Strong recovery in the performance of funds of funds in 2014

> Funds of funds delivered strong performance of 8.0%
> Non-European funds of funds outperformed for five years in a row
> Open end funds of funds underperformed for six years in a row

Fund of funds remain an important non-listed real estate product, representing €28.8 billion of total real estate AUM by fund managers globally, according to the ANREV / INREV / NCREIF Fund Manager Survey 2015.

In 2014, funds of funds delivered a total return of 8.0%, the strongest performance seen since 2007. This is a significant jump from the 0.2% total return achieved in 2013, signaling that the fund of funds industry is recovering. The recovery of this industry is further supported by the narrowing of spreads between the performance of upper and lower quartile groups. The gap is 11.9% in 2014, which is significantly lower than those seen in 2008 and 2009 of 21.5% and 24.7% respectively.

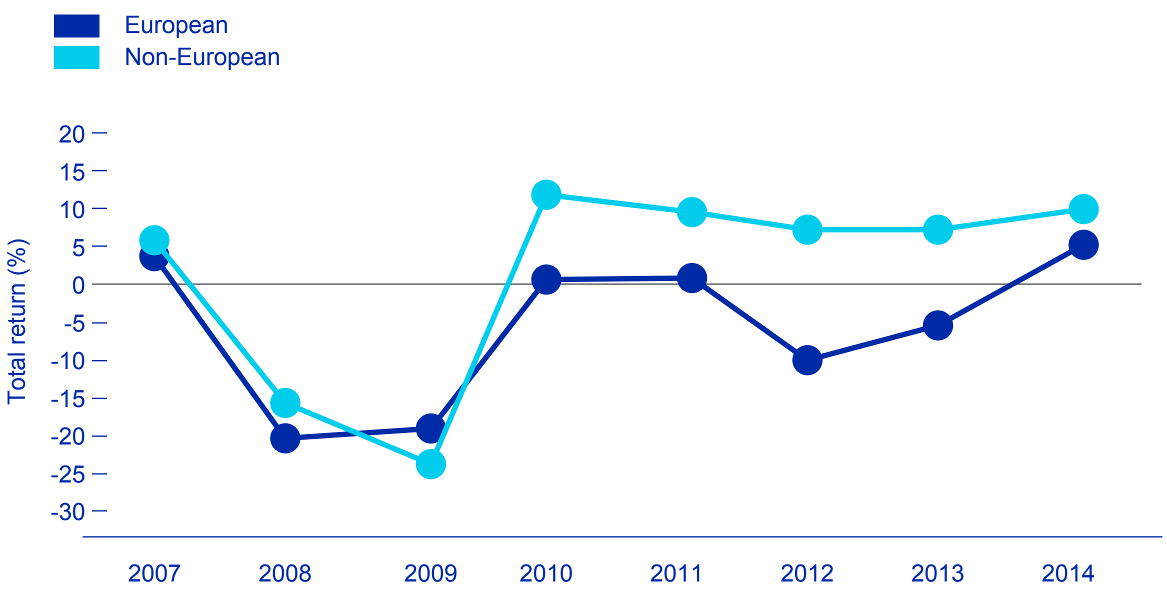
Modest recovery in the performance of funds of funds is seen in those with either a European or a global strategy.

Funds of funds focusing on the European market delivered 5.2% in 2014, an increase from the negative performance of -5.1% in 2013. Similarly, non-European funds of funds achieved superior performance of 9.8% in 2014, the highest seen since 2011.

Funds of funds with a global mandate led performance in 2014 with a total return of 11.9%, while funds of funds targeting the Asia Pacific markets delivered negative performance of -3.3% in 2014.

By structure, closed end funds of funds continued to outperform their open end counterparts in 2014. Closed end funds of funds delivered 8.9% total return in 2014, 110bps higher than the 7.8% total return exhibited by open end funds of funds. This is a trend observed since 2009 when closed end funds of funds have consistently outperformed open end funds of funds.

