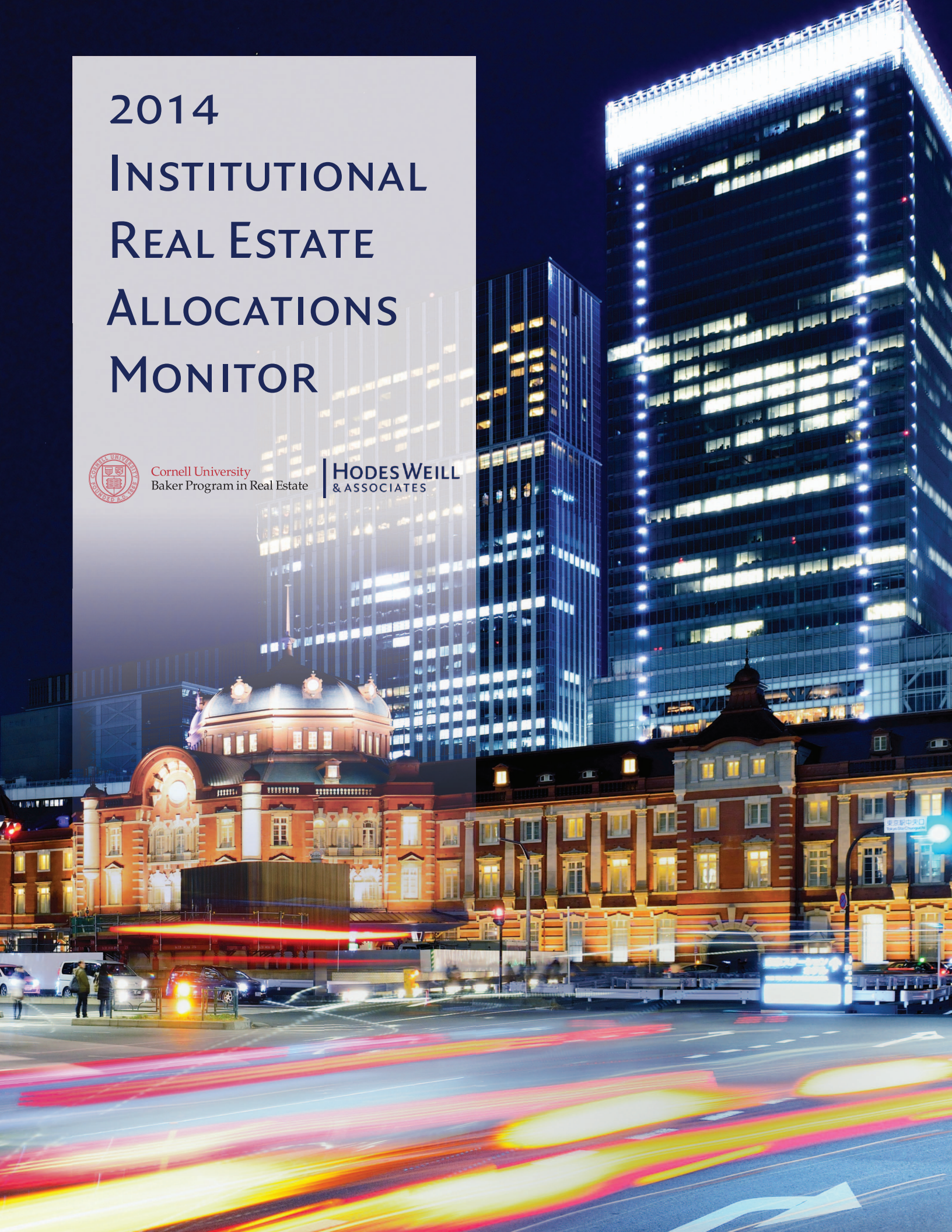


# 2014 INSTITUTIONAL REAL ESTATE ALLOCATIONS MONITOR



Cornell University  
Baker Program in Real Estate

HODESWEILL  
& ASSOCIATES





## DEAR INDUSTRY FRIENDS,

Cornell University's Baker Program in Real Estate and Hodes Weill & Associates, LP are pleased to present the findings of the second annual Institutional Real Estate Allocations Monitor (the "**2014 Allocations Monitor**"). The Allocations Monitor was created in 2013 to conduct a comprehensive annual assessment of institutions' allocations to, and objectives in, real estate investments by analyzing trends in institutional portfolios and allocations by domicile, type and size of institution. We are extremely grateful to the 231 institutional investors (the "**Participants**") in 28 countries that completed our survey. The 2014 Participants represent total assets under management ("**AUM**") exceeding US\$8 trillion, including approximately US\$700 billion invested in real estate.

The 2014 Allocations Monitor focuses on the role of real estate in institutional portfolios, and the impact of institutional allocation trends on the investment management industry. Our survey consisted of 40 questions concerning current and future investments in real estate, portfolio allocations to the asset class, investor conviction, investment management trends including the use of third-party managers, and the role of various investment strategies and vehicles within the context of the real estate allocation (e.g., direct investments, private funds, real estate securities, real estate debt and real assets).

The primary conclusion of the 2014 Allocations Monitor is that institutions continue to allocate significant capital to new real estate investments, which is consistent with the trends anticipated in the inaugural 2013 Allocations Monitor. As highlighted in the 2013 Allocations Monitor, the weight of this capital is having a significant impact on the industry, with respect to transaction volumes, fund raising, lending activity and property valuations. Although some industry research indicates that the property markets may be nearing a peak, we believe that the continued supply of capital may sustain current valuation and financing metrics (including capitalization rates and the cost of debt capital). However, the concerns for the potential rise in interest rates, slower economic growth, new supply and valuations outpacing fundamentals have contributed to moderating investor conviction regarding the investment opportunity in real estate.

