

2005 and a First Look at 2006 Survey Results

Overview

The Pension Real Estate Association (PREA) is a nonprofit trade group representing more than 500 member firms, including corporate and public retirement plans, endowments, foundations, Taft-Hartley plans, real estate asset managers, advisors, consultants, investment bankers, real estate investment trusts, and others. PREA's mission is to serve its members engaged in institutional real estate investment through the sponsorship of objective forums for education, research initiatives, membership interaction, and the exchange of information.

The *PREA Plan Sponsor Research Report* is an annual publication that provides a comprehensive analysis of, and unique insights into, the real estate investment holdings and strategies of the universe of public and private retirement plans, endowments, foundations, and other funds in general and of PREA investor members specifically. Each fall PREA surveys its investor members to gather detailed information on target and actual real estate allocations, investment strategy, investment structures and other information not available from public sources. This information is supplemented with industry data from *Standard & Poor's Money Market Directory* and from *Pensions & Investments* annual survey of the top 1,000 plan sponsors to provide a comprehensive analysis of real estate holdings by plan sponsors.

The report summarizes findings from a PREA survey of its investor members conducted in the 4th quarter of 2005 and 1st quarter 2006 (the 2005 survey). Data are based on the responses from 67 PREA members that at the time of the survey held more than \$2 trillion in assets and nearly \$150 billion in real estate-related investments, with almost \$130 billion in private real estate equity. (See Exhibit 1.)

Exhibit 1. PREA Reporting Group Profile, 2005

	Assets (\$ Millions)	Allocation (%)
Total Assets Reported	2,122,667	
Breakdown by Plan Size		
> \$25B in assets	1,737,033	81.8
< \$25B in assets	385,633	18.2
Asset Breakdown by Plan Type		
State or Municipal	1,424,518	67.1
Corporate	290,822	13.7
Other	407,326	19.2
Total	2,122,667	100.0
Holdings in Real Estate-Related Investments*	146,803	6.92
Holdings in Real Estate Equity	129,483	6.05

* private real estate equity, debt & public real estate (REIT, REOC, CMBS).

Source: Pension Real Estate Association

Throughout the report, results to date from the 2006 investor survey accompany the discussion of the 2005 findings to provide a sense of the change in real estate allocations and strategies over the past year as well as an up to date snapshot of the characteristics of real estate investments held by PREA members. PREA is in the final stages of collecting and compiling data from its 2006 survey. The 2006 survey includes new questions about public real estate investments, liability-driven investment (LDI), interest in commercial real estate derivatives and responsible property investment (RPI).

* Pension Real Estate Association, 100 Pearl Street, 13th Floor, Hartford, CT 06103 (p) 860-692-6341 www.prea.org

The early (or “first look”) 2006 figures reported here are based on the responses of 50 PREA members with reported total plan assets of approximately \$1.9 trillion and more than \$132 billion invested in real estate equity, as of June 30, 2006.¹

Highlights

◆ From the 2005 & 2006 PREA investor surveys:

	2005 PREA Survey	2006 Survey: A First Look
Actual Real Estate Equity Allocation	<ul style="list-style-type: none"> ✓ Overall, real estate equity accounted for 6.05% of total assets. ✓ Mean (average) reported allocation to real estate equity was 6.13% ✓ Median allocation was 6.35%; more than one half of the investors surveyed by PREA held 6% or more of their total assets in real estate equity. 	<ul style="list-style-type: none"> ➤ Overall, real estate equity accounts or 6.90% of total assets. ➤ Mean (average) reported allocation to real estate equity is 7.3%; for the same plans it was 6.3% in 2005. <p style="text-align: center; border: 1px solid black; padding: 5px;">Real Estate allocations ↑ about 1%</p>
Target Real Estate Equity Allocation	<ul style="list-style-type: none"> ✓ Mean reported target real estate equity allocation was 7.98%; median was 8%. ✓ More than 35% of investors surveyed by PREA had a target allocation between 8 and 10% and more than 90% of respondents had a target allocation between 4 and 10%. ✓ Mean of target versus actual real estate equity allocation was +1.94% 	<ul style="list-style-type: none"> ➤ Mean reported target real estate equity allocation is 8.01%; median is 8.25%. ➤ Mean of target versus actual real estate equity allocation is +1% <p style="text-align: center; border: 1px solid black; padding: 5px;">(Target–Actual) allocation difference ↓</p>
Investment Strategy	<ul style="list-style-type: none"> ✓ Of the real estate properties held by PREA investor members, 68.1% were classified as core, 16.7% as value-added and 15.1% as opportunistic. 	<ul style="list-style-type: none"> ➤ 61% classified as core, 20% as value-added and 19% as opportunistic. <p style="text-align: center; border: 1px solid black; padding: 5px;">Core % ↓, Value-Add & Opp. % ↑</p> <ul style="list-style-type: none"> ➤ Two thirds of investors responding plan to invest internationally in 2007.

