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The Asset Owner Real Estate Investment Process: Risk management insights from the MSCI/IPD survey

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1. INTRODUCTION

During the final quarter of 2013, MSCI conducted a survey into the asset allocation processes of institutional asset owners, with a particularly close examination of their real estate exposures. These results were written up in a summary document that was released in February 2014. This paper provides a more detailed analysis of the real estate element of the survey, with a particular focus on risk management through the investment process.

As for the previous paper, the results are based on a desk-based analysis of 138 asset owners, as well as an on-line survey and in-person interviews with 40 investors carried out in conjunction with MSCI. To ensure clarity about the survey samples, the in-person and online interview participants are labelled 'Survey Participants', while the asset owner data obtained from public documents are referred to as the 'Sample Universe'.

The paper focuses on pension funds and Sovereign Wealth Funds, providing in-depth coverage of these institutions across 28 countries. The individual survey responses were anonymous, but the depth of coverage has allowed a series of rich insights to be drawn from the research. From a real estate perspective, the research provides a comprehensive review of the role of the \$700bn of real estate equity in asset owner portfolios, including their allocations to different investment styles, their geographic exposures and their approaches to execution (Section 3).

The more innovative aspects of the research (covered in Section 4) relate to the approach of asset owners to real estate risk management, explaining the potential for misalignment at various stages of the investment process. This includes alignment between strategic asset allocation and actual real estate exposures, the use of appropriate benchmarks, and the link between portfolio and asset-specific monitoring and the strategic asset allocation process. The final section of the paper (Section 5) draws out some of the implications of the research including a categorization of different types of asset owner and the steps beginning to be taken by a series of 'global leaders' seeking to strengthen risk management through the investment process.

2. MULTI-ASSET-CLASS ALLOCATIONS

The survey results confirm that "40/40/20 is the new 60/40"¹ with alternatives (hedge funds, private equity, and real estate) accounting for close to 20% of overall allocations, and the remainder broadly split between equities and fixed income (Figure 1). The recent increase in exposure to alternatives is set to continue, with PWC projecting that global alternative assets will grow by 9.3% a year between 2012 and 2020².

¹ Urwin, R. (2013) "The changing role of the asset classes: the investor perspective", IPD European Conference

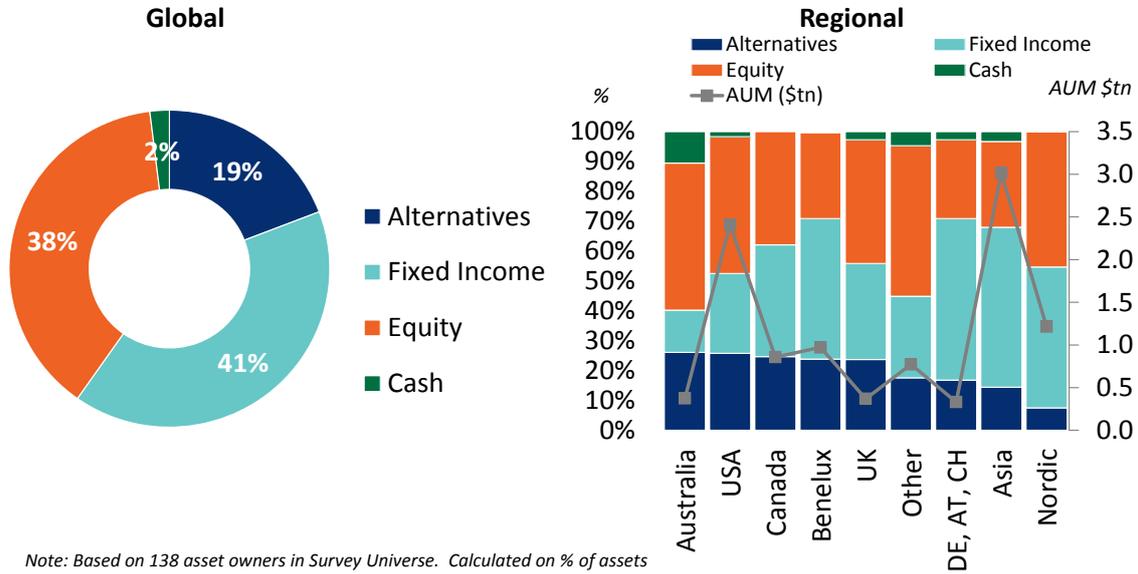
² PWC (2014) "Asset Management 2020: A Brave New World"



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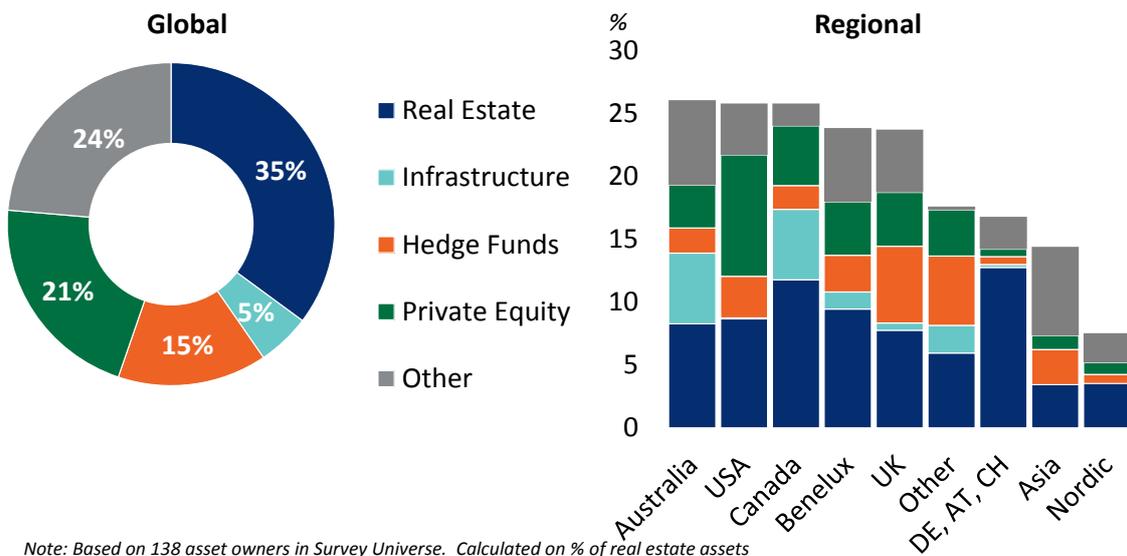
Figure 1: Asset Allocations Across Regions



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

There are, however, significant variations in allocations across regions, with higher exposure to fixed income in Asia, Germany/Switzerland, Benelux and the Nordics (around 50%), compared with the US (27%) and Australia (14%). The US sample is weighted towards state pension plans, which tend to be underfunded, and therefore may be seeking return rather than trying to match their liabilities. Australia is primarily a defined-contribution market, where media attention is given to the returns of superannuation plans, and where the domestic fixed income market is relatively small.

Figure 2: Alternative Allocations Across Regions



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



The largest allocations to alternatives are in Australia, Canada, the US, Benelux and the UK. In Benelux, these allocations seem to be at the expense of public equities, whereas in Australia and, to a lesser extent the US, they seem to reduce fixed income allocations. The lowest allocations to alternatives are in Nordic markets (8%) and Asia (14%). In the former, asset owners instead appear to seek returns from equities; and in Asia, the low alternatives allocation seems to be part of a generally conservative asset allocation. Within alternatives, real estate is the main asset class in all markets, except for the US where private equity accounts for a larger share of the total.

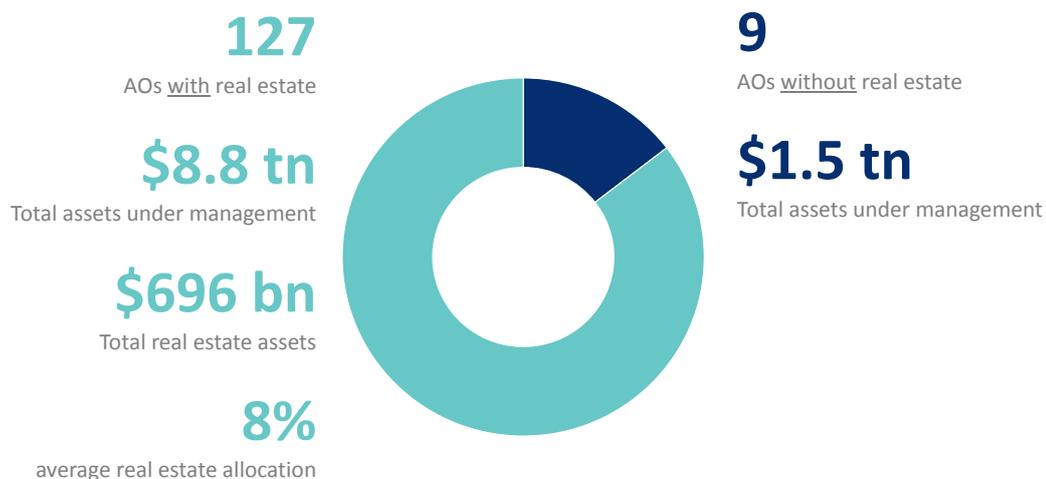
3. ASSET OWNER REAL ESTATE EXPOSURE

Real Estate Allocations

The survey confirms the importance of real estate to major asset owners. In overall terms, for the 138 asset owners covered by the survey, the average holding was 6.7%, representing close to \$700bn of their total \$10.3tn AUM (Figure 3). If the nine asset owners with no exposure to real estate are excluded, the average allocation rises to 7.9%.

This 7.9% represents the equity investment of these asset owners, but the underlying real estate exposure is larger for two reasons. First, the use of leverage, particularly for opportunistic but also for value add and REIT strategies, means that the asset owners control a larger amount of real estate, approximately \$1.2 trillion. Second, some of the real estate exposure is not disclosed in the “*real estate allocation*” of the asset owners. This is particularly the case for some REIT and CMBS exposures that are managed in the equities and fixed Income portfolios and often not disclosed separately. But there are also cases where opportunistic fund exposure is managed as part of the private equity allocation, while real estate debt (in the form of mortgages, RMBS and CMBS) is mostly held in the fixed income portfolio.

