DTZ INVESTORS

LGPS pooling: cost saving whilst maintaining performance

Amid an ever sharper focus on cost saving in the real estate industry, investors are pushing for increased transparency to better understand the true costs of investing in the sector. While a global trend, the issue has been specifically highlighted here in the UK by the Local Government Pension Scheme (LGPS) pooling process. The process is well underway and the national government is closely monitoring the pools' progress and the associated costs that are being incurred.

We share some of the UK property industry's wider concerns about the negative impacts of these transition costs that the pooling will create. The complex and largely unknown nature of the process means the costs are likely to have been underestimated, particularly in respect of the property exposure. However, the intention behind this process remains well founded and DTZ Investors has been employing a similar strategy as a house for many years when transitioning and repositioning our clients' indirect investment portfolios.

In this brief snapshot, we discuss the difference in costs between indirect investment and direct investment into the property sector; explain when and how indirect investment can be used to deliver outperformance; and detail our track record of successfully transitioning and growing an indirect portfolio to a direct portfolio whilst delivering sustained outperformance relative to market benchmarks despite the negative impact of transaction costs.

Costs

Balanced indirect vehicles typically charge a management fee of up to 1.0% of NAV per annum. In addition, for clients investing via a fund of funds structure, there are additional overlay management fees to consider.

However, investing in a direct portfolio not only provides an investor with more control, but also results in significant cost savings. Segregated account management fees can be up to half of those charged by fund managers of balanced funds and are typically charged based on a percentage of the portfolio value.

Our strategy

For larger clients (typically £100m+), DTZ Investors advocates investing in real estate directly in order to gain exposure to the mainstream sectors (retail, office, industrial) of the UK real estate market with sufficient diversification. We do not believe that it makes sense for an investor to incur the additional costs involved with obtaining this type of exposure indirectly. We base this view on the lack of control it affords and consistent underperformance relative to the wider direct market, due to higher fee levels and the performance drag from the cash balances held in the open-ended structures for liquidity management purposes.

That said, investing indirectly is a strategy we have successfully employed for a number of our clients who want balanced exposure, or some specialist expertise, over the last 20 years. Our experience tells us that the higher costs typically charged by managers of indirect vehicles can be justified where specialist strategies are employed which deliver outperformance and more than offset the increased management costs and reduced control.

In addition, we believe that indirect investment is the right strategy to gain access to sectors with large lot sizes and low tenant diversification (e.g. distribution warehouses); or where specialist management skills are required (e.g. healthcare and student accommodation). Such sectors are not easy to access directly and some carry the risk of reputation damage if linked to poor operators through direct investment.

At DTZ Investors, we have always advocated investing in real estate directly to obtain mainstream exposure … however, we do use indirect vehicles to access diversified exposure and to secure specialist management expertise, helping to deliver outperformance to our clients.

Successful indirect strategies that DTZ Investors has utilised include using indirect investment to:

- Obtain immediate exposure to the market at a low cost (transaction costs typically equate to 25bps on the secondary indirect market)
- Provide increased exposure to a rising market whilst a direct portfolio was being built up (then selling down the exposure once the direct portfolio had reached a critical mass)
- Secure tactical exposure to a sub sector of the market anticipated to outperform the wider market to which the client was unable to gain timely and sufficient direct exposure
- Gain diversified exposure to global real estate markets

Case Study

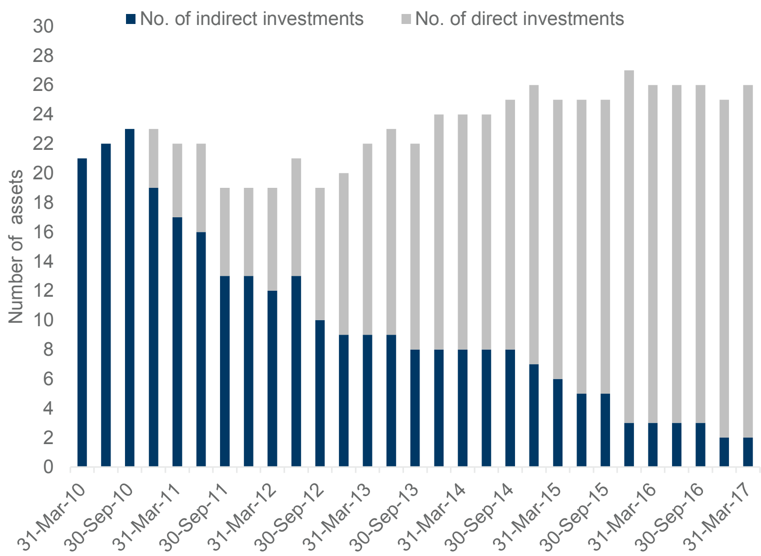
In 2010, DTZ Investors was instructed to manage a portfolio consisting of over 20 indirect assets with a total value of <£50m. Following a period of significant underperformance under the previous fund manager, our target was to significantly outperform the fund's IPD/MSCI based benchmark over a three year rolling period.

Our solution was to transition the portfolio from a wholly indirect portfolio to a predominantly directly held portfolio, using indirect exposure to access specialist investments which cannot easily be acquired or managed directly.

The fund outperformed its benchmark significantly in 2016 and is exceeding its target objective over three years to Q4 2016.

Over time, the client's allocation to real estate has also increased ten fold.

Client transition over time



Risk warning: past performance is not a guide to the future

Important information

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