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For real estate, investment performance benchmarking is the comparison of returns from a property, group of properties, or funds, with those of a benchmark.

The benchmark measures the performance of the broadest-available sample of assets of a similar type and location open to investment by the portfolio manager, or a group of portfolios/funds that shares a similar profile or mandate.

The performance of the portfolio or fund is benchmarked against a set of assets that has been documented and measured in an identical manner.

This is most achievable by participating in a data pooling service such as IPD’s, which encompasses a large sample of individual property assets; primarily held within a number of investment portfolios, all of whose data has been assembled and processed using a single set of rules and procedures.

Investment performance is measured over time, most commonly annually, quarterly or in some cases monthly.

As for other investment asset classes, the overall measure of real estate investment performance is the total return delivered over the period, as proposed by the Global Investment Performance Standards (GIPS). Total return incorporates both capital growth and income elements, and is aggregated across assets pro-rata to the capital employed.

‘Capital employed’ – the denominator of the total return calculation – is derived from the property market price or the appraised value of the asset. An appraised capital value is used in many cases as there is often no market price information available for the investment at the desired measurement point.

Capital employed also reflects expenditure on improving the asset as this can be significant for real estate investments.

To provide the greatest benefit to users, benchmarking not only compares the performance of a portfolio or fund with an authoritative yardstick - but also and arguably more importantly, analyses the sources of performance outcomes in the portfolio or fund.

This provides investors and managers with a better understanding of their assets’ performance characteristics.

IPD benchmarking reports not only state overall returns against a relevant benchmark, but also provide a wide range of other financial comparisons as part of IPD’s complete portfolio analysis service.

Benchmarking shows what performance was achieved relative to the market.

Portfolio analysis explains why and how.
IPD is the leading global provider of real estate benchmarking services, with more than 25 years’ experience working with major investing institutions around the world. It provides benchmarking on portfolios of property assets held by investing institutions, and also on fund structures, which are increasingly used as financial wrappers for holding such assets.

In principle, any real estate portfolio held for investment purposes in these 32 countries can be measured, benchmarked and analysed by IPD, with no restrictions on the size or function of the portfolio.

IPD now provides real estate benchmarking and portfolio analysis in 32 countries around the world. These services incorporate more than 1,500 funds containing nearly 70,000 individual properties, with a total capital value of €1 trillion.

IPD services in development:

- Americas
- EMEA
- Asia Pacific

Portfolios benchmarked by IPD range from major institutional portfolios comprising many hundreds of properties, to small family-run operations with a handful of assets. Portfolios can be measured in one of two ways:
  - at fund/net asset value (NAV) level, taking gearing, fees and other financial structuring into account, or
  - solely on the basis of gross asset value (GAV) of the assets held.
### 9 OF THE TOP 10 GLOBAL REAL ESTATE ASSET MANAGERS

<table>
<thead>
<tr>
<th>Asset Manager</th>
<th>AUM ($m)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Prudential Financial Inc.</td>
<td>44,767</td>
</tr>
<tr>
<td>JP Morgan Asset Management – Global Real Assets</td>
<td>39,111</td>
</tr>
<tr>
<td>ING REIM</td>
<td>88,507</td>
</tr>
<tr>
<td>AEW Capital Management LP</td>
<td>45,067</td>
</tr>
<tr>
<td>CB Richard Ellis Investors</td>
<td>37,600</td>
</tr>
<tr>
<td>Morgan Stanley</td>
<td>63,059</td>
</tr>
<tr>
<td>Jones Lang LaSalle, Inc</td>
<td>43,023</td>
</tr>
<tr>
<td>RREEF</td>
<td>43,500</td>
</tr>
<tr>
<td>Heitman</td>
<td>22,385</td>
</tr>
</tbody>
</table>

Source: Towers Watson Global Alternatives Survey 2011

### 9 OF THE TOP 10 EUROPEAN PROPERTY FUND MANAGERS

<table>
<thead>
<tr>
<th>Fund Managers</th>
<th>AUM ($m)</th>
</tr>
</thead>
<tbody>
<tr>
<td>AXA REIM</td>
<td>39,744</td>
</tr>
<tr>
<td>Credit Suisse</td>
<td>27,236</td>
</tr>
<tr>
<td>ING REIM</td>
<td>26,361</td>
</tr>
<tr>
<td>Aviva Investors</td>
<td>25,483</td>
</tr>
<tr>
<td>Aberdeen Asset Management</td>
<td>22,574</td>
</tr>
<tr>
<td>UBS Global Asset Management</td>
<td>17,342</td>
</tr>
<tr>
<td>AEW</td>
<td>16,900</td>
</tr>
<tr>
<td>Commerz Real AG</td>
<td>16,500</td>
</tr>
<tr>
<td>RREEF</td>
<td>16,396</td>
</tr>
</tbody>
</table>

