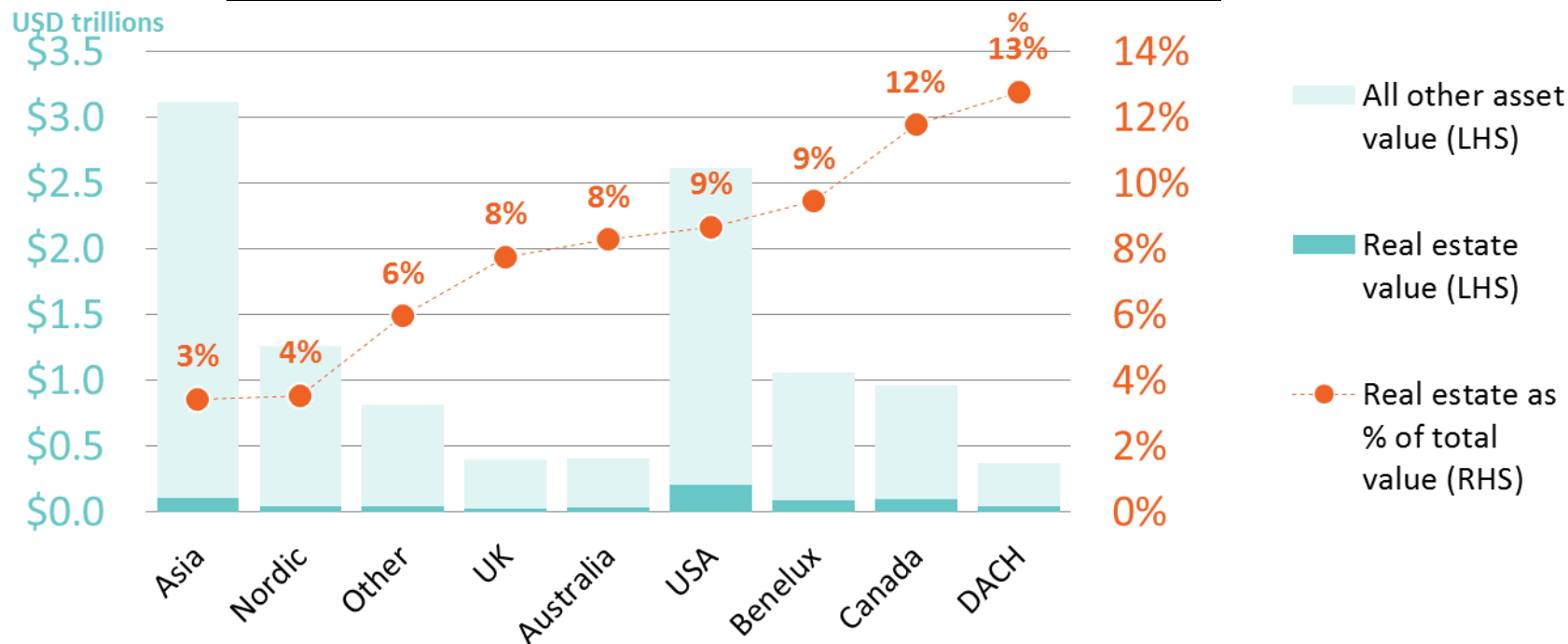


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Real estate represents 8-12% of exposure for most mature investment markets, with significant variations across regions

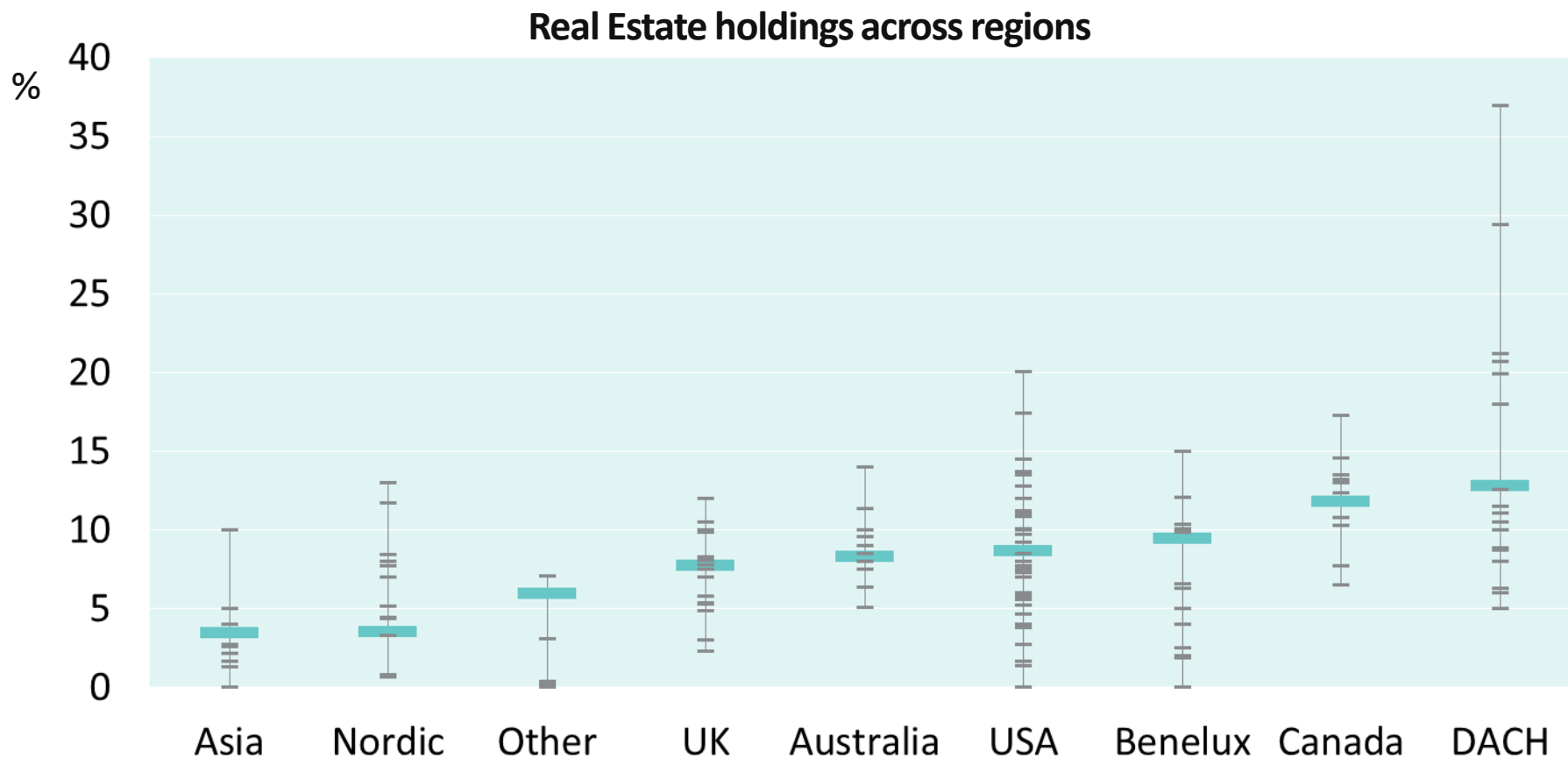
- Lowest allocations in Asia and Nordics due to
 - Legacy of early-1990s crisis (Japan and Sweden)
 - Emergence of new AO's ramping up Real Estate (Nordics and Asia)
- Allocations set to grow across all markets

Total assets and real estate exposure across regions



Exposure Varies Within Regions as Much as Between Them

- No relationship between size and allocation to real estate
- Group of global asset owners with >\$15bn each, increasingly internalizing



