Research Programme 2015-2018

MANAGING CURRENCY RISK IN REAL ESTATE INVESTMENT

Invitation for Research Proposals

April 2017

Background

As investors increasingly seek to diversify their real estate exposure beyond their domestic markets, there is a need to consider the impact currency fluctuations may have on the performance of these holdings. Circumstances, such as Brexit, have caused currency volatility and, by implication, the cost of hedging to increase and, thus, this has become a more pressing topic for investors and fund managers.

Recent research[1] has sought to identify how investors handle currency issues and examined the relationship between volatility of currency and the effect of currency hedging on returns and risk. A number of questions remain unanswered, however, including where responsibility should lie in evaluating and executing strategies to protect real estate returns against currency risk. Should asset managers be left to manage their property holdings, leaving others to manage currency fluctuations? What strategies do investors actually implement in order to achieve protection against downside risk?

The Brief

The IPF wishes to commission research to provide greater insight into how investors and managers manage currency exposures when investing in real estate, which, due to the illiquid nature of the asset class, raises distinct issues to those attaching to other types of investment. Research teams are invited to add their own interpretation to the broad topic area described above. However, it is expected that the research will address the majority of areas outlined below:

- A concise examination of the theoretical concepts underpinning foreign exchange markets and brief description/definition of key terms and concepts (e.g. 'spot', 'forwards', cross currency swaps, options, interest rate differentials, etc.). Do participants use currency management to minimise risk (hedging) or to improve returns or both? (20%)
- An examination of the different approaches to managing the currency risk associated with non-domestic real estate investments (to include the decision not to hedge). These should be described and comparisons made between the perceived strengths and weaknesses of each approach. Where necessary, distinction should be drawn between the perspectives of investors and third party fund managers (collectively described as 'participants'). (75%)

  This analysis should ideally consider (but not necessarily be limited to) the following questions:

  - What process does the participant use to determine its currency management policy? Do participants typically adopt 'programmatic' currency management (following a policy irrespective of market conditions) or do they tailor their approach based on market conditions or other considerations?
  - Who manages currency risk (property managers or treasury departments) and at what level within an organisation does responsibility lie?
  - Do participants benchmark their real estate performance on a hedged or unhedged basis?
  - Do participants distinguish between capital hedging and income hedging? If one and not the other, why? Where they do make a distinction, what are the different approaches used?

[1] INREV The impact of currency on the performance of European non-listed real estate funds 2017

- Foreign exchange hedging increases leverage off balance sheet. How do participants view the relationship between currency hedging and overall leverage?
- Are there different strategies for managing emerging market and developed market currencies?

- What is the long-term impact (over a property market cycle, say) of currency volatility on investment performance? How critical is the time period over which such performance is measured and how subjective is the nature of any analysis? (5%)

Scope
The research should span global markets in examining currency management within real estate investment portfolios.

Outputs
The findings are to be presented in a format that is accessible to general real estate investment practitioners and that clearly conveys the practical implications of the research findings. Worked examples and/or case studies will help to illustrate a number of issues identified in the brief, in particular, to support analysis in answering the final question.

Outputs will comprise a detailed report (including an executive summary of no more than two pages), as well as a non-technical summary report, drawing out key implications and their relevance for the industry. In terms of relative importance, the report should be broadly weighted in accordance with the percentages noted for each of the main section described previously.

Research Monitoring
A Project Steering Group (PSG) will be appointed by IPF to oversee the research, the membership of which will include IPF Research Director, Pam Craddock, and other parties knowledgeable in the subject area. The PSG will meet with the appointed party periodically throughout the term of the project to act as a monitoring group but also to provide constructive support to the appointee. The PSG will also be responsible for approving the final report prior to publication.

Project Duration
No estimate has been made as to the time that may be required to execute the brief. However, the results, incorporated into a final report, should be available for publication no later than **30 November 2017**. The IPF reserves the right to require the appointee to present key findings at its 2017 investment conference, taking place on 23/24 November 2017.

Appointment Process
Proposals should be submitted to the IPF Research Director, Pam Craddock (pcraddock@ipf.org.uk) by close of business, **Monday 8 May 2017** in a format consistent with the IPF Research Submissions Guidelines, available via the IPF website.

The IPF reserves the right not to proceed with any proposal, as well as to appoint a research contractor without conducting interviews.

It is intended that an appointment will be made within two to three weeks of the deadline for submissions, depending upon the number of proposals received.

Cost
At this stage a cost ceiling has not been set, as this will be dependent upon the perceived value for money of proposals received. As a guide, however, the typical budget the IPF sets for major studies of this nature is in the range of £40,000 to £50,000, excluding production costs.