

# CHARTWELL VIEWS

## Exploring Global Real Estate Indices

Selecting an appropriate internal benchmark is a challenge for active and passive managers, and their investors. Investment strategies within the same asset class can differ considerably in terms of market capitalization ranges, sector and/or country allocation, and other metrics (profitability, earnings, quality/investment grades). Additionally, the number of indices has multiplied in recent years, providing each asset class with numerous benchmarking options. It is important for managers to select benchmarks which most closely represent (or correlate) with their portfolios and for investors to use appropriate benchmarks for performance evaluation purposes.

Global real estate/REITs is an asset class that has considerable variability between its constituents and available performance benchmarks. We researched the three most used indices in the global REIT space to see what their differences and similarities are; the MSCI World Real Estate, the S&P Global REIT and the FTSE EPRA/Nareit Developed indices. Here is what the research shows:

### **Performance – Short-Term, Long-Term and Calendar Year – through May 31, 2019**

	YTD	1 year	3 years	5 years	10 years
MSCI World Real Estate Index	14.5%	9.5%	6.5%	5.7%	10.4%
S&P Global REIT Index	13.3%	9.1%	4.3%	5.2%	11.9%
FTSE EPRA/Nareit Developed Index	12.7%	8.1%	5.5%	4.9%	10.5%

	2018	2017	2016	2015	2014	2013
MSCI World Real Estate Index	-6.4%	14.7%	2.8%	0.2%	14.2%	2.7%
S&P Global REIT Index	-5.9%	7.4%	5.8%	-0.4%	21.5%	1.7%
FTSE EPRA/Nareit Developed Index	-5.0%	10.9%	3.2%	-0.7%	15.3%	2.5%

### **Index Construction – Capitalization, Financial Criteria and Rebalancing**

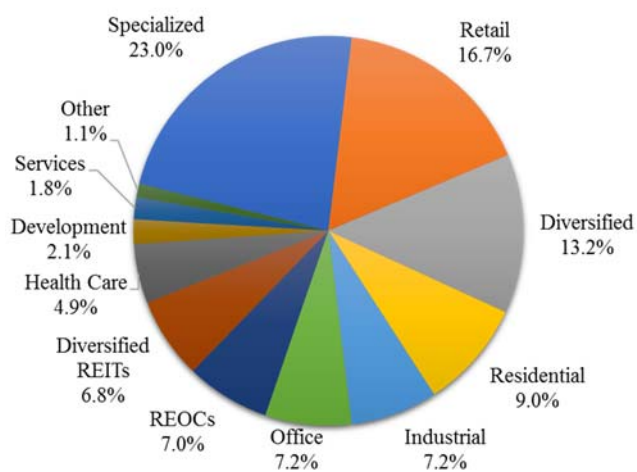
	Inception Year	Capitalization Range	Number of Securities	% of Mkt Cap in Top 10 Securities	% non-US Stocks	Annual Rebalancing Frequency
MSCI World Real Estate Index	9/15/1999	\$1.5B-\$92.1B	104	33.0%	38.4%	2
S&P Global REIT Index	12/31/1992	\$43.0M-\$50.1B	401	23.2%	35.7%	1
FTSE EPRA/Nareit Developed Index	1/27/2005	\$127M-\$49.9B	336	20.6%	46.2%	4

## The MSCI World Real Estate Index

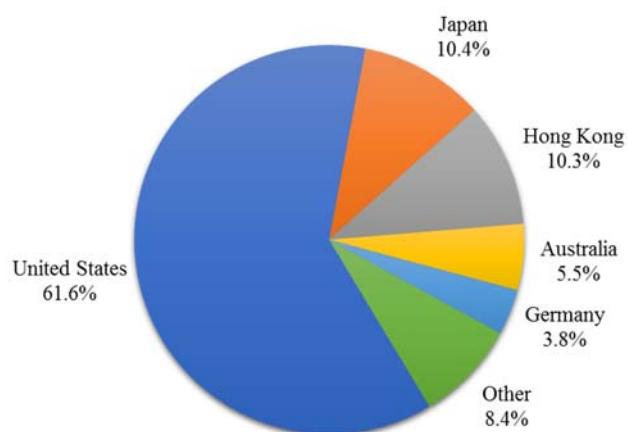
Launched in 1999, the MSCI World Real Estate Index is a free float-adjusted market capitalization index that consists of large- and mid-cap equities across 23 developed market countries; including REITs, REOCs, and other real estate-related equities. 104 constituents make up the index, ranging from \$1.5 billion to \$92 billion in market capitalization. There are no small-cap or emerging market companies present in the index.