Source: EuroProperty/NREVSurvey 2011

Portfolios benchmarked by IPD have a range of mandates including the investment support of pensions and superannuation schemes, life and general insurance policies, and traditional private interests.

Their mandates further extend to indirect and pooled provision of real estate exposure to end investors - whether institutions or individuals, listed or unlisted investment funds, some of which support retail investment, i.e. funds open to the general public.

IPD is constantly looking to expand the potential for real estate benchmarking, by developing new databases in mature markets where the necessary valuation and cash flow data is available.

At present IPD services are under development in South America and Africa, and throughout Asia, to add to the existing services already available in Japan and South Korea.

Organisations who are interested in benchmarking their investments should contact IPD to discuss the options that could be available within the context of their market.
Key benefits of property portfolio benchmarking

**Improved investment process**
- Enhance investment allocation, selection and management processes
- Take a disciplined approach to asset and portfolio risk management

**Reduced costs**
- Monitor operating efficiencies and address relative weaknesses
- Outsource data management and integrate information into one platform

**Increased revenues**
- Facilitate capital raising with key client facing information
- Demonstrate independent performance track record
- Strengthen investor communications and transparency through performance reporting
- Align manager fees and remuneration with performance benchmarks

**Performance**
Benchmarking is widely used in business to improve processes by learning from best practice. Real estate benchmarking leads to the improvement of the investment process by providing a better understanding of performance outcomes.

Benchmarking puts portfolio and fund returns in the context of the market, providing a comparable performance level an investor might realistically expect to achieve. The performance of groups of assets held can then be compared with that of relevant sub-sectors of national markets, allowing more focused and informative comparison for assets in the portfolio.

These comparisons can then be developed through attribution and activity analysis to generate weighted scores measuring the impact of portfolio structure, stock selection, and the relative effects of active management strategies and timing on performance. These analyses help to identify the sources of strong and weak performance within the portfolio, allowing investment issues to be addressed as they arise.

"Benchmarking is essential in risk management but in addition to that, measuring a fund against a reliable benchmark can indicate transparency and governance as well as allowing metrics such as performance attribution and fee analyses to be undertaken."

Jayne Bok  
Director of Investment Services  
Towers Watson
Real estate performance benchmarking also enables a disciplined approach to risk management at both portfolio and asset levels. Risks can only be controlled if measurements of market and portfolio returns are compared over time, creating a synchronised view of relative volatilities.

Performance measurement allows the sources of volatility to be identified and compared to norms in the marketplace. Property-based factors that underlie financial risk can then be analysed in detail, computing measures of volatility and downside tail risk, using analytics such as the IPD RiskWeb service.

Investment risks are increasingly recognised to run beyond the volatility of performance, to include other aspects of management such as credit risk, liquidity risk, counterparty risk and operational risk.

Real estate investment benchmarking addresses these risks through analyses of income security, asset quality and income concentration; and through reporting relative performance itself.

These risks are recognised by the European Alternative Investment Fund Managers Directive (AIFMD) which applies to unlisted real estate investment funds and their consideration is an implicit requirement of the Dodd-Frank Act in the US.
Reporting

Benchmarking allows the relationship between return and risk within a property portfolio to be comprehensively assessed and set against that of holdings in other asset classes.

Key benefits of investment performance benchmarking are the independent reporting of performance for stakeholders and potential investors, and to guide employees’ remuneration. In a challenging financial climate, investors are increasingly keen to see the performance of their investments measured by a recognised independent body.

For managers promoting investment in their real estate funds, independently verified performance track records set against market benchmarks are becoming an essential marketing tool.

Property investment benchmarking ensures that like-for-like inputs are fed into the asset allocation process.

IPD performance measures are produced following the same principles as those commonly applied for other asset classes.

Alongside the performance of the real estate portfolio itself, benchmarks stating market or peer group returns are also vital to assess expected future returns. Detailed performance analysis makes it possible to assess the success of previous asset allocation strategies in depth.

