Institutional funds ramp up overseas property investments

EPF and KWAP enlarge real estate portfolios abroad for better returns, but are they opening themselves up to new risks?

IN the last three years, local institutional funds have been significantly increasing their holdings of overseas assets, particularly real estate.

Funds such as the Employees Provident Fund (EPF) and Kumpulan Wang Persaraan (KWAP) have ramped up their real-estate investments outside Malaysia. Both the EPF and KWAP have property assets in the UK, Australia and other countries.

Apart from owning real property, the EPF also holds significant equity positions in various property developers and asset trust managers across Europe.

KWAP doubled its investments in overseas properties to RM4.07 bil in FY13 from RM1.99 bil a year earlier. Property investment certainly makes sense with prices soaring to record heights the last few years, but what are the risks, especially in investing overseas?

Institutional funds continue to record impressive net profits. However, the heavy investment in overseas real estate markets does open doors for a property bubble risk.

According to Capital Dynamics managing director and CEO Tan Teng Boo, there are various risks involved in property investment, especially on a large scale and more so in an unfamiliar foreign market.

When funds dedicate a significant portion of their portfolios to overseas property investments, they need to be mindful of the associated risks. "Yes, it is rather common for these funds to invest in overseas properties. The risks are typical – overpaying, wrong timing, wrong locations and foreign exchange [losses]," Tan tells ***FocusM***.

In 2008, the US housing bubble saw the collapse and shedding of US property prices which lasted at least until 2012. In 2008 alone, the US government had to allocate over US$900 bil for special loan rescues related to the sub-prime property crash. What a time it must have been for those who invested heavily in the US property market.

The Dubai property crash is another lesson for property investors. A law change in 2002 saw foreign investors sweeping into the Dubai property market, pushing prices up so severely that the house of cards eventually came crashing down. In 2009, Dubai property prices crashed by as much as 60%. What didn't help was the sub-prime was also at its peak then.

Fast forward to this year. While Dubai has since recovered, industry observers are already warning that signs of another potential bubble burst are already in play.

In the US, there is talk of another potential upcoming bubble. However, this time around the US is not alone, as the "golden decade" in the Chinese real estate market is said to be coming to an end soon.

Recently, prices of luxury property in Singapore's Sentosa Cove took a dive, falling about 20% from last year. The UK government too is urgently trying to quell house price growth or risk a bubble burst, with rent now taking up to 59% of the average Londoner's take-home salary.

Hence, with local funds holding significant properties abroad, could they be unsuspectingly exposed to various risks and possible future crashes in the various hot global property markets?

Another lesson for investors is the Dubai property crash which saw prices crashing by as much as 60% in 2009

by Dinesh Immanuel

Tan says there are various risks involved in property investment, especially on a large scale and more so in an unfamiliar foreign market

An industry analyst with knowledge of fund investment strategies opines that local funds simply have no choice but to look to overseas investments, for the simple reason they have "too much cash". The analyst explains to ***FocusM*** that there is a mismatch between investment opportunities in Malaysia and the high-cash position of local funds.

A quick look at the EPF's latest annual reports show the provident fund holding RM3.7 bil in cash assets (with another RM20.1 bil in bank deposits) while KWAP holds some RM5.36 bil in cash. According to Lembaga Tabung Angkatan Tentera's (LTAT) 2012 annual report, the fund had RM7.45 bil in cash and balances.

"There's no choice. Funds need to look outside the country to derive better returns. There simply aren't enough opportunities in Malaysia. [Malaysian] equities and bonds are not enough," the analyst says, noting that "if you kept pumping cash into equities, soon the local funds will hold almost half of all the [local] stocks".

In announcing its Q2FY14 results, EPF CEO Datuk Shahril Ridza Ridzuan attributed its 13.5% quarter-on-quarter (qoq) growth to, among others, significant contributions from its investments outside Malaysia. Some 22% of the EPF's RM612.4 bil fund is invested in global markets, mainly in equities.