Figure 1: European vs Non-European funds of funds' performance



Differences can be seen across funds of funds with different investment styles. Core funds of funds are generally larger in size and are more diversified. The average number of vehicles and managers these funds of funds have invested in is 17 and 13 respectively. Core funds of funds also have an average target net internal rate of return (IRR) ranging between 8.0% and 10.0%. This is not surprising given that these funds of funds have a relatively low average target gearing level of 44.1%.

At the opposite end of the spectrum, funds of funds with a non-core strategy are likely to pursue a more niche strategy. This is reflected in the number of vehicles and managers they are investing in. The average number of vehicles invested in by value added funds of funds is 8, while opportunity funds of funds have invested in 10 vehicles, on average.

Furthermore, value added funds have invested with 7 fund managers, while opportunity funds of funds have invested with 8 fund managers, on average.

Non-core funds of funds generally have higher risk levels as shown by their target average gearing level. Value added funds of funds have an average gearing of 59.0%, while opportunity funds of funds have an average gearing level of 68.6%. With higher risk levels, it comes as no surprise that non-core funds of funds have higher average target net IRR compared with core funds of funds.

Opportunity funds of funds have the highest average target net IRR of 14.9% compared with 12.6% for value added and 8.5% for core funds of funds.

It is anticipated that the funds of funds industry will undergo transformational changes in the future. This is especially true given that 39 funds of funds are due to terminate within the next ten years.

Collectively, these funds of funds represent €2.7 billion. A peak of 11 fund terminations is expected to occur in 2019.

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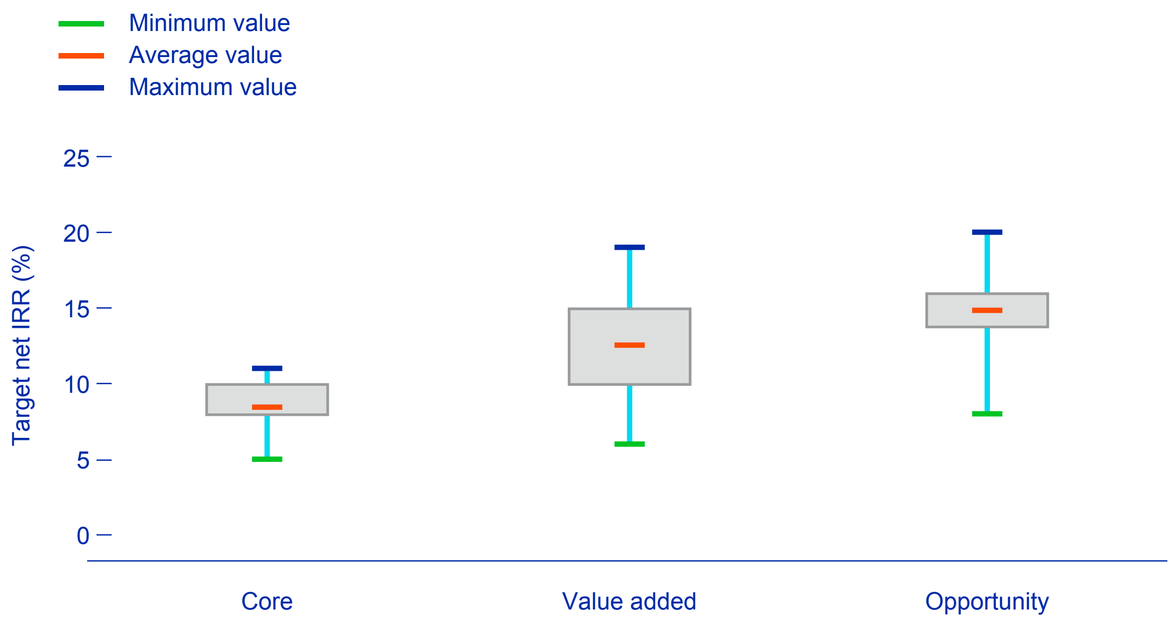
Figure 2: Target net IRR



*The box represents the interquartile range, the difference between the upper quartile and lower quartile values.