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2018 Institutional Real Estate Allocations Monitor, Survey Highlights

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Abstract
[Excerpt] Cornell University's Baker Program in Real Estate and Hodes Weill & Associates are pleased to present the findings of the sixth annual Institutional Real Estate Allocations Monitor (the "2018 Allocations Monitor"). The 2018 Allocations Monitor focuses on the role of real estate in institutional portfolios, and the impact of institutional allocation trends on the investment management industry. Launched in 2013, the 2018 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
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Cornell
Baker Program
in Real Estate

2018 Institutional Real Estate Allocations Monitor

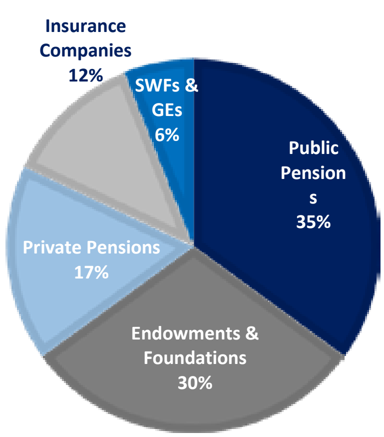
Survey Highlights

INTRODUCTION

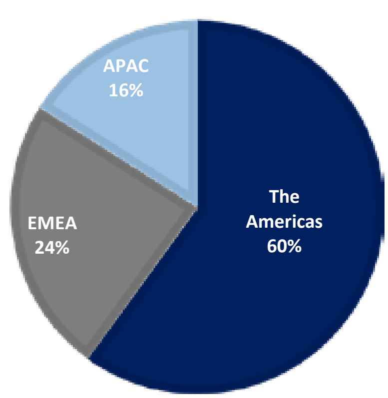
Cornell University's Baker Program in Real Estate and Hodes Weill & Associates are pleased to present the findings of the sixth annual Institutional Real Estate Allocations Monitor (the "2018 Allocations Monitor"). The 2018 Allocations Monitor focuses on the role of real estate in institutional portfolios, and the impact of institutional allocation trends on the investment management industry. Launched in 2013, the 2018 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.

The 2018 Allocations Monitor includes research collected on a blind basis from 208 institutional investors in 29 countries. The 2018 participants hold total assets under management ("AUM") exceeding US$11.0 trillion and have portfolio investments in real estate totaling approximately US$1.0 trillion. Our survey consisted of 24 questions concerning portfolio allocations to the asset class, current and future investments in real estate, 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.

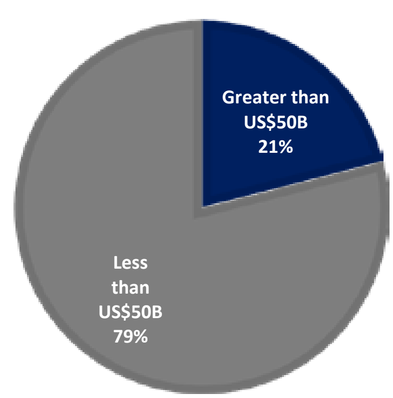
Breakdown of Participants By Type of Institution



Breakdown of Participants By Location of Institution



Breakdown of Participants By Size of Institution



1. **Target allocations to real estate in institutional portfolios continue climbing in 2018.** Average target allocations to real estate increased to 10.4 percent in 2018, up 30 bps from 2017 and up approximately 150 bps since 2013. While an increasing percentage of institutions are holding flat or decreasing their target allocations year-over-year, the 30 bps increase is consistent with the rate of change in each of the past five years (which has ranged from 20 bps to 40 bps per year). In 2018, 30 percent of institutions (up from 18 percent in 2017), decreased their target allocation by an average of 140 bps.

2. **Led by institutions in Asia Pacific and EMEA, institutions are forecasted to increase average target allocations over the next 12 months.** On average, institutions are expected to increase target allocations to real estate by 20 bps over the next 12 months. This increase can be largely attributed to institutions in Asia Pacific and EMEA regions, with each region forecasting increases of 40 bps, as compared to target allocations for institutions in the Americas, which are expected to remain constant.