Figure 3: Real Estate Exposure for Major Asset Owners

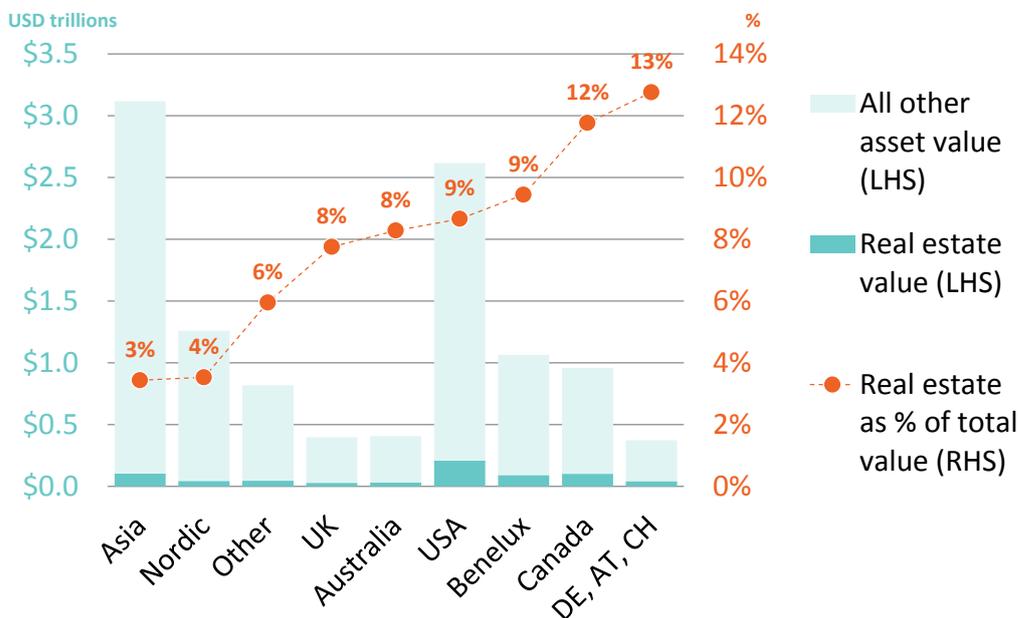




The results are similar to those of other studies exploring the real estate exposure of investors across global markets. Although these surveys vary in their scope and coverage, they all tend to confirm that asset owners investing in real estate allocate around 6-10% of their assets to the asset class³. These surveys also confirm that most asset owners plan to increase their real estate exposure. This is particularly the case for investors new to the asset class, such as many in Asia and many Sovereign Wealth Funds, with few investors seeking to reduce their allocations.

Although the overall allocation to real estate is substantial, there are marked variations by region and, more significantly, within regions (Figures 4 and 5). On a regional basis, the lowest allocations are in Asia and the Nordics at 3-4%, compared with 12-13% in Canada and Germany/Switzerland. The low allocations in Asia are largely due to the relative immaturity of the asset owner industry in the region and the tendency to focus on the established and more liquid asset classes of equities and fixed income. The low allocations are also a consequence of the real estate crisis in Japan during the late-1980s. In the years following the crisis, investors lost confidence in the real estate asset class and significantly reduced their exposures. There are signs that this may now be changing⁴, but from a very low base. For the rest of Asia, many asset owners currently have high allocations to fixed income, with relatively low private asset class allocations. Recent surveys suggest that this is changing, with many Asian asset owners expanding their real estate exposure⁵.

Figure 4: Asset Owner Real Estate Holdings across Regions.



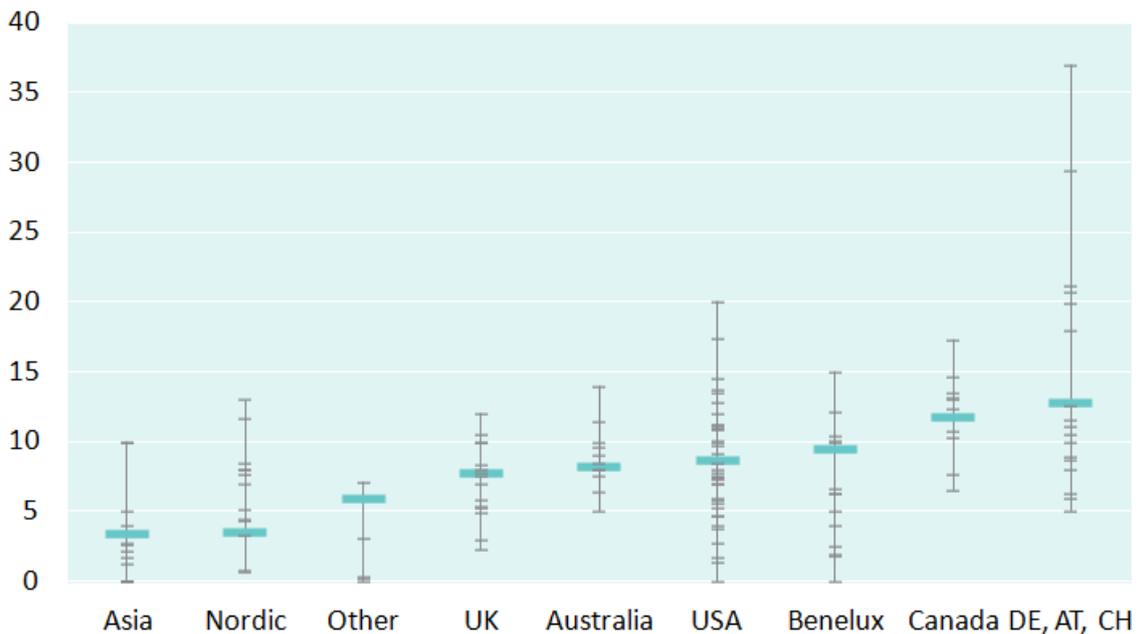
³ Cornell and HodesWeill (2013) "Institutional Real Estate Holdings Monitor 2013"; INREV (2010-12) "Investor Universe Series"; IPE/Invesco (2013) "European Institutional Real Estate Survey 2013"; IREI/Kingsley (2013) "Annual Plan Sponsor Survey"; PREA (2013) "Investor Report"; BlackRock (2014) "Global Survey of Institutional Investors" quoted in Wall Street Journal January 16

⁴ Millard, C. (2014) "100 million depend on reform of Japanese state pension", FTfm, January 13th, p. 12

⁵ Newell, G. (2013) "The significance of real estate for Asian Pension Funds", APREA November.

The variations within regions are more significant than between regions; for example, the low allocation regions of Asia and the Nordics have some funds with 10% or more in real estate, while high allocation regions such as Germany/Switzerland, Benelux and the US have asset owners with 5% or less in real estate. There is however no relationship between size of asset owner and real estate allocation.

Figure 5: Range of Allocations to Real Estate across Regions.



Although the survey focused on those asset owners with real estate exposure, there are a small number of major global investors without any real estate. A range of reasons were cited for this. As already mentioned, many Asian asset owners have low or zero allocations, either due to the legacy of the real estate crisis in Japan or because they are newly established organizations. Another group of asset owners have overall priorities based on their funding status which mean that real estate is not seen as appropriate for their needs. This is particularly the case for corporate schemes seeking flexibility and liquidity in their pension assets, whether due to the shift from Defined Benefits (DB) to Defined Contributions (DC) schemes, the potential for merger and acquisition activity or the difficulty of deploying large sums of capital in real estate markets over short time periods.

Role of Real Estate for Asset Owners

It is well established that there are significant variations in the performance characteristics of real estate within the asset class, ranging from 'core' to 'opportunistic', and from real estate debt to REITs. The diverse role of real estate is nicely described in the UBS Annual Pension Fund Indicator Report⁶:

⁶ UBS (2012) "Annual Pension Fund Indicator Report"



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“Real estate can offer a range of investment characteristics with different risk levels. At the lower end of the risk spectrum is core real estate investment, which is focused on predictable income streams available from high quality tenants. Risk is reduced when a building is already operational and generating income. Riskier strategies that aim to improve existing properties are commonly referred to as value-added and opportunistic. Often, with these types of strategies, lease lengths are shorter and tenant covenants less secure than those of core properties. The most risky investment strategies include real estate development, which involves new buildings being delivered to the market, and purchasing distressed property or debt at discounted values. As is evidenced by the range of investment styles available, real estate income streams can also be broken down in many ways, offering investors a wide spectrum of risk/return possibilities.”

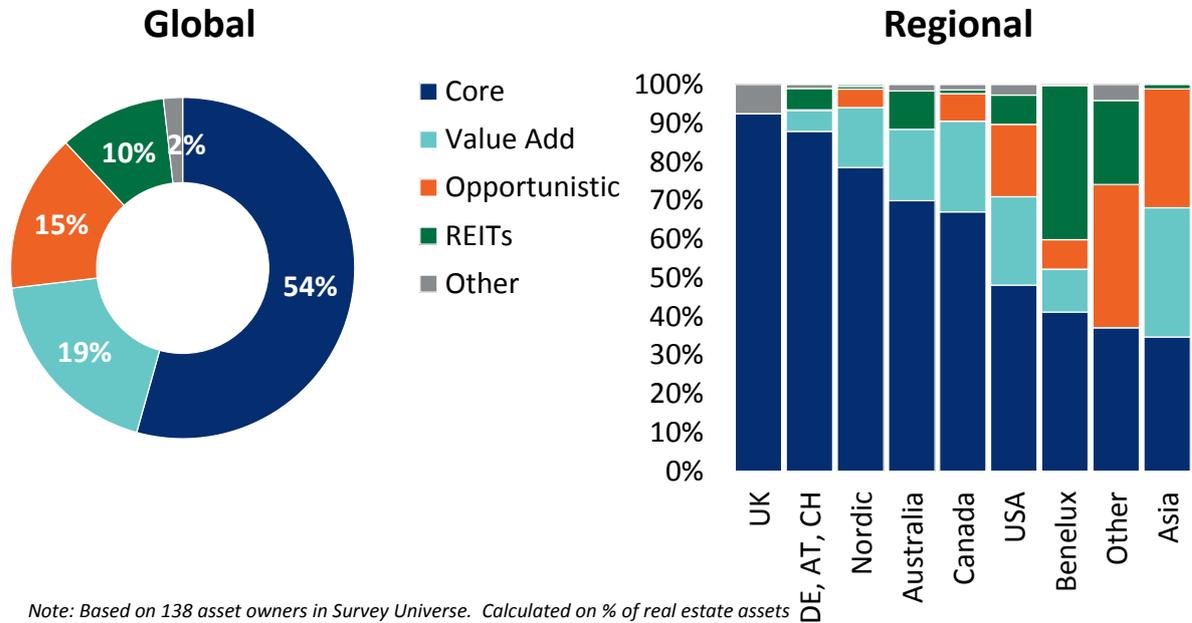
The MSCI Sample Universe data confirm the primary focus on core real estate in the allocations of most investors, with over 50% of exposure in this category (Figure 6). The high allocation to core real estate is not surprising given the desire for relative stability, high income return, and diversification benefits, as well as some scope for appreciation⁷. These reasons for holding core real estate were apparent during the interviews with Survey Participants, who made persistent references to these positive characteristics:

“The real estate programme produces two-thirds of its return through income and a third or less through capital. We like the income as it is linked to CPI. Capital is linked to meeting the growth element of our liabilities.” **Canadian Pension Fund**

“We feel the main risks to the overall portfolio are growth and inflation, and want to hedge ourselves against these – hence the attraction of the real assets portfolio.” **Nordic Pension Fund**

⁷ Hudson-Wilson, S., et al (2005) “Why Real Estate?” *The Journal of Portfolio Management*, Vol. 31, No. 5, pp. 12-21.

Figure 6: Allocation of the Sample Universe to Different Styles of Real Estate, by Region.



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

Although core dominates, other categories represent 46% of the total allocation, confirming the different roles that real estate plays within asset owner portfolios. There are marked variations in the emphasis on different styles across markets. The strongest focus on core real estate is in Australia, Canada, Germany/Switzerland and the UK, where the allocations exceed 80%.

