Investor views: Real estate attractive despite pricing concerns

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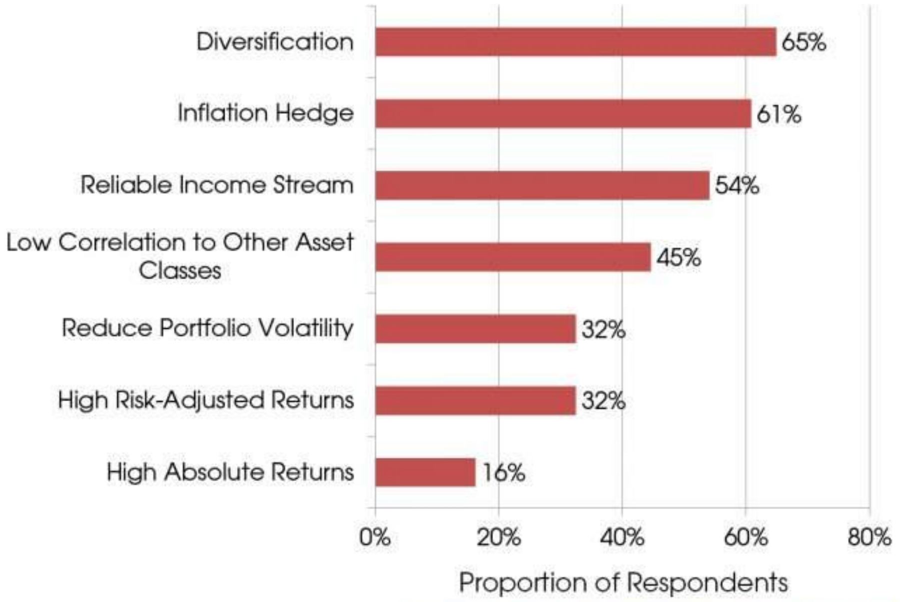
Using information from the recently released *Preqin Investor Outlook: Alternative Assets H2 2015*, Preqin explores institutional investors' objectives, satisfaction with returns and activity within the real estate asset class in this extract from *Preqin Real Estate Spotlight*.

Investor objectives for real estate

A diverse range of institutional investors choose to invest in the real estate asset class, each with their own set of objectives. Fig 1 shows that there are a multitude of reasons that surveyed investors place above returns as their main motivation. The diversification benefits of real estate were cited by the largest proportion of respondents, most likely due to the asset class's relatively low correlation to traditional asset classes and the diversity of property types, strategies and locations available on the market. Large proportions of surveyed investors also choose to invest in real estate because of its inflation hedging properties and the asset class's ability to generate a predictable and reliable income stream.

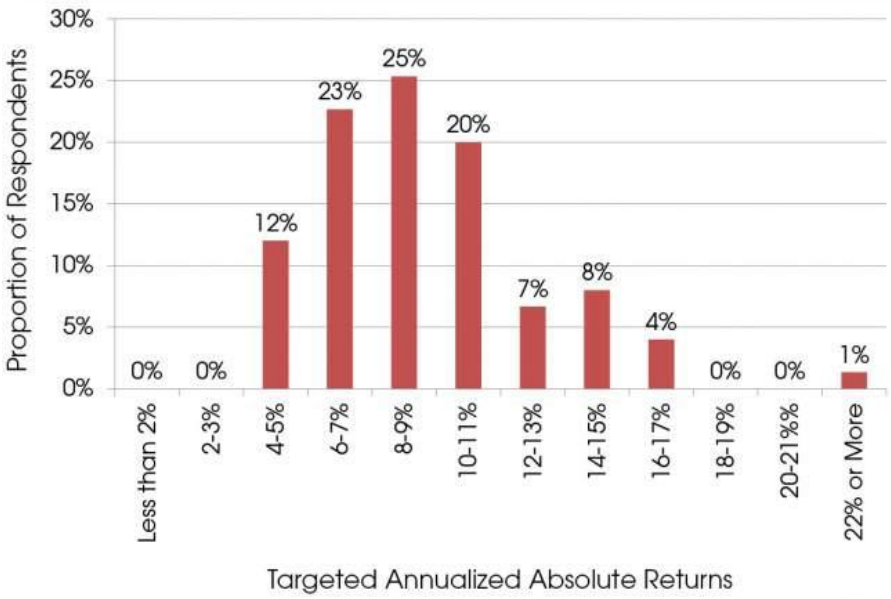
Fig. 1: Investors' Main Reasons for Investing in Real Estate



