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INDIRECT INVESTMENT IN REAL ESTATE:
LISTED COMPANIES AND FUNDS

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**INDIRECT INVESTMENT IN REAL ESTATE:**
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## Abstract

In Europe today, there are two main vehicles for indirect investment in real estate: real estate investment funds and listed real estate companies. With these instruments not only does the investor take a position in the real estate market, he/she also acquires different risk/return structures, which may vary according to the instrument being used. In some European countries, real estate companies have modified their financial structure and tax position by adopting a legal form based on REITs (Real Estate Investment Trusts), which originated in the US; this changes their position compared to real estate funds. In this paper we compare real estate funds and listed real estate companies and analyse the appearance of REITs in Europe and their impact on the real estate industry.



**Keywords:** real estate, real estate investment, real estate fund, real estate company, REIT

**INDIRECT INVESTMENT IN REAL ESTATE:**
**LISTED COMPANIES AND FUNDS***

## Introduction

Because of the increase in volume and the sophistication of investment in real estate, indirect channels of investment through investment entities are being given increasingly frequent consideration. These entities can take different legal forms and may vary in their characteristics, but they tend to be divided into two large groups: companies and real estate investment funds.

This paper describes the main characteristics of the large indirect investment vehicles taking the form of listed companies and real estate investment funds in Europe. It includes a cross-country comparison of the performance of the two types of vehicle and direct investment in real estate.

## Listed real estate companies

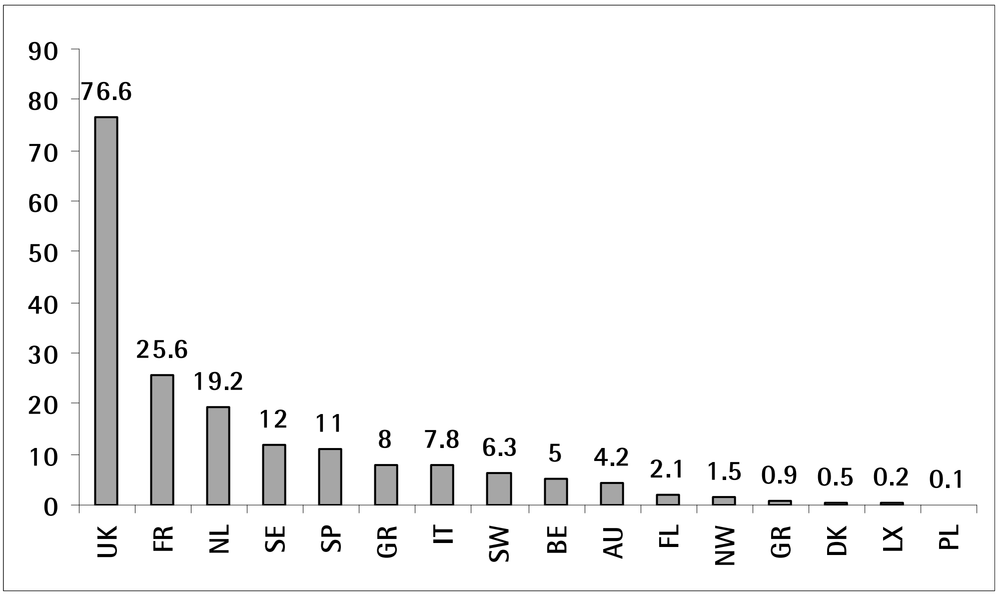
### a) *Investment volume*

The portfolio of the 100 largest European listed real estate companies[1] is 180 billion euros, with a market capitalization of 110 billion euros. By country of origin, the UK, France, the Netherlands, Sweden and Spain have the largest volumes, as can be seen in Graph 1.

The difference between the UK, with 76.6 billion euros, and the other countries is notable, despite a period of takeovers and privatisations in the UK due to an unfavourable market environment following the abolition of “Advance Corporation Tax”[2].

* Paper presented at the 12th European Real Estate Society Annual Conference, Dublin, Ireland, June, 2005
[1] EPRA Ranking, “Europe Real Estate Yearbook 2005”, EPRA.
[2] “Europe Real Estate Yearbook 2005”, EPRA. “From 6 April 1999 the imputation system was replaced. Advance corporation tax was no longer payable. The tax credit on dividends was reduced to 10%, but the tax credit no longer had any value for companies. However, those subject to income tax can set off the tax credit against their income tax liabilities. ACT that had already been incurred could still be set off against a company’s tax liability, provided the company would have been able to set it off under the old imputation system.” Answers.com, United Kingdom Corporation Tax.

**Graph 1. 100 largest Listed Real Estate Companies.**
**Investment volume by country of origin (billion euros), January 1, 2005**




British Land, from the UK, is the largest company, with a value of 17.7 billion euros. It was traded at a 10% discount to net asset value (NAV). In second place is Land Securities, also a British company, with 12.1 billion euros in real estate assets. These two companies invest only in the UK and 90% of their portfolio is invested in offices and shopping centres. The third place goes to Gecina, a French property investment company focusing on the residential and offices industry, mainly in Paris.[3] The rest of the ten largest companies are: from the UK, Liberty International, Hammerson, and Slough Estates, focusing on the offices and commercial industries, with the exception of Slough Estates, 50% of whose portfolio is invested in the industrial sector; from The Netherlands, Rodamco, "a large European retail property company, with 89% of assets invested in retail and the remainder largely in offices"[4]; from France, Unibail and Klépierre, also focusing on the offices and commercial industries; and lastly, the Spanish real estate company Colonial (see Table 1).

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3 In March 2005, Gecina was bought by Metrovacesa. If the investments of Gecina (8.4 billion euros) and Metrovacesa (3 billion euros) as of January 2005 were added together, they would occupy third position.
4 "Europe Real Estate Yearbook 2005", page 497.

**Table 1**
**Ten largest listed real estate companies in Europe.**
**Investment volume and market capitalization (billion euros), January 1, 2005**

| Name | Origin | Investment Vol. | Market Cap. | Free Float** | Premium/ Discount*** | Scope |
|---|---|---|---|---|---|---|
| British Land | UK | 15.7 | 6.6 | 100 | - 10 | National |
| Land Securities | UK | 12.1 | 9.3 | 100 | 7 | National |
| Gecina | FR | 8.4 | 4.5 | 50 | - 5 | National |
| Liberty International | UK | 7.4 | 4.4 | 80 | 9 | National |
| Rodamco Europe | NL | 7.3 | 5.2 | 70 | 23 | Multinational |
| Unibail | FR | 6.6 | 5.3 | 100 | 39 | National |
| Hammerson | UK | 5.7 | 3.4 | 100 | - 3 | Multinational |
| Slough Estates | UK | 5.2 | 3.3 | 100 | 1 | Multinational |
| Klépierre | FR | 4.6 | 3.0 | 40 | 16 | Multinational |
| Inmb. Colonial | SP | 4.3 | 1.7 | 60 | - 12 | National |

Source: "Europe Real Estate Yearbook"
*** Kempen & Co

By market capitalization, Land Securities takes first place, followed by British Land, Unibail, Rodamco Europe, Liberty International, Hammerson, Slough Estates and Corio, a Dutch real estate company with a market capitalization of 2.9 billion euros in January 2005. Corio focuses mainly on investment in shopping centres. In 2003, 71% of its portfolio was invested in commercial property, 23% in offices and 5% in the industrial sector, with investments in the Netherlands, France, Italy and Spain and a portfolio value of 3.8 billion euros.[5] Below Corio are Gecina and the Austrian company Immofinanz, with 1.8 billion euros in market capitalization in January, 2005. Immofinanz is Austria's largest real estate company. Its 3 billion euro, 3.54 million m² portfolio includes 900 properties from all the real estate sectors in 19 countries, with a focus on Central Europe.[6]

With regard to premiums or discounts on Net Asset Value, EPRA, in its report "Europe Real Estate Yearbook 2005", states that discounts on NAV tend to exist in countries where there is no legal equivalent to REITs[7], whilst in countries where there is an equivalent, there is a tendency to trade above Net Asset Value.

