INVESTOR UNIVERSE ITALY Regulations have made participation in real estate markets difficult for Italian pension funds. **Carlo Svaluto Moreolo** investigates

Will Italians rise to the challenge?

Renewable energy assets could be attractive for Italian pension funds

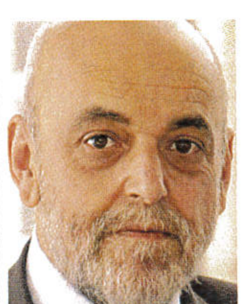
Foreign investors are looking at Italian deals and Italian investors are looking abroad. But so far there has been little involvement of institutional investors, most of which have failed to take advantage of opportunities in the Italian real estate sector.

The few institutional investors that have tapped into real estate are to be found among pension schemes that existed before the 1993 pension reform (which institutionalised second-pillar, or private, pension investment schemes), and among Casse di Previdenza (pension schemes for white-collar professionals). The latest regulatory update, the 252 law of 2005, sets strict rules for post-reform pension schemes (also called 'negoziali' because they are a result of negotiations between corporations and trade unions).

All but one of the many large and small post-reform funds (rail workers' scheme Eurofer) has invested in real estate, while the others simply have not taken up the challenge. How likely is it that the country's pension schemes will start investing in real estate any time soon, as the crisis fades and this category of institutional investors comes of age?

We put that question to two of Italy's largest pension schemes, Cometa (mechanical industry) and Fonchim (chemical industry), as well as Inarcassa (the engineers' and architects' Cassa di Previdenza), the private pension regulator, COVIP and Assoprevidenza, association of directors of private pension schemes. In particular, we asked whether the time was right for Italian pension schemes to enter this market, what skills they need to do so, and whether their involvement in this sector can help the Italian economy grow.

"The regulatory framework already foresees real estate as an integral part of the investment strategy of Italian pension funds," according to Fabio Ortolani, chairman of Fonchim. "During the initial phase of the life of new pension schemes such as Fonchim, the AUM were too little to make any significant investment in real estate. Then, as the masses grew, the opposite happened: there were no Italian real estate funds large enough for schemes such as ours to invest in. The only way we can invest is to invest directly by buying stakes of real estate funds or companies and we can invest up to 20% of our funds – we found that no Italian real estate funds had the capacity to accommodate our needs."



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Maurizio Agazzi

Ortolani says there were talks among pension schemes about creating a larger, common fund or several smaller funds, but he says: "The idea did not come to life."

He adds: "Fonchim has no immediate plans to add real estate assets to its portfolio but it may happen when we review our mandates in 2016. I think that pension schemes that choose to be involved in real estate can help the economy grow, but the investment needs to be on public infrastructure rather than residential or office space, and investing in these assets without the state is difficult. Clearly the point is that any investment has to be focused on the needs of the members of pension schemes."

In 2010, Cometa planned to introduce real estate into its portfolio by investing in two balanced property funds. "We had decided to allocate respectively 3% and 5% of our Reddito and Crescita funds in real estate," says Maurizio Agazzi, chairman of Cometa. "Then we had to review our plans because of red tape and regulatory difficulties, as well as declining indicators for the sector.

"The main difficulty was that we had to invest directly in closed real estate funds, and it was difficult to interpret how the direct investment should have been managed. Now we have no exposure to real estate, but it is clear that this could change in the future, since we feel that this is an asset class that certainly fits in the strategic asset allocation of a pension scheme such as ours."

Agazzi says a future catalyst may be political interests to encourage pension funds to invest in projects that help "re-launch the economy". He says: "Italians like alternative energy but any real estate project which combines income for the investor and social benefits should be welcome."

Europe and beyond

Inarcassa has a history of investing in property "partly because of the inclination of its members," says chairman Paola Muratorio. "We always put quality before profitability and price. Historically our exposure to real estate has fluctuated between 20% and 25%, and at the moment we have around 22% of our portfolio in real estate."

There have been some recent changes to the strategy. "We ran an EU-wide public search to find the right asset manager to manage a portion of our investment budget and grow our real estate portfolio," Muratorio says. "We identified Fabrica SGR, which has created a fund specifically for us. Through the Fabrica fund we do acquisitions and deals that suit our philosophy while focusing on long-term objectives, chiefly the stabilisation of income for our members."

She adds: "Despite the crisis, where one would think that there would be more assets available, we have difficulty finding assets of the quality we are looking for, especially in terms of energy savings and sustainability. The characteristics of an asset that can fit our portfolio are quite specific: we won't invest if the asset needs refurbishment or any kind of intervention. Also, we are looking for contractual stability."