3. **The value of institutional real estate portfolios grew significantly over the past 12 months.** A combination of appreciation, a rise in transaction volumes and an increase in capital commitments to real estate private equity vehicles, has contributed to a significant increase in actual allocations (i.e., percent invested) from 9.1 percent in 2017 to 9.5 percent in 2018. Due to the consistently strong performance of virtually all assets driving up the value of investable assets (the so called "denominator effect"), aggregate capital exposure to real estate has likely increased well in excess of 10 percent over the past 12 months.

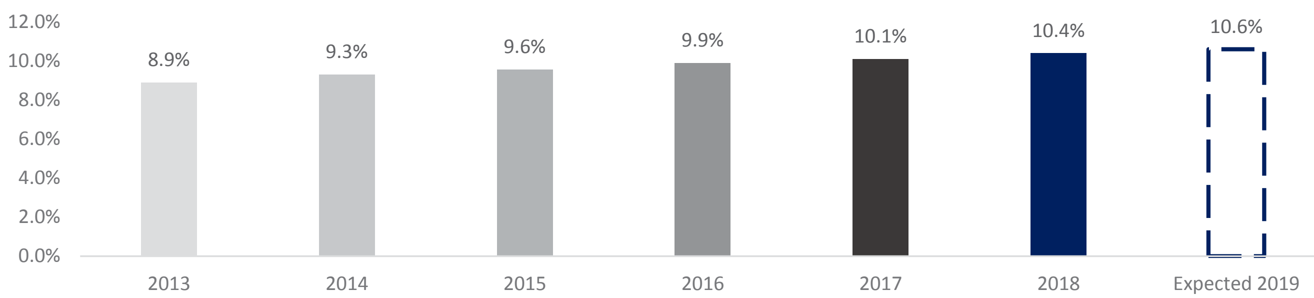


Figure 1. Weighted Average Target Allocation to Real Estate, All Institutions.

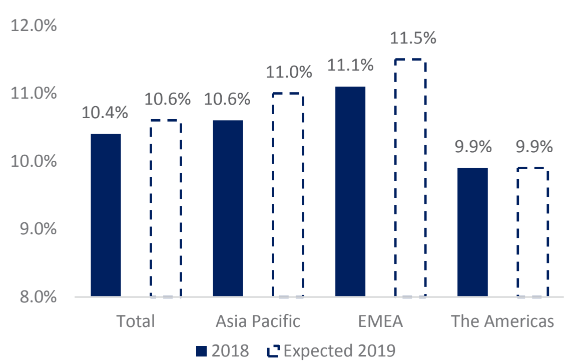


Figure 2. Weighted Average Target Allocation, By Location of Institution.

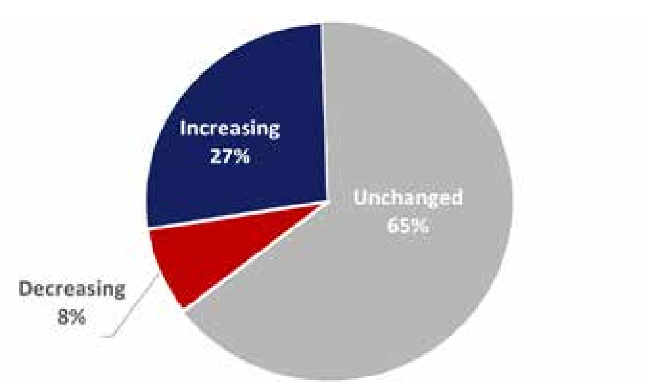


Figure 3. Expected Change In Target Allocations, All Institutions.

