Galiniene, B., Bumelyte, J. (2011), "Real Estate Funds: Their Place in the Investment Funds Universe and Development Trends", *Transformations in Business & Economics*, Vol. 10, No 1(22), pp.34-49.

---------TRANSFORMATIONS IN --------
BUSINESS & ECONOMICS

REAL ESTATE FUNDS: THEIR PLACE IN THE INVESTMENT FUNDS UNIVERSE AND DEVELOPMENT TRENDS

Birute Galiniene[1]
Department of Economic Policy
Faculty of Economics and Management, Building II
Sauletekio al. 9, Vilnius
Lithuania
Tel.: +370 5 2366129
E-mail: birute.galiniene@ef.vu.lt

Junona Bumelyte[2]
Department of Economic Policy
Faculty of Economics and Management, Building II
Sauletekio al. 9, Vilnius
Lithuania
Tel.: +370 5 2366129
E-mail: junona.bumelyte@ef.vu.lt

[1]**Birute Galiniene,** PhD in Social Sciences, Full Professor and Head of the Department of Economic Policy, Faculty of Economics, Vilnius University (Lithuania), Dean of Faculty of Economics. She is Member on Editorial Boards of the scientific journals of Vilnius University "*Ekonomika*" (=*Economics*), "*Transformations in Business and Economics"* and Vilnius Gediminas Technical University (Lithuania) "*International Journal of Strategic Property Management*". She is Council Member of the Lithuanian Association of Property and Council Member of the Lithuanian Institute of Audits, Accounting and Valuation.

[2]**Junona Bumelyte**, PhD student at Faculty of Economics, University of Vilnius (Lithuania). Her articles have been published in the scientific journal of Vilnius University "*Ekonomika*" (=*Economics*).

Received: September, 2010
1st Revision: November, 2010
2nd Revision: January, 2011
Accepted: March, 2011

***ABSTRACT**. Real estate with its exceptional characteristics plays a very important role among other investment instruments. This is due to the fact that the allocation of real estate, as an alternative investment instrument, increases diversification possibilities of the investment portfolio. A wide range of different investment vehicles now exists to gather assets from investors, and investing those assets in a diversified portfolio of financial instruments. One of these investment vehicles, real estate fund, represents an important part of current European investment funds market. The main purpose of this article is to overview real estate investment funds, its main characteristics and instruments, and to evaluate the situation of European real estate funds market and the development of such investment products in Lithuania. The article analyses investment fund instrument paying special attention at the common categorization of the investment funds in the Europe Union (EU); presents an overview of the legislative basis and current developments in the EU investment fund market as well as classification and comparison of the main products. Finally, authors present their insights into the real estate fund developments in Lithuania.*

KEYWORDS: investment fund, investments in real estate, real estate fund market, real estate fund instrument, the EU, Lithuania.

JEL classification: L11, L85, G11, P2.

Introduction

A wide range of different investments vehicles now exists to gather assets from investors, and investing those assets in a diversified portfolio of financial instruments. Variety of collective investment gives costumers greater opportunity to meet their financial needs. Also possibility to choose between different products creates competition which in turn should deliver lower cost and improved returns. Real estate funds represent an important part of current European investment funds market (Marčinskas and Galinienė, 2005; Zavadskas *et al*., 2009; Kaklauskas *et al.*, 2010; Wang, 2010). The regulation of real estate funds, their establishment and possibility to enter the Lithuanian market were essential as most European Union (hereinafter – "EU") Member States have already created conditions for the formation of analogical national investment products.

This article focuses on the investment vehicles that provide investors with the exposure to the real estate asset class. The authors first present a general overview on the investment fund instrument paying special attention to the common categorization of the investment funds in the EU. Then, the authors overview the EU investment fund market, which is accompanied by brief review of recent amendments in the legislative basis under financial crisis. The second part of the article presents the real estate investment fund vehicle concentrating on the classification and comparison of the main products. Finally, the authors investigate the real estate fund developments in Lithuania.

1. Investment Fund Instrument and its Classification

1.1 Main characteristics of the investment fund

Investment funds are specially constituted investment vehicles, created with the sole purpose of gathering assets from investors, and investing those assets in a "diversified portfolio of financial instruments. […] Legal or natural persons manage the assets by the right of common partial ownership under the trust right in accordance with the procedure and under the conditions established in legal acts and the rules of the investment fund. Investment funds mobilize house-hold savings and channel them towards productive investments" (EFAMA, 2008).

"Investors buy units issued by the fund against the portfolio of underlying assets, and the value of those units fluctuates with the value of the portfolio". In this way, "small investors can buy exposure to a professionally managed and diversified basket of financial instruments. Over-heads […] are spread over the pool of investors, reducing average cost for the investor" (European Commission, White Paper, 2006). Possibility of collective investment gives costumers greater opportunity to meet their financial needs. Furthermore, possibility to choose between different products creates competition, which in turn should deliver lower cost and improved returns.

Company's management, depository and national regulator could be identified as the main actors of the investment funds. Company's management is responsible for the day-to-day management of the fund. This usually involves the management of the assets but also a number of associated administrative functions such as record keeping, regulatory compliance monitoring. Depositary typically carries out two functions: (1) the safe-keeping of the assets and (2) the monitoring of the operation of the fund. It has, therefore, a crucial role in the protection of investors' interests. Assets of a collective investment undertaking must be entrusted to a depository for safe-keeping. National regulator is a national authority responsible for the authorisation and on-going supervision of the fund/management company (European Commission, Expert group report, 2008).

1.2 Main European investment fund classifications and place of real estate investment fund instrument

"Fund categories represent a critical device to sort out the universe of investment funds.[…] Regulators and trade associations maintain classification systems in many countries. To evaluate funds on a comparative basis, market data vendors also use fund categories. As a result, many different classification schemes today are competing in the European fund landscape to provide the most relevant fund categories. […] The founders of the European Fund Categorization Forum (hereinafter – "EFCF") took on the task of defining a new, harmonized classification system of cross-border funds to help European investors compare funds from different jurisdictions without being misled by inconsistent fund categories" (EFAMA, 2008). Classification and statistical data presented below are based on European Fund and Asset Management Association (hereinafter – "EFAMA") project to facilitate the comparison of investment funds".