Table 2 shows the percentage invested in the different sectors by the 10 largest European real estate companies. As mentioned in previous paragraphs, office and commercial property clearly predominates.

[5] "Europe Real Estate Yearbook"; Top 100 European Real Estate Companies/ Vehicles, page 492.
[6] "Europe Real Estate Yearbook"; Top 100 European Real Estate Companies/ Vehicles, page 493.
[7] The concept, characteristics, functioning and behaviour of REITs will be explained at a later stage.

**Table 2**
**Investment characteristics of 10 largest listed real estate companies.**
**Percentage of investment, by type of assets**
**January 1, 2005**

| | Asset categories | | | | |
|---|---|---|---|---|---|
| | Office | Commercial | Residential | Industrial/ Logistics | Other |
| British Land | 43 | 52 | | | 5 |
| Land Securities | 44 | 48 | | 5 | 3 |
| Gecina | 58 | | 42 | | |
| Liberty International | 9 | 91 | | | |
| Rodamco Europe | 10 | 87 | | 3 | |
| Unibail | 47 | 44 | | | 9 |
| Hammerson | 31 | 69 | | | |
| Slough Estates | 16 | 17 | | 50 | 17 |
| Klépierre | 18 | 82 | | | |
| Inmobiliaria Colonial | 81 | 10 | 5 | 2 | 2 |

Source: “Europe Real Estate Yearbook 2005” EPRA.

### *b) Introduction of REIT-equivalents into some European countries*

In some European countries, real estate companies can adopt a legal status similar to that of a REIT, or Real Estate Investment Trust.

REITs appeared in the US following an amendment to a popular legislative landmark: the 1960 tax extension law on cigarettes/cigars. In fact, they date back to the nineteenth century, 1880 to be precise, when investors were able to avoid double taxation by using Trusts, which were exempt from tax at corporate level if profits were shared out among investors. In 1930, this tax advantage was abolished and any passive investments had to be declared by each investor, first at corporate level and, then, individually. This tax disadvantage lasted for 30 years, despite the fact that Real Estate Investment Funds (in shares and bonds) were not liable to such double taxation.

After the Second World War, the growing demand for Real Estate Funds led “President Eisenhower to sign the *1960 Real Estate Investment Trust Provision*, which eliminated this double taxation, qualifying REITs as pass-through entities”.[8] In 1986, the Reform Act allowed REITs to manage their real estate directly, that is, they could exist without an intermediary management company. This eliminated many of the conflicts existing between REITs and their administrators. In 1993 the barriers preventing pension funds from investing in REITs were removed.[9]

A REIT, a “legal guise” used by real estate companies whose securities can be traded on the stock market, is a property investment company whose main activities are managing, letting or selling real estate, investing in other real estate companies, and even financing real estate. REITs are far more liquid than other alternative investment vehicles. They generally operate like any other property or real estate company; what makes them

[8] Source: www.reitnet.com
[9] Source: www.reitnet.com

different is that they are exempt from corporate tax provided their investment policies and income distribution (in the US, 90% of income) comply with the prevailing laws in each country.

REIT regimes started appearing gradually in the different European countries. In 1969, BIs (*Fiscale Beleggingsinstelling*) appeared in the Netherlands[10] as a result of the Dutch Corporate Tax Act. The BI regime is a pure tax regime, and therefore any company wishing to adopt this legal form does not have to fulfil any legal requirements.

BIs are listed on the securities market and therefore come under the supervision of the *Dutch Financial Market Authority*. BIs must be exclusively devoted to portfolio investment activities and can only have a leverage of 60% of the fiscal book value of the real property and 20% of the fiscal book value of all other property.

BIs must distribute 100% of their operating income, while capital gains or losses are placed in a tax-free reserve, which does not have to be distributed. Profits must be distributed within 8 months of the close of the financial year.

In 1995, the SICAFI structure (S*ociété d'investissement à capital fixe en immobilière*), a specific real estate investment institution with a favourable tax treatment, was created in Belgium. A SICAFI is defined as "a listed property fund, with a fixed amount of corporate share capital, whose role is to provide tax neutrality for collecting and distributing the rental income"[11].

SICAFIs must have the specific legal status of an investment fund, as well as complying with numerous legal requirements, which include having to have a suitable corporate form (Limited liability company or Limited partnership with shares under Belgian law). The company must be resident in Belgium, have a minimum shareholders' equity of 1.25 million euros and be incorporated for an unlimited period of time. The portfolio directors and managers must also have appropriate professional experience, etc.

SICAFIs may have leverage of 50% of the company's assets at the time the loan agreement is concluded and they must distribute 80% of their net profit in the form of dividends. Capital gains do not have to be distributed and remain tax-free provided they are reinvested within four years after they are obtained. Profits must be distributed on an annual basis.

In France[12], at the end of 2003, the SIIC (*Société d'investissement immobilier cotée*) tax regime was created in order to promote the development of real estate investment funds and strengthen their position in the market with respect to Dutch, Belgian and German open-ended funds. The SIIC was also designed to generate non-recurrent budget resources to help reduce the French deficit. SIICs come under the supervision of the *Autorité des Marchés Financiers*.

Any listed real estate investment company, or any subsidiary whose capital is at least 95% held by the parent company, can adopt this legal form.

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[10] "Epra Global REIT Survey. A comparison of the major REIT regimes in the world", EPRA, September 2004.

[11] "Epra Global REIT Survey. A comparison of the major REIT regimes in the world", EPRA, September 2004.

[12] "Epra Global REIT Survey. A comparison of the major REIT regimes in the world", EPRA, September 2004.

A SIIC's main activity must be passive investment in the real estate industry, although it may also commit to other activities providing they remain ancillary to the main qualifying activity. Financial leasing is permitted but may not account for more than 50% of the company's gross assets. Other ancillary activities such as real property development or brokerage are also permitted, but they may not account for more than 20% of the company's gross assets. In addition, these other activities do not have the same tax privileges. Unlimited leverage is permitted.

SIICs must distribute 85% of profit from real estate leasing and 100% of the dividends received by any subsidiary that has opted for the SIIC regime.

Fifty percent of capital gains arising from the transfer of real assets or the shares of real estate companies, as well as from the shares of any subsidiary companies which have opted for the SIIC structure, must be distributed.

1994 saw the introduction in Italy of FIIs (*Fondi di investimento immobiliare*), special funds which are not pure REITs.[13]

FIIs are defined as "Fiscally non-tax-transparent investment funds which invest exclusively in immovable assets, rights in rem in immovable assets and shareholdings in real estate companies. They are not legal entities, but rather pools of investment owned jointly by the unit holders. The unit holders of FIIs are taxed only when a profit is distributed or when they dispose of their units". FIIs are not permitted to lend money or invest in financial instruments issued by the SGR.

FIIs are tax-exempt and are managed by a managing company, called a "*Società di gestione del risparmio*" (SGR). They can have a leverage of 60% of the value of the real estate and 20% of the value of other assets. As regards tax, they are under no obligation to distribute operating profit or capital gains.

The following table sums up the tax treatment given to the different REIT regimes in Europe.[14]

[13] "Epra Global REIT Survey. A comparison of the major REIT regimes in the world", EPRA, September 2004.

[14] REIT regimes also exist in other countries, including Australia (the LPT, since 1985) and South Africa (the PUT). The LPT and the PUT are highly successful tax transparency vehicles which have been a far-reaching investment stimulus in both markets. J-REITs have existed in Asia since the year 2000, K-REITs in Japan since 2001 and RETFs in South Korea since 2004. Hong Kong has had REITs since 2003 and Singapore, S-REITs since 2002. Canada has had MFTs (Canadian REITs) since 1994 and Jersey (England) has PUTs, which are more similar to the REITs currently existing in the UK than any other regime.