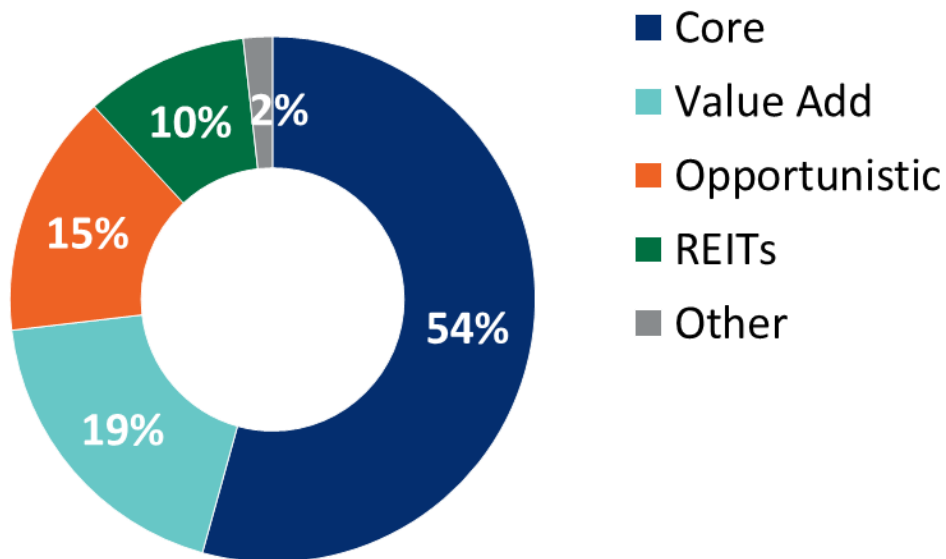


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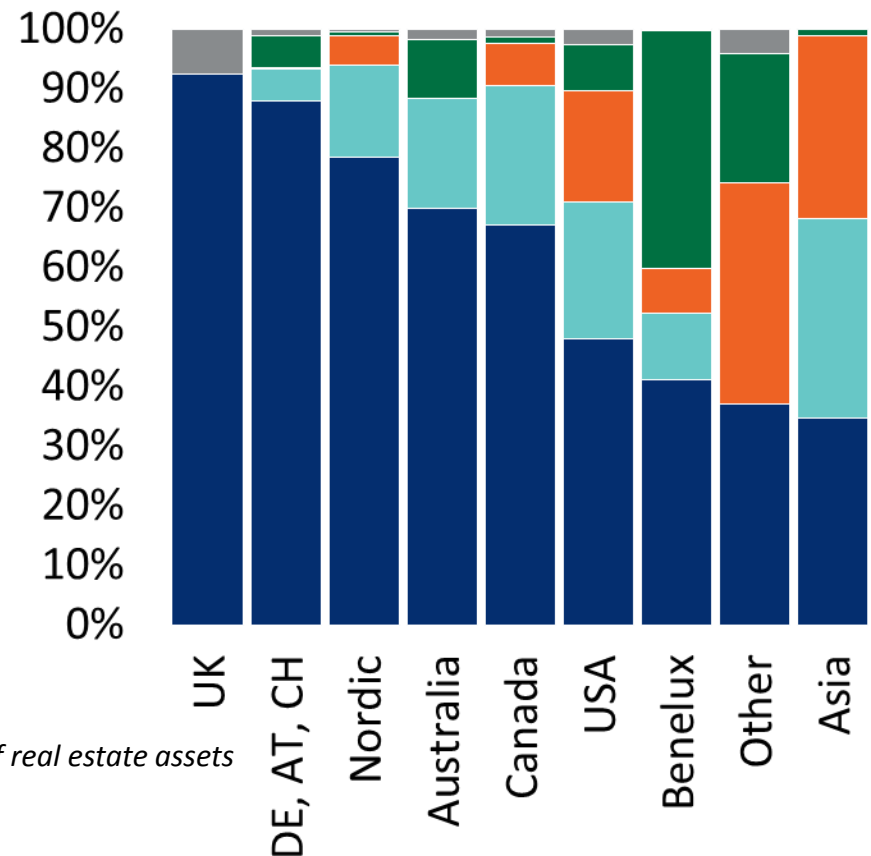
Core Dominates Investment Style, but 45% Playing Other Roles Especially U.S., Asia and ME

Allocations to Investment styles of real estate across regions

Global



Regional



Note: Based on 138 asset owners in Survey Universe. Calculated on % of real estate assets in each category, not number of asset owners.

Sources: IPD; MSCI

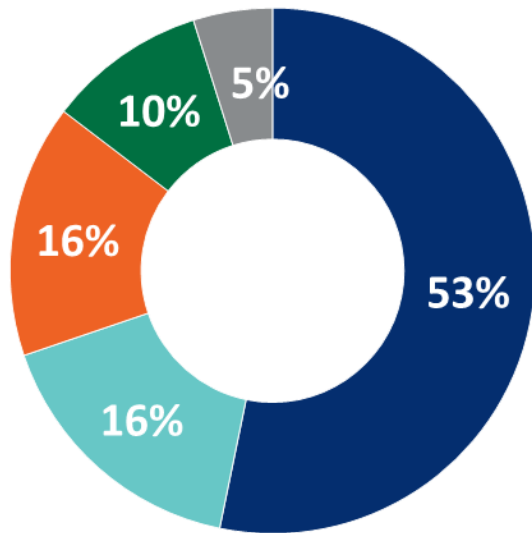


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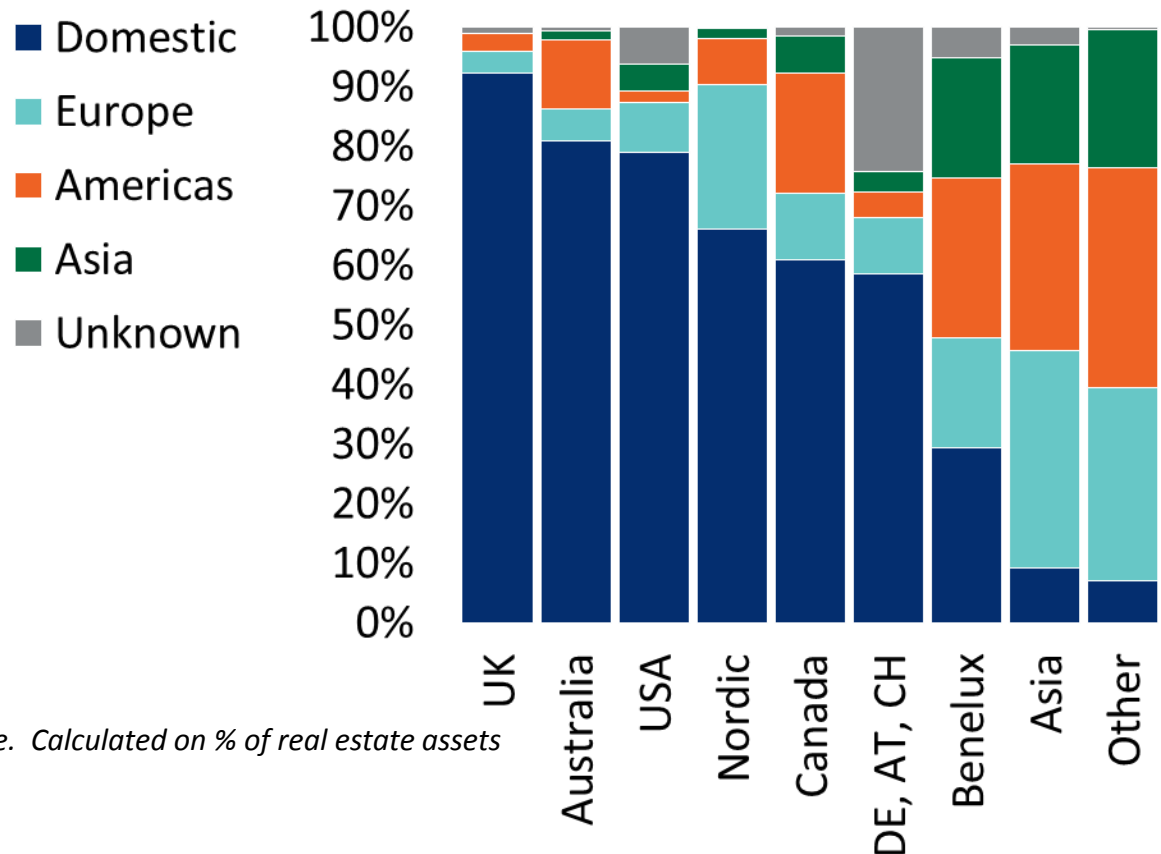
Home Bias Remains but Appetite for Non-Domestic is Growing Across all Markets