◆ From industry data sources:

For the larger universe of more than 700 U.S. pension plans, endowments, foundations and other funds investing in real estate, real estate equity accounted for **5.6%** of total assets in 2005 and **6.1%** in 2006. For the top 50 plans, in terms of dollars invested in real estate equity, real estate accounted for **6.3%** of total assets in 2005 and **7.1%** in 2006. The top 50 plans accounted for nearly 72% of the total amount invested in private real estate in 2005, and the top 200 plans for 92% of the total.

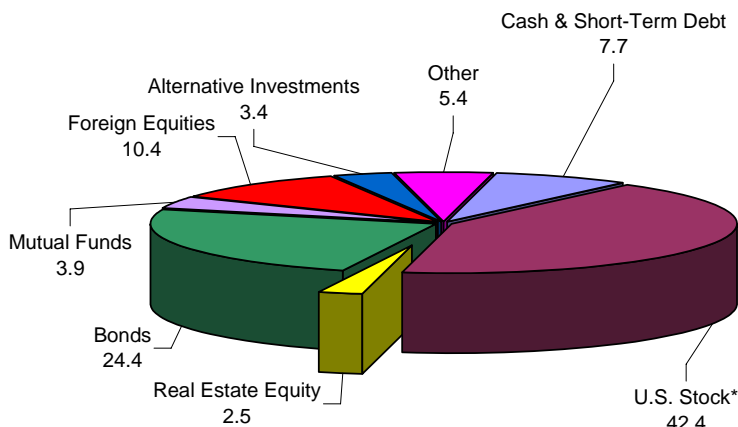
¹ Typically the Plan Sponsor Report is published in March each year. Collection, analysis and publication of the 2005 survey data was delayed due to the vacancy in the PREA Director of Research position that existed between late 2005 and September 2006. Complete 2006 findings will be published in a comprehensive report in late March or early April.

Industry Data

Since PREA members have a special interest in real estate, the asset allocations in general, and real estate investments in particular, of the investors that participated in the PREA surveys may not necessarily reflect those of the wider plan sponsor/investor universe. As a result, the PREA survey results were supplemented with industry data to help develop a better understanding of real estate asset allocations by the broader institutional investor community.

Exhibit 2 shows the percentage allocated to major asset classes in 2005 for the universe of tax-exempt investors included in *Standard & Poor's Money Market Directory*. Exhibit 3 provides dollar figures as well as a breakdown of the investments included in the Alternative Investments category. For the sample group of more than 2800 investors collectively holding more than \$6.3 trillion in assets, real estate equity accounts for about 2.5% of assets, with aggregate holdings of \$157 billion in 2005.

Exhibit 2. Plan Sponsor Asset Allocation, 2005
(Percentage Allocation - Major Asset Type)



Figures derived from asset holdings of 2,814 plan sponsors having assets greater than or equal to \$250 million.
Source: PREA and Standard and Poor's Money Market Directory

Exhibit 3. Plan Sponsor Asset Allocation, 2005
(All Plan Sponsors with Total Assets > \$250 million)

Asset Category	Allocation	
	\$	%
Cash and Short-Term Debt	485,845,509	7.7
U.S. Stock*	2,684,571,084	42.4
Foreign Equities	657,814,617	10.4
Bonds	1,548,474,132	24.4
Mutual Funds	244,117,564	3.9
Real Estate Equity	157,008,466	2.5
Alternative Investments	215,497,702	3.4
Private Equity	65,953,811	
Venture Capital	13,270,632	
Hedge Funds	43,065,549	
Unclassified	93,207,710	
Other	344,306,855	5.4
Total Assets	6,337,635,929	100.0

* includes real estate investment trusts (REITs)

Figures derived from asset holdings of 2,814 plan sponsors
Source: PREA and Standard & Poor's Money Market Directory

While providing an indication of the overall importance of private real estate in plan sponsor asset allocations, Exhibits 2 and 3 are not that informative because the vast majority of plans included do not invest in private real estate. The \$157 billion of real estate equity is held by only 711 of the more than 2,800 plans. Focusing on the asset allocations of only those plans that invest in real estate reveals an overall allocation of 5.6% of total assets in 2005, a number essentially unchanged from 2004.