**Table 3. Tax treatment of the different REIT-like legal categories in Europe**

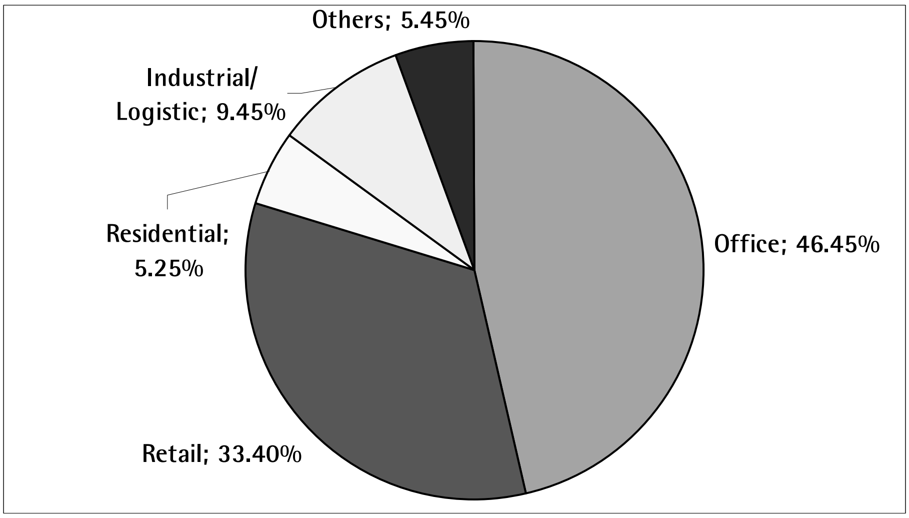
| | **Revenue** | **Capital Gains** | **Withholding tax** |
|---|---|---|---|
| **The Netherlands** BI | Real estate income is included in the tax exemption and is taxed at 0%. | Capital gains or losses are allocated to a tax-free reserve and are, therefore, exempt from tax. | 25%, which may be reduced due to a double taxation treaty. Capital gains allocated to tax-free reserve are considered capital and are not, therefore, subject to withholding tax. |
| **Belgium** SICAFI | Subject to 33.99% corporate tax, but qualifying real estate income is excluded from the tax base. | Capital gains are not included in taxable profit. | 15% dividend withholding tax, which may be reduced pursuant to application of tax treaties. |
| **France** SIIC | Leasing, management, and real estate investment activities are exempt from corporate tax, as are dividends from subsidiaries which have adopted the SIIC regime. All other activities are taxed at 33.33%, increased to 35.43% by surcharges. | Capital gains resulting from disposal of assets or real estate participations and which have been duly distributed are exempt from corporate tax. | 25% dividend withholding tax, which may be reduced to 15%, 5% or 0% pursuant to application of tax treaties. |
| **Italy** FII | Tax exempt. | Tax exempt. | 12.5%, which may be reduced to 0% in case of distribution to qualified resident or non-resident unit holders. |

Source: "EPRA Global REIT Survey". A comparison of the major REIT regimes in the world

### *c) Investment characteristics: types of assets and debt.*

According to the ranking of the 100 largest listed real estate companies by investment volume, the percentage of portfolio invested in the investment categories is as shown in Graph 2.

**Graph 2. Investment category.**
**Total investment of the 20 largest companies by investment volume,**
**January 1, 2005**




Source: Prepared by the authors using data from the "Europe Real Estate Yearbook 2005" EPRA[15]

Graph 2 clearly shows that most investment occurs in offices, with 46.45% of the portfolio, followed by retail, with 33.40%. Investment in these categories takes predominance in most of the 20 companies. The exceptions are: Gecina, which invests 42% of its portfolio in the residential sector; Slough Estates, which invests 50% of its portfolio in the logistics and industrial sector; Immofinanz, which has a diversified portfolio, investing principally in the offices sector, approximately equal amounts in the commercial, residential and industrial sectors and 26% in other sectors; Brixton, which invests 90% of its portfolio in the industrial sector; and Pirelli Real Estate, which invests 25% of its portfolio in the residential sector.

Table 4 shows the percentage invested by the 20 largest European companies in each sector.

[15] Of the 20 largest companies, 6 are from the UK, 3 from France, 2 from the Netherlands, 3 from Spain, 1 from Sweden, 1 from Austria, 2 from Italy, 1 from Germany and 1 from Switzerland.

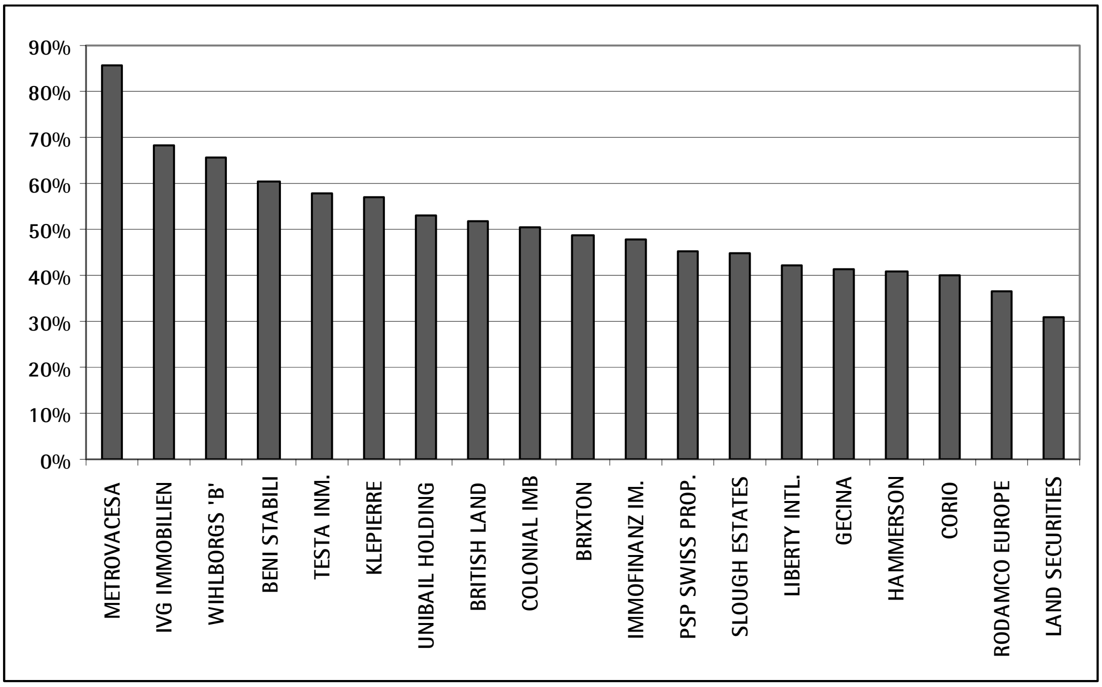
**Table 4. Percentage by investment category, December 2004**

| | Origin | Offices | Commercial | Residential | Industrial/ Logistics | Other |
|---|---|---|---|---|---|---|
| British Land | UK | 43 | 52 | | | 5 |
| Land Securities | UK | 44 | 48 | | 5 | 3 |
| Gecina | FRANCE | 58 | | 42 | | |
| Liberty Internatio. | UK | 9 | 91 | | | |
| Rodamco Europe | THE NETHERLANDS | 10 | 87 | | 3 | |
| Unibail | FRANCE | 47 | 44 | | | 9 |
| Hammerson | UK | 31 | 69 | | | |
| Slough Estates | UK | 16 | 17 | | 50 | 17 |
| Klépierre | FRANCE | 18 | 82 | | | |
| Inmb. Colonial | SPAIN | 81 | 10 | 5 | 2 | 2 |
| Wihlborgs | SWEDEN | 98 | | 2 | | |
| Corio | THE NETHERLANDS | 21 | 73 | 1 | 5 | |
| Immofinanz | AUSTRIA | 35 | 12 | 13 | 14 | 26 |
| Beni Stabili | ITALY | 84 | 11 | 1 | | 4 |
| IVG Immobilien | GERMANY | 81 | 4 | | 11 | 4 |
| Metrovacesa | SPAIN | 51 | 28 | 5 | 3 | 13 |
| Testa Inm. Renta | SPAIN | 54 | 27 | 11 | 6 | 2 |
| PSP Swiss Prop. | SWITZERLAND | 68 | 13 | | | 19 |
| Brixton | UK | 10 | | | 90 | |
| Pirelli Real Estate | ITALY | 70 | | 25 | | 5 |

Source: "Europe Real Estate Yearbook 2005" EPRA.

