Advice to pension fund essay sample

Business, Marketing

Velculescu (2008) reported that Norwegian Oil Fund (Norwegian Government Pension Fund - NGPF) has agreed to purchase a stake on Regent Street buildings in 2010. Despite the investment was considered beneficial NGPF managers expressed a desire to know if there were other opportunities which could be more liquid. This paper aims at consideration of other possible opportunities for investing NGPF monetary funds in UK property.

In accordance with Velculescu (2008), NGPF prioritized office and retail investment. Target need for these investments is 35% and 30% while actual allocation equals 15% and 10% accordingly. Also, allocation band of NGPF presupposes additional 10% for apartments and industrial property in general asset structure while 5% is allocated for hotel property as well as for other types of property.

As NGPF managers are interested in buy-to-let property market research, the following overview is devoted to the examination of the current tendency in the mentioned property market.

Total wealth fund assets made up $2, 93 billion in 2007 while expected investments in real estate in UK market are 5% ($0, 146 billion). Pension funds usually do not need high level of liquidity. However, for some of them an issue of liquidity is crucial (Inderst, 2009).

Property investment decisions are highly dependent from current investment policy. Usually investors prioritize tax efficient, liquid, transparent investment opportunities with low costs of transaction (Norway Ministry of Finance, 2009).

Pan-European real estate markets had been significantly influenced by the crisis and now they are recovering at different speeds. However, by 2010 they have almost returned to their pre-crisis level. In accordance with RREEF (2011) report, currently London is placed among the outperformers taking into account the attractiveness of current return opportunities.

Real estate market in the United Kingdom is characterized with high liquidity and transparency. One of the most efficient vehicles in UK real estate market is Real Estate Investment Trust (REIT). Using REIT for allocating funds offers several advantages for potential investors, namely: normally REIT possesses several tools for resolving investment issues of the UK market of property being able to widen access to the returns of commercial property; it may also resolve a number of critical issues with regard to distribution, taxation, and structure (eligible activities, level of gearing, asset base maintenance and depreciation, tax treatment, capital gain treatment); using listed REIT is justified for retail investors as REIT is characterized with high flexibility and low level of constraints; REIT can create tax-neutral investment vehicle of property. REIT can provide excellent investment vehicles for investing in infrastructure and sub-sectors, such as new hotels which could be another promising perspective for NGPF (Yermo, 2008).

One of the latest innovative solutions in the sphere of investment vehicles are tax increment financing (TIF). The UK government considers the possibility to implement these vehicles to attract pension funds' investments in infrastructure. TIF can be effectively used for financing the upfront infrastructure through the use of municipal bonds in accordance with USA experience. Besides, TIF as an investment vehicle could be good for development of district areas in order to generate income. TIF have certain advantages, such as the opportunity to generate income using tax-exempt bonds which, in its turn, generates tax-free returns; property owners (i. e. potential investors) could benefit from the opportunity to redevelop funds t the expense of taxes without raising their own taxes; property owners will benefit from development as the property value increases. Possible disadvantages of TIF include irregularity of risk allocation between investors and local bureaucracy (Inderst, 2009).

Guemsey Property Investment Company is a very popular investment vehicle because it listable in UK; offers nil transfer tax; it does not charge UK capital gains tax at property level; it offers high liquidity level; it has no investor restrictions. It is largely challenged by REIT and tax liabilities cannot be fully reduced (Yermo, 2008).

NGPF could invest in private property vehicles. UK real estate market investments are in line with core strategy of NGPF. The Crown Real Estate buildings are considered to be the best alternative while there are other investment opportunities that are not considered profitable since they do not exercise a traditional investing strategy. Besides, investment policy of NGPF aims at diversification of investments. For the optimization of the NGPF real estate portfolio diversification of property types which would correspond with IPD Europe Index is needed.