Possibly as an indication of the uncertainty in global property markets, EPF's income contribution from its Real Estate & Infrastructure segment unexpectedly fell year-on-year (yoy) to RM184.12 mil in Q2FY14 compared with the same period a year ago. According to the EPF, its foreign real estate investments make up only 1% of its portfolio, which is about RM6 bil. Its total real estate investments make up 2.4% of its funds in 2014.

Shahril explained its significant overseas asset holding is required to mitigate risks and hedge market bets.

"Part of our portfolio diversification strategy includes expanding our investment portfolio overseas as well as outsourcing funds to external fund managers. This move allows the EPF to capitalise on investment opportunities in both the developed and emerging markets as well as to mitigate risks that may arise if we were to maintain our focus in a single market," he says.

Similarly, according to KWAP's 2013 annual report, its total fund grew 12.6% to reach RM99.9 bil, almost doubling in size since its inception in 2007. Like the EPF, KWAP also holds fixed income and equity investments outside Malaysia.

KWAP's first foray into the international property market was the purchase of real estate in Melbourne, Australia in 2010. It now owns about nine properties in Australia and in London, UK, worth about RM4.07 bil.

In an interview last year, KWAP CEO Wan Kamaruzaman Wan Ahmad Said said the fund has plans to increase its overseas property investments. "We want to increase our real estate investments because it fits into our strategy and will give us steady recurring income from rentals and upside on asset appreciation."

In June this year, KWAP purchased the three-floor Intu Uxbridge shopping centre in West London for almost RM1 bil, and is in the process of buying two commercial properties in Kuala Lumpur.

Established in 2007, KWAP is responsible for assisting the government in financing its pension liability in accordance with the Retirement Fund Act 2007. It manages contributions from the government, statutory bodies, local authorities and other agencies.

The EPF's role, on the other hand, differs as it manages the retirement fund contributions from the private sector.

In July last year, the EPF was said to be planning to spend over RM2 bil on industrial properties in Germany and office space in France. By January, it had invested another RM842 mil for a 50% stake in the UK-based Arena Trust which owns various properties in the country.

Locally, the EPF is also actively involved in real estate, especially in the township development of the 26ha Rubber Research Institute land in Sungai Buloh, Selangor.

The LTAT is also actively involved in property development through the Boustead Group. However, it is not clear whether the fund owns overseas properties or what its portfolio spread is. The LTAT manages retirement contributions from Malaysian armed forces personnel.

Equities still largest contributor

Nevertheless, despite the increasing attention given to overseas property investments by local funds, investments in equities and bonds remain the largest revenue contributor.

Despite fears of uninspiring equity market performance this year, the EPF still holds some RM265 bil in local equities, or about 43% of its portfolio. KWAP has almost 30% of its fund invested in local equities.

Local funds are generally actively involved in local equities, unlike their foreign counterparts. "[Foreign sovereign funds'] portfolios are typically very diversified but they are not [usually] involved in as big a manner in their own equity markets as the EPF is in Bursa," Tan says.

Both the EPF and KWAP are also exposed to global equities and other funds via external fund managers. To date, the EPF's overseas investments managed by external fund managers stood at 12.7% for equity and fixed income products, quite similar to KWAP.

Ultimately, despite the risks, it is probably necessary for the local institutional funds to not only diversify their asset portfolios but also the geographical dynamics of their portfolios.

"There are not [enough] investments in Malaysia to match the high cash position of the local funds. Also, you don't want to be in a position where all your money is in one country," notes the industry analyst. FocusM

Institutional funds' investment portfolios

Fund	Portfolio (%)				Total cash & deposits (RM bil)
	Equities	Bonds & loans	Real estate	Others	
EPF	43.3	50.1	2.4	4.2	23.8
KWAP	29	54.1	4	12.9	5.4
LTAT	–	–	–	–	10.1

Source: Latest annual reports