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Bringing global consistency to real estate performance measurement

Real estate investment is increasingly recognized as a global asset class by institutional investors. Although the preference for domestic investment is strong, more and more institutions are adopting a global approach to real estate in order to fully exploit the substantial diversification potential offered by the asset class (See [Private Real Estate: from asset class to asset](#)).

IPD is supporting these trends by providing its clients with objective insights to power multinational portfolio allocations, construction and management. In order to be most widely used, measures of real estate performance need to be comparable internationally and across asset classes, allowing for integrated analysis from the market down to fund, asset and tenant levels. To improve that, IPD has begun the ambitious project of enhancing the global consistency of its indexes and portfolio analytics.

1. ACHIEVEMENTS

IPD's efforts in this area in 2013 were primarily focused on enhancing the global consistency of its measurements for portfolio applications.

Effective allocation to real estate within multi-asset portfolios needs real estate performance and risks to be measured consistently with equity and bond markets. Barra and IPD joined forces in 2013 to remedy shortcomings in real estate measurement such as smoothing and lagging, which tend to undermine inter-class comparability. This collaboration has resulted in the integration of a real estate risk model into Barra's total risk analysis model "Barra One". Along with real estate, Barra One now covers all asset classes globally, from bonds and equities to hedge funds and private equity.

Real estate portfolio construction and management requires consistent measures of performance and risk across real estate markets. This applies at three levels:

- consistency of performance measurement formulae
- comparability of input variables
- consistency of market segment definitions

Four significant steps towards enhanced global consistency in real estate performance measurement were **launched in 2013**. These initiatives are currently subject to client consultation.

Establishing a list of key financial variables

IPD has brought together the key performance measures that are already consistent from a formulaic viewpoint. These range from headline total returns to basic income and price components. They will be delivered in H2 2014 as part of IPD "Global Intel", comprising 20 key measures on 32 countries and 5 sectors. For each sector the distributions as well as averages of results will now be shown. In the first half of 2015, the number of globally comparable measures and the granularity of their segmentation will increase further.

Standardized methodology for performance excluding currency impacts ("local currency benchmarks")

Currency rate variations can have a significant impact on the performance of multinational aggregates. Investors and managers often want this effect to be neutralized when analysing results and thus be able to identify pure real estate performance. IPD is considering changing its standard methodology so that currency effects are neutralized from month to month rather than for longer reporting periods, removing the previous need to restate historical performance.

Standardized methodology for index rebalancing

Index/benchmark rebalancing is used where segment weights in IPD indexes differ from estimated market/natural weights or investors' strategic target/neutral weights. IPD is considering changing the standard multiplier approach used for rebalancing indexes/benchmarks to reflect capital employed rather than capital value, bringing the methodology into line with the IPD total return calculation. Rebalancing multipliers would also be applied on a continuous monthly basis, removing the need for historical restatement.

Global standardization of fund level performance

Fund-level return calculations would previously differ between regions and with prevailing industry standards. In order to converge towards a global methodology in line with industry standards, IPD is considering changing its standard methodology by ending the use of unitization and by moving towards a weighted cash flow methodology.

2. NEXT STEPS

IPD's recent initiatives relate mainly to the consistency of measurement formulae. The consistency of the **inputs** provided to IPD by clients and appraisers - for example on asset and debt valuations, rents, fees and floor areas – remains to be addressed. Although these are challenging issues that will take time to resolve – in partnership with the whole industry - IPD is in an excellent position to catalyse change, and plans to play an increasingly active role in this area globally.

The comparison of performance between national markets also requires the use of a globally consistent and accepted **property classification**. IPD has begun to develop a standardized global market segmentation, developing a common language for defining property types.

Finally, as stated above, enhancing global relevance is not only about data comparability, but also about enhancing the relevance and integration of its **analytics**. Improving the relevance of IPD analytics includes the development of more conclusive and practical diagnoses for the assessment of a manager's alpha; adding new segmentation dimensions like asset quality to benchmarks; and providing analytics more appropriate for value-added funds. The integration of IPD analytics will mean relating fund level performance analytics to asset and tenant level analytics in a more comprehensive and coherent way.

3. COMMENT AND FEEDBACK

IPD are eager to continue gathering the thoughts, and responding to the needs, of the industry and would welcome your comments. Do you support IPD's initiative of standardizing its performance measurement globally? Do you agree with the concepts proposed in this note? What other areas of real estate investment performance would benefit from similar standardisation?

Please contact your IPD Client Consultant, Oliver Mege, Executive Director, Research, or email feedback@ipd.com to share your views or discuss any aspect further.

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