SOVEREIGN PENSION PLANS INVESTING HEAVILY IN REAL ESTATE: STUDY

By *Sara Tatelman*

Real estate has become the main driver of increasing alternative allocations for sovereign investors, according to Invesco's 2016 global sovereign asset management study.

From 2012 to 2015, sovereign investors' real estate assets grew to 6.5 per cent from three per cent of their portfolios, which represented faster growth than that of private equity and infrastructure combined, according to the report released today. For many large pension plans, common alternative investments comprise up to 30 per cent of portfolios.

While infrastructure offers stable returns and inflation protection, "the queues to get into a manager and then the queues to actually get the deal executed and the money invested are getting longer and longer," says Michael Peck, senior vice-president of institutional investment at Invesco Canada Ltd. in Toronto. "So because these sovereign wealth funds tend to be net cash-flow positive, as a general rule, these delays can be harmful to them sometimes. So they've discovered that real estate is an area where they can get their money invested a lot more quickly."

Earlier this month, the British Columbia Investment Management Corp. launched an in-house real estate management firm, an arrangement Peck says is common for large sovereign plans. But while internal real estate managers can handle what Peck calls "vanilla" transactions, such as Canadian core commercial real estate, many sovereigns funds will still work with external managers for innovative international assets. "Real estate is very much a local game," he says.

The Invesco study also noted it's easier for sovereign funds to find real estate asset managers than infrastructure asset managers. That's primarily because institutions have been investing in real estate for a very long time, says Peck. Opportunities to invest in Canadian infrastructure, on the other hand, only became available in the 1990s, he notes, adding the construction of the Greater Toronto Area's Highway 407 was the first "really big deal."

Peck also points out smaller pension plans looking to invest in real estate may not buy physical buildings but will often do so indirectly instead. "If I just draw a parallel to our business here, we have a number of Canadian plans that buy U.S. real estate through us because you can get access to 120-odd properties in one investment," he says. "If you're only deploying $10 million or even $50 million, you can't even buy a building for that."

When it comes to Canadian pension plans looking to invest in physical buildings abroad, the U.S. market recently became much more attractive. In December 2015, the United States amended its Foreign Investment in Real Property Tax Act of 1980 so qualified foreign pension plans were exempt from paying the levy, says Peck.

The change made the United States a much more attractive investment option. The tax had "never stopped people but it was always factored into the risk/reward analysis," says Peck.