Geographic exposure for real estate portfolios

Global



Regional



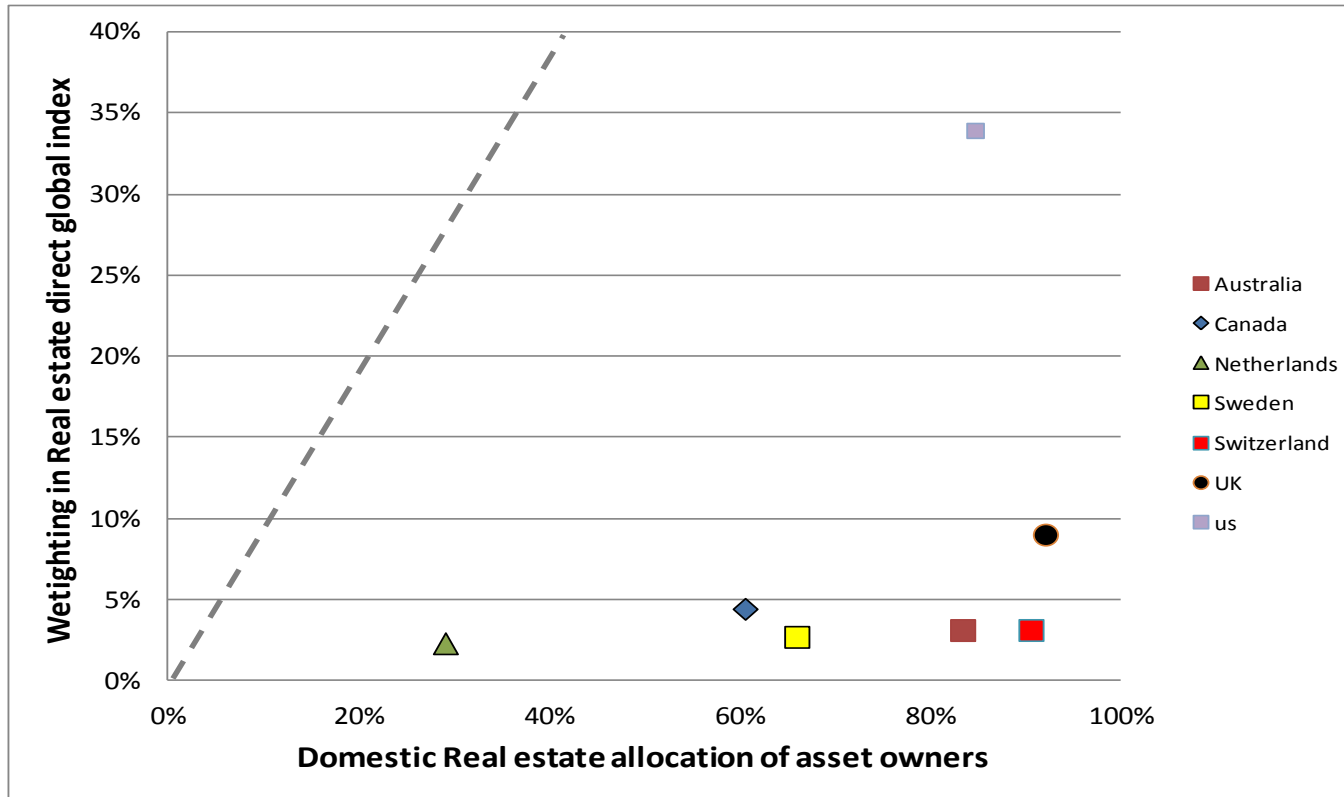
Note: Based on 138 asset owners in Survey Universe. Calculated on % of real estate assets in each category, not number of asset owners.

Sources: IPD; MSCI



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Home Bias Remains but Appetite for Non-Domestic is Growing Across all Markets



Note: Weighting in IPD global index.

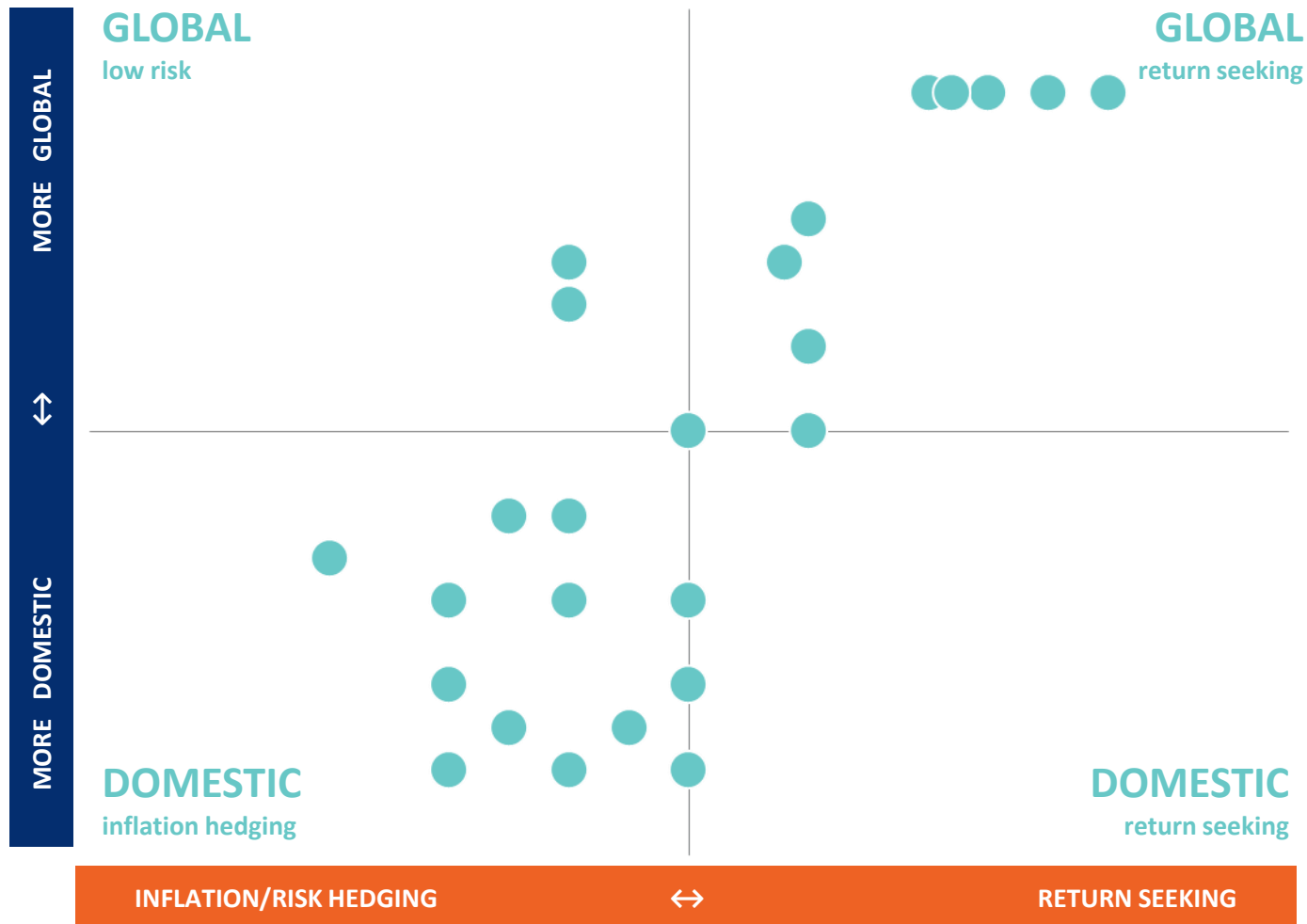
Sources: IPD; MSCI



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AO Survey Reveals a Range of Options for Investing Within Real Estate: Risk/Return and Geography

Schematic representation of role of real estate for major Asset Owners



Note: Each dot represents a specific Asset Owner.

