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Elaine Worzala, C. F. Sirmans, Colin Lizieri,
 Karl-Werner Schulte, Joseph Ooi, Aart Hordijk, Graeme Newell

An International Comparative Study of the Pension Plan Community and Real Estate Investments

LFollowing the Association's mission to provide relevant research, PREA funded a study that was distributed to PREA members in January. Its objective was to examine the pension fund community and the role and significance of real estate investment in six major countries: the United Kingdom, Germany, Singapore, the Netherlands, Australia, and the United States. Given the relevance and timeliness of this study, called *An International Comparative Study of the Pension Plan Community and Real Estate Investments*, highlights of its findings are presented in this article.

The research was conducted by a team of leading real estate academics, each of whom is actively involved in the institutional investment community of his or her country. The six countries selected have mature pension fund community structures encompassing Europe, Asia, and the United States. Though the report identifies similarities among the countries, the unique characteristics of each country are also highlighted. For example, readers will note that, though growing levels of indirect real estate investment are characteristic of pension funds in

most countries in the study, pension fund allocations to real estate vary considerably by country.

The report includes an overview of the pension plan community, the real estate investment management community, the real estate investment strategies of pension plans, and the management of real estate assets by pension plans for each country. To further assist institutional real estate investors, the report includes an overview of real estate industry associations that can be found in each country. An important objective of the report was to provide some insight into the current international practice of institutional investors with regard to their real estate investment portfolios. As the focus on global real estate investment intensifies, so does the need for a better understanding of cross-country real estate investment differences, which have been highlighted in the report. This *PREA Quarterly* article highlights some of the key similarities and differences across the six countries regarding the role and significance of real estate in pension plan portfolios and compares the varying nature of real estate investment vehicles in each country and how these have evolved over time. Readers should consult the full report for a more detailed analysis.

Exhibit 1: General Profile of Pension Fund Plans

Number of Funds	
■ UK: employment-based pension schemes (94,000)	
■ Germany: pension funds (1,54), insurance funds (111)	
■ Singapore: predominantly CPF government scheme	
■ Netherlands: 740 employment-based pension schemes	
■ Australia: employment-based funds (1,376), insurance funds (234), miscellaneous small, self-managed funds (295,000)	
■ U.S.: private funds (866,000), state and local funds (2,200)	
Total Funds (2004)	
■ UK: \$1.3 trillion	■ Netherlands: \$666 billion
■ Germany: \$899 billion	■ Australia: \$506 billion
■ Singapore: \$135 billion; includes \$67 billion in funds withdrawn for housing purchase by members	■ U.S.: \$10 trillion
Major Type of Pension Plan	
■ UK: defined contribution	■ Netherlands: defined benefit
■ Germany: defined benefit	■ Australia: defined contribution
■ Singapore: defined contribution	■ U.S.: defined contribution
Retirement Age	
■ UK: 65 for men; 60 for women	■ Netherlands: 65
■ Germany: 67	■ Australia: 65, but not compulsory
■ Singapore: 62	■ U.S.: 65

Source: An International Comparative Study of the Pension Plan Community and Real Estate Investments

Each of the six surveyed countries has an extensive pension fund history. Pension structures typically follow a “three-pillar” pattern, comprising

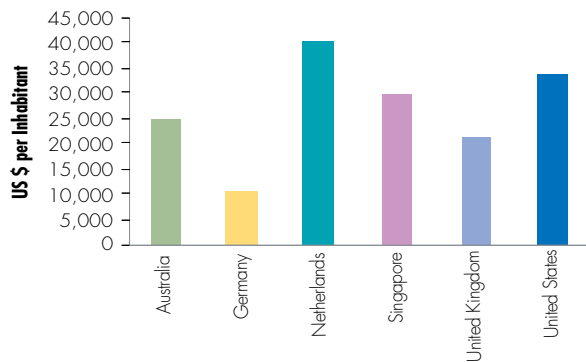
1. a government pension plan: typically a compulsory, basic, defined-benefit retirement package;
2. an employment-based pension plan: typically a voluntary scheme¹ provided at a company level or an industry-wide level, involving both employer and employee contributions;
3. a personal pension plan: a voluntary, typically individual scheme offered by insurance companies and financial institutions.

Some significant variation occurs among the countries. For example, Singapore emphasizes to a greater extent the national pension plan that is centrally administered by the Central Provident Fund (CPF), and Australia emphasizes compulsory, employment-based pension plans. Exhibit 1 summarizes the pension plan communities in each of the countries analyzed.