The following are several key findings that we expand upon in this report:

- 1. THE REAL ESTATE ASSET CLASS CONTINUES TO EXPERIENCE AN ACCELERATION OF INSTITUTIONAL CAPITAL ALLOCATIONS.** The average target allocation to real estate stands at 9.38%, up 49 bps from 2013. Moreover, institutions have indicated an intention to increase their average target allocation by 24 bps to 9.62% over the next 12 months.
- 2. DESPITE AN INCREASE IN INVESTMENT ACTIVITY OVER THE PAST 12 MONTHS, INSTITUTIONS REMAIN SIGNIFICANTLY UNDER-INVESTED RELATIVE TO TARGET ALLOCATIONS.** On average, institutional portfolios are 8.49% invested in real estate, or approximately 88 bps under-invested (i.e., under-allocated) relative to target allocations. This level of under-investment is comparable to 2013, when institutions were approximately 89 bps under-invested relative to a then target allocation of 8.89%.
- 3. INVESTOR CONVICTION REGARDING THE INVESTMENT OPPORTUNITY IN REAL ESTATE FROM A RISK/RETURN BASIS IS MODERATING AFTER SEVERAL YEARS OF POSITIVE SENTIMENT.** Institutions expressed a decline in conviction between 2013 and 2014 in terms of the investment opportunity in real estate. Over 60% of institutions indicated a decline in conviction, while just 19% indicated an increase. This shift in sentiment is further supported by commentary provided by institutions, which included concerns with respect to the potential for rising interest rates, slow economic growth, new supply and too much capital pushing valuations ahead of fundamentals.
- 4. WHILE INVESTOR CONVICTION HAS DECLINED SLIGHTLY, THE MAJORITY OF INSTITUTIONS ARE ACTIVELY PURSUING INVESTMENTS IN 2014, ALBEIT AT A SLOWER PACE.** The percentage of institutions actively investing in real estate declined from 81% in 2013 to 73% in 2014, after increasing for several years following the Global Financial Crisis (GFC). Moreover, 26% of institutions expect to invest more capital in 2014, down from 39% in 2013.

