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Indirect Property Investing—An Alternative to Direct Ownership?

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As institutional investors seek alternative sources of return and income, their attention has returned to real estate. Investors can access the real estate markets in two general ways:

- *Direct real estate:* Directly owning real estate properties, either individually or through pools; or
- *Indirect real estate:* Purchasing equities of listed real estate companies.

Historically, pension funds have used direct investments in real estate. The asset class offers some very attractive features, including a stream of rental income, the ability to hedge inflation, potential for capital gains and diversification.

At the same time, investing directly in real estate—whether by owning buildings or by participating in pools of buildings—has a number of drawbacks as well. Not the least of these drawbacks are illiquidity and the lack of a meaningful asset valuation most days of the year. When these drawbacks made their presence felt in the early 1990s, many pension funds reduced their exposure to this asset class—once they were able to do so.

Perhaps it is not a coincidence that the early 1990s also witnessed the rapid expansion of a new, liquid way to invest in the real estate markets—the real estate investment trust or REIT. In 1990, REITs accounted for under 20 percent of the total market capitalization of U.S. real estate investment, while by 2000 REITs had become about 70 percent of the (much larger) total. This vehicle, together with similar publicly traded real estate equities, has grown in use worldwide. But does indirect real estate offer pension funds a way to access the benefits of direct ownership of real estate described above?

Meeting Pension Funds' Objectives

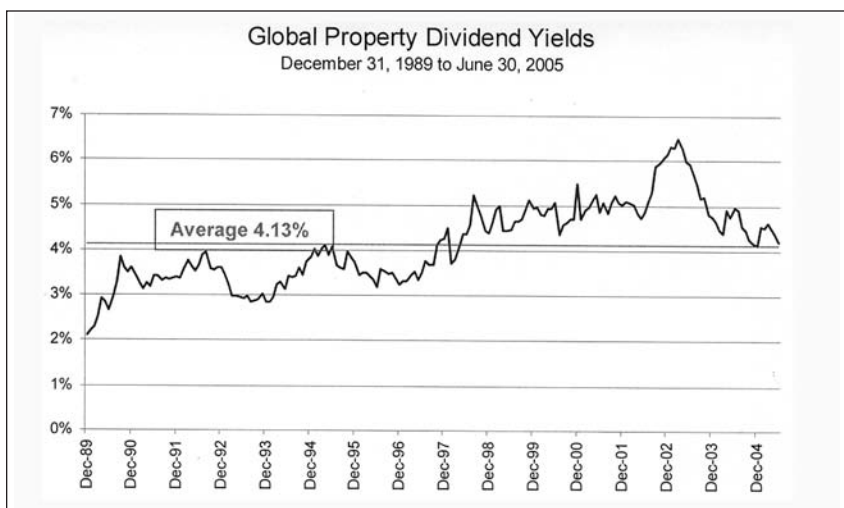
In fact, indirect real estate investment does provide income (based on rents and hence linked to inflation), growth potential and diversification.

The graph on this page shows the historical dividend yield of the Global Property Research 250 Index, a global index of listed real estate equities. Over the 15 years through mid-2005, the dividend yield of the index has averaged over 4 percent per annum.

In addition, as shown in the following graph on the next page, over the last 20 years indirect real estate has provided the same return as global equities.

The graph on the next page also suggests that at times indirect real estate moves quite differently from general equities, and this is borne out by the low correlation between the two: For the 10 years ending April 2005, the correlation of the GPR index with the MSCI World Index was 0.5 (all figures in CAD).

Furthermore, a number of U.S. studies have shown that when the differences in the character of the indirect and direct real estate indices are taken into account, the risk and return characteristics of the two approaches are very similar (see for example Public versus Private Real Estate Equities—A risk-return comparison, Joseph L. Pagliari, Kevin A. Scherer and Richard T. Monopoli, *The Journal of Portfolio Management, Special Issue 2003*).



Source: GPR, ABN AMRO Asset Management

Thus, indirect real estate investing can meet the same objectives as direct real estate.

Additional Benefits of Indirect Real Estate


Because indirect real estate investing uses listed equities, it incorporates all the benefits of the listed equity markets including liquidity and transparency. Capital requirements are minimal and lock-up requirements non-existent. In addition, indirect real estate makes it much easier for institutional investors to obtain broad diversification across geographic regions and real estate industry sectors.

