

**The ROZ/IPD Real Estate Index:
Some Dutch Lessons for the U.S. Industry?...**
An Interview with Aart Hordijk

As part of its "Closing the Gap" study for PREA, focusing on alternative benchmarking and index possibilities for the U.S. private real estate investment industry, RERI conducted the following interview with Aart Hordijk, Secretary General of the Dutch Real Estate Council. The Dutch Council hired the IPD in 1995 to begin producing the first successful private real estate investment performance index and benchmarking service in the Netherlands, the ROZ/IPD Index. The following interview was conducted during mid-July, 2000, via e-mail (supplemented by phone conversations). The questioner was RERI Principal Investigator David Geltner. The interview is divided into two parts: the first part deals with the background and history of the Dutch indexing experience. The second part deals with how the Dutch industry works with the IPD to provide their indexing services.

1. Background and History:

RERI: *Aart, what is the ROZ, and what does it do?*

Hordijk: The ROZ is an umbrella organization composed of the real estate interests of all the major Dutch associations having to do with investment and real estate, including institutional investors, private investors, developers, notaries, brokers, social housing and home owners. The ROZ used to be mainly the representative of the institutional investors in lobbying the government for construction cost subsidies for residential (rental) property. Nowadays it mainly focuses on the ownership of property and related activities such as property financing, development, management and sales. We sometimes say that the ROZ acts as an "umbrella of umbrellas", with particular responsibility for the representation of collective Dutch real estate interests at the European Union level through our membership in the European Property Federation (EPF). Among the major regular publications we are responsible for, in addition to the ROZ/IPD Index, we publish standardized rental contract frameworks, which are constantly being amended because of changes in legislation. ROZ stands for "Raad voor Onroerende Zaken", which in English literally means "Council for Real Property Affairs", though we usually refer to ourselves in English as the Real Estate Council of the Netherlands. The ROZ was first established in 1934.

RERI: *How many industry associations are in your "umbrella"?*

Hordijk: We have eight member organizations on our Board of Directors. The member most associated with the ROZ/IPD Index is the IVBN, which is the major association of Dutch institutional investors (perhaps similar to a combination of PREA, NAREIT, and ACLI in the U.S.). We also have Neprom and NVB representing the real estate development industry (perhaps somewhat like ULI or NAIOP in the U.S.), the NVM representing brokers (similar to a combination of the NAR and the SIOR or CCIM in the U.S.), and several other associations largely representing the residential sector.

RERI: *What types of real estate investors are represented by the ROZ?*

Hordijk: The investors we represent include pension funds, insurance companies, and both listed (that is, publicly traded) and unlisted (private) real estate companies. Keep in mind that in The Netherlands most pension funds directly manage their own real estate investments (I think this is a bit different from the situation in the U.S.), and we have, in comparison to the U.S., only a very small number of institutions, but they are relatively large.

RERI: *How would you describe the ROZ's overall mission?*

Hordijk: To put it all in one sentence, I would say our purpose is to stimulate increasing professionalism in the real estate industry.

RERI: *Why did the Dutch industry decide to start an investment performance index, and how did the ROZ get involved?*

Hordijk: I would say that foreign investment demand for Dutch real estate played a large role. The idea to start an index goes back to the late 1980s. The market was booming, but foreign investors, especially from the U.S. and England, wanted an index to measure Dutch real estate performance. The ROZ was a natural entity to organize the effort, because we represent most of the interested parties.

RERI: *Tell us something about the history of the development of the Dutch index?*

Hordijk: The ROZ actually made two attempts to start an index. The first attempt failed, but we learned some valuable lessons. The first attempt started in 1989. At the time two possible routes to establishing an index were identified, both using the methodology and data processing capabilities of external organisations: World Markets Company (WM) and Investment Property Databank (IPD). WM was established as an organisation measuring the performance of equities and fixed interest securities for institutional investors. IPD on the other hand was dedicated to measuring property investment performance.

