Briefing note:
Using balanced funds to get short term exposure to IPD

This note outlines the benefits of using open ended balanced funds as a short term store of capital for clients with cash to invest in direct property assets.

The return on cash is negligible whereas our house forecast for the total return from property in 2013 is 6.9%, and 8.4% in 2014. Although DTZ IM is not typically judged on the performance of clients' portfolios including uninvested cash, from this point in the cycle our clients may suffer a significant performance drag in relation to any uninvested capital.

Balanced funds offer an attractive way of helping clients reach their full property allocation whilst their direct property portfolios are under construction for two reasons: i) they closely track IPD; ii) our forecasts for All Property are strong; and ii) balanced funds are relatively liquid.

i) Proxy for IPD

Balanced funds aim to provide their investors with a well diversified property exposure. As such they tend to track IPD All Property quite closely. Any outperformance over and above IPD that is created by manager expertise is eroded by fund management fees and costs. The larger balanced funds are more successful at tracking IPD, as they are better diversified and more closely mirror the makeup of IPD. The fact that balanced funds are a good proxy for IPD means that clients can use them to supplement their direct holdings and increase their property exposure relatively quickly.

ii) Liquidity

Open ended balanced funds are subject to (at least) quarterly subscription and redemption windows. The bid-offer spread is around 6%. This spread provides an upper and lower limit to secondary market trading prices (in normal market conditions), so open ended funds don't normally trade at the wild variances to NAV which we see on closed ended funds. The round trip costs of investing in open-ended funds should therefore not prohibit investing in open-ended funds on a short term basis given our strong forecasts for All Property in the short to medium term.

Analysis

The below table compares several of the largest open-ended funds on a number of parameters. Only the largest funds have been selected for comparison as these offer the best liquidity/IPD proxy benefits. As the table demonstrates, all of the selected funds' returns have been well correlated with the IPD Annual over the review period (1994 – 2012), at around 97%.

The Blackrock and Schroder funds have been the most liquid, trading every quarter over the last 3 years, and currently they can be bought at small premiums to NAV. They have also been the best performing funds over the last 1, 3 and 5 year periods. If investors buy into either the Blackrock or Schroder open-ended fund today, in the worst case scenario (normal market conditions prevailing) the round trip costs of investing, including brokerage fees would be 3.15% and 2.75%, respectively. Based on our forecasts investors would only need to be invested for a period of around 6 months before the costs of investing were recuperated. In practice it may be possible to exit both funds at similar premiums to that which would have to be paid on acquisition thereby significantly reducing round-trip investment costs.

	Correlation between fund returns and IPD Annual (1994 – 2012)	NAV	Number of quarters fund has traded over last 3 years	Average value of trades per quarter over last 3 years	Current secondary market pricing	Total return to 30 June 2013		
						12m	3yr	5yr
Blackrock	97.2%	£2,415.5m	12	£18.7m	NAV +0.8%	2.6%	4.6%	0.1%
Standard Life	96.9%	£1,925.3m	Info not available	Info not available	c.NAV	2.1%	3.9%	-0.2%
Schroder	97.3%	£1,243.8m	12	£19.4m	NAV + 0.5%	3.7%	5.7%	0.1%
Aviva	97.4%	£1,045.7m	7	£9.2m	NAV – 2%	0.4%	3.0%	0.1%

Summary

For the reasons of size, close correlation with the IPD Annual, liquidity, track record, and low likely round trip investment costs, I would recommend the Blackrock and/or Schroder funds for providing a short-medium term and liquid proxy for IPD.