The size of the pension systems varies widely among the countries, as measured by pension fund assets per capita for each country (Exhibit 2). Some differences can be explained by variation in investment alternatives across countries that might result in divergent investment cultures. For example, Germans often set up their own “private” pension schemes in addition to the collective one. As a result, their per capita investment in more traditional pension funds is lower.

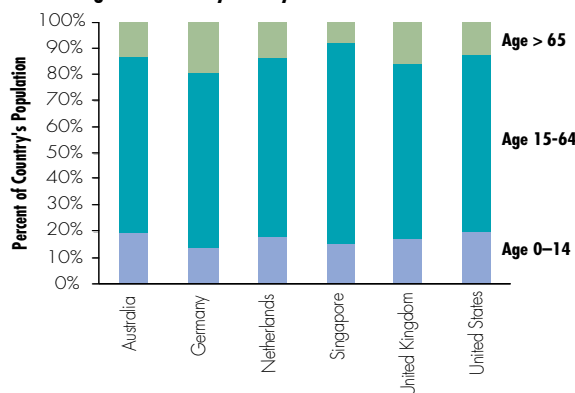
Of course, because pension funds are established to provide capital for the population as it retires, it is important to analyze the age distribution within each country. As illustrated in Exhibit 3, the age breakdown of the population varies slightly among the analyzed countries. At first glance, the differences may not seem important, but one possible consequence of the distribution in Germany is that the cash outflows of some pension funds might eventually outstrip the cash inflows from paid premiums plus return on investment.

Exhibit 2: Pension Fund Holdings Per Capita



Source: Authors’ calculations, based on 2004 data from AP Guides published in 2005 (UK); GDV Gesamtverband der deutschen Versicherungswirtschaft, 2004 (Germany); Central Provident Fund (Singapore); www.cbs.nl (Netherlands); Australian Prudential Regulation Authority, 2005a (Australia); Federal Reserve Flow of Funds Accounts, First Quarter 2004 (U.S.)

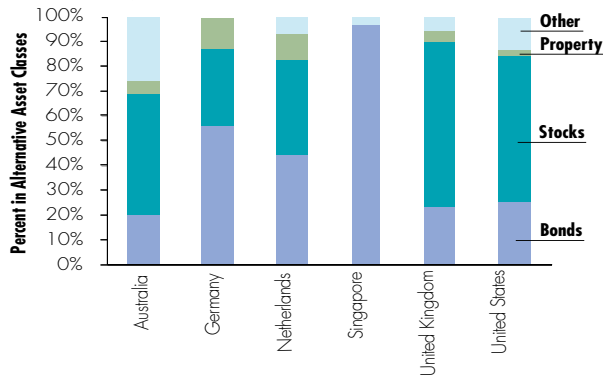
Exhibit 3: Age Distribution by Country



Source: Authors’ calculations based on government data sources

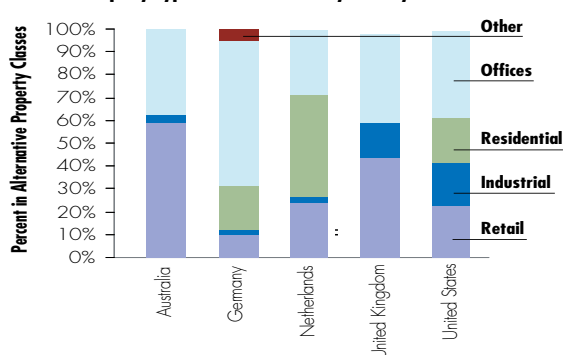
1. The term *scheme* is used in some countries to mean “plan.”

Exhibit 4: Average Portfolio Asset Allocations by Country



Sources: AP Guides (UK); Gesamtverband der deutschen Versicherungswirtschaft, 2004 (Germany); Central Provident Fund (Singapore); PVK/DNB (Pension and Insurance Supervisory Board and Dutch National Bank) (Netherlands); Australian Prudential Regulation Authority, 2005a (Australia); PREA, 2005 (U.S.)

Exhibit 5: Property-Type Asset Allocations by Country



Sources: Investment Property Databank, 2001 (UK); FERI Institutional Management/ebs Department of Real Estate, FIMSS Real Estate, 2004 (Germany); www.cbs.nl (Netherlands); Property Investment Research, 2004 (Australia); NCREIF, 2005 (U.S.)