Exhibit 4 provides additional information about the real estate allocation of the 711 pension funds, endowments, foundations and other funds that have real estate holdings, broken down first by plan type and second by real estate holdings. The sample of plans is comprised 60% of public/government plan sponsors, 24% corporate and 16% other (union pension plans, endowments, foundations and others) based on total plan assets. Looking back at Exhibit 1, that shows the profile of the PREA survey members, reveals that the 2005 PREA survey is somewhat underweighted in corporate relative to government plans. Comparing the total asset and real estate equity investment reported by PREA members to the Money Market Directory figures indicates that the PREA survey captures a very large share of the institutional real estate investor universe. The 67 PREA members reported assets of roughly \$2.1 trillion dollars and real estate equity of \$130 billion while the 711 investors in the total plan universe have approximately \$2.8 trillion dollars of total assets and \$157 billion of real estate equity.

Hence, the PREA survey captures 75% and 83% of plan asset and real estate equity “market share”, respectively.

Exhibit 4. Real Estate Allocation by Plans with Real Estate Assets, 2005

(a) By Plan Type

Plan Type	Total Plan Assets		Real Estate Equity		
	\$ (millions)	% Dist.	\$ (millions)	% Dist.	% Allocation
Corporate	672,112	24.0	29,321	18.7	4.4
Government	1,669,263	59.7	103,268	65.8	6.2
Other	455,126	16.3	24,419	15.6	5.4
Total	2,796,501	100.0	157,008	100.0	5.6

Figures derived from asset holdings of 711 plan sponsors with real estate equity investment.

(b) By Real Estate Holdings*

	Total Plan Assets		Real Estate Equity		
	\$ (millions)	% Dist.	\$ (millions)	% Dist.	% Allocation
Top 50 plans	1,772,826	63.4	112,299	71.5	6.3
Top 100 plans	2,112,430	75.5	130,278	83.0	6.2
Top 150 plans	2,246,957	80.3	138,839	88.4	6.2
Top 200 plans	2,365,925	84.6	144,394	91.9	6.1
Other Plans**	430,576	15.4	12,614	8.1	2.9
All Plans	2,796,501	100.0	157,008	100.0	5.6

711 plans with real estate ranked in descending order by \$ of real estate equity.

**Remaining 511 plans with real estate equity investment.

Source: PREA and Standard and Poor's Money Market Directory

PREA members tend to be larger funds with a propensity to invest in real estate, and it is this group of plans that accounts for most of the real estate equity investment. Exhibit 4(b) illustrates this by sorting the plans by dollar amount of real estate equity held. The results clearly highlight that a large share of plan sponsor real estate equity is held by a relatively small number of plans. The top 50 plans account for nearly two thirds and the top 200 for more than 90% of all real estate equity investment. The 200 largest plans, in terms of real estate equity, have an overall average real estate allocation of 6.1%, identical to the figure from the 2005 PREA membership survey reported in Exhibit 1. The holdings of the remaining 511 plans invested in real estate comprise only 2.9% of their total assets and make up less than 10% of the total real estate equity held by all plans.

A First Look at 2006: Money Market Directory and Pensions & Investments Top 1,000

To quantify the change in real estate allocations for the plan sponsor universe over the 2005-06 period we provide preliminary figures derived from the 2006 *Standard and Poor's Money Market Directory*² as well as an analysis of changes in real estate allocations for defined benefit pension plans based on the annual top 1,000 plan sponsor survey published each January in *Pension & Investments*.

² We refer to the 2006 Money Market Directory numbers as preliminary because the asset allocation data for some plan sponsors has not been updated since early 2006. Hence, the numbers may potentially not fully reflect the year to year change in allocations for these plans.

2006 data reported to date in *S&P's Money Market Directory* indicates the following updated real estate holdings and allocations for the universe of plan sponsors with real estate investments:³

<i>S&P Money Market Directory</i>	2006 Real Estate Equity	
Plans with real estate:	\$(billions)	% Allocation
All plans	180	6.1
Top 50 plans	136	7.1
Top 100 plans	153	6.8

Source: PREA, Standard & Poor's Money Market Directory and Plan Sponsor Websites

Comparing the results to the 2005 numbers in exhibit 4(b) shows that the overall real estate allocation increased by about 0.5% (5.6% to 6.1%), with the allocation by the top 50 plans, ranked in terms of real estate holdings, increasing by almost 1%, moving from 6.2 to 7.1%.

A second source of industry information is *Pensions & Investment's (P&I's)* annual survey of the 1,000 largest plan sponsors. Each January P&I publishes a survey that includes the real estate equity holdings of the top 200 defined benefit pension plans, based on plan asset holdings in September of the previous year. This is a somewhat different sample than the one derived from the Money Market Directory, given that it is focused more narrowly only on defined benefit (DB) plans, and because "top" is defined in terms of ranking of total plan assets, not real estate equity holdings as in Exhibit 4(b) above. In addition, the analysis undertaken here with the P&I survey data employs the same sample of pension funds in both years, thereby providing a more exact measurement of changes in plan sponsor real estate allocations for this "matched sample" subset of the investor universe.