The index is based on the MSCI Global Investable Indexes (GIMI) Methodology – an approach to index construction that considers regional comparisons across all market capitalizations, sectors, and styles. This methodology aims to provide complete coverage of the publicly traded real estate opportunity set with a strong emphasis on index liquidity, investability and replicability. The index is reviewed quarterly (mid-quarter) in February, May, August and November, with the objective of reflecting change in the underlying equity markets in a timely manner while limiting unnecessary index turnover. During the May and November semi-annual index reviews, the index is rebalanced, and the large- and mid-cap cutoff points are recalculated.<sup>1</sup>

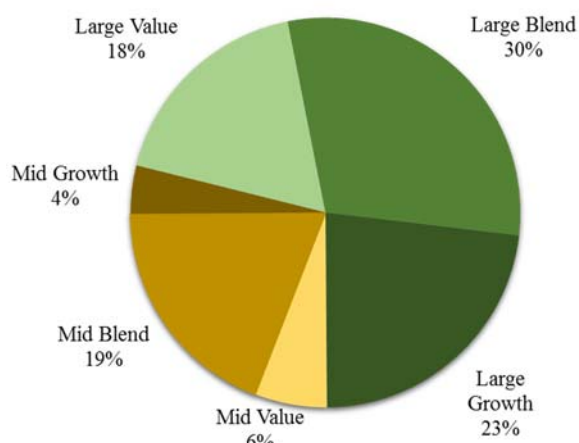
Sector Allocation



Country Allocation



Market Capitalization

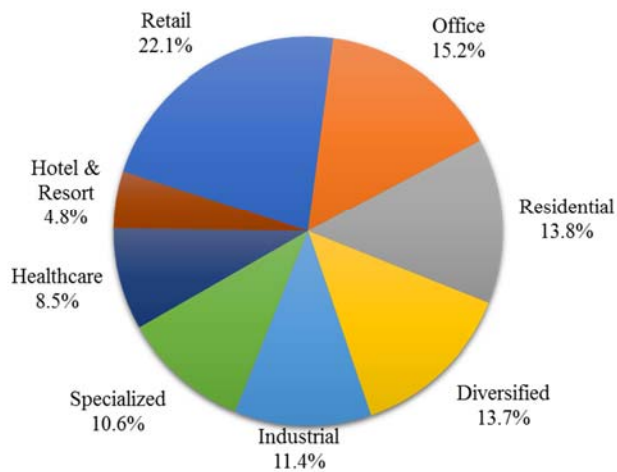


## The S&P Global REIT Index

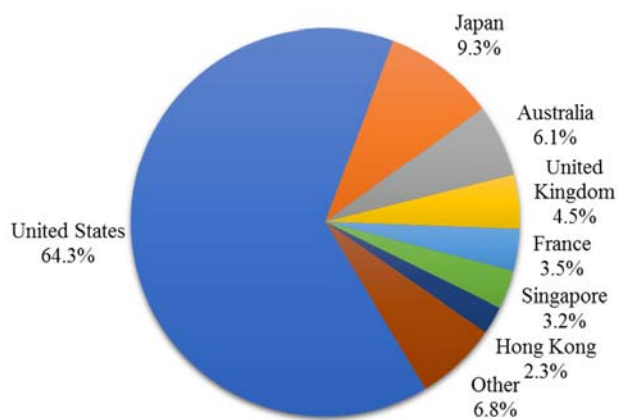
First started in 2000, the S&P Global REIT Index was created to serve as a benchmark of publicly traded equity REITs listed in developed and emerging markets. It is a float-adjusted market cap weighted index composed strictly of equity REITs – securities defined by S&P as conforming to the legal structures that define a real estate investment trust in the U.S., or similar guidelines in the country of their domicile. Timber REITs, mortgage REITs, and mortgage-backed REITs are excluded from consideration. 401 constituents make up this index, ranging in market capitalization from \$45 million to \$50 billion.

The S&P Global REIT Index is considered a sub-index of the S&P Global Property Index, which is comprised of companies that are involved in a broader range of real estate-related activities, such as property management, development, rental, and investment. This index serves as the universe of companies from which the more narrowly focused S&P Global REIT Index draws its constituents. The S&P Global Property Index, along with all its sub-indices, is fully reconstituted each September using end-of-July data and becomes effective at the close of the 3<sup>rd</sup> Friday of September.<sup>2</sup>