Exhibit 6: Real Estate Investment Performance Benchmarks

United Kingdom

■ Investment Property Databank (IPD); data on 11,000 properties valued at \$233 billion; representing 45% of investment-grade commercial real estate in the UK; subsector performance available

Germany

■ Deutscher Immobilien Index (DIX); data on 3,490 properties valued at \$82 billion; representing 30% of German investment-grade real estate; prepared jointly with IPD; subsector performance available

Singapore

■ No institutional benchmark available; government and real estate agency (e.g., JLL) performance series available

Netherlands

■ ROZ/IPD; data on 6,200 properties valued at \$53 billion; represents 60% of Dutch investment-grade real estate; subsector performance available

Australia

■ IPD/Property Council of Australia (PCA); data on 471 properties valued at \$35 billion; representing 36% of Australian investment-grade real estate; subsector performance available

United States

■ National Council of Real Estate Investment Fiduciaries (NCREIF); data on 4,554 properties valued at \$166 billion; subsector performance available

Source: *An International Comparative Study of the Pension Plan Community and Real Estate Investments*

There is a considerable degree of variation in portfolio allocation (that is, to stocks, bonds, real estate, and other investments) among pension funds in the different countries (Exhibit 4). For example, pension funds in Singapore have an allocation to bonds in excess of 90 percent and no allocation to real estate. (However, Singaporeans can use part of their pension money to invest in their own homes, and any resulting private real estate holdings are not reflected in the allocation data.) The Germans and Dutch have the largest holdings of real estate as an average percentage of the pension plan portfolio. Real estate is a significant asset class for the pension plan communities in five of the six countries studied. Relative to those in the United States, the average real estate allocations are much higher in pension plans in other countries.

Exhibit 5 details the allocation of funds among the major real estate subsectors: office, retail, residential, and industrial. There are significant differences among the allocations in the five countries where data were available. The property sector allocation for U.S. investors is highly diversified, and Dutch investors show a preference for residential property. German investors allocate heavily to the office sector, and British and Australian investors seem to prefer retail. Detailed investment data were not available for the pension funds in Singapore.

The report addresses the performance of the real estate asset class and reviews the benchmarks that are typically used in each country to measure this performance. Exhibit 6 provides a summary of the indices that are presently available and widely referenced in each country.

Another of the study's findings is that indirect real estate has taken on an increasingly important role in recent years in most of the countries. This finding is substantiated by a report recently released by UBS Global Asset Management called *Real Estate Research: Global Real Estate Investable Universe Continues to Expand and Develop*. The UBS report notes the strong growth in both the private and the public dimensions of the global

real estate investment universe. Special emphasis is placed on the precipitous “rise in [the] equity market capitalization of publicly traded real estate and the proliferation and growth of REIT-like structures around the globe.” Indeed, the market capitalization of the FTSE EPRA/NAREIT global listed real estate index grew by an astounding 27.5 percent in 2005 and posted an 11.5 percent return in the first six months of 2006. This trend is expected to continue because indirect real estate investment conveys a number of advantages that direct investment does not offer. Among these are a high level of liquidity and the ability to tap the expertise of acquired management teams. An additional advantage of REITs compared with non-real estate stocks is a high level of tax transparency. In light of these advantages, the importance of REITs and other indirect real estate vehicles in Asian and European pension funds is expected to grow further in coming years.

The full report, *An International Comparative Study of the Pension Plan Community and Real Estate Investments*, contains much more detailed information on the topics highlighted above. It also includes a case study section presenting the results of interviews with individual asset managers for large and small, public and private funds on the role of real estate in their portfolios. A section of the report lists most of the trade associations and other property organizations in each country, making it a useful reference for anyone venturing to invest in these real estate markets.

The report is available on the PREA website (www.prea.org; click on Research and Other Research). For a printed copy, please contact PREA’s Research Director, Jim Clayton, at jim@prea.org or 860-692-6341.

The PREA report was prepared by Elaine Worzala (Johns Hopkins University, United States), C. F. Sirmans (University of Connecticut, United States), Colin Lizieri (University of Reading, United Kingdom), Karl-Werner Schulte (University of Regensburg, Germany), Joseph Ooi (National University of Singapore, Singapore), Aart Hordijk (Delft University of Technology, the Netherlands), and Graeme Newell (University of Western Sydney, Australia). ■