Inbeeld

BOUWINVEST MAGAZINE
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10

‘Success starts with a clear focus on the final goal’

Bouwinvest

Foreword

Looking back at 2013, we can see that the market is starting to recover, and this is also evident from the interest being shown by investors in real estate. At the end of last year, we signed a contract with the first new investor in the Residential Fund, the Rabobank Pension Fund.

In terms of timing, the situation is also favourable. Last year, we signed contracts for € 800 million of investments - four times as much as in previous years - of which € 400 million was invested in the Netherlands. It's becoming increasingly clear that it's a good time to step into the market. Diversification is one of the major advantages of investing in real estate. The IVBN has done research into the diversification effect of Dutch residential properties on the real estate portfolio. The report will be published within the next few months.

International investments also provide diversification within the portfolio, and the returns realised outside the Netherlands have been significantly higher than in the Netherlands. Nevertheless, it's essential to weigh all the aspects involved. Although higher returns can be realised outside the Netherlands, such investments also involve higher costs and risks.

In 2014, we again expect to realise a high investment volume. We will also explore opportunities in the Dutch healthcare property sector and take further steps in the direction of sustainability. We will also be closely monitoring the various markets with our Global Market Monitor. Some are starting to become overheated, which can result in increased procyclical risk.

Many players will also be wondering whether they will receive their AIFMD licence in July 2014. We've taken all the necessary steps and look towards the future with a great deal of confidence!

Dick van Hal, CEO

Colofon

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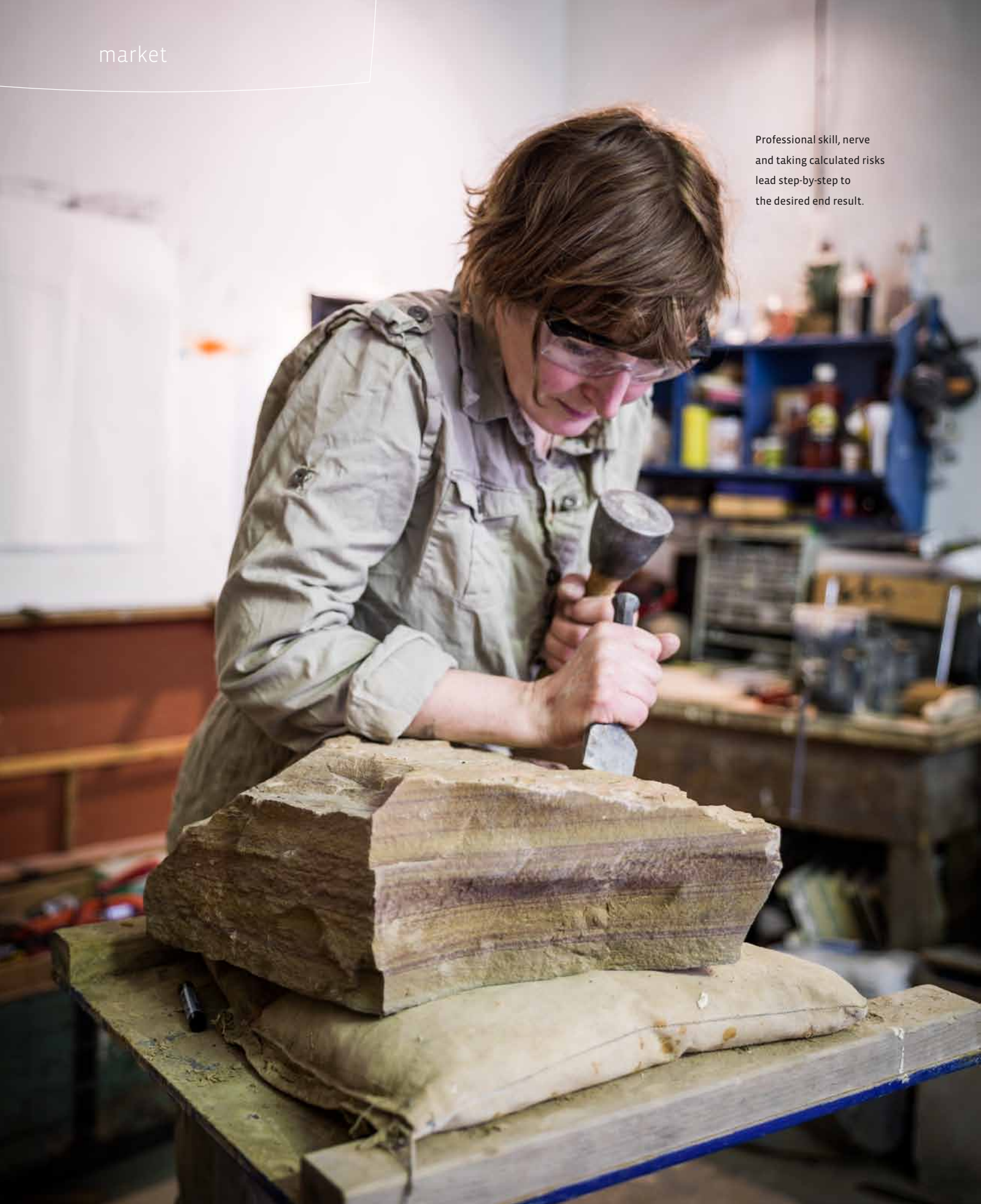
'Investors have to remain flexible and target areas offering the best opportunities'

4 ▪ Risk-based allocation

Trends in diversification within the real estate sector

Analysts at Bouwinvest give us their perspective on diversification trends in the real estate sector. Investors are looking for higher returns but are carefully weighing the alternatives and risks.



Professional skill, nerve and taking calculated risks lead step-by-step to the desired end result.

TRENDS IN DIVERSIFICATION WITHIN THE REAL ESTATE SECTOR

Risk-based allocation

Nothing was or is risk-free. That is the simple lesson we can learn from the financial crisis. Diversification is necessary, not only in asset categories but also within these categories, in order to limit the risk contained in the investment portfolio. With the drastic corrections of the recent crisis still fresh in everyone's memory, it is no surprise that a very strong aversion to risk has taken hold of most investors and resulted in a strong focus being placed on core real estate.

Friso Berghuis and Leender Massier

At present, this aversion to risk is gradually starting to fade, and there is increasing demand for a somewhat higher risk-yield profile (core-plus and value added). In the first place, investors are being forced in this direction due to the relative scarcity and resulting high price of the core real estate being offered for investment. In the second place, investors are being driven by the need to realise higher yields in the present low-interest-rate environment. But investors are also making much greater efforts than they did in the past to weigh risk against yield. They are also investing more time and energy in carrying out a thorough due diligence analysis of the investment case. As a result of increasing transparency, the international market for real estate investments

is expanding, and this provides more opportunities for risk diversification. The market is also becoming broader due to the emergence of new categories of real estate such as healthcare properties, datawarehouses, student housing, and infrastructure.

Focus on risk

A trend that is clearly emerging is risk-based allocation. The idea here is to first identify the risks involved and to then use this information as a starting point for constructing the optimum portfolio. This approach aims to realise the same yield at lower levels of volatility and risk or to realise improved yields at the same levels of volatility and risk.

‘Sometimes it’s appropriate to invest in listed real estate’

Over the most recent period, investors have been very averse to risk. Within Europe, the focus was primarily on core real estate in safe real estate locations such as London and Paris. However, due to the increasing interest shown by investors, the prices of core real estate have gone up sharply as have the risks associated with their future value. Core real estate generally refers to properties at top locations with very low vacancy rates, financially solid tenants, and relatively long-term rental contracts. The guaranteed flow of future rental revenue is already largely discounted in the present price of the property. The high price paid for such properties does not leave much room for a further increase in their value via optimisation of rental revenue or for a further adjustment of the yield demanded in the investment market.

The real estate market in London is a core market, but some comments are in order here. The market is very liquid, and this is an advantage for many investors. The other side of the coin is that volatility is also quite high. As became apparent during the crisis, the value of investments can fluctuate very strongly over a short time period. This is a risk that is still underestimated. In times of stress, liquidity can dry up very quickly. In this market, you have greater certainty that you will be able to sell, but the right timing is essential. Otherwise, the entire investment case falls apart. The volumes traded in a market such as London are higher, which means that prices can also be more volatile. Due in part to its liquidity, in combination with the attractiveness of this metropolis, investors are willing to invest here for relatively low rates of return.

