



## Contribution of RERI Closing the Gap Study

We appreciate the opportunity to contribute to the RERI study, commissioned by PREA and conducted by Professors David Geltner and David Ling (G-L Study). The authors have kindly copied to us the extensive working papers produced through the last few months, and other inputs they have elicited from third-parties. We congratulate the authors on an impressive achievement, which is comprehensive, closely argued, and on many technical points in line with our own experience.

This note sets out IPD's vision of how the primary objective of the G-L Study – improved research indices and manager evaluation benchmarks for US real estate – could be achieved. It is not a detailed response to all the points G-L raise, which has been sent direct to the authors. It is, rather, a re-statement of IPD's current proposal to US investors and managers with special reference to the valuable and constructive spirit of the G-L Study.

### 1. IPD background

Investment Property Databank (IPD) is a specialist information business, and the world's largest supplier of real estate index and benchmarking services. It produces the industry-standard services in seven countries, with development underway in a further three.

The company:

- Is independent, with no interests in consulting, investment advice or other real estate activities which would conflict with its primary role of objective, impartial measurement of real estate performance.
- Was established in the UK fifteen years ago, expanding through the last decade to Ireland, the Netherlands, South Africa, Sweden, Germany and France, with Belgium, Denmark and Portugal currently being added to the list.
- Provides Index and market performance measurement across seven countries based on records of 32,000 buildings with a market value of \$235 billion.
- Provides confidential benchmarking reports and performance attribution services to the investors and managers of nearly 400 individual portfolios.
- Employs a staff of 100 in its London headquarters, with subsidiary or affiliated offices in five other countries, has an annual turnover of \$8m, and a 10-year record of sustained growth and profitability.
- Applies stringent confidentiality criteria agreed with its clients to protect commercially sensitive information on individual buildings, portfolios or investors.

## 2. Improved indices and benchmarks for US real estate

### 2.1 The gap

From our external perspective, G-L's assessment of the strengths and weaknesses of the Index and benchmarking capability of the NCREIF system seems wholly accurate. The system has the strength of an excellent base on standards and technical definition, and a reasonable coverage of tax-exempt fiduciary investments in real estate. But NCREIF has fallen behind the best practice found in other countries because it does not cover enough of the total real estate investment market, or provide a complete record of all properties in the portfolios of its contributors. The first point weakens its value as a research index; the second point weakens its value as a manager evaluation benchmark.

The complexity of real estate investments means that a large volume of accurate information is necessary to give a reliable and credible measure performance. The construction of a database with sufficient breadth and depth of coverage imposes costs on both the data contributors and the agency involved in data validation, processing and analysis. It is unlikely that a simple Index and research database can provide sufficient benefits to data contributors, or revenues to a performance measurement agency, needed to support a viable service.

### 2.2 IPD process and business model

IPD's solution to this problem is to offer investors and managers of real estate portfolios state-of-the-art benchmarking and performance attribution as a fee generating service. Comprehensive, confidential reports on each portfolio calculate returns on each portfolio on a rigorously consistent basis, give like-for-like comparisons against fair benchmarks, and unpeel the layers of strategy and manager skill that contribute to performance – investment style, active management through transactions and developments, asset allocation, property selection, down to building management.

These Benchmark Reports are used by clients for:

- Client reporting and investor relations.
- Setting fair benchmarks, targets and incentive rewards for performance.
- Internal analysis of the strengths and weaknesses of portfolio management, and building selection, and property manager and other vendor performance.

Because benchmark reports are a valuable tool for many core tasks in portfolio management, investors and managers are attracted to contribute to the system, and have a strong commitment to the supply of comprehensive and accurate records of their investments. The revenues from benchmarking clients are the pump-primer for a full range of Index and market analysis services.

Given this cornerstone, IPD aims to collect:

- Detailed records on any meeting its reporting standards – a full building by building statement of a periodic market-to-market appraisal, complete revenue and capital cash flows, supporting occupancy and operating cost information).