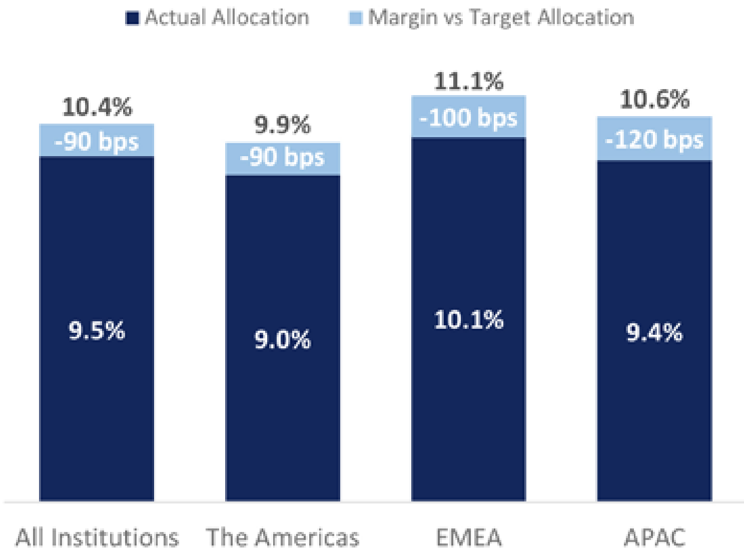


Figure 4. Actual Versus Target Allocation, By Location of Institution.

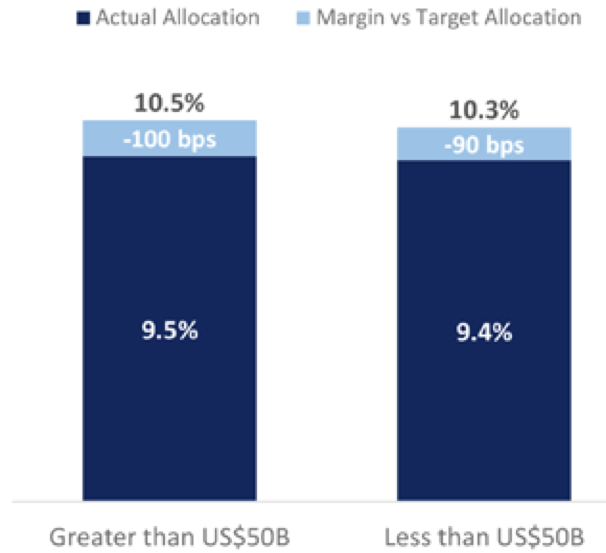


Figure 5. Actual Versus Target Allocation, By Size of Institution.

4. **Despite an increase in actual allocations, institutions remain meaningfully under-invested relative to target allocations.** While 92 percent of institutions report that they are actively investing in real estate, institutions remain approximately 90 bps under-invested relative to target allocations. Insurance companies are the most under-invested, while Endowments & Foundations are closest to their target allocations. Approximately 60 percent of institutions are under-invested relative to target allocations by an average of 200 bps

5. **After two years of moderating portfolio investment returns, performance increased in 2017.** Real estate portfolios generated an average annual investment return of 9.2 percent in 2017, up from 8.7 percent in 2016. This is consistent with industry-wide real estate returns, which trended upward in 2017, spurred by a rebound in economic growth which led to stronger operating fundamentals (i.e., rent and occupancy trends) across asset classes and geographies. Moreover, investment returns continue to outpace target returns by a meaningful margin over trailing one, three and five-years.

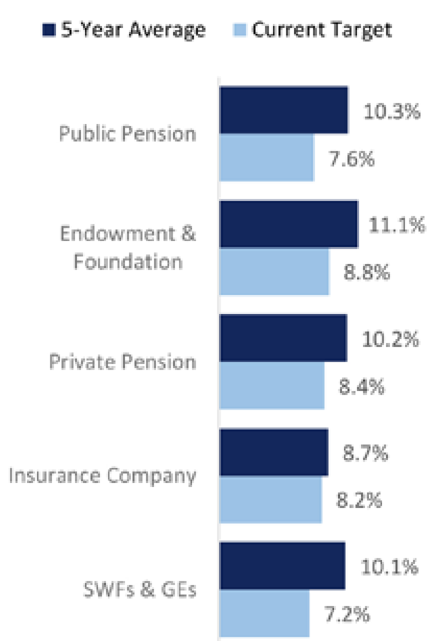


Figure 6. Target Versus Historical Returns, By Type of Institution.

