OAK INVESTMENT MANAGEMENT GROUP

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A sovereign wealth fund (SWF) takes many forms. Typically a SWF has been founded by a country that seeks to insulate a windfall from current budget requirements. As a result it is an attempt to provide a 'nest egg' for the benefit of future generations. SWFs perform an important function the global real estate market as they are able to draw on deep liquidity in order to be able to make investments that many others would not be able to.

Also, critical for real estate purposes, SWFs have a longer time horizon, and can have the ability to be less rigid (for better and for worse) in their investment processes. Respectively, this allows them to invest in projects with many years of no cash returns and projects that can be creative in terms of vision.

From the perspective of SWFs real estate has a particular allure. Often the underlying purpose of setting up and maintaining a SWF is to diversify from a natural resource with the volatility and over-exposure that that might bring. As a result, real estate is an important component for SWFs not only because it is an alternative asset class but also because of its inherent geographical segregation and it's prime / favoured legal protection in most jurisdictions throughout the world.

Real estate has an ability to absorb cash in a relatively useful way that is both quick and secure. There is less discrete (or continuous) calibration as there would be to a broad allocation to shares and bonds. There is somewhat less volatility (though some analysts might argue compensated through lack of liquidity) than other asset classes. There is often an element of national pride in ownership of a flagship piece of real estate that would not necessarily exist for the same value of share certificates. All of these aspects are important in understanding the behaviour and strategic orientation of SWFs.

It is important, however, to remember that just like any other pension fund or mixed fund, real estate for a SWF never dominates over bonds and equities. Most would pursue an allocation of less than 20 per cent to direct real estate as well as real estate funds. As a result, and as would be expected, absolute allocations to real estate are usually very responsive to a) inflows into the fund from their primary source or b) the performance of the rest of the market. In particular, SWF real estate allocation has a strong correlation with the political risk that a SWF may carry. A SWF can become a lightning rod for political discontent in a host country, which would render the likelihood of investing in an illiquid asset less likely. A SWF investment is always more high profile than an analogous pension or mixed fund investments.

Finally, it is important to put the influence of SWFs in perspective. The overall assets under management (AuM) of SWFs is perhaps $5 trillion, but this figure represents approximately one tenth of the AuM available to pension and money market funds around the globe. So while SWFs are certainly a force to be reckoned with and will invariably get more media attention than other funds – they are only part of investor universe.

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