Figures for the group of 55 DB plans that ranked in the top 50 in either the 2005 or 2006 P&I surveys, show the following real estate allocations in 2005 and 2006:⁴

<i>P&I Top 50 Defined Benefit Plans</i>	2005	2006
Total Plan Assets (\$ millions)	2,203,664	2,451,378
Real Estate Equity (\$ millions)	103,102	140,982
Overall Real Estate Allocation (%)	4.68	5.75
<i>Individual Plan Sponsor Information:</i>		
Mean Real Estate Allocation (%)	5.2	6.3
Median Real Estate Allocation (%)	5.1	6.0
Mean Change in RE Allocation (%)		+1.1

Source: PREA, *Pensions & Investments*, and Plan Sponsor websites.

The overall real estate equity allocation of this group is slightly lower than those indicated by either the PREA membership survey or the Money Market Directory, indicating that this sample of the largest DB plans does not capture some higher real estate allocation investors in other investor categories. The P&I numbers show an increase in the overall allocation to real

estate equity of just over 1% for the largest DB pension plans. While total plan assets grew by about 11% over the year, real estate equity holdings increased by almost 37% for this sample.⁵ The average (mean) allocation to real estate equity increased 1.1%, moving from 5.2 to 6.3%.

While the P&I surveys indicate a slightly more pronounced shift in portfolio allocations to private real estate for DB plans than suggested for the wider universe of investors based on the Money Market Directory, both sources suggest an overall *increase in the real estate allocation of about +1% in 2006.*

³ For some plan sponsors the Money Market Directory (MMD) plan asset and real estate equity figures were replaced with more recent figures based on data available from plan sponsor websites and/or PREA 2006 survey results.

⁴ Figures from *Pensions & Investments*, January 23, 2006 and January 22, 2007 issues. The matched sample is created by including all plans listed in the top 50 plans listed in the top 200 plans with real estate equity in either the 2005 or 2006 surveys

⁵ The National Council of Real Estate Investment Fiduciaries (NCREIF) property index shows a total return of 16.6% over this period.

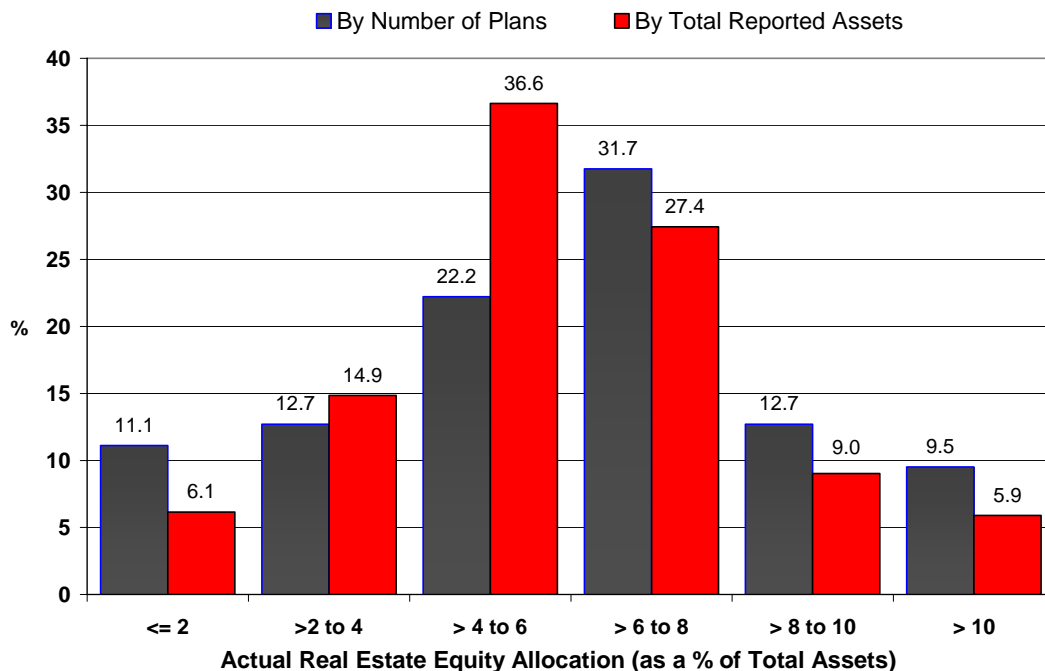
PREA Plan Sponsor Membership Survey Results