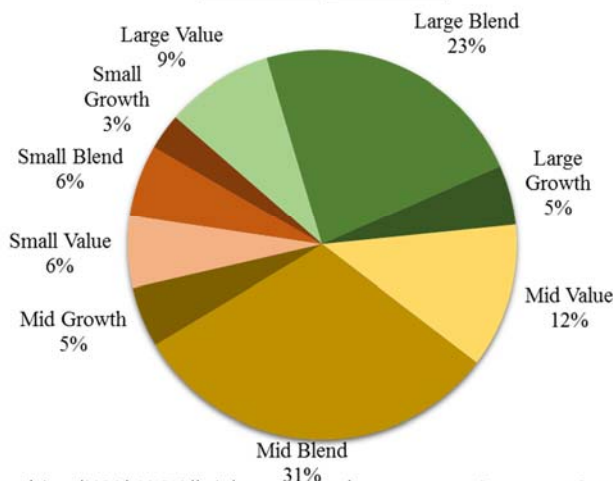
Sector Allocation



Country Allocation



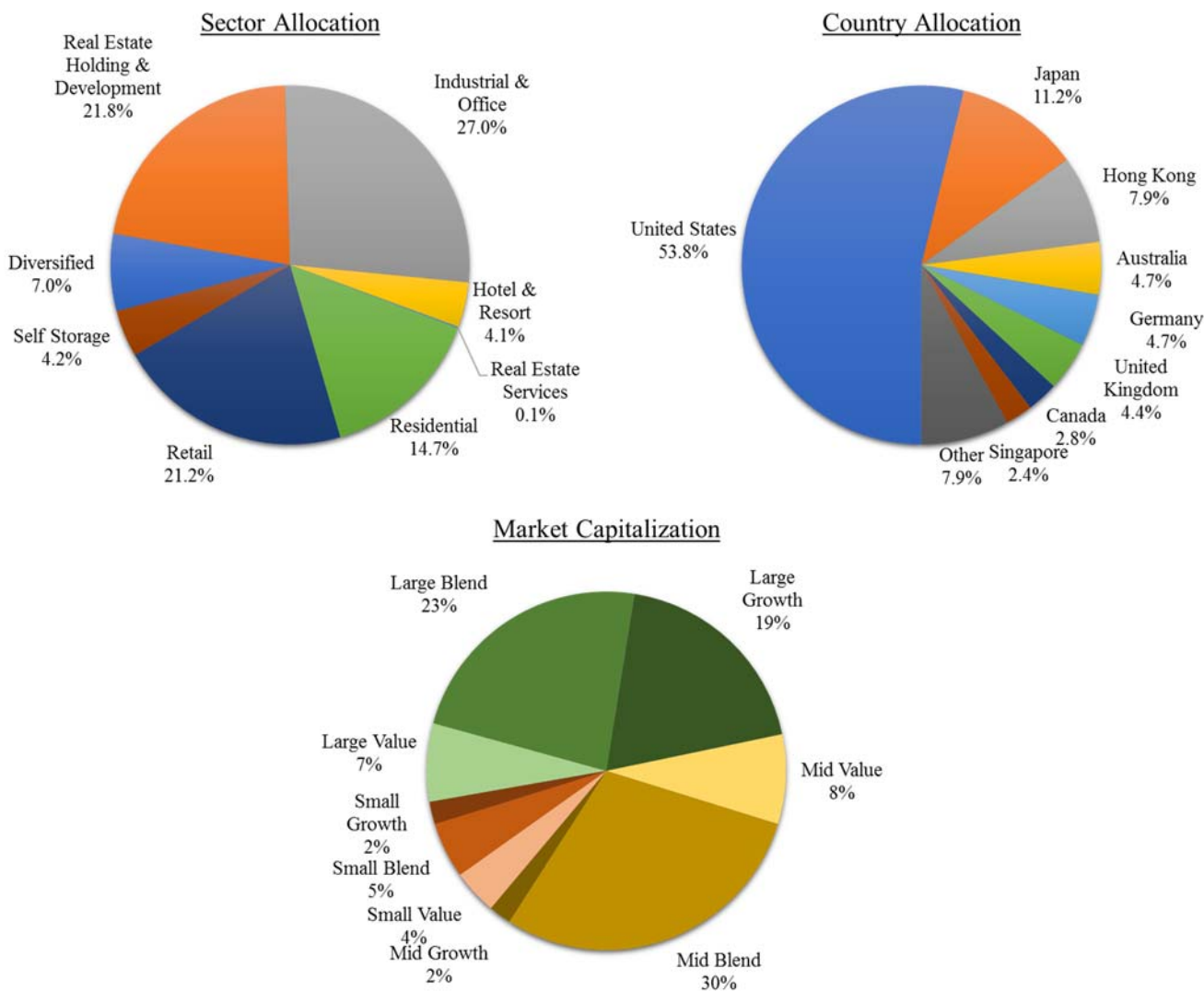
Market Capitalization



### The FTSE EPRA/Nareit Developed Index

The FTSE EPRA Nareit Developed Index was launched in 2005 to track the performance of publicly traded real estate companies and REITs in developed markets. Like the previously mentioned benchmarks, this index is free-float adjusted, and screened by liquidity, size and revenue in order to be investable and replicable in index-tracking strategies. There are 336 constituents in this benchmark at the time of this writing, and they range from \$127 million to \$50 billion in market capitalization.