- 5. CROSS-BORDER INVESTMENT ACTIVITY CONTINUES TO INCREASE, AS INSTITUTIONS ALLOCATE ADDITIONAL CAPITAL TO NON-DOMESTIC STRATEGIES.** While institutions remain most focused on investments in their home country markets, appetite for international investments is on the rise. Following North America, Europe and the U.K. are the most desired destinations for new investing, with 44% of institutions actively pursuing investments in these markets.
- 6. WHILE CROSS-BORDER FLOWS CONTINUE TO INCREASE GLOBALLY, INTEREST IN STRATEGIES IN THE EMERGING MARKETS REMAINS MODEST.** Approximately 22% of institutions are actively investing in the emerging markets in 2014, as compared to 18% in 2013. Globally, institutions are most interested in Latin American strategies, followed by China.
- 7. INSTITUTIONS ARE INCREASINGLY FOCUSED ON HIGHER RETURN VALUE-ADD AND OPPORTUNISTIC STRATEGIES.** Approximately 66% of institutions are actively pursuing value-add and/or opportunistic strategies in 2014, as compared to 52% for core strategies. Further indicative of a shift in allocations towards higher return strategies, 71% of institutions expect to invest in private funds in 2014, up from 58% in 2013.
- 8. INSTITUTIONS CONTINUE TO SHIFT FROM DIRECT INVESTING TO OUTSOURCING MANAGEMENT TO THIRD-PARTIES.** Approximately 70% of institutions have 100% of their investments managed by third-parties. In addition, despite much discussion to the contrary about institutions internalizing portfolio management functions, institutions are three times more likely to allocate new capital to third-party managers than to in-house management.
- 9. WHILE REITS & REAL ESTATE SECURITIES ARE AN IMPORTANT ALLOCATION IN INSTITUTIONAL PORTFOLIOS, NEW CAPITAL ALLOCATIONS ARE MODERATING.** Over 50% of institutions are invested in real estate public equities, but just 16% of institutions expect to allocate additional capital in 2014 (down from 20% in 2013).
- 10. THE SUBSTANTIAL MAJORITY OF INSTITUTIONS ARE ACTIVELY INVESTING IN REAL ASSETS, WITH AN AVERAGE TARGET ALLOCATION OF 4.0%.** While the approach to investing in real assets (including infrastructure, agriculture, timber and energy) varies by type and location of institution, 73% of institutions have portfolio exposure to real assets and 56% are allocating capital to new investments in 2014.

The 2014 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 on 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 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 all of the Participants for their support in this initiative.

