IPE REAL ESTATE

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Shayla Walmsley wonders whether new property laws and funds will at last persuade Italian pension funds to invest beyond their domestic borders.

AXA's announcement that it had raised €118m from Italian institutions for the first close of a fund targeting European office represents a significant shift for pension fund investors traditionally limited to major cities in their domestic market.

Even trying to target the Italian pension fund market with a cross-border proposition takes an intrepid fund manager. There is a precedent, said AXA fund manager Giorgio Pieralli – but even he acknowledged it was a small one. It amounts to a couple of pension funds with small allocations to cross-border funds and Cariplo pension fund's ownership until earlier this year of a Manhattan office block.

In fact, despite an albeit short history of investing directly in real estate within a clearly circumscribed market centred on Milan, there has long been ambivalence about investing in real estate at all.

That is changing for two reasons. As fund managers and advisers up their emphasis on the benefits of diversification through third-party funds, costs associated with managing directly owned domestic portfolios have encouraged pension fund investors towards alternative investment strategies.

Pieralli's fund, though cautious, is structured for maximum diversification. No one of its assets will exceed 15% of the total portfolio, and no one tenant may represent more than 20% of revenue. But the domestic consensus is growing over the need to move away from residential more quickly and to invest, for example, in commercial or logistics, according to Armando Piccinno, senior associate at investment consultancy Mercer.

"There's an awareness of the need to move away from residential more quickly and to invest, for example, in commercial or logistics," he says. "The question is how fast."

Give us rules
AXA has established a precedent. A couple of things now need to happen to mainstream Italian pension funds investing in overseas real estate. Getting the regulator to regulate is one of them. This year, reforms both of the 703 law governing pension fund investments and of Italian pensions regulator COVIP's operating rules for pension funds – notably the introduction of a new rule on 'proportion' – could liberalise schemes' investment strategies. But one obstacle to date has been that Italian pension schemes have been cautious about breaking rules that do not exist – at least not yet.

"For reasons no one understands, COVIP has never set rules for investing in real estate," says Davide Cipparrone, chief executive at financial risk consultancty MangustaRisk. "In theory, pension funds have been able to invest in real estate from the beginning, but it never really happens because the rules haven't been set."

One example he gives is a mandate for MangustaRisk from AUM €5.7bn Fondo Cometa to design a portfolio for Italy's largest pension scheme. The theoretical portfolio the consultancy came up with included real estate, but Cometa's board declined to green-light it in case it embarrassed COVIP by breaching non-existent rules.

"The debate [over rules] has been going for five years," says Cipparrone. "Every year, someone says 'It's time to change' and the discussion starts up again, even stronger. We have to pull up this layer of uncertainty. It's useless, and it's damaging pension funds."
That might be about to happen. "Maybe it will happen in the next few months," says Cipparrone, sounding unconvinced. "Perhaps now is the right time." Then again, it might not.

In the meantime, AXA has lost no time in launching its fund, saying it has "nothing to fear" from (putatively) upcoming regulatory changes. "Funds with solid fundamentals and a commitment to transparency have nothing to fear regarding a change in regulations," says Pieralli. "We're more than comfortable that any potential change in regulations or frameworks will not impact the fund's operations."

A second, more difficult to achieve requirement for investment liberalisation will be to resolve – or skirt – inherent conflicts between various factions on pension fund boards. With the typical Italian pension scheme board divided between employer and trade union appointees, it is likely to be split between two different investment styles.

"If the employer wants to invest in a big Milan development, the trade union might want to invest in a small, former industrial area," says Cipparrone. "Trade unions will have different ideas about how to invest money than employers. It will be difficult to find the balance."

"This is, after all, Italy – everything is political," he adds, pointing to likely disruption of existing interests if Cometa were to come to the market with €1bn to invest in real estate.

"Pension fund investment will have more of an impact – so the basis will be more contentious – than, say, investment in equities," Cipparrone says. "You can buy Fiat shares, but it won't change much unless you own a lot of them. With real estate, it would be moving big interests in the market because it would be moving alone."

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