2005 marked the fourth consecutive year PREA conducted a survey of its plan sponsor members to gather detailed information about investor member real estate allocations and investments. The majority of the data reported on the PREA survey are current as of June 30, 2005. A few plans reported as data as of September 30 or December 31, 2005. The 2005 results presented in the following exhibits are based on the responses of 67 PREA investor members that collectively had \$2.1 trillion dollars in total plan assets and \$129.5 billion dollars, or 6.1% of plan assets, allocated to real estate equity. As in previous years, public (state or municipal) plans account for two thirds of the asset holdings. Corporate plans comprise about 14% and other (foundation, endowment, union pension plans and others) make up the remaining 19%. The early (or “first look”) 2006 survey figures reported below are based on the responses of 50 PREA members with reported total plan assets of approximately \$1.9 trillion and more than \$132 billion invested in real estate equity, as of June 30, 2006.⁶

Real Estate Allocations: Actual and Target

Real estate equity allocations reported by PREA members as of June 2005 are distributed or centered about a mean allocation of 6.13% (see Exhibit 5). More than one half of survey respondents reported an allocation greater than 4% but less than or equal to 8% of plan assets. Given the breakdown shown in Exhibit 5, the greatest number of plans had allocations in the “more than 6% but less than 8%” range, though when broken down by plan size the greatest dollar amounts allocated to real estate fall into the 4 to 6% of total plan asset range.

**Exhibit 5. Real Estate Equity Allocation, 2005
(% Distribution)**



Source: Pension Real Estate Association

⁶ Data represented in the PREA investor member survey is not necessarily representative of the investment activity of the universe of pension funds, foundations, endowments and other investors. PREA members clearly have a special interest in real estate investments and in many cases will have higher allocations to real estate than non-PREA plan sponsors. On the other hand, a number of plan sponsors that have minimal real estate holdings have recently joined PREA to learn more about the real estate asset class. These plans, some of which participated in the survey, are overshadowed in terms of total dollar holdings by those plans with an investment history in the asset class.

PREA members were also asked to report their *target* real estate allocation. The average of the reported target allocations is 7.98%, nearly 2% greater than the average of current reported allocations at the time. Nearly one half of the plans responding to the survey had a target real estate allocation higher than 4% but not greater than 8% (see Exhibit 6). This proportion jumps to almost two thirds when broken down by plan assets instead of number of plans. Similar to the distribution of actual allocations in Exhibit 5, a few plans have target allocations either greater than 10% or less than or equal to 4%, though by asset dollars these plans collectively make-up about one tenth of the sample.⁷

Exhibit 6. Target versus Actual Real Estate Equity Allocations, 2005

(a) Target Allocation

% Distribution	By Number of Plans	By Total Reported Assets
> 10%	10.7	5.6
> 8% <= 10%	35.7	23.6
> 4% <= 8%	44.6	65.0
<= 4%	8.9	5.8
Median target allocation is 8%		

(b) Actual vs. Target Allocation

% Distribution	By Number of Plans	By Total Reported Assets
Actual < target	76.8	76.7
Actual = target*	3.6	6.0
Actual > target	19.6	17.4
* within a 0.2% margin		

Source: Pension Real Estate Association

More than three quarters of respondents indicated that their current allocation to real estate equity was below the target level. The average difference between the individual reported target and actual real estate equity allocations is +1.9%. About 20 percent of investors had allocations greater than their target or policy allocation.

A First Look at 2006 Real Estate Allocations

Consistent with the *Money Market Directory* and P&I survey findings, PREA member survey results indicate that on average investors increased portfolio allocations to private real estate equity by about 1% in 2006. Target allocations, on the whole, increased only marginally with the result being that the 2% gap between target and current allocations has been closed significantly. There does seem, however, to be significant variation amongst plans that is partly hidden by focusing only on averages. While a number of plans are comfortably at allocations close to target and content to stay there, a few large plans have recently announced fairly major increases in their target allocations to real estate, and a there are a number of plans that have only recently added real estate and are well below target.

Actual and Target Allocations	Average of Reported Allocations (%)
Current: 2006	7.3
2005	6.3
Target	8.1
Target – Actual	1.0

PREA investor members were asked whether they plan to increase or decrease their percentage allocation to private real estate equity or not make any changes, and if a change is planned what the estimated dollar impact is. The majority of survey respondents plan to maintain their current allocation (72%). The remaining 28% expect to increase their portfolio allocation to real estate equity. Based on the responses to date, not a single investor member plans to decrease the allocation to real estate equity in 2007. The 14 investors (28% of 50) planning an increase in real estate allocation have indicated dollar amounts that total to about \$5.7 billion, yielding an average increase of about \$410 million.

