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Survey Highlights: 2016 Institutional Real Estate Allocations Monitor

The Editors
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Abstract

Cornell University's Baker Program in Real Estate and Hodes Weill & Associates are pleased to present the findings of the fourth annual Institutional Real Estate Allocations Monitor (the "2016 Allocations Monitor"). The 2016 Allocations Monitor focuses on the role of real estate in institutional portfolios, and the impact of institutional allocation trends on the investment management industry. Founded in 2013, the Allocations Monitor is a comprehensive annual assessment of institutions' allocations to, and objectives in, real estate investments. This report analyzes trends in institutional portfolios and allocations by region, type and size of institution.

Keywords

Cornell, Real estate, Baker Program in Real Estate, Hodes Weill & Associates, institutional portfolios, real estate investments, Allocations Monitor, Conviction Index, Environmental, Social & Governance policies, ESG, allocation strategies

Survey Highlights

Introduction

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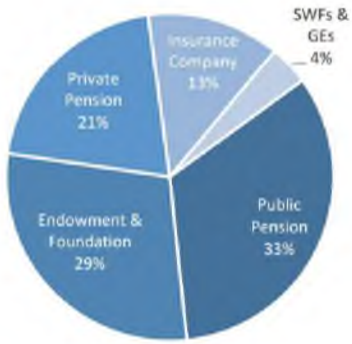
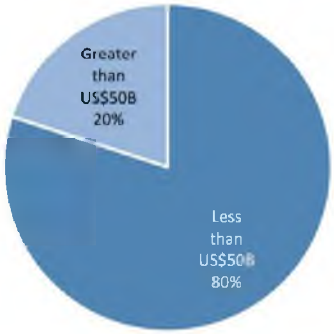
The Allocations Monitor includes research collected on a blind basis from 228 institutional investors in 28 countries. The 2016 participants hold total assets under management ("AUM") exceeding US$10.3 trillion and have portfolio investments in real estate totaling approximately US$920 billion. Our survey consisted of 27 questions concerning current and future investments in real estate, portfolio allocations to the asset class, investor conviction, investment management trends and the role of various investment strategies and vehicles within the context of the real estate allocation (e.g., direct investments, joint ventures, private funds). We also included questions regarding historical and target returns as well as environmental, social and governance ("ESG") policies.

A full copy of the report is available online at:

http://www.hodesweill.com/research/allocations-monitor/





A. Key Findings of the 2016 Allocations Monitor

1. Real estate is trending towards a 10%+ institutional portfolio allocation. The average target allocation to real estate now stands at 9.9%, up 34 bps from 2015 and up approximately 100 bps over the past four years. Institutions have indicated an intention to increase their target allocations by an average of 40 bps over the next 12 months to 10.3%.

2. Institutions remain broadly under-invested relative to target allocations. Despite concern about late cycle valuations, 90% of institutions remain active in allocating capital to real estate. Portfolios are 8.9% invested in real estate, up 40 bps from 2015. However, institutions continue to chase their target allocations as portfolios remain approximately 100 bps under-invested.

3. Institutional real estate portfolios continue to demonstrate strong investment performance. Real estate has generated an average annual investment return of 10.7% over the past four years. This compares favorably to institutions' average target return of 8.4%, as well as various property return indices over the same time period. Institutions in the Americas get the trophy for the highest four-year average annual return at 11.8%.