Source: IPD; MSCI

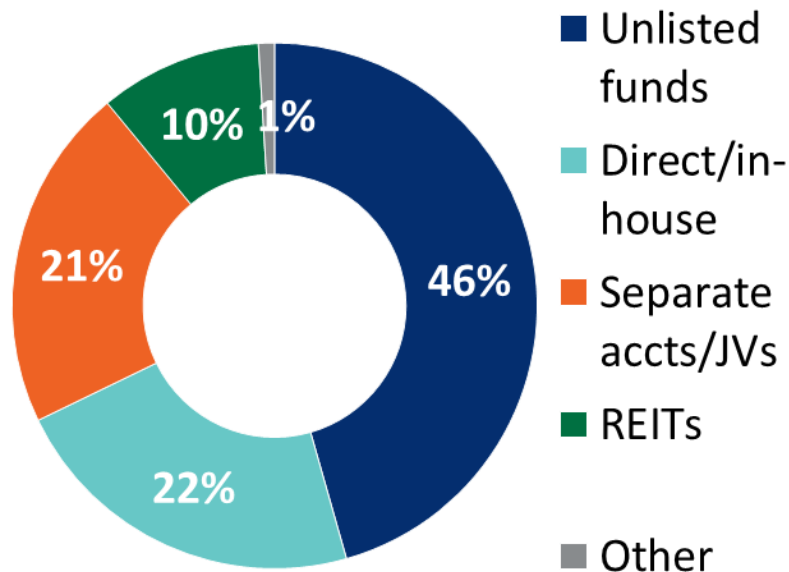


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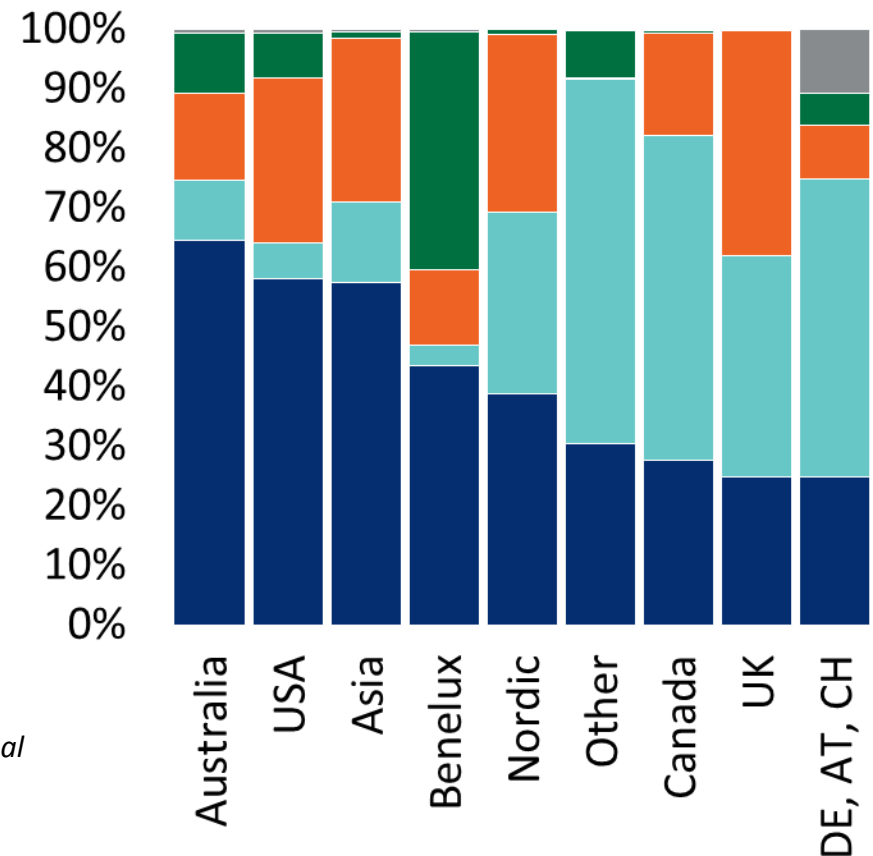
External Management Dominates, Although this Conceals a Drive for Greater Control by the AO's

Allocations to different modes of execution

Global



Regional



Note: Based on 138 asset owners in Survey Universe. Calculated on % of real estate assets in each category, not number of asset owners.
Sources: IPD; MSCI



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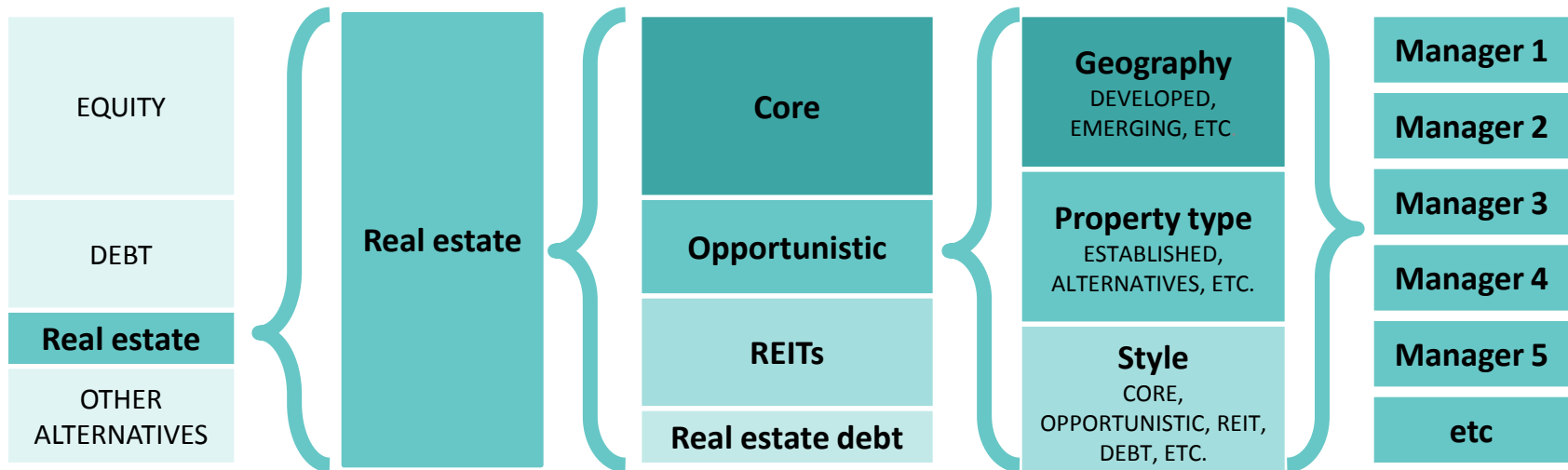
Real Estate Risk Management: Within the Multi-Asset portfolio, and Within the Real Estate exposure



1. Allocation TO REAL ESTATE

2. Allocation WITHIN REAL ESTATE

3. Selection OF PORTFOLIO & ASSETS



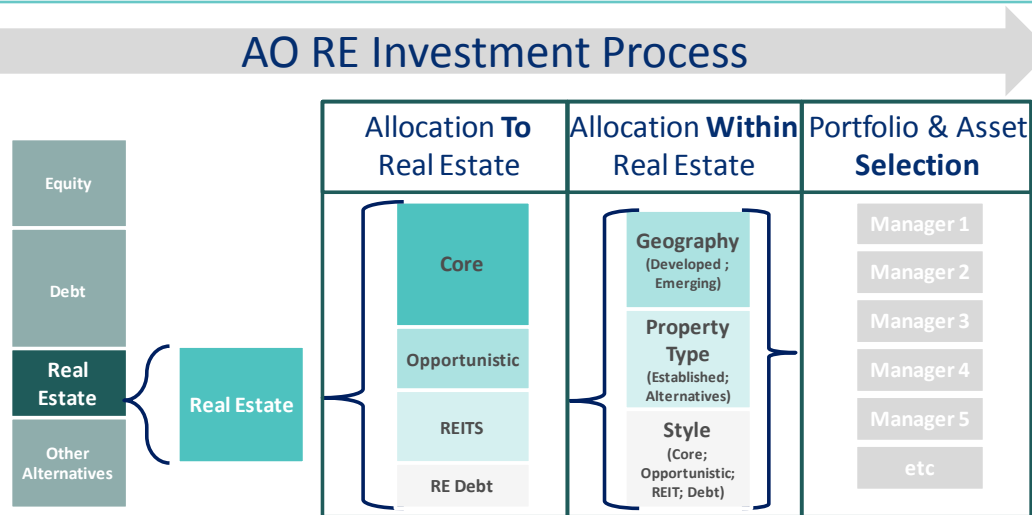
Are risks aligned to allocation and selection decisions?