Other categories

Investors are now also turning their attention to core plus and value added properties that fall outside the prime segment but still represent a good product. There is a greater focus on properties that either have a good location or that have attractive tenants and rental contracts. An example is the Atrium on the Zuidas in Amsterdam. The occupancy rate for this building is a bit lower than for the surrounding objects, but the property is attractive from a long-term perspective due to the excellent location. Investors are now looking for this type of product-market combination, as it offers higher yields in the medium to long term. Investors are looking for new opportunities and for properties that have potential but come with acceptable levels of risk.

Investors can choose from a great many objects within the real estate investment category, and it is therefore very important for them to clearly define their limiting conditions. It’s not the allocation of capital to real estate that determines the risk, but rather the limiting conditions that are set out beforehand for allocation to real estate. You can, for example, decide to invest in real estate loans, but do you categorise these as a type of bond or as real estate? And what about listed real estate: is that categorised as an investment in shares or in real estate? The answer depends upon various factors such as the investor’s approach towards investing, his investment horizon, his need for liquidity, and his aversion to volatility or risk.

From the perspective of portfolio diversification, investing in unlisted real estate is a good choice as the correlation with the share market is quite low. However, the availability of a product can also play an important role. It can sometimes be a good idea to invest in specific regions and sectors via listed real estate due to its availability or attractive valuation level. For example, the top segment of the large-scale regional shopping centres in the US is held by publicly traded parties. Exposure to this type of property is therefore almost only possible via listed real estate shares.

Globally, the real estate investment market has become a full-fledged asset category. Over the last years, the market for investing in real estate has expanded due to its increased global transparency. The quality and frequency of valuations are increasing, and an increasing number of countries are being seen as transparent. Parties can now choose from a greater number of markets and can pick their investments to comply with their limiting conditions. Real estate remains a category of tangible assets that generates stable revenue flows and fit in very well with a long-term investment horizon.

International investors

Real estate is inherently late-cyclical in nature. In recent years, various Dutch real estate sectors have delivered subpar performances, but it looks like the market is now bottoming out. International capital flows are again moving in the direction of real estate, as is also evident from various reports. Large amounts of capital are becoming available via the issuance or flotation of shares. However, investors have become much more aware of the risks involved and are very cautious when it comes to making use of debt capital. More products are now also being offered in the form of funds and other low-leverage

propositions. This is in part due to the fact that financiers have become more conservative and can no longer obtain high levels of leverage. In this respect, the crisis has had a salutary effect and resulted in a turning point. Before the crisis, a great deal of leverage was invested in opportunistic propositions. That is no longer the case.

‘Investors are looking for new opportunities, for real estate that offers potential rewards but at acceptable risks’

Investors are also taking a different view towards correlations between different asset categories. Risk cannot be completely eliminated via diversification, but an increase in the quantity of real estate available internationally does make it easier to diversify. However, it should be noted that international diversification does not automatically lead to risk reduction. Diversification over office buildings in New York, London and Singapore that all have tenants from the same sector, e.g. the financial sector, offers only a limited benefit in terms of diversification.

American (private equity) investors, who are often more opportunistic than institutional investors and tend to lead the cycle, are now targeting Europe. In part, this is due to the limited opportunities available in their own real estate investment market. The American economy has been showing signs of a strong recovery for some time now, and this also influences the real estate market. The positive developments in the consumer market have already been largely discounted in the investment market. With the prospect of interest rate normalisation in the near future, further increases in valuation would seem to be possible only on the basis of rental income growth. Accordingly, investors who tend to take the lead see more opportunities in Europe, where the shortage of liquidity in the market and the dried-up development pipeline offer opportunities. In particular, markets which, as a result of the correction, are now priced at historically attractive levels are seen as sources of opportunity.

Interest rates

The big question for the coming period is whether we will be dealing with a deflation or inflation scenario and whether, as a result, interest rates will remain low or return to normal levels or spike up to substantially higher levels. Changes in interest rates are always projected to have an impact on real estate, and rising interest rates are assumed to be bad for real estate. This is true up to a point. On the other hand, the leverage in the real estate sector has been reduced, which means that the level of risk has also been reduced. In addition, inflation and higher interest rates are often the result of robust economic growth, and that in turn is positive for real estate.

The composition of the optimum real estate portfolio differs per (institutional) investor and depends in large part on the role played by liquidity and the need for liquidity. Liquidity differs per real estate sector and per region and over time. Investors should therefore start by setting out clear goals for the allocation of capital to real estate. Investing in real estate also requires thorough preparation and planning, whereby the goal needs to be made clear and all the necessary steps must be worked out beforehand.

Friso Berghuis has been working for Bouwinvest since 2010 as a strategic investment analyst. Leender Massier has been working for Bouwinvest since 2012 as a market analyst.

GLOBAL DIVERSIFICATION IN REAL ESTATE

Limiting conditions determine the risk

At the beginning of the 20th century, the explorers Amundsen and Scott were engaged in an intense competition to become the first person to reach the South Pole. Although the weather conditions were the same for both of them, the results of their efforts were quite different. Amundsen was the first to plant his flag at the South Pole and survived the expedition. Scott reached the South Pole two weeks later, but he and his team found a tragic death on their way back.

Amundsen's success was not a matter of chance. In his view, luck simply did not exist, and he left nothing to chance. Accordingly, he prepared meticulously for the entire expedition and always kept his eye on the final goal. According to Friso Berghuis, strategic investment analyst at Bouwinvest, and Leender Massier, market analyst at Bouwinvest, investing in real estate demands as thorough a preparation and planning as that of Amundsen. The goal must be quite clear, and all the steps must be worked out in detail beforehand. There are an enormous number of choices available within the real estate investment category, and it's essential for investors to set out clear and transparent limiting conditions. According to both Friso and Leender, it's not the allocation of capital to real estate that determines the risk, but rather the limiting conditions that are set out beforehand for allocation to real estate.

Strategy

As Berghuis explains, "Bouwinvest diversifies globally in real estate. In doing so, it looks at investment markets that meet the conditions

set out beforehand, for example on transparency and corruption. The results of the research carried out are matched against the available spectrum of real estate investments, such as listed or unlisted and direct or indirect investments, club deals, joint ventures, fund investments etc. We invest in core real estate and aim for a portfolio with a low risk profile. On an international level, we have only limited exposure to developing countries and projects that entail a greater level of risk."

'You either try to stay ahead of the pack, or else you try going in the other direction'

Market monitor

With the help of the Global Market Monitor, a tool developed in-house by Bouwinvest Research, all potential real estate investment markets are monitored. At least twice a year and, when sufficient data is available, once every quarter, the most recent data on market expectations is fed into the monitor. "The monitor can quantify the level of attractiveness of different countries and real estate markets all over the world," according to Massier. "It does so based on a large number of indicators. By comparing markets to each other for each indicator and weighing the individual scores, one arrives at an overall score which gives us insight into how the markets are positioned relative to each other on a global level. This makes it possible for us to discuss, in a reasoned and logical manner, whether or not to invest in a specific market."

When formulating investment strategy, consideration is also given to the size of the various markets and how liquid they are. What kind of risks do we wish to run? Greater liquidity generally implies greater volatility. We also look at gaps in the portfolio, in other words what kinds of investments need to be done via funds or structured real estate products for the purpose of diversification? When making such decisions, we also consider whether the timing is right."

Exposure

Once a decision is taken to invest in a specific market, it becomes a question of how it can best be done. "In the Netherlands, we invest directly in real estate, and outside the Netherlands we invest in real estate funds, joint ventures, or listed real estate. Our International Investments business unit considers various aspects such as what our yield targets are and what kinds of risks we are willing to take to realise these targets. These analyses are carried out successively for various sectors and regions in order to arrive at the desired target portfolio. Based on the present conditions in the market, we then consider how we can realise this in a responsible fashion and at what needs to be added to the portfolio for that purpose."