Although on balance the IPD approach was seen as the more suitable (particularly as it provided participants with a comparative portfolio analysis as an integral part of the product), nevertheless the industry decided to go with WM in its first attempt to start an index. For one thing, many investors were already familiar with the WM system. Also in WM's favour was that the supply of input data was at a higher level of aggregation, namely at the fund level rather than on that of individual properties. This required less detailed information to be supplied, lessened concerns on the release of confidential information, and reduced the risk of poor investments being exposed in the results. These considerations tilted the argument in favour of WM, which was chosen to undertake the property performance task. Information was collected from investors and indices were duly produced.

RERI: *What happened with the WM Index?*

Hordijk: It became quickly apparent that the WM Index did not provide the results that the property market had been wanting. "Too general" and "useless" were common comments. The

accuracy of the results was also seriously questioned. After three years it was decided to abandon the project.

RERI: *What went wrong?*

Hordijk: The reason for the failure is complex. I would say that the WM Index had major technical problems that were largely responsible for the failure. But there were also problems caused by the real estate market.

RERI: *What were the major technical problems in the WM Index that caused its failure?*

Hordijk: Among the technical problems, I would identify four that were most serious. First, there was a lack of clear and unambiguous definitions. Terms and measures were not unambiguously defined. For example, a key concept such as "gross rental income" was interpreted in many different ways. Similarly "transaction price" proved open to many different interpretations: including or excluding transaction costs and sometimes also including an internal fee. As a result the index was comparing apples with oranges.

A second major technical problem was with valuations. Although it had been agreed that valuations would take place on the basis of the open market values of fully let properties, this again was interpreted in widely different manners. Whilst one organisation might adhere to the guideline, another might use the historical cost price and yet another one the historical cost price after deduction of depreciation charges. Once again the problem of a lack of clear definitions manifested itself.

A third major technical problem had to do with infrequency of valuations. The common practice among Dutch institutional investors was to have 20% of their property portfolio externally valued each year. By not adjusting the values of the remainder of the portfolio, at any time only 20% of the value of such portfolios reflected current market conditions. The lack of annual valuations meant that outdated and misleading information was used in calculating the index.

Finally, a fourth technical problem was that the index reported only one figure, the total return each year. One index figure is far too general. For example, the total return of the Dutch office market was by itself not very meaningful and did not lend itself to further analysis.

RERI: *Were there other problems besides these technical ones that led to the failure of the WM Index?*

Hordijk: Yes. Apart from the technical shortcomings, the state of the property market at the time also contributed to the project's failure. When the initiative was first taken, foreign demand in the Dutch property investment market was high and property directors would talk of upside potential rather than downside risk and the market proved them right. The bottom line was that property investors did not want their performance measured. If this could not be avoided, a minimalist approach was the most they would accept. The lack of a genuine commitment from the start sealed the initiative's fate.

RERI: *What happened next?*

Hordijk: By the end of 1993 the property industry was back where it had started in its efforts to establish a property index. In fact it had arrived at a cross-roads: either progressing with the development of a proper and meaningful index or giving up the idea altogether, accepting the potentially damaging consequences for the future of property investment.

RERI: *What motivated the Dutch industry to try again to set up a performance index?*

Hordijk: As it happened a number of developments caused the case for an index to gain momentum. The first was a rapid reversal of market conditions, when the euphoric mood of the late 1980s was abruptly replaced by the international property crisis of the early 1990's. Another factor was increasing pressure from outside the property industry to establish a property index. Property typically makes up 5% to 10% of institutional investment portfolios in The Netherlands. The performance of the other main asset classes such as equities, bonds and mortgage lending can be measured objectively and frequently. Clearly property could not be allowed to escape measurement. The use of increasingly sophisticated quantitative methods and techniques in other fields of investment begged the question why property should be beyond measurement. The need to establish an objective and accepted method of comparative performance measurement was also reinforced by the trend amongst larger investors to spin off their directly held property investments into separately run subsidiaries. The managements of these new funds were given the task of developing their funds and attracting other investors. They had to build up a performance record and a benchmark was required whereby their track record could be judged.

These developments were instrumental in convincing a large number of investors of the need of a property index. By the end of 1993 they agreed to an approach based on that used by IPD since 1985. A committee of representatives drawn from the various types of property investors represented in ROZ (including pension funds, insurance companies, listed and unlisted real estate companies) was given the task of taking the necessary steps to ensure the launch of a property index.

