# Swiss Pension Funds Cross Real Estate Boundaries

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**One in three Swiss pension funds held more real estate investments than permitted by regulations at the end of last year. They now want to correct things, but the real estate boom has faded.**

Everything is relative. For pension fund managers, **Albert Einstein's** adage has a special ring to it at the moment. Their investments in equities and bonds have fallen sharply over the past year, while real estate holdings suffered less. In relative terms, the result is they often gained significant weight in the investment portfolios of pension funds, according to data made exclusively available to *finews.com*.

At the end of last year, observers warned a quarter of Germany's pension funds would have to sell or devalue real estate investments because their weightings exceeded the Ordinance on Retirement, Survivors' and Disability Pension Plans (BVV2) thresholds. Regulations prescribe a quota for real estate investments not exceeding 30 percent.

### Threshold Violations

**Heinz Rothacher**, CEO of St.Gallen-based pension fund consulting firm Complementa tells *finews.com* that such violations were more extensive than feared at the end of last year. «More than a third of the pension funds have reported a real estate quota of over 30 percent,» he says. «There are a few pension funds that had a threshold violation because of the increase in ratios.»

The OOB2 ordinance allows some wiggle room in portfolio ratios that pension funds can use to shape their investment strategy. But this leeway has its limits, and when reached, two options are available: Wait it out or correct the portfolio.

### Maintain Quotas

As a first step, pension plans have opted for the former. «Since it is a passive violation of the limits, they tolerated it and decided to keep the existing quota,» Rothacher says. The same applies to violations of the BVV2 30 percent limit.

Complementa surveyed around 150 decision-makers in the occupational pension sector about the problem. At the end of last year, the real estate ratio averaged 24.1 percent, 3 percentage points higher than the year before.

The wait-and-see approach hasn't worked out badly for pension funds so far. Rothacher reports the real estate quota declined as stock market performance improved, so the breach «has been partially remedied.»

Surveys by Credit Suisse show Swiss pension funds generated an average investment return of 3.86 percent through the end of  June. At UBS, the average performance after deducting fees was 3.51 percent, meaning that the funds have generated returns exceeding statutory minimum distributions of 1 percent annually.

### The Crux of Illiquidity

Still, the problem hasn't gone away, and pension funds have to be concerned about maintaining defined thresholds over the medium term due to their investment strategy. Another sticking point is that because of the illiquidity of the asset class, it's difficult to adjust the ratio in the short term for directly held properties or investment foundations.

That leaves insurers to adjust liquidity where it's most likely to be available, which is in listed real estate investments. «Thirty-seven percent of the funds participating in the survey are planning to cut back on listed real estate funds,» Rothacher says. A further 11 percent of respondents are considering cutting back on non-listed holdings.

**Higher Redemption Fees**

As it turns out, Swiss real estate fund prices fell sharply last year. The SIX Real Estate Funds Broad Index (SWIIT) lost more than 15 percent of its value last year while stagnating this year. Meanwhile, non-listed investment groups are experiencing lower demand for additional investments.

Various real estate vehicles received significantly fewer commitments than planned where capital increases have been carried out. «Not long ago, oversubscriptions were the norm,» the CEO recalls.

He doesn't expect any major sales of such vehicles but knows of individual investment groups that increased redemption fees this year to protect existing investors and act as a selling deterrent. «Redemption fees for different investment vehicles vary widely and can sometimes account for a large portion of an annual performance,» Rothacher comments.

**Reaching for the Red Pen**

Even those who stubbornly cling to their real estate positions may suffer. That's the case when there are valuation corrections because the real estate appraisers are then forced to raise discount rates due to further interest rate increases.

In the Swiss market, the low level of construction activity, immigration, and rising rents make such measures premature. However, further interest rate hikes by the Swiss National Bank could still prompt appraisers to make cuts.

Local pension funds often have a pronounced «home bias» in their real estate investments and would probably be sensitive to a decline in valuations.