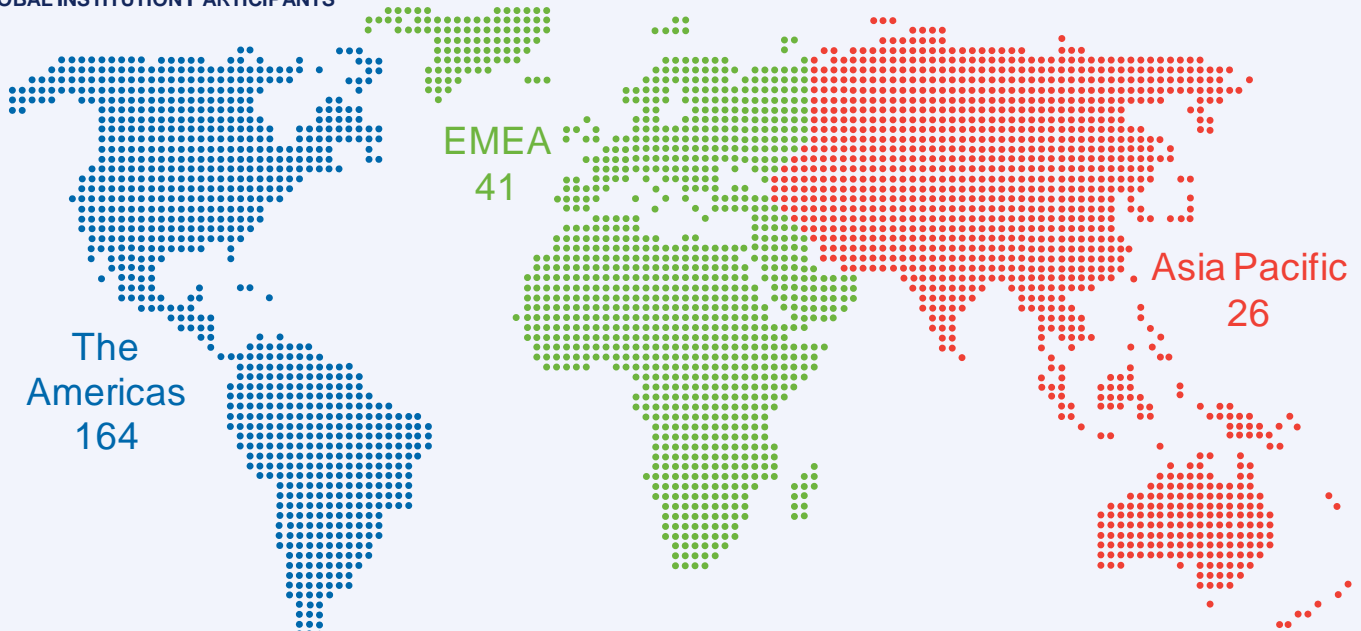
Regards,

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## GLOBAL INSTITUTION PARTICIPANTS



### Americas

Abilene Firemen's Relief and Retirement Fund  
 Air Force Aid Society  
 Alberta Investment Management Corporation  
 Andrew W. Mellon Foundation  
**AT&T Pension Fund\***  
 Baylor College of Medicine Endowment  
 Boston Foundation  
 California Community Foundation  
 Carnegie Corporation of New York  
 City of Fort Lauderdale General Employees' Retirement System  
 City of Phoenix Employees' Retirement System  
 Claude Worthington Benedum Foundation  
 Clearwater Employees Pension Fund  
 Colorado Public Employees' Retirement Association  
**Cornell University Endowment\***  
 Dalhousie University Endowment  
 Deere & Company Pension Fund  
 Duke Faculty & Staff Retirement Plan  
 Earlham College Endowment  
 Employees' Retirement System of Rhode Island  
 Employees' Retirement System of Texas  
 Employees' Retirement System of the State of Hawaii  
 Exelon Corporation Pension Fund  
 Florida A&M University Foundation  
 Fundacao Atlantico  
**General Board of Pension and Health Benefits, United Methodist Church\***  
 Government Employees Retirement System of the Virgin Islands  
 HRM Pension Plan  
**IBM Retirement Fund\***  
 Indiana Public Employees' Retirement Fund  
 International Monetary Fund Retirement Plan  
 Ivanhoe Cambridge  
 Kentucky Retirement Systems  
 Lincoln National Life Insurance Company  
 Maine Community Foundation  
 Maryland State Retirement and Pension System  
**Massachusetts Pension Reserves Investment Management Board\***  
 MetLife Real Estate Investors  
 Metropolitan Government of Nashville & Davidson County Employees' Trust Fund  
 Minneapolis Foundation Investment Partnership  
 National Life Group  
 National Trust for Historic Preservation in the United States  
 Nebraska Investment Council

