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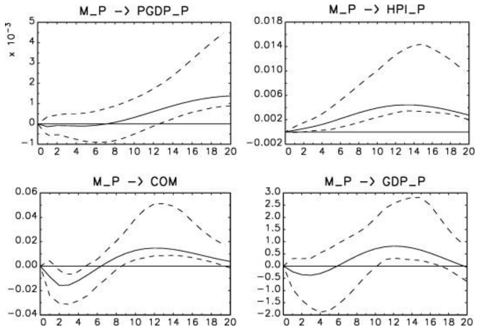

Benchmarking is the art of measuring the opportunity cost of an investment decision over a period of time. An investor and an investment manager must seek to out-perform a chosen benchmark, which is the average of their general and comparable market, if they are to demonstrate that they are better than passive (and cheaper) indices that mimic the general performance of the market.

In real estate (as other asset classes) there are considerable difficulties in ascertaining how a benchmark is constituted. The most profound challenge is what the universe of comparable assets should be. Generally, large commercial real estate can get quite particular in terms of both unique characteristics as well as liquidity at different 'lot sizes', so often there needs to be a weighted average on demonstrable characteristics based on observed performance. On a dynamic basis (i.e. inter-temporal), the composition of the investment universe is important. Subtle exclusions or inclusions can move an average one way or another with obvious and compounding implications.

Because benchmarks need to be maintained out of a defined investment universe and on a dynamic basis, there is a need to accommodate both comparables that fall out of and those that emerge into the index. Rather like the FTSE 100, CAC 40 or the DAX, a real estate benchmark needs to cater for the changing tastes, allocations and behaviour of the market. This creates 'survivor bias' as well as an understatement of the risk implied through investing, but it also allows for a continuous comparable in the real estate market that is lumpy, uneven and less mathematically discrete than any other asset class.

The aim of successful benchmarking in real estate is that the comparable universe of assets are broadly consistent, transparent and relevant. As we have seen, benchmarking the performance of any asset is not as easy as it sounds. It requires analytical judgement and intellectual honesty. It is important because through a benchmark it is possible to distinguish between general market movements and idiosyncratic ones. In this way it is possible for an investor to judge, to critique and to reward performance. Bonuses for managed real estate investment (as distinct from real estate projects) should be linked to out-performing the market – not for being part of it.

There are other important factors in benchmarking; the unpredictable interplay between capital markets and real estate; divergent cycles throughout different sectors of the economy linked to real estate; variant behaviour of real estate in different geographically locations of the world; different access to and use of leverage which can magnify success or failure in different economies; unrelated foreign currency movements which can undeservedly multiply or accidentally impair expected returns from a real estate commitment.

All of these factors make it hard to reduce the 'noise' around the performance of real estate and focus on the 'alpha' of the investment manager in question. But the mere fact that the process is hard does not make the discipline of trying to account for performance any less legitimate. This in itself means that an investment manager is taking their responsibilities (and competition) seriously.

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