Core real estate funds offer entry route to investors

- Designed as a guide for new and existing investors
- Qualitative and quantitative arguments for core real estate funds
- Genuine exposure to real estate - one of key benefits

RESEARCH

Core real estate funds give investors genuine exposure to real estate type returns, according to the report "The Investment Case for Core Real Estate Funds".

The findings are included in this quantitative and qualitative guide for new and existing investors, which is designed as an accessible overview of the arguments for investing through funds, and therefore should be seen as a useful tool for fund managers as part of their marketing activities.

Core real estate funds can provide investors with a proxy for direct real estate investment, demonstrated by how closely funds track the established direct property market index, with a high (0.87) correlation to the IPD Pan-European All Property Index.

Table 1 shows the tracking errors of the different investment approaches to the IPD Pan-European All Property Index. The results show that the tracking errors for a portfolio of 10 or 20 funds are much lower at 5.8% and 5.6% compared with a direct portfolio of €100m or €200m at 11.0% and 8.2% respectively and listed at 28.3%.

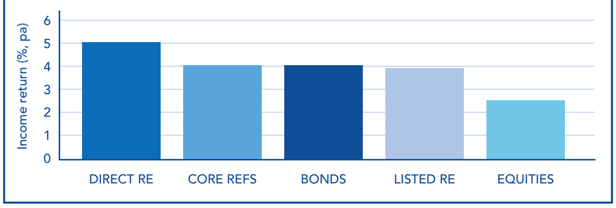
Table 1: Returns and tracking errors for property investment approaches

Strategy–2001-2013 2001 vintage	TWRR (mean)	Direct tracking error (mean)
IPD Pan-Europe All Property Index	6.00%	
INREV Core Funds Index	5.21%	
Direct €100m	5.09%	11.0%
Direct €200m	5.09%	8.2%
Single non-listed fund	5.19%	9.1%
Dual non-listed fund	5.29%	7.6%
€100m multi-manager (10 core funds)	4.93%	5.8%
€200m multi-manager (20 core funds)	4.93%	5.6%
Listed fund	10.88%	28.3%

Source: PFR, INREV, CBRE Global Investment Partners, EPRA, IPD

A further benefit is the ability to offer investors a high and stable income return relative to other asset classes. As a rule, their strategies focus on generating a high proportion of returns from income. Between 2001 and 2013, the time-weighted rate of return (TWRR) for the income component of core real estate funds was 4.08% per annum (Figure 1). Further analysis shows a low variance of this income return, meaning the levels of income remained relatively consistent through all phases of the cycle in the ten year period, including during the global financial crisis (GFC). It should be noted that bond returns were unusually high during this period.

FIGURE 1: INCOME RETURNS OF ASSET CLASSES 2001-2013



Source: PFR, INREV, EPRA, IPD, Thomson Reuters

Core real estate funds can also provide good diversification potential at a multi-asset allocation level. This can be seen by the fact that, in general, core real estate funds' returns sit between bonds and equities on a risk-adjusted basis. The research provides some evidence to support this but also reflects the unusual circumstances affecting all asset classes during the GFC.

To demonstrate this, Figure 2 plots time-weighted rate of return (TWRR) against standard deviation. It shows that between 2001 and 2013, returns for core real estate funds were lower than listed real estate, as expected, but also, slightly underperformed bonds and outperformed equities. It should be noted that the returns for bonds were unusually high in this period due to continued low inflation, downward pressure on interest rates and high yields delivered by government bonds in Southern European markets. The performance of the equities market was also unusual in this period, as it experienced both the dot.com crisis early in the 2000s and the financial crisis from 2008 onwards.

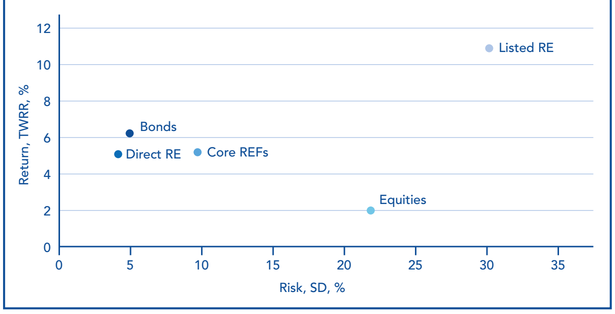
RESEARCH

OTHER KEY BENEFITS:

- Access to specialist management still key
- Core real estate funds benefit from a broad range of products
- Professionalism and the next generation fund model

The risk profile of the three asset classes is more in line with expectations. Looking at standard deviation on the x-axis as a measure of risk, core real estate funds sit in their expected place, which is below equities and listed real estate and above bonds.

FIGURE 2: RISK RETURNS COMPARISONS FOR ALL ASSET CLASSES 2001-2013



Source: PFR, INREV, EPRA, IPD, Thomson Reuters

A second indicator of the ability of core funds to support diversification is the low correlation with the other asset classes. This is set out in Table 2 and indicates a negative correlation with bonds given the -0.24 coefficient and a low positive correlation coefficient of 0.39 with equities. It is important to note that both figures are statistically insignificant from zero implying that there is no statistical evidence of a relationship between the returns of non-listed real estate with bonds and equities. This confirms that non-listed real estate offers investors diversification benefits when included in a multi-asset portfolio.

Table 2: Correlations between asset classes

	Core REFs	IPD	Listed RE	Equities	Bonds
INREV Core REF Index	1.00	***0.87	**0.57	0.39	-0.24
IPD		1.00	**0.51	**0.54	-0.42
Listed RE			1.00	***0.81	-0.26
Equities				1.00	*-0.49
Bonds					1.00

*significant at 90%, **significant at 95%, ***significant at 99%

Source: PFR, INREV, EPRA, IPD, Thomson Reuters

Parts of this report are based on research by Property Funds Research.

The full report is available to members at www.inrev.org
For further information contact research@inrev.org