“Benchmarking is absolutely essential in modern real estate portfolio management, and IPD provides valuable benchmarks to real estate managers and investors.”

Bernhard Berg
Chairman, IVG Institutional Funds GmbH

“As a REIT, IPD’s benchmarking capability is integral for us to demonstrate our underlying performance to shareholders. The analysis is also central to our remuneration and helps inform and assess our investment strategy.”

Phil Redding
Chief Investment Officer, SEGRO
Senior management use benchmarking to see how well their portfolios perform compared to the competition, and to understand the key factors behind their relative success or failure. Benchmarking also makes it possible to identify the stronger and weaker performing parts of portfolios, to ensure teams are focusing on the issues with the biggest impact on performance.

Strategists and researchers can benefit from greater understanding of the performance impact of past strategies that benchmarking brings. Interrogating benchmark series gives a stronger quantified grasp of performance patterns in relevant markets. It also allows a gauge of risk-return profiles for portfolios relative to market betas, and the identification of structural factors underpinning these relationships.

Fund and property management teams use benchmarking to assess the impacts of active management on asset and portfolio performance, including how acquisitions and disposals have influenced returns. Benchmarking also improves managers’ understanding of how stock selection has affected performance by making comparisons with market averages for submarkets, employing the discipline of attribution analysis. It provides a stronger awareness of asset operating costs and an indication of the parts of the portfolio where these are affecting net income most significantly relative to industry averages.

At the fund performance level, detailed benchmark reporting gives managers insight into their levels of leverage, exposure to cash and other financial assets, as well as the impact of management and performance fees on the final net asset value (NAV) return.
IPD property benchmarking principles and practice

The uniqueness of real estate as an asset flows largely from its heterogeneity, indivisibility and resulting illiquidity. This is most evident in the calculation of capital values and thereby the definition of the capital employed in investment returns.

For these crucial variables it is necessary to use market values as approximations for prices, since current price data is not available in the majority of assets, as they will not often have been recently traded on the open market.

The principles applied by IPD to calculate asset and portfolio performance mirror those used for investments in other asset classes, particularly equities and bonds. There are however various aspects that are unique to real estate, and for which it has been necessary to develop conventions specific to the asset class.

Market value definitions and methods of calculation vary from country to country, but IPD insists that all data contributors conform to the International Valuation Standards (IVS). Separate valuations for each individual asset are required for IPD performance measurement and benchmarking, as these provide the greatest analytical potential and enable essential detailed verification checks on data input.

To obtain a meaningful measure of investment performance, cash flows of measured assets should be recorded net of capital and revenue costs.

This ensures that cash flows recorded are those ultimately receivable by the fund, net of any costs incurred.

Capital expenditures made for acquiring and improving assets are recorded gross of taxes and all other costs, to reflect fully all expenses associated with real estate investment.

Furthermore, income should be measured net of all non-recoverable revenue expenses. The potential for recovering expenses from tenants varies greatly, depending on the lease contract conditions in operation; in many places revenue expenses can be significant. When measuring fund-level performance, income distributions to investors are recorded net of fees and other operating expenses.

“IPD’s benchmarking service forms an important part of Allianz’s internal performance measurement process. We rely on benchmarks from IPD not only at a national but also a European level.”

Olivier Piani
CEO, Allianz Real Estate GmbH
The timing of cash flows is key to performance measurement. A true reflection of investment performance in which management controls day-to-day cash flows requires the rigorous application of accruals accounting principles, where the timing of cash flows is recorded to reflect payment due based on the contracts in effect, rather than the timing of monies clearing bank accounts. This principle ensures that the timing of cash flows reflects property investment considerations and is not affected by accounting conventions or efficiencies.

To compare the performance of investment managers fairly over varying time periods, returns are usually time-weighted rather than money-weighted, as defined by GIPS. Returns delivered in any one measurement period are therefore each given equal weight over any longer period, irrespective of the amount of capital invested during that period. This rule makes the conventional assumption that managers do not normally have control over the timing of major capital flows.

For more opportunistic investment funds however, where capital raising is itself seen as an important aspect of performance, money-weighted internal rates of return may be deemed an appropriate measure for comparison. In this instance the calculated return will give greater emphasis to the effect of investment timing.