Exhibit 3: Average Target Allocation, All Institutions

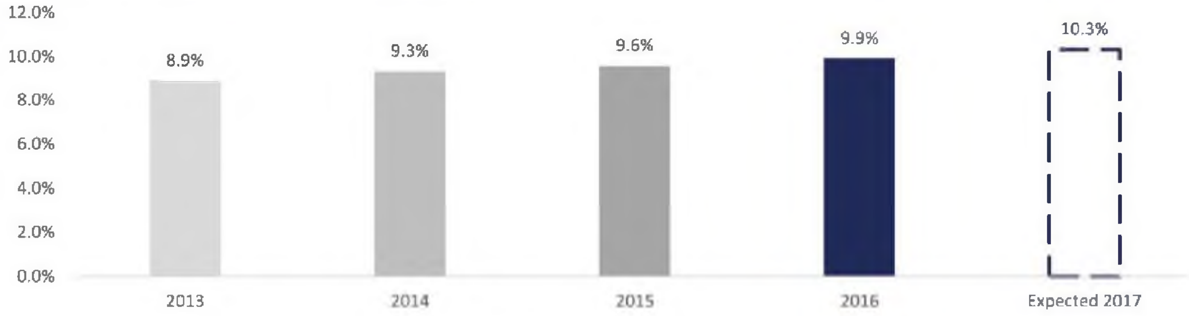


Exhibit 5: Average Target Allocation, By Type of Institution

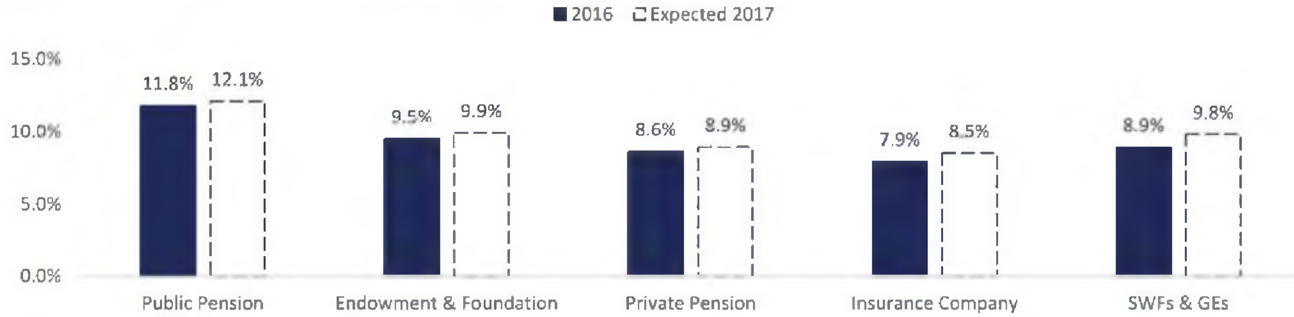


Exhibit 8: Percent Invested vs. Target Allocation, All Institutions and By Location of Institution

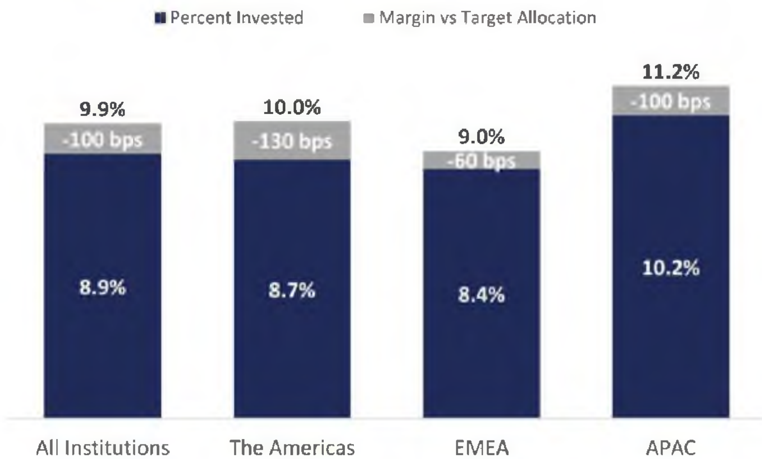
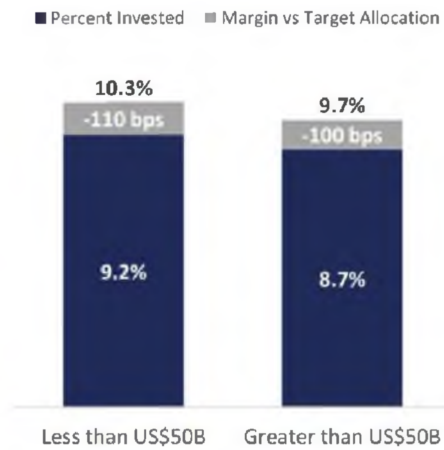


Exhibit 9: Percent Invested vs. Target Allocation, By Size of Institution



4. Institutional conviction for the asset class declined for the fourth consecutive year. In contrast to continued momentum in capital flows to the asset class, investor conviction has declined steadily since 2013 as institutions are increasingly concerned about asset valuations, rising interest rates and geopolitical risks. Between 2015 and 2016, our "Conviction Index" declined from 5.6 to 5.4.