New categories

According to Berghuis, real estate is potentially a larger asset class than shares or bonds. Whereas in the past real estate was viewed as an alternative investment, it has been considered a mature asset class for some time now. In addition, the market is continuing to grow and new categories are still being added.

One of these potential new categories is healthcare property. "We are presently researching the market for healthcare properties. It is still not yet completely clear to what extent the healthcare property market is ready to be treated as an investment category. There is still a mismatch between users and investors, as they each speak a different language, but there is no longer any doubt that a demand for healthcare property does exist."

Since 2010, Bouwinvest has also had a Hotel Fund. "An investment in a hotel is sometimes thought of as being comparable to an investment in office space, but there are significant differences in terms of investment profile," explains Massier. "In many cases, the contracts entered into with hotel operators have terms of 20 to 25 years. Compared to office space, it's even more important

for a hotel operator to ensure that the hotel has an excellent location and is easily marketable. As long as the right hotel chains are chosen and the type of hotel contract entered into is also appropriate, a hotel investment can generate a stable and long-term revenue stream. This is very much in line with the characteristics of a pension fund."

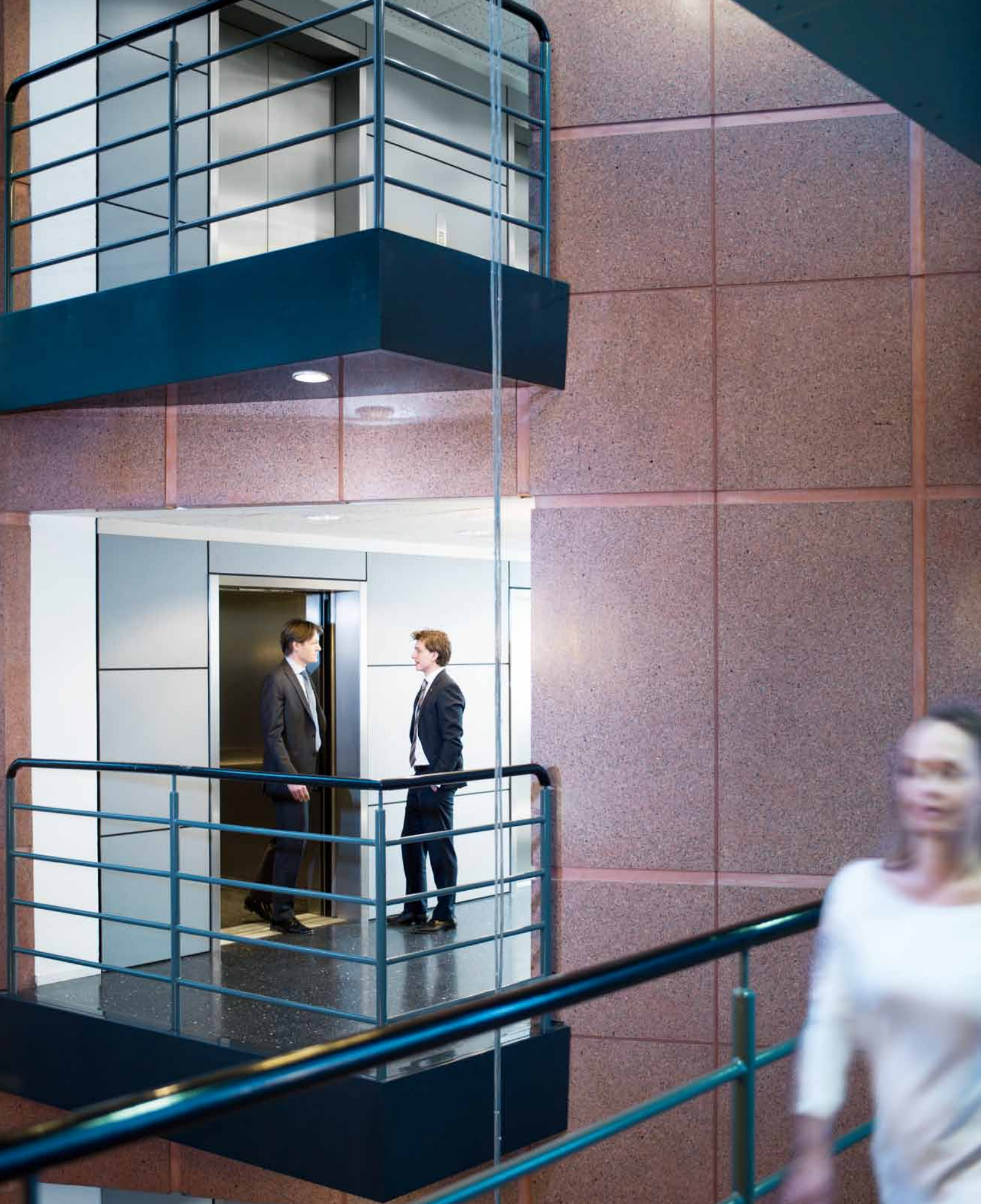
International diversification

The Netherlands has accumulated an enormous amount of pension savings compared to other countries, and these assets cannot be invested in the Netherlands alone. Bouwinvest invests indirectly in the international market, says Berghuis "Last year, for example, we invested in a logistics fund. After the earthquake, the logistics centres in Japan were rebuilt in accordance with new regulations in order to ensure that they would be better able to resist earthquakes. This resulted in the development of new state-of-the-art logistics centres that are earthquake-resistant. It also provided us with interesting opportunities to invest in the best products at the best locations."

Society is exerting pressure on pension funds to invest in mortgages. Berghuis replies, "It's up to the pension funds themselves to decide whether or not they wish to do so, but first they need to set out clear and transparent frameworks. Do they view such investments as bonds or more as real estate, in the form of collateralised asset- or mortgage-backed securities? Once that is clear, you can make further subdivisions within the compartments. You can look at inflation linked bonds or at real estate as an inflation hedge. There is of course a reason why we are overweight in residential properties – rental prices are indexed annually. The same does not always apply directly to the value of the property, but in the long term, that will also increase as a result of active portfolio management."

Whereas a year ago attention was focused primarily on core real estate as a safe haven, investors are now again looking around for new opportunities. Berghuis: "Internationally, we operate with very little leverage. Due to the high level of demand, the initial yields for core real estate are so low that the downside risk is greater than the upside one. Secondary real estate is not opportunistic, but you do need to find the right balance. You either try to stay ahead of the pack, or else you try going in the other direction."

Sculptress Ingrid Rekers in cooperation with Dirk Lansink Dodero



“Investing in real estate demands meticulous preparation”

FRISO BERGHUIS, STRATEGIC INVESTMENT ANALYST AT BOUWINVEST

LEENDER MASSIER, MARKET ANALYST AT BOUWINVEST

AN ALTERNATIVE APPROACH TO INVESTING IN REAL ESTATE

DIVERSIFICATION OF CAPITAL STRUCTURE

Richard Urban, Head of Real Estate Investment at Cardano

In recent years, many investors in real estate felt like they were in for a ride on a roller coaster with a great many ups and downs, and this feeling also influenced investor behaviour. Fear is a very important driver, and the volatility experienced over the last two years has led most investors to go looking for a safe haven, a haven which they found in core real estate. This sector of the market consists of properties with a desirable location that are effectively let via long-term contracts that provide a stable return on investment. This is the type of real estate investment preferred by institutional investors, but its low risk profile also means that the return is also rather low.

We do not have any fixed allocation in terms of real estate categories and are convinced that we can also realise returns of 5% to 6% in other investment categories that are much more liquid such as bonds or stocks. Accordingly, we focus our efforts on finding higher rates of return in real estate because we want compensation for the lack of liquidity inherent in real estate.

When investing for clients, we focus on high-yield strategies. This involves diversification, by which we mean diversification not only in terms of geography and sectors but also in terms of capital structure. As a result, we look for opportunities in areas such as real estate loans, real estate structured products and global investments in opportunistic bricks and mortar. In doing so, we also take into account the various phases in the real estate cycle. Over the last five years, our primary focus has been on the debt side of the market.