2. The Role of the IPD in the Dutch Index:

RERI: *What are the major organizational structures that you have observed in use by the IPD in Europe, in terms of how the IPD interacts with the local investment industry?*

Hordijk: In Europe I would say that we can distinguish three different organizational structures, or ways in which the IPD interacts institutionally with the real estate investment industry. Different structures are used in different countries. I will label these three structures: (i) the "direct client relationship"; (ii) the "foreign subsidiary relationship"; and (iii) the "liaison with an independent industry association".

RERI: *What do you mean by the first structure, the direct client relationship?*

Hordijk: Here I am referring to the structure that IPD uses in the United Kingdom, the IPD's home country where they first started out. In that situation, the IPD has a direct relationship with

their clients, the data-contributing members of the IPD. Standard and additional products are agreed directly between IPD and the client.

RERI: *What about the second structure, the foreign subsidiary relationship?*

Hordijk: IPD owns shares of the subsidiary, together with one or more organisations or private persons in the host country. The IPD services are organised and delivered through the subsidiary. The IPD subsidiary deals directly with the data-contributing clients as IPD does in the U.K., only it is a subsidiary with some degree of ownership and interest from the host country, and the specific methods and procedures are of course conformed to the local needs. Examples are Germany and France.

RERI: *And the third structure, the liaison with an independent local industry association? I suppose that is the structure used in The Netherlands, with ROZ being the local association?*

Hordijk: Well, yes, more or less. Normally the local association would tend to be an umbrella organisation like ROZ. The way this works is that the participants in the host country have organised the index/benchmarking activity by starting an independent organisation (typically a non profit foundation). This association acts on behalf of the local participants, intermediating the relationship between IPD and the local data-contributing firms or entities. Where possible, the local industry association makes collective arrangements with IPD, rather than direct relationships between IPD and the local data contributors. The industry association then typically receives a share of the IPD fee as compensation. Examples of this approach are the Netherlands and Sweden. In the Netherlands the ROZ initially operated directly with IPD, though we have subsequently set up a special non-profit foundation to manage the Index with IPD.

RERI: *Why is the first approach, direct operation of IPD from England, not used in Europe outside of the British Isles?*

Hordijk: There are pretty good reasons for that. Although index calculations seem to be straightforward, in Europe we have to do with completely different systems as far as lease lengths, operating costs and legislation are concerned. To give an extreme example, leasable space in Germany is being calculated differently from city to city. Also the valuation system in Germany varies from the open market value as being calculated by Anglo Saxon countries and is not easy to change since a number of valuation procedures are embedded in the German legislation. Other important factors are the cultural differences and the language barrier. It is therefore necessary to have an acceptable representation in each country and of course sufficient support from the institutional investors.

RERI: *Why did the Dutch industry decide to use the third approach, the collective industry association intermediation with IPD?*

Hordijk: In the Netherlands we have always been in favour of our model by a vast majority. For one thing, we did not have a lot of professional experience with the index product. A lot has to be organised, a user manual has to be produced with all kind of rules and definitions. You need agreement of all participants for this kind of thing to work. In other words, you need a collective arrangement.

RERI: *But why does the lack of prior professional experience with an index imply that you need a collective industry association to mediate a relationship with IPD?*

Hordijk: Each country will have its own developed real estate industry. Compared to the Anglo Saxon countries the real estate industry in Continental Europe developed much more recently over a much shorter time span. Looking at the experience IPD had in France as the first target country, they were not very successful there at the beginning, because IPD could not get the message across. Similarly, when IPD started to negotiate with the Netherlands about implementing their system, they offered to send over a couple of people to describe the Dutch real estate market in a fortnight and then the Dutch system could be developed. We warned IPD that this was not going to work in the Netherlands because the institutional investors never would have accepted this from foreigners. We therefore installed a user committee to describe necessary items like valuation rules, segmentation, operating costs, definitions etc.

Another major task was the test of the IPD system with Dutch data to find out if there were any differences between the UK and the Netherlands and if modifications in the UK system were necessary to make it suitable for Dutch circumstances. We discovered a lot of differences and in the end IPD decided to develop another system and databank for the Dutch real estate market.