There is a marked contrast in the strategy of Middle Eastern and Asian investors, many of which have higher allocations to value add and opportunistic real estate. US asset owners also have significant exposure to higher yield real estate, but this seems to have been reduced since the global financial crisis⁸. A number of major US asset owners are implementing multi-year strategies to de-risk their real estate exposure, primarily by reducing allocations to opportunistic strategies. This de-risking of real estate seems to be a secular trend but, more recently, there are some signs that the cyclical upturn is increasing appetites for real estate risk⁹. This upturn and the increasingly aggressive pricing of core markets is leading investors to take on more leasing and market risk. But despite this increasing cyclical appetite for higher risk real estate, the survey suggests that most real estate investors globally will remain focused on securing ‘core’ investment performance from their exposures.

It is perhaps surprising that listed real estate (REITs) represents such a small share of real estate allocations, given the series of academic studies that have demonstrated the long term relationship between listed and direct real estate performance. The finding is consistent with other studies such as that by Consilia Capital, which found that “only eight of 56 interviewees, or 14% of our sample, claimed to have an internally integrated approach to the management of

⁸ IREI/Kingsley (2013) *ibid*; PREA (2013) *ibid*

⁹ Cornell and HodesWeill (2013) *ibid*; ULI (2014) “Emerging Trends Europe”



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listed and direct/unlisted real estate.”¹⁰ Only 24 out of the 138 asset owners in this paper treat listed real estate as part of their real estate exposure, with the greatest focus on REITs being found in the US and Benelux markets. Dutch asset owners have a particularly strong allocation to REITs, accounting for half of the total REIT exposure of the asset owners covered in the survey.

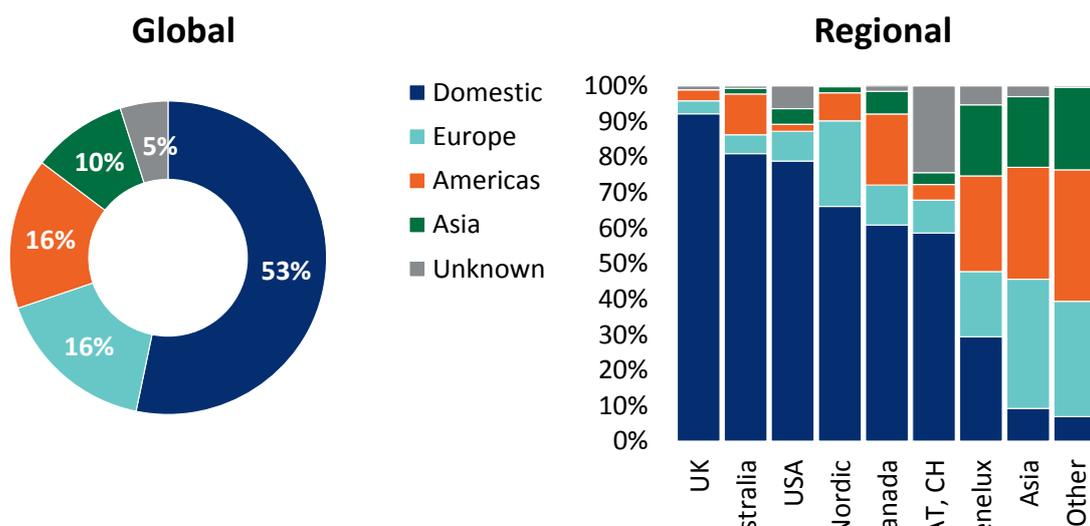
The reasons for relatively low allocations to REITs within the main real estate portfolio seem to relate to differences in investment performance behavior and execution skills. As stated by one major Canadian investor: “We don’t hold REITs as we don’t see them as income generators or behaving in same way as direct real estate.” But despite this low exposure to REITs within real estate departments, it is clear that many asset owners invest in listed real estate through their broader equities programs.

Real estate debt remains a small component of the overall allocation, although some asset owners have built up significant exposure to real estate debt that is managed from within the real estate department. This is particularly the case in Canada and the US, with signs that asset owners in Australia, UK and parts of Europe are also building up their exposure.

Domestic versus Global Exposure

During the past 30 years, the liquid asset classes of equities and fixed income have become ‘global’, with most investors seeking to build exposure across markets. Real estate, in contrast, has retained a strong “home bias” with over 80% of asset owners focusing primarily on domestic markets. There are exceptions, most notably Sovereign Wealth Funds, who have made an explicit decision to diversify away from domestic exposure, and some large asset owners in relatively small real estate markets with a large asset owner industry, such as the Netherlands and Canada.

Figure 7: Geographic Exposure of Real Estate Portfolios in the Sample Universe.



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

¹⁰ Consilia Capital (2013) ibid



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There tend to be two major reasons for retaining a home bias: one relates to the role of real estate in the portfolio, and the other to the perceived execution risks of overseas exposure. In a number of cases, the asset owners surveyed said that given the role of real estate in providing a hedge against domestic inflation, there was little benefit in investing globally. As one Nordic investor stated: *“We are mostly domestic as most of it is ‘core’, and we want real estate as a hedge against inflation within our overall portfolio. If we have, for instance, US real estate, this doesn’t help as a hedge against the overall portfolio.”* **Nordic Pension Fund**

The second reason for home bias is due to the perceived risks of investing overseas, particularly related to execution. Often these perceived risks are based on mistakes made in the past, particularly in Australia, Japan and the UK. Others, particularly those in North America and the Nordics, recognize the case for global investing, but are held back by the perceived *“need to build a big internal team or have a strong partner to avoid execution risks.”* **US Pension Fund**

Despite this home bias, the survey reveals an increasing appetite for foreign real estate, which is confirmed by other studies¹¹. This increasing appetite is driven by supply and demand factors. The improved availability of execution options has removed some of the supply barriers that existed in previous years. Alongside this, there has been greater demand for foreign investment, whether due to concerns over the pricing of domestic markets, particularly in Canada and Australia, or to the desire to exploit the diversification benefits of international real estate¹².

Real Estate Investment Options

A number of recent studies have identified a long-term trend towards external management¹³, but the new MSCI Sample Universe data suggest that there has been some reversal in the years since the global financial crisis. The asset owners surveyed by MSCI indicated that only 23% of their real estate exposure is managed in-house, while a further 21% is managed through separate accounts and joint ventures (see Figure 8). The interviews with Survey Participants indicate a general move to more direct control, through separate accounts and joint ventures, and through internalizing real estate programs. Some feel that this can lead to outperformance: *“Since the launch of the internal real estate program we have been outperforming the benchmark return ... a difference that reflects the long-term value added through active management by the real estate group.”* **Canadian Pension Fund**

¹¹ Cornell and HodesWeill (2013) *ibid*

¹² IPD (2013) *“Private Real Estate: from asset class to asset.”*

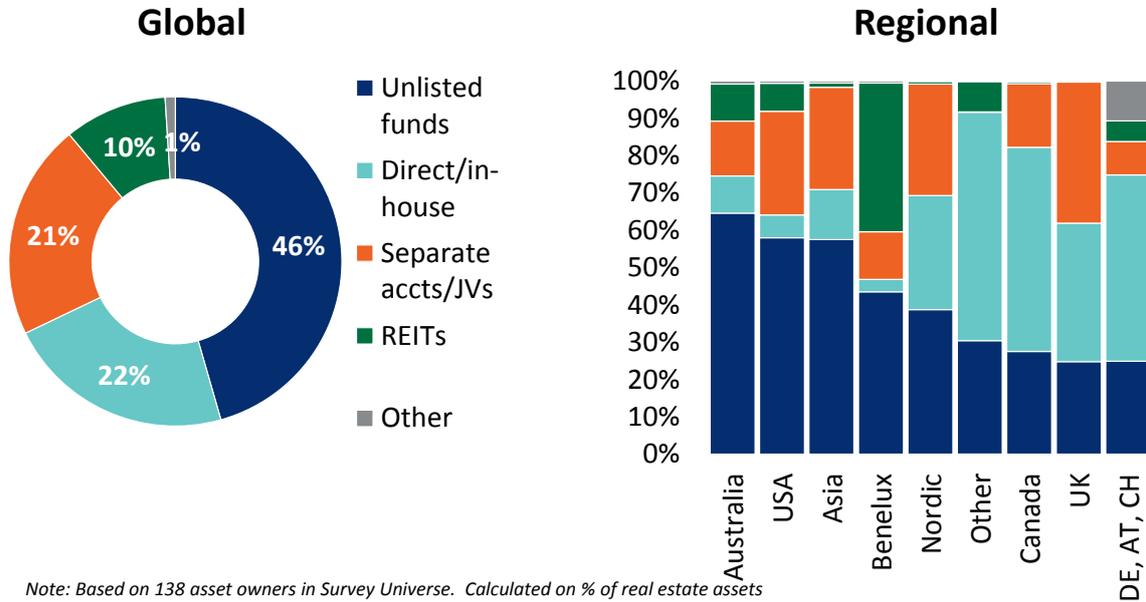
¹³ Andonov, A. et al (2013) *“A Global Perspective on Pension Fund Investments in Real Estate” The Journal of Portfolio Management, Vol.39 No. 5, pp. 32-42.; Cornell and HodesWeill (2013) ibid*



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Figure 8: Allocations to Different Modes of Execution by Region.



More generally, this move towards internalization and separate accounts reflects a desire to achieve greater control over the real estate allocation and greater alignment of interest. This is a particular trend for the world’s largest asset owners, most of whom seem to be internalizing many of their activities or building strategic relationships with a small number of managers. These asset owners, particularly in Canada and the Netherlands, but also in the Nordics, Middle East and Asia, are coming to act as asset managers themselves, often managing assets on behalf of other asset owners.

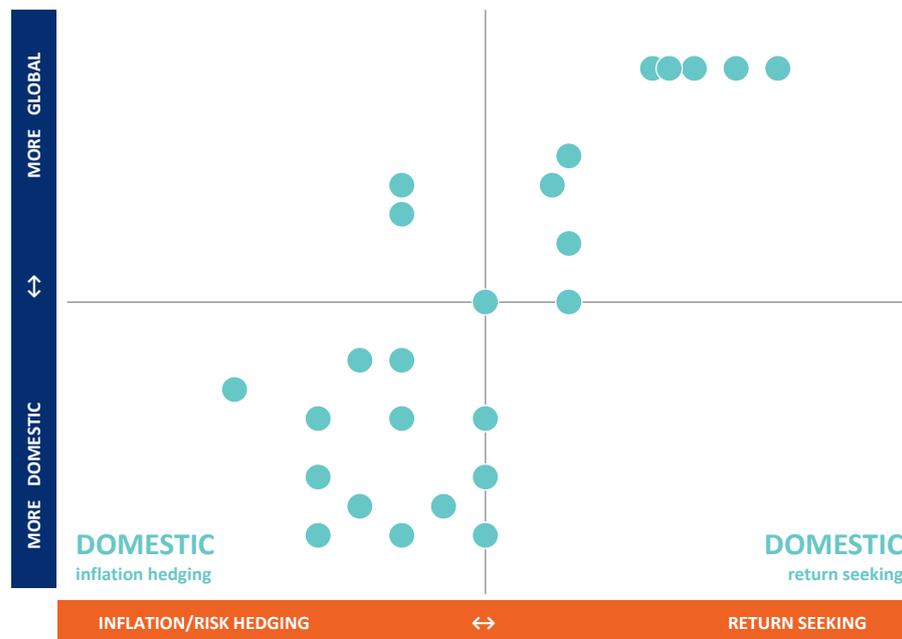
The Role of Real Estate in Asset Owner Portfolios: a Summary

With regard to style, geographic focus and approaches to execution, the survey reveals significant variations across the range of asset owners. A number of important themes emerge, most fundamentally related to the varying role and geographic focus of real estate for asset owners, as summarized in Figure 9. Real estate invariably falls within the “active” element of the portfolio, but beyond this tends to play very different roles ranging from low return inflation-hedging through to high absolute return seeking. In certain cases asset owners divide the real estate allocation into different “buckets”, with one asset owner explaining that they have different strategic allocations to “high risk (transitional) real estate that is focused on creating or enhancing cashflows and to lower risk (stabilized) real estate that is focused on cashflows that already exist.”

