

# Solutions for adjusting real estate exposure



An integral part of a comprehensive asset allocation strategy

Strategy Spotlight

**Brennan Lang**, Trader Derivatives

**Brian Causey**, CFA, Director, Overlay Portfolio Management

As investors have moved to diversify beyond equities and fixed income, real estate has become an integral part of a comprehensive asset allocation strategy. Aside from direct investment in a real estate fund or separate account, there are other options for adjusting a portfolio's exposure to real estate.

## Private real estate

Private real estate investments, like other private investments, are harder to replicate than their listed counterparts. Like private equity, private real estate funds have significant lockup periods and are not traded on major exchanges. For many U.S. institutions, the official policy benchmark for private real estate exposure is the NCREIF Property Index (NPI). The NPI measures the total return (income and capital value) of commercial real estate properties based on data collected from NCREIF contributing members. Before the global financial crisis, swaps on the NPI were possible. Since then, however, it has become very illiquid and most counterparties are no longer willing to facilitate trades on this index.

## Listed real estate

Real Estate Investment Trusts (REITs) provide a transparent and relatively liquid alternative for investors seeking real estate exposure. Listed and private real estate investments can provide two distinctly different kinds of exposure. Below we discuss three ways to access listed exposure. Each solution offers different costs, liquidity, tracking error, and underlying exposure.

## Futures on a REIT index

The Chicago Mercantile Exchange offers a futures contract on the Dow Jones U.S. Real Estate Index under the ticker DJEA. This contract is moderately liquid and suitable for smaller trades (<\$10 mm). Larger blocks of liquidity can also be accessed via market makers, but availability and pricing are subject to market conditions and dealer balance sheet capacity. All-in costs to own DJEA futures, including commissions, spread, and roll costs are around 40 bps per year.

## Total return swap on a REIT index

With a total return swap, an institution can receive the price and income returns of a REIT index and pay a specified financing rate. In the U.S., the Dow Jones U.S. Real Estate Index (ticker: DJUSRE) and the MSCI US REIT Index (ticker: RMSG) are the two most common indices for total return swaps. Terms of the swap can be customised, based on the needs of the investor. The financing cost varies by index.<sup>1</sup> Total return swaps on global real estate indices are not as common as their U.S. counterparts. Swaps on indices such as the FTSE EPRA/NAREIT (ticker: RUGL) can be structured and traded in small amounts, typically \$50 mm or less. Total return swaps on specific country real estate sectors can be a more liquid solution and are available for many developed markets (Japan, Hong Kong, Australia, Eurozone, etc.). They can be traded in isolation or together by investors seeking diversified global exposure.

## Exhibit 1: Comparison of U.S. real estate ETFs

TICKER	NAME	BENCHMARK INDEX	MANAGEMENT FEE	ANNUALISED TRACKING ERROR	AVERAGE DAILY VOLUME
VNQ	Vanguard Real Estate ETF	MSCI US REIT Index	12 bps	167 bps	\$530 mm
XLRE	Real Estate Select Sector SPDR Fund	Real Estate Select Sector Index	13 bps	120 bps	\$175 mm
IYR	iShares US Real Estate ETF	Dow Jones US Real Estate Index	42 bps	58 bps	\$500 mm

## Exhibit 2: Non-U.S. real estate ETF

TICKER	NAME	BENCHMARK INDEX	MANAGEMENT FEE	ANNUALISED TRACKING ERROR	AVERAGE DAILY VOLUME
RWX	SPDR Dow Jones International Real Estate ETF	Dow Jones Global Ex-U.S. Select Real Estate Securities Index	59 bps	184 bps	\$16 mm

Source: Bloomberg, May 2020

## Exposure via an exchange-traded fund

As of May 2020, there are a multitude of exchange-traded funds (ETFs) available that track the U.S. real estate market. By far the largest in terms of AUM is the Vanguard Real Estate ETF (ticker: VNQ). Other popular options include the Real Estate Select Sector SPDR Fund (ticker: XLRE) and the iShares U.S. Real Estate ETF (ticker: IYR). As shown in Exhibit 1, each comes with different pros and cons in terms of liquidity, management fees, benchmark exposure, and tracking error.

## Interim portfolio management

On an interim basis, an exposure management provider such as Russell Investments can build and manage a custom portfolio of publicly traded REITs based on a benchmark REIT index. The portfolio would be optimised within a predefined tracking error target and rebalanced in accordance with client parameters. The estimated transaction costs to build a \$100 million physical portfolio that tracks the Dow Jones U.S. Real Estate Index would be approximately 30 to 35 basis points. Similarly, the transaction costs to build a portfolio that tracks the Dow Jones Global Ex-U.S. Select Real Estate Securities Index would be approximately 50 to 55 basis points.

## Concluding thoughts

While not intended to be an exhaustive list, the aforementioned real estate exposure alternatives can all be implemented relatively quickly with the assistance of an exposure management provider.<sup>2</sup> Importantly, the exposure management provider can advise on the trade-offs between tracking error, costs, and liquidity associated with each option while incorporating details specific to each investment situation.

<sup>1</sup> In addition to the financing rate, additional commissions may be charged by the swap counterparty at the beginning and end of a REIT swap. If the swap is terminated before maturity, a break fee may apply. Please contact your Russell Investments representative for current pricing and break fees.

<sup>2</sup> In addition to providing a flexible platform for executing several different types of strategies, an exposure management provider can assist with setting up accounts and navigating the required documentation for trading physical securities and derivatives (listed and over the counter).

---

## About Russell Investments

Russell Investments is a global asset manager with a unique set of capabilities that we believe is essential to managing your total portfolio and to meeting your desired outcome. At Russell Investments, we stand with you, whether you're an institutional investor, a financial adviser, or an individual guided by an adviser's personalised advice. We believe the best way to reach your desired outcomes is with a multi-asset approach that combines: asset allocation, capital markets insights, factor exposures, manager research and portfolio implementation.

## For more information

Call Russell Investments at **020 7024 6000** or visit [russellinvestments.com](https://russellinvestments.com)

## Important information

### **For professional clients only.**

Unless otherwise specified, Russell Investments is the source of all data. All information contained in this material is current at the time of issue and, to the best of our knowledge, accurate. Any opinion expressed is that of Russell Investments, is not a statement of fact, is subject to change and does not constitute investment advice.

The value of investments and the income from them can fall as well as rise and is not guaranteed. You may not get back the amount originally invested.

Issued by Russell Investments Implementation Services Limited. Company No. 3049880. Registered in England and Wales with registered office at: Rex House, 10 Regent Street, London SW1Y 4PE. Telephone 020 7024 6000. Authorised and regulated by the Financial Conduct Authority, 12 Endeavour Square, London, E20 1JN. Russell Investments Limited is a Dubai International Financial Centre company which is regulated by the Dubai Financial Services Authority at: Office 4, Level 1, Gate Village Building 3, DIFC, PO Box 506591, Dubai UAE. Telephone + 971 4 578 7097. This material should only be marketed towards Professional Clients as defined by the DFSA. Russell Investments Ireland Limited. Company No. 213659. Registered in Ireland with registered office at: 78 Sir John Rogerson's Quay, Dublin 2, Ireland. Authorised and regulated by the Central Bank of Ireland.

KvK number 67296386

© 1995-2021 Russell Investments Group, LLC. All rights reserved.

First used: July 2014. Updated: May 2020

MCI-02476/24-05-2022 EMEA 2033 TV0336