⁷ The target allocation is termed the policy allocation by some plans. Not all PREA investor members surveyed have a defined target allocation and some have established an optimal policy range rather than a hard specific target. In the latter case, the target is assumed to be the midpoint of the indicated range. Readers should also note that for a small number of plans the reported actual and target allocations include public REIT holdings as well as private real estate equity investment.

Real Estate Investment Structure

Most private real estate investment is made through direct investment and commingled funds, with these two structures together accounting for more than 80% of private investment (See Exhibit 7).⁸ Direct investment is by far the vehicle of choice for larger plans. Joint ventures account for 11% of private real estate investment dollars, and are also more likely to be a part of the investment strategy for larger investors.

Exhibit 7. Real Estate Investment Structure of PREA Members, 2005

	Reporting Group		By Total Plan Assets	
	% of Private	% of Total	% of Total Real Estate	
	Real Estate	Real Estate	> \$25B	< \$25B
Private				
Commingled Funds	22.6	19.6	13.2	41.0
Direct Investment	56.2	48.8	50.7	34.7
Operating Company	3.2	2.7	3.3	0.4
Joint Venture	10.8	9.4	10.1	5.4
Mortgage	1.3	1.1	1.4	0.1
REIT	2.0	1.7	1.7	1.5
Other	3.8	3.3	3.6	2.1
Total Private	100.0	86.8	87.7	85.2
Public	% of Public			
	Real Estate			
REIT	94.5	12.5	12.1	12.2
REOC	2.4	0.3	0.2	0.7
CMBS	2.9	0.4	0.0	1.8
Other	0.1	0.0	0.0	0.1
Total Public	100.0	13.2	12.3	14.8

Source: Pension Real Estate Association

PREA investor members were also asked about public real estate investment holdings. Similar to private investments, equity dominates debt with REITs accounting for 95% of public real estate investment and CMBS hardly registering. Public REITs, however, comprise only about 12% of total (public and private) real estate investment and are held by slightly more than one half of the plans surveyed. 35 of the 67 PREA investor respondents report public REIT investment holdings of approximately \$17 billion, implying an average investment of about \$500 million.⁹

It is possible that the PREA survey results understate public real estate investment by plan sponsors and other investors since the survey is generally answered by PREA members in the real estate group at member plans, and public REIT/REOC and CMBS/CDO investment and allocation decisions may be within the realm of the stock (equity) and fixed income groups, and not handled by the real estate decision makers. To investigate this possibility and further our understanding of the role of public real estate investments within the overall real estate strategy, **the 2006 survey** adds new questions about public real estate. PREA investor members are asked to indicate whether or not the real estate group makes public REIT/REOC and CMBS/CDO investment decisions, and also about their views on public

⁸ Closed-end funds make up 60% of the commingled fund total, with open-end funds accounting for the remainder.

⁹ According to *Pensions & Investments* survey of the top 1,000 plans, the top 200 defined benefit plans held a total of \$22.5 billion in REITs in the 2005 and \$29.1 billion in 2006. To date the 50 respondents to the 2006 PREA survey report holding about \$14 billion in REITs.

REITs relative to private real estate investment. The specific questions posed and initial findings to date derived from 40 completed responses to these questions are shown below.

A First Look at 2006 Findings Based on Questions about Public REITs

Public Real Estate Investments within the Overall Real Estate Strategy

i. Does your real estate group handle public REIT/REOC and CMBS/CDO investment decisions?

Yes 40%

ii. How do you view public REITs relative to private real estate equity investment?
(Check all that apply)

	(x)	
REITs are a substitute for private real estate over the long-term	14	}
REITs are used to adjust the real estate allocation in the short-term	11	
REITs are stocks and not considered part of the real estate allocation	15	