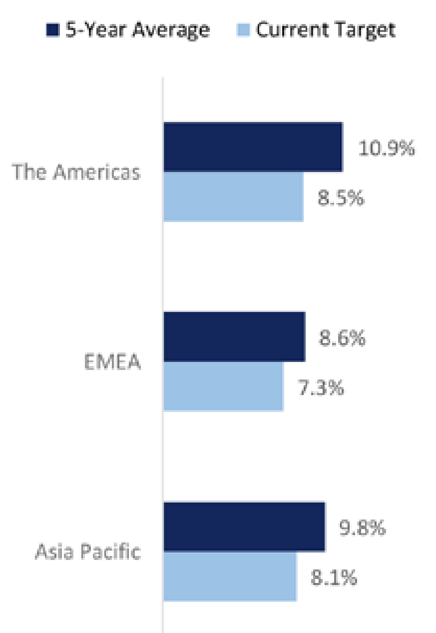


Figure 7. Target Versus Historical Returns, By Location of Institution.

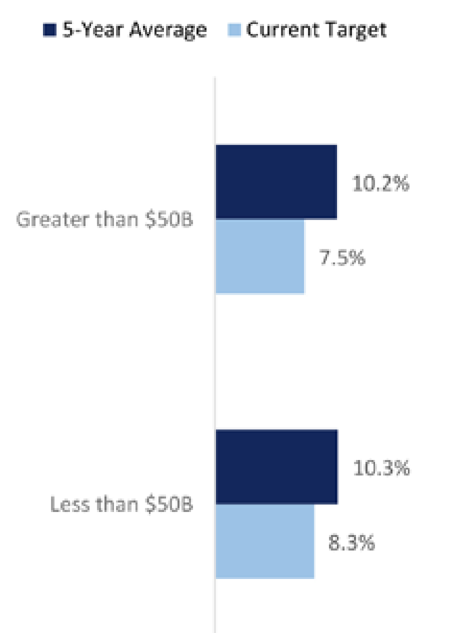


Figure 8. Target Versus Historical Returns, By Size of Institution.

6. **Institutional conviction for the asset class increased in 2018. Between 2017 and 2018, our "Conviction Index", which measures institutions' views of real estate as investment opportunities from a risk-return standpoint, increased from 4.9 to 5.1.** This follows four years of steady declines and comes as somewhat of a surprise, as investors continue to cite concerns regarding rising interest rates, asset valuations, and geopolitical risks, in addition to the perception of being late in the cycle (i.e., "late innings" for baseball fans). The increase in the Conviction Index was consistent across all regions (i.e., the Americas, EMEA and APAC).

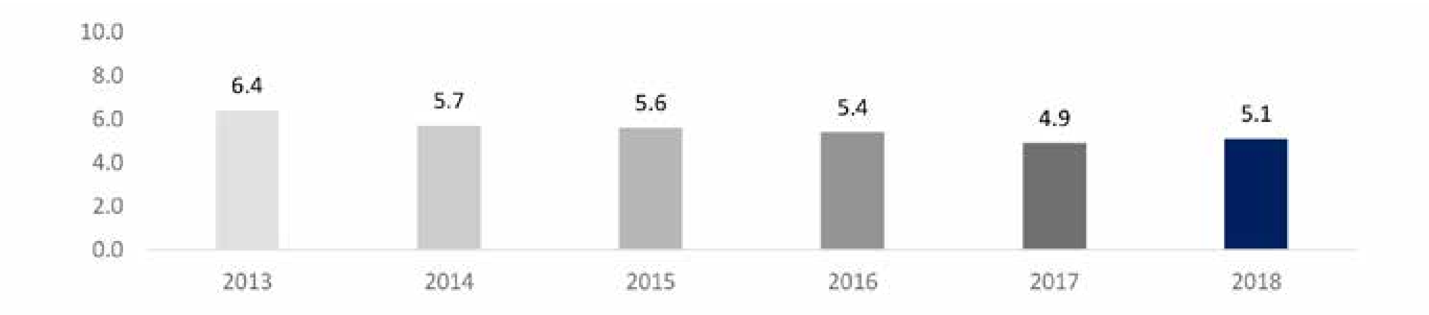


Figure 9. Conviction Index, All Institutions.

7. **Institutions continue to shift allocations to alpha-generating strategies, including value add investments.** Notably, approximately 90 percent of institutions reported that they are actively focused on value add strategies, as compared 63 percent of institutions that are actively focused on core strategies (which is down from 69 percent in 2017).