Source: Preqin Investor Interviews, June 2015

With only 16 per cent of respondents choosing high absolute returns as their main reason for investment, it is unsurprising that the majority of surveyed investors (60 per cent) target absolute returns of less than 10 per cent, with this proportion rising to 80 per cent for investors targeting less than 12 per cent (Fig 2). While investor attitudes towards risk differ based on the tolerance of the distinct institution, real estate does offer opportunities for investment across the risk spectrum, with 13 per cent of respondents seeking high absolute returns of 14 per cent or more.

Fig. 2: Investors' Targeted Annualized Absolute Returns for Real Estate



Source: Preqin Investor Interviews, June 2015

Satisfaction with returns

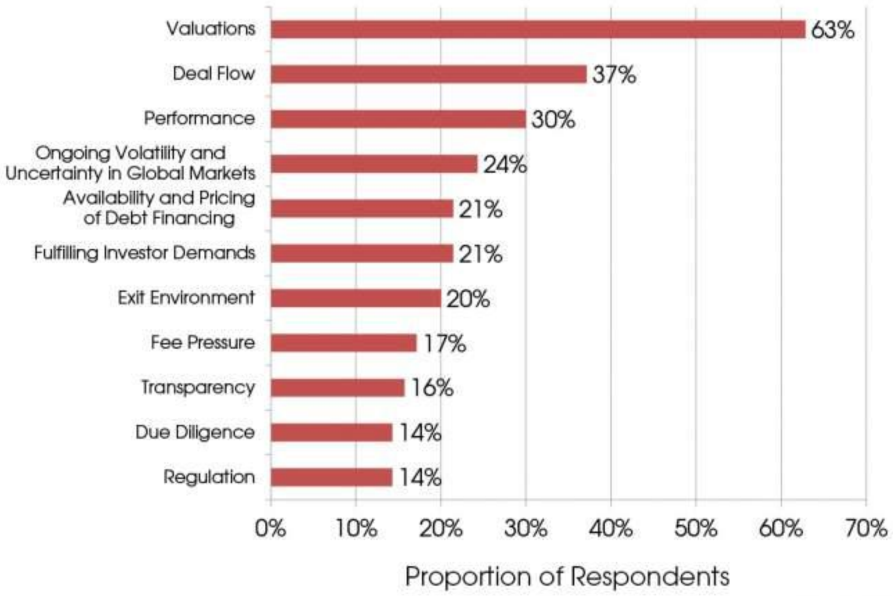
Encouragingly, the majority (57 per cent) of surveyed investors have a positive perception of the real estate asset class at present, a large change in sentiment from the 37 per cent that felt this way in December 2014.

However, 6 per cent have a negative perception of the industry at present, while none stated this at the end of 2014.

Investor satisfaction with the asset class has continued to grow; 39 per cent of investors surveyed in June felt that the performance of their real estate portfolios exceeded their expectations, up from 33 per cent in December 2014 and 3 per cent in December 2012. Furthermore, investors' confidence in real estate's ability to achieve portfolio objectives over the last 12 months has remained stable; over three-quarters (77 per cent) of investors have seen no change in the last year, while 10 per cent have gained confidence in the asset class. This continued satisfaction in the real estate asset class has led to over a quarter (26 per cent) of investors expecting to invest more capital in private real estate over the next year compared with the previous 12 months, while 52 per cent expect to maintain the same level of capital commitments.

Interrelated issues are the key concerns of investors at the beginning of H2; inflated asset prices, a highly competitive deal environment and concerns over the eventual performance of real estate vehicles were chosen by 63 per cent, 37 per cent and 30 per cent of surveyed real estate investors respectively (Fig 3). Macroeconomic uncertainty and volatility in global markets are also on the minds of investors, with 24 per cent indicating this is a key issue for private real estate in 2015.

