Open-Ended Fund Indices

Most NCREIF members are familiar with the ODCE Fund Index (Open-ended Diversified Core Equity Fund Index). However, not many people know that NCREIF collects data on 18 additional open-ended funds that do not qualify for ODCE. NCREIF is in the process of looking at other fund level indices which can be created from this additional data.

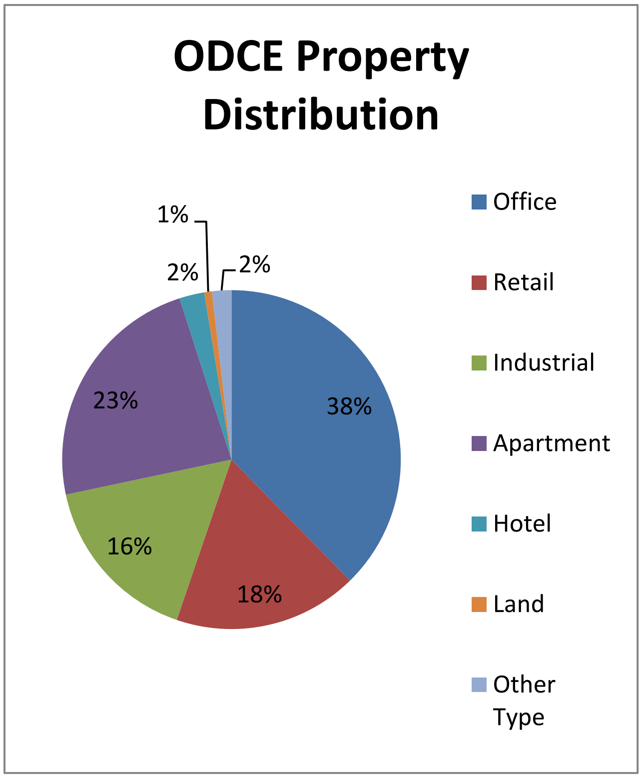
Before delving into the details I want to thank Sue Kolasa and Joe D'Alessandro. They did a tremendous amount of work with the data on these funds and allowed me to borrow some of their work for this paper. Any errors that may occur due to updating and formatting are the fault of the author!

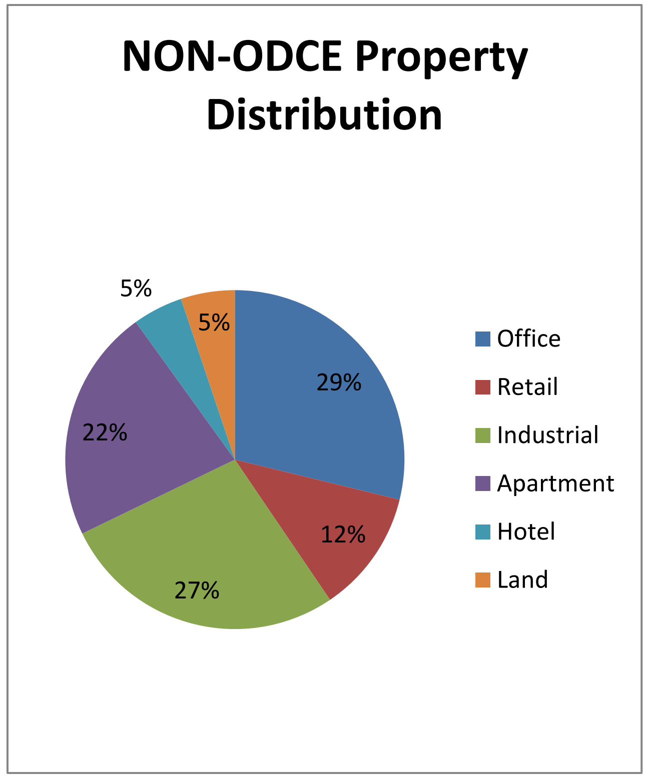
Before comparing returns, a short analysis of the composition of the non-ODCE funds and why they are not included in ODCE is useful. One fund is relatively new and not enough history is available to include it in any index at this time. As the fund matures, it may be added to ODCE or it could fit in one of the other categories below. The other 17 can be summarized into four different groups. These funds have different risk/return profiles than ODCE and different profiles among themselves.