New England Teamsters and Trucking Industry Pension Fund  
 New Mexico State Investment Council  
 New York State Teachers' Retirement System  
 Nunavut Trust  
 Ohio Police & Fire Pension Fund  
 Old Dominion University  
 Oregon State Treasury  
 Pennsylvania Public School Employees' Retirement System  
 Pitney Bowes Pension Fund  
 Police Retirement System of St. Louis  
 Public Employees' Retirement System of Mississippi  
**Public Sector Pension Investment Board\***  
 Rasmuson Foundation  
**Regents of the University of California\***  
 Rocky Mountain UFCW Unions and Employers Pension Plan  
 Rutgers University Foundation  
**San Francisco City & County Employees' Retirement System\***  
 San Luis Obispo Pension Trust  
 Santa Barbara County Employees' Retirement System  
 SBLI USA Mutual Life Insurance Company  
**State of Wisconsin Investment Board\***  
 Tacoma Employees' Retirement System  
**Teacher Retirement System of Texas\***  
 Texas Children's Hospital  
 Texas Christian University Endowment  
 Texas Permanent School Fund State Board of Education  
 Texas Tech University System Endowment  
**Tulane University Endowment\***  
 UC Santa Barbara Foundation  
 United Parcel Service of America Pension Plan  
 United Technologies Pension Fund  
 University Corporation For Atmospheric Research  
 University of Louisville Foundation  
 University of Missouri Retirement, Disability and Death Benefit Plan  
 University of Oklahoma Foundation  
 University of Québec Pension Plan  
 University of Toledo Foundation  
 University of Western Ontario Endowment  
 Virginia Retirement System  
 Winthrop Rockefeller Foundation  
 Yale University Endowment  
 YMCA Retirement Fund  
 and 79 anonymous participants

### EMEA

Ahold Pension Fund  
**AP-Fonden 2\***  
 Bahrain National Holding Company  
**Church Commissioners for England\***  
 DNB Life  
 Fonds de Pension Metal  
 Fonds de Pensions Nestlé  
 Gasunie Pension Fund  
 GOSI  
 Guy's & St. Thomas' Charity  
**Hermes Real Estate\***  
 Kápan Pensioner  
**Migros-Pensionskasse\***  
 MN  
 Norsk Hydro Pension Plan  
 PGGM  
 SPF Beheer  
 State Oil Fund of the Republic of Azerbaijan  
 UNIFOR  
 Versorgungswerk der Zahnärztekammer Nordrhein  
 Zurich Insurance Company  
 and 20 anonymous participants

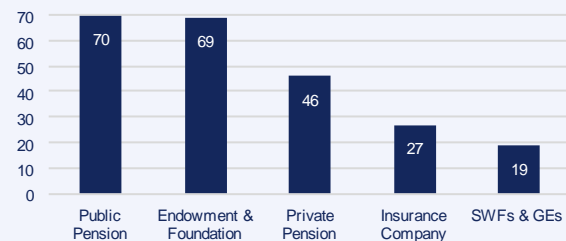
### Asia Pacific

ANZ Australian Staff Superannuation Scheme  
 ASB Community Trust  
 Construction and Building Industries Superannuation Fund  
 Construction Workers Mutual Aid Association  
 Dainippon Ink & Chemicals Pension Fund  
 Energy Super  
**Future Fund\***  
**GIC Private Limited\***  
 Government Superannuation Fund  
 HESTA Super Fund  
 Local Finance Association  
 Media Super  
 Muang Thai Life Assurance  
**National Pension Service of Korea\***  
**National University of Singapore Endowment Fund\***  
 SunSuper  
 TWUSUPER  
 and 9 anonymous participants

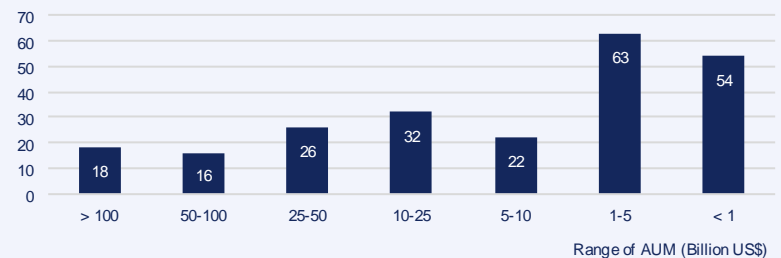
\*Founding Participants

### Number of Participants

by Type



by AUM (US\$)