The FTSE EPRA Nareit Developed Index is designed to represent general trends in eligible listed real estate stocks worldwide. Eligible real estate activities are defined as the ownership, trading and development of income-producing real estate. Real estate financing, property management, commodities storage, infrastructure assets, timberland, outdoor advertising, and revenue from parking lots and parking services are not considered eligible activities. Quarterly review and rebalancing of the index constituents occurs every March, June, September, and December.<sup>3</sup>



## Observations

The differing methodologies that MSCI, Standard & Poor's, & FTSE employ when constructing their indices have produced widely varying returns over short and longer time periods. As the **Performance** tables on page 1 show, *calendar year performance* has differed by as much as 7% per year.

The **S&P Global REIT** index is the oldest (1992 inception) with the largest number of constituents (401) and is reconstituted only once per year. From an *investment exposure* standpoint, it has the most US exposure (64%), has the largest exposure to small caps (15%) and is the only one of the three indices to have emerging markets exposure (2.2%).

The **MSCI World Real Estate** Index was incepted in 1999, has the smallest number of constituents (104) and is *reviewed* quarterly but *reconstituted* only twice per year. This index does not invest in small cap securities or emerging markets. From a performance standpoint, it is the *best performing* of the three, for all trailing time periods except for the trailing 10 years.

The **FTSE EPRA/Nareit Developed** index is diversified with 336 constituents, but eligible constituents are more limited than the other two indices (FTSE *excludes* investments in real estate financing, property management, commodities storage, infrastructure assets, timberland, outdoor advertising and revenues from parking lots and services). This index has the least exposure to the US (53%), no exposure to emerging markets and 11% in small caps. It is reconstituted 4 times per year, each calendar quarter.

The **FTSE EPRA/Nareit Developed** index is the only one of the three indices that does not have a sector allocation to *Specialized REITs* (see *Glossary* on next page). The MSCI World and S&P Global REIT indices have 23% and 10.6% invested in Specialized REITs, respectively.

As performance benchmarks, each index fits its own niche of investment strategy in the global real estate category. Investment mandates can call for different policies when it comes to portfolio management. As investing needs become more specialized, and categories become more tightly defined, it is important to understand the differences between these constraints and how they affect investment performance.

	% US Exposure	% Small Cap Exposure	Largest Sector	%EM Exposure	Style/Size Bias
MSCI World Real Estate Index	61.6%	0.0%	Specialized REIT	0.0%	Large/Blend
S&P Global REIT Index	64.3%	15.0%	Retail	2.2%	Mid/Blend
FTSE EPRA/Nareit Developed Index	53.8%	11.0%	Industrial & Office	0.0%	Mid/Blend

## **Glossary of Terms**

**REIT (Real Estate Investment Trust):** A publicly traded investment company that owns real estate assets such as buildings, land, and real estate securities. REITs are legally required to distribute at least 90% of their taxable income to investors. Income is derived from rents, property management fees, and leasing of the properties in the portfolio.

**REOC (Real Estate Operating Company):** Similar to a REIT, a REOC is a publicly traded investment company that invests in real estate assets. REOCs are more flexible however, in that they may reinvest their income into more properties rather than distribute them to shareholders.

**Free Float Adjusted Market Cap:** A method of calculating market capitalization that excludes locked-in shares, such as those held by company executives and governments.

**Specialized REIT:** A REIT that can invest in properties beyond the framework of traditional REITs, including, but not limited to: data centers, movie theaters, timber companies, racetracks, baseball parks, and golf courses.

**Diversified REIT:** A REIT whose portfolio contains properties in more than one sector. For example, a diversified REIT may invest in retail, hotel, and storage properties.

**Real Estate Holding & Development Company:** A company that engages in activities that range from the renovation and re-lease of existing buildings to the purchase of land and the sale of developed land to others.

## **Bibliography**

- 1.) "Real Estate Indices - MSCI." MSCI.com. Morgan Stanley Capital International, n.d. Web. 19 June 2019. <https://www.msci.com/real-estate-indexes>
- 2.) Dow Jones Real Estate Indices S&P Global Property Indices SCORECARD. 2019. Standard & Poor's
- 3.) "FTSE EPRA Nareit Global Real Estate Index Series." European Public Real Estate Association, National Association of REITs. N.p., n.d. Web. 19 June 2019.