The average leverage of these 20 largest companies is 50.97%, although there is considerable variation, as can be seen in Graph 3.

**Graph 3**
**Debt ratio of the 20 largest European real estate companies by investment volume.**
**Total ST + LT loans / total loans + shareholders' equity + reserves, December 31, 2004**



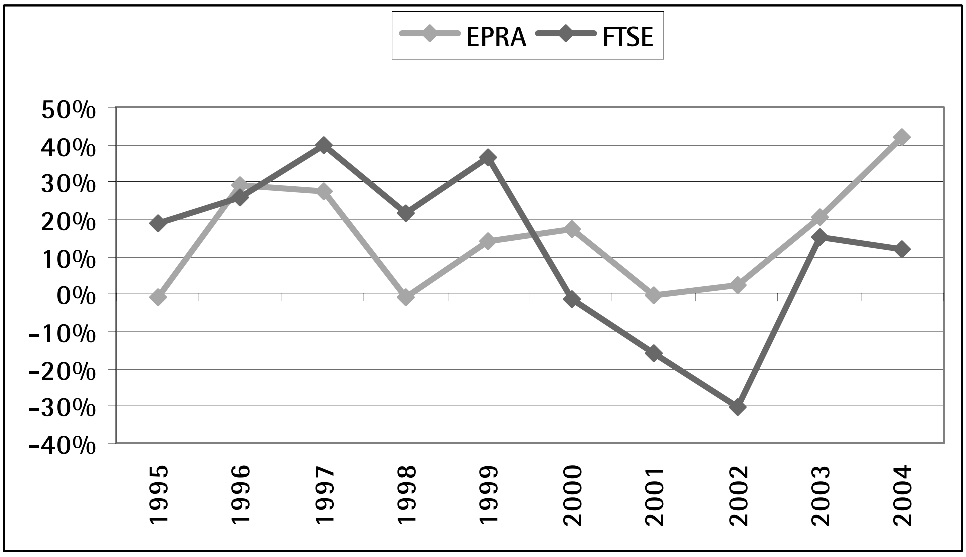

Source: Prepared by the authors using Data Stream data
* Pirelli Real Estate not available

It should be noted that Land Securities, Europe's second largest company in terms of investment volume, has a financial leverage of just over 30%, while Metrovacesa, sixteenth largest, has a financial leverage of over 85%. British Land, the top European real estate company in the ranking, has a financial leverage equal to the European average.

## *d) Performance of listed real estate companies*

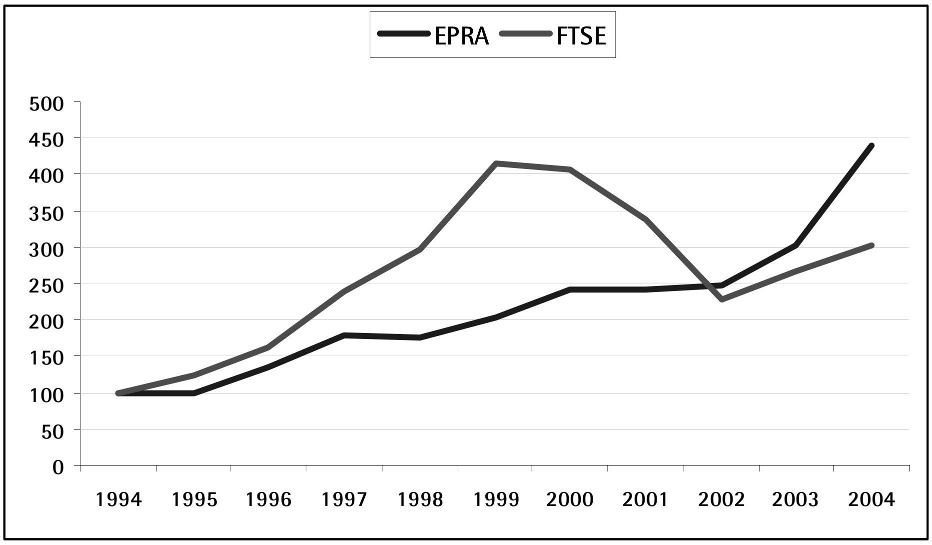
Graph 4 shows the annual change in the EPRA Europe return index and the FTSE 300. Although both indexes are very variable along the period, the annual change is bigger in the FTSE 300 than in EPRA Europe. On the other hand, the standard deviation is bigger in the EPRA index (424.64) than in the FTSE (395.39).

**Graph 4. Comparison between EPRA Europe and FTSE 300 Index Annual Change**




Source: Prepared by the authors using Data Stream data

**Graph 5. Comparison between EPRA Europe and FTSE 300**
**Return index for the entire period**




Source: Prepared by the authors using Data Stream data

Graph 5 shows a return index for the entire period (1994=100). The return of the global index increased until 1999, when it began to decrease. In contrast, EPRA increased throughout the period, especially after 2002, when it started to grow strongly.

In addition, Table 5 shows the five-, three- and one-year performance of the 10 largest real estate companies in Europe.

**Table 5. Average performance 10 largest real estate companies, January 2005 (%)**

| | Av. perf. at 5 years | Av. perf. at 3 years | Av. perf. at 1 year |
|---|---|---|---|
| British Land | 18.7 | 26.3 | 56.2 |
| Land Securities | 18.2 | 25.0 | 45.3 |
| Gecina | 8.6 | 20.7 | 30.8 |
| Liberty International | 19.1 | 29.6 | 46.4 |
| Rodamco Europe | 12.9 | 19.0 | 32.8 |
| Unibail | 24.8 | 29.4 | 61.9 |
| Hammerson | 17.6 | 28.2 | 39.0 |
| Slough Estates | 12.1 | 21.7 | 29.1 |
| Klépierre | 17.7 | 25.3 | 42.2 |
| Inm. Colonial | 26.2 | 39.8 | 60.6 |

Source: "Europe Real Estate Yearbook, 2005", EPRA

The highest average annual performance among the top ten can be seen in Colonial, with 26.2%, followed by Unibail and British Land, with 24.8% and 18.7%. The highest average annual performance in Europe as a whole, however, was recorded by Town Centre Securities, from the UK, with 34.2%, followed by Grainger Trust, also from the UK, with 33.3%, and Danish company Sjaelso Gruppen, which achieved an average of 32.5%.

## Real estate investment funds in Europe

### *a) Concept:*

The definition of real estate investment funds was inspired by the term UCIT, family savings management products, which were a gateway to investment in financial securities.

Real estate investment funds are unincorporated Collective Investment Institutions. Savings drawn from the public are deposited in a fund to be used basically to purchase property, which is then let in order to obtain a return. They differ enormously depending on the type of investor they are aimed at. Funds aimed at the general public, which are subject to strict monitoring by a government body, are classed as "Retail", whilst those aimed at a privately controlled group of companies, which are not subject to any public monitoring, are classed as "Private equity".