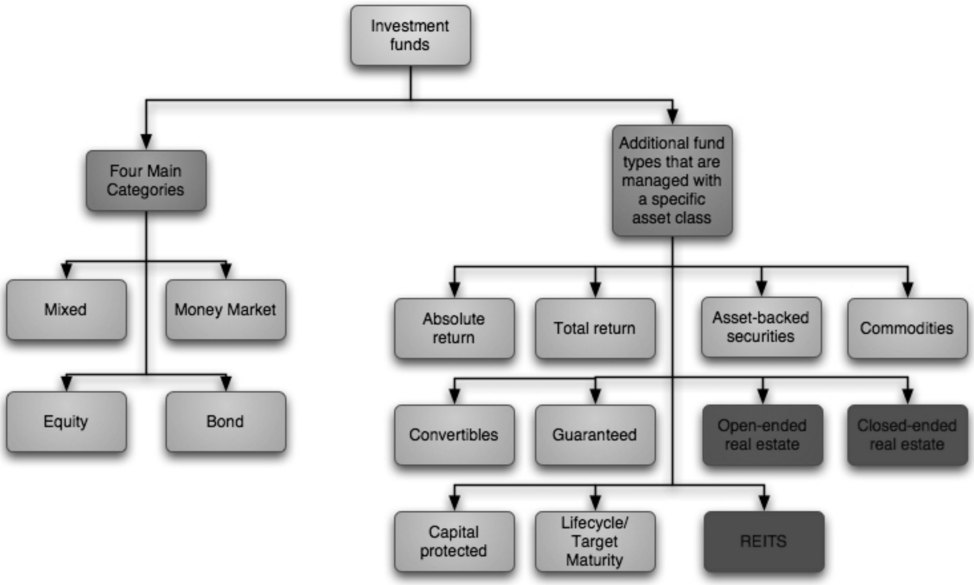
According to EFAMA, "the funds are either assigned to one of four main categories according to the assets in which the fund invests, or classified the following fund types that are not managed in relation with a specific asset class. Four main categories include the following funds: (1) equity funds; (2) bond funds; (3) money market funds; and (4) mixed funds" (EFAMA, 2008).

"Equity funds invest at least 85% of its assets in stocks. These funds can be differentiated according to three classification criteria: (1) country or region; (2) sector; and (3) market capitalization. In addition, each fund can be assigned one or several structural characteristics such as socially responsible, funds of funds, managers of managers, etc. Bond funds which invest at least 90% in fixed income transferable securities. Bond funds can be differentiated according to four classification criteria, in addition to some structural characteristics: (1) currency exposure; (2) emerging market exposure; (3) credit quality and (4) interest rate exposure. Money market funds are categorized along duration (from an average maturity of 60 days until a weighted average modified duration of one year maximum) and investment possibility (from investment grade money market instruments to transferable debt instruments). Three types of money market funds that differ in terms of their investment policy could be identified: (1) short-term; (2) regular and (3) enhanced money market funds. In addition, money market funds can also be differentiated by the currency of insurance of their assets Mixed funds invest in stocks, bonds and cash. These funds can be differentiated according to three classification criteria: (1) currency exposure; (2) country or region exposure; (3) asset allocation" (EFAMA, 2008).

In addition to these four broad categories, the EFCF has also classified the following fund types that are not managed in relation with a specific asset class: (1) absolute return; (2)

total return; (3) convertibles; (4) lifecycle/target maturity; (5) asset-backed securities; (6) commodities; (7) guaranteed; (7) capital protected; (8) open-ended real estate; (9) closed-ended real estate and (10) real estate investment trusts (hereinafter – "REITs"). Open-ended and closed-ended real estate funds as well as REITs are three categories of the investment funds that invest primarily in real estate and will be discusses separately in the following chapters (see *Section 1.3* for detailed description) (EFAMA, 2008).

The European Fund classification system (presented in *Figure 1*) can be characterized by three key principles: (1) transparency (high thresholds define fund categories to ensure transparency for investors and fund management companies and enable like with like comparison of funds); (2) investor protection (well defined fund categories, subjected to robust criteria, and effective monitoring based on the portfolio holding of the funds, will help investors buying funds knowing their inherent qualities); (3) independence (compliance with the classification criteria will be monitored by a neutral classification administrator).



Source: created by authors, based on EFAMA, 2008.

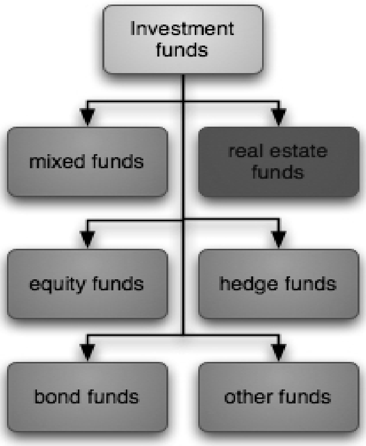
Figure 1. **The European Fund Classification: EFAMA Pan-European Approach**

The launch of the European Fund Categorization, supported by EFAMA, is an important development for the European fund industry. EFAMA has not only created common categorization of the investment funds in Europe but has also presented a tool for comparison of products based on sound investment fundamentals.

Another important classification of investment funds in the EU is laid down in Regulation ECB/2007/8 (hereinafter–"Regulation") (European Central Bank, Regulation, 2007), which defines the statistical standards according to which investment funds must report information on their assets and liabilities to the national central banks (hereinafter–"NCBs"). This Regulation is complemented by Guidelines ECB/2007/9 (hereinafter–"Guideline") (European Central Bank, Guidelines, 2007), which sets out the procedures to be followed by NCBs when reporting investment fund statistics to the European Central Bank (hereinafter–"ECB") (European Central Bank, Manual on Investment Funds Statistics, 2009).

In order to comply with the definition of an investment fund in the Regulation, an investment undertaking must be "collective". An investment undertaking is considered a collective investment undertaking if the document, which establishes the undertaking, allows for investments from more than one investor. Therefore, even if an undertaking de facto only has one investor, but legally (*ex ante*) more than one investor is allowed, the undertaking is to be considered collective.

In accordance with the Guideline, NCBs shall report statistical information on investment fund assets and liabilities broken down into the following six sub-sectors: (1) equity funds; (2) bond funds; (3) mixed funds; (4) real estate funds; (5) hedge funds and (6) other funds (see *Figure 2*).



Source: created by authors, based on Guidelines ECB/2007/9.