## TABLE OF CONTENTS

## PARTICIPATION AND METHODOLOGY

Participation & Methodology	4
Target Allocations to Real Estate	5
Portfolio Investments	7
Investor Sentiment	9
Investment Activity & Intentions	10
Investment Management Trends	14
The Real Estate Portfolio Sub-Allocations	16
Conclusion	20

This year, we distributed our survey to over 3,000 institutions with investable assets. We conducted the survey over an approximate four-month period from mid-May 2014 to early September 2014. Our survey targeted primary allocators to investments, such as pension plans, insurance companies, sovereign wealth funds, endowments and foundations. As such, we did not target intermediaries including fund of funds, consultants and investment companies.

We again want to thank the 231 institutional investors located in 28 countries that completed our survey. The Participants hold total assets under management (AUM) exceeding US\$8 trillion and have portfolio investments in real estate totaling approximately US\$700 billion. The Participants represent approximately 8% of institutions contacted and the participation rate was greater than 5% across a range of stratifications including region, investor type and investor size. We believe these are statistically significant figures with respect to interpreting the results of the survey. We note, however, that while the substantial majority of Participants completed the entire survey, not all Participants answered each question.

### Several important notes to readers regarding methodology:

- For the 2014 Allocations Monitor, we decided to exclude commercial banks and family offices. After a careful review of the results, we determined that these categories of investors have a wide range of asset allocation objectives. For example, in many cases, the institution did not utilize an asset allocation policy, or had a primary objective of investing in real estate (in particular several family offices), thereby skewing overall results. Therefore, this data were excluded from 2014, as well as 2013 for comparative purposes.
- In this year's report, we are presenting percent invested, target allocation and projected target allocation figures on a weighted average basis by total AUM. We believe this provides a more relevant presentation of trends, in particular year-over-year comparisons. It also provides a better indication of potential gross capital allocations to the asset class. To confirm that our results from the 2013 Allocations Monitor have not been distorted, we back tested our change in methodology by comparing year-over-year results on a "same-store" basis. Unless otherwise stated, all other figures in the report are based on straight averages, including for investment activity, intentions and risk/return objectives.♦

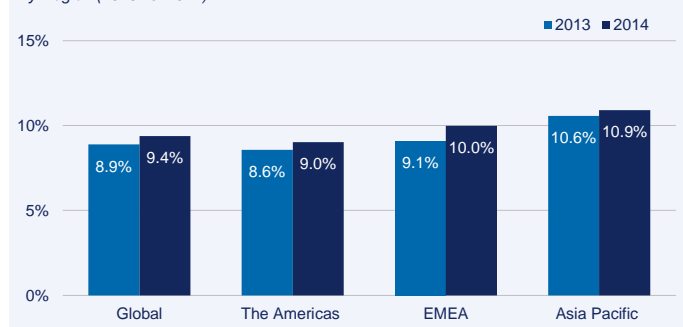
## TARGET ALLOCATIONS TO REAL ESTATE

**The real estate asset class continues to experience an acceleration of institutional capital allocations.**

The average target allocation to real estate stands at 9.38%, up 49 bps from 2013. Moreover, institutions have indicated an intention to increase their average target allocation by 24 bps to 9.62% over the next 12 months (*Charts 1 and 4*).

This is a substantial year-over-year increase and indicates the potential for greater capital flows to the asset class and continued liquidity in the marketplace. The increase in the average target allocation in 2014 is consistent with investors' stated intentions in 2013.<sup>1</sup> Furthermore, according to a research report released by Evestment and Casey Quick, real estate is the fastest growing asset allocation across institutions' portfolios.<sup>2</sup>