They are:

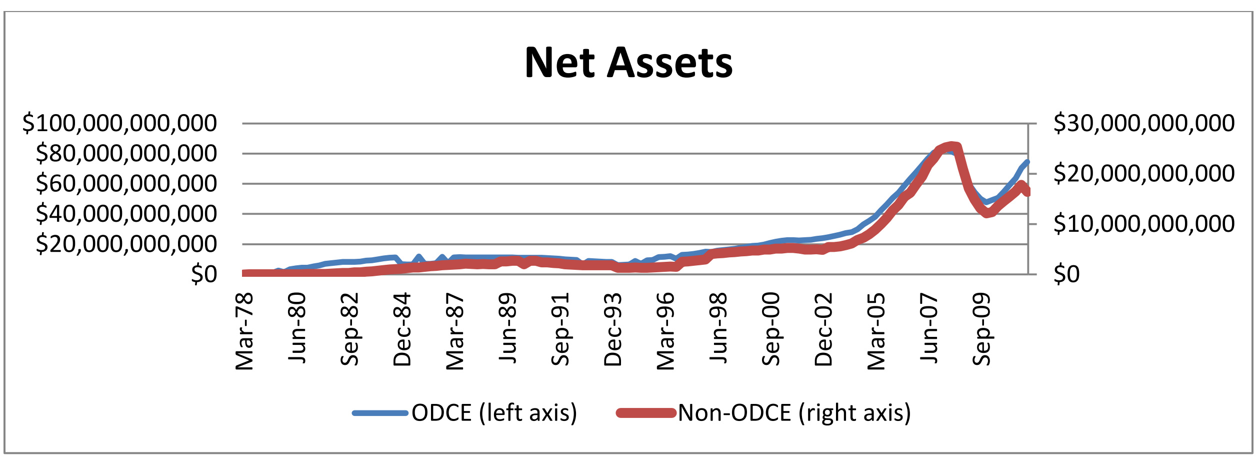
- Eight U.S. real estate diversified equity funds
    - Pursue moderate leverage (above the ODCE limit)
    - Target greater than 20% in non-operating investments (above the ODCE limit)
- Five single property type funds (violates ODCE diversification requirement)
    - Focus primarily on the hotel, industrial, and multi-family sectors
    - Generally target lower leverage than other non-ODCE funds
- One debt focus fund
    - Arrives at target return through different means: higher share of total return from income
- Three leveraged core funds (higher leverage than ODCE allows)
    - Higher income and lower appreciation
    - Pursue low (<5%) exposure to non-operating assets

The two pie charts below show the property type distribution for the third quarter of 2011 for ODCE and non-ODCE funds. Neither set of funds had timber or agriculture, mixed-use or healthcare allocations this quarter. The non-ODCE group had more hotels and more land in their portfolios, which isn't surprising given the higher risk profile. There is very little difference in the regional holdings with the Pacific division accounting for 32% of the holdings for both. The Northeast is the second largest with 19% and 22% respectively.

