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PREA: Mixed picture for private equity real estate

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According to a study presented at the annual Pension Real Estate Association conference, institutions are indicating an intention to increase their average target allocation to RE over the next year and are increasingly focused on higher return value-add and opportunistic strategies. Yet, they are investing at a slower pace compared to very recent years.

The second annual Cornell University Baker Program and Hodes Weill & Associates' Institutional Real Estate Allocations Monitor has painted a mixed picture of fortunes for the private equity real estate industry.

On the one hand, the study presented yesterday at the annual Pension Real Estate Association conference in Los Angeles, found institutions indicating an intention to increase their average target allocation by 24 basis points to 9.62 percent over the next 12 months from 9.39 percent - even though they are still underweight in the asset class.

In addition, institutional investors are increasingly focused on higher return value-add and opportunistic strategies with around 66 percent of a sample of 231 investors actively pursuing such strategies in 2014 compared to 52 percent for core.

On the other hand, the sample of investors accounting for some $700 billion of capital in real estate continue to pursue investments. But they are doing so at a slower pace compared to very recent years, the study said. The percentage of institutions actively investing in real estate declined from 81 percent in 2013 to 73 percent in 2014, after increasing for several years following the global financial crisis of 2008. Concerns investors shared that impact on the rate of investment in the asset class are: potential rising interest rates, slow economic growth, new supply and too much capital pushing valuations "ahead of fundamentals".

Founding investors that fed in the study come from the Americas, EMEA and Asia Pacific and include the AT&T Pension Fund, General Board of Pension and Health Benefits of the United Methodist Church, IBM Retirement Fund, Teacher Retirement System of Texas, Church Commissioners for England, Future Fund from Australia and GIC Private, the sovereign wealth fund of Singapore.

In the background, the Institutional Real Estate Allocations Monitor found that institutions continue to shift from direct investing to outsourcing management to third parties. More than 70 percent of those that responded had all of their real estate managed by third parties. The report stated: “As liquidity has returned to the markets, and institutions have come to the realization that internal management is manpower intensive and requires a local market presence, the data suggest a shift back towards the long-term trend of outsourcing. This is consistent for all institutions, regardless of size, and contrary to conventional wisdom that larger institutions are relying less on third party managers.”

Sovereign wealth funds and government entities have the largest overall percentage of their portfolios managed by third party managers followed by endowments and foundations. Insurance companies, meanwhile, are much more likely to manage assets internally because they generally have larger staff and focus more on core and lower yield investments as well as direct lending.

Most large institutions have adopted “pragmatic” approaches to arrive at investment targets, added the report. Even those that have been investing directly for years and maintain a large number of staff and resources do use external managers when investing in markets where “access can prove more challenging and local market knowledge is critical”. This is often the case for emerging markets or geographically distant ones.

The study – which does not include family offices and or commercial banks - overall is positive for higher returning fund managers. The report states how for several years, there has been a strong preference for lower risk strategies, including core and real estate securities. It also points out that core remains in vogue for a subset – notably insurance companies that require long dated income generating assets along with diversification benefits. However, investors responded to the survey suggesting they were concerned about current valuations. The report predicted interest in core may moderate in the future.