Sovereign Wealth Fund

While a number of asset owners segment their real estate exposure in this way, in most cases a range of characteristics (income, inflation hedging, diversification and return) combine to make real estate attractive to asset owners. Although the combination of these characteristics can create attractive performance outcomes, this can also create significant challenges for asset owners. On the one hand, the combination of a series of complex performance characteristics makes it hard for risk managers to understand and model the risks of real estate. On the other, it creates the potential for misalignment between the role of real estate, which is often poorly defined, and the implementation of the real estate program. This is covered in more detail later in the report.

Figure 9: Schematic Representation of Role of Real Estate for Major Asset Owners.



Note: Each dot represents a specific Asset Owner.
Source: IPD; MSCI



The second dimension captured on Figure 9 is the geographic exposure of real estate portfolios. Although home bias remains an important feature for most asset owners, there is a general trend to increase non-domestic exposure, with some asset owners having an explicitly “*global*” remit for their portfolios.

4. RISK MANAGEMENT THROUGH THE REAL ESTATE INVESTMENT PROCESS

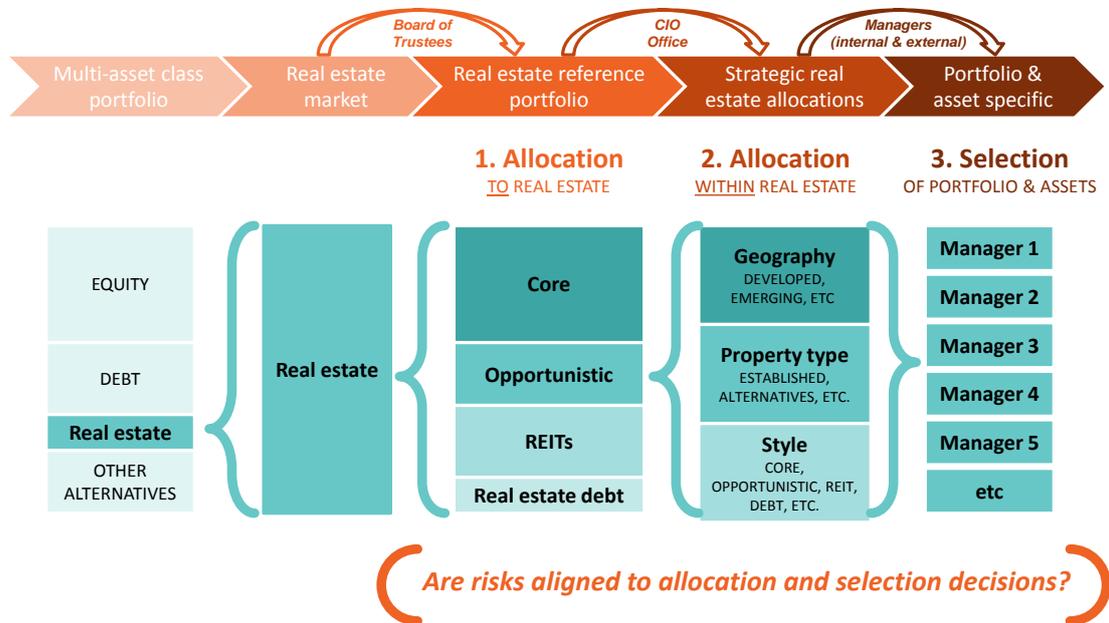
Although the survey provides important insights into the role of real estate in investor portfolios, the more innovative element of the research investigated approaches to risk management. Particular focus was given to whether risk management processes are in place to ensure alignment between investment objectives and execution.

The survey covered two important dimensions of real estate risk management. First, the extent to which real estate exposures and risks are integrated with the multi-asset-class investment process and second, the ways by which the risks of the real estate exposure are monitored and managed within the real estate department.

These different dimensions are summarized in Figure 10, which shows the key steps involved in risk management through the real estate investment process. The investment process is seen to incorporate three main stages:

1. First, the overall allocation to real estate within the multi-asset-class context, incorporating an understanding of the way in which real estate can contribute to portfolio objectives. This includes the scope of the real estate exposure: whether it should be focused on direct core real estate or also include REITs, real estate debt and opportunistic real estate. It also involves comparing real estate performance patterns and risks with other asset classes through the strategic asset allocation process.
2. Once the scope and objectives are established, the second stage involves developing the strategy and benchmarks for the real estate exposure or the real estate department - the reference or policy portfolio. It is this policy portfolio against which the real estate team tends to be measured and monitored.
3. The third stage involves the more specific mandates or strategies for particular property types or markets. These mandates, which can either be managed internally or externally, represent tactical exposures to specific markets, property types or, in some cases, assets.

Figure 10: Risk Management in the Multi-Asset Portfolio and the Real Estate Exposure.



The survey explored the approach of asset owners through this investment process with a particular focus on the extent to which risk management is aligned with investment objectives. The research complements other studies on this issue, including forthcoming research by Kennedy and Baum¹⁴ focusing on alignment between asset allocation and implementation.

4.1 Real Estate in the Multi-Asset-Class Risk Management Process

Real estate is one of the most mature alternative asset classes, with a tradition of allocation in institutional portfolios for 40 years or so in North America and a number of European countries. During this time, there has been an increasing availability of performance and risk data on the asset class, and considerable experience of holding and managing real estate in institutional portfolios. Despite this experience, real estate remains an alternative asset class that is often poorly integrated with the overall strategic asset allocation process. Although many investors have significant exposure to real estate, the asset class is, as described by Roger Urwin, “dripping with issues”¹⁵ that represent major concerns for the boards and CIOs of many asset owners. These issues include the appropriate business model for the real estate exposure, such as whether it should be internally or externally managed, and the challenge of high costs compared with other asset classes. There are also issues associated with governance, and the ability effectively to analyse the asset class on a consistent basis with other asset classes.

Interviews with the Survey Participants confirmed the challenges faced by CIOs and risk departments as they seek to oversee the real estate exposure and integrate it with other asset classes. These challenges are based on a number of related factors, including the complexity of the real estate asset class, data limitations and a relatively weak understanding of the different roles that real estate can play in the overall portfolio. The combination of these factors has

¹⁴ Kennedy, P and Baum, A. (forthcoming) “Aligning asset allocation and real estate investment: some lessons from the last cycle”

¹⁵ Roger Urwin (2013) *Private markets – A dynamic approach to thematic investing*, FT Seminar, November



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tended to create a gulf between central risk functions (CIO, risk, and allocation departments) and the real estate department. As one major Sovereign Wealth Fund respondent said: *“There is a fundamental difference between equities and real estate where implementation is so much harder for the strategic asset allocation team to get involved in. Specific risks are much harder to trade away than alternatives.”* **Sovereign Wealth Fund**

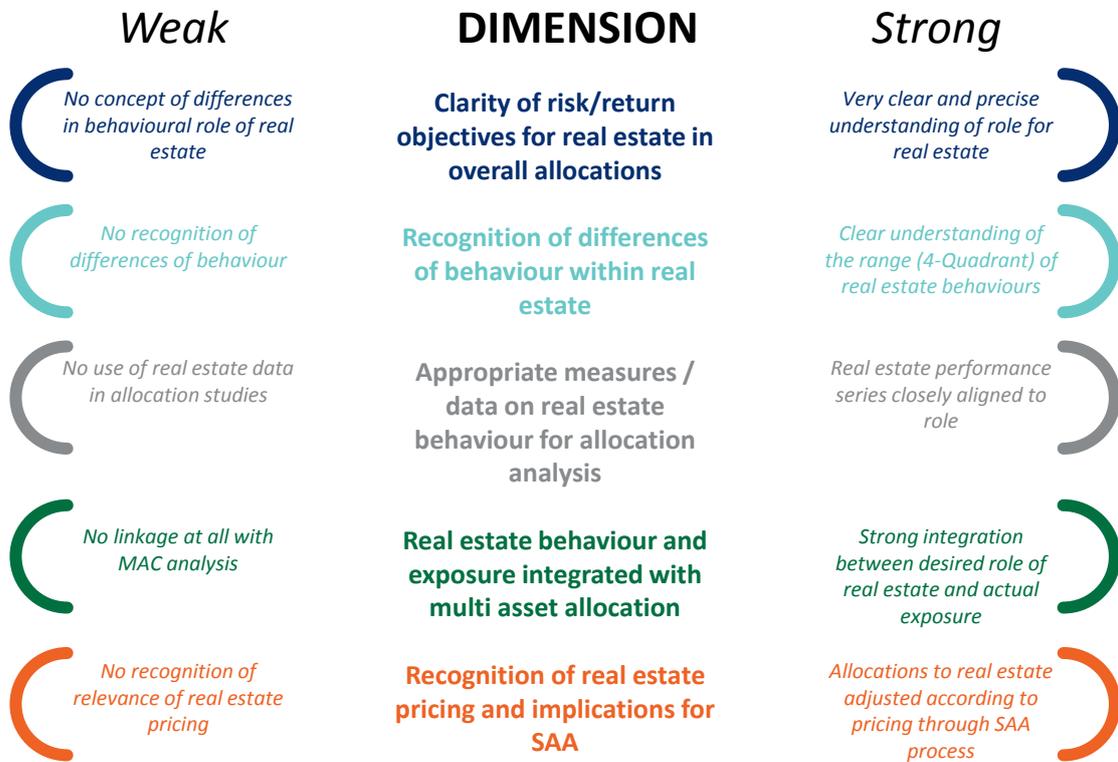
In effect, the relatively small scale of the real estate exposure coupled with its idiosyncrasies has meant that many risk teams have left real estate departments to manage their own risks, contributing to the poor integration with other asset classes. This was certainly the case prior to the global financial crisis, but the crisis has proved to be a catalyst that is changing this situation: *“As private markets – including real estate - are both complex and typically represent a relatively small part of overall portfolios, these potential deviations have historically been overlooked by asset allocators on the basis of materiality. However, over the last 20 years the growth of the real estate private equity industry, combined with an increase in the use of complex investment strategies and structures, has enhanced the potential ‘cost’ of misalignment. Arguably, the market correction of 2008/9 provided a clear demonstration of the potential consequences of the industry’s approach as well as a valuable lesson.”*¹⁶

The global financial crisis provided a catalyst for strengthening risk management throughout the industry. The drivers for change tended to be tighter regulation and moves from central risk functions to increase their oversight of real estate departments. This desire for greater oversight was clearly revealed through the interviews. One major US plan sponsor said: *“I don’t see much from our real estate teams from a risk perspective, and feel the risk team didn’t know much about portfolio risk except for leverage. There is a case for a ‘no charts’ discussion with the real estate team.”* **US Pension Fund**

Beyond signs of change across most of the asset owners, there are marked variations in the sophistication of attempts to integrate real estate in the overall strategic asset allocation process. The leading asset owners surveyed by MSCI offered some useful guides for ‘best practice’ on a range of dimensions. These dimensions are summarized in Figure 11, and explained in more detail in the following sections.