In 2008, we made our first alternative investments in mortgage-backed securities, often simply referred to as MBS. The fall of Lehman Brothers led to a great deal of fear and uncertainty in the market with regard to toxic loans and MBS, which in turn created new opportunities. A great many loans and MBS really were toxic, and there was very little chance that these would ever

be repaid, but there were also a great many that were a good investment and that were being sold at too low a price simply due to the general atmosphere of fear and uncertainty. Our focus then was on purchasing bonds that were priced too low but which we expected to end up being repaid. These could be purchased for a fraction of their nominal price, and they ended up paying back significantly more than their purchase price.

We then also started investing in 'non-performing loans', i.e. loans whereby the debtor is in financial difficulties and can therefore not comply with the terms of the loan. Many loans also became non-compliant due to a steep fall in the value of the underlying property, as a result of which the ratio between the loan and the value of the underlying security, i.e. the loan-to-value ratio or LTV, became too high. Via an additional injection of capital, the owner of the property could satisfy the bank, but that is no easy matter in times of crisis. This, however, did create additional opportunities for investors.

In the same way that we were able to profit from cheaply priced MBS, we were also able to purchase discounted loans for less than their nominal value. The important thing here is to ensure that the loan is secured by a property worth more than the purchase price. By purchasing such loans from local and regional banks before other parties become aware of them or a public auction takes place, it's possible to avoid a situation in which several players end up competing for the same loans, thereby driving up the price.

When we purchase a loan portfolio, it's not always our aim to acquire each individual underlying property. However, it does give us the opportunity to negotiate with the mortgagor regarding a solution. Such a solution can take various forms. Sometimes, part of the debt is simply paid to us, which resolves the matter then and there. After all, we purchased the loan at a discounted price and are still benefiting from it, whereas the mortgagor also gets a certain amount of 'debt relief.' If the tenant does not wish to cooperate, the tenant can return the key to the property and be done with it. This avoids a legal battle and gives us a building that we can sell more quickly.

We have also purchased loans with the intention of acquiring the underlying property in order to redevelop it – the so-called loan to own strategy – in which case we are not actually interested in finding a solution. In addition to existing properties, we've gone a step further and also focused on purchasing large-scale non-compliant construction loans. Take, for example, a hotel developer that goes into bankruptcy after the hotel is only half finished. The bank ends up with a half-finished building and a loan of $80 million to the bankrupt developer. That's a bad scenario for the bank, as there's not much of a market for a building that is only half finished. Assisted by fund managers with knowledge of real estate development and financial expertise, we acquired the building in order to complete its construction and development. This is a very difficult market sector with a high entry barrier, but it does offer opportunities for high returns.

RICHARD URBAN

Richard Urban has been Head of Real Estate Investment at Cardano since October 2008. He focuses on analysing and selecting real estate investments for Cardano's clients. Before joining Cardano, Urban was a member of the real estate finance team at CB Richard Ellis. Prior to that, he worked for Moody's, where he was a member of the Commercial Mortgage Backed Securities (CMBS) team and responsible for evaluating CMBS transactions. Urban has also worked as an assessor for GVA consultants and was a member of the investment team of SEGRO, a publicly listed British real estate fund.

Much of our strategy is based on value creation. We look for buildings and properties that are less attractive but where we can create added value using our specific knowledge and expertise. Our aim is to buy in a market that nobody is looking at and to sell in a market that everyone is looking at. So you could say that we adopt a contrarian market strategy or that we aim to make sure that we stay a bit ahead of the market.

Everything we do is focused on 'risk adjusted returns.' We wish to be compensated for the risks we run in the activities we take. We buy at the bottom of the cycle for a discounted price, which means that the downwards risk is fairly low. In addition, when investing in MBS we mostly purchase senior bonds with a very low risk of non-payment. All the other bonds must first go under before we get hurt, which means that our position is very well protected.

Pension funds take a cautious approach to these markets, largely due to their lack of understanding of and familiarity with such markets. This lack of understanding, in particular, is a major barrier. The markets involved are extremely complex, making it very difficult for non-specialists to act. Very few people feel really comfortable in this world, but complexity does not always mean additional risk. You simply need to have a good understanding of the market. And of course there's also the fear factor. After all, the crisis started with complex products and pension funds have gone through difficult times over the last five years when it comes to real estate, so the last thing they want to do is invest in complex products.

Looking towards the future, it's important for investors to remain flexible and target areas offering the best opportunities. Such opportunities may lie in a specific sector or geographic area, but they can also depend upon the capital structure. In identifying areas with the best opportunities, it's also important to take the current phase of the cycle into account. In addition to being flexible, you also need to have the knowledge and experience to diversify in terms of capital structure. And if you don't have this type of experience yourself, it's best to look for an advisor who does and who can identify the opportunities for you.

Over the last five years, we have focused largely on the debt market, but over the past 18 months we started investing into bricks and mortar in the British market. In a fast-growing market, it's not wise to be invested only in debt. When the market is on the upswing, bricks and mortar also offer opportunities.

CARDANO

Cardano was established in 2000 by Theo Kocken. The company provides support to institutional investors, primarily European pension funds, in realising their strategic goals by offering customised solutions in the area of Solvency Management and Risk Management.

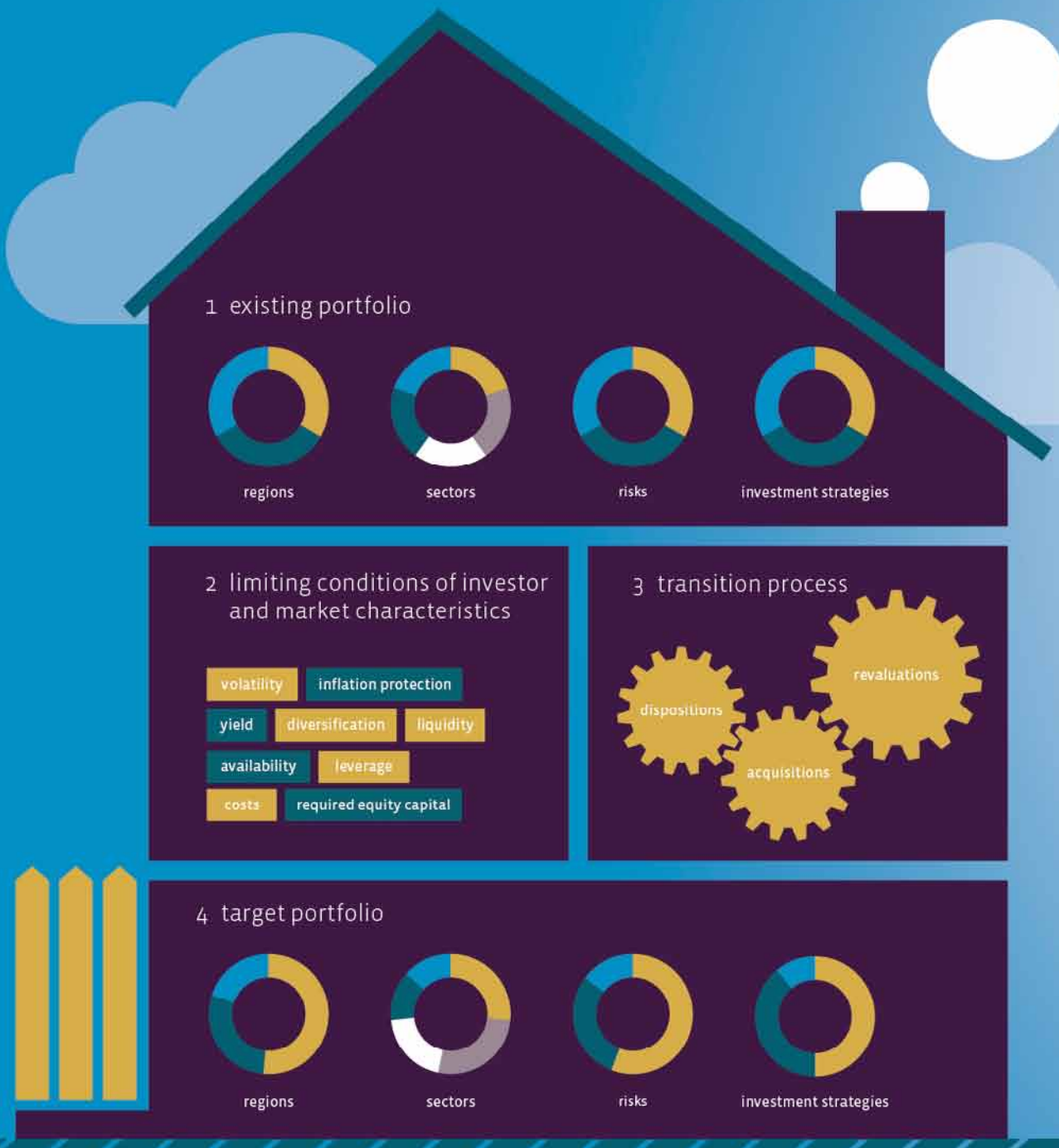
In 2007, Kerrin Rosenberg established Cardano UK. The company now employs over 120 professionals and has branches in Rotterdam, Amsterdam and London. Over the last several years, the company has experienced rapid growth in terms of turnover, clients, and headcount.