In accordance with this time-weighted principle of measurement, IPD calculates performance for individual monthly periods and then chain-links these returns to produce measures for longer time periods. This standard is applied globally, irrespective of the frequency of valuations in the national market concerned.

Monthly recording allows assets held in different countries to be measured together in multinational real estate portfolios, and gives the flexibility to show performance for any time period of more than one month.

For the accurate measurement of a portfolio’s performance, it is crucial that all assets held over the measurement period are included, irrespective of their perceived quality or status. Therefore, portfolios and funds analysed by IPD incorporate all real estate holdings, including any developments and land banks they contain, and all transactions in which they participate.

In many markets it may also be important to include holdings of indirect and non-property assets held within portfolios, as this is becoming an increasingly important way of accessing the asset class.

The inclusion of all assets ensures that returns are not biased by a desire to include only the better-performing assets, and that benchmarks are similarly unbiased.

“The value destruction of the 2008/9 crisis led many multi-asset class investors to reassess their allocations to real estate. The stress of that time, coupled with the desire for greater transparency, has led to a step change in the demand for the benchmarking of real estate exposure, and most managers now recognise the importance of robust benchmarking to strengthen their investment process.”

Professor Andrew Baum
Henley Business School
University of Reading
Key measures for assessing real estate investment performance

As the most widely recognised ‘bottom line’ figure, total return is the most important measure of overall investment performance to compare different assets across time periods. It incorporates both capital and income elements, as described below.

Total return is calculated as a percentage value change plus net income accrual, relative to the capital employed. It is recognised by GIPS as the standard composite measure of investment performance.

**Capital growth** or indirect return, measures the change in asset capital values over a period of time, relative to the capital employed. This measure of the ‘growth’ component of performance is based on the change in appraised value for properties held at the start and end of an analysis period. It also takes account of actual transaction prices for bought or sold assets.

The calculation is performed net of any capital expenditure and receipts over the period.

**Income return** or direct return, measures the income receivable in relation to capital employed over a period. This measure is calculated net of all non-recoverable costs that are incurred by the investor – which will depend upon the terms of the tenant lease contracts in place.

Many other performance measures can be produced to analyse the returns on real estate investment in greater depth.
These measures are often used to identify drivers of change in appraised values and the factors which underpin the level of net income. Normally, changes in open market values – and therefore in capital growth rates – will depend on changes in the levels of market rents and investment yields, each sifted through lease structure effects on income patterns. These impacts can all be separately identified and quantified.

In parallel, net income can be seen as the outcome of gross rent less a series of non-recoverable operating costs – each of which may be shown as a percentage of income or capital employed, to assess the impact on overall returns.

Gross rent is itself the outcome of many distinct leasing arrangements in place across a portfolio, giving the potential to assess growth prospects and income at risk against benchmarks specific to these areas.

With the provision of lease contract data now available in most markets, it is possible to show indicators of strengths and weaknesses in a portfolio’s income profile – being one of the most immediately manageable aspects of real estate investment performance.

When comparing and analysing fund-level performance, extra layers of disaggregation are required to move from the overall net asset value (NAV) return to the return from the underlying assets, based on their gross asset value (GAV).

These contributions to performance from the fund structure may include the impact of indirect holdings, joint ventures, derivatives and the effects of fund costs, cash and leverage.

“IPD affects everything we do and is a major partner in our analytical process, providing detailed analysis on all 15 of our portfolios.”

Peter Cuthbert
Head of Canadian Real Estate, Standard Life Investments
Performance measurement over time

Monthly recording of financial data on property investments opens up a range of possible benchmarking frequencies. Yearly analysis is paramount for most businesses to align with standard reporting and accounting periods.

For real estate, the investment time horizon is generally medium (3-10 year) or long-term (>10 years), so measurement over these periods is also important to assess the success of strategies and their implementation.

More frequent measurement may be relevant for portfolios with monthly, quarterly or half yearly reporting to assess pricing of investment units, particularly in the case of unlisted funds, segregated accounts and separate mandates.

Volatility of returns over time is only likely to become apparent with the perspective of longer time horizons.

For the measurement of real estate investment risk there is likely to be a trade off between the need for a sufficient number of observations to provide meaningful measures, and long enough intervals to limit valuation ‘noise’. In this regard quarterly measurement is a good compromise, but feasibility depends on timing of market valuations.

The composite total return does not equate precisely to the sum of its capital and income components - over periods of longer than one month. This is due to the effect of the separate compounding of each of the three series.

