Press Release

INTREAL

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First Performance Analysis:

Article-8 Funds Start Earning Positive Returns Earlier in the Fund Cycle than Article-6 Funds

- Analysis by IREBS and INTREAL Solutions to compare the performance of Article-6 and Article-8 funds
- Article-8 funds reach break-even point in their IRR performance about a month-and-a-half sooner
- 26 Article-6 funds and 10 Article-8 funds examined

INTREAL Solutions, an IT service provider, consultancy firm and subsidiary of third-party AIFM INTREAL, collaborated with the International Real Estate Business School (IRE|BS) at the University of Regensburg to conduct a performance analysis of 26 Article-6 funds and 10 Article-8 funds. Here is the key finding of this first survey: Article-8 funds tend to reach their break-even point, meaning the time after which the fund starts generating positive returns based on the internal rate of return (IRR), around 1.7 months earlier than Article-6 funds do.

Annika Dylong, Head of Consulting and Services at INTREAL Solutions, commented: "At their core, our research findings show that, from an investor's point of view, Article-8 funds do not show significantly inferior performance curves in their early life cycles than Article-6 funds. In fact, the Article-8 funds covered by our data set actually started earning positive returns before their Article-6 peers did. Prior to our examination, we assumed that Article-8 products also show a significantly longer negative yield performance than Article-6 products in the early phases of their life cycles. This assumptions we can now cautiously refute with our first investigation. We deliberately chose to analyse the yield performance via the IRR on the level of the vehicle so as to rate the performance from the investors' point of view. The background to this is that market players often share their concern with us that sustainability on the vehicle level will precipitate significantly higher costs and thus have an adverse impact on performance. We found no basis for this notion in our data."

The survey run by IREBS and INTREAL Solutions analysed both the absolute rate and the time curve of the yield performance on the fund level. The development follows a J-shaped curve (hence called "the J curve"). Annika Dylong on the background factors: "The initial assumption in regard to the yield performances had been that the selection of suitable properties which meet the ESG criteria of the funds would take longer than the acquisition of conventional real estate. Moreover, the initial costs, such as for a more extensive—and thus more expensive—pre-acquisition due diligences, are conceivable higher because they also cover the fund's ESG criteria. Documentation and reporting are also generally more demanding and more costly for Article-8 or Article-9 funds. So, the required time effort and the corresponding extra costs would seem to diminish the returns on investment. Our analysis shows, however, that the yields of Article-8 funds do not seem to be diminished by higher upfront costs. In fact, these funds outperformed Article-6 funds during the early phase while the phase of negative returns extended over a shorter period of time. Two reasons to explain this come to mind. For one thing, it appears that the costs of the fund launch as well as the due diligence and acquisition processes of the properties do not depend on the type of the respective fund. Another possibility is that the higher initial costs amortise sooner once the cash flow has stabilised."

The survey represents a first analysis of the behaviour of property fund returns under the new ESG regulatory regime at EU level. Further research on the long-term yield performance of fund vehicles under the Sustainable Finance Disclosure Regulation (SFDR) is required. With its research, INTREAL has provided a first indication of the influence that the classification under the SFDR has and of the actual performance of these property funds. "We are closely watching the developments related to the Sustainable Finance Disclosure Regulation and their implications for real estate market players. To do justice to the intrinsic purpose of the EU regulation, it is of the essence to conduct investigations that objectively examine the performance of investment products from the perspective of the financial sector. Our contributions seek to use clear-cut analyses to position the sometimes hazy meaning of the term 'ESG' within a finance context. With the regulatory framework so recently created, it is still too early to conduct long-term studies. A final assessment of the returns paid by a property fund is impossible until that fund has been wound up and all of its properties have been sold off. Accordingly, these research findings provide a first indication of the short-term performance behaviour, to be followed up by future insights that we will share with the market from time to time as they emerge. We at INTREAL Solutions want to contribute our data basis and our analytical know-how to the search for answers to the industry's most pressing questions concerning the subject of sustainability. As Germany's leading investment fund platform, we have all the building blocks in place to generate value added. So, we see our market position not least as a mandate to mastermind the search for answers in the sustainability context," as Dylong elaborated.

Principally speaking, the yield performance of a newly launched property fund follows a typical pattern during the early phase right after going live: The short-term performance tends to be defined by high upfront costs that include administrative costs, taxes, notarial fees and all of the due diligence costs, among other things. Moreover, the investors' funds are drawn down not immediately after the fund launch but successively, in time for the acquisition of real estate eligible for the fund. Both factors will cause the fund to show a negative performance, particularly at the beginning, before it moves into the positive range after a certain time. It is this trajectory that explains the coinage of the term "J curve."

Methodology

To analyse the IRR curves of the investment funds, the average internal rate of return (IRR) was calculated for either fund category and mapped over time, starting with the fund launch. Next, the two "J curves" produced were analysed both as to their absolute levels and as to their intersection with the zero line (break even). As it turned out, the mean IRR of the Article-8 fund is effectively flatter and intersects with the zero line sooner than the curve of the Article-6 fund does.

Note on the Image Rights:

About INTREAL

As a third-party AIFM, INTREAL concentrates exclusively on the business of launching and managing regulated real estate funds on behalf of third parties under the German Capital Investment Act (KAGB). The platform lets clients take advantage of every service an AIF management company (KVG) provides without having to form one of their own. Options include the launching of open-ended and closed-end property funds or the outsourcing of AIFM back offices to INTREAL. Employing 490 staff, the INTREAL Group offers long-term real estate know-how along with detailed and highly professional fund management expertise.

In Luxembourg, the largest investment fund centre in Europe, INTREAL is represented by its subsidiary, INTREAL Luxembourg. INTREAL Luxembourg is an independent AIFM and central administrator for Luxembourg-domiciled property funds and property-related assets classes for German and international clients.

Through another subsidiary, INTREAL Solutions, the company makes its comprehensive property fund experience available to other market players within the scope of best-practice consultancy. These advisory services combine the IT subject with other specialist areas like ESG, risk management and process consulting. INTREAL collaborates with a large number of third-party fund partners to administrate 297 investment funds with a combined investment volume of c. 62.1 billion euros (all figures as of the end of Q4 2022).

About IREBS

As the largest centre for real estate economics, the IREBS International Real Estate Business School comprises eight chairs and professorships in economics and law plus ten honorary and visiting professorships at the University of Regensburg. Teaching at IREBS is interdisciplinary and practice-oriented in order to prepare students optimally for their future jobs. The research done here covers current application-oriented issues as well as demanding basic research.

At its satellite campuses in Frankfurt am Main, Munich, Berlin, Düsseldorf, Eltville, Hamburg and Vienna, IREBS devotes itself moreover to the continued professional development of junior executives and high-skilled professionals. With its broad-based academic spectrum, IREBS therefore ranks among the best higher education institutions in international real estate economics.