Figure 2. **The European Fund Classification: Central European Bank Approach**

Given the difficulties in adopting harmonised definitions of investment funds broken down by the nature of their investment, the glossary of the Guideline simply defines: (1) bond funds as investment funds investing primarily in securities other than shares; (2) equity funds as investment funds investing primarily in shares and other equity; (3) mixed funds as investment funds investing in both equity and bonds with no prevalent policy in favour of one or the other instrument; (4) real estate funds as investment funds investing primarily in real estate; (5) other funds as the residual category (i.e. investment funds other than bond funds, equity funds, mixed funds, real estate funds or hedge funds).

It is obvious that real estate fund, which is the object of this article, plays an important role in investment fund classification. More detailed analysis of this investment product (classification inside this asset class, main characteristics of the fund, investment propositions) as well as specificity of investing in real estate is presented in the following chapters of this article.

1.3 Investment fund universe and legislative framework in the European Union

The development of a single market for European investment funds has seen many successes as it has moved from being a distant vision to becoming a vibrant international industry accounting for billions of Euros of customer assets from the largest institutions to the individual investor (EFAMA, 2008). In the 1980s, the European industry for investment funds had started to develop over the decades it become a key actor in European capital markets.

The European fund industry currently manages over EUR 5 trillion of assets (European Commission, Green Paper, 2005). The assets managed by the EU investment fund sector have increased four times over the last decade. Although banking deposits and insurance reserves dominate household savings in most European countries and saving in investment funds is one of the many options for households to allocate their assets, funds play an important role today. Their average share in the EU household assets amounts to 11.5%, varying from 4.1% in the United Kingdom to 26.1% in Sweden (European Commission, Expert group report, 2008). The importance of investment funds will continue growing as most of European investors use them for the accumulation of pension funds. Ed Moisson of Lipper FMI, a Thomson Reuters company, predicts that assets under management in the European fund industry could reach EUR 6.8 trillion by 2014 (Hedgeweek, 2010).

Council Directive 85/611/EEC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (hereinafter – "UCITS") (Council Directive, 1985) serves as the cornerstone of the EU framework for investment funds. The UCITS Directive has provided the focal point for the growth of a vibrant European fund industry. This market is increasingly organized on a pan-European basis. The UCITS product passport is in widespread use. Cross border fund sales represented some 66% of the total net industry inflows in 2005 (European Commission, White Paper, 2006).

Alternative investment funds (hereinafter – "AIF") are defined as all funds that are not harmonised under the UCITS Directive (non-UCITS funds). The AIF sector manages around EUR 2 trillion in assets at the end of 2008. AIF invest in financial instruments such as stocks, bonds and other securities or commodities, as well as shares in real estate and infrastructure projects and controlling stakes in companies (European Commission, Financial services, 2009). The activities of AIF market are currently regulated by a combination of Member State financial and company law regulation, as well as cross-cutting provisions of Community law.

However, recent events have demonstrated that the activities of AIF market are not sufficiently transparent and that the associated risks are not sufficiently addressed by current regulatory and supervisory arrangements. On April 30, 2009, the European Commission published a draft Directive on Alternative Investment Fund Managers (hereinafter - the "AIFM Directive"). The Commission intends the AIFM Directive to establish a common regulatory and supervisory framework for all non-UCITS funds. Under this directive managers, whether organized in the EU or elsewhere, of hedge, private equity, infrastructure and real estate funds with assets under management of EUR 100 million or more will all therefore be affected, i.e. funds managed by such alternative investment managers would be allowed to market their funds to professional investors on a cross border basis via a simple notification to host Member States (in practice creating a sort of limited passport for alternative investment funds) (Lam and Delcourt, 2009).

The European Commission working document on AIFM Directive concludes that, "when judged from an EU perspective, the current regulatory environment does not represent a comprehensive or effective basis for monitoring and responding to risks posed by AIF market to their counterparties and the financial system. The European dimension of the public good to be protected by regulation and supervision is not sufficiently taken into account" (European Commission, Proposal, 2009). "The draft Directive is particularly criticized for aiming at all forms of "alternative" products without allowing taking into account the specificities of the very diverse industries that form the "alternative investment management" world in Europe. Managers of hedge funds, real estate funds or private equity vehicles all fall within the scope and shall have to adapt to the obligations imposed by the draft AIFM Directive" (Lam and Delcourt, 2009).

Although the AIFM Directive is at a very early stage of the legislative process and will not come into force before the end of 2011 (and the proposals relating to the promotion of funds incorporated outside the EU will not come into force for a further three years after that), were it to be implemented in its current form, would significantly reshape the European investment management landscape, requiring all entities managing or promoting pooled funds of any kind in EU to be subject to regulation (Bibby *et al.,* 2009).

2. Real Estate Fund Instrument

2.1 Investments in real estate

Real estate is a highly varied asset class comprising fixed land and buildings. Real estate can be perceived as a physical object (land and its appurtenances, i.e. structures), legal (legally real estate encompasses all property interests, privileges and rights related to ownership of physical real estate) or economic category. More detailed definitions of real estate help to have a comprehensive perception about the nature and characteristics of this specific type of property, however, in practice there is no so strict division among conceptions and real estate is usually realized as a physical object with legal and socio-economic features (Galiniene and Bumelyte, 2008).

This approach is also "common while analyzing the real estate market, which may be described as a certain set of mechanisms, according to which property rights and related interests are transferred, prices set and different land uses distinguished" (Galiniene, 2004). "The real estate market may be analyzed by various sections: types of real estate, regions, nature of operations related to real estate, etc. A concrete distinction of real estate enables a more accurate determination of real estate value" (Galiniene, *et al.,* 2006).

Real estate, like other asset classes is subject to cyclical movements which reflect, to varying degrees, movements in the broader economy – the asset prices are determined by the underlying supply and demand for the individual properties by paying tenants. For the past five years real estate in many European countries has seen dramatic growth until global financial crisis (Liow, 2007).

"The downswing of real estate markets in the early 1990s and the subsequent withdrawal of equity capital created a major void for property as an asset class. As the effects of low inflation and low trading volumes became increasingly apparent the property profession realised that it must take steps to re-define property as an investment medium. The search for increased liquidity through new investment vehicles has been to the forefront and is recognised as vital in placing property on a par with other asset classes. Given the illiquidity, indivisibility and lack of flexibility associated with direct property investment, there has been a concerted attempt in recent years towards the conversion of major single property assets into tradeable securities" (Berry *et al.,* 1999).

