The Unusual Suspects: Emerging Sources of International Capital in U.S. Markets
In the fourth quarter of 2011, the global distribution of capital in direct commercial real estate investment was valued at $106.2 billion (USD). Even though the United States saw decreased activity on transactions of capital placement in this quarter, interest in the U.S. market remains strong, with institutional investors keeping their doors open to deploy more capital our way. The U.S. has traditionally received a great deal of attention among international investors thanks to its myriad real estate opportunities. Because of this status, it seems, one question is rarely asked: “Who is not investing in the U.S.?”

While only a small number of international funds are absent or underinvested in U.S. real estate, it is worth considering who they are and what they offer to this market. U.S. fund managers would be wise to study these international investors and consider how the U.S. could fit into their diversification strategy. The landscape of global real estate is changing. Understanding the role of U.S. markets in a rapidly evolving global economy is essential if we are to maintain our position at the forefront of international real estate activity. Moreover, the U.S. market’s ability to attract international investment requires a view of the future real estate landscape: Who are the emerging players? What opportunities do they present? This conversation is crucial to identifying and attracting new sources of international capital—before the next country does.
INVESTOR OUTLOOK ON THE U.S.

All signs indicate the appetite for real estate in the U.S. remains strong for 2012. Investors still view the U.S. as the safest and best opportunity for capital appreciation. According to the 2012 AFIRE Investor Survey, the average size of members’ U.S. real estate portfolios is $6.4 billion, as reported in Q4 of 2011.²

Despite the pessimism that has loomed over the U.S. market in the aftermath of the 2008 real estate crash and economic recession, foreign investors are approaching the U.S. with an outlook of opportunity. In 2012, an outstanding majority of investors are prepared to invest at least as much capital in the U.S as they did in 2011. Of these, 60% plan to increase investment in 2012, which is down from the 72% who reported these sentiments at the beginning of 2011. This slightly less optimistic outlook is in response to changing market fundamentals, international economic conditions, and the reform of FIRPTA taxation policy. Overall, the view is that viable equity investments remain difficult, yet to a lesser extent than a year ago. Still, the overall outlook remains positive, predicting that the U.S. market will once again see a considerable amount of capital placement this year.
“With the influx of viable real estate markets in the coming years, analysts predict investment dollars will be spread across more markets.”

THE GLOBAL CAPITAL RACE

According to current data, foreign investors are allocating their capital to an increasingly broad selection of countries. Because opportunities continue to emerge in new areas of the world, we are seeing many markets redefined as hubs of real estate investment. In the next few years, these emergent markets will likely cause many investors to reassess how they pursue opportunities. As investors broaden their horizons, the continuing appeal of U.S. real estate must not be taken for granted.

With the influx of viable real estate markets in the coming years, analysts predict investment dollars will be spread across more markets. This will intensify the competition for global capital.³

MARKET PLAYERS TO WATCH

For real estate professionals, the increasing competition for international funds necessitates research of potential institutional investors. These institutions, after all, are themselves keeping abreast of the United States’ real estate offerings. Due to the relatively secure outlook maintained by many gateway and secondary U.S. markets, it is tempting to assume all available funds for U.S. investment have already been procured.

This is not necessarily true. The goal of this article is to predict and explore additional, emerging sources of international capital for U.S. real estate. Of particular relevance to this study are European institutional investors showing signs of expanding their U.S. holdings in the coming years.
Here are several prominent funds worthy of exploration. In researching these potential investors, it is important to analyze each fund’s history, its motives for shifting capital placement to U.S. markets, its target markets within the U.S., and the parameters of its investment strategy.

**BPF Bouw**

BPF Bouw, also known as The Foundation for the Construction Industry Pension Fund, is an Amsterdam-based fund that was founded in 2003. The fund relies on equity committed to commercial real estate via commingled funds, separate accounts, joint ventures and direct property investments. PERE, the global news service for private equity real estate, values the fund’s real estate investments at $7.4 billion as of September, 2011. Though BPF Bouw already has a global presence, U.S. property funds would be wise to track this organization’s activity.

Since 2010, BPF Bouw has been working to diversify its portfolio with more substantial international investment. Since announcing its intentions to dilute shares of its domestic portfolio, the fund has been redirecting capital to funds in the U.S., Europe and Asia. Rather than selling off their assets in the Netherlands, however, they allowed other pension funds the opportunity to assume interest.
The overall BPF Bouw fund will continue to maintain its 25% allocation to real estate. However, it will reduce its investment in Dutch assets from 80% to 60%. The fund plans to increase its weightings over a 4- to 5-year period, providing an increased interest in global markets.⁵

According to Stephen Tross, director of international investments for Bouwinvest (which manages the pension fund’s real estate investment program), BPF Bouw is “looking for fund managers to expand the fund’s footprint into core assets outside of the Netherlands.”⁶ If the fund’s 2011 entry into Australia is any indication, core office and retail assets in major cities are the organization’s focus. In January 2012, Investments & Pensions Europe reported that BPF Bouw’s international investing would also focus on core investments with low leverage.