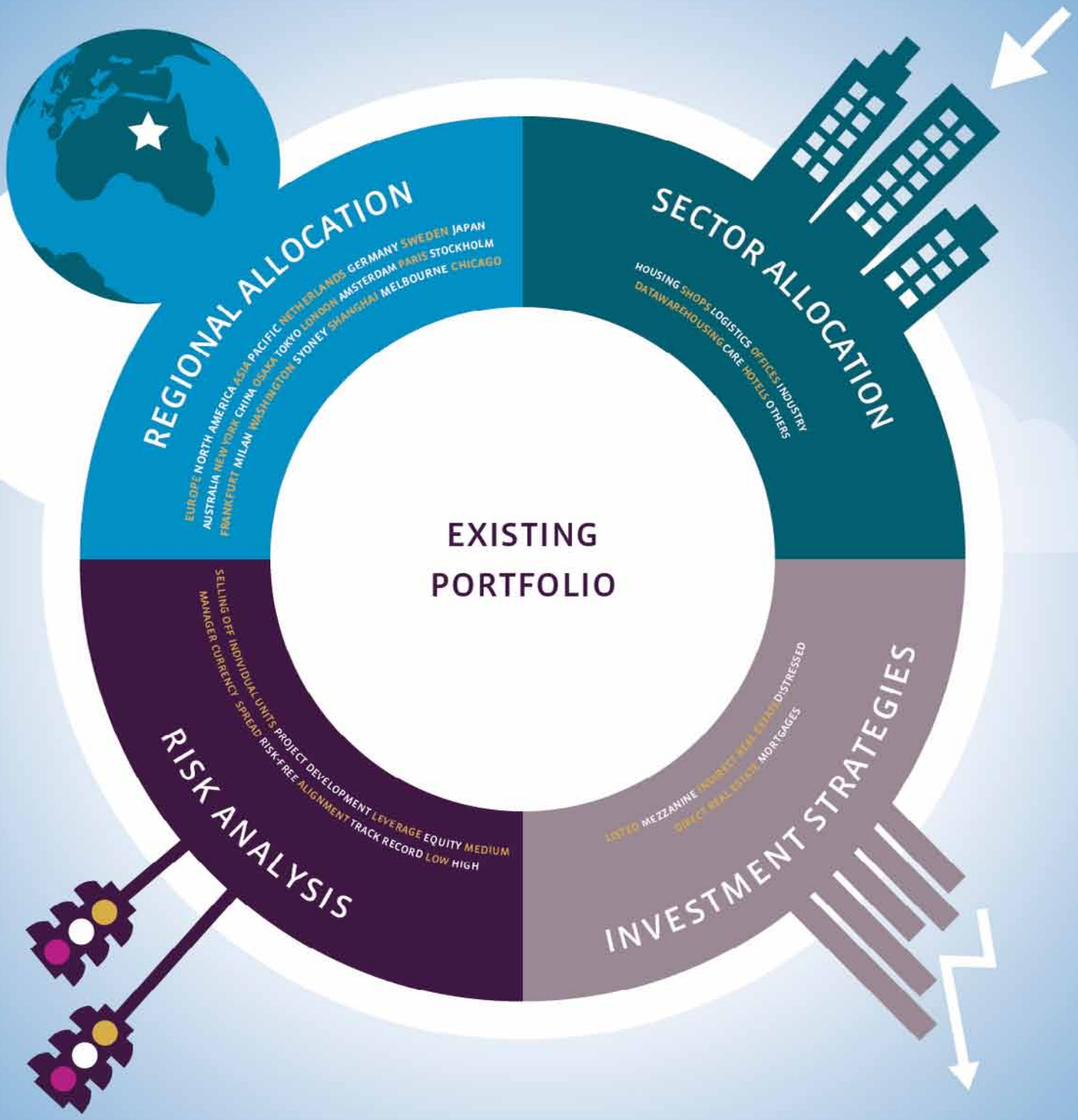
“Everything we do is focused on risk adjusted returns”

RICHARD URBAN, HEAD OF REAL ESTATE INVESTMENT AT CARDANO

The 4-step plan

TOWARDS A TARGET PORTFOLIO




REGIONAL ALLOCATION
EUROPE NORTH AMERICA ASIA PACIFIC NETHERLANDS GERMANY SWEDEN JAPAN
AUSTRALIA NEW YORK CHINA OSAKA TOKYO LONDON AMSTERDAM PARIS STOCKHOLM
FRANKFURT MILAN WASHINGTON SYDNEY SHANGHAI MELBOURNE CHICAGO
SECTOR ALLOCATION
HOUSING SHOPS LOGISTICS OFFICES INDUSTRY
DATAWAREHOUSING CARE HOTELS OTHERS
EXISTING
PORTFOLIO
RISK ANALYSIS
SELLING OFF INDIVIDUAL UNITS PROJECT DEVELOPMENT LEVERAGE EQUITY MEDIUM
MANAGER CURRENCY SPREAD RISK-FREE ALIGNMENT TRACK RECORD LOW HIGH
INVESTMENT STRATEGIES
LISTED MEZZANINE INDIRECT REAL ESTATE DISTRESSED
DIRECT REAL ESTATE MORTGAGES

DIVERSIFICATION OFFERS NEW OPPORTUNITIES FOR THE FUTURE

Investing in hotel and health care real estate

A differentiated real estate portfolio can reduce investor risk. However, diversification is not only about managing risks. It's also about creating and taking advantage of new opportunities and possibilities for growth. Bouwinvest see such opportunities for growth in hotel and health care real estate and will make significant investments in these categories in the coming year.

Bas Jochims is Head Asset Management Office and Hotels. Erwin Drenth is Manager Healthcare Real Estate at Bouwinvest. They discuss the risks and opportunities presented by these new branches on the family tree.

Hotels

"Our client, bpfBOUW, aims to realise a stable predictable rate of return so hotels are an interesting investment," explains Jochims. "It's a growth market with a good supply of hotels available, as many operators who still own their properties wish to sell. This gives us opportunities. Investing in hotels means investing in long-term, indexed rental contracts, and as long as these contracts are based on good rental rates with good-quality debtors, the return is predictable and stable." Critics point out that the hotel market is sensitive to cyclical trends, but according to Jochims, relevant risks and management measures have been identified. "We first take a long hard look at the location and then analyse hotel occupancy figures, paying attention to the distribution of occupancy between business and private sectors. Excessive dependence on one of these, particularly on business customers, is risky. We work with long-term contracts and do not sign any management contracts where we

are completely dependent on the results of the operator."

Specialised knowledge

Running a hotel requires specialised knowledge. According to Jochims, that is why Bouwinvest works only with professional hotel chains that have such knowledge. "But we always stay in touch with the operator and think with him: we require the operator to reserve funds each year to replace facilities when needed and also monitor competitors' occupancy rates and prices. This type of benchmark gives us the information we need to discuss results with tenants." Jochims adds that the hotel market is special in that operators are usually quite attached to their building. "That's not so with offices, where you can simply pick up your work desk and move to a building across the street. That is also one reason we see the hotel market as a good complement to office investments." The Hotel Fund targets the four big cities and Maastricht, with a focus on acquisition activities on Amsterdam. But we're presently discussing whether we should invest only in the Netherlands to realise the targeted fund size of 300 million euros in 2016 or whether we should also look at other European cities such as Munich, London or Paris."