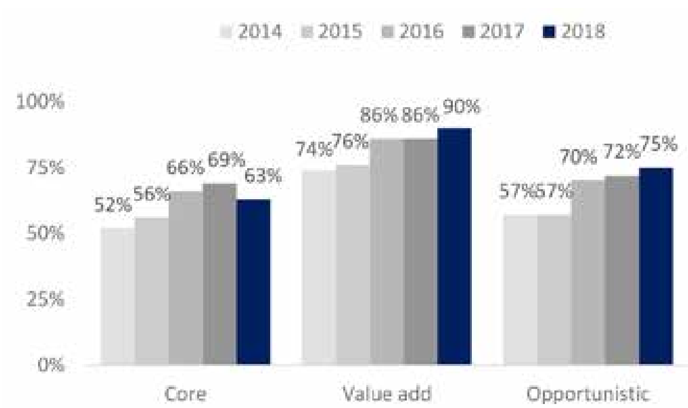


Figure 10. Risk Preference, All Institutions.

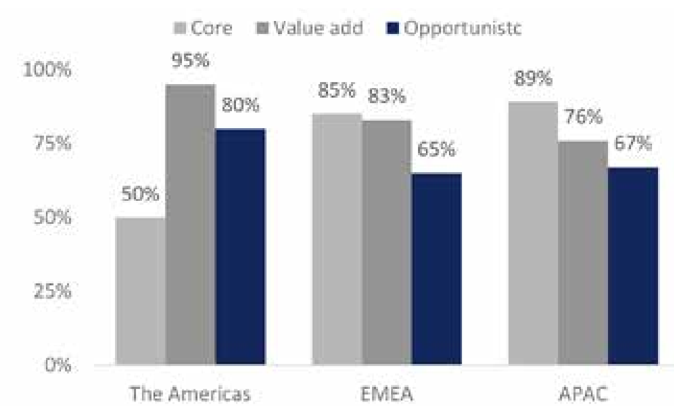


Figure 11. Risk Preference, By Location of Institution.

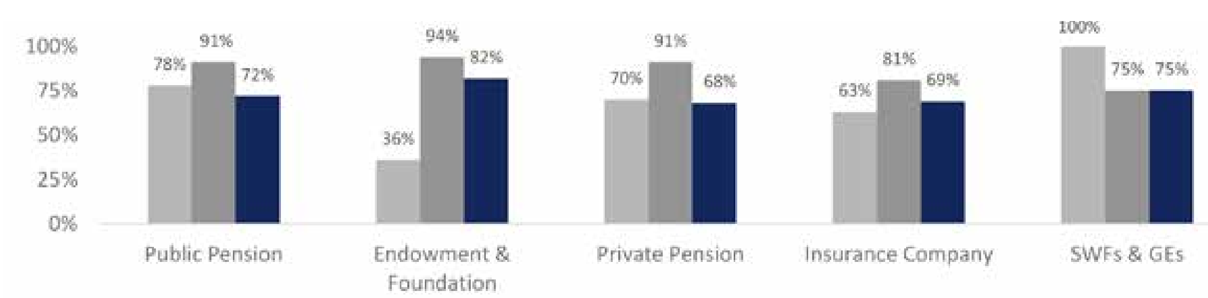


Figure 12. Risk Preference, By Type of Institution.

8. **Third-party managed assets under management (AUM) continues to trend upward.** Institutions are allocating the substantial majority (approximately 85 percent) of their new investment allocations to third-party managers. This trend, in combination with rising allocations and capital appreciation, is driving strong growth in assets under management for the investment and fund management industry. This is particularly the case for Smaller Institutions (i.e., institutions with less than US$50 billion in AUM), that do not have the resources to internalize management functions, as well as for institutions that are allocating investments cross border.

9. **Cross border capital flows remain strong, as interest shifts from investment in the US to Europe and Asia.** Despite the strong performance of US real estate over the past several years, interest in US-focused investment strategies appears to be waning. This has been compounded by currency hedging considerations for institutions in EMEA and APAC, as the US dollar has strengthened considerably year-to-date. Interest in Europe and Asia focused strategies is on the rise, and a notable trend is that APAC institutions have shifted their focus to regional strategies in Asia.