5. Institutional interest in core, value-add and opportunistic strategies has trended steadily upward over the past four years. By a substantial margin, institutions are most focused on value-add strategies, followed by opportunistic strategies. The strong interest in higher yielding strategies demonstrates that institutions have a growing appetite for alpha-generating strategies.

6. Industry-wide AUM continues to trend upward, as allocations to third party managed products remain robust. Despite headlines that institutions are internalizing management functions, the substantial majority of institutions rely on third party managers for their real estate investments. Approximately 94% of institutions have some or all of their investments managed by third parties. In addition, institutions expect to allocate 85% of their invested capital in 2016 to third party managers.

7. Institutions are showing an increase in appetite to add managers to their portfolios. Large-cap managers continue to win more than their "fair share" of capital allocations. However, boutique managers may be better positioned to gain allocations over the coming years, as 28% of institutions intend to add managers to their portfolios over the next 12 months.

	Target Returns		Actual Returns				
	2015 Target Return	***2016 Target Return***	***Actual 2012***	***Actual 2013***	***Actual 2014***	***Actual 2015***	***Actual 4-Year Average***
All Institutions	8.2%	8.4%	9.6%	10.8%	11.7%	10.8%	10.7%
By Type							
Public Pension	7.9%	7.9%	10.3%	10.0%	11.7%	11.1%	10.8%
Endowment & Foundation	8.9%	9.6%	9.3%	13.9%	12.5%	11.0%	11.7%
Private Pension	8.2%	7.8%	9.1%	10.5%	13.4%	10.9%	10.9%
Insurance Company	7.7%	7.8%	6.8%	7.3%	7.4%	9.5%	7.7%
SWFs & GEs	7.4%	8.8%	14.4%	11.4%	12.7%	9.9%	12.1%
By Location							
The Americas	8.6%	8.5%	10.6%	12.5%	12.6%	11.7%	11.8%
EMEA	7.1%	8.0%	5.9%	6.2%	10.3%	8.5%	7.7%
APAC	7.7%	8.4%	9.4%	9.3%	9.2%	10.3%	9.5%
By Size							
Greater than US$50 billion	7.9%	7.7%	10.2%	10.1%	10.6%	10.9%	10.4%
Less than US$50 billion	8.3%	8.5%	9.5%	10.9%	12.0%	10.7%	10.8%