Fig. 3: Investors' Views on the Key Issues for the Private Real Estate Market over the Next 12 Months



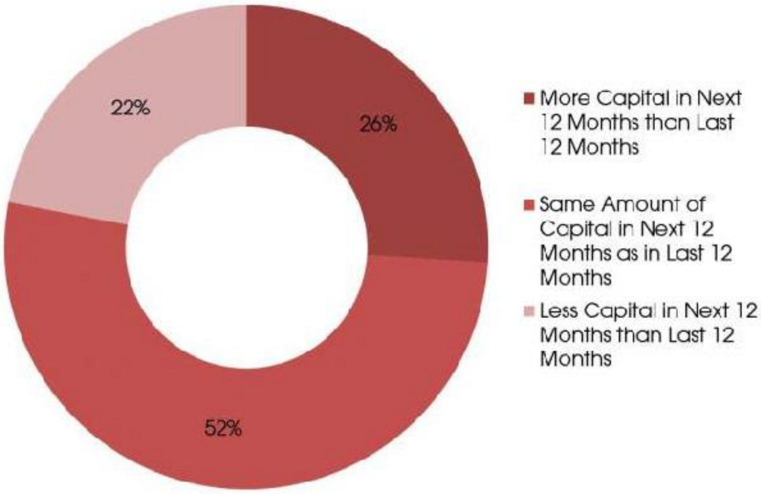
Source: Preqin Investor Interviews, June 2015

Exposure to real estate

Many investors will increase their exposure to the real estate asset class over the next 12 months; 78 per cent of surveyed investors expect to commit the same amount of capital, or more, to real estate in the next 12 months compared with the previous year (Fig 4). In the longer term, over half (55 per cent) of respondents will look to maintain their allocations to real estate. However, further growth in the asset class is expected as more investors are planning to increase their allocations than reduce them.

While California Public Employees' Retirement System (CalPERS) has made headlines with moves to reduce the number of managers in its portfolio, this does not appear to reflect a widespread trend. The majority (60 per cent) of investors are looking to maintain the number of fund manager relationships they currently have, while a greater proportion of investors (29 per cent) are looking to increase the number of fund manager relationships they hold in comparison to those looking to reduce them (11 per cent).

Fig. 4: Investors' Expected Capital Commitment to Private Real Estate Funds in the Next 12 Months Compared to the Last 12 Months



Source: Preqin Investor Interviews, June 2015

Strategies and regions targeted

Value added, core and opportunistic remain the most favoured strategies in the next year, with core funds being targeted by the same proportion of investors (54 per cent) as value added strategies. There has been a noticeable decline in investors' preference for distressed funds, suggesting that the strategy type is not as appealing as in previous years, possibly due to a more stable macroeconomic environment and the deleveraging process undertaken by banks reducing the number of viable distressed opportunities in comparison to few years ago.

As expected, the majority of investors looking to make commitments in the next 12 months have a strong domestic bias, with investors much more likely to deploy capital to opportunities in the region in which they are based. However, investors in all regions are looking to expand their exposure to non-domestic markets in the next 12 months. North America-based investors favour greater geographic diversification, and demonstrate the greatest level of interest in targeting global opportunities.

Outlook

There is a general sense of satisfaction among real estate investors, with the majority holding a positive perception of the asset class and believing that their private real estate investments have met or exceeded their expectations in the previous year. Positive sentiment is driving further investment in the asset class in the short term and further growth in the asset class is expected over the long term as more investors are planning to

increase their allocations than reduce them.
Also contributing to investor satisfaction is the alignment of interests between investors and fund managers. However, a large proportion of investors have decided not to invest in a fund due to the proposed terms and conditions, indicating fund managers need to be sure they are aligned with market rates or can effectively justify the fees they charge if they want to ensure these issues are not an obstruction in gaining commitments from investors.

However, investors are still concerned about a range of interrelated issues including valuations, deal flow and performance. How fund managers address and mitigate these concerns could be the differentiator in a successful fundraise within the highly competitive fundraising environment.

This article is taken from Preqin Real Estate Spotlight – September 2015.