Amsterdam

Although the number of hotel rooms available in Amsterdam has increased, Jochims is convinced that new hotels can still make a difference. "Growth can be seen in high-quality hotels offering competitive room rates. We're invested primarily in the 3-star and 4-star segments. During the crisis, the disappearance of business customers was compensated by customers from the private sector. The advantage of the 3-star and 4-star segments is that the hotel can lower its prices somewhat, making it more affordable for tourists, without damaging its image. For a 5-star hotel, that's much more difficult."

Jochims also thinks the city can benefit from more hotel beds. "Amsterdam is now missing out on congresses because there are not enough beds available. Hopefully, these congresses will choose Amsterdam once there are enough beds. The reopening of several major museums in Amsterdam has also contributed to the growth of tourism." Acquiring the right hotel properties is not always simple, even when Bouwinvest has sufficient capital available, as their low risk profile is attracting increasing investor interest. The Hotel Fund now has 135 million euros invested in properties, and its targeted average long-term yield is 7%."

'Bouwinvest will also make significant investments in health care real estate in the coming years'

Healthcare real estate

Besides significantly expanding its investments in hotels, Bouwinvest will also make significant investments in health care real estate in the coming years. Whether this will be done via a specific health care fund or whether the properties will be included in the Residential Fund is still up for discussion. The answer will depend on where the best opportunities can be found within the inclusive concept of 'health care real estate' which includes the 'cure market' as well as the long-term care market. "One reason we aim to expand the fund is to create even more diversification for bpfBOUW in the direct Dutch real estate investment sector," explains Drenth. "It's a new category and very much in demand. In the long-term care market, demand is driven by the sharp rise in the ageing population, which is the result of improved living conditions and the post-World War II baby boom. Additional factors driving demand include the separation between regular housing and care housing, a spike in demand for properties to replace older 1960s and 1970s properties, and a trend towards rationalisation in the health care sector whereby

HOTEL FUND

The Hotel Fund has four hotels in its portfolio. In 2010, the fund owned: Casa 400 and the NH Hotel in the WTC complex in The Hague. In 2013, the following hotels were added: Novotel in the Forum Rotterdam, a multi-use project with residential units and shops scheduled for completion in 2017. The Aitana Hotel of Room Mate that recently opened in Amsterdam.

Bas Jochims, Head Asset Management Office and Hotels at Bouwinvest

care providers are asking whether it makes sense to continue holding properties on their balance sheet. Providers view care more as a service that needs to be provided and see real estate simply as an instrument for efficiently providing it. These trends also play a role in the cure segment."

New category

A new category of real estate is emerging as a result of the above. In the long-term care segment, the midrange segment in particular will be interesting due to the separation of housing and care. "In the cure segment, we see specialised for-profit parties taking advantage of opportunities in specific niches such as private clinics," according to Drenth. "Properties associated with hospitals fall outside the scope of our activities, as this market is still much too unstable." The targeted yield for the fund is 6.5%, which is significantly higher than the yield realised on residential properties. In view of the recent emergence of this market, such a target is justified. Pension funds also need this kind of yield to meet their long-term obligations. Finally, though little information is available for this segment in the Netherlands, such yields have proven quite feasible in the countries around us." There is a difference between health care providers and real estate investors with regard to the yields that can be realised. Corporations generally operate with yields of 5% to 6%, but we're already seeing that corporations are not really interested in these properties. The advantage enjoyed by Bouwinvest relative to other parties is that we don't have to worry about funding. The bpfBOUW pension fund has allocated 300 million euros for the health care segment in its three-year plan."

Risk profile

"It's not yet clear what the risk profile of health care real estate is," adds Drenth. "Together with other investors and via the IVBN (Dutch Association of Institutional Investors in Real Estate), we're sponsoring research into the yields realised on health care real estate. It's difficult to estimate the risks involved, as there's no comparative material available. The only thing we know is that the market is changing. In the long-term care market, nursing homes are disappearing but their target group is not. A total of 280,000 persons have been classified as entitled to admittance into a nursing home or other care facility, and between 30% and 50% of

ADVANTAGES OF INVESTING IN HEALTH CARE REAL ESTATE

- It has an attractive risk-yield profile
- The health care real estate market is a growth market
- The social aspect: banks and corporations are pulling out
- It offers a kind of hedge against the ageing population. Investing in health care real estate makes it possible to benefit from the ageing population.

Erwin Drenth, Manager Healthcare Real Estate at Bouwinvest, in the show home of Rosorum

these individuals will need a place outside a care facility in the coming years. So large numbers of people will soon be looking for an environment which gives them some level of support and care, which avoids the pitfall of loneliness, and which does so sustainably for the rest of their life. The main risk is the risk that we will not succeed in offering these people the products they need." To limit the risk involved, we need to take a hard look at the marketability of the property, i.e. is it attractive enough for other care providers and can it be used for alternative purposes? By asking for rental guarantees and carrying out thorough due diligence at the care provider, it's possible to limit the risk. We also use our own knowledge of real estate and health care and screen locations very thoroughly." The first steps towards investing in health care real estate have already been taken in the high-end market in a Rosorum care villa. I expect other properties will follow, including properties owned by regular health care providers. After all, providers in the care as well as cure segment want to remove properties from their balance sheet.

Government

The government is an uncertain factor in the future of the health care real estate sector, but according to Drenth, this should not be exaggerated. "If anything is certain, it's that we will end up paying more in future and will have to depend more upon ourselves. So to ensure that we don't become too dependent upon government, we're also looking at the overall affordability of rental plus care. We need to make sure this total package remains affordable, even if government introduces new cost-cutting measures." Changes still need to be made in the area of government regulations to make health care real estate attractive for investors. Drenth: "Due to the separation between the residential sector and care sector, we already have to deal not only with the municipal alderman for care but also the alderman for housing. This results in discussions being started all over again. Where locations were previously being made available for care, housing officials now say, 'These are new housing units, so 30% must be reserved for the regulated rental sector.' Investors then end up quickly losing interest."

ADDING LISTED REAL ESTATE AS AN INVESTMENT

Diversification through listed real estate

Mark Roberts

Boris van Warmerdam

In the past, investors classified real estate as a niche investment, but real estate has become a mature asset class. The United States NCREIF-index for unlisted real estate investments has grown at an average of 20% per year since the nineties, mainly due to improved governance, transparency and investor information.

In addition to unlisted and direct real estate investments, listed real estate investments have also experienced substantial growth. The introduction of Real Estate Investment Trusts (REITs), which offer investors a tax-efficient way of investing in real estate, fuelled much of this growth. In the Netherlands, the REIT regime was introduced in 1969, nine years after it was invented in the United States.

According to Mark Roberts, Head of Research & Strategy, Alternatives and Real Assets at Deutsche Bank Asset & Wealth Management (DeAWM), the increased popularity of real estate is also due to its strong inflation hedge qualities. Boris van Warmerdam, Senior Portfolio Manager Listed Real Estate at Bouwinvest, mentions another factor that has contributed to the maturity of this asset class. "The low interest rate environment since the global financial crisis has driven investors to look for higher yielding investments as an alternative to government bonds."

Shares or real estate

Many wonder whether listed real estate should be classified as shares or as real estate.

Roberts has a clear answer. "I look at real estate, listed or non-listed, as an asset class that reacts differently to economic cycles and that performs differently than the general stock markets. REITs are real estate if you consider returns over longer periods of time, after correcting for the use of leverage. Despite its correlation with stock markets, listed real estate delivers real estate returns in the long term."

Van Warmerdam also views listed real estate investments as real estate. "In our view, listed real estate behaves like real estate in the long run, which matches our long horizon investment strategy. However, we also recognize the differences, especially from an operational perspective. We needed a bit of time to familiarize ourselves with this type of investment, and due to its distinctive nature, we also work together with experts in this field."

Bouwinvest initiated its active strategy for listed real estate over a year ago. The total of Bouwinvest's six billion euros of managed assets consists of four billion euros of direct real estate investments in the Netherlands and two billion euros of international indirect real estate investments. Currently, 85% of the international portfolio is invested in unlisted real estate funds and 15% in listed real estate. The listed real estate investments are targeted to grow to 25% of the international portfolio as defined in the investment plan.