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Real Estate Risk management on two important dimensions:

1. Within the Multi-Asset portfolio, and
2. Within the Real Estate exposure



1. Role of RE in the overall portfolio :

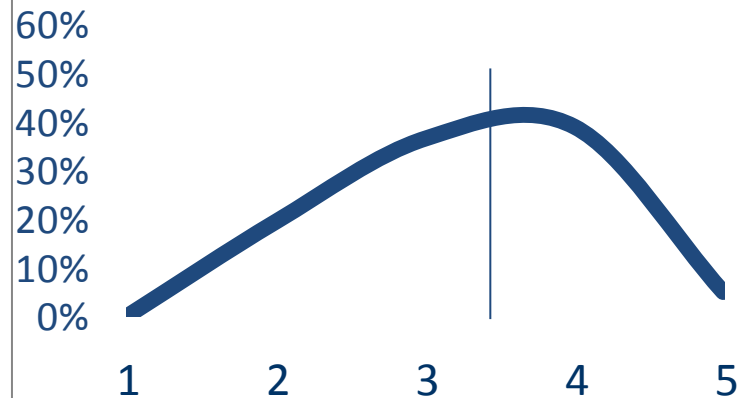
- ✓ **Risk/Return Objectives** for RE
- ✓ Are **differences of behaviour** within real estate recognized in the allocation process?
- ✓ Is RE behaviour and exposure **integrated with multi asset allocation studies**?
- ✓ Is **real estate pricing** recognized in allocation process?



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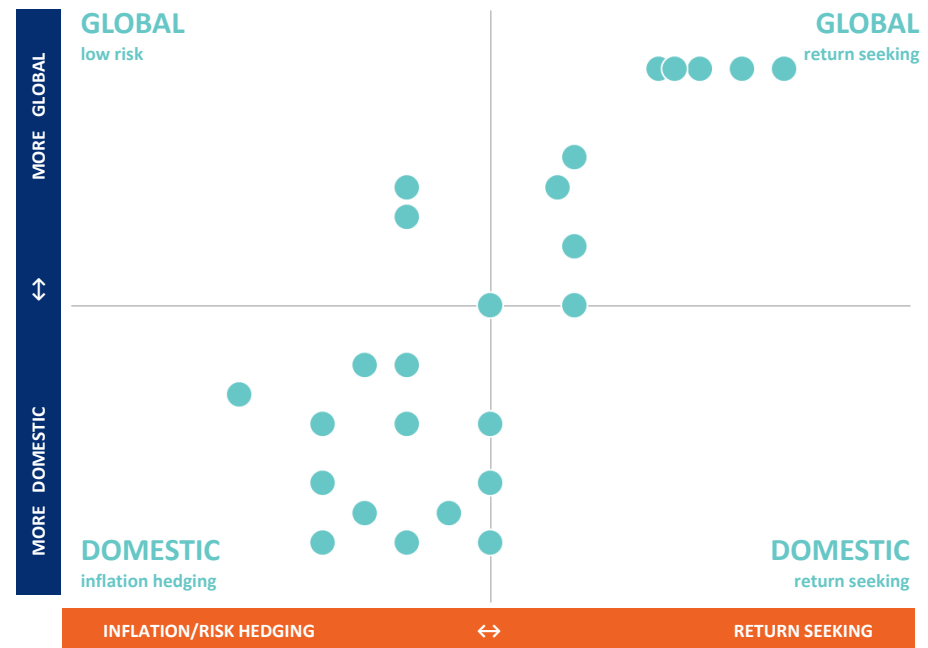
1.1 The Role for Real Estate in a Multi-Asset-Class Context

Clarity of risk/return objectives for real estate
in overall allocations



Note: Based on the rating of the strength of approach on each dimension (0 = very weak, 5 = very strong) for the 40 asset owners interviewed. Sources: IPD; MSCI

Role of real estate for major Asset Owners



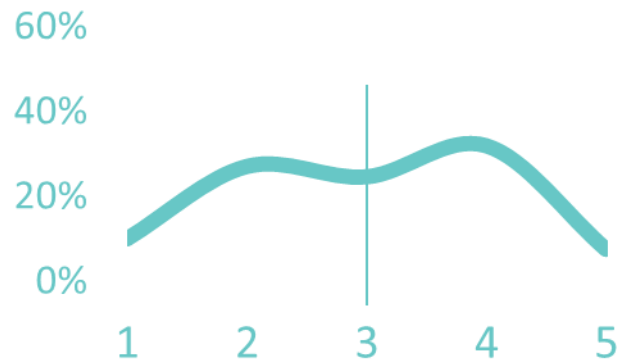
“Real estate characteristics are not well understood and not well integrated into the overall allocation and risk process. We want to better understand the inflation and interest rate sensitivity of real estate; how this varies according to the quality, vacancy rates and discount rates.” US Pension Fund, IPD/MSCI Survey Feb 2014



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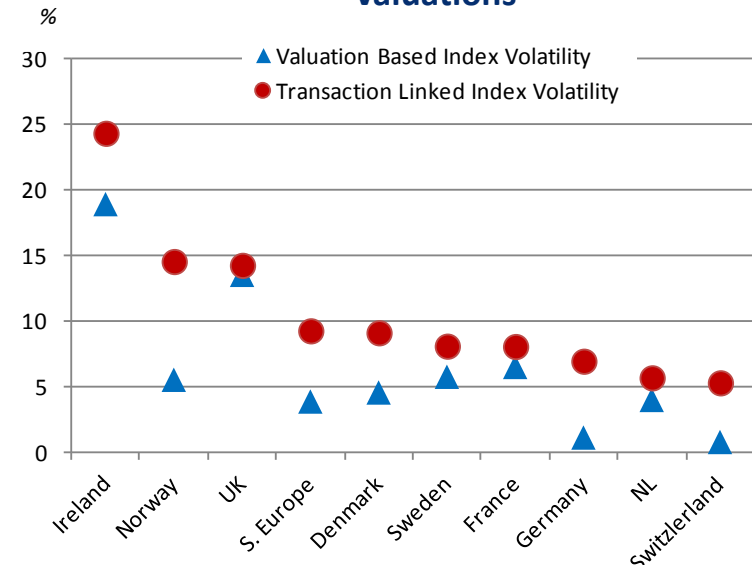
1.2 Differences of Behaviour In the Allocation Process

Recognition of differences of behaviour
within real estate



Note: Based on the rating of the strength of approach on each dimensions (0 = very weak, 5 = very strong) for the 40 asset owners interviewed. Sources: IPD; MSCI

Real estate volatility measured by “transactions” and “valuations”



Source: IPD

Note: Based on annual volatility over 10 years with quarterly observations, to end 2011

“we have struggled to get the right real estate data to use in our ALM process.”
Nordic Pension Fund, IPD/MSCI Survey Feb 2014

“We have good understanding of real estate in the return space, but not in the risk space”. US Pension Fund, IPD/MSCI Survey Feb 2014



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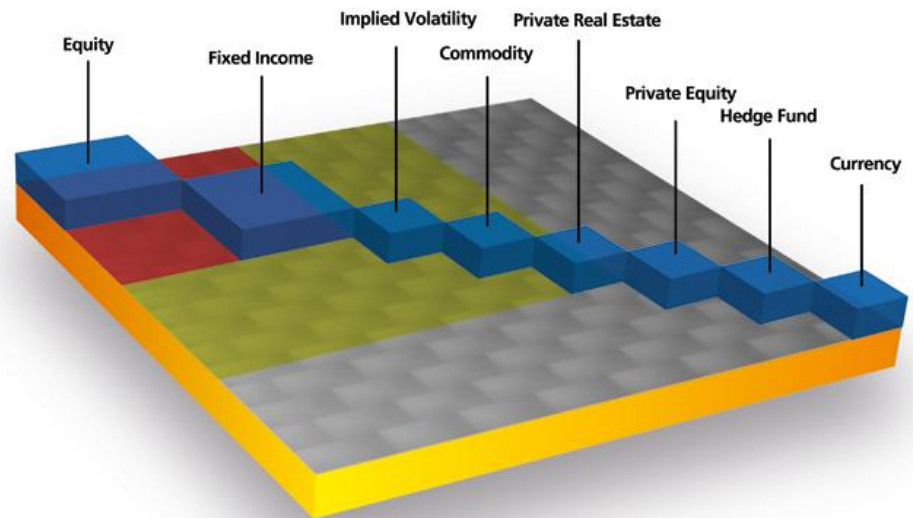
1.3 Real Estate Exposure Integrated in M-A-C Analysis