Inarcassa is also looking outside Italy for real estate investments. "Today we are taking another step forward in terms of diversification, which has always been something we look for, as well as optimisation," Muratorio says. "We are looking specifically at opportunities abroad to invest almost one-fifth of our portfolio. We are looking at the EU and beyond.

"To do this we will look for the right partners, since we don't think we have the necessary experience to invest directly. We will look for asset management deals at the right cost and expected returns that are in line with our current returns."

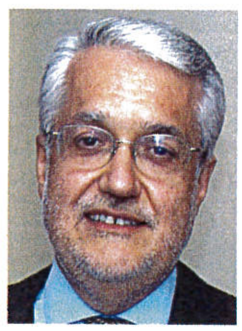
Inarcassa will target the hotel, retail, and logistics sectors. "Instead of office space, of which there is plenty, we'd rather have hotels that bring lower returns unless you find the right deal – and that's what we're looking for," Muratorio says. "For us it's about reaching the correct level of diversification. Also, we don't want to have duplicates in our portfolio, so we look carefully at our managers' portfolios to avoid duplication. To find the right EU and potentially global partner we will run a beauty contest, rather than a tender, and it will be based on a quality classification.

"We will continue to invest in Italy but it is a challenging market, no matter what expertise one has. Small assets of up to €30m in value, which we sometimes look at, are very often snapped up by very aggressive private players. And it is difficult to find assets without lease agreements already in place, which is what we would prefer. We have also had some problems with assets that have been vacated by state agencies because of spending reviews."

Improving real estate and infrastructure in Italy is a challenge, he says. "It takes a very long time to get permissions compared to other countries in Europe. I believe that to improve real estate and infrastructure in the country we need to focus on greenfield projects. This should be a priority over brownfield improvements. And, at the moment, there are no Italian real estate companies with experience in greenfield developments. KPMG has done an internal survey for us to look at certain details in the sector and have found that Italian real estate companies are lacking this experience."

COVIP, Assoprevidenza in favour

The 252 law of 2005, which represents the main regulatory framework for post-1993 pension schemes, stipulates that schemes cannot invest directly in real estate assets. They can gain exposure to the real estate sector by buying stakes in closed-ended real estate funds or by buying shares in real estate companies. The law also stated that pre-existing schemes (those that were operational before the reform of 1993), could invest no more than 20% of their portfolios in real estate. This meant that, when the law was approved, many assets had to be dismissed or that direct ownership in assets had to be turned into indirect ownership.



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"At the same time, while new schemes are required to hand the management of their equity and bond portfolios to external asset managers, they retain more autonomy with real estate portfolios," says Raffaele Capuano, director general of COVIP.

"As long as they invest indirectly – for example, they do not actually own real estate assets – they can do it autonomously, without the intervention of an asset manager. This, however, means they have to build an internal structure that can manage those kinds of investments. Because this is a lengthy and difficult process, most Italian schemes have failed to take advantage of that opportunity. Only in recent times have they started to build the expertise and skills to invest in real estate, and at the moment almost none of the newly-founded Italian schemes have exposure to real estate."

Capuano says COVIP encourages diversification into the asset class. "We have made an effort to help schemes achieve the level of solidity that will allow them to implement serious diversifications strategies," he says. "The document that was released in March 2012 sets the guidelines for the investment policy of schemes, including how they should be structured to pursue sensible, diversified investment strategies that are coherent with their members' needs. COVIP has always adopted a maieutic method to make sure pension schemes find the way by themselves."

He adds: "I don't think that the lack of investment in real estate so far is caused by a lack of professional skills. It's rather a culture problem, where funds have been very cautious – and this has meant better results during the dark years of the crisis such as 2008 and 2009 – but now the time has come to diversify. On our part, we plan to implement further initiatives to encourage diversification in real estate and other assets, which will consist of conferences and courses."

Sergio Corbello, chairman of Assoprevidenza says the "time is right" for Italian schemes to invest in real estate. "Obviously it is a fairly illiquid asset, so we will not see large flows to this market, but it should be part of the right diversification strategy and I am optimistic that we will see some deals in 2014."

He adds: "It should be noted that, when we speak about 'real estate', we could easily include assets that are not genuinely real estate in this category, such as renewable energy. The difficulty for schemes will be to invest directly. And, in order to do that successfully, they need to embrace a culture change, by improving the skills of the people in charge of investments inside the schemes. Nothing prevents them from getting support from advisers, but they need to increase their level of professionalism if they want to learn to invest directly in this difficult line of assets. They need to take ownership of their role as investors – and COVIP has helped them by releasing its investment policy document."

Corbello is more cautious about the capacity of pension schemes to support the economy through investment in real estate. "Pension schemes should focus on doing their job to the highest level, rather than attempting to support the economy by themselves," he says. "If, by providing for their members, they manage to help the Italian economy through difficult times, then all the better."