- Records which cover all forms of active management – purchases, sales, development and rehabilitation projects.
- Records from any type of property owner – insurance general accounts, segregated and pooled pension funds, listed trusts and property companies, limited partnerships – on their exposure to real estate in any form – leveraged or unleveraged private equity, shares in joint ventures or listed vehicles, domestic and overseas.

IPD has therefore been able to capture records of (for example) 17,000 buildings in the UK with a market value of \$137 bn (equivalent to 75% of the asset of all UK institutions and listed property companies), and 7,000 buildings in the Netherlands with a market value of \$28 bn (80% of the institutional and listed company portfolios).

### **2.3 Application to the US**

Although some features of the structure of the US real estate investment industry are different from the typical European pattern, it shares the need for objective and credible information for use both in the management process and in market analysis. We therefore believe the IPD approach could trigger the expansion in coverage, range of information and quality of information set as an objective by G-L.

In addition to the private benchmarking services, that system would produce public information in the form of:

- A Real Estate Index showing all-property and sector performance, published and widely distributed for free, with the aim of becoming the accepted, respected and universally used measure of performance within the real estate industry, the financial and research communities.
- Detailed market analysis reports available on subscription to any user, showing breakdowns of total returns, capital and income, rental and yield performance, operating costs, investment flows and portfolio structures for all major property types and market areas, with further splits by property characteristics such as size and age, and type of fund.
- A research database, providing user-specified sets of results defined by any building characteristic on a for-fee basis for commercial users, and where appropriate offering free and extensive access to bona-fide academic researchers.

We believe these outputs would meet the primary objectives for a Research Index, and the base for exploration of Index improvements through the incorporation of other sources of information, with the application of advance statistical methods, as set out by G-L. (Though we are less convinced than G-L that there is a widespread immediate demand for synthetically constructed indices which depart significantly from the fundamental portfolio records held in the database.)

In short, we believe that the core performance measurement and reporting objectives of major actors in the US real estate market could be fulfilled – and rapidly fulfilled – by the adoption of the IPD approach.

### 3. Institutional and governance issues

In all countries, IPD recognises that scale economies and the desire for a single, unambiguous measure of real estate performance, mean that an accepted and credible Index and benchmarking service is likely to occupy a dominant position in the industry. That position carries a responsibility to ensure that the service is technically robust, meets the broad needs of the industry, and is not exploited for excess commercial gain.

It is not necessarily the case that a dominant market position leads to monopoly profits, as suggested by G-L. Normal commercial bargaining between IPD and the relatively small number of clients who supply the bulk of the data on which a performance measurement service depends, and IPD's long-term interest in good client relations and customer retention, limit our financial targets to normal rather than exceptional rates of return.

#### 3.1 Governance

In addition, we take care to ensure that the commercial and technical interests of the industry and our clients are represented in the governance and operation of the business. This takes the form of:

- Representation for benchmarking clients and other industry leaders on the board of the company, with access to full financial information and influence over pricing policy.
- Representation of benchmark clients, index users and technical experts drawn from academia, the real estate industry, related financial industries, and government on the advisory panels which establish the standards and conventions to which the system works.
- Close alliances with other organisations with a shared interest in the delivery of the best possible real estate information.

#### 3.2 Link with NCREIF

NCREIF clearly falls under the last of points above. Any new or improved Index and benchmarking services for US real estate must take into account the need for consistency with the (excellent) technical standards NCREIF has applied, and the desirability of maintaining the long historic NPI record. It must also take into account the industry's desire to avoid duplication of effort in submitting data, and any danger of confusion from the existence of competing Indices. We have discussed these issues with NCREIF at length, and offered draft terms for a working agreement between IPD and NCREIF which we believe would meet all these concerns, and provide a sound base for joint working toward the common objective of world-class information on US real estate investment performance.

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