There are many different real estate investment vehicles available in Europe, making it very challenging to decide on the most appropriate structure and investment market selection. Expected return on property selection, expected economic growth of the area and safety of title are considered significant factors affecting the attractiveness of real estate investment market (Flackebach, 2009). Also the liquidity of the investment, the flexibility of income distributions models or the required diversification of the property portfolio are all factors that need to be considered, and differ significantly from one country (or fund) to the next (Lam and Delcourt, 2009).

2.2 Classification of real estate funds

One of the possibilities to invest in real estate in EU is real estate investment funds, which are attributed to the investment instruments that look for investment opportunities in one concrete market branch. Real estate fund is a broad term, potentially applicable to a wide range of different products, which provide investors with exposure to investments in property, land and other property related assets.

"To varying degrees across Europe, retail investors are able to invest indirectly into real estate through a variety of professionally managed investment products. The most important ones are: (1) open-ended real estate funds; (2) closed-ended real estate funds; (3) Real Estate Investment Trusts (REITs) and (4) other property companies" (Expert group report, 2008).

"Open-ended real estate funds are regulated at national level by fund-specific regulation and have the following characteristics: (1) are redeemable at certain moments at the request of unit/shareholder; (2) are allowed to invest directly or indirectly through participations in real estates and / or in shares / units of other open-ended real estate funds; (3) comply among others with well-defined rules concerning risk diversification, net asset value calculation and subscription and redemption rules" (EFAMA, 2008).

"Closed-ended real estate funds - listed or not - are regulated at national level, not necessarily by fund-specific regulation and (1) have a fixed number of shares outstanding; (2) are allowed to invest directly or indirectly through participations in real estates" (EFAMA, 2008).

As regards REITs, they are listed and traded on major stock exchanges and are often considered to be more closely correlated with equity market investments (particularly of short time frames). In several Member States REITs regimes have been introduces alongside, or as alternative to open-ended real estate funds – partly to assist access to real estate by a wider investor base, which includes retail investors. However, REITs tend to display different performance characteristics from those of open-ended real estate funds and are subject to different levels of regulations and investor protection safeguards. Therefore, even if they are often compared to in-vestment funds, REITs are not investment funds and do therefore not fall under the UCITS / non-UCITS consideration (PricewaterhouseCoopers, 2008). It is not foreseen in any future develop-ment of the current pan-European regulatory framework governing investment funds to allow UCITS products to have direct exposure to real estate assets other than via limited investments in shares of REITs or listed companies active in the property business (Lam and Delcourt, 2009).

2.3 Comparison of real estate investment products

Although both closed-ended real estate funds and open-ended real estate funds invest into the same underlying asset (real estate), they offer investors a different investment proposition. It should be noted that REITs and other property companies are not a part of this article which exclusively focus on investment fund products.

Based on analysis (Expert group report, 2008) carried out by the Expert Group on Open- Ended Real Estate Funds (hereinafter – "OEREF") appointed by the EU Commission, *Table 1* compares the key investors considerations, such as market size, track record, interest in cross border distribution, minimum investment threshold, liquidity of investment, diversified property portfolio, correlation to domestic real estate market, volatility, trading at

Net Asset Value, valuation standards, extent of borrowing, reporting standards, possibility of the product be easily sold to retail investors in another Member State.

Table 1. Features of real estate fund types and key investors considerations

	Open-ended real estate funds (OEREFs)	Closed-ended real estate funds (CEREFs)
Market size	Growing EU retail market in excess of EUR 110 billion	About EUR 90-100 billion
Proven track record	Yes, in Germany OEREF have a track record of more than 40 years. OEREF have been operating in 12 other Member States since the 1990s. In Germany and the Netherlands OEREF experienced liquidity crises and proved to be able to cope with it. Regulatory frameworks and liquidity and risk management have been improved in the aftermath. The UK market seems also to recover from a break-down in 2007	No, there is no EU retail market for CEREF. Retail investments in CEREF seem to be rather marginal.
Interest in cross border distribution	Yes, retail investors in 12 Member States have shown increasing appetite in domestic OEREF, whereas investors in 15 Member States still have no access to OEREF	N/A, there are neither clear indications for sufficient retail demand nor for interest on the supply side for cross-border distribution to retail investors
Minimum investment threshold[1]	Low	High
Liquidity of investment[2]	Medium/High	Very low, investors in a closed-ended fund may typically only redeem their units at maturity (generally after 7-10 years) when the fund is wound up.
Diversified property portfolio	Yes, all national frameworks for OEREF contain mandatory diversification rules that oblige OEREFs to manage a portfolio instead of a few properties. In some Member States no single property may exceed a certain percentage of the fund's value, whereas in others a minimum number of properties is required.	Partially, e.g. CEREF cover a wide range of fund types. In some Member States they invest only in few properties and in some cases only in one property whereas in other Member States there are also CEREF with large and diversified portfolios.
Correlation to domestic real estate market	Partially, e.g. this depends on the degree of geographic diversification of the OEREF. A number of OEREF still predominantly invest in domestic real estate, whereas other OEREFs have a geographically well balanced portfolio taking into account the different local property cycles.	Usually high, many CEREF invest mainly in the domestic real estate market.
Volatility[3]	Medium	Low
Sources of main risk	Low	Risk concentration/difficult exit: investor in CEREF typically cannot redeem units during the fund's lifetime, but only when the fund is wound up (after 7-10 years). As there are no functioning secondary markets for closed-ended funds, investors face serious problems in a buyer for their units.
Trading at Net Asset Value[4]	Yes, in most Member States OEREFs have to calculate the net asset value on the basis of the property values determined by independent appraisers	No, as CEREFS do not subscribe and redeem units on a regular basis, there is no need for publishing net asset values. Prior to the maturity of the CEREF, investor can therefore only sell their units to the other investors at a process subject to offer and demand

[1] The minimum amount of money that is required for investing into a particular product.
[2] The term "liquidity of investment" refers to how easy it is for the investor to sell the shares or units. The more liquid an investment is, the easier a sale can take place.
[3] In this context volatility describes how much the unit/share price is subject to changes (increase and decrease of value). A low volatility means that the prices are rather stable and risks are low.
[4] This means whether the price of the units or shares is based on the net asset value of the underlying assets or whether it is a market price subject to offer and demand.