Real estate behaviour and exposure integrated with multi asset allocation



Note: Based on the rating of the strength of approach on each dimensions (0 = very weak, 5 = very strong) for the 40 asset owners interviewed. Sources: IPD; MSCI

Integration of real estate within multi-asset-class risk analysis tools



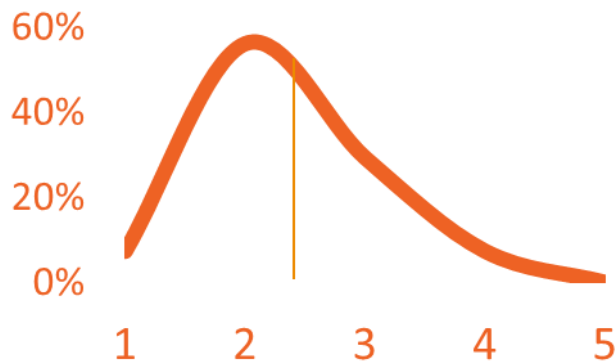
““asset managers think like fixed income managers 30 years ago when there was little regard to investment-specific risks. The risk team struggles to drill through to the real estate risks and boil these down to six or seven numbers.” SWF, IPD/MSCI Survey Feb 2014



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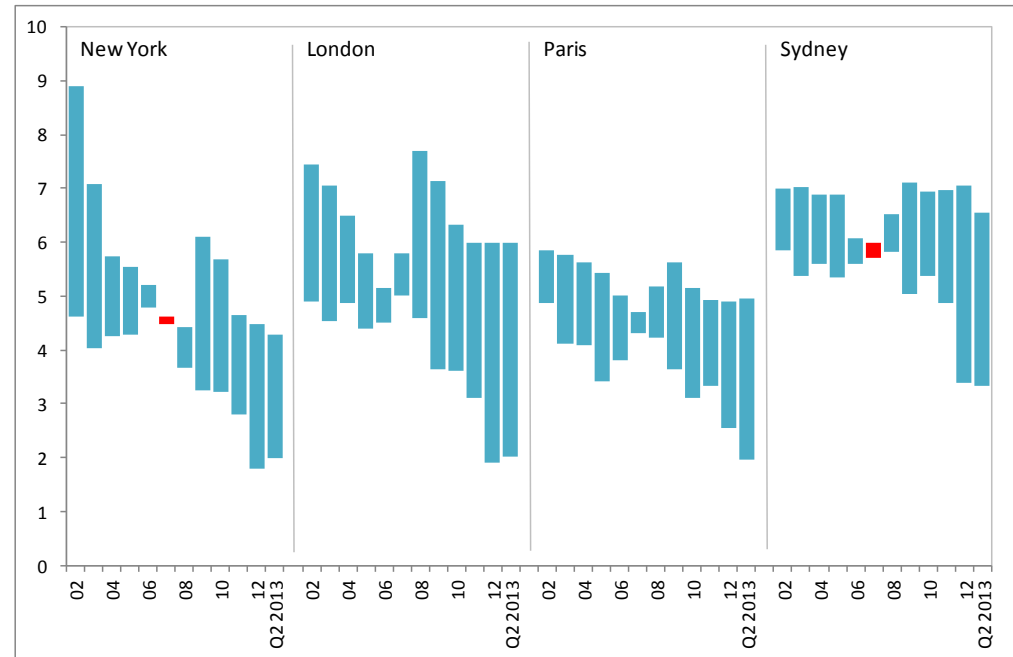
1.4 Real Estate Pricing in a Multi-Asset-Class context

Recognition of real estate pricing and implications for SAA



Note: Based on the rating of the strength of approach on each dimensions (0 = very weak, 5 = very strong) for the 40 asset owners interviewed. Sources: IPD; MSCI

Average yield spread over 10-yr government bonds

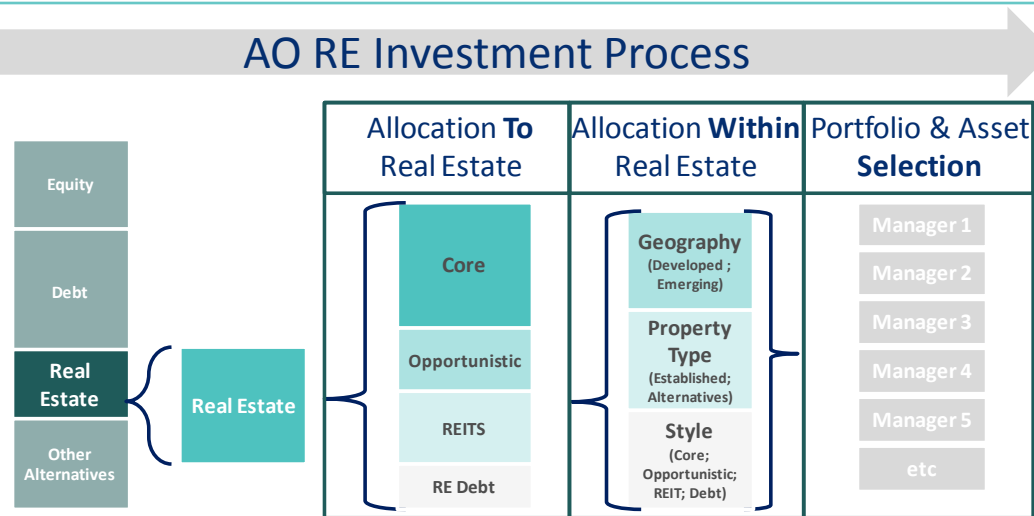


“We do not have explicit allocations to real estate as this tends to encourage teams to fill up the allocation bucket rather than make investments that are appropriate for the portfolio as a whole. Australian Pension Fund, IPD/MSCI Survey Feb 2014



Real Estate Risk management within the Real Estate exposure

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2. Risk management of the RE exposure:

- ✓ Extent of **Board oversight/involvement** in RE activities
- ✓ Are **benchmark(s)** adopted for
 - the overall RE exposure
 - specific RE mandates/portfolios?
- ✓ Are **RE risks** monitored at the level of the
 - Asset/lease
 - Portfolio?