¹⁶ Kennedy, P and Baum, A. (forthcoming) *ibid*

Figure 11: Key Dimensions of Real Estate Risk Management in a Multi-Asset-Class Context



i. The Role of Real Estate in Multi-Asset-Class Portfolios: Clarity of Risk/Return Objectives

The fundamental starting point for asset owners with exposure to real estate is understanding risk/return objectives from specific types of real estate within a multi-asset-class context. This clarity of return objectives is, therefore, closely related to the recognition of differences in performance behavior within real estate. As explained earlier, real estate can play very different roles within investment portfolios, from inflation hedging to absolute return, with varying degrees of liquidity. The survey reveals marked variation in the sophistication with which these differences are recognized. On the one hand, there are investors who have limited understanding and seem to be happy “just holding real estate.” At the other extreme, there are those with a very clear understanding of real estate behavior and its role in a multi-asset-class context. One major Survey Participant, for instance, sees a clear role for real estate as an inflation hedge: “We want to measure ‘duration’ and understand the impact of changes in interest rate on the real estate asset class. The risk information we want to monitor relates to the duration sensitivity of the portfolio – if interest rates change then what are the implications for the market?” **Nordic Pension Fund**

A number of asset owners who recognize these differences have moved to creating different “buckets” for their real estate exposure. More generally, however, there remains “...considerable uncertainty regarding the role of real estate...”¹⁷, with many risk officers still unsure of the role that it should play in the overall portfolio. They often echo the views of one US investor who

¹⁷ Idzorek et al. (2006) “Commercial Real Estate: The Role of Global Listed Real Estate Equities in a Strategic Asset Allocation”. NAREIT and Ibbotson Associates



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stated that *“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.”* Another stated: *“We want to know the factors that drive the real estate portfolio risk. We know that a 1bp rise in interest rates won’t impact real estate, but what about a 100 bp rise?”*

These concerns seem to reflect the general steps that are being taken to develop a more robust and systematic approach to the role of real estate, alongside other private asset classes. As one of the world’s largest investors said: *“One of the key discussion points we are having across our whole portfolio relates to managing the risk assumptions and exposures of the private asset classes.”* **Canadian Pension Fund**

ii. Real Estate Data in the Multi-Asset-Class Modelling Process

A further broad area in which sophistication varies relates to the measures of real estate performance behavior used in the multi-asset-class modelling process. Most respondents face difficulties in this area, echoing the views of one major Nordic pension fund that has *“struggled to get the right real estate data to use in our ALM process.”* Asset owners face two broadly distinct difficulties in modelling real estate behavior. Firstly, the scope of real estate that is used for modelling purposes. Clearly, there is a range of performance behaviors within the asset class with, for instance, opportunistic, core and REIT exposures generating very different risk/return characteristics. For those asset owners with global exposure there are also issues associated with geographic focus, affecting whether a purely domestic or more global time series should be used for modelling purposes.

The second set of issues is more technical, related to the availability of good quality data that appropriately capture real estate behavior. This is particularly the case for opportunistic and debt-based strategies, but also for core strategies in more emerging markets. Most asset owners are aware of the smoothed nature of appraised real estate time series, and many take steps to de-smooth them as part of the asset allocation process. Often these approaches follow the work of Geltner¹⁸, but there remain concerns over the robustness of the analysis that has been developed, particularly the ways in which any de-smoothed series are used in the modelling process. As stated by one of the more sophisticated US pension funds: *“We have good understanding of real estate in the return space, but not in the risk space”*. These views are shared by most of the risk managers who are seeking to improve the robustness of the way real estate is captured in the multi-asset-class modelling process.

iii. Integration of Actual Exposure with Multi-Asset-Class Allocation Analysis

There are also marked variations in the extent to which real estate exposure is integrated with multi-asset allocation studies. As explained above, many asset owners take great care to ensure that their real estate investment strategy is aligned with the role that real estate is meant to play in the multi-asset portfolio. There is, however, scope for the actual exposure to diverge from the strategy by ‘style drift’, for example, leading to higher risk exposure than intended.

¹⁸ Geltner, D. (1991) *Smoothing in appraisal based returns*. Journal of Real Estate Finance and Economics. No. 4, pp. 327-345.



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A number of the asset owners surveyed recognize this issue and devote considerable effort to ensuring that the actual exposure is aligned to strategic objectives. One Nordic pension fund, for instance, has real estate playing an inflation-hedging role for the overall portfolio, an aspect which they monitor down to the level of asset-specific exposure: *“We monitor the extent to which our portfolio provides these characteristics, so we look at the nitty gritty of the portfolio – we have people dedicated to doing this at the asset level. We really like our [removed for confidentiality reasons] portfolio given its inflation hedged nature – this is the type of real estate we want to hold for multi-asset-class purposes.”* **Nordic Pension Fund**

Another asset owner makes a direct link between exposures within their real estate and equities portfolios. When they recently acquired a major office building occupied by a financial services tenant, they disposed of some of their equities portfolio holdings in that company to manage their overall exposure to the specific company.

Although these two examples show how some asset owners connect their real estate risks to the broader portfolio, the vast majority of risk teams tend not to monitor the portfolio and asset-specific risks of the underlying real estate portfolio in detail. This is primarily due to the perceived difficulty in measuring these risks on a systematic basis and rolling them up for the portfolio as a whole. Some asset owners draw parallels with the more liquid markets from a different era, as stated by one head of fixed income: *“Private 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.”* **Sovereign Wealth Fund**

iv. Recognition of Real Estate Pricing in the Allocation Process

Many Survey Participants are grappling with the pricing behavior of real estate and trying to compare it on a consistent basis with other asset classes. Most feel they are not at the stage of adjusting their exposure according to the pricing of real estate, often stating that the illiquidity of the asset class makes it hard to change allocations on a short term basis. There is, however, an important group of some of the world’s largest and most sophisticated investors who make an explicit assessment of relative pricing when making real estate investment decisions. These investors tend to make investment decisions relative to a multi-asset-class portfolio-wide ‘reference’ portfolio. Such investors prefer to evaluate the merits of individual investment opportunities relative to the portfolio as a whole. One Australian respondent in the MSCI survey said: *“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**. Such investors make an explicit assessment of the pricing of real estate investments relative to other asset classes.

Summary of Real Estate in the Multi-Asset-Class Risk Management Process

The Survey Participants provide a series of important insights into the way real estate is considered in the multi-asset-class risk process. First, this is a major issue for asset owners, with concerns over the appropriate role for real estate and the risks that it represents. In the wake of the global financial crisis, there seems to be a concerted effort by risk teams to increase the



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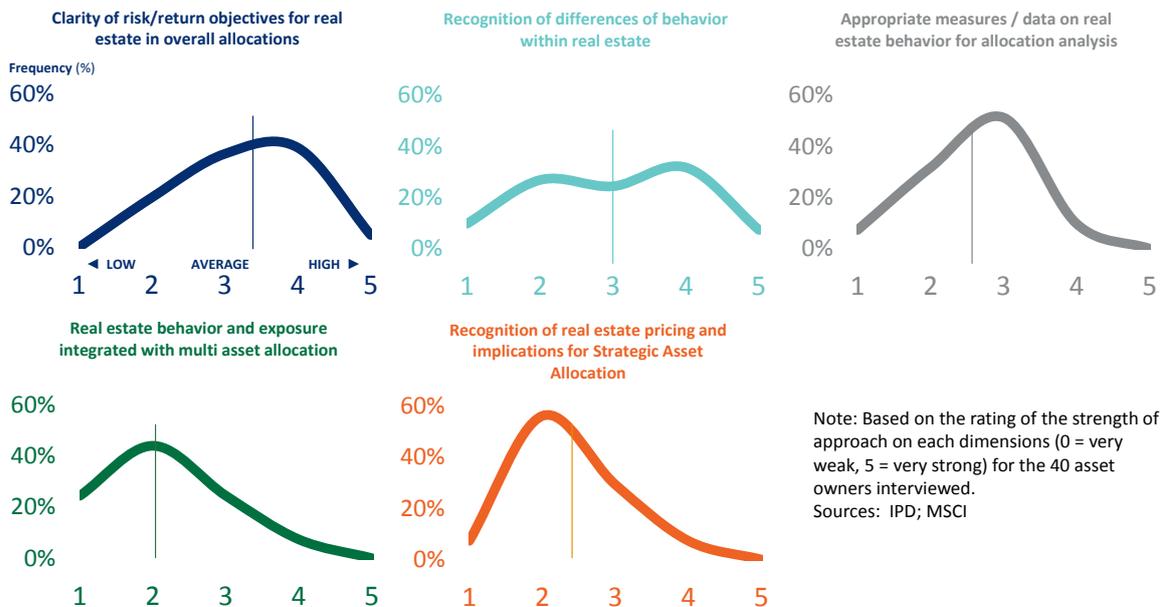
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oversight of real estate departments, to better manage the risks of their exposure, and to integrate it with overall risk management.

Second, asset owners without effective risk oversight of real estate departments are exposed to the consequences of misalignment between strategic allocation decisions and the implementation of strategy. As stated by Kennedy and Baum¹⁹, “the real estate market correction of 2008/9 offers numerous examples of the potential impact of misalignment between asset allocation intent and implementation....[In such cases], the deviation in performance was, by definition, a failure of both asset allocation and implementation. Specifically, the asset allocation team should have been aware of the potential performance implications of the specified guidelines, implementation approach and investment committee approvals, while the implementation team should have sought guidelines that, based on their knowledge of the asset class, provided a closer proxy for the exposure implied by the policy benchmark and, therefore, the asset allocation process”.

Third, the variation in approach across asset owners points to a number of clear areas of best practice that can be followed by individual asset owners. The results summarized in Figure 12 are based on the positioning of individual asset owners interviewed in the survey (the Survey Participants) on the five dimensions discussed earlier, and summarized in Figure 11.

Figure 12: Strength of Approach to Key Dimensions of Multi-Asset-Class Risk Management of Real Estate Exposure.



¹⁹ Kennedy, P. and Baum, A (forthcoming) *ibid*



The results in this figure show the range of scores for each of the dimensions, with the highest average scores in the chart labelled 'clarity of risk/return objectives for real estate in overall allocations'. This indicates that most Survey Participants have a good understanding of the role of real estate in the multi-asset-portfolio. Against this are the relatively low scores for other dimensions, particularly the weaker score for 'real estate behavior and exposure integrated with multi-asset allocation'. These low scores confirm the generally weak alignment between investment objectives and risk management of the real estate exposure.