The Government Pension Fund of Norway

A little over 20 years ago, Norway, the world’s third-largest oil exporter, realized its fortunes as a petroleum producer would be temporary. In 1990, its government responded with a long-term strategy to safeguard its economy against its oil dependency, resulting in the Government Pension Fund of Norway. Now valued as the largest pension fund in Europe, it has grown into a powerhouse mutual fund that converts Norwegian revenues from petroleum into bonds and stocks. Despite its name, the fund does not have any formal pension obligations; rather, it operates as a tool to manage the nation’s financial challenges and diversify its economy in preparation for the day that its petroleum revenue runs dry.⁷

The Government Pension Fund is operated by the Norwegian Ministry of Finance on behalf of the Norwegian people. It is comprised of two separate sovereign wealth funds: the Government Pension Fund-Norway (GPFN) and the Government Pension Fund-Global (GPFG). The Government Pension Fund-Norway was established in 1967 as the “National Insurance Scheme Fund,” but was renamed in 2006. Assets of the GPFN are invested strictly in the equity (60%) and fixed-income markets (40%). The fund invests in domestic companies on the Oslo Stock Exchange in Norway (85%) and elsewhere in the Nordic region, excluding Iceland (15%).⁸

The golden goose for emerging investment opportunity lies within the GPFG. The Government Pension Fund-Global was founded as the “Petroleum Fund of Norway” but was renamed, along with its domestic counterpart, in 2006. The fund was set up as a fiscal policy tool to support long-term management of Norway’s petroleum revenue. The fund is integrated with the State’s budget: the Norwegian Ministry makes regular
transfers of petroleum revenues into this fund. The capital is then invested internationally, in equity, fixed-income, and real estate markets.

Over time, Norway's petroleum revenue is expected to count for a smaller and smaller percentage of the Fund's total capital. As projected petroleum revenues fall, completely disappearing around 2020, the fund will need to allow withdrawals by the state budget. These withdrawals are projected to remain below 3%, while the Fund is expected to see continued growth from its numerous investments.

![Simulated net inflow to the GPFG](image)

Norges Bank Investment Management (NBIM) has managed The Global Pension Fund -Global since 1998. The fund is weighted with 60 percent equities, 35-40 percent fixed-income securities and up to 5 percent real estate investments. It was not until 2008 that the Ministry of Finance included real estate in the fund's investment profile. In March 2010, the Ministry mandated that as much as 5 percent of the fund should be gradually invested in real estate, reducing the fund’s share of fixed-income investments.

Because the GPFG’s property investment is funded with fixed-income capital, fixed income and real estate are grouped together. Regulations allow the amount of combined fixed-income and real estate investments to fluctuate as a percentage of the entire fund, meaning there is room for growth in the fund’s real estate investment platform. While the GPFG's current strategy has it investing in the European part of the Investment Property Databank (IPD) Global Property Index, the fund’s benchmark may expand over time to include non-European countries in the IPD index. In such an event, there would be a significant opportunity for the United States to attract the fund’s investment.

Figure 5
Expected Net Transfers to GPFG. (Source: Norwegian Ministry of Finance)
The fund did not place its first real estate investment until April 2011, so the timing is ripe for U.S. firms to court GPFG capital. According to the Norwegian Ministry of Finance “2010 Management of the Global Pension Fund Report,” total market value of the GPFG fund increased by NOK 437 billion, reaching NOK 3 077 billion ($525 billion USD). At its current valuation, the fund’s real estate portion is worth approximately $26.25 billion (USD). Given the flexibility of the fund’s allocation structure, a rebalancing of the fund could translate to upwards of 30-50% in real estate and fixed-income investments.

The fund’s real estate investment strategy calls for a gradual increase in investments and a portfolio that is well diversified across geography, sectors, property types and investment instruments outside of Norway. The mandate of the fund gives preference to office and retail investment over residential, industrial or other property types. The fund aims to invest primarily in unlisted real estate, traditional property types and well-developed markets. The fund’s mandate allows for investment in property, equity and interest-bearing instruments issued by listed or non-listed companies. Further, the fund may invest in fund structures and other enterprises focused on buying, managing, developing or financing real estate. There is also an option to invest in derivatives linked to real estate instruments.

From a return perspective, the fund is benchmarked against the European Index of the IPD. GPFG has a long-term horizon and is well equipped to assume the additional risk associated with incorporating real estate into its portfolio. Assuming value and liquidity factors, the fund’s exposure to more risk types is projected to garner a better ratio of total risk to expected return.

**ATP**

ATP is the Danish Labor Market Supplementary Pension Scheme. With over $60 billion (USD) in investment assets, ATP ranks as one of the largest pension funds in Europe. According to Maarten van der Spek of PGGM Investments, a Netherlands-based pension fund investment management firm, ATP is a fund to watch. “ATP started investing in the U.S roughly three to four years ago,” Mr. van der Spek says. “The fund is looking to increase their [real estate] allocation exponentially and the U.S. is still on their radar.”