With regard to the NGPF investment policy and current real estate market analysis, a few findings are to be considered. Returns in the office sector are significantly influenced by the rental growth. RREEF (2011) experts predict that London office sector will be among other outperformers in 2011-2012. Core and value added strategy includes consideration of secondary assets together with secondary markets since they are expected to produce risk-adjusted returns. Value gains for office space are likely to be expected in the medium perspective. The most attractive office space offerings will be among those with limited supply of new objects. While the UK economy almost recovered from the world crisis, the rental prices lower than in pre-crisis period. After final restoration prices are likely to increase and tenants would seek cheaper premises. Therefore, it could be beneficial to purchase office spaces in peripheral district of London by 2013. As regional markets are less exposed to market volatility, they could perform a basement for stable earnings (RREF, 2011).

Retail property market is well-developed in the UK. In 2010 this market outperformed with 15. 8% of annual return. Prime returns of UK (London) shopping centers' are anticipated in 2014. However, retailers are influenced by operating in a highly competitive environment and consumers' resistance against price increase. They would likely close non-performing stores for not being able to pay high rent. This tendency could negatively impact the demand for retail space. Thus, returns from retail property could decrease accordingly (RREF, 2011).

Demand for office and retail property is significantly influenced by the world megatrends. The development of advanced technologies will stimulate changing the concept of working place and reduction of working space per worker. Obviously, store portfolios will be reduced and retailers would likely change their preferences in favor of moderate-priced premises. Continuing urbanization will favor growing demand for office space and apartments.

Growth of online sales in retail sector will negatively impact rent growth and force rationalization of store portfolios. Also, investors will have to change retail locations attractiveness in order to satisfy renewed retailers' demand. Also, demand for office spaces and retail stores will be influenced by availability of skillful labor force, adaption of working places to the needs of older workforce and ageing customers. It is quite possible that Asian countries will take the lead over European countries in attracting skillful workforce. Therefore, investing in Asian property is seen as a challenging perspective taking into account long-term orientation of NGPF investment. Workspaces have to be adapted to the ageing European workforce needs. Thus, investors and property owners should consider these tendencies in order to develop an appropriate farseeing investment strategy (RREF, 2011).

The Crown Real Estate buildings belong to a retail sector of commercial property. Investing in this sector will stay profit-making in the near perspective (10-25 years). Therewith, there is a tendency of UK commercial property depreciation and ageing (The Crown Estate, 2011).
Buying a stake in a lease on Regent Street buildings for a relatively short-term period of approximately 10-25 years is a good idea. The leasing period of Regent Street buildings is 150 years under the terms of the contract that seems to be a short-sighted proceeding. RREEF (2011) research revealed the tendency to office use shortening and retailers' shift to the Internet commerce. Thus, the NGPF investment portfolio should be diversified in accordance with UK real estate market trends in the long run. However, such a strategy is supposed to be in line with the core and value-added strategies of NGPF.

Core and value-added strategies include consideration of secondary markets and secondary assets as they could provide attractive and risk-adjusted returns. Accordingly to medium term prognosis office space demand is to increase stimulated with limited new supply.

On the other hand H2-Solutions experts advise investing in infrastructure that is the most recent trend in investing. Along with traditional approaches there are several alternative suggestions regarding allocation of assets. Thus, McCormick (2009) offered quite different approach to the asset allocation process which included operating within wide ranges of asset allocation, tracing the changes within asset classes, looking for value added class of assets, implementation of a new approach for the asset diversification, disregard of cultural biases concerning merits of investments, utilization of maximum of available vehicles to collect many opinions, extrapolation of merger of asset mix and economic scenarios, consideration of the role of impulse and sentiment targeting asset (McCormick, 2009).

Inderst (2009) offered a research of a new opportunity for pension funds of investing in infrastructure. This is a good opportunity for those funds which strive to diversify investments. Infrastructure offers an opportunity for a long-term investment, thus it fits with long-term liabilities of pension plans. In addition, it represents a socially responsible investing which is supported both by industrial and public pension plans. Inderst (2009) applied to a global experience where global listed infrastructure average annual return made up 12. 8% in 2006. To compare, the returns of global equities total 9.

2%. Listed infrastructure in Europe produces 20. 3% of annual return with risk rate of 13. 7% while European property returns 16% (Linton, 2011).

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