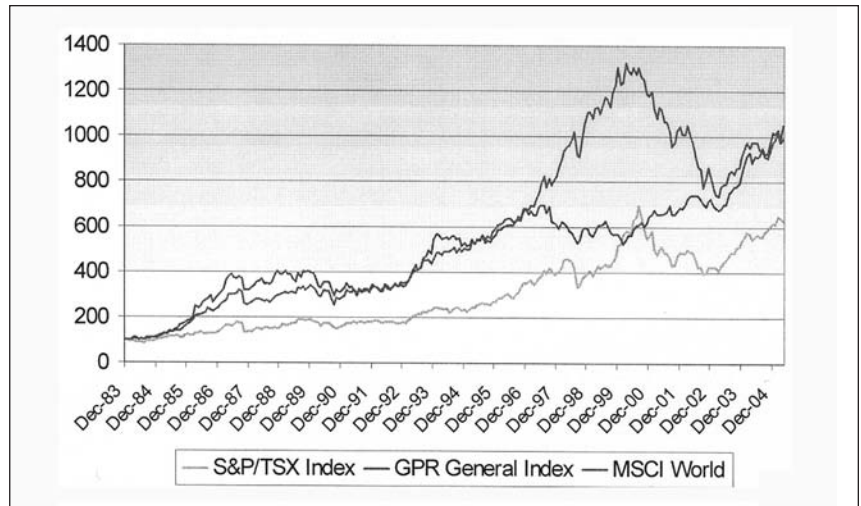
As the chart to the right makes clear, geographic diversification makes excellent sense, as no one region of the world systematically under- or over-performs:

Real estate is very much a local phenomenon; office rents in Singapore have little to do with warehouse rents in Chicago, for example. Indeed, unlike general equities where the correlation across different countries is quite high and the main contribution to diversification comes from industry and stock-specific factors, country diversification is high in the indirect real estate markets. The chart below illustrates this fact by breaking out the country components of the GPR 250 Index in a five-year risk/return scatter graph.

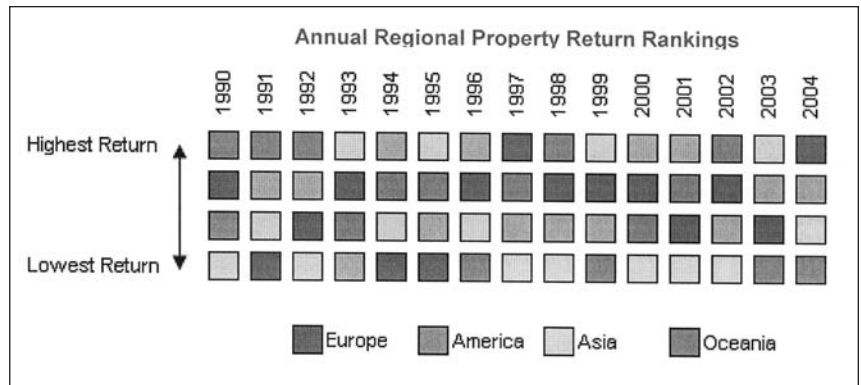
Regional correlations are quite low, and regional dividend yields are also at times countercyclical, so that the global diversification possible through indirect real estate can generate stable returns and yields through time.

Conclusion

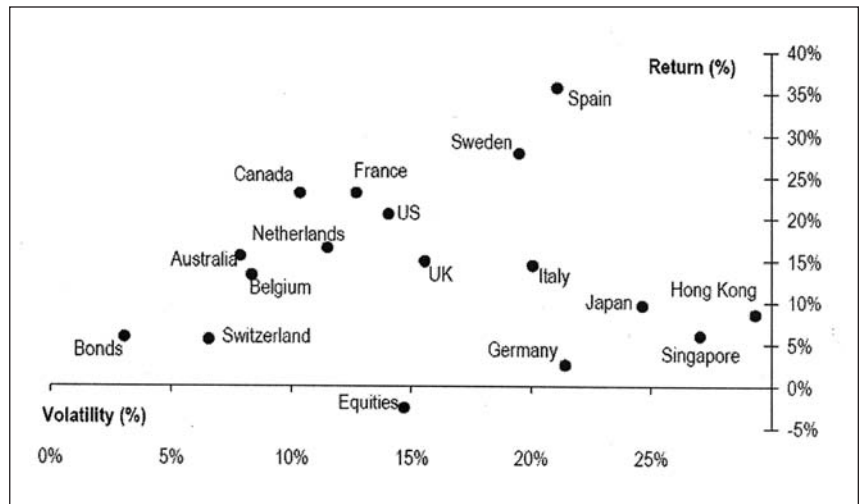
Indirect real estate investing offers pension funds and other institutional investors all of the benefits of direct property ownership while eliminating many of the drawbacks of direct ownership. In addition, indirect investing allows much greater diversification across geographic regions and real estate industry sectors, enhancing further the benefits of the asset class. 



Source: ABN AMRO Asset Management – total return indices in CAD



Source: GPR, ABN AMRO, all indices are total return indices, measured in local currencies



Source: GPR Market Update August 2005 — local currencies