WALL STREET JOURNAL

Some Retirement Plans Include Private Commercial-Property Funds

These Funds Are Far Less Common Than Those Holding Publicly Traded Real-Estate Investment Trusts

By
Michael Shari
Updated Sept. 5, 2014 8:07 p.m. ET

A New York office building partially owned by a J.P. Morgan Chase real-estate fund that is available in some retirement plans. J.P. Morgan Chase

Retirement-plan participants typically invest in stocks and bonds. A small but growing number of such investors are also putting a portion of their workplace savings into funds that hold office buildings, shopping centers and other commercial real estate, experts say.

Commercial real estate can help diversify the risk in a retirement portfolio. But investors should also be aware of drawbacks to the funds, which can include layers of fees that eat into returns and potential difficulties in liquidating investments to meet redemption requests.

Workers had $22 billion invested directly in commercial properties at midyear, says Brian Velky, a managing director at Real Estate Research in Des Moines, roughly double the amount they had in such properties at the end of 2009.

These property funds differ from real estate investment trusts, or REITs—publicly traded companies that buy properties and must pass on at least 90% of their profits to investors to qualify for their federal income tax-free status.

Rents paid by commercial tenants of office buildings, factories and shopping malls can provide a stable source of income that can serve as a hedge against inflation as the U.S. economy grows.

Commercial real estate returned an average 8.6% a year in combined appreciation and income over the decade ended June 30, according to an index of more than 7,000 U.S. properties compiled by the National Council of Real Estate Investment Fiduciaries. That compares with an annualized 7.8% for the S&P 500, including dividends, and 4.9% for the Barclays U.S. Aggregate Bond Index, according to data tracker Lipper.

WALL STREET JOURNAL Some Retirement Plans Include Private Commercial-Property Funds

Verizon Communications VZ -1.27% has offered a fund that holds commercial real estate as one option in its 401(k) plan for management employees since 2007, says spokesman Ray McConville.

The plan also offers all-in-one target-date portfolios that include a real-estate component. Target-date funds generally hold a mix of stocks and bonds and grow more conservative as investors approach retirement.

"Private real estate is a tremendous diversifier," says Michael Riak, who was director of Verizon's savings plans until he joined private-equity manager Pantheon Ventures last year. He says physical real estate tracks the stock market less closely than REITs, which are traded like stocks and "which take a dive when stocks take a dive."

Physical real-estate holdings are far less common than REITs in retirement plans. Typically, commercial real-estate investments in retirement plans are structured as so-called collective investment trusts, which are institutional accounts that aren't subject to all the same regulatory rules as mutual funds and which, partly as a result, typically have lower expenses.

In addition, TIAA-CREF, a major provider of retirement plans, offers the TIAA Real Estate Account, a variable annuity, in some of the retirement plans it manages on behalf of academic institutions and nonprofits.

J.P. Morgan Chase, JPM -1.39% Principal Financial Group, PFG -1.29% UBS UBSN.VX -0.61% and Prudential Financial PRU -1.00% are among the other asset managers that offer commercial real

This Washington, D.C., office building is owned by the TIAA Real Estate Account. CoStar Group estate as an investment option in retirement plans they work with.

Edward McIlveen, director of research at Pewaukee, Wis.-based Francis Investment Counsel, which selects asset managers for retirement plans, says the trend signifies acceptance of physical real estate among some plan sponsors.

Still, $22 billion is only 0.4% of the $5.86 trillion in defined-contribution retirement plans, as reported by the Investment Company Institute, a trade group. About $13.9 billion of that $22 billion is in the TIAA Real Estate Account.

One issue for investors is multiple layers of fees. Fees and expenses for holders of the Prudential fund can add up to as much as 1.58% a year, including charges for underlying real-estate funds and record keeping.

Another issue: how to make an illiquid asset work as an investment option inside plans that typically allow investors to buy and sell a fund any day. After all, it is far more difficult to sell a shopping mall than to sell a stock or a bond.

The TIAA account and commercial real-estate funds such as the Prudential Retirement Real Estate Fund, which is an option in the Verizon plan, and J.P. Morgan's JPMCB Diversified Commercial Property Fund all have about 75% of their assets in commercial buildings and about 25% in liquid securities such as REITs and cash. The UBS Trumbull Diversified Property Collective Fund currently has 15% of its assets in liquid securities.

The liquid securities are supposed to provide a cushion to meet redemptions.

The Principal U.S. Property Account was recently about 96% invested in direct commercial real estate, with 4% in cash, says Principal Financial spokesman Adam Lackey. Robert Best, senior managing director of Principal Global Investors, a Principal Financial unit, says the $6.54 billion property account has sufficient liquidity from rental income to cover withdrawals.

Corrections & Amplifications

Fees and expenses for holders of the Prudential fund can add up to as much as 1.58% a year, including charges for underlying real-estate funds and record keeping. An earlier version of this article referred to charges that could add up to 2.3%. (Sept. 5, 2014)