'The investments in listed real estate serve as a complement to our unlisted portfolio'

"We manage a well-diversified global portfolio of investments in unlisted real estate funds, but in certain sectors or countries we are unable to invest through unlisted funds," explains Van Warmerdam. "Since 2012, we have had the opportunity to evaluate whether listed real estate is an attractive alternative in such cases. The investments in listed real estate serve as a complement to our unlisted portfolio. This type of investment also has other benefits, of which liquidity is the most obvious. In effect, we have expanded our options in terms of liquidity and our ability to rebalance the portfolio in the future."

Diversify

According to Roberts, the ability to diversify investments over sectors and countries is another important feature of listed real estate investments. "Real estate investments offer a strong dividend yield, solid inflation hedging characteristics and competitive returns compared to stocks and bonds. Real estate is very attractive when one seeks to increase risk-adjusted returns in a multi-asset portfolio and minimize downside risks. Depending on specific risk-return objectives, investors allocate an average of 5-10% of their portfolio to real estate. Institutional investors targeting higher returns, allocate 10-25% of their portfolio to real estate. Diversification is the biggest challenge for investors when investing in real estate, because it requires a lot of capital. The average size of an institutional-quality, prime single asset is 30 to 50 million euros. Listed real estate offers investors the opportunity to diversify their real estate portfolio while investing significantly less capital in comparison to direct real estate."

John Robertson, Head of Real Estate and Infrastructure Securities of DeAWM, adds the following. "Many of the prime real estate assets in the world, landmark buildings, are owned by listed real estate companies. Although some of these properties are also held by private parties, they are not traded very often."

This also became evident to Bouwinvest when it concluded that it was underweight in retail in the US and decided to source retail investments in the United States. "The opportunities to invest in non-listed real estate funds that own prime quality regional shopping malls are very limited," explains Van Warmerdam. "Most A-quality malls are held by REITs. So when it became possible for us to add listed real estate investments to the portfolio, this was the first opportunity that we assessed. The average investment value of a mall is between 200 and 250 million US dollars. We could have never achieved comparable diversified exposure to the underlying real estate assets by investing directly or through non-listed funds."

With a market capitalization of approximately one trillion dollars, listed real estate companies are only a small part of total global stock markets.

The likelihood that Bouwinvest will duplicate existing investments in the pension fund's portfolio by investing in listed real estate is therefore small.

> 'Many of the prime real estate assets in the world, landmark buildings, are owned by listed real estate companies'

Van Warmerdam: "The listed real estate companies we invest in have limited overlap with the existing general equities portfolio of the pension fund."

Volatility

Besides liquidity and availability, volatility also played a role in the decision to invest in listed real estate. "Short-term volatility creates opportunities for long-term investors like us," says Van Warmerdam. "It gives us opportunities to invest under attractive conditions compared to unlisted real estate investments. The timing difference of returns also helps to further diversify the portfolio. Several recent studies show that returns on listed real estate investments lead returns on direct and unlisted real estate investments. In the past year, the Sharpe ratio of the real estate portfolio (return measured per unit of risk) increased as a result."

Recently, Roberts and his DeAWM colleagues published their research on the impact of listed real estate on a multi-asset portfolio from a risk-return perspective. "We focused on total returns, and dividend yields in particular proved to be important for capital allocation decisions. Investors who targeted higher returns and better risk adjusted returns shifted from the private market to the public market. That results in higher volatility, as REITs experience periods of correction, but in the long term prices recover.

As opposed to the investment products of financial institutions, real estate has intrinsic value in the bricks and mortar. Because it is a real versus financial asset, real estate can provide downside protection to investors."

Dividend yield

According to Robertson, REITs have been a profitable investment in the past two decades. "An investment of 100 dollars in REITs in the early nineties would be worth approximately 700 dollars today, whereas the same investment in general equities would be worth only 375 to 400 dollars today. The long-term total return on REITs is higher than for the general stock market, mainly due to the dividend yield. In 2012, REITs outperformed general equities by 4.7%, due in part to a dividend yield of 4.9%, while the S&P500 yielded only a 2.1% dividend. There are those who claim that this difference is caused by the use of leverage, but the difference in leverage levels actually diminished over time."

Roberts thinks Bouwinvest's arbitraging strategy is leading the market. "They have the ability to globally assess individual cities and tactically utilize differences between the value of real estate and the stock prices of listed real estate. In doing so, they also improve the level of diversification of the real estate portfolio."

Van Warmerdam confirms that this is one of Bouwinvest's objectives. "We actively seek to add value when we choose listed over unlisted real estate, but we do so only if we are certain that, among other things, the underlying real estate and management teams are of high quality. Once we establish that, we can base our investment decision on relative pricing. So far, the strategy has proven to be successful for parts of the portfolio. Combining listed and unlisted investments in a real estate portfolio is a fairly progressive strategy. Many institutional investors talk about it, but few actually do it."

DEUTSCHE ASSET & WEALTH MANAGEMENT

In 2012, Deutsche Asset & Wealth Management (DeAWM) evolved out of the consolidation of all the asset and wealth management activities of Deutsche Bank, including RREEF Real Estate. With close to one trillion euros of assets under management, DeAWM is one of the world's 10 biggest asset management entities that are part of a bank.

The assets under management include 94.2 billion euros of alternative investments, such as private equity, hedge funds, inflation linked bonds |(TIPS) and investments in real estate, commodities and infrastructure. Approximately 39% of the alternative investments are in real estate.

Investing in art, primarily for its aesthetic value

Prof. Dr. Patrick Verwijmeren, Erasmus University of Rotterdam

Investing in art is on the rise, and we regularly read news stories about record amounts being paid for paintings. But is art really such a good financial investment?

An important aspect of investing in art is that it's much more difficult to determine the returns realised on art than it is for other investments such as shares. Whereas share prices are publicly available at any time, the price of a painting becomes apparent only when it is actually sold, and the length of time between successive auctions of a painting can easily stretch to 30 years or more. In this respect, a painting is not all that different from a property.

Based on data from auctions of thousands of paintings that were auctioned at least twice since 1972, it turns out that the average annual return realised on investing in art is approximately 10%. However, it also turns out that the paintings auctioned off are not representative of the overall market for paintings. After all, paintings are generally offered to the market when the seller thinks that a high return can be realised on his investment. Paintings in styles that are no longer in fashion are underrepresented and are often never even seen at auctions. Returns estimated on the basis of data on paintings sold therefore provide an overly optimistic view of investing in art. In times of economic crisis, the paintings sold would appear to provide quite good returns, but these paintings are more the exception than the rule.

If we correct for the fact that paintings which increase in value are more likely to be auctioned, the return realised on paintings representative of the overall market goes down to about 6% per year, with a positive correlation to the share market. Although such returns are still reasonable and definitely provide some opportunity for diversification, there would no longer appear to be all that important a role reserved for paintings within the framework of portfolio optimisation. The same applies to investing in particular schools or sectors such as Old Masters, the Impressionists, or modern art.

If we also take into account transaction and insurance costs, the above conclusion becomes even stronger. Investing in art is therefore not really attractive enough from a financial perspective, unless you really have excellent insight into the future demand for art. In my view, the most important reason for purchasing art is simply the pleasure that you can get from its purely aesthetic value.

3X Diversity

Within the framework of diversification, Bouwinvest is investigating new investment opportunities to add to its portfolio. However, the focus will remain primarily on Dutch real estate, which is held in the Residential Fund, Retail Fund and Office Fund, and which, together with the international investments held by Bouwinvest, forms the core of Bouwinvest's activities. In spite of the crisis affecting the real estate market, these funds performed well, particularly in view of the circumstances surrounding the real estate market.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Bouwinvest

1 The retail market is rapidly changing. The rise of online shopping, shrinking populations outside the Randstad, and the sharp rise in the ageing population are radically transforming the shopping landscape. The two most important trends that will be crucial to the future of retail are experience and convenience.

