Why Do ODCE and NPI Returns Differ?

A question frequently asked of NCREIF is "Why is there a difference between the NPI and ODCE returns?" This question applies to all forms of returns, income, appreciation and total.

Channeling my inner David Letterman, here are ten main reasons the returns from ODCE do not match the income, appreciation or total returns from the NPI:

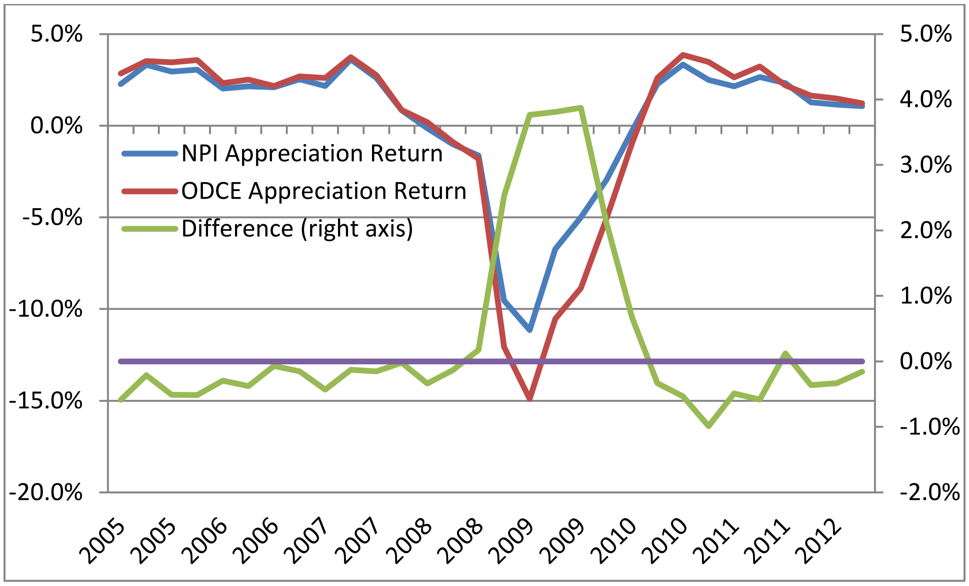
1. Not all ODCE properties and property types are in the NPI (seniors housing, student housing, development, etc.)
2. Leverage is included in fund level calculations, but not in the NPI.
3. JV properties in ODCE may be managed by non-NCREIF members so the data isn't reported in the NPI, but does appear in ODCE.
4. JV properties in ODCE may be managed by NCREIF members but all the cash flow reported in the NPI may not go to NCREIF members.
5. Fund level expenses (accounting, legal, etc.) impact fund level returns, but may not be allocated down to the property level.
6. The waterfall distributions from JV properties may impact the returns at the fund level differently than the property level.
7. Cash held at the fund level is a drag relative to income from properties.
8. Differences in property type distributions (for example, ODCE has more office).
9. Differences in regional distribution (for example, ODCE has more properties in the West).
10. The average building size in ODCE is larger than the average NPI property.

The following paragraphs highlight in detail a few examples of the differences. Showing examples for all ten items would make the paper longer than necessary without adding value. The few examples shown can be replicated for some of the other differences.

As one might expect, leverage has the greatest impact on appreciation and total return. The greater the move, up or down, the greater the impact leverage has on those returns. Chart 1 shows the appreciation return series for both indices as well as the difference between the two. They track closely except for the sharp downturn during the recession when the NPI 'outperformed' (falling 30% instead of 45% is outperformance in by default).

Looking at the data shows that the performance is rarely equal. Most quarters have at least a slight difference and during times of significant movement, a large difference.

Chart 1



Property count is another area that causes confusion since the numbers never match. It is important to understand what is being reported with the ODCE data and the NPI data. The ODCE report lists investments, while the NPI reports properties. Many of the ODCE funds aggregate properties they report into the NPI as investments for management and reporting purposes.

