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Stunned by Losses, Institutions Ask: What Now?

Institutional investors saw the value of their investment portfolios drop by an astonishing 31% in 2008, which has begged the ongoing question of 2009: What now? A new study by Greenwich Associates, a Stamford, Conn.-based consultant and research firm, finds that when it comes to future real estate investing, the news is good. Burned by the wild gyrations of publicly traded stocks, most institutional investors are rightfully pulling back from the equity markets. Less than half of institutions surveyed, 40%, say they plan to make significant changes in their allocations, and 20% of that group said they were planning to increase their investment in real estate. Greenwich Associates conducted in-person interviews from July through October 2008 with fund professionals from 578 corporate funds, 229 public funds, and 241 endowments and foundations. Of the 154 public funds making predictions, 25% said they expect to increase their real estate holdings by 2011. Only 3% said they would decrease their real estate allocations. Of the 192 corporate funds making predictions about their future portfolio mix, 17% expect to increase their real estate holdings by 2011 versus 4% planning a decrease. Those survey responses confirm what many advisors already know — real estate will continue to be an integral part of diversified portfolios. “Institutions like real estate, they know real estate,” says Ted Leary, a 30-year veteran of the institutional investing business and founder of Crosswater Realty Advisors, a consulting company in Los Angeles. “They are not going to get out of real estate. Some may shrink their allocations, some may increase their allocations.” Greenwich Associates proposes that institutional investors will respond to the economic crisis in three phases. The first phase, or the present, finds institutions coming to grips with the new market realities, taking a deep breath and holding pat until the markets stabilize. Greenwich’s research found that as recently as January, institutions were shunning drastic actions in the midst of crisis. It’s a twist on the old adage, “Don’t just do something, stand there.” As part of their normal year-end analysis, institutional investors are in the midst of reviewing what went wrong in 2008 and what can be done to mitigate losses in the years ahead. But one of the biggest takeaways from the study reveals that while many institutions are shifting the balance of their allocations across their investment classes, they are not planning major shifts away from the overall investment strategies that they have used for the past few years. In other words, institutions still do not yet believe the significant losses racked up over the past year discredit their overall investment approaches. According to Greenwich Associates, the second phase of the recovery will find institutions returning to a “business as usual” mode, resuming more normal day-to-day operations, making new investments and deciding on how best to rebalance their portfolios. The third and final stage will be a top-to-bottom reassessment of long-term diversification strategies, reviewing fund manager due diligence practices and risk management procedures. Institutions will be pondering the most important question of their time — is their broad portfolio management strategy and risk management practice flawed or were they overwhelmed by a 100-year event? The answer to that question will take time and strain the limited resources of many institutional investors. In recent years institutions have downsized their internal due diligence function, so today they rely more heavily on their external managers. Greenwich found that the typical U.S. institution employs only two professionals to select and supervise outside managers. But this downsizing comes at an inconvenient time, since portfolio diversification creates more complexity in the due diligence process. This scenario

finds institutions putting more pressure on their investment managers to perform. "In reality, the Madoffs of the world are few and far between," notes Greenwich Associates consultant Dev Clifford. "The primary due diligence challenge facing institutions is not weeding out the frauds, but rather identifying those managers with the skill and consistent, repeatable processes needed for investment success. That is impossible to do without sophisticated due diligence capabilities." The real lesson of 2008, says Clifford, is that institutions need to either increase their own in-house capabilities or acquire them externally. "Doing without is not an option."

Surprisingly, even in the face of mounting investment losses, the study found that fees paid to fund managers have increased by 30% on average since 2004. This is another product of portfolio diversification, which brings with it increased time for due diligence of alternative investments and international and emerging market investments. Greenwich notes that one trend that was taking hold before the calamity of 2008 was a move by funds away from using so-called "boutique" managers — which specialize in particular assets, like real estate — and toward larger fund managers that have teams of in-house market specialists. Ultimately this tactic could decrease the fees paid by institutions to fund managers, reduce the number of managers and more closely align the interests of both parties as they navigate through the months ahead. **(National Real Estate Investor/Ben Johnson)**

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U.S. Retail Sales Outperform Expectations

Nationwide retail sales were stronger in February than expected, according to statistics released Thursday by the U.S. Commerce Department. Total sales volume for U.S. retailers dropped just 0.1 percent last month, which was substantially better than the consensus forecast of a 0.5 percent decline. Even better was the news that retail sales, excluding automobiles, actually increased by 0.7 percent in February. Sales volume increased in February for clothing, electronics, furniture and gasoline. It declined for automobiles, building materials and restaurants. The Commerce Department also revised the January retail figures upward. January actually saw a 1.8 percent increase in retail sales, based on updated data. The initial report for January had pegged the increase at 1.0 percent. **(Denver Business Journal)**

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	CURRENT	1 MONTH PRIOR	1 YEAR PRIOR
FED FUNDS RATE	.25	.25	3.00
3 MONTH LIBOR	1.32	1.24	2.80
PRIME RATE	3.25	3.25	6.00
10 YEAR TREASURY	2.89	2.78	3.53
30 YEAR TREASURY	3.66	3.45	4.45