When shopping for fashion and lifestyle products, future consumers will increasingly be looking for an experience, i.e. experiencing a brand or product in large Flagship Stores located primarily in the major shopping cities. When doing their daily shopping, consumers increasingly prefer shopping centres that distinguish themselves by offering convenience. These are generally strategically located and accessible shopping centres where they can go for their daily shopping, easily park their cars, and find attractive products.

Shopping locations that focus on these core aspects will be relatively futureproof. These are locations along the main shopping streets of major shopping cities (A1- locations) with a focus on experience and shopping centres with a focus on convenience. There are opportunities for redevelopment projects in existing shopping streets that can improve the quality of as well as the return realised by the portfolio. Major international retailers are attracted primarily to locations that offer large retail floor surfaces.

In the coming years, Bouwinvest will make significant investments in existing locations to optimise the existing portfolio of 600 million euros of shopping locations.

Bouwinvest's major investments are the redevelopment projects at Damrak 70 and Nieuwendijk 196 in Amsterdam. At Nieuwendijk 196, the Spanish clothing chain ZARA will open a new shop in 2015 over three floors in a building that until recently consisted primarily of office space. At Damrak 70, the C&A shop will be transformed into the first Dutch Flagship Store. Besides C&A, Primark will also establish its largest shop in the Benelux here. To complete the customer experience here, STARBUCKS has opened a branch at Damrak 80-81 at the end of 2013.

Last year, the fund also realised several acquisitions focusing on convenience, including the Mosveld and Stadionplein shopping centres under development in Amsterdam that are scheduled for completion in 2016.

Whereas the large Flagship Stores located on important shopping streets in the major cities are using online shopping to encourage visitors to opt for the real life experience, locations along streets and in centres outside the major cities are finding it increasingly difficult to compete. Bouwinvest is actively looking for innovative ways of providing its tenants with additional support in order to minimise shop vacancies in the portfolio.
In response to the growth of online shopping, a cooperative venture has been entered into with Social Media Expert xXess360 to develop an online platform for shopping centres focusing on independent entrepreneurs. In these locations, a 'Mobile Shopping Mall' is used to attract new customers to the bricks and mortar shops and to reward existing customers.

'Shopping locations that focus on experience and convenience will be relatively futureproof'

A healthy dose of creativity as well as the ability to pick up signals from the market and tenants is needed to facilitate existing tenants in their efforts to run a successful business. Our efforts to that end have helped to ensure that the Retail Fund has beaten the benchmark over the last two years while at the same time significantly growing the portfolio.

Bouwinvest Dutch Institutional Retail Fund
A selection from our Retail Fund portfolio can be seen here.
For more projects, check out our portfolio at www.bouwinvest.nl/en/funds

2 **The strategy of Bouwinvest's Office Fund is to make a difference in the investment market for offices characterised by high vacancy rates and downward pressure on rental rates. The main focus of the fund, with invested assets worth 450 million euros, will be to optimise the portfolio over the coming years.**

Bouwinvest will do so by investing in sustainable and multifunctional buildings that can serve several tenants at the same time. The locations must be attractive ones that people enjoy coming to and where there are sufficient facilities present in and around the building, such as coffee shops, day-care centres, and places where people can get together. These offices are located primarily in the four major cities in the Randstad.

In spite of difficult market conditions over the recent period, Bouwinvest succeeded in maintaining the occupancy rates of the office portfolio at a level of 91% via active asset management. Several important rental contracts were renewed, including those for CentreCourt in The Hague, Maincourt in Amsterdam, and Maasparc in Rotterdam. The Office Fund was also able to attract a number of smaller tenants due to building renovations, including new tenants for Brabantse Poort in Nijmegen, for Arthur van Schendelstraat in Utrecht, and for De Laraissestraat in Amsterdam.

Demand for office space will continue to remain subdued in the coming years. Businesses are increasingly making use of new ways of working and flexible workspace strategies. As a result, they need fewer permanent workstations and can make do with less office space. At the same time, there is still a healthy demand for centrally located offices in large cities that are multifunctional in nature and easily accessible. More than ever, active asset management is crucial for success. By staying in close touch with the tenant and thinking things through together with him, we can take his present as well as future needs for office space into account. It all comes down to supporting entrepreneurs in their efforts to improve their business. One way of doing so is by focusing on sustainability within the framework of managing and developing office buildings. Last year, Bouwinvest worked together with Search to develop the *Duolabel Kantoren*, which involves meeting and talking with the tenant about ways to make the office building as well as the business processes concerned more sustainable.

Market developments and trends

A modest recovery of the Dutch economy is projected for this year, but unemployment is expected to continue rising for some time yet. According to the DTZ, the average vacancy rate for office space is about 14.7%. At the same time, a division is becoming apparent in the office market, whereby multifunctional and easily accessible buildings are coming out on top at the expense of office buildings with only a single tenant or use that are located outside the major cities. For the near future, vacancy rates are expected to increase, particularly in secondary and peripheral office locations. In these locations, the decrease in the value of office buildings has already resulted in redevelopment plans.

> 'More than ever, active asset management is crucial for success'

The prospects for a number of office locations in the four major cities look promising. Although the rental rates are not increasing very much, the value of these properties in the Netherlands can still increase due to the increasing interest being shown by other investors from outside the Netherlands. The competition for acquiring offices at top locations such as the Zuidas in Amsterdam is therefore quite fierce. Bouwinvest will investigate opportunities for working together with other institutional investors in order to be able to benefit from the present conditions in the market.

Bouwinvest Dutch Institutional Office Fund
A selection from our Office Fund portfolio can be seen here. For more projects, check out our portfolio at www.bouwinvest.nl/en/funds

3 **The portfolio of Bouwinvest's Residential Fund consists largely of residential property in the liberalised middle segment of the market in the Netherlands, with a focus on the Randstad city centre areas. The present size of the portfolio is 2.53 billion euros, and the goal is to increase this size significantly in the coming years.**

Over the last year, 145 new family homes and 253 apartments were added to the portfolio of the Residential Fund. Over the coming year, new investments are scheduled to take place in 1056 residential units.

In 2013 and the beginning of 2014, the following new projects were added to the portfolio: Hoogh Havezathe (Zwolle), Brandevoort (Helmond), Vathorst-De Bron (Amersfoort), de Heelmeesters (Amsterdam) and Deo Neo (Haarlem).

The strategy of the Residential Fund is focused on realising growth by utilising the momentum available in the residential market. Prices are very attractive and there are a great many properties on offer, which means that Bouwinvest can afford to be selective and to focus only on the best properties in the best locations.

These locations are found primarily in the Randstad. Due to ongoing urbanisation, the four largest cities are expected to account for one third of total population growth. The number of households will increase somewhat as the average number of individuals per household continues to decrease. The demand for single-person residential units will experience strong growth whereas the supply will remain low. Bouwinvest will respond to these developments by focusing, in addition to single-family units, on the mid-to-lower segment of the market with first-time buyer units as well as rental units suited in particular to single-person and two-person households. One example of this is the project named Het Baken in Amsterdam. Sustainability is a primary focus for all residential units, as is the demand of future tenants for flexible residential space that will meet their future needs regardless of which path their life takes.

Prospects

The long-term prospects for the Dutch residential investment market look good. The present situation is already characterised by a quantitative as well as qualitative shortage of housing, and the shortage is expected to become more acute due to the lower rates of housing construction. Due to the reduction of subsidies in the owner-occupied and regulated markets, the competitive position of the liberalised rental sector is improving. Increasingly, the rental market is becoming a mature and full-fledged alternative. If we also take into account that housing corporations are increasingly being forced to return to their core mission – providing affordable housing in the regulated sector – the overall result is expected to be a shift in emphasis to the liberalised rental market.

'The demand for single-person residential units will experience strong growth whereas the supply will remain low'

The significant decrease in the price of housing, the lack of liquidity in the owner-occupied market, and the increasing need for flexibility all contribute to the popularity of rental units. In the view of Bouwinvest, today's stable and high levels of occupancy in combination with stable rental revenues mean that it is now an excellent time to invest in the residential housing market.

Bouwinvest Dutch Institutional Residential Fund

A selection from our Residential Fund portfolio can be seen here. For more projects, check out our portfolio at www.bouwinvest.nl/en/funds

Bouwinvest

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