Exhibit 19: Conviction Index, By Type of Institution

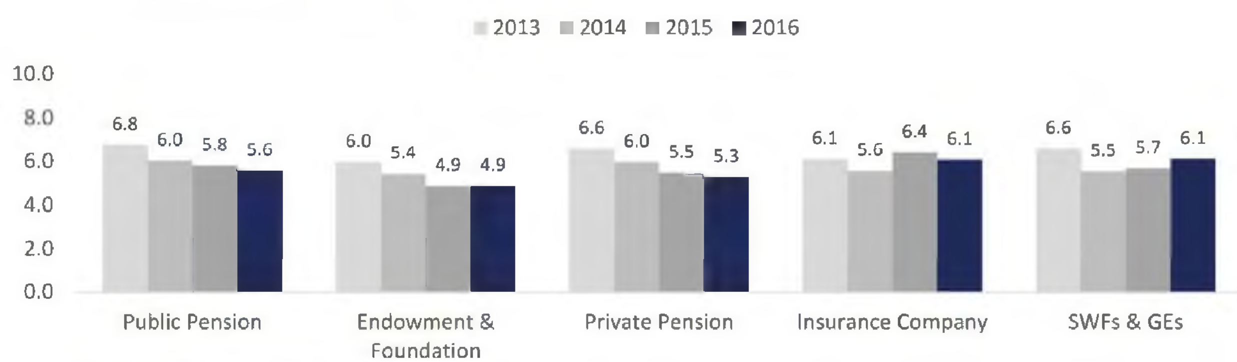


Exhibit 18: Conviction Index, By Location of Institution

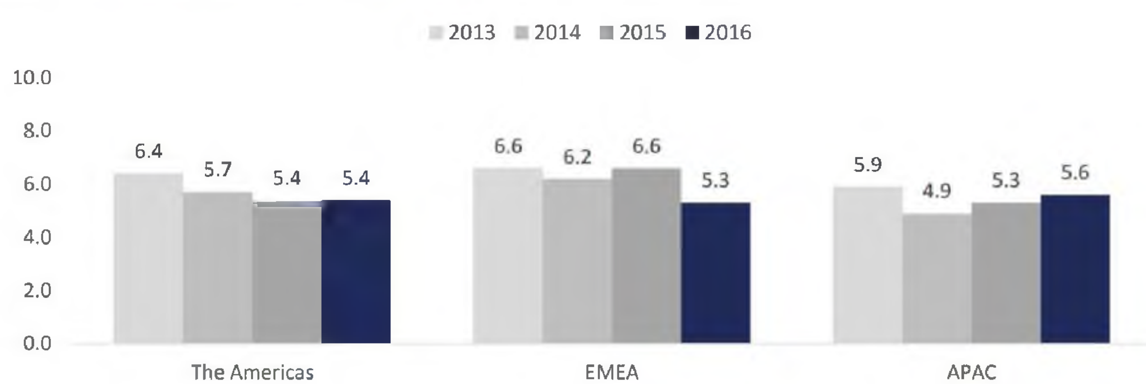


Exhibit 24: Risk Preference, All Institutions

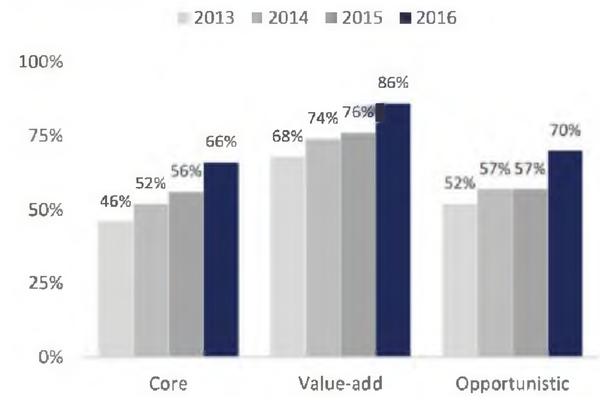


Exhibit 25: Risk Preference, By Location of Institution

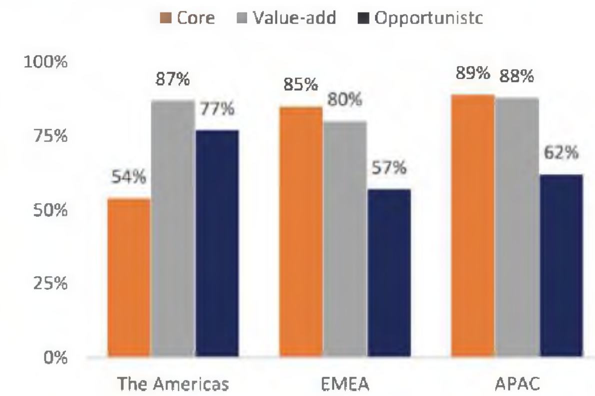


Exhibit 26: Risk Preference, By Type of Institution

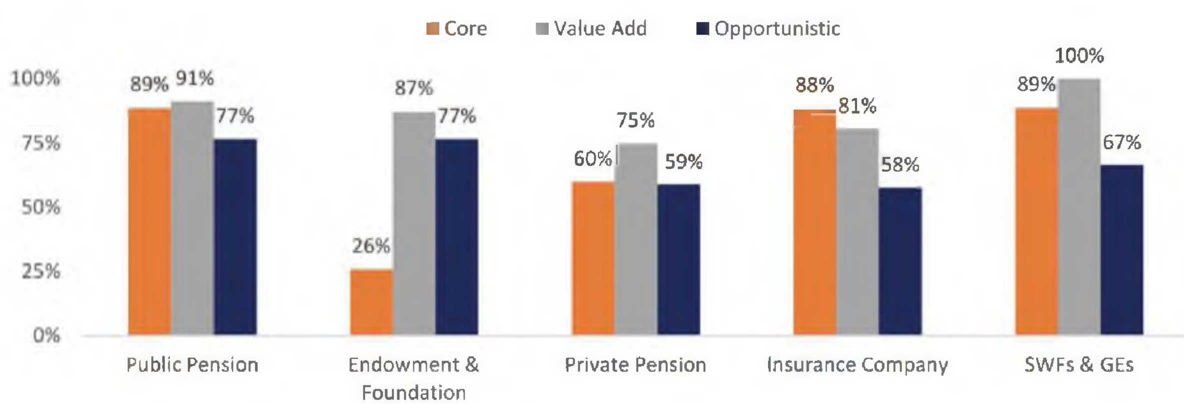
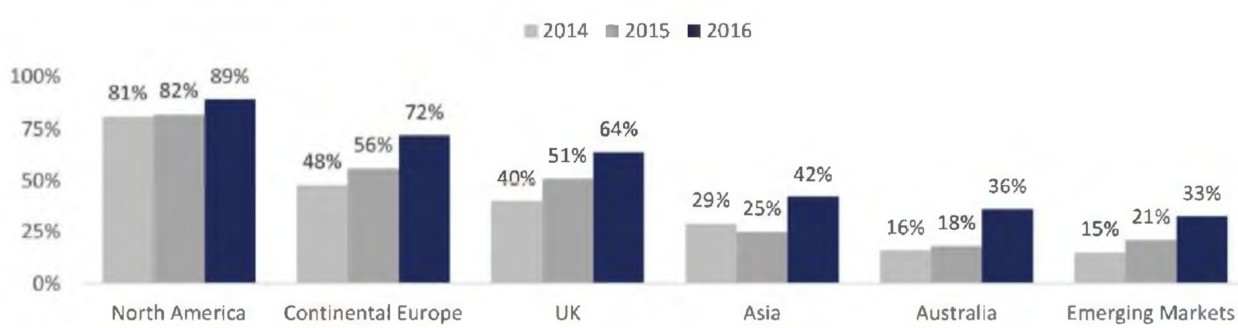


Exhibit 27: Geographic Focus, All Institutions



8. While North America continues to be the primary destination for investing capital, interest in other geographies has increased substantially. Although North America and EMEA-based institutions are prioritizing investments in their home markets, cross border capital flows continue to increase. Interest in emerging markets is on the rise, with one out of three institutions actively investing.

9. Demand for real estate private funds remains strong. Nearly 80% of institutions are interested in closed-end private funds. There is growing interest for open-end funds, despite recent signs of an acceleration in redemptions. Larger institutions continue to show strong interest for non-fund vehicles including direct investing, joint ventures and separate accounts.

10. Environmental, Social & Governance (ESG) policies are beginning to influence investment strategies. While the percentage of institutions with formal ESG policies remained relatively the same year-over-year, the percentage of institutions that indicated that their investment processes are influenced by ESG considerations increased to 29% in 2016 from 16% in 2015.

The 2016 Allocations Monitor leverages the academic resources of Cornell University and the global institutional relationships and real estate experience of Hodes Weill & Associates. We hope this report provides unique insight into the institutional investment industry, serving as a valuable tool for institutional investors in the development of portfolio allocation strategies and for investment managers in business planning and product development. With this goal in mind, please feel free to contact us with any comments, questions or suggestions.

We look forward to sharing additional insights and our perspective on the industry with you more directly in the near future. Again, we would like to express sincere appreciation to everyone that participated in this year's survey.