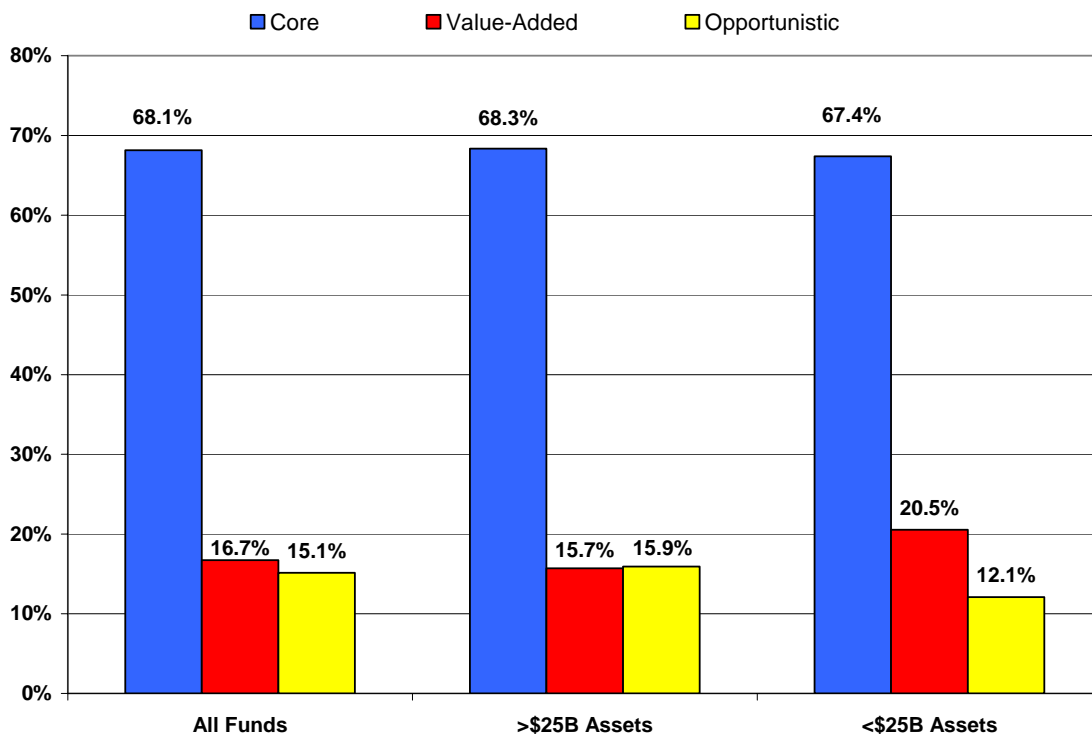
of responses

The real estate groups at 16 of 40 plans handle both public and private real estate investment decisions. These plans tend to view REITs as a substitute for private real estate over the long-term and as a vehicle for short-term fine tuning of the real estate portfolio. More than 50% of plans separate REIT and private real estate decisions and view REITs more as part of the stock allocation. There is clearly significant variance across plans in terms of the perception and role of public REITs within the overall real estate investment strategy.

Real Estate Investment Strategy

The survey asks PREA investor members to allocate their private real estate equity investments into core, value-added and opportunistic strategies based on their plans interpretation of the relevant definition for each. Core properties, as expected, make up the largest share of plan sponsor investments, accounting for 68%, a number in line with previous year survey findings (See Exhibit 8).

Exhibit 8. Distribution of Private Real Estate Equity Investment by Strategy, 2005
(Excludes investments not readily allocable by strategy)

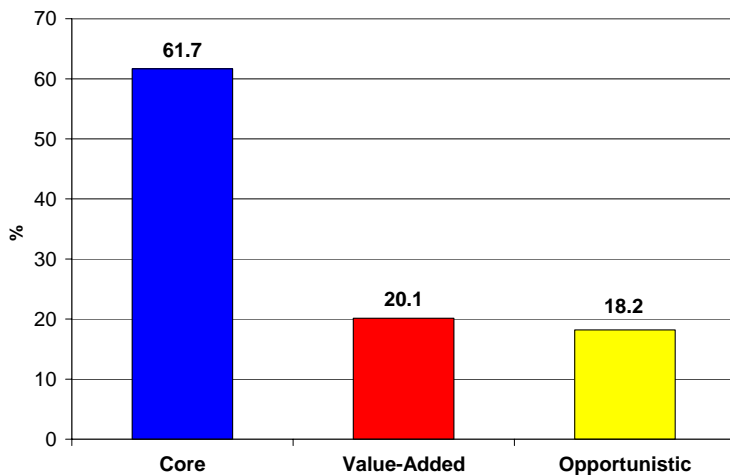


Source: Pension Real Estate Association

For the full sample, 16.7% of real estate equity holdings are allocated to value added investments, and 15.1 % to more opportunistic, higher risk-return investments. Plan size does not appear to impact the core allocation much, but it does affect the split between value added and opportunistic with smaller plans tending to focus more on value added versus opportunistic strategies.