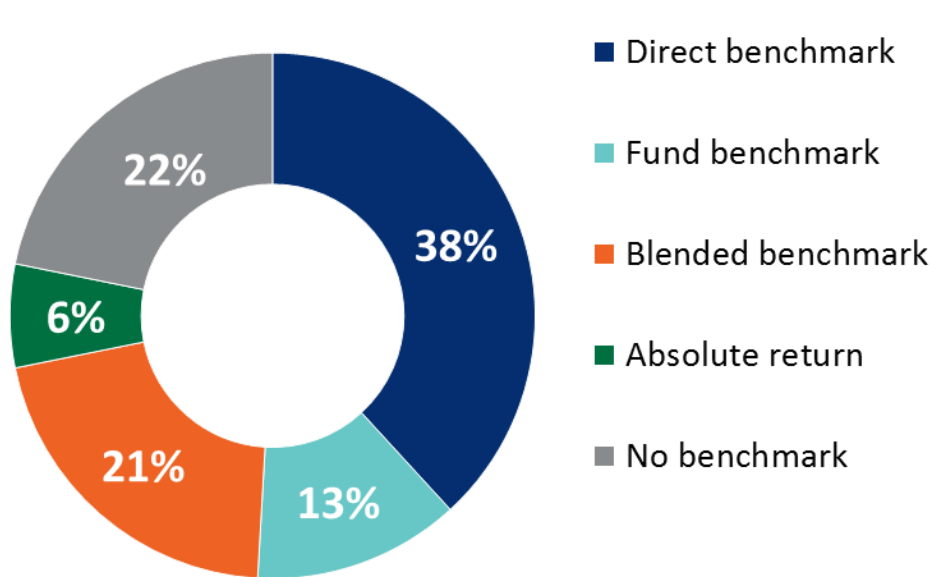


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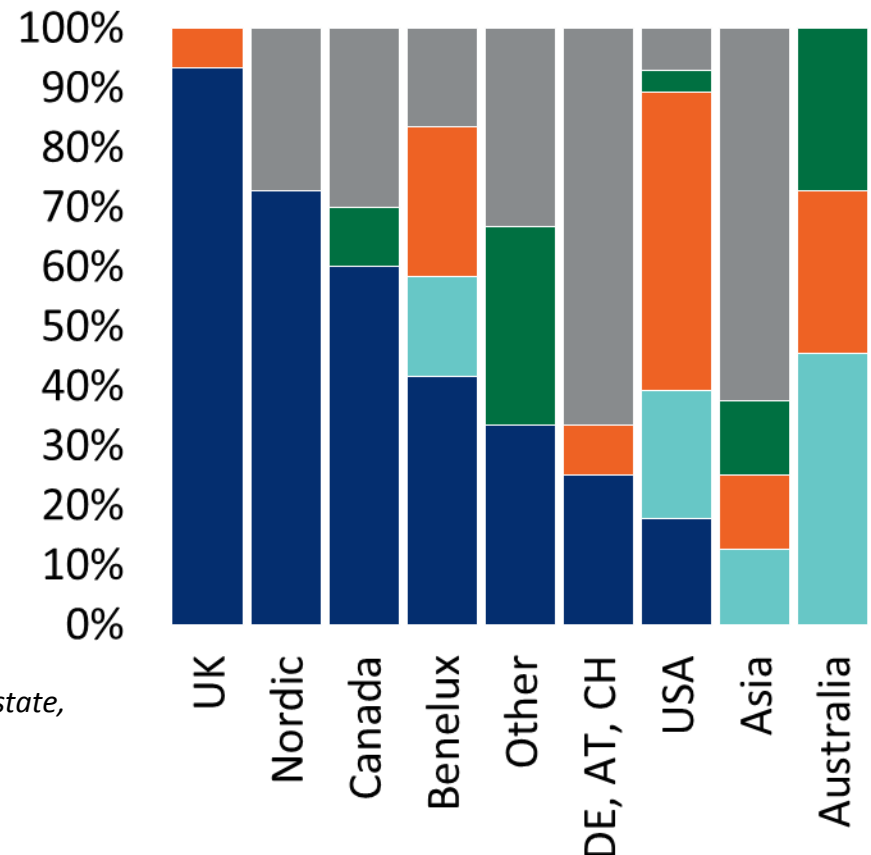
Real Estate Risk Management is Starting to Improve, But Challenges Remain: The Case of Benchmarks

Use of Benchmarks for AO Real Estate Exposure

Global



Regional



Note: Based on % of asset owners in each category, not value of real estate, and for the 110 AO's for which benchmark information is available

Sources: IPD; MSCI

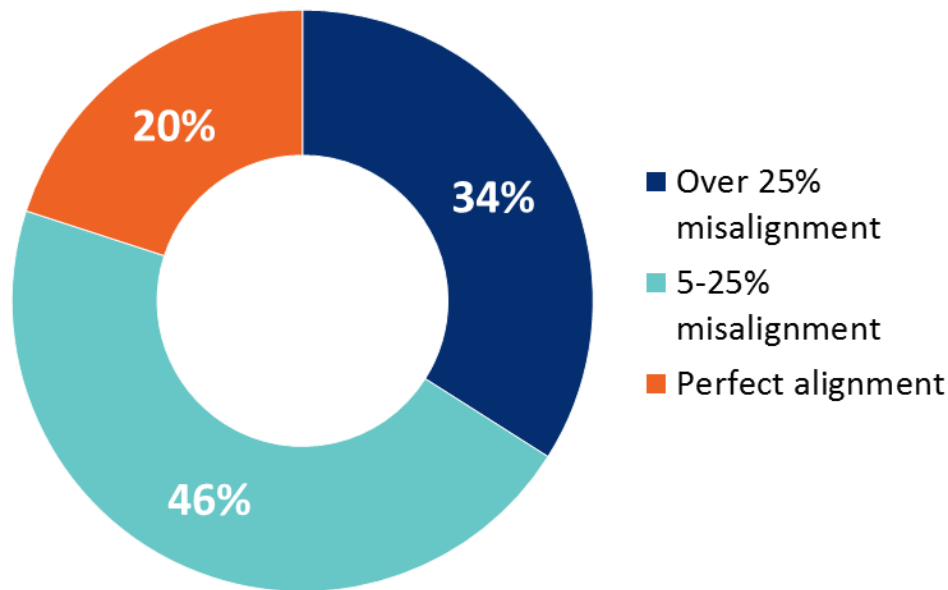


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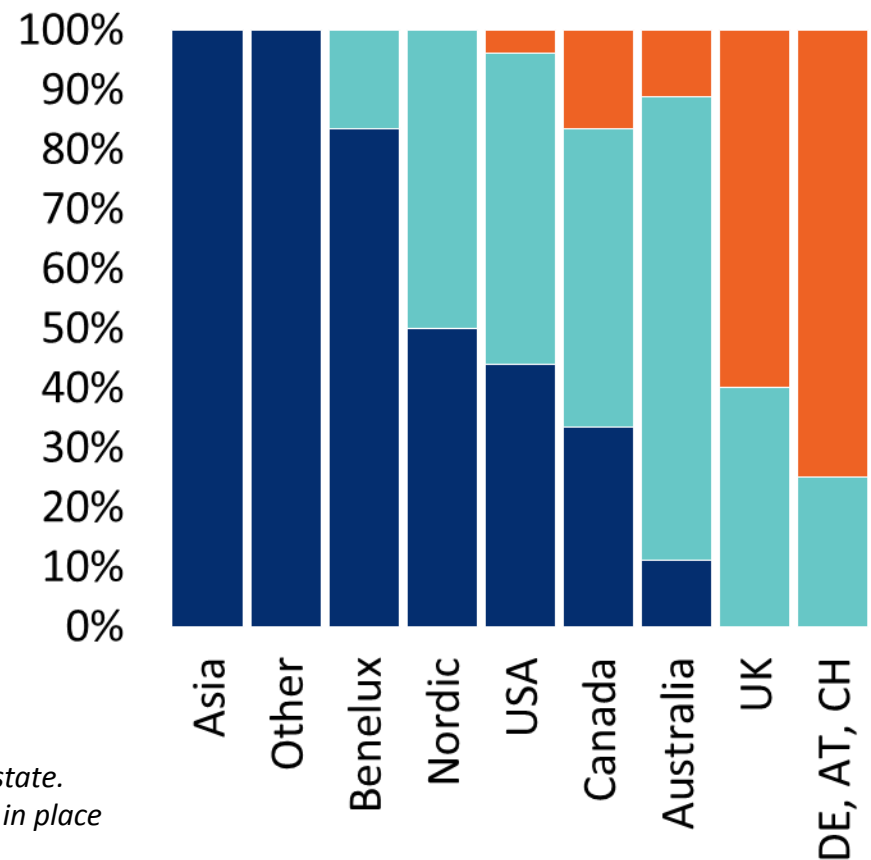
80% of Asset Owners have Some Benchmark Misalignment