This is the only approach that ensures consistency across all medium and long term relative return computations and comparisons, and conforms to GIPS for all investment performance reporting. These variances will be very small, except in the most extreme market conditions.

Source: IPD Portfolio Analysis Service
Compiling benchmarks

Benchmarks incorporate the full range of real estate assets open to an investor in the market, referred to as the ‘investment universe’. Funds with more specific mandates (i.e. ‘unavoidable’ restrictions on their strategies due to say, size or level of discretion), may require a more appropriate version of that ‘investment universe’ – a sub-universe reflected in the pool of investments held by a peer group.

Until quite recently these investment universes have been defined as national markets or sub-markets, reflecting the history of real estate investment organised on the basis of nation states. This has been in part because real estate law has developed differently from country to country, and also because financial institutions started out working and assembling portfolios within these boundaries.

However over the last decade or so, real estate investment has followed equities and bonds to become an international asset class, leading to an increased demand for cross-border benchmarking. To meet this demand, IPD has developed a suite of multinational products including multinational portfolio analysis services, the IPD Pan-European Property Fund Index and peer group benchmarking.

With professionally managed real estate investments amalgamated into portfolios, markets can be viewed as the aggregation of a number of portfolios. IPD constructs property investment benchmarks from data on real estate assets held within these investment portfolios, and aims to maximise the coverage of each investment market.

Portfolios combined to constitute benchmarks must be held for investment purposes and valued to open market levels, in accordance with the standard benchmark timing.

Data for portfolios and benchmarks must be recorded in the same structure – at the level of individual assets - which means there is exact comparability and alternative/bespoke benchmarks can be created based on specific portfolio requirements.

At direct real estate level, investment performance benchmarks are sometimes confused with indices. However, the differences between these two measures are significant.

Real estate benchmarking covers all assets and investment holdings including purchases, sales, developments, indirect holdings and other financial assets. Whereas, property indices are based on standing investments alone, for completed and lettable properties, and exclude properties that are purchased, sold or in development during the measurement period.

They are comparable with indices for other asset classes, which also exclude such costs, and give a clearer, ‘stackable’ representation of underlying market and sub-market movements.

The illiquidity and lumpiness of real estate markets mean that individual transaction and development impacts can be driven by non-market or ‘deal-specific’ factors in the short term, potentially causing indices to move away from market trends, given the value weighting of individual asset contributions.

Download the IPD Index Guide at ipd.com/indexguide for more information about the index universe, construction methodology and calculation process, index review procedures, and calculation timetables.
Comparing a portfolio with its benchmark

The degree of success of an investment asset compared to its benchmark is best gauged through a measure of relative return, as this reflects its money-weighted impact on performance.

Relative returns can be meaningfully compared across time periods to identify improvement or deterioration – since the performance attained in each period is weighted equally.

Relative return is calculated as the ratio rather than the difference between the portfolio and benchmark percentage rates of return, ensuring numerical consistency over all time periods.

A portfolio’s performance may also be ranked against its peers, or the entire investment universe, to give a size- or strategy-neutral indication of success.

This is due to each portfolio/strategy being weighted equally, whatever the total value of assets included.

Rankings and returns of other constituent portfolios remain confidential in IPD national databanks, like the rest of their data and performance results, unless they wish to publicise them.

“A successful manager must embrace benchmarking and the associated attribution analysis as an integral risk management tool allowing them to understand and improve performance at the asset, portfolio and fund level.”

Simon Mallinson
Director of European Research
Invesco Real Estate
Attribution analysis is a powerful technique for understanding the reasons for a portfolio’s outperformance or underperformance of a benchmark. It breaks down the relative return into structure-specific and property-specific scores, allowing the influences of sub-market allocations and asset selection to be clearly distinguished.

Real estate strategies are generally based on building types and locations, the former most often in terms of ‘sectors’ – which usually reflect different economic uses – such as retail, office and industrial; locations are most often regionally based.

For the purposes of attribution analysis and strategy assessment, IPD has established sector-region segmentations for each national market, to reflect the prevailing basis of strategies in operation. This has been achieved following extensive consultation with benchmarking participants. These scores are built up from returns calculated for each individual market segment within the portfolio.