Table 1 (continued)

	Open-ended real estate funds (OEREFs)	Closed-ended real estate funds (CEREFs)
Valuation standards	Regulated / High standards / valuation by independent valuers. Valuation of these funds are typically carried out in accordance with the International Valuation Standards published by the International Valuations Standards Committee	Typically less regulated / valuation by independent valuers not always required
Extent of borrowing	Maximum threshold	Typically unregulated
Reporting standards	Medium	Typically none
Can the product be easily sold to retail investors in another Member State?	No	Yes, in principal. When complying with the Prospectus Directive, a closed-ended fund can be offered to retail investors in another Member State

Source: Expert group report, 2008.

The comparison clearly shows that although both products invest into the underlying asset class (real estate), they offer investors a different investment proposition. The most striking distinctions between open-ended real estate funds and closed-ended real estate funds are that the first ones are a regulated retail investment product which ensures a high level of investor protection safeguards which are not mandatory for closed-ended real estate funds, such as diversification rules, appointment of depository, valuation by independent appraiser based on valuation standards, cap on borrowing, high level reporting procedures (Expert Group report, 2008). This comparison is also important in the context of AIFM Directive and criticism for aiming at all forms of "alternative" products without allowing taking into account the specificities of the very diverse industries (see *Section 1.3*) not to mention difference inside the same asset class (as presented above).

2.4 European real estate investment fund market

Europe is one of the "leading real estate fund markets in the world and jurisdictions combining a sophisticated but flexible fund regime and opportunities to launch flexible structures to optimize tax burdens became domiciles of choice for non-listed vehicles. Luxembourg, United Kingdom, Germany and the Netherlands became the most developed European real estate fund markets and other European countries also realized the importance of offering specialized real estate vehicles to investors seeking to benefit from steady and uncorrelated returns on real estate portfolios" (Lam and Delcourt, 2009).

"Bond and share investment funds constitute the largest part of all investment funds. It should be noted that a part of real estate funds is relatively small, i.e. 4% (shares – 30%, bonds–28%)" (Galiniene and Bumelyte, 2008). Even though real estate investment funds in comparison to other types of funds take the smallest share, since 1998, the number of new non-listed fund launches in Europe has increased from 40 to almost 500 funds in total at the end of 2009 with assets under management of EUR 260 billion (INREV, 2009).

The financial crisis has shed further light on the role that real estate funds market play in financial markets. While AIF market was not the cause of the crisis, recent events have placed severe stress on the sector. Many AIF market have experienced liquidity problems as they struggle to manage the mismatch between the degree of liquidity promised to investors and the illiquidity of their investments. In some cases, adverse impacts have been felt by the wider market (European Commission, Staff Working Paper, 2009).

It is expected that 2011 will still be challenging for the European real estate fund industry however recent more positive outlook in the economy is providing a sense of hope that investors interest in real estate as an asset class will return. The future of the real estate fund industry looks again promising provided it will manage to face off the challenges in respect of changing regulatory environment (Lam and Delcourt, 2009).

2.5 Development of real estate funds in Lithuania

A possibility for investment funds to operate in Lithuania, i.e. in a form of collective investment funds, appeared in 2003 when the Law of the Republic of Lithuania on Collective Investment Undertaking of 4 July 2003, No IX-1709 (Official Gazette, No 74-3424) (hereinafter – "Law on Collective Investment Undertaking") was adopted. Regulations of the above mentioned Law valid until 2007 implemented most of the main EU legislations and additionally provided only a possibility to set up national collective investment undertakings of limited distribution, meaning that the regulated and supervised alternative investment schemes that could be used by investors could not be established in Lithuania. A necessary edition of the Law on Collective Investment Undertaking came into force from 1 March 2008.

According to the Law on Collective Investment Undertaking, a collective investment undertaking has the following legal forms: (1) a harmonized collective investment undertaking (that meets requirement of EU legislation); (2) a specialized collective investment undertaking (that does not meet the requirements of the EU legislation).

Therefore, the amendments broadened the structure of collective investment undertakings as well as introduced new investment fields such as private equity funds, funds of funds, alterative investment funds, hedge funds and real estate funds. The latter falls under the category of a specialized collective investment undertaking.

The Law on Collective Investment Undertaking provides for a certain specificity of real estate funds. The major features of the regulation of real estate investment funds are identified below:

1) it is allowed to invest directly into a land, building, premises, real estate under construction, securities of real estate companies, investment units or shares of other real estate funds as well as movable property necessary for the exploitation of the real estate object, etc. (Article 74, Point 1);

2) the law provides for a prohibition to buy real estate with limited ownership right to it (Article 74, Point 2);

3) assets must be evaluated by at least two independent licensed real estate evaluators authorised to engage in the activity of real estate valuation, with the exception of the property valuator assistants who would produce individual reports (Article 72, Point 1);

4) a real estate investment company or management company managing the assets of a collective investment undertaking may borrow up to 75 percent of the net asset value existing in the instruments of collective investment undertaking incorporation on the borrowing day for a period determined in advance (Article 75, Point 3);

5) the investment portfolio of the real estate collective investment undertaking established may not comply with the diversification requirements set in the Law for 4 years as of the day when its instruments of incorporation and prospects are approved by the Securities Commission, provided that the investment portfolio complies with other necessary provision foreseen in the Law on Collective Investment Undertaking (Article 75, Point 8).

In summer of 2008 quite a few leading companies were exploring possibilities for real estate funds market in Lithuania as well as analysing new legal basis for establishment of such funds. The leader in the market was investment company *Sindicatum Capital International UAB* (current *Synergos Capital International UAB*). On 19 June 2008 Lithuanian Securities Commission approved amendments of the license of *Sindicatum Capital International UAB* and the company received the right to manage special collective investment vehicles on the basis of the Law on Collective Investment Undertaking. On 3 July 2008 Lithuanian Securities Commission approved prospectus and rules of the new close-ended real estate fund Sindicatum Growth Fund. It was the first such kind of investment fund in Lithuania, constructed in accordance with the new regulation (Sindicatum Capital International UAB, 2008).

The fund was the first specialised investment fund of the kind to be established in Lithuania. The major part of the investment by the fund was foreseen to be represented by real estate objects, such as land, buildings, premises registered in the Real Property Cadastre and Register of the Republic of Lithuania, also the objects under construction as well as securities and money market instruments of companies whose main activity is the acquisition of real estate. To maintain liquidity the remaining part of the assets will be invested in financial instruments (Securities Commission, 2008).