A First Look at 2006 Strategies

Over the past year much has been written in industry publications about institutional investors shifting investment dollars towards riskier property investment strategies in the search for higher returns. Early results from the 2006 PREA survey tend to support this. The allocation to core is at 62%, versus 68% for 2005 and 70% for 2004, while value added and opportunistic strategies have increased to 20% and 18%, from 17% and 15%, respectively.¹⁰



New to the survey this year is a question asking investors whether they plan to change the share of real estate equity allocated to core property investments, relative to value-added and opportunistic strategies in 2007. Four (9%) of the 46 investors that responded to this question have indicated they plan to increase the allocation to core and 28 (61%) reported no change or an increase to core. On the other hand, 14 (or 30% of) respondents plan to decrease the proportion of the private real estate portfolio invested in core property investments and increase the proportion allocated to value-added and opportunistic investments. The estimated dollar impact is \$3.2 billion to be taken out of

core and invested in value added and opportunistic assets. Readers should keep in mind that the 2006 findings are preliminary and could change as information from additional PREA member survey results are incorporated into the analysis.

Other Strategic Considerations: Financial Leverage and International Investment

PREA investor members are asked to provide information about financial leverage they employ in their real estate portfolios. Specifically, investors are asked about the current leverage level and also the maximum amount they are permitted to use at the portfolio level. More than 90% of respondents report using debt financing and the overall average portfolio level loan to value ratio is about 40%.

Exhibit 9. Portfolio Debt Financing (Leverage), 2005
(Maximum allowed as a % of Total Property Value)

% Distribution Range	% of Respondents
0 to 10%	0.0%
11 to 30%	5.7%
31 to 50%	49.1%
51 to 75%	39.6%
> 75%	5.7%

Nearly half of survey respondents have maximum allowable leverage limits in the 31 to 50% range (See the full distribution of responses in Exhibit 9). Interestingly, for this group of investors, average permitted portfolio financial leverage is comparable to that employed by public REITs on average. There appears to be little change for 2006.

Source: Pension Real Estate Association

¹⁰ The apparent shift in investments away from core further up the risk-return spectrum is often discussed within the context of investors need for return necessitating such a move, implicitly implying that investors may be taking on too much risk. However, if core property is over-priced in some sectors then value added and opportunistic investments may actually be less risky than core, not in absolute sense, but in terms of a more favorable risk-return tradeoff. This issue will be addressed in more detail in the complete 2007 report.

The search for higher return real estate investment opportunities, as well as additional diversification benefits, has led a number of investors overseas. With the integration of global capital markets it is only natural that real estate will follow and become a more global marketplace, a process that is well underway. While there has been significant interest in international or global real estate investment at PREA conferences and in PREA publications, previous surveys have failed to uncover significant investment activity by PREA investor members.

Exhibit 10. % Distribution of Foreign Private Real Estate Investments, 2005

Canada*	0.4
East Asia/Pacific Rim	24.3
Western Europe	70.9
Eastern Europe	0.5
Latin America	3.9
Total Foreign	100.0

*excludes Canadian holdings by Canadian investors.

Source: Pension Real Estate Association

PREA investor members are asked about current international allocations and investment intentions. 2005 survey results reveal that 1 out of every 2 U.S. investors responding to the survey had foreign property holdings and collectively, these PREA members held \$7.4 billion in real estate equity outside the United States. As in previous years, the bulk of this is in Western Europe, followed by Asia/Pacific, though the holdings in Western Europe decreased while those in Asia/Pacific increased as a percent of total investment since 2004.

A First Look at 2006 Results

29 of 48 U.S. plans report foreign real estate equity holdings totaling approximately \$9 billion.¹¹ International investment would appear to be on the upswing. PREA investor members were asked to indicate if they planned to invest internationally in 2007 and 32 answered in the affirmative. This includes 5 plans making inaugural foreign investments, and is consistent with recent announcements by a number of public plan sponsors to invest capital into both commingled funds and REIT funds with a global strategy.

Additional 2006 Survey Details

The 2006 survey ends with questions in a new section titled “Getting the Pulse on Emerging Issues” designed to gauge the interest of PREA investor members in new or emerging strategic issues. The three topics addressed this year, along with the number of affirmative responses in the 50 surveys tabulated to date, indicating interest in each, are shown below.

Getting the Pulse on Emerging Issues

- a. Has your fund implemented, or does it plan to implement, a **liabilities-driven investment (LDI)** strategy?
Yes 4 # of responses
- b. Is your fund giving serious consideration to employing **commercial real estate (CRE) derivative** products (eg. NCREIF or IPD index-based capital total return and property-type return swaps) in its real estate strategy?
Yes 7 # of responses
- c. Does your real estate investment strategy contain explicit goals for **socially responsible investment (SRI)**?
Yes 5 # of responses

¹¹ The 2006 *Pensions & Investments* survey of the top 1,000 plans initiated coverage of international real estate investing. It shows that the top 200 defined benefit plan sponsors had about \$7.7 billion of real estate equity allocated internationally.