

# NCREIF Open-End Fund Property Index

Jeff Fisher, Indiana University and NCREIF Consulting Director of Research & Technology

Neil Myer, The Townsend Group and Cleveland State University

Brian Webb, UBS Realty Investors LLC

## Introduction

The NCREIF Property Index (NPI) was originally designed to measure the general return characteristics of core, unleveraged property in the United States. It is now being used to a greater extent as a benchmark for manager and individual fund performance, with fees and performance bonuses sometimes being determined by this comparison. The difference in the procedures and timing of valuations of specific funds, compared to the aggregate procedures and timing of valuations reflected in the NPI, becomes critical when market conditions are reversing direction and/or changing rapidly.

A reasonable benchmark for evaluating quarter by quarter performance should obviously reflect the same valuation procedures and timing as the fund whose relative performance is being measured. The properties in the NPI are held by 67 different managers in a combination of open-end funds, closed-end funds and separate accounts. Open-end funds generally value their properties each quarter, and an appropriate benchmark for these funds should only include properties that are valued each quarter. Properties in closed-end funds and separate accounts are more typically valued once a year, and an appropriate benchmark for evaluating quarter by quarter performance should ideally include only properties that are valued on the same frequency (and at the same point in time) as properties in the fund being examined.

For the last few years, NCREIF has collected data on the fund that each property in the NPI is held within, and now has the ability to construct an index of properties exclusively in funds of a given type. This information can be used to construct indices that should improve the benchmarking for the various types of funds. This article introduces the NCREIF Open-End Fund Property Index, the most flexible of the fund type, property level indexes given that valuation frequency is greatest for open-end funds. This index will be produced and available in the *NCREIF Real Estate Performance Report* starting in the first quarter of 2002.

## NCREIF Open-End Fund Property Index

NCREIF identified the following open-end funds as currently having properties in the NPI. The 899 properties reported to NCREIF that are held within open-end funds comprise approximately 26% of the properties in the NPI, and 27% of the value. Open-end funds were an even larger component of the NPI in the early years of the index.

It is important to note that properties in open-end funds need to be reasonably valued every quarter, since quarterly transactions (deposits and withdrawals) are allowed within these accounts based on the appraised values of the properties in the fund. Properties in closed-end funds and separate accounts are often valued less frequently as they do not have to support quarterly fund-level transactions.

Exhibit 2 compares the average number of quarters between reported value changes of properties in open-end funds compared to properties in closed-end funds and separate accounts. In Exhibit 2, values are considered to change from one quarter to the next if the value was supported by a third party, independent appraisal, or if there is a reported value change that is different than the amount of capital improvements during the quarter by 0.1% or more. A change in value due solely to capital improvements is presumed to be an accounting motivation for a change in value that needs to be validated by an independent appraisal of value. Note that even though properties in open-end funds have the need for quarterly valuations, not all properties report a value change each quarter. Particularly in times of stable real estate markets, and/or for properties with consistent rent rolls in place from one quarter to the next, discernable changes in value may not be evident.

The lead article in this publication last quarter described how the frequency of valuations is the primary issue that explains why the NCREIF Property Index (NPI) is slow in recognizing the impact on returns of changes in real estate market conditions - both positive and negative. For example, last quarter only 32% of the properties in the

**Exhibit 1 – Open-End Funds in the NPI**

Manager	FundName	Properties
American Ventures Realty Adv.	American Ventures Property Fund, LP	4
Clarion Partners	Lion Fund	11
Henderson Global Investors	US Property Fund	25
J P Morgan Fleming Asset Management	Special Situation Property Fund	38
J P Morgan Fleming Asset Management	Strategic Property Fund	83
Kennedy Associates Real Estate Counsel	Multi-Employer Property Trust	111
Lend Lease Real Estate Investments	Prime Property Fund	88
Principal Capital Real Estate Investors	RESA	142
Prudential Real Estate Investors	PRISA	179
Prudential Real Estate Investors	PRISA II	82
RREEF	RREEF America REIT II	37
Sentinel Real Estate Corporation	Sentinel Real Estate Fund	85
SSR Realty Advisors	Tower Fund	53
TimesSquare Capital Mgt.	Charter Open-End Real Estate Fund	62
UBS Realty Investors	PMSA	36
UBS Realty Investors	RESA	103
Washington Capital Management	Washington Capital Real Estate Equity Fund	6

NPI reflected value changes at a time when the economy was officially declared to be in recession, two of the highest profile buildings in the world were destroyed by terrorists, and real estate market fundamentals weakened considerably. A higher percentage of properties are typically valued in the fourth quarter, and 53% of properties in the NPI recorded value changes this quarter. The -1.3% appreciation of the NPI in the fourth quarter, compared to the -.48% appreciation in the third quarter, to a large extent reflects the greater percentage of properties revalued in the fourth quarter.

All things equal, an index based on properties in open-end funds should lead the NPI, and more closely reflect underlying market conditions over time given the greater frequency of valuations of this subset of properties.

Exhibit 3 shows that the NCREIF Open-End Fund Property Index started reflecting weakening real estate market fundamentals in the second quarter of 2001, and recorded greater write-downs in each of the third and fourth quarters than the overall NPI.

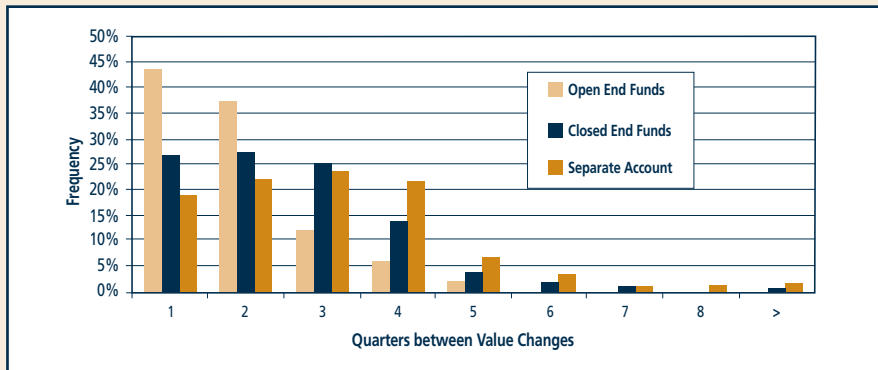
It is possible that these differences in write-downs could be attributed to differences in the types of properties in the Open-End Fund Property Index compared to the NPI. The following charts (bottom right) present the property type and geographic region compositions of properties in the Open-End Fund Property Index compared to the NPI.

As can be seen from the charts the property type and regional diversifications are nearly identical. The largest differences are a slightly higher concentration for the NPI in the office property type and the west region. Regional and property type differences would not seem to be a likely source for differences in performance. A more thorough analysis of the make-up, history and return characteristics of the Open-End Fund Property Index is forthcoming in *Real Estate Finance* and will be made available on the NCREIF web site.

**Conclusion**

The use of the NPI as a benchmark for different types of funds with different valuation frequencies is particularly problematic during periods where valuation changes are significant and/or reversing direction. In response to the real estate industries desire for better benchmarks, NCREIF is constructing the NCREIF Open-End Fund Property Index that should, at the very least, be a better benchmark for open-end funds. Given that properties in the Open-End Fund Property Index are valued more frequently than properties in other types of funds, this index provides the flexibility to generate custom benchmarks that mimic the valuation frequency of other funds, whether annual or otherwise.

**Exhibit 2 –  
Time Between Value Changes for Properties in Different Types of Funds**



**Exhibit 3 –  
2001 Appreciation Returns**