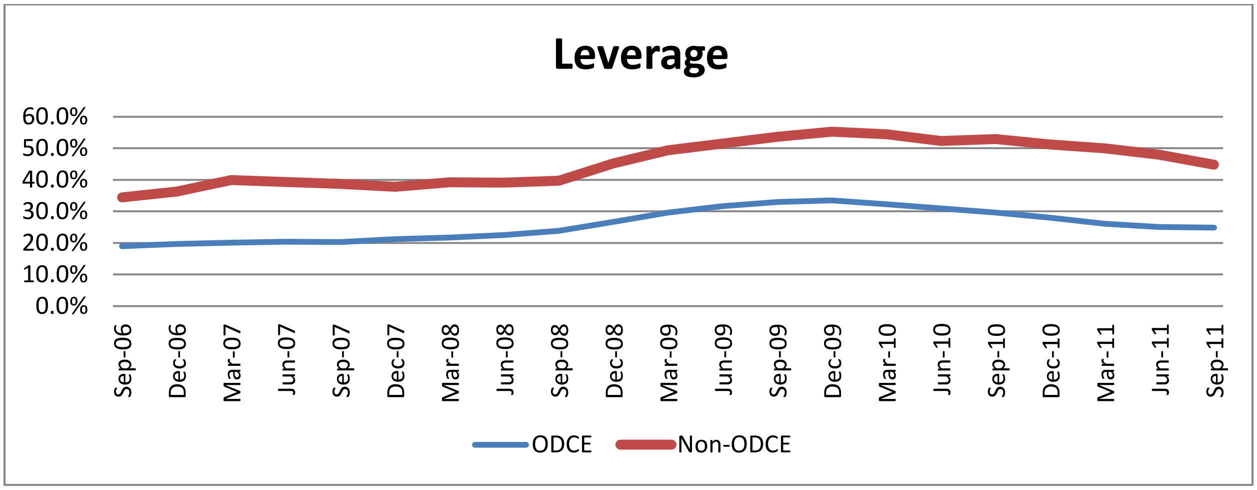




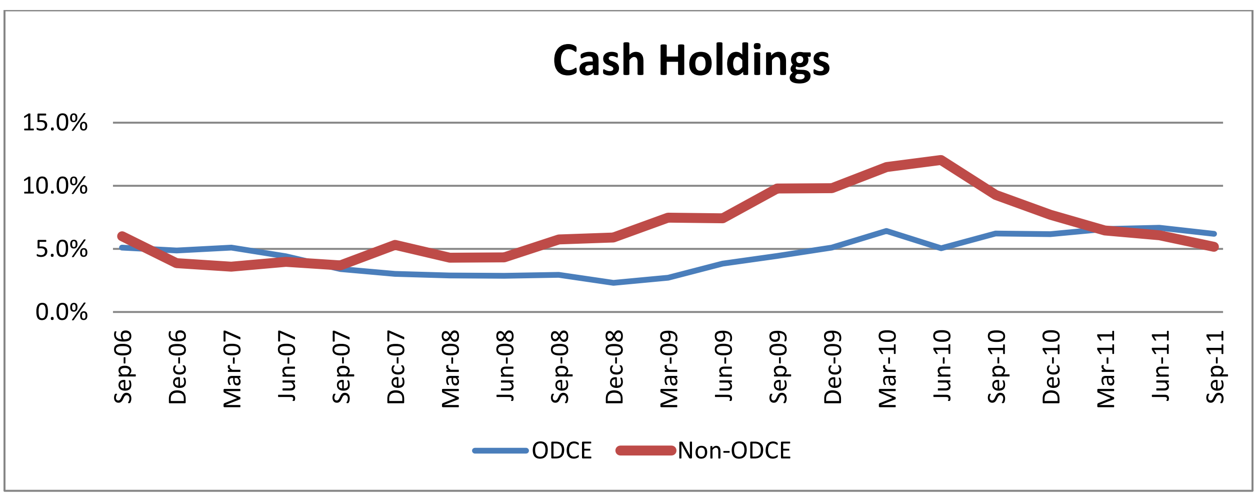
The holdings in the ODCE portfolio dwarf those in the non-ODCE funds. However, the pattern of growth for the two is similar. The ODCE net assets are on the left hand axis and the non-ODCE is on the right hand axis. They follow the same pattern. The lines are almost on top of each other. Growth was steady until the middle of last decade when the number of assets increased dramatically. Once the recession hit in 2007, the net assets fell precipitously. Since the bottom in 2009, the assets have increased at a rapid pace again. Neither set of funds has regained their previous high, but they are on the proper trajectory. There are almost three times more assets in ODCE than the other open-ended funds.



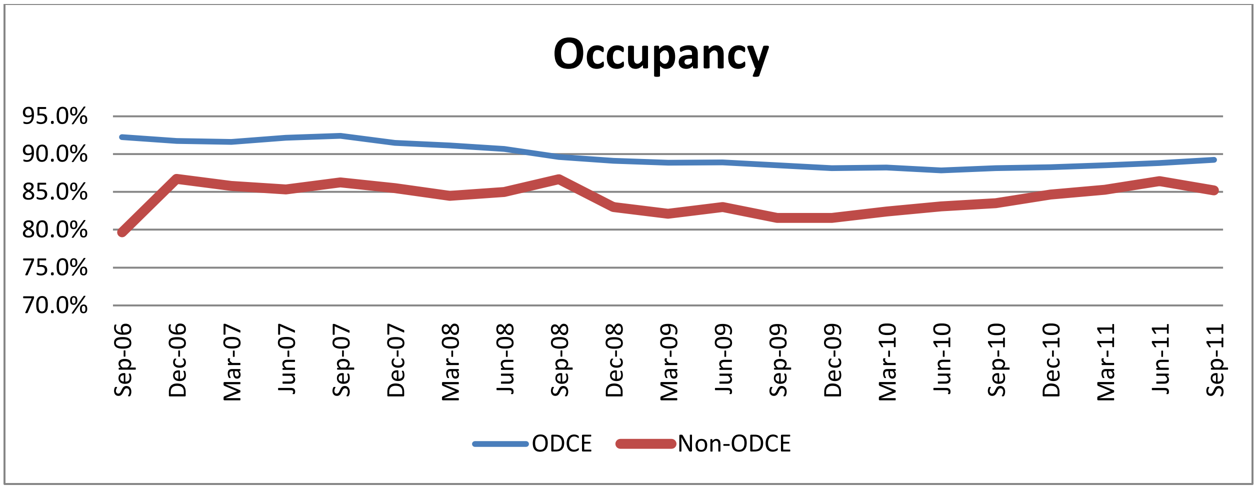
The ODCE funds operate at a much lower leverage level. To be included in the ODCE index a fund cannot have greater than 40% leverage. The non-ODCE funds have no such restrictions. At the bottom of the cycle as values fell and the value of the debt increased, the ODCE fund leveraged peaked at 33% compared to 55% for the non-ODCE funds. This is the biggest difference between the two sets of funds!



