The holy grail of property investment?

A new concept in commercial property investment is set to revolutionise the way UK pension schemes view this asset class. It has been described by one senior consultant as the 'holy grail' of property investment

The benefits of commercial property investment are relatively well understood. It can help pension schemes to diversify risk and improve the risk-adjusted returns of multi-asset portfolios. Property investment also offers additional qualities, including attractive income-generation; inflation-hedging characteristics; and relatively low volatility when compared with other asset classes.

The choice of property options available to pension schemes is wide and varied, including direct investment, real-estate investment trusts (REITs), open-ended property funds, private equity vehicles, and multi-manager approaches. The traditional challenge for pension schemes is that these options introduce a range of issues:

- Only the very largest schemes have the scale to construct direct property portfolios while maintaining reasonable levels of diversification.
- Property is an illiquid asset class with high transaction costs. This can make it difficult for property managers – and their investors – to switch out of underperforming strategies.
- Traditional approaches to property investment typically adopt 'alpha' strategies in an attempt to beat market returns. However, allocations to property from pension schemes are principally an asset allocation decision, with the pursuit of risky 'alpha' returns secondary to the primary pursuit of 'beta.'
- Although REITs are relatively liquid (by virtue of being listed equities), they can be volatile and performance can be highly correlated with equities, particularly in the short term.
- A self-perpetuating cycle of investor redemptions from open-ended funds can be extremely damaging to investment returns and can catch out 'buy-and-hold' investors who fail to act.
- Property funds-of-funds enable pension schemes to benefit from diversification of property exposure as well as spreading manager risks. However, there can be problems with these vehicles, not least illiquidity and excessive leverage from exposures to private equity vehicles.

Passive investing comes to UK commercial property

In other asset classes, such as equities and fixed income, we have seen passive solutions become very popular with pension schemes. However the demands of commercial property as an asset class have meant that index-tracking approaches have not been available – until now.

Our 'active beta' property strategy seeks to match the performance of the UK commercial property funds market through investment in a diversified portfolio of property funds. In short, it is the first commercial property tracker for UK pension schemes.

The 'active' part of the name reflects the modest and risk-controlled active management required to achieve an index return. This involves carefully monitoring and adjusting the component funds, using the secondary market to mitigate transaction costs, while avoiding unnecessary and costly replication strategies and undesired exposures.

The 'beta' part of the name reflects the objective of the strategy. We are seeking to closely match the total return of the MSCI/AREF UK All Balanced Property Funds Index, while maintaining levels of risk that are appropriate for UK pension schemes investing in property as a diversifying asset. We achieve this by building a portfolio that is diversified across 12-15 open-ended balanced property funds.

The active beta property strategy is available as a segregated portfolio or through a pooled pension fund. We also offer the option of in-specie investment of existing holdings for schemes already invested in open-ended balanced property funds.

www.kamescapital.com/activebeta

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