RERI: *Are there other reasons why you think it is best to have a local industry association mediating the relationship between IPD and data contributors?*

Hordijk: It doesn't matter what stage of development the real estate profession in a country is in, it will always be necessary to develop an own-country view on subjects related to the IPD benchmarking system. In our view this can be better achieved by having IPD work with and through a local industry umbrella association, because such an association is unbiased by any commercial aspects. An independent foundation clearly works on behalf of the participants and will be as such the counterpart of IPD, while an IPD subsidiary clearly acts on behalf of IPD (commercial interest).

RERI: *What do you mean by "commercial aspects" and "commercial interest"? Can you be more specific about the types of potential problems you are hoping to avoid by having the ROZ mediate between the IPD and the local Dutch data contributors?*

Hordijk: By "commercial" I am referring to the profit-making orientation of a private company like IPD. Naturally, they must have as their first concern the profitability of their firm for its owners. In the Netherlands it was *felt* that a non-profit organization would be most appropriate in order to be able really to represent the industry. If it would have been on a commercial basis who would be the clients' representative in (re)negotiations with IPD? (Keep in mind that the "clients" over here, the data-contributors, are for the most part investment institutions directly, such as the pension funds themselves, rather than firms specializing in real estate investment management.) Also the mediation of the industry association between the data-contributing clients and the IPD gives the client a freer position to develop ideas about new products and new developments in the IPD system.

After five years of presentations to the clients we at the ROZ/IPD Index Foundation have built up a very good relationship with the clients, much better than if we would have had only a commercial relationship. The independent non-profit status placed us in the position to undertake all type of new initiatives, such as standard segmentation for retail, offices and residential property throughout the country . We have been asked in consultations related to various valuation/appraisal issues. Also, to attract new participants is much easier from a non-profit position than it would be from a commercial (for-profit) position. When visiting new potential customers, the question is usually not so much *if* they are going to participate but *when*. Also the position of IPD is more clear within our structure: IPD is the databank provider, and the users decide what type of new products are required and, more importantly, under what conditions the users will continue with IPD's services.

RERI: *With all of these arguments in mind for using a local non-profit industry association to mediate between data-contributors and IPD, why do you think Germany and France, two of the largest nations in Europe, are not using this approach, but dealing directly with a private, for-profit IPD subsidiary instead?*

Hordijk: This is a matter of attitude by institutional investors in each country, negotiation with IPD, and coincidence. In France, IPD took over an existing index organisation, BD2i, which had already been operating an index on a commercial basis. In Germany, the institutional investors opted for a for-profit company with representation on the Board along with IPD and the firm's management. For IPD this is easier because they have more direct control over the operations.

RERI: *Are there any other benefits you haven't mentioned yet in having an industry umbrella association work with IPD to provide the index and benchmarking services?*

Hordijk: Yes. The collective start of the index gave the Netherlands a coverage of 75 % right from the start. Since the start the coverage went up to even 85% in the year 2000 and we expect to get around 5% more coverage during the next couple of years.

RERI: *85% coverage of all investment property sounds very impressive to Americans. How have you done that?*

Hordijk: We are very proud of this degree of coverage, but keep in mind the Dutch situation. We have a number of umbrella organizations of institutional investors, all meeting each other at ROZ meetings. Furthermore the Dutch attitude to achieve consensus with all parties concerned first before introduction of new systems is a particular national trait of the Dutch, at least between well established umbrella organisations. In our case this creates already a high coverage of the real estate market of the institutional investors.

RERI: *To what extent would you attribute your high percentage of property market coverage to IPD energy and enterprise promoting and facilitating participation in the index?*

Hordijk: The influence of IPD on the market coverage has been minimal. It was a pure Dutch affair.

RERI: *That being the case, why did the Dutch industry decide to hire a private firm to provide the index and benchmarking services, instead of just doing this itself, directly, for example through the ROZ?*

Hordijk: First of all, we had already a major task in the development of the system itself, to computerise it would have added another major risk which easily could have grown out of control. It was also felt that the Board of the ROZ index foundation should have an arms length distance to the investment process to avoid any possible conflict of interest. Third, we saw no reason to "reinvent the wheel" (so to speak). A private firm was available that was able and willing to do the job. It was not clear that a non-profit association like the ROZ could do it at all, much less as effectively.