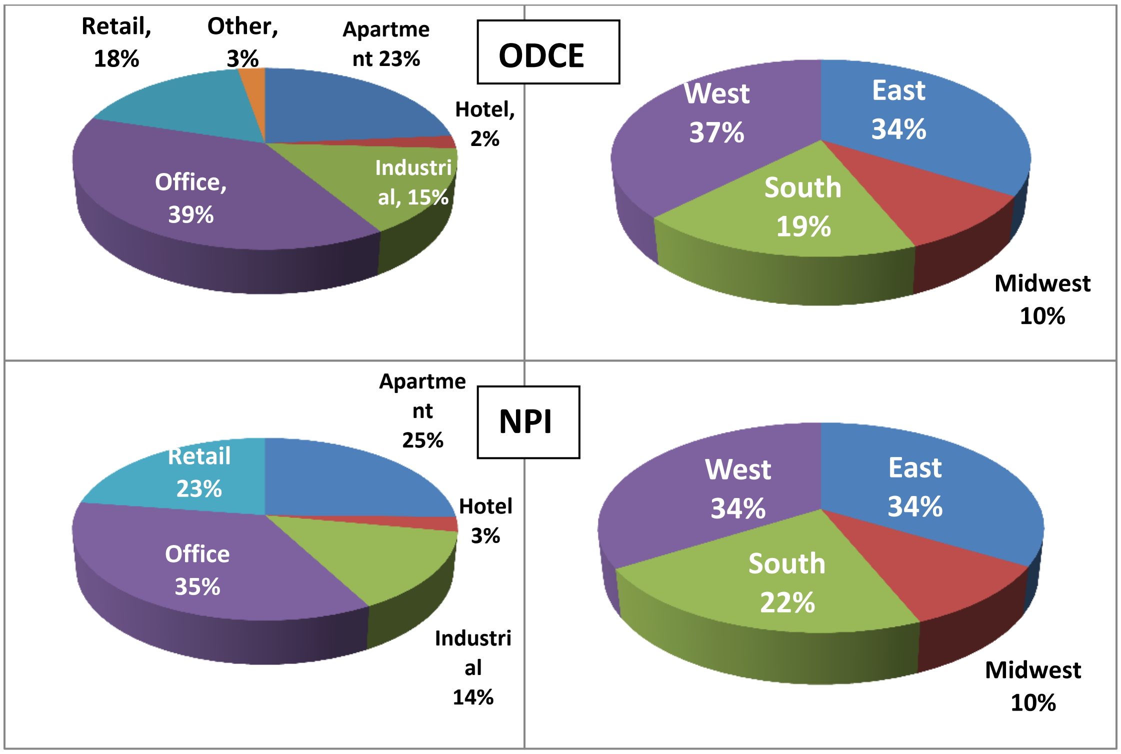
Another difference is the NPI only includes apartments, hotels, industrial, office and retail. ODCE includes all property types and other types of investments. Even though self-storage, seniors housing, student and others account for a small portion of the investments in ODCE, 3% in second quarter 2012, there are enough properties that the property count numbers vary. Since these properties are generally smaller, the count is greater than their 3% market value. The investments also include debt and securities that aren't counted in the NPI.

The table below shows the difference in property count for NPI compared to investment count in the ODCE report over the past four quarters. The most recent quarter, which has the narrowest gap of the four, is still different by more than 100 properties/investments. In the past, there were times when the NPI count was higher due to ODCE investments aggregating multiple NPI properties and the number of non-NPI property types was small. Currently, the other property types more than offset the aggregation to the ODCE and the count is larger.

Year	Property Count NPI	Investment Count ODCE	Difference
2011Q3	1600	1838	238
2011Q4	1626	1840	214
2012Q1	1646	1844	198
2012Q2	1776	1881	105

The distribution of properties by region and property type not only impacts total returns, it also influences the income return. The pie charts below show the second quarter 2012 distribution by property type and region for ODCE and NPI. The results are similar, but not the same. These slight differences contribute to differences in returns (both total and income).

Cash drag and fund level expenses that aren't pushed to the properties also impact income returns.



Conclusion

Investors comparing NPI versus ODCE returns and other metrics are often surprised they are different. They should be different! This paper lists ten reasons why returns differ and it provides additional details to support the differences. There may be additional reasons that haven't been discussed here, but the moral of the story is that the differences are driven by leverage, region, property type and several factors involving joint ventures.