Another category, C*losed-Ended Funds*, or closed funds, can be established for the structure of real estate investment vehicles. These are funds with a limited life and a specific investment volume which does not fluctuate over time, that is, if the investor wishes to disinvest, he/she must sell the stake because the fund will not sell it for him/her, which is why these funds have an initial capital collection period. Vehicles with this structure are normally aimed at institutional investors and their activity is regulated by their own rules. This is the most common structure for indirect investment vehicles, and funds with an opportunist or core-plus style usually adopt this structure because they do not adapt easily to disinvestment and therefore require capital to be committed for a certain period of time in order to achieve their objectives.[16]

[16] ABN-AMRO / IPD Directory of European Property Vehicles 2003.

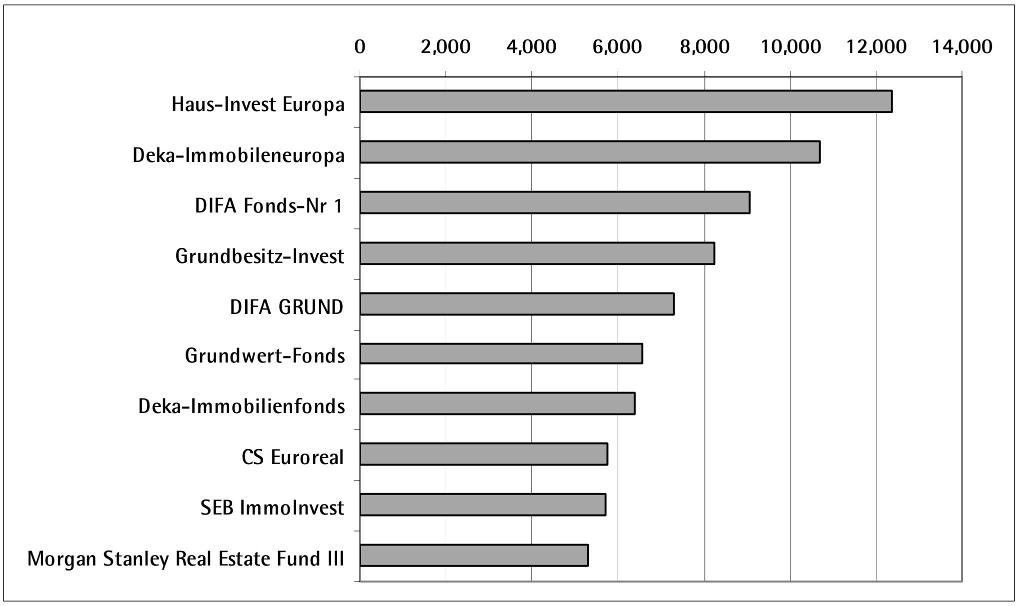
The second category is open funds, or *Open-Ended Funds*, which, in contrast to closed funds, do not have a limited life and are always open to new investment, so their assets increase and decrease over time.

Of the total funds in the INREV (European Association of Investors in Non-Listed Real Estate Vehicles) database as of December 2004, 157 were open-ended, with a Gross Asset Value (GAV) of 155.7 billion euros, and 243 were closed-ended, with a GAV of 105.3 billion euros.

### *b) Ranking of real estate funds in Europe*

Using the INREV database, the largest real estate funds in Europe were ranked according to Gross Asset Value, that is, the value of the property portfolio as of March 31, 2005. The result is shown in Graph 6.

**Graph 6. Ten largest real estate investment funds by GAV (in million euros), January 2005**




Source: Prepared by the authors using INREV data.

All these funds, with the exception of the Morgan Stanley Real Estate Fund III, are German. German funds have a strong tradition in Europe and handle very significant volumes of assets compared to other European funds. German open-ended funds are private, indirect real estate investment vehicles with no predetermined life and are always open to new investment and depreciation, except where this is impossible for legal reasons. For this reason, the size of these investments varies over time.

There are currently 30 “open-ended funds” in Germany. They are divided into three groups depending on the degree of geographical diversification: domestic funds, which invest only in Germany; European funds, which invest in other European countries as well as in Germany; and global funds, which invest at European and world level as well as in Germany. All of these funds are public funds for the individual saver.

The behaviour of these German funds is strongly linked to the geographical location of the investments: the higher the percentage of international investment (outside Germany), the stronger the performance. Domestic funds do not give very good returns, owing to the poor situation of the real estate industry in Germany.[17]

"German open-ended funds" are among the European funds that have experienced the most growth over the last few years. After the German closed-ended funds, they have the highest capitalization according to gross asset value. "What makes these funds attractive to the individual investor is their stability and low volatility (average 4-5%), the tax exemptions in the yearly allowance and the guaranteed liquidity they offer on a continual basis"[18].

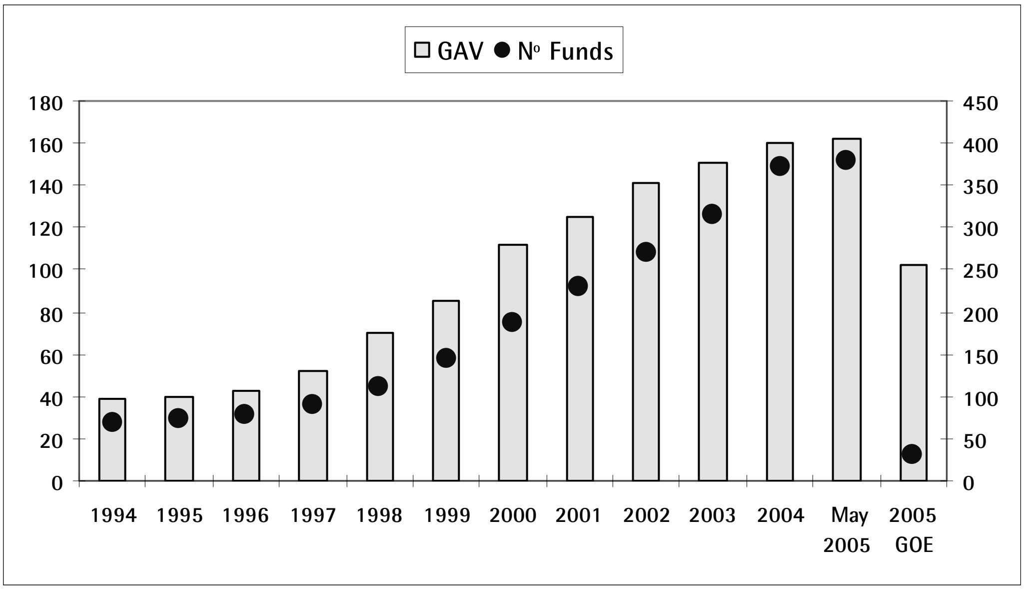
As can be seen in the Graph, the German funds are one of the best vehicles in the world for collecting real estate capital. In fact, they collected between 14 and 15 billion euros in 2003. However, the capital flow invested in these funds decreased in 2004 to around 3 billion euros due to deterioration in their performance. Average performance dropped from 5.4% in 2001 to 4.7% in 2002, and to 3.5% by the middle of 2003. For this reason, many of these capital flows were moved to investment in "German open-ended equity", German transferable funds.[19]

A major factor in the withdrawal of capital was the corruption scandals in some German real estate funds, which led to the first mass withdrawal in 15 years. Today, German funds have to sell assets in order to offer their investors due performance, the problem being that the law does not allow assets to be sold for less than their book value. In the meantime, the cost of renting is decreasing and investments are becoming paralysed.[20]

Of the total 408 real estate funds included in the INREV database, only 30 are "German open-ended funds", but their investment assets account for 43.45% of the total assets. As can be seen in Graph 7, German open-ended funds have assets amounting to 102 billion euros, whilst the rest have assets amounting to 162.3 billion euros.