The technique not only identifies the overall impact of strategic asset allocation and property selection effects on the portfolio’s performance, but also identifies the sources of those effects at market segment level. Attribution analysis helps to identify structural impacts on the performance of the portfolio, which if persistently negative, can suggest the need for rebalancing between market segments.
It may also lead to the identification of persistent property effects, indicating the potential for disposals, acquisitions and active management to improve the building, income and/or location quality of the portfolio. This can be assisted by running the analysis for overall performance as reflected by total return, and separately for the capital and income elements of that return.

To distinguish between one-off and continuing influences on portfolio returns, this analysis should be applied over both short and long time periods. By highlighting structural and asset level effects, the analysis will suggest areas for further investigation.

For example, these may relate to appraisal effects and lease events that have had an impact on performance over the analysis period.

Attribution analysis should be used in parallel with IPD’s weighted contribution analysis. This identifies and scores the separate impacts of available types of active, as opposed to passive, portfolio management.

These impacts include not only buying, selling and developments, but also the injection of refurbishment capital into retained investments, part-trading of assets, and the use of indirect investments.

Additional analyses can also be applied to reflect the impact of the property market cycle on real estate portfolio performance.

Its impact on investment pricing in particular may be seen through ‘vintage year’ analyses, by which an asset’s performance is compared to properties within the benchmark sample acquired at a similar time.
Choosing and using benchmarks

IPD datasets enable benchmarking of a portfolio against a data sample tailored to its own characteristics, mandates and constraints, as well as against the national market ‘universe’.

These benchmarks are drawn not only from samples of directly-held property assets, but also from samples including indirect holdings in other vehicles, financial investments and derivatives, cash, debt and fund level costs and fees, should this be appropriate.

Benchmarking may be undertaken at the fund level for vehicles which are open to third-party investment.

For general investment portfolios not set up to invest in particular market segments, it is however important to keep the ‘universe’ benchmark in view.

Whatever the size or objective of the portfolio, the market universe return should always be regarded as an important part of the ultimate baseline for judging allocation and relative performance.

This is especially important now it is possible to use indirect funds to access parts of the market with large property sizes or a requirement for specialist investment knowledge.

Furthermore, ‘universe’ benchmarks are completely independent of any manager influence or bias towards investing in certain parts of the market that may influence ‘fund type’ or peer group benchmarks.

By definition, the ‘universe’ will provide the largest available sample for the market concerned, and is therefore likely to be the most statistically robust. This is particularly important where the market coverage of the databank is limited.

“The management of large real estate portfolios has become increasingly complex over the past decade. At the same time, competition among managers has intensified. The analytical tools that IPD provides Clarion Partners afford us the ability to achieve market leading investment returns, while managing portfolio risks.”

Stephen Hansen
Managing Director
Clarion Partners

Nevertheless, portfolio-specific peer group benchmarks have a crucial role to play when the ‘investment universe’ is not easily accessible, or the portfolio’s objectives are judged to be more akin to those of a particular sub-group within the market.

It should be emphasised that common practice amongst a peer group may not amount to best practice for the portfolio concerned, even if its specific objectives closely mirror those of the peer group.

Benchmarks chosen should be appropriate to the objectives and constraints of the portfolio and/or fund, likely to be determined by the type of investment vehicle, its investment horizon, its risk/return profile and liabilities.

These will affect requirements for liquidity, the degree of portfolio diversification/specialisation, its focus on either growth or income, and its degree of risk tolerance.
Framework for choosing portfolio-specific benchmarks

To understand the possibilities for setting up fund-specific benchmarks, it is helpful to review some of the most common frameworks for benchmark selection.

Portfolio type and size are the most common considerations for peer group benchmarks, for a sample of portfolios with similar objectives and constraints.

The most usual portfolio types for benchmarks include life (insurance) funds, segregated pension funds, unit-linked property funds and listed property companies/REITs. A possible refinement of the fund type approach is to select a benchmark of specific competitors.

Portfolio size can be used to establish a ‘peer group’ benchmark sample, as this will have a strong bearing on the type of investment assets that can be acquired for the portfolio. In some cases this is combined with portfolio type, as in the case of a benchmark for ‘large insurance portfolios’ or ‘small segregated pension funds’.

Property type or ‘style’ benchmarks are restricted to certain property types. They are appropriate for assessing the performance of specialist funds, and are generally based on target weightings of the portfolio as between the property types covered.

Style benchmarks are also based on the size of properties contained in the sample, if asset size is a determining factor in the investment strategy of the fund.