RERI: *Why did the Dutch industry choose IPD versus hiring some other private firm to run the Index and provide the benchmarking services?*

Hordijk: There were several reasons for that. First, we could benefit from IPD's experience since 1985: new products, new developments and research possibilities constantly being developed by IPD in the UK market. Secondly, because of reasons of confidentiality it was an advantage to have a foreign country taking care of the processing of Dutch data. Thirdly, there were really not many alternatives. At the time only World Markets, IPD, and Frank Russell could provide this type of service. Frank Russell was considered to be too far away to be practical, and I have already described the history of the choice between IPD and WM.

RERI: *How does the fee sharing arrangement with IPD work?*

Hordijk: The fee arrangements with IPD vary from country to country but are basically dependent upon the number of properties in each portfolio in a sliding scale; the more properties the lower the fee per property. The fee will be split in 70% for IPD and 30% for ROZ. Although the fee will be calculated in English pounds, the ROZ fee has a fixed exchange rate to the pound since the costs of ROZ are in Dutch guilders too. The fee will be adjusted by the UK CPI each year. Additional products are being charged in the same way.

RERI: *What products is IPD providing in the Netherlands?*

Hordijk: The standard products the clients receive are :

- the index results as presented at the (free) annual "unveiling" conference (where the new year's index results are presented);
- the comparative report and presentation at the client's offices;
- the local market report;
- the statistical digest;
- the (free) autumn meeting on technical issues of the IPD system.

RERI: *How do you make sure that all properties are seriously re-valued every year, and what is IPD's role in this process?*

Hordijk: We set up certain requirements for the obligatory data submissions by the data-contributing members. One requirement is that all property valuation reports are to be audited. Normally this audit function is the responsibility of the individual data-contributing firms or institutions. Large institutions have internal auditors, but most data-contributors have external auditors. These are the auditors the firms use for other purposes as well. It is not a function performed by the IPD. On the other hand, the ROZ and IPD have set up a series of probability checks on the input data to insure data integrity and quality.

RERI: *What is the data ownership arrangement between IPD and ROZ?*

Hordijk: IPD and ROZ are joint owners in equal share of the Trademarks, while copyrights of the input data belong to each individual participant, while the copyrights of processed data and all other standard products belong to IPD.

RERI: *In practice, how does this arrangement guarantee the integrity and accessibility of the index and its underlying database? For example, if an independent academic researcher wanted to study some aspect of the methodology by which the data was compiled into the index, and ROZ supported the study but IPD did not, what sort of data access would be available for the study?*

Hordijk: IPD is very concerned about other organizations taking over their system and methods. Therefore I believe that a university studying their methodology would be nearly unthinkable. For research purposes (older) data can be provided to academics as long as it will not be used commercially. An audit of the IPD system by a Dutch organization never took place, although I don't think that it would be impossible if such an audit would be confidential for outsiders. An audit really would be a good idea to find out the state of the art of the computer systems IPD uses as well (partially batch oriented and partially interactive).

RERI: *Was there any consideration about successor entities to IPD, if, for example, IPD were bought by another firm or IPD should for some reason go out of business? Are there provisions for such contingencies?*

Hordijk: Take-overs have never been considered and IPD confirms all the time that they will continue to operate on an independent basis.

RERI: *How would you describe your (and the Dutch industry's in general) overall degree of satisfaction with the IPD in their role in the Netherlands?*

Hordijk: I would say that in general we have operated successfully with IPD, and the clients are satisfied with the service and are enthusiastic about it. The IPD has a successful track record of achieving a useful and widely-respected index here in the Netherlands. I would also say that their track record in other countries indicates that IPD has considerable flexibility and range in their ability to work in various local cultural and institutional environments.

RERI: Does the ROZ ever provide any advice to other countries thinking of setting up indexing services?

Hordijk: ROZ has been asked by Sweden and Germany to advise them on an independent basis regarding the process of setting up cooperation with IPD in these countries. Because of our experience with IPD, we were more than willing to advise Sweden and Germany.

RERI: *Aart, thank you very much for your time. Your perspective and experience are certainly of interest and relevant to the U.S. real estate investment industry at this time.*

Hordijk: You are quite welcome. Please let me know if I or the ROZ can be of any further service.