The fund has been incorporated an investment vehicle for institutional investors intending to invest not less than EUR 50,000. The anticipated operation period was 5 years with a possible extension for a period not longer than 10 years. Investment units were foreseen to be sold or re-deemed on the last day of each quarter. The initial offering period was 3 days.

On 21 August 2008 Lithuanian Securities Commission approved amendments of the license of another investment company *Finasta investicijų valdymas UAB* which also received the right to manage special collective investment vehicles (Market news, 2008). Another investment company *JT Investicijų valdymas UAB* was also interested and planning to establish close-ended real estate fund.

Despite intention to develop real estate fund market after necessary amendments to the Law on Collective Investment Undertaking financial conditions in Lithuania tightened up all possibilities in the last quarter of 2008 development of all possible investment activities (including alternative investments). According to the prognosis of Central Bank of Lithuania negative Gross Domestic Product (hereinafter – "GDP") growth since last quarter of 2008 was projected for the two coming years. GDP was expected to reach its lowest level in the second half of 2010 (Bank of Lithuania, 2009). Moreover, in March 2009 Ministry of Finance of the Republic of Lithuania projected that GDP could fall 10.5 percent in 2009 (Ministry of Finance, 2009).

Unfavourable borrowing conditions translated into diminishing domestic demand, which resulted into exceptionally poor performance of internally oriented economic activities. Both construction and real estate sectors were affected the worst by the economic downturn. After several years of rapid expansion, the value added (at constant prices) created by construction sec-tor changed marginally in 2008, while that of three quarters last year nosedived by vast 43 per-cent year-on-year. Due to the stasis in the market commercial RE developers suffered from market stagnation and increasing vacancy rates (Rudzkis and Rojaka, 2010).

Economic trends in Lithuania during the period of 2008 and 2009 implied the deteriorating supply of financing, in particular from the banking sector, the decline of construction sector due to more strict lending policies of the bank. On 11 February 2009 Lithuanian Securities Commission taking into account request from Sindicatum Capital International UAB to liquidate close-ended real estate fund Sindicatum Growth Fund abolished its decision by which prospectus of the fund was approved. The investment company was not successful in raising investments into the fund; the company has only paid necessary down payment as well as depository fee which was covered by own company‘s recourses (Vertybinių popierių komisija, 2009 [Securities Commission, *in Lithuanian*]).

Despite stagnation of the real estate market and difficult development of a financial sys-tem, economic situation in the Baltics in 2009 created very favourable conditions to acquire high-quality commercial property and to earn attractive returns from the changing value of real estate assets as a result of the general recovery of the Baltic economies, improving financial conditions and professional management of the acquired properties, i.e. created favourable conditions to create new alternative investment instruments.

On 3 July 2008 Lithuanian Securities Commission approved prospectus and rules of the new close-ended real estate fund Lords LB Baltic Fund I established by Lords LB Asset Management UAB. The objective of the Fund is to secure long-term growth of investments, taking advantage of favourable situation in the real estate market. The Fund intends to mostly invest into commercial real estate in Lithuania, Latvia and Estonia, which generates rental income, equities of real estate companies (i.e. companies, main activities of which are acquisition, reconstruction, lease, trade or development of real estate) and high-quality distressed property. The Fund is going to invest only into commercial real estate facilities: shopping and office centres, warehouses, and is not going to invest into residential real estate or hotel properties (Lords LB Asset Management UAB, 2010).

The EUR 25 million Fund was structured to be offered to investors in three rounds, but for no longer than 18 months from the start of placement. With planned minimum investment sum of EUR 50,000 for private investors and EUR 300,000 for institutional investors, the Fund is oriented towards investors tolerating above average long-term risk (Lords LB Asset Management, Opportunity Fund, 2010).

In just one month after the Prospectus of the fund Lords LB Opportunity Fund I was registered (27 August 2010) the real estate investment fund management company Lords LB Asset Management UAB has placed already investment units for LTL 10 million and has reached the target (Lords LB Asset Management, Opportunity Fund 2010). Net Asset Value of Lords LB Opportunity Fund I on November 30, 2010 was LTL 5,086,066.83, Net Asset Value of one fund unit was LTL 1.6495. Annual return of the Fund since the start of the Fund (August 27, 2010) was 249.55 percent (Lords LB Net Asset Value on November 30, 2010).

Due to the stagnation of the real estate market, the development of a financial system and new alternative investment instruments, until the end of 2010 real estate funds did not became an attractive investment instrument. However, the real estate industry experts unanimously maintain that the sector has already bottomed out and is slowly inching its way up. As a result, Lithuania in the longer term is expected not to miss opportunity and the real estate fund sector should experience increasing number of vehicles being launched.

The regulation of real estate funds and possibility to enter the Lithuanian market were essential as most EU Member States created conditions for the formation of analogical national investment products. The regulation set allowed developing alternative markets of investment instruments in Lithuania. In this way potential incorporators of real estate funds will not have to use legal bases of foreign countries and establish it in other countries with regulated operation of real estate funds.

Conclusions

The European industry for investment funds had started to develop over the decades it become a key actor in European capital markets. Council Directive 85/611/EEC serves as the cornerstone of the EU framework for investment funds. Alternative investment funds, such as real estate funds, are defined as all funds that are not harmonised under the UCITS Directive. Currently the European Commission considers new legislative amendments which would significantly reshape the European investment management landscape, requiring all entities managing or promoting pooled funds of any kind in EU to be subject to regulation.

Real estate funds represent an important part of the investment fund classifications. To varying degrees across Europe, retail investors are able to invest indirectly into real estate through a variety of professionally managed investment products. The most important ones are open-ended real estate funds and closed-ended real estate funds.

Europe is one of the leading real estate fund markets in the world. The financial crisis has shed further light on the role that real estate funds market play in financial markets. However future of the real estate fund industry looks promising provided it will manage to face off the challenges in respect of changing regulatory environment.

The development of the real estate funds in Lithuania was primarily connected to the principal changes in the legal basis which provided a foundation for the development of the real estate fund system. As well as in EU, the real estate funds in Lithuania are currently under strain as a result of the financial crisis. However, first examples of real estate fund practice in the market could already serve as some basis for future lessons and developments. It is likely that due to the stabilization of the real estate market in the near future, the development of a financial system and new alternative investment instruments, including real estate funds, will soon become an attractive investment instrument in Lithuanian financial market.