Unlike the previous two metrics we examined, the cash holdings are more intertwined. The non-ODCE funds continued to increase their cash holdings until the middle of 2010 with the hopes of deploying that cash in some riskier strategies than those allowed by ODCE. That additional cash was deployed in 2011 as net assets rose and cash levels fell. The cash movement for ODCE was much more restrained, with cash falling to 2% in 2008 and rebounding to the 5-7% range that it has held since the end of 2009. The cash holdings for the two sets of funds have been relatively consistent and do not have a great variation.

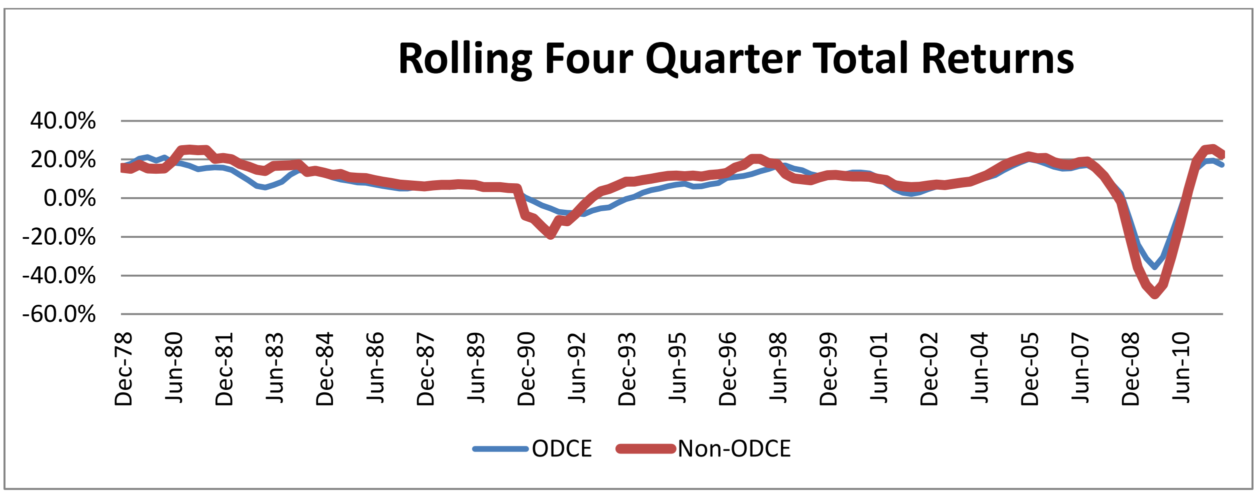


As would be expected with a core portfolio, the occupancy rate for ODCE has been consistently higher than the non-ODCE funds. After leverage, this is the area that shows the greatest difference between the funds. The gap had been closing, but widened in the past two quarters.



So how does this impact the return patterns of the various funds?

The return patterns for ODCE and non-ODCE aggregates are similar! However, the non-ODCE returns are much more volatile. The average quarterly return for ODCE funds is 1.8% with a standard deviation of 2.8%. By comparison, the non-ODCE funds average 2.0% total return each quarter, but the standard deviation is 4.0%. These are the aggregated numbers; the movement of the individual funds in each group is even greater.



In conclusion, the non-ODCE funds have some similar characteristics with ODCE funds and looking at them as one universe isn't unreasonable. However, there are some differences that need to be kept in mind when doing the comparison.