[17] IXIS AEW Europe, Research and Strategy "The German Open ended fund market – stressed?"
[18] IXIS AEW Europe, Research and Strategy "The German Open ended fund market – stressed?"
[19] IXIS AEW Europe, Research and Strategy "The German Open ended fund market – stressed?"
[20] "Fondos alemanes a la baja", Joaquín Piserra, *Expansión Inmobiliario*, April 21, 2005, page 54.

**Graph 7. Growth of the non-listed real estate fund market by year of launch.**
**GAV (billion euros), left-hand scale**
**No. of vehicles, right-hand scale**




Source: INREV
Note: GAV of GOE funds are not included in GAV of May 2005

German open-ended funds can invest at European or global level, although in the latter case 80% of their assets are almost always invested in the continent of Europe.

The following 10 funds in the ranking by GAV are originally from the US, but are based in the UK, the Netherlands, Jersey (UK), Switzerland and Germany.

In addition, since 2000, a growth trend has been observed in the launching of these real estate funds, with 40 funds having been launched per year since that date. Specifically, 16 new real estate investment funds were launched in the first half of 2004.

These real estate investment funds can be invested in at national or international level, but the major growth in this market has come from international investments and for the following reasons[21]:

- Firstly, according to the transparency index prepared by Jones Lang LaSalle, Western European markets have become more attractive to investors at international level, and this is due to the increase in available information. In other words, there has been an increase in market transparency in the last 4 years, which has meant an increase in investment in these funds at international level.

- Investors are becoming increasingly eager to diversify their portfolios in countries such as the Netherlands or Northern European countries, which have firmly established institutional investment systems (pension funds or assurors) which are in need of somewhere to invest and do so through real estate funds.

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[21] Presentation by Judy Hill, ex-managing director of INREV.

- International investment through these real estate investment funds allows investors access to new markets and special industries. Investors are increasingly eager to invest in markets which are unknown to them and in which they have no experience. At the beginning of the nineties, a few countries such as the Netherlands or the United States attempted to penetrate these markets directly, but the results obtained were poor and, for this reason, many of them began investing in real estate investment funds, for which they did have the expert management knowledge to allow them to obtain good returns.

- Indirect investment through listed and non-listed funds allows small investors to invest in large real estate assets to which they would not have direct access and, in the same way, allows institutional investors access to more financial leverage which, although it may subject them to greater risk, may also bring higher returns.

- Lastly, non-listed funds also give investors "alignment", bringing them far closer to the fund management than in other types of companies. In addition, the fund management works along the same lines and is provided with a good system of incentives and is therefore far more motivated.

### *c) Types of real estate fund*

There are three investment styles:

- Core or Nuclear.
- Core-plus or Value-Added
- Opportunity

**"Core" Funds** are funds which invest in low-risk real estate assets and have a low financial leverage, if any. They normally aim at returns of between 0% and 11.5%, which is comparable to those achieved in the bond investment market. The majority of vehicles in the UK and Germany use this style of investment.[22]

**"Core-Plus" or "Value-Added" Funds** invest in medium-risk real estate assets and usually have a financial leverage of between 30% and 70% of the gross asset value of the portfolio. The main difference between core-plus funds and core funds is that core-plus funds' investment strategy focuses more on capital growth and the expected returns are between 11.5% and 17%.

These two investment styles are the ones normally used by "Retail Investor" funds.

Lastly, **"Opportunity"** or opportunistic funds are funds which invest in high-risk assets and have high levels of financial leverage, in excess of 60%. In their investment strategy, they place equal emphasis on capital growth and performance, which tends to be between 17% and 25%. Some examples of investment in this type of fund are asset renewal or updating opportunities, or intensive management characteristics.[23]

There are quite a few opportunity funds, particularly in the United States, which have specialist managers who, if they spot a good opportunity, use this style of fund, which

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[22] ABN-AMRO / IPD Directory of European Property Vehicles 2003.
[23] ABN-AMRO / IPD Directory of European Property Vehicles 2003.

includes the expert knowledge the investor lacks. (Investment in a building in Eastern Europe, for example.)

The following table summarizes the different types of fund described above, together with their characteristics.

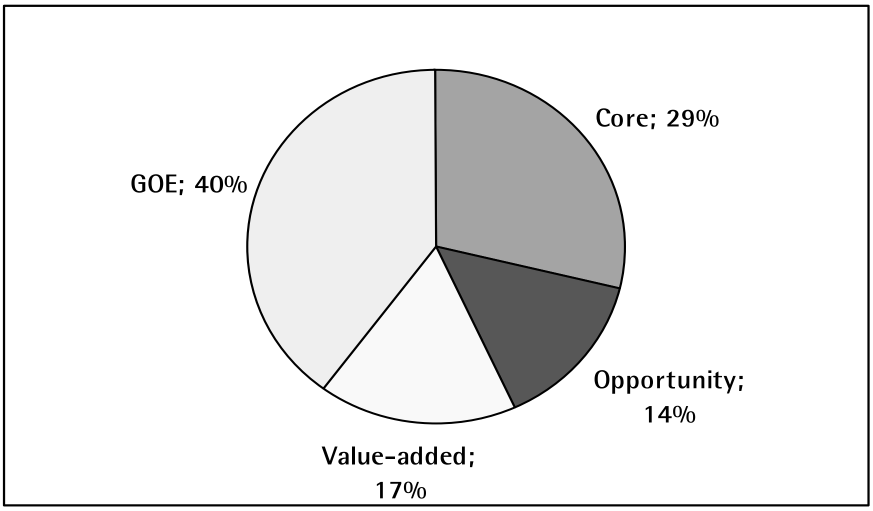
**Table 6. Real estate investment fund management styles**

| | Core | Value-Added | Opportunity |
|---|---|---|---|
| General Characteristics | Low-risk<br>Low-Return | Medium-Risk<br>Medium-Return | High-Risk<br>High-Return |
| Internal Rate of Return | ≥ 11.5% | > 11.5% and < 17% | ≥ 17% |
| Financial Leverage | ≤ 60 % | ≥ 30% and ≤ 70% | ≥ 60% |

Source: “Manager styles in Real Estate, A Model Approach on Non-Listed European Real Estate Vehicles”. INREV Research Committee, Arjan Planning, Lisette F.E. van Doorn, Maarten R. van der Spek

According to the INREV database in December 2004, which had 400 funds with a gross asset value of 261 billion euros, there were 188 core, 128 value-added and 54 opportunity funds. The 30 remaining funds were German open-ended funds. Graph 7 shows the percentage of total gross asset value corresponding to each style. As can be seen in the Graph, the real estate investments of open-ended funds amounted to a noteworthy 40% of the total. These funds are very popular, despite the fact there are very few of them, and they have significant amounts of capital. The core funds are in second place, with 29%, despite being a majority in terms of number of funds. They are followed by the value-added funds, with 17%, and the opportunity funds, with 14%. The latter also account for a major part of the total gross asset value.