References

Bank of Lithuania (2009), *Economic Outlook for Lithuania*, available at, http://www.lb.lt/eng/economy/macroeconomy/PranesimasSpaudai_200901_EN.pdf, referred on 13/10/2010.

Berry, J., McGreal, S., Sieracki, K., Sotelo, R., (1999) "An assessment of property investment vehicles with particular reference to German funds", *Journal of Property Investment & Finance*, Vol. 17, No 5, pp.430-444.

Bibby, P., Marshall, H., Leonard, Ch. (2009), "EU proposes directive on alternative investment fund managers", *Journal of Investment Compliance*, Vol. 10, No 3, pp.54-57.

Council Directive (1985), *On the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities,* (UCITS) (85/611/EEC).

EFAMA: European Fund and Asset Management Association (2008), *The European Fund Classification*, available at, http://www.efama.org/index.php?option=com_content&task=view&id=2&Itemid=46, referred on 15/09/2010.

European Central Bank (2007), *Guidelines of 1 August 2007 on monetary, financial institutions and market statistics*, (ECB/2007/9).

European Central Bank (2009), *Manual of Investment Fund Statistics*, May 2009, available at, http://www.ecb.int/pub/pdf/other/manualinvestmentfundstatistics200905en.pdf, referred on 20/08/2010.

European Central Bank Regulation (2007), No 958/2007 of 27 July 2007 concerning statistics on the assets and liabilities of investment fund (ECB/2007/8).

European Commission (2005), *Green paper on the enhancement of the European Union framework for investment funds*, SEC (2005) 947.

European Commission (2006), *White Paper on Enhancing the Single Market Framework for Investment Fund*, Brussels, 15.11.2006, COM (206) final.

European Commission (2008), *Expert group report on open ended real estate funds*, available at, http://ec.europa.eu/internal_market/investment/docs/other_docs/expert_groups/report_en.pdf, referred on 20/08/2010.

European Commission (2009), *Financial services: Commission proposes the European Union framework for managers of alternative investment funds*, Brussels, 29 April 2009, available at, http://europa.eu/rapid/pressReleasesAction.do?reference=IP/09/669, referred on 20/08/2010.

European Commission (2009), *Proposal for a Directive of the European Parliament and of the Council on Alternative Investment Fund Managers and amending Directives 2004/39/EC and 2009/.../EC*, Brussels, 30 April 2009, COM(2009) 207 final.

European Commission (2009), *Staff Working Paper*, No SEC (2009) 577, Available at, http://ec.europa.eu/internal_market/investment/docs/alternative_investments/fund_managers_executive_summary_en.pdf, referred on 20/08/2010.

Flackebach, H. (2009), "Market selection for international real estate investments", *International Journal of Strategic Property Management*, Vol. 13, No 4, pp.299-308.

Galiniene, B. (2004), *Turto ir verslo vertinimo sistema: formavimas ir plėtros koncepcija*, Vilnius, Vilniaus universiteto leidykla [The system of property and business evaluation: formation and development, *in Lithuanian*].

Galiniene, B., Bumelytė, J. (2008), "Development of real estate funds in Europe and Lithuania", *Ekonomika*, Vol. 83, pp.58-70.

Galiniene, B., Marcinskas, A., Malevskiene, S. (2006), "Baltijos šalių nekilnojamo turto rinkos ciklai", *Ūkio technologinis ir ekonominis vystymas*, Vol. XII, Nr 2, pp.161-167 [Real estate cycles in the Baltic states, *in Lithuanian*].

Hedgeweek (2010), *European fund industry could reach EUR6.8trn by 2014*, 23 March 2010, available at, http://www.hedgeweek.com/2010/03/23/40049/european-fund-industry-could-reach-eur68trn-2014, referred on 23/10/2010.

INREV (2009), *Annual Report 2009*, available at, http://www.inrev.org/index.php?option=com_content&task=view&id=5&Itemid=96, referred on 16/09/2010,

Kaklauskas, A., Zavadskas, E.K., Bagdonavicius, A., Kelpsiene, L., Bardauskiene, D., Kutut, V. (2010), "Conceptual modelling of construction and real estate crisis with emphasis on comparative qualitative aspects description", *Transformations in Business & Economics*, Vol. 9, No 1(19), pp.42-61.

Lam, B., Delcourt, F. (2009), *Pan-European real estate funds*, European Monitor, available at, http://www.deloitte.com/assets/Dcom-Luxembourg/Local%20Assets/Documents/Press%20articles/2009/lu_paneuropeanrealestate_112009.pdf, referred on 18/10/2010.

Law of the Republic of Lithuania on Collective Investment Undertaking of 4 July (2003), No IX-1709 (Official Gazette, No 74-3424).

Liow, K.H. (2007), "Cycles and common cycles in real estate markets", *International Journal of Managerial Finance*, Vol. 3, No 3, pp.287-305.

Lords LB Asset Management Opportunity Fund (2010), *Lords LB Opportunity Fund I has been placed*, available at, http://www.lordslb.com/en?com=content&id=281; Lords LB Asset Management. Net Asset Valueon November 30, 2010, available at, http://www.lordslb.com/en?com=content&id=292, referred on 09/10/2010.

Marčinskas, A., Galinienė, B. (2005), "Property Valuation in the Context of Transformations: The Case of Lithuania", *Transformations in Business & Economics*, Vol. 4, No 1 (7), pp.139-147.

Market news (2009), *Finasta investicijų valdymas steigs specialiuosius fondus*, rugpjūčio 21 d., available at, http://www.marketnews.lt/naujiena/finasta_investiciju_valdymas_steigs_specialiuosius_fondus, referred on 25/09/2010, [Finasta investicijų valdymas will establish special investment fund, *in Lithuanian*].

Ministry of Finance of the Republic of Lithuania (2009), *Projections of Lithuanian Economic Indicators*, available at, http://www.finmin.lt/web/finmin/aktualus_duomenys/makroekonomika, referred on 28/09/2010,

PricewaterhouseCoopers (2008), *The retailisation of non-harmonised investment funds in the European Union*, (ETD/2007/IM/G4/95), available at, http://ec.europa.eu/internal_market/investment/docs/other_docs/study_non-harmonized_funds.pdf, referred on 19/09/2010.