4.2 Benchmarking and Risk Management for the Real Estate Department

If the first dimension of 'risk management' explored in the survey relates to the way real estate is integrated with broader multi-asset-class processes, the second relates to risk management within the real estate department. A number of studies have explained the way that weak risk management contributed to the losses experienced by asset owners through the most recent financial crisis: *"Risk management failed to deliver. Trillions of dollars have been wiped off the value of the real estate asset class, and the dislocation has caused fundamental burdens for the broader economy. The crisis has represented a challenge to the credibility of the real estate asset class and something that better risk management could, surely, have done more to prevent."*²⁰

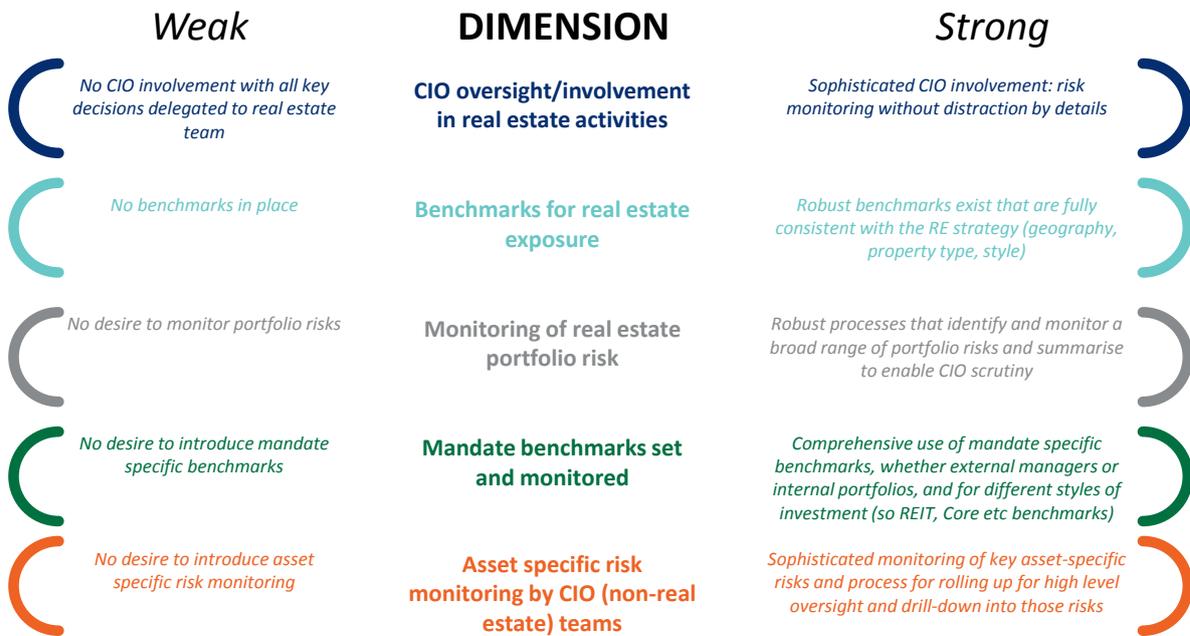
Although the fundamental reason for the crisis related to excessive leverage and overheated markets, the difficulties experienced by individual asset owners were based on weak risk management. These weaknesses were often caused by poor alignment between strategy and implementation that led to style drift through the run up to the crisis. As explained by Baum, *"issues associated with 'style drift' ... were relatively common within the real estate funds management industry over the last decade."*²¹

An important dimension of this alignment between allocation and implementation relates to the effectiveness of risk monitoring through the real estate investment process. The survey explored these issues and identified two related dimensions on which steps towards stronger risk management are taking place within the real estate department. First, benchmarking real estate is helping to monitor exposures and support alignment with investment objectives. Second, asset and portfolio-specific risks are being reported and monitored more explicitly. These different dimensions are summarized in Figure 13, and explained in more detail in the following sections.

²⁰ Hobbs, P. (2011) *"Risk Management - Assessing Active and Beta Risk"*, IFE

²¹ Baum, A. (2012) quoted in Kennedy, P and Baum, A. (forthcoming) *ibid*

Figure 13: Key Dimensions of Real Estate Risk Management: Characteristics of “Weak” and “Strong” Approaches.



i. Benchmarking Real Estate Performance and Risk

The private nature of real estate creates significant challenges in the creation of meaningful benchmarks with which to measure performance and manage risks for the asset class, certainly compared with liquid markets. Despite these challenges, benchmarking has come to be seen as an increasingly important aspect of real estate risk management for a number of reasons. Most fundamentally, benchmarking can provide strategic insights to improve decision-making, a factor that is central to improving risk management: *“Benchmarking is much more than just a way in which investors can monitor manager performance versus a yardstick. A successful manager must embrace benchmarking and the associated attribution analysis as an integral risk management tool allowing them to understand and improve performance at both the asset, portfolio and fund level.”*²² Benchmarks can also help improve governance of the investment process, either through greater transparency or by increasing the alignment between allocation and implementation.

The increasing desire of CIOs to have greater oversight of real estate departments coupled with the rising availability of real estate benchmarks²³, has led to an increase in the use of such benchmarks in recent years. These benchmarks have tended to be applied at two different stages of the real estate investment process. First, in terms of overall real estate exposure through ‘policy’ or ‘reference’ benchmarks and second, more portfolio and asset specific benchmarks

²² Simon Mallinson quoted in Hobbs et al (2012) “Building Investor Confidence”, February, IREN Europe, p. 34-37

²³ ULI (2011) “Global Investment Performance Standards”, September; Towers Watson (2012) “Survey of private market benchmarks report,” January.



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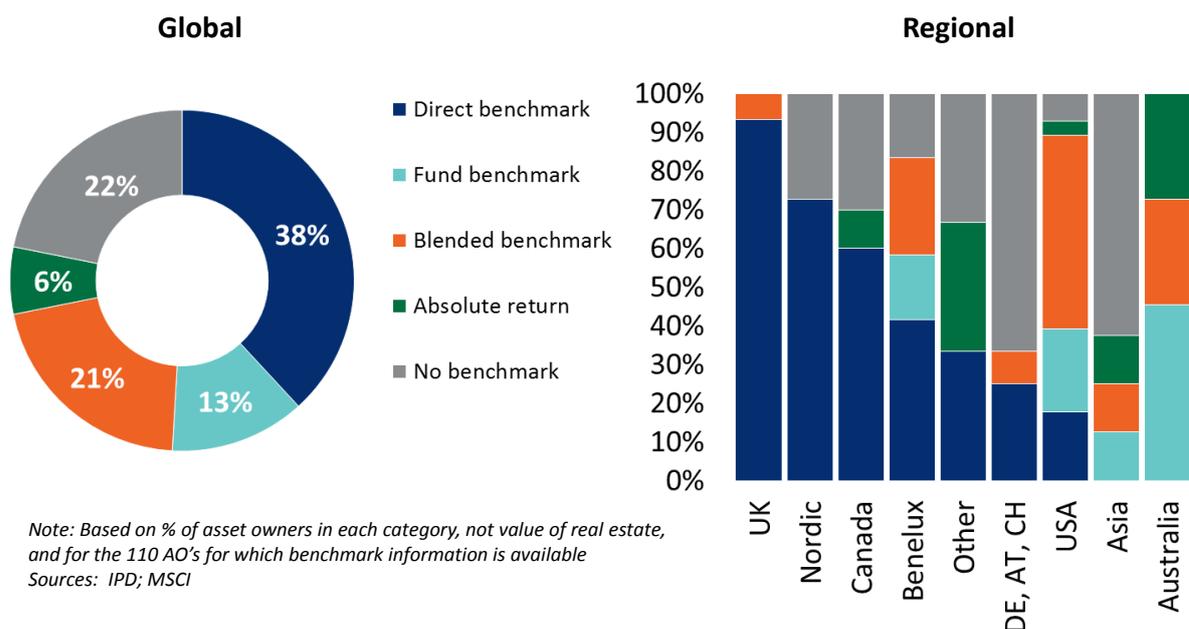
associated with specific ‘mandates’. The MSCI interviews and on-line survey confirm that the overwhelming use of benchmarks among respondents tends to be at the policy level, rather than for mandates.

In terms of policy real estate benchmarks, there are many options, ranging from absolute return measures to those based on relative performance, with relative benchmarks tending to be based on direct, fund or listed (REIT) performance.

The results show that over 70% of the Sample Universe of 110 asset owners for which benchmark information is available have some form of policy benchmark (see Figure 14), generally on a rolling three, four or five-year basis. A large proportion of these benchmarks are based on ‘direct’ or property-specific indexes (38% of the total), with ‘blended’ and ‘fund’ benchmarks also being used by a large number of asset owners. Their usage is most widespread in the more established ‘western’ investment markets, with the Asian, German and Swiss asset owners having relatively low benchmark adoption. There is also strong national influence on the type of benchmarks being used. In Australia there tends to be more use of fund level benchmarks, while in Canada, UK and Continental Europe there is a tendency to use direct benchmarks.

The US is the principal market in which ‘blended’ benchmarks are used, often combining private real estate performance (direct or fund) with listed market indexes. This increasing use of blended benchmarks seeks to address some of the alignment issues identified through this report. If the allocation strategy incorporates both listed and direct real estate, the policy benchmark should reflect these intentions. Asset owners making use of such blended benchmarks often have a secondary set of strategy benchmarks for the specific investment style (for example, core, opportunistic, or listed).

Figure 14: Use of Policy Benchmarks for Asset Owner Real Estate Exposure.





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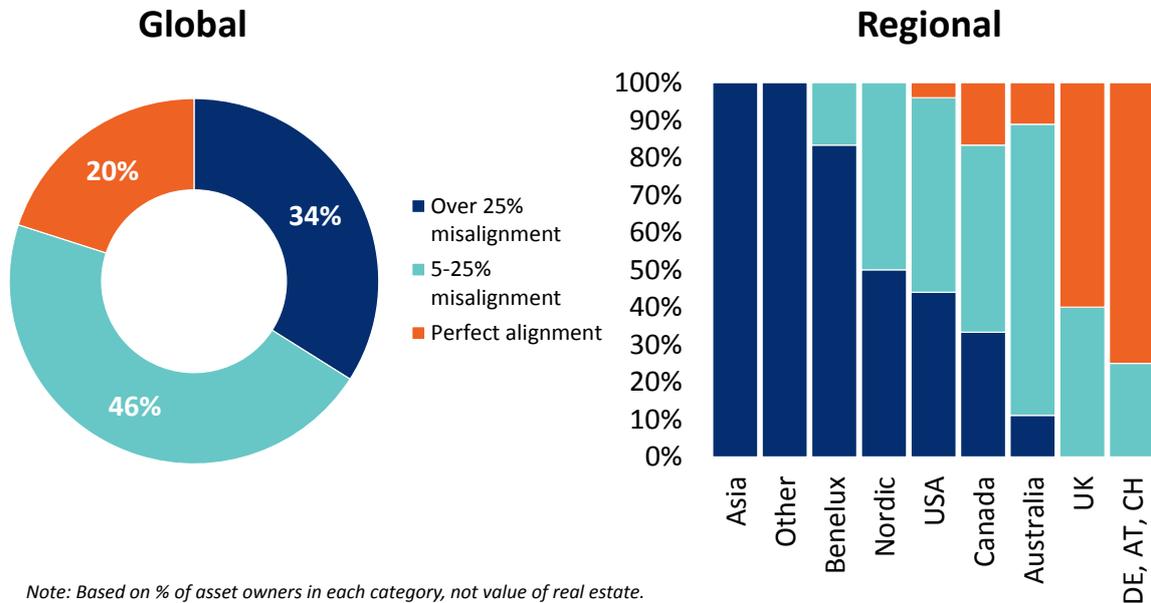
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The majority of Sample Universe asset owners not using benchmarks are relatively new to real estate investing, and most are based in Asia and the Middle East. In other markets there is a subset of investors who prefer to monitor their real estate exposure through absolute return targets. Often these investors have deep experience of real estate investing and feel that the uniqueness of their exposure means that it is not possible to construct relevant real estate benchmarks. In these cases, real estate is often provided with absolute targets, generally based on CPI plus a margin (often 300-500 bps), or government bond yield plus a margin (often 200-300 bps) or a combination of the two. The use of absolute return targets has some important limitations, with general dissatisfaction over the use of absolute benchmarks for real estate, echoing the views of one asset owner: *“We have a relative benchmark for real estate in contrast to infrastructure which is CPI+5 %. We don’t like this absolute measure as it is a non-volatile benchmark that we compare with a volatile portfolio.”* **Canadian Pension Fund**

Although relative benchmarks are widely used, the survey reveals inconsistencies in their implementation, often resulting from the use of relatively narrow benchmarks compared with the active decisions being taken within the real estate department (Figure 15). Despite steps being taken to create more appropriate benchmarks, there seem to be two main areas in which benchmark misalignment exists. First, in relation to the style of real estate covered by the benchmark, with many using a core benchmark for a strategy that includes opportunistic and REIT investments. This misalignment is less of an issue for those asset owners holding real estate for core purposes with little REIT exposure (such as those in Australia, Canada, Continental Europe and the UK), but can be an issue for those in the US, Middle East and Asia with a mixed exposure to real estate.