While portfolio-specific benchmarks can be chosen to meet these criteria, it should be emphasised that the sample of portfolios from which the benchmark is constructed must be adequate.

Narrowly defined benchmarks may demonstrate erratic results reflecting specific circumstances of individual portfolios, rather than general patterns of behaviour which are useful in formulating strategies.

The potential sustainability of the sample or sampling basis over time must also be considered. Using a precise banding of portfolio values as the inclusion test in a rapidly rising or falling market is likely to mean that portfolios will come into, and fall out of, the benchmark sample from one year to the next. This may not be the desired outcome and will almost certainly make the interpretation of longer term relative returns more complex.

Benchmark examples using this framework:

- A $350m U.S. open-ended fund aiming to track domestic property market performance may select a $250-500 open-ended peer group fund benchmark, including direct and indirect assets, operating a rolling 3- or 5-year manager remuneration scheme.

- A specialist pan-European shopping centre fund may select a NAV benchmark of other pan-European shopping centre funds and/or an underlying direct property (style) benchmark, comparing its performance to the widest sample of European shopping centres’ performance.

“The IPD Pan-European Property Fund Index covers a representative group of the core balanced/specialist pan-European funds that the multi-manager industry can access. It is also available comparatively soon after the quarter end, making it very useful for client reporting and benchmarking.”

Ivo de Wit, Director Fund of Funds
CBRE Investors, Global Multi-Manager
Once an IPD databank has reached critical mass and market segments have stabilised, it is possible to fix the historical returns without much likelihood of deviation. This provides a consistent perspective on strategies from year to year. It also ensures a stable basis for calculating remuneration – particularly significant when the assessment period runs over three or five years, during which time it is clearly undesirable to adjust historical years’ benchmarks retrospectively.

Benchmarks specifically chosen for funds will need to confront this issue for the subset of the data sample they are accessing.

In deciding whether or not to freeze historic benchmarks, IPD considers a number of divergent arguments.

When the market coverage of a benchmark dataset is relatively small, increasing the sample size will improve the quality of historic statistics, make finer splits of the data possible, and generally increase the overall diagnostic power of the benchmarking service. This will, however, be at the price of tolerating greater complexity in the specification of remuneration or other formalised manager assessment procedure.

Historic benchmarks are only frozen by IPD when market coverage has reached over 50% of the potential investment universe size.
Developing new benchmarks from limited samples

Global real estate markets are characterised by different levels of maturity, in terms of the scale of transparency. This influences the potential for providing benchmarking services, which require the pooling of high quality data by a significant proportion of market participants.

Nevertheless, even when the level of data is limited, a number of organisations with an interest in developing benchmarks can be brought together in a consortium-style project to establish data conventions, market segmentation, and detailed analysis relevant to their market.

The benefits from adopting a benchmarking framework such as that operated by IPD go beyond the management and governance inputs for each participating organisation.

Benchmarking also builds the credibility of real estate as an investment sector, both nationally and internationally.

The adoption of benchmarking is a step towards greater market transparency and sophistication, encouraging the international integration of the market, and its acceptance as part of a global investment domain, appropriate for consideration by large multinational investors, such as global management houses and sovereign wealth funds. This increases the challenge of providing robust benchmarking as each new territory begins to move into the globally transparent investment universe.

During development, it is important that each national market works closely with IPD to ensure a smooth progression from feasibility testing through to comprehensive portfolio analysis and benchmarking. This usually involves a partnership/membership model so that industry wide definitions and standards apply locally and comply with IPD’s protocols.

Benchmarking for pooled funds

Increasingly over the last 10–15 years, investors are using ‘indirect’ investments (i.e. unlisted pooled funds and listed real estate) to access real estate markets. This has resulted in a growing need to measure fund level returns for both investors and managers.

The performance of pooled funds depends on the returns from the assets in which they have invested, but also on financial structures, underlying levels of borrowing, cash and fees. Performance accruing to the investor will be denominated in terms of net asset value (NAV).

There are however various arguments for simultaneously measuring and benchmarking the performance of the assets held directly within the fund, based on gross asset value (GAV) to show the outcome of the real estate strategy and stock selection.

The GAV and NAV performance should be compared, to assess the effects of the fund’s financial structuring, fund level expenses, management and performance fees, and dividend distribution policy.