ATP is a statutory, fully funded and defined-contribution scheme that was established in 1964. It was designed to provide a lifelong pension from the age of 65 and dependent benefits in the event of a member’s death. ATP covers all wage earners and a majority of social security beneficiaries, with workers contributing 9-17% of their earnings. ⁹ ATP
started investing in indirect real estate in 2002, later forming ATP Real Estate in 2006 to manage all of the fund’s indirect real estate investments.

The current mandate of ATP Real Estate covers investments in joint ventures and private equity real estate funds in the United States and Europe, with a focus on office, retail, industrial and residential properties. ATP Real Estate currently has three portfolios under management with a total investment potential of $3.5 billion (USD). With $3 billion spread between the ATP Real Estate Partners (REP) and ATP REP I funds, an opportunity exists in the remaining $0.5 billion currently being invested in the REP II fund. The fund seeks a return on equity of 9-11% at portfolio level before PAL (Danish pension yield taxation). According to the fund’s portfolio overview, there is $530 million of committed capital in the US markets within the ATP Real Estate Partners I K/S and ATP Real Estate Partners II K/S portfolios. The first capital commitment into US real estate was $75 million in May of 2008. The fund has steadily increased its presence since.

**Ontario Municipal Employees Retirement System (OMERS)**

The U.S. real estate market is a top priority in the strategy of the Ontario Municipal Employees Retirement System. “OMERS is looking to triple the amount of U.S. investment from $1.5 billion to $5 billion over the next several years,” reports Erik Kolb, an editor with international real estate resource PERE. OMERS recently opened a new office in New York City, he reports, and the fund has plans to conduct activity through wholly owned subsidiary Oxford Properties.

OMERS was established in 1962 as a pension plan for employees of municipal governments, school boards, and libraries, as well as police officers, fire fighters and members of other agencies throughout Ontario. As the real estate investment arm of OMERS, Oxford Properties manages a global real estate portfolio of $16 billion.

OMERS is deploying capital quite aggressively. Its intention is to place 90% of its total funds by the end of 2012 (in contrast to its goal of 70% at the end of 2007). This ties into the fund’s long-term goal of assigning 50-60% of its total capital outside of Canada. In the U.S., the firm is strategically focused on office and retail investment. More specifically, the firm seeks to build a substantial class A office portfolio in business districts of Boston, New York City and Washington, D.C.
Public Sector Pension Investment Board (PSP Investments)

Like fellow Canadian fund OMERS, the Public Sector Pension Investment Board (PSP Investments) is not content to remain within its borders. According to PERE editor Erik Kolb, the fund is “looking to diversify their portfolio outside of the Canadian market with an eye on the U.S. being a part of that equation.” As of March 2011, net assets in PSP’s real estate portfolio totaled $5.3 billion, a $200 million increase from the year prior. In 2011, their total investments showed a respectable annual return of 13.8%. Looking forward, the fund has plans to increase its real estate holdings from 9.1% to 13% of its total assets.¹³

The firm’s largest investment focus is the retirement sector, with assets therein accounting for 28.6% of its overall portfolio. PSP Investments’ recent year-over-year revenue surge has been attributed to the substantial increase in demand for retirement and long-term care real estate.

While PSP currently has a presence in the U.S., that presence is relatively new. Approximately half of the firm’s portfolio is concentrated in Canada, while about three quarters of the overall portfolio is invested in North America.¹⁴ Though primarily focused on Canadian properties, PSP Investments has a growing footprint in the U.S. that will likely increase in the coming years.

Figure 6
PSP Investments’ Real Estate Diversification by Location
(Source: PSP Investments 2011 Annual Report)
Why Emerging Capital Matters

The landscape of global real estate investment has been changing gradually over the last 10 years. Though the U.S remains the “golden” market for real estate investment, growing opportunities around the globe are making the fight for capital more competitive. This reality suggests U.S. real estate professionals must consider how to present domestic opportunities in a way that keeps the U.S. real estate market at the forefront of the international investment conversation.

Courting institutional funds—whether these funds have opted out of U.S. investment or are actively looking to increase their presence in the U.S. market—will help sustain the country’s place in the global real estate market while creating opportunities for long-term partnership. It is much easier to attract new capital than to compete for money already deployed to other markets. Partnership with foreign institutional investors is critical to the continued strength of our gateway markets and necessary to the growth of emerging U.S. cities.
References

2. Association of Foreign Investors in Real Estate (AFIRE). “2012 Foreign Investment Survey.”
4. PERE. “Global Investor 30.” 2011
5. Ibid.
10. ATP Real Estate Partners.

Additional Resources: research interviews with Erik Kolb, Editor, PERE; Jim Fetteger, CEO, AFIRE; Maarten van der Spek, PGGM Investments; Blake Eagle, NCREIF.

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