Rudzkis, R., Rojaka, J. (2010), "The Baltic State and Poland", *Business and Management*, 6th International Scientific Conference May 13–14, 2010, Vilnius, Lithuania, pp. 147-153, available at, http://www.vgtu.lt/leidiniai/leidykla/BUS_AND_MANA_2010/Finance_Engineering/147-153_Rudzkis_Rojaka.pdf, referred on 09/11/2010.

Securities Commission (2008), *The Rules of the first real estate investment fund approved*, 10 July 2008, available at: http://www.vpk.lt/en/market-news/other-market-information/13828/, referred on 15/10/2010.

Sindicatum Capital International UAB (2008), Pirmas specialus investicinis fondas Lietuvoje, liepos 9d., available at, http://www.sci.lt/news.php?detail=44, referred on 09/10/2010, [The first specialised investment fund, *in Lithuanian*].

Vertybinių popierių komisija (2009), *Informacinis pranešimas apie Komisijos posėdį*, vasario 11, available at, http://www.vpk.lt/lt/vpk-pranesimai/vpk-sprendimai/14019/, referred on 09/11/2010, [Securities Commission, Information note on Commission meeting, *in Lithuanian*].

Wang, K.-M. (2010), "Are Real Estate Inflation Hedges Affected by Risk Asymmetry in Taiwan Metropolitan Areas?", *Transformations in Business & Economics*, Vol. 9, No 2(20), pp.103-117.

Zavadskas, E. K., Kaklauskas, A., Raslanas, S. (2009), "Modelling of real estate sector: the case for Lithuania", *Transformations in Business & Economics*, Vol. 8, No 1, pp.101-120.

NEKILNOJAMO TURTO FONDAI: JŲ VIETA INVESTICINIŲ FONDŲ RINKOJE IR VYSTYMOSI KRYPTYS

Birute Galinienė, Junona Bumelytė

SANTRAUKA

Per pastaruosius dešimtmečius pasaulinėse rinkose išpopuliarėję nekilnojamo turto fondai, tapo svarbia Europoje investicinių fondų rinkos dalimi. Nekilnojamas turtas, lyginant su kitais investiciniais instrumentais, vaidina svarbų vaidmenį kaip alternatyvi investicinė priemonė bei priemonė didinanti investicinio portfelio diversifikavimo galimybes, o nekilnojamo turto fondai teikia patrauklius rizikos ir pelningumo santykius tose šalyse, kur tokių fondų egzistavimas yra reglamentuotas.

Straipsnyje siekiame pristatyti nekilnojamo turto investicinio fondo instrumentą, pagrindines charakteristikas, nekilnojamo turto fondų vystymosi tendencijas Europoje ir pirmuosius žingsnius Lietuvos investicinių fondų rinkoje. Ypatingas dėmesys skiriamas bendrai investicinių fondų klasifikacijai Europos Sąjungoje (toliau – ES), nekilnojamo turto fondų užimamai vietai. Straipsnyje taip pat apžvelgiamas teisinis reglamentavimas ir pastaruoju metu svarstomi pakeitimai ES lygmenyje. Galiausiai autoriai pateikia nekilnojamo turto fondų vystymosi apžvalgą Lietuvoje.

Per pastarąjį dešimtmetį investicinių fondų sektorius užėmė svarbų vaidmenį Europos kapitalo rinkose. Investiciniai fondai pritraukia privačias santaupas ir jas produktyviai investuoja. Nors nekilnojamo turto fondai Europoje, palyginti su kitais fondų tipais, užima nedidelę investicinių fondų rinkos dalį, tačiau išlieka viena pirmaujančių nekilnojamo turto fondų rinkų pasaulyje.

Pažymėtina, kad ES vieningos nekilnojamo turto fondų praktikos nėra, t.y. tokio tipo fondai reglamentuojami nacionaliniu kiekvienos šalies lygiu ir nėra susieti su Tarybos direktyva 85/611/EEB dėl įstatymų ir kitų teisės aktų, susijusių su kolektyvinio investavimo į perleidžiamus vertybinius popierius subjektais. Straipsnyje yra akcentuojamas pastarųjų metų svarstymai kaip modernizuoti ES investicinių fondų sistemą stiprinant finansinį reguliavimą, siekiant sugrąžinti investuotojų pasitikėjimą po finansų krizės. Autoriai taip pat atkreipia dėmesį į ES egzistuojančias skirtingas investicinių fondų klasifikacijas bei alternatyvių investicinių fondų, įskaitant ir nekilnojamo turto fondų tipų, jose užimamą vietą.

Lietuvoje nuo 2008 metų turi teisę veikti ne tik suderintieji investiciniai fondai ir, kurie veikia pagal ES teisės reikalavimus, bet ir specialieji investiciniai fondai, kurių grupei priklauso ir nekilnojamojo turto fondai (kurie nepatenka į Tarybos direktyva 85/611/EEB reguliavimą). Tų pačių metų vasarą buvo įsteigtas pirmasis uždaro tipo nekilnojamojo turto investicinio fondas Lietuvoje. Susidarius nepalankiai situacijai rinkoje 2008 m. pabaigoje, valdymo įmonei nepavyko pritraukti investuotojų ir į pirmojo nekilnojamo turo fondo sąskaitą buvo įmokėtas tik valdymo įmonės pradinis įnašas.

2010 m. pabaigoje Lietuvoje veikė vienas uždaro tipo nekilnojamojo turto investicinis, įsteigtas praėjus metams nuo pirmojo nekilnojamo turto fondo įsteigimo, t.y. 2010 m. rugpjūčio mėn. Fondo tikslas - uždirbti grąžą iš investicijų į nekilnojamąjį turtą išnaudojant palankią situaciją investicijoms rinkoje. Atsigavus situacijai rinkoje, minėto fondo valdymo įmonė išplatino šio fondo investicinių vienetų už 10 mln. litų ir, praėjus vos mėnesiui, pasiekė užsibrėžtą tikslą. Straipsnyje pateikiama išvada, kad, stabilizuojantis nekilnojamo turto rinkai, plečiantis finansų sistemai bei ieškant alternatyvių instrumentų artimiausioje perspektyvoje nekilnojamo turto fondai, tikėtina, taps patrauklia investicine priemone Lietuvoje.

REIKŠMINIAI ŽODŽIAI: investicinis fondas, investicijos į nekilnojamą turtą, nekilnojamo turto rinka, nekilnojamo turto fondo instrumentas, Europos Sąjunga, Lietuva.