IPF Research Programme

AT A GLANCE
SEPTEMBER 2018

CURRENT PRACTICES IN BENCHMARKING REAL ESTATE INVESTMENT PERFORMANCE

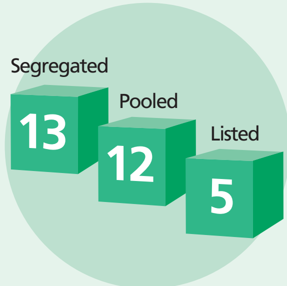
This research examines the nature of benchmarks and investigates their range and application, predominantly in relation to the UK private real estate market but touching on global practices. To identify prevailing practices, a survey of major institutional investors was undertaken, with real estate assets under management approaching £180bn in the UK and £515bn overseas.

Survey

No. Contributors

AUM (£bn)

Vehicle types



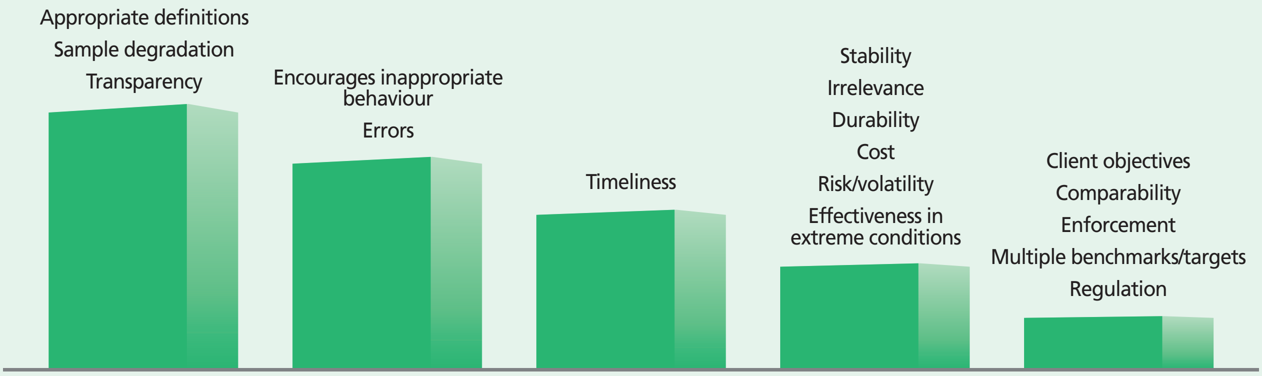
Organisations represented a range of clients, mainly segregated (i.e. separate) and pooled funds.
Many pooled funds incorporated pooled retail funds as well as institutional funds. The sample included a small proportion of sovereign wealth funds.

Considerations in constructing benchmarks

Beneath those factors identified by the survey, additional questions need to be addressed on the nature, knowledge and preferences of the client, including their appetite for risk.

Risk/Volatility · Durability · Time horizon · Timeliness · Cost · Measurability · Relevance · Transparency · Size · Performance attribution · Investability · Client objectives

Hazards of defining & implementing benchmarks



Challenge for the future

To design a system that can cope with changing market conditions and deliver a balance between measurement and attribution of performance that adequately captures risk and return. It will also need to take into account where the portfolio lies in the cycle.

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Key Points

- Three approaches are employed typically to evaluate real estate performance: peer comparison, relative return and absolute return.
- In the UK, a commonly used benchmark for market comparison in the unlisted sector is provided by MSCI/IPD, although issues, such as lack of transparency, degradation of samples as markets change, effectiveness of designated risk measures and timeliness of delivery, particularly in relation to data availability of other asset classes, are causes of concern to users.
- Choice is determined by the characteristics of the fund/client and the investment objective.
- Of the 17 houses surveyed, almost all use absolute benchmarks irrespective of style or type where no transparent market indices are readily available for benchmarking purposes. This is also true of many overseas markets.
- Clients make a significant input into the choice of benchmarks in the majority of cases and many of those with absolute strategies combine absolute benchmarks with peer or relative market benchmarks.
- Most fund houses are reluctant to change benchmarks regularly but developments, such as a degrading sample, will eventually stimulate a rethink.
- There is a question whether investors are conditioned by receiving the same (or similar) forecast and performance data from a small number of sources.
- The global financial crisis has not generally changed policies on types of benchmark used.
- Transaction-based indices are seen as analytical tools rather than benchmarks.
- There is no real evidence that the use of peer or market-based benchmarks constrains strategy.
- Relevance is, by far, the most important factor in the choice of benchmark, followed by size (defined both as number of funds and market coverage) and the measurability of the benchmark.
- The primary problem faced by investors when choosing a benchmark is ensuring transparency, with sample degradation and confidence in metrics provided being further important considerations.

The full report may be downloaded from the IPF website: **www.ipf.org.uk**.

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