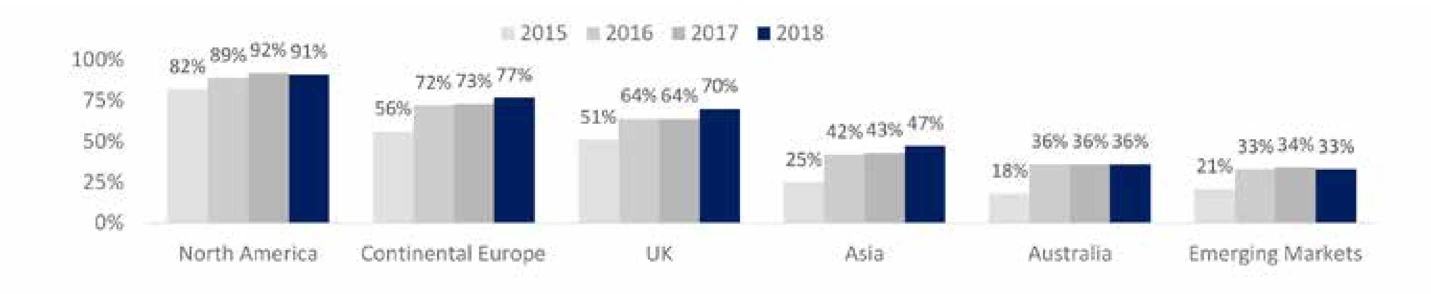


Figure 13. Geographic Focus, By Location of Institution.

10. **Closed-end funds continue to gain favor with institutional investors.** Approximately 93 percent of institutions are actively allocating capital to closed-end funds (up from 87 percent in 2017). While Larger Institutions continue to prioritize direct investments, joint ventures and separate accounts, 89 percent of which report being actively focused on closed-end funds, in particular for niche and harder to access strategies and geographies.

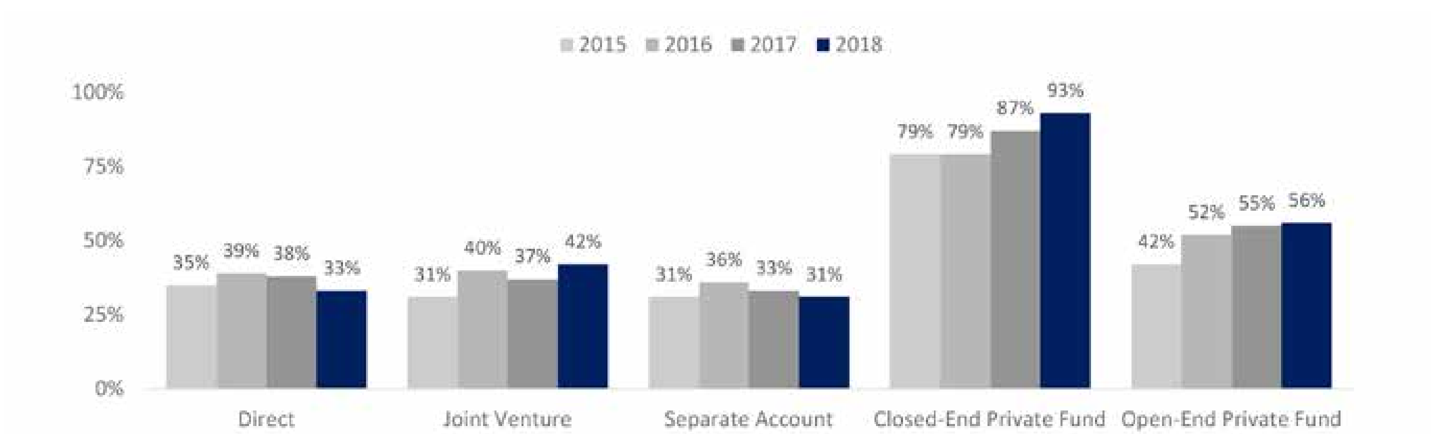


Figure 14. Investment Product Preferences, All Institutions.

The 2018 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 investors in the development of portfolio allocation strategies and peer benchmarking of returns, 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 our sincere appreciation to everyone that participated in this year's survey.