The second area of misalignment, that of geographic coverage, is more pervasive with over 80% of asset owners having a disconnect between their geographic exposure and their policy benchmark (Figure 15). The strongest alignment tends to be found in those countries where there is a heavy domestic focus to investment, including Australia and the UK. Among the survey respondents, the most striking disconnect is in the US, where 80 percent of asset owners using benchmarks have a greater than 25 percent misalignment. Such asset owners might, for instance, be using a domestic fund benchmark when they have over 25% of their assets in overseas markets or in REITs. Such misalignment also exists in Canada and the Nordics where there are trends towards asset owners increasing their foreign real estate exposure.

Figure 15: Alignment of Real Estate Benchmarks with Investment Strategy.



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

The survey also reveals relatively low use of mandate benchmarks, although in all markets there are a small number of asset owners making use of them, at least on an ad hoc basis. This limited use of mandate benchmarks contrasts sharply with the liquid equities and fixed income markets where such benchmarks are the norm for investment management. There are signs that this is changing, particularly in the Nordics, Australia, UK and US. In these markets, asset owners are increasingly seeking mandate-specific benchmarks to help monitor their individual strategies and improve transparency and communication between the CIO/strategy teams and those responsible for implementation. Such mandate-specific benchmarks are often accompanied by risk controls, including limits on leverage and the amount of development activity, as well as ranges within which allocations should be made to different markets. An important theme raised through the interviews is that these mandate benchmarks can be helpful in avoiding style drift, whether related to internally or externally managed real estate exposure.

Although the survey reveals an increasing trend towards the use of policy benchmarks, there are marked variations in the way in which they are used. On the one hand, there are those ‘high level’ benchmark users where the targets comprise one or a small number of metrics for the real estate department. On the other, a series of asset owners are far more active or ‘granular’ in the use of their benchmarks, linking them to the underlying drivers of performance and risks. In many cases ‘high level’ benchmarks are used for compensation purposes, with the compensation of the real estate team being linked to performance relative to the benchmark.

The users of more granular benchmarks often link compensation to relative performance, but such benchmarks are also used as a way of providing insight into the reasons for over and under performance. A common theme to most of these granular benchmarks is some form of attribution analysis. This analysis explains the reasons for over/under performance, often by



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focusing on two components of a portfolio's relative return. "The first is relative return which is due to 'structure' – the allocation of investment to 'segments' of the market with different average rates of return. The second is 'stock selection' – the choice of individual assets within each market segment which have returns above or below the averages for that market segment."²⁴

Some asset owners conduct this attribution analysis on each of their mandates and roll this up for the portfolio as a whole. Others review the results of the attribution analysis in conjunction with their managers. Such asset owners ask their managers to report on performance through the lens of attribution analysis, as way of improving understanding and strengthening the relationship between owner and manager. These examples of granular benchmarking point to significant variations in the sophistication with which risk is managed by real estate teams. Although many asset owners might have moved to using benchmarks, it seems that most make use of them at the 'high level' rather than using their 'granular' insights to strengthen risk management.

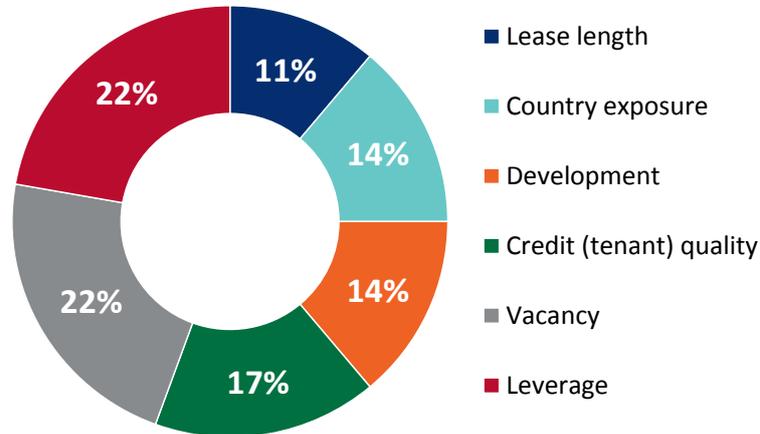
ii. Asset and Portfolio Risk Monitoring

Beyond the use of benchmarks as risk management tools, the meetings with the Survey Participants reveal considerable efforts to focus more on the asset and portfolio-specific risks of real estate exposure. Monitoring these risks is seen as a way of avoiding the style drift that plagued many asset owners through the global financial crisis. This risk monitoring can be related to the use of benchmarks, but requires additional data and analysis. As stated by one European pension fund: *"We do review all the individual projects that we acquire, but are not so good at reviewing the portfolio across our funds and properties. I feel there should be a 'benchmark tree' all the way down to help in reporting to the board and in providing discipline for the real estate teams."* **Nordic Pension Fund**

The main dimensions on which these risks are monitored relate to the 'asset' and the 'portfolio'. The heterogeneity of real estate assets and the dynamic nature of these risks through the market cycle can make them difficult to understand. Despite these challenges, there is a considerable body of research that identifies the main sources of asset and portfolio specific risks, and the MSCI survey confirms the importance of these dimensions (see Figure 16).

²⁴ Baum, A. and Farrelly, K. (2009) *Sources of alpha and beta in property funds: a case study*, Journal of European Real Estate Research, Vol. 2 No. 3, pp. 218-234

Figure 16: Real estate Risk Factors to be Monitored through the Risk Management Process.



Discussions with the Survey Participants revealed that many asset owners receive summary reports on portfolio and asset risk metrics from their managers or consultants. These metrics tend to cover the issues identified in Figure 16. Although these metrics provide a useful way of summarizing the risks of the real estate exposure, there are two distinct shortcomings. First, the range of risk metrics available is seen to be limited, leading to a desire for data across a broader set of risk factors. As summarized by one US survey respondent: *“Beyond the location and leverage risk data we have, I would like to see more on ‘income analysis’ including tenancy exposure by sector and the length of leases across the portfolio, as well as more on ‘fees’.”* **US Pension Fund**

This paucity of asset and portfolio specific data is a particular issue for asset owners seeking to integrate real estate risk exposure with multi-asset-class analysis. One such investor explained: *“We have good data on the portfolios we control directly, and many of our managers also provide the necessary asset-specific data, but there are just as many funds where we have little insight into such granular data. This poses real challenges for us in monitoring the risks across our entire portfolio.”* **Sovereign Wealth Fund**

While asset owners can overcome this first challenge by devoting more effort to the collection of appropriate data, the second area, the timeliness of reporting and valuation accuracy, is a more fundamental issue. The appraised nature of real estate performance metrics means there is a lag and potential smoothing in the reporting of performance, and the MSCI on-line survey identified this as the biggest challenge for risk analysis in the real estate portfolio. This is a challenge for the real estate industry as a whole, and a particular issue for asset owners seeking more closely to integrate real estate risk analysis and reporting with other asset classes.

The Survey Participants identified a range of issues including data shortages, timeliness and valuation accuracy facing risk departments seeking to build real estate into multi-asset-class risk analysis. These information issues have also been a major reason for asset owners historically excluding real estate exposure from such analysis and relying on the judgment and expertise of real estate departments instead. In many circumstances, certainly for smaller asset owners, the



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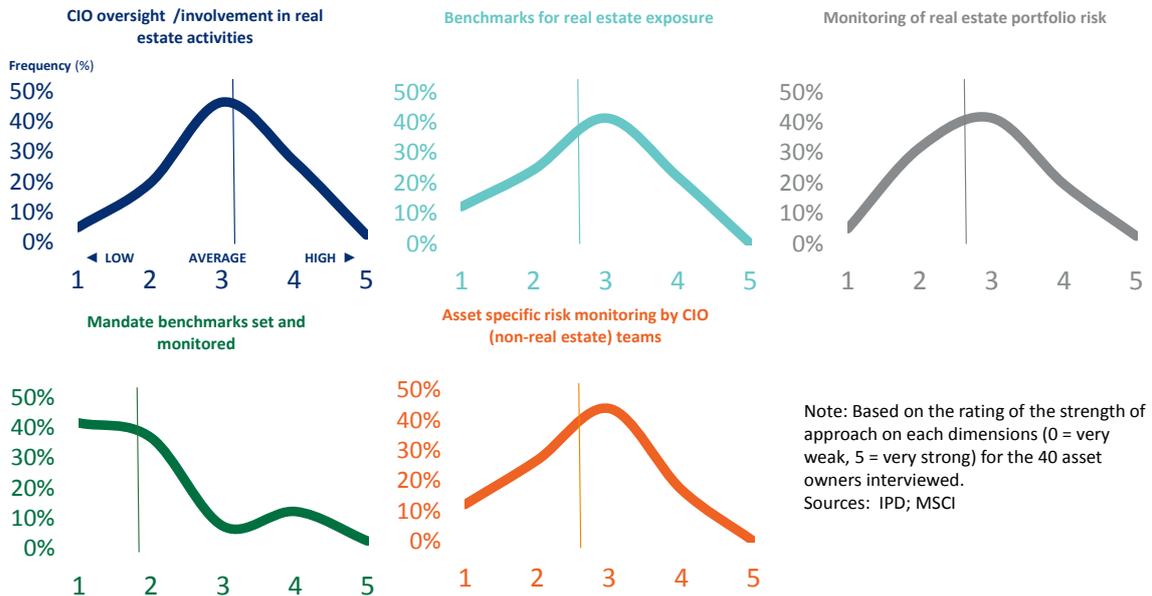
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CIO, or the boards themselves, are involved in reviewing individual property-specific investment decisions. Such CIO oversight can improve risk management of the real estate exposure and alignment with broader investment objectives. It is, however, relatively inefficient and a number of larger and more sophisticated asset owners have found ways to summarize real estate risks on a number of key metrics. In such organizations, CIOs focus on these portfolio-wide risk metrics and their relationship with other parts of their portfolio, rather than individual assets.