**Graph 7. Percentage of indirect real estate investment funds according to investment style. January, 2005**

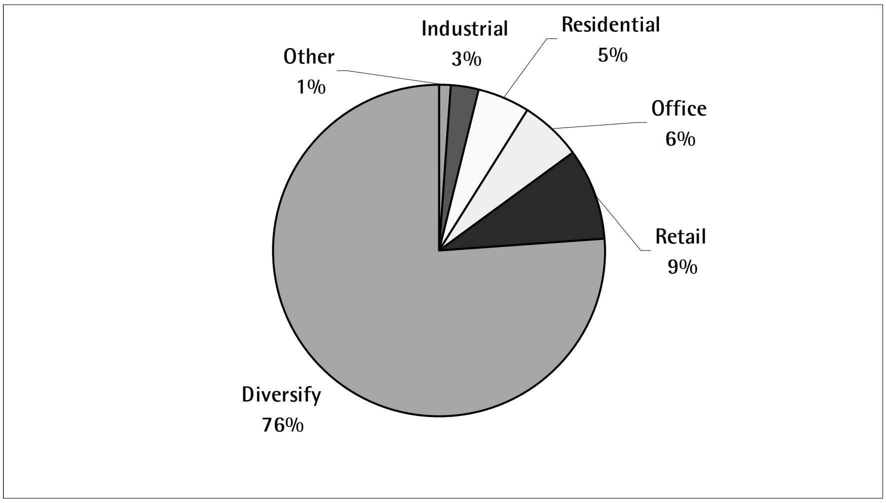



Source: INREV, OPC.

### *d) Investment characteristics: types of assets and debt*

Of the 400 funds in the INREV database as of December 2004, 230 had a diversified strategy. As can be seen in Graph 8, they accounted for 76% of the gross asset value. In other words, the majority of funds diversified their investment: 51 invested in commercial properties, accounting for 9% of the GAV; 47 specialized in offices, accounting for 6%; 34 specialized in the residential market, accounting for 5%; and 23 invested in the industrial sector, accounting for 3%.

**Graph 8. Fund strategy by sector, % of GAV, January 2005**

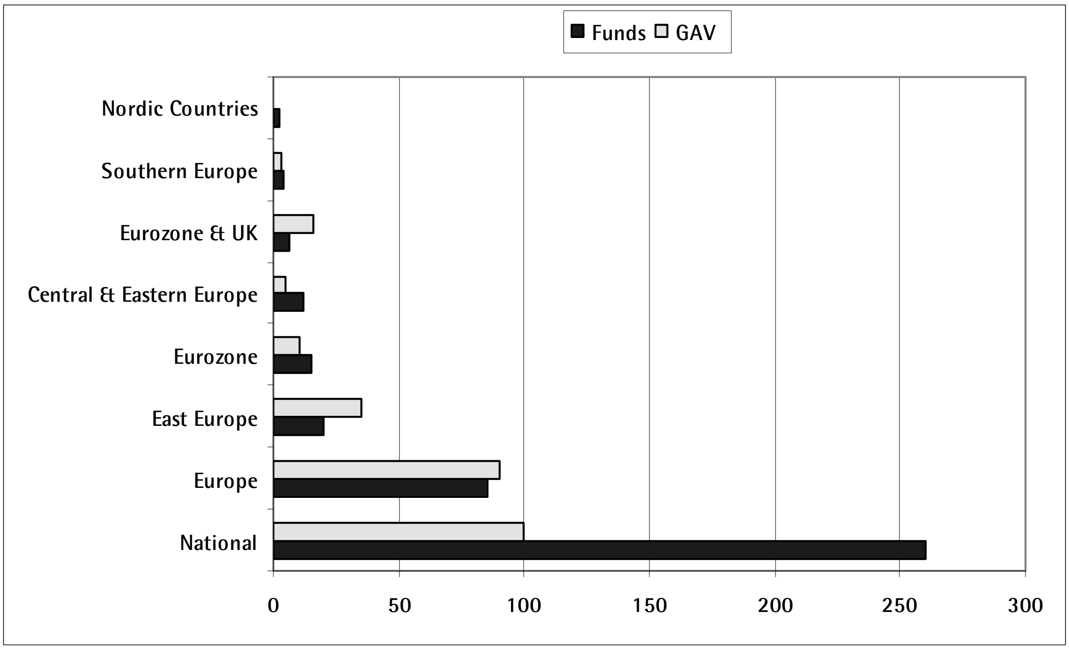



Source: INREV, OPC

With regard to the geographical location of assets, we can distinguish between national funds, which invest over 75% of their capital in one single country, and global funds, whose portfolio is spread over different countries, with not more than 75% of their assets invested in any one country.

As can be in Graph 9, the majority of European funds invest at national level and in different areas of the European continent.

**Graph 9. Geographical location of European fund investment.**
**GAV, billion euros, January 2005**




Source: INREV, OPC

The amount invested by national vehicles is shown in Table 7, by GAV, in million euros.

**Table 7. National Vehicles**
**Investment destination by GAV, in million euros**

| | |
|---|---|
| 1. UK | 49,600 |
| 2. Switzerland | 16,100 |
| 3. The Netherlands | 12,300 |
| 4. Italy | 7,100 |
| 5. Germany | 6,200 |
| 6. France | 4,900 |
| 7. Portugal | 4,600 |
| 8. Spain | 1,800 |
| 9. Austria | 200 |

Source: INREV, OPC

Clearly, most investment by far is made in the UK, in the commercial industry in particular (15,700 million euros) followed by the offices industry (5,000 million euros) and the industrial sector (3,500 million euros). The second most popular country is Switzerland, followed by the Netherlands and Italy.

The other vehicles invest on a global scale, spreading their portfolio over several territories, and are divided into: funds which invest at European level, funds which invest in Eastern Europe, funds which invest in countries that have adopted the euro, funds which invest in Central and Eastern Europe, funds which invest in the UK as well as in the euro zone, southeast Europe and Northern European countries.

In relation to the level of financial leverage, INREV has prepared an index on the basis of a study of 75 real estate funds, classed as national funds when they invest over 75% of their assets in one single country, and as foreign funds when their portfolio of real estate assets is spread over several European countries. A further category is established, dividing them into funds aimed at individual or institutional investors.[24]

Table 8 shows the level of financial leverage in national and European funds and, among these, in the subgroups of funds aimed at private or other investors. The level of financial leverage is defined as the face value of the debt as a percentage of the Net Asset Value of the fund.

**Table 8. Levels of financial leverage in European real estate funds**

| | Debt as a % of Net Asset Value | | |
|---|---|---|---|
| National Vehicles | | | |
| | 2001 | 2002 | 2003 |
| Germany<br>– Individual Investors<br>– Others | | | <br>12.54%<br>- |
| Italy | | | 10.58% |
| The Netherlands | 12.81% | 14.27% | 20.06% |
| Switzerland<br>– Individual Investors<br>– Others | <br>10.81%<br>- | <br>17.36%<br>- | <br>20.81%<br>- |
| UK | | | 27.72% |
| European Vehicles | | | |
| Europe<br>– Individual Investors<br>– Others | 31.26% | 16.70%<br>11.50%<br>53.31% | 19.86%<br>15.52%<br>68.29% |
| Averages National and European Vehicles | | | |
| Average National Vehicles excluding Private Investors | 11.39% | 9.96% | 17.26% |
| Average National+European Vehicles excluding Private Investors | 25.64% | 21.82% | 28.80% |
| Average National Vehicles | 18.37% | 17.38% | 16.03% |
| Average National+European Vehicles | 21.18% | 17.04% | 18.16% |

Source: "INREV Index Consultation Release". Prepared by Investment Property Databank Ltd.

[24] "INREV Index Consultation Release". Prepared by Investment Property Databank Ltd. INREV.

As can be seen in Table 8, the levels of financial leverage in these vehicles are not very high. The average financial leverage, including national and European vehicles, as well as those aimed at individual investors, is 18.16%. In contrast, the average financial leverage including national and European vehicles but excluding funds aimed at private investors is much higher, 28.8%. In other words, vehicles aimed at institutional investors assume higher levels of debt, which means they are aiming to achieve higher returns.