Any leverage applied by the fund will accentuate the returns produced by the underlying assets held, both positively and negatively, while cash holdings will tend to dampen returns, though this will depend on the level of interest being earned. Meanwhile fees charged by the fund manager will reduce returns, but the impact will depend on the basis of the calculation, for example performance or asset value.
Real estate investment has grown over the past decade, due to an increasing number of multinational funds, coupled with a growing interest in cross-border investment using both diversified and specialised instruments.

The principles of multinational performance benchmarking are the same as those for national markets. However, variations in real estate investment practice between markets, combined with the probable introduction of multi-currency management, mean that benchmark specification is more complex, and reporting must be adapted accordingly.

Given the range of international investment options available, benchmarks must be closely tailored to the investment constraints set by the end investor or fund manager. Reporting will normally be required both in the end investor’s own currency (or currencies for pooled funds) and in local market currencies, allowing currency and real estate market factors to be clearly distinguished.

For multinational portfolios, total return, together with its capital and income components, remains the foundation of benchmark reporting. Attribution analysis is generated from a mix of market segment level returns, based on segmentation across national or regional markets, and perhaps further subdivided between property types.

As for national markets, income returns are broken down from gross to net, allowing non-recoverable operating costs to be examined; while the analysis of valuation impacts may be confined to current yields if market rents are not used across all markets covered by the portfolio.

Multinational performance benchmarks must be drawn from those markets where benchmarking data already exists, even if the portfolio can theoretically invest across a wider geography.

It is now possible for European cross-border portfolios to be benchmarked against peer groups of similarly-focused entities. IPD recently launched a pan-European property fund index and cross-border benchmarking service, incorporating fund level and property level measurement.

In other markets, and still for many pan-European mandates, benchmarks are most appropriately drawn from the widest available sample of similar investment assets, whether held in ‘peer group’ funds or otherwise.

It is likely that for some time to come, such widely-drawn benchmarks will be required alongside peer group benchmarks to ensure broadly representative market and sub-market returns are invoked for performance comparison and diagnosis. Small peer groups of cross-border mandates can give misleading representations of overall market patterns.

In assessing the success of multinational portfolio strategies, the benchmark ‘investment universe’ should reflect the limits of the investor/manager’s remit. Within these constraints, benchmark samples should be as wide as possible, even if it has not yet been decided to invest in all markets covered.

Attribution analysis should be established to highlight the effects of strategy in terms of both geography and sub-categories of asset type, held or targeted. Peer group comparisons, particularly in these early days of genuine cross-border mandates, should be used with caution and in parallel with more broadly drawn benchmarks.
IPD benchmarking is consistent with international investment performance standards – both GIPS and the International Valuation Standards (IVS).

Developed by the Chartered Financial Analysts Institute, GIPS is ‘a set of standardised, industry-wide ethical principles that provide investment firms with guidance on how to calculate and report their investment results to prospective clients’.

GIPS is not compulsory for investment managers, but has been adopted in 30 different countries worldwide. As at the start of 2012 it is recommended that all real estate assets be externally appraised on an annual basis, and internally or externally on a quarterly basis.

The IVS Committee’s primary goal is to promote consistency in international valuation standards through a principles-based system.

IPD measurement and benchmarking standards are consistent across global real estate markets and are designed to match reporting conventions for other asset classes. They provide a fair, transparent and consistent framework for reporting real estate returns, both for investing organisations and fund management bodies.

For investors, IPD provides a measure of the performance of all real estate assets within their ownership, whether in directly-held property assets or externally-managed funds. These assets can be benchmarked against the appropriate investment universe and the most relevant peer group. IPD can give independent and objective advice on the most appropriate peer group for an investor’s portfolio.

The IPD Measured Fund logo supports fund managers in their marketing and investor relations, endorsing their fund performance for the benefit of investors.

The logo helps to promote portfolios and funds as independently measured, enabling investors to identify, more readily, professionally managed investments.

Investors have come to expect that managers of their real estate fund interests provide independently measured returns in the context of appropriate benchmarks. Such a process can play a key role in giving an independent basis for performance-related fees.

Those investing with a manager for the first time are increasingly seeking objectively-verified track records. This applies across the risk spectrum, from core to opportunistic, and for those requiring absolute and relative returns from real estate.

IPD benchmarking, and indeed the associated IPD Measured Fund logo, have become a central indicator of the professionalism of the real estate fund management business in markets around the world. For more information visit ipd.com/measuredfundlogo