A Summary of Benchmarking and Risk Management for the Real Estate Department

As for the analysis of real estate risk in the multi-asset-class context, meetings with the Survey Participants provided a series of important insights into the monitoring of real estate specific risks (see Figure 17). With the exception of mandate benchmarks, the clustering of the results around the “average” score suggests that there is widespread understanding of the relevance of these dimensions of real estate risk management. But despite this awareness, relatively few of the asset owners scored highly (4 or 5 in the rating), suggesting that only a few asset owners excel on each of the dimensions. Although there are only a few ‘global leaders’, their approaches nevertheless represent the best practice that others seem to be trying to follow.

Figure 17: Strength of Approach to Key Dimensions of Real Estate Risk Management.





5. REAL ESTATE RISK IN THE MULTI-ASSET-CLASS CONTEXT: IMPLICATIONS OF THE SURVEY

The 2013 MSCI/IPD Global Asset Owner Survey identifies a number of key themes in the areas of asset allocation and real estate risk management. These themes include wide variation in asset allocation across regions, differences in investment processes and variations in governance structures. The survey also reveals significant variation in the role of alternatives in asset owner portfolios. Although the market as a whole has moved towards a 20% allocation to alternatives, this conceals big differences, with high allocations in Australia and Canada, and low allocations in parts of Europe and Asia. There are also differences in the appetite for specific alternatives, although real estate is the dominant alternative in all markets except for the US.

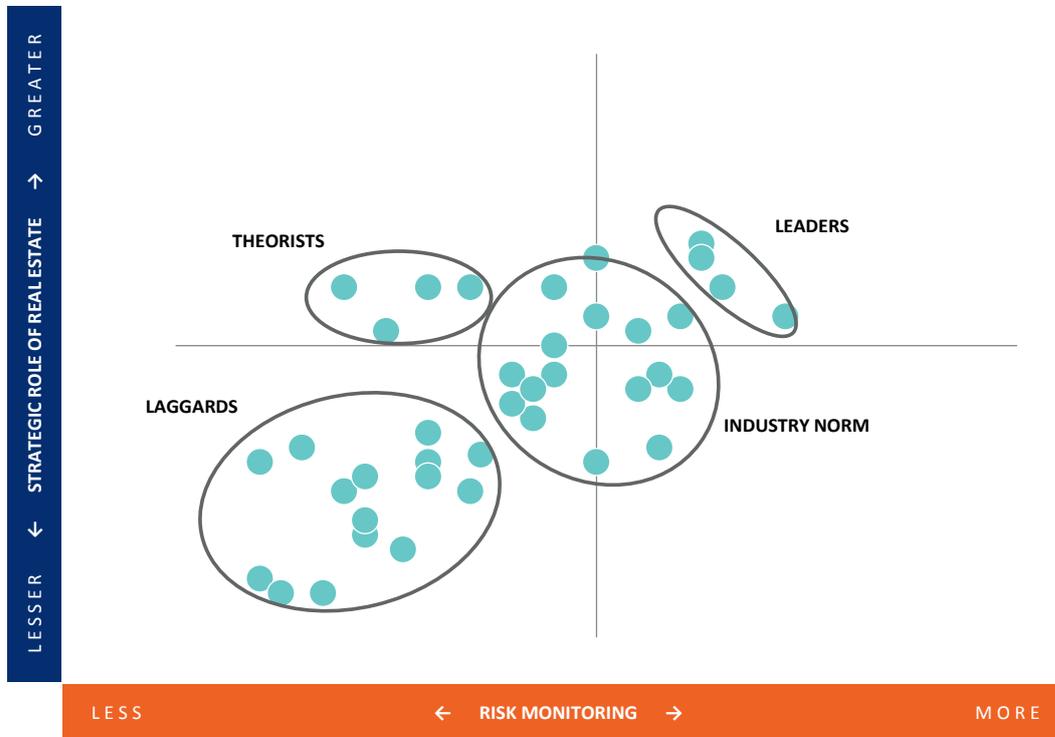
The main focus of this paper is on real estate, and it provides a series of insights into the risk management of real estate within the multi-asset-class context. The quantification of asset owners' real estate exposure confirms the important role of the asset class in their portfolios, with an average of at least 8% being held in real estate. The survey also reveals that while home bias remains an important feature for most asset owners, there is a general trend to increase non-domestic exposure, with some having an explicitly 'global' remit for their portfolios.

Although a large and increasingly global asset class, the survey reveals significant variation in the role of real estate, from low return inflation-hedging through to high absolute return seeking. In certain cases, asset owners divide the real estate allocation into different "*buckets*", but for most it is the combination of characteristics (income, inflation hedging, diversification and return) that makes real estate assets attractive. 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 any analysis 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 tactical mismatches such as the use of inappropriate benchmarks or the limited strategic monitoring of portfolio and asset specific risks. Both these mismatches can lead to style drift in the actual real estate exposure.

Although the survey reveals significant cases of potential misalignment, it also identifies a series of asset owners who represent 'best practice' in real estate risk management. This spectrum of sophistication is captured in Figure 18 for the two dimensions of real estate in the multi-asset class risk management process, and the more specific process of real estate risk management. Each mark on the chart represents an individual asset owner that has been rated on the series of dimensions covered in the survey findings.

Figure 18: Sophistication of Approach to Real Estate Risk Management.

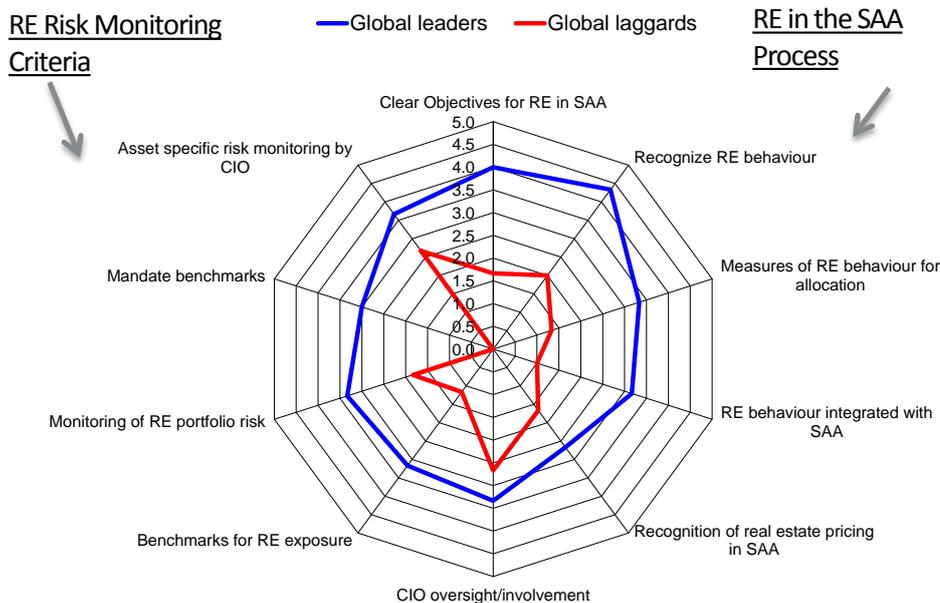


The chart reveals four main types of asset owner:

- On the bottom left is the group of less sophisticated investors with minimal formal real estate risk management, and poor integration between the real estate team and the broader portfolio ('laggards'). A number of these investors are relatively new to real estate investing, and are starting to improve processes on both dimensions. But there is another set within this category that have relatively large real estate teams which have tended to operate in a semi-autonomous way, apart from the rest of the portfolio. The experience and judgment of such teams places them in a good position to manage the real estate exposure. Despite this, the limited nature of formal risk management processes and weak integration with the rest of the portfolio leaves the real estate team, and the portfolio as a whole, exposed to the kind of mistakes suffered by a number of asset owners through the global financial crisis.
- The group of investors in the top left quadrant tends to have a highly sophisticated strategic perspective on the role of real estate, with clear risk/return objectives as well as tools and processes to integrate with multi-asset-class risk monitoring ('theorists'). The sophistication of this approach is often led by a small group of individuals within the central risk or strategy teams familiar with multi-asset-class risk analysis. Despite this sophistication, there tends to be a disconnect between the strategic objectives and the implementation of the strategy. This is often due to relatively weak asset and portfolio-specific risk metrics within the real estate departments. Most of these asset owners are taking steps to better integrate risk management at strategic and tactical levels but, without closer alignment, are likely to be particularly exposed to style drift.

- The largest group of asset owners is clustered in the middle of the diagram. These are making efforts to monitor the risks of the real estate portfolio, and to integrate this with other asset classes ('industry norm').
- Although most asset owners are seeking to improve their risk management processes, nearly all fall short of the fourth category, the 'global leaders', identified in the top right hand quadrant. These asset owners tend to be very sophisticated on most of the dimensions relating to real estate risk management. Figure 19 sets out some of these best practices, which are starting to be applied by asset owners as a whole. The chart summarizes the results of the leading and lowest scoring asset owners on the ten dimensions. At a glance, the diagram shows how the 'laggards' score poorly on most of the dimensions, particularly in the use of benchmarks and the integration between real estate and multi-asset-class risk management. In contrast, the global leaders tend to have a sophisticated understanding of the role of real estate. They also have strong risk tools in place both to integrate this analysis with the rest of the portfolio and to drill into actual real estate exposure.

Figure 19: Risk Management Approach: Key Criteria and Rating of Global Leaders and Laggards.



Note: Rating of sophistication of approach on each criterion (0 = very weak, 5 = very strong). Based on average scores for five best and worst performers

Source: IPD

Beyond these steps by individual asset owners, there are clearly a number of industry-wide developments that could help tighten alignment through the investment process. Academic research, data improvements, modelling capabilities, industry body activity and regulatory changes could all support this tightening of alignment. In terms of multi-asset-class risk analysis they particularly relate to the availability of better quality data that cover all forms of real estate



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behavior and the modelling capability to integrate this with more liquid asset classes. There is also a need for better, more granular data and risk analysis tools for the real estate teams themselves. Both groups are challenged by the data shortages, timeliness and valuation accuracy that overshadow the analysis of private real estate markets. The combination of industry-wide efforts to overcome these challenges as well as organizational changes by asset owners could serve to tighten the alignment through the real estate investment process. In turn, this should serve to increase the relevance, and reduce the risk, of the real estate exposure of asset owners.

These insights are particularly significant given the structural and cyclical forces that are set to drive real estate investment in the second half of this decade. Structurally, real estate has become an important element of the multi-asset-class portfolio, and has started to move beyond its home bias to become a truly global asset class. This increased significance has occurred despite the severity of the losses of the global financial crisis. The combination of these factors has led to greater scrutiny from risk managers and CIOs, and a desire to better integrate real estate with broader multi-asset-class risk management. Cyclically, the recovery in real estate markets coupled with concerns over the pricing of other asset classes, has led to an influx of capital and concerns over the pricing of real estate itself. This weight of capital is likely to test the resolve and the skills of asset owners as they seek to maintain alignment and manage risks through the investment process. It is hoped that this survey and its insights into best practice, can be of use to asset owners and their managers as they strengthen their investment processes during 2014 and beyond.



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