

Pension Systems Plow Equity Into Real Estate

The nation's 50 largest public pension systems committed an astounding \$19.9 billion of equity to new real estate separate accounts, joint ventures and commingled funds last year — double the amount in 2004.

The soaring flow of capital into the real estate sector follows several years of outsized returns on such investments. The commitments indicate that pension systems broadly view real estate as an asset class likely to continue providing attractive yields.

Last year, the total real estate holdings of the 50 largest public systems climbed by 19.4%, or \$15.5 billion, to \$95.1 billion, according to Real Estate Alert's annual survey (see tables on Pages 10-19). That followed a 1.9% increase in 2004.

Real estate holdings equaled 5.3% of the system's total assets, up from 4.6% at yearend 2004. (The figures exclude REIT shares, as well as timber and agricultural holdings.)

The systems, which oversee the retirement benefits of state, county and municipal workers, had another \$36.7 billion of "unfunded" commitments — that is, money allocated to specific advisors for real estate investments, but not yet spent. When that number is added to actual real estate holdings, the ratio of real estate investments climbed to 7.5%.

"The returns generated by real estate — they've been very strong, and very consistent," said **Craig Ramsey**, a director in **Deutsche Bank's** real estate investment banking group. "That means that real estate per unit of risk undertaken is giving you more bang for your buck." As a result, Ramsey said, pension systems have been steadily increasing their level of commitments.

The biggest net increases in real estate investments last year were logged by **California State Teachers** (up \$2.8 billion, to \$8.3 billion), **New York State Teachers** (up \$2.7 billion, to \$4.9 billion), **Massachusetts Pension Reserve** (up \$1.6 billion, to \$3.2 billion) and **Michigan Retirement** (up \$1.1 billion, to \$4.2 billion).

Eight of the Top 50 systems were net sellers, including the nation's largest pension fund, **Calpers**, whose real estate portfolio declined by \$436 million, to \$10.7 billion. But while Calpers sold off at least \$6.8 billion of properties, that was largely offset by new investments. What's more, Calpers has a whopping \$7.8 billion of unfunded commitments.

About 92% of the capital committed to real estate last year, or \$18.3 billion, went to opportunistic, value-added or core-plus separate accounts, joint ventures and commingled funds, as well as high-yield debt funds. Not surprisingly, the five funds that lined up the most money from the pension



systems last year each seek opportunistic returns: **Fortress Investment Group's** Residential Investment Deutschland (\$940 million of commitments); **Aetos Capital's** Asia Fund 2 (\$900 million); **Cherokee Investment Partners'** Investment Partners 4 (\$850 million), **Morgan Stanley's** Real Estate Fund 5 International (\$830 million) and **Rockpoint Group's** Real Estate Fund 2 (\$690 million).

For years, many pension systems primarily made core investments, supplementing them with some high-yield plays. That's not the case anymore, said **Jack Berquist**, managing director of San Francisco placement agent **Presidio Partners**. "They are looking at real estate differently now than before," he said. "They are looking for higher returns and more diversifications. They are looking for opportunities outside the U.S. to achieve higher yields."

Why take on additional risk? "The pensions are under enormous pressure to make money for the retiring baby

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boomers,” said Ramsey. “Either [the systems] can contribute more money, or their existing portfolios can show greater returns.”

And real estate has been a stellar performer. Institutional investors reaped an 11.5% average annual return on real estate investments from 2001 to 2005, according to an index compiled by the **National Council of Real Estate Investment Fiduciaries**. While some systems simply benefited from the overall runup in property values, others far exceeded the average yield by taking on more risk.

Given the strong returns on real estate, a number of public systems have entered the sector and rapidly built up portfolios. **Missouri Public School Employees**, which only began investing in 2004, now has the 31st-largest real estate portfolio among public pension systems, with \$680 million of assets, plus \$217 million of unfunded commitments. Other relatively new players that were aggressive last year included **Rhode Island Employees** (\$270 million of commitments), **New Mexico Permanent Funds** (\$249 million) and **Arizona State Retirement** (\$116 million).

That trend is expected to continue this year. New players in the sector include **New Jersey Division of Investment**, which has already made \$275 million of commitments this year, and **Texas Permanent School Fund**, which has made \$250 million of commitments. **Milwaukee City Employees**, **Montana Board of Investments**, **New Mexico Educational Retirement Board**, **Oklahoma Police**, **Philadelphia Public Employees** and **Phoenix Employees** could make their first commitments to the sector later this year.

RREEF remained the most-active real estate advisor, rep-

Top Commitments to Individual Funds in 2005

By Top 50 Public Pension Systems

	Fund Operator (Fund)	Mandates	Amount (\$Mil.)
1	Fortress Investment (Resid. Investment Deutschland)	4	940
2	Aetos Capital (Asia Fund 2)	4	900
3	Cherokee Investment Partners (Investment Partners 4)	3	850
4	Morgan Stanley (Real Estate Fund 5 International)	4	830
5	Rockpoint Group (Real Estate Fund 2)	8	690
6	CIM Group (Urban REIT)	4	645
7	GI Partners (Fund 2)	1	500
8	CB Richard Ellis Investors (Strategic Partners 4)	6	430
9	Starwood Capital (Hospitality Fund 1)	6	400
9	Lehman Brothers (Real Estate Partners 2)	3	400
9	LNR Property (Commercial Property Investment Fund)	1	400

resenting 27 of the Top 50 systems. **Prudential Real Estate Investors** was again the runner-up, with 24 clients, followed by **CB Richard Ellis Investors** (18 clients), **LaSalle Investment Management** (16 clients) and **J.P. Morgan Investment Management** (15 clients). Ranked by mandates, Prudential led with 43, followed by RREEF (39) and **Westbrook Partners** (38), whose tally includes four opportunity funds raised from 1994 to 2003 that it co-manages with the principals of **Rockpoint Group**.

Among the subset of separate accounts and joint ventures, **Invesco Realty Advisors** led the way with 12 clients. RREEF and LaSalle tied for second with 11 clients, while RREEF tied Invesco for most mandates, with 12.

Among fund advisors, Prudential led with 20 clients, followed by RREEF (16) and **Credit Suisse** and **CB Richard Ellis Investors** (12 each). Ranked by mandates, Prudential topped the field with 39, followed by Westbrook's 35 and **Goldman Sachs'** 34.

Townsend Group once again dominated the ranking of consultants. Thirty-seven of the Top 50 had real estate consultants, and 18 of those used Townsend. Although that figure was down by one from 2004, Townsend remained well ahead of runners-up **Callan Associates** (7 clients) and **Pension Consulting Alliance** (6), each of which picked up one client from a year earlier. The survey counted only full-time real estate consultants. General consultants, back-up consultants and “project-by-project” consultants were excluded.

Overall, the Top 50 systems last year maintained 678 advisory relationships involving 983 investments or commitments. That's up from 595 advisors and 834 investments or commitments in 2004, and 489 advisors and 715 investments or commitments in 2003. Timber, agricultural/farm-land and REIT advisors were not included. ❖

Real Estate Consultants

For Top 50 Public Pension Systems

	Clients (2005)	Clients (2004)
Townsend Group	18	19
Callan Associates	7	6
Pension Consulting Alliance	6	5
Russell Real Estate Advisors	4	5
Courtland Partners	2	1
NONE	13	18
TOTAL	50	50