Alignment of real estate benchmarks with investment strategy

Global



Regional



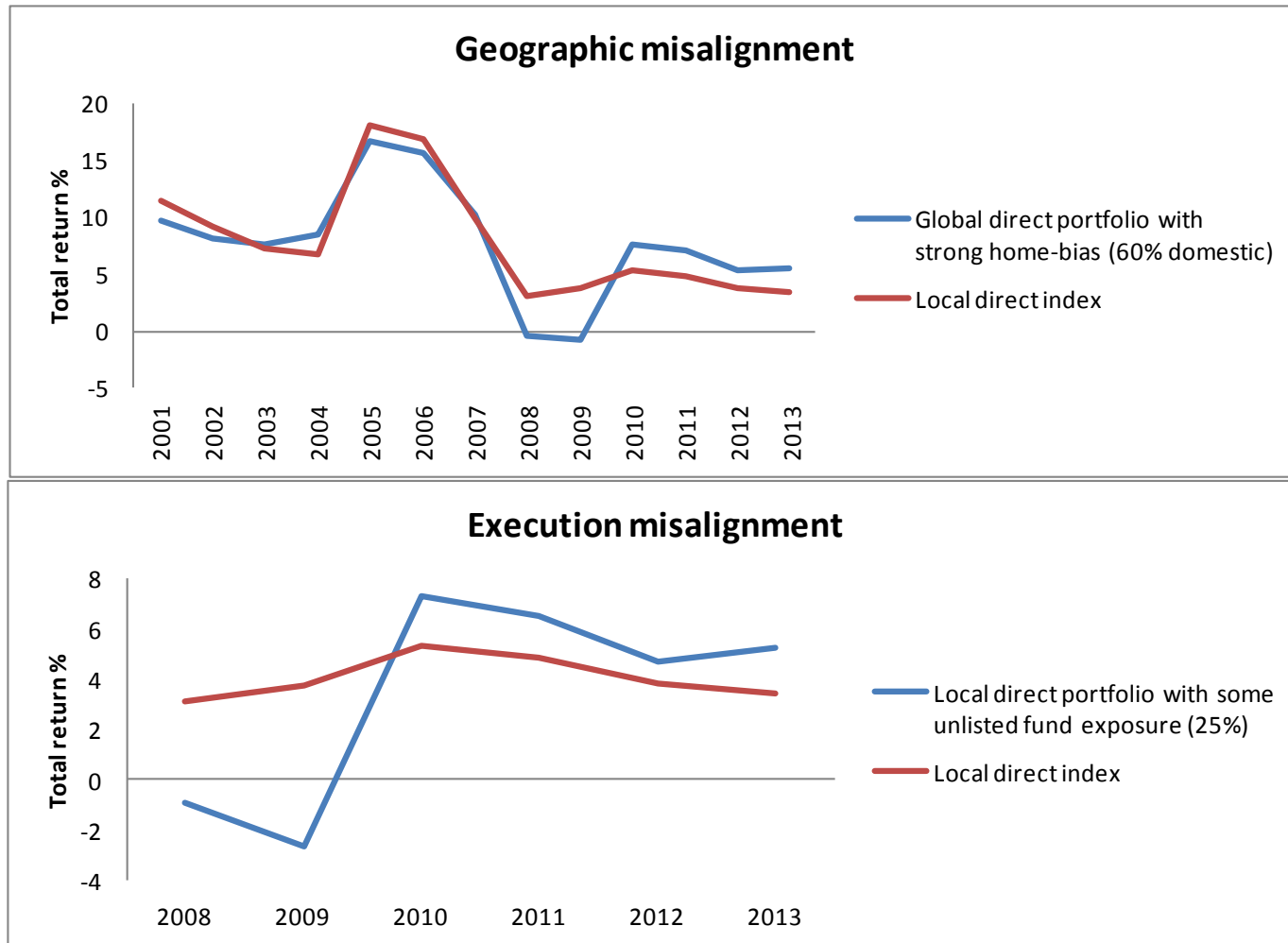
*Note: Based on % of asset owners in each category, not value of real estate.
Benchmark alignment based on those for which a Policy benchmark is in place
Sources: IPD; MSCI*



Potential impact of Benchmark Misalignment

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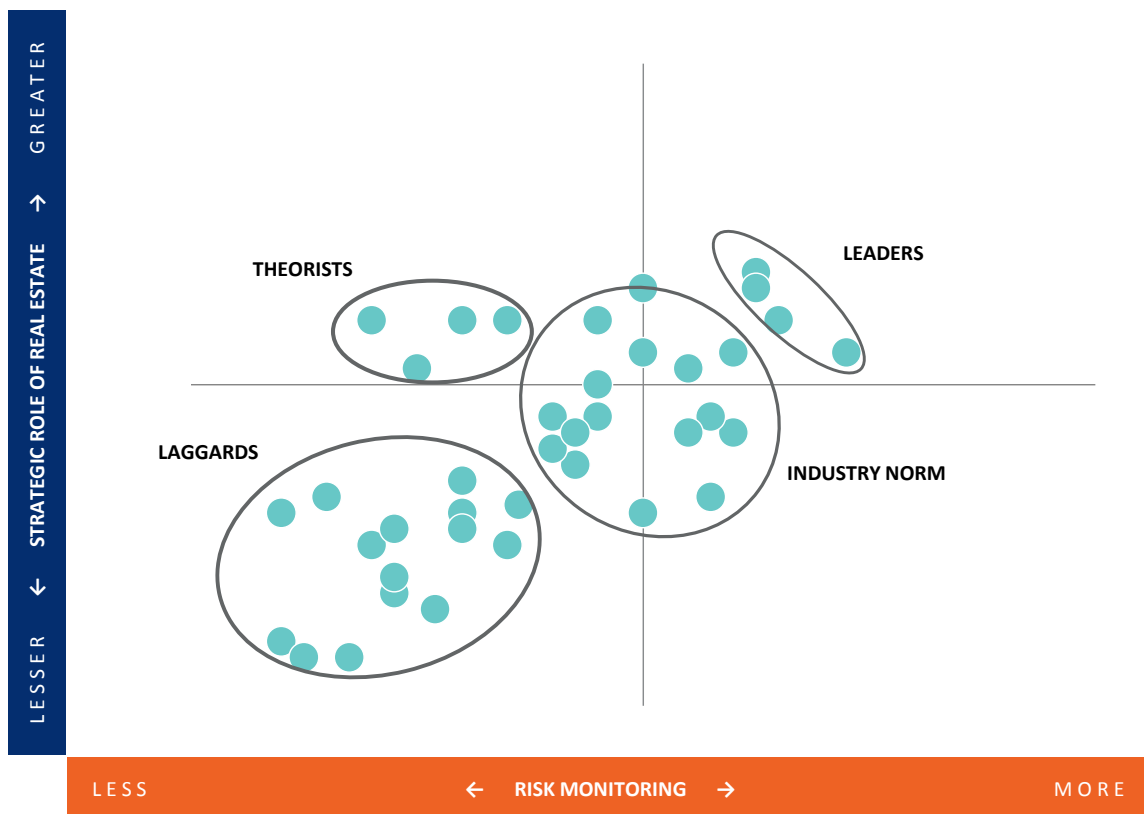
Effect on benchmark return due to misalignment



Huge variations in approach to Real Estate Risk management

- **Real estate within the multi-asset portfolio**
 - Understanding of RE Behavior & clarity of objectives
 - Integration with SAA
 - Recognition of pricing
- **Real Estate risk monitoring**
 - CIO drill-through insight
 - Benchmarks – strategic & mandate
 - Portfolio and asset specific risk metrics

Sophistication of approach to Real Estate risk management



Note: Positioning of individual asset owners on two key dimensions of risk management
Source: MSCI/IPD



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Key messages from the survey

- **Real estate is a favoured asset class.** **Home bias** remains but there is a trend to increase non-domestic exposure.
- Significant **variations in the role of real estate** from low return inflation-hedging through high absolute return seeking. It is precisely this combination that can create significant **challenges for asset owners**, since it is difficult for risk managers to understand the risks of real estate exposure and integrate with other asset classes.
- This lack of clarity over the role of real estate creates the **potential for misalignment** through the real estate investment process.
 - Most fundamentally, this misalignment can occur between the strategic role for real estate and the actual exposure of the real estate portfolio.
 - This potential for strategic misalignment is often created by more tactical mismatches such as the use of inappropriate benchmarks or limited strategic monitoring of portfolio and asset specific risks.
 - Both these mismatches can lead to **style drift** in the actual real estate exposure.
- **Risk managers** are working hard to overcome these challenges, by better integrating real estate with other asset classes, and tightening up the formal risk management of the real estate exposure