International vehicles which invest in Europe have marginally higher levels of financial leverage than those investing at national level: the former borrow 19.6% of the net worth of their assets and the latter 16%.[25]

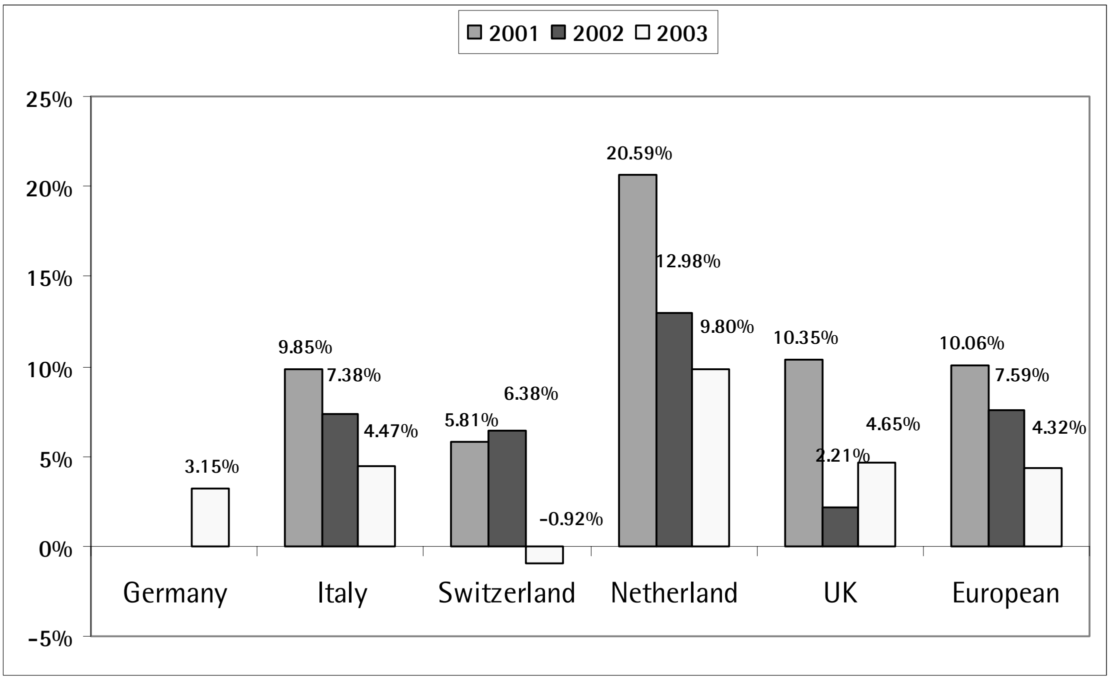
### *e) Fund performance analysis*

INREV and Investment Property Databank prepared an Index based on a study of 75 European funds with a GAV of 68 billion euros.

Of the 75 funds, 63 are national, 32 of which come from the UK, 13 from the Netherlands, 8 from Switzerland, 6 from Italy and 4 from Germany. The remaining 12 are European. European funds account for 44% of the total GAV (the majority are German open-ended funds), German funds 18%, UK funds 18%, Dutch 10%, Swiss 5% and Italian 5%.[26]

The following Graph shows the performance of national funds in 2001, 2002 and 2003.

**Graph 10. National and European funds Index return**
**Performance in euros**




Source: "INREV Consultation Release". Prepared by Investment Property Databank Ltd.

[25] "INREV Index Consultation Release". Prepared by Investment Property Databank Ltd. INREV.
[26] "INREV Consultation Release". Prepared by Investment Property Databank Ltd.

As can be seen in the Graph, the return on both national and European funds has fallen since 2001, and recovered only in the UK in 2003. In 2003, funds investing in the UK performed best, with a return of 12.01% in local currency, although in this Graph the returns are given in euros. On the other hand, Dutch funds performed best on average over the three years, with an average return of 13.78%[27].

The average return for national and European vehicles together, that is the 75 funds included in the sample, in 2001, 2002 and 2003 was 9.90%, 5.97% and 4.45%, respectively. These percentages are calculated also in euros. If this is compared to the performance of the EPRA Europe share index (10.7%, 10.7% and 11%), it is clear that the real estate securities market performed much better over the period.

Finally, the following Table shows the performance of these 75 national and European funds, re-classified according to the sector in which they invest, so that a fund is referred to as investing in a particular category of real estate when more than 75% of its assets are invested in that category, otherwise as a diversified fund.

**Table 9. Fund performance by investment sector**
**National currency**

| | | Diversified | Industrial / Logistics | Offices | Residential | Commercial |
|---|---|---|---|---|---|---|
| Italy | 2001 | | | | | |
| | 2002 | | | 7.72% | | |
| | 2003 | 2.62% | | 6.16% | | |
| The Netherlands | 2001 | | | 20.56% | 27.87% | 10.15% |
| | 2002 | | | 10.76% | 17.40% | 8.04% |
| | 2003 | | | 2.71% | 12.67% | 9.67% |
| Switzerland | 2001 | | | | 3.11% | |
| | 2002 | | | | 4.94% | |
| | 2003 | | | | 4.90% | |
| European | 2001 | 8.63% | | | | |
| | 2002 | 6.99% | | | | |
| | 2003 | 3.75% | | | | |
| Spanish+European | 2001 | 6.16% | 24.47% | 20.56% | 17.07% | 10.22% |
| | 2002 | 6.31% | 15.06% | 9.42% | 10.57% | 9.57% |
| | 2003 | 3.72% | 4.86% | 4.01% | 9.24% | 11.19% |

Source: “INREV Consultation Release”. Prepared by Investment Property Databank Ltd.

As Table 9 shows, Dutch funds show the highest performance, specifically in the residential industry, with 12.67%. The general drop in performance in all sectors and all countries should be emphasised. In an analysis of the total sample (national + European), the commercial industry reports the highest returns for 2003, 11.19%.

[27] The average calculated is the geometric average.

## Comparison of the most significant factors with regard to performance

**Table 10. Performance of listed real estate companies, real estate investment funds and direct investment in real estate.**
**National Currency, 2001-2003[28]**

| Country | Company | Fund | Direct Investment in Real Estate |
|---|---|---|---|
| UK | 11.84% | 9.27% | 8.92% |
| The Netherlands | 12.29% | 14.37% | 8.93% |
| France | 12.12% | | 8.76% |
| Spain | 13.65% | 7.47% | 8.38% |
| Germany | 6.09% | 3.15%* | 4.20% |
| Sweden | 14.52% | | 2.70% |
| Switzerland | 9.27% | 4.18% | 5.44%** |
| Italy | 15.26% | 5.74%** | 10.4%* |
| Europe | 11.66% | 7.52% | 7.00% |

Source: Prepared by the authors using “INREV Index Consultation Release” data. Prepared by Investment Property Databank, Data Stream, and INVERCO for Spanish data.
*Total performance 2003
**Geometric average 2002 and 2003

Listed real estate companies in the UK outperform the other two types of investment. These companies hold the top position in the European market in both investment volume and market capitalization. Investment in real estate stocks produced a 2.5% higher return than investment in funds or direct investment.

In the Netherlands, by contrast, it was the funds which performed best. In fact, Dutch and German funds have the longest tradition in this market, although German funds investing in Germany had very low returns, due to the recession in this market. However, many German funds invest at European level, where they have high returns.

There are no performance data at the moment for real estate funds in France, but we have observed that investment in real estate securities is above direct investment. This may be due, in particular, to the recent approval of the SIIC regime, which has strengthened the market.

In Spain, real estate companies produce the highest returns, followed by direct investment in real estate. It should also be emphasised that although there are very few real estate investment funds in Spain, they offer relatively high returns compared to their counterparts in other countries, such as Germany, Switzerland and Italy.

In Germany, Sweden, Switzerland and Italy, listed companies offer higher returns. Italian funds do not perform badly, but the figures are half those for direct investment in real estate, which produces the highest returns in Europe.

[28] These returns are influenced by portfolio composition.

At European level, funds and direct investment in real estate give similar returns and investment in real estate securities gives a return of 11.66%.

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