**Chart 1: Target Allocation**  
By Region (2013 vs. 2014)

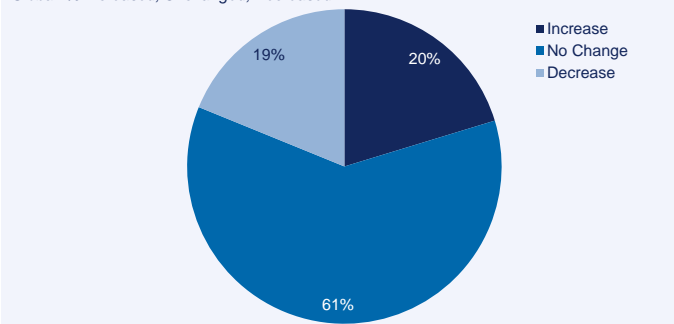


Institutions in Asia Pacific have the largest target allocation at 10.9%, while institutions in the Americas have the lowest target allocation at 9.0% (*Chart 1*). In terms of year-over-year changes in target allocations, institutions in EMEA had the largest increase at 89 bps, while the Americas and Asia Pacific increased 46 and 35 bps, respectively.

Over the past 12 months, approximately 20% of institutions increased their target allocation (by approximately 306 bps on average), while 61% of institutions held their target allocation

flat and just 19% decreased (by approximately 175 bps on average) (*Chart 2*).

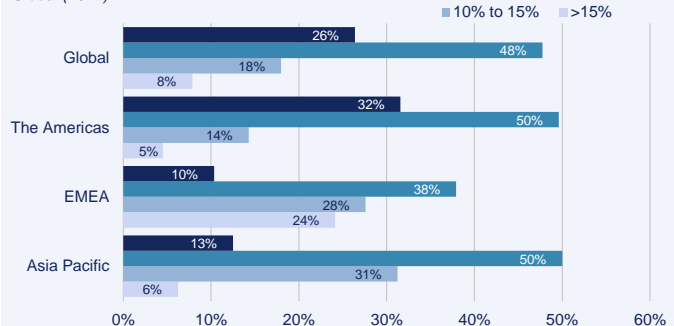
**Chart 2: Target Allocation 2013 vs. 2014**  
Global: % Increased, Unchanged, Decreased



Approximately 27% of institutions surveyed indicated an intention to increase their target allocation over the next 12 months by approximately 100 bps on average, while 67% of institutions intend to hold their target allocation flat and just 6% intend to decrease their target allocation by approximately 182 bps on average.

While institutions continue to raise their target allocation to real estate, the substantial majority have a target allocation less than or equal to 10% (*Chart 3*). Approximately 26% of institutions surveyed have a target allocation to real estate greater than 10%. It is also worth noting that over 50% of institutions in EMEA have a target allocation to real estate greater than 10%, and about one in four have a target allocation greater than 15%.

**Chart 3: Range of Target Allocations**  
Global (2014)



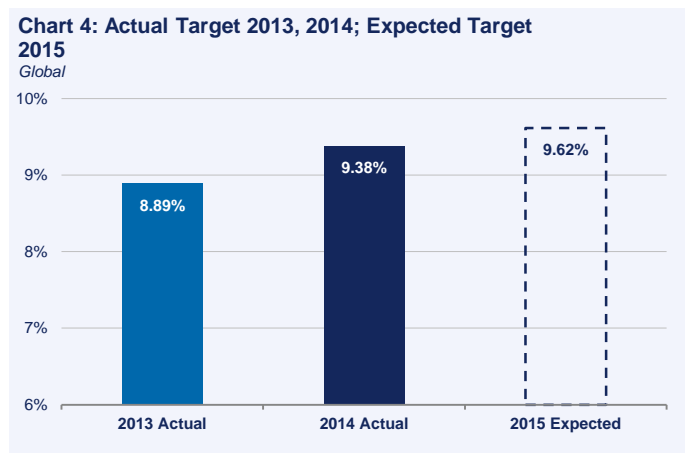
<sup>1</sup>On a "same-store" basis, including 95 participants in both of the 2013 and 2014 Allocations Monitors, institutions indicated an intention to increase target allocations on average by 48bps from 2013 to 2014.

<sup>2</sup>A Tailored Approach: Positioning to Outcome-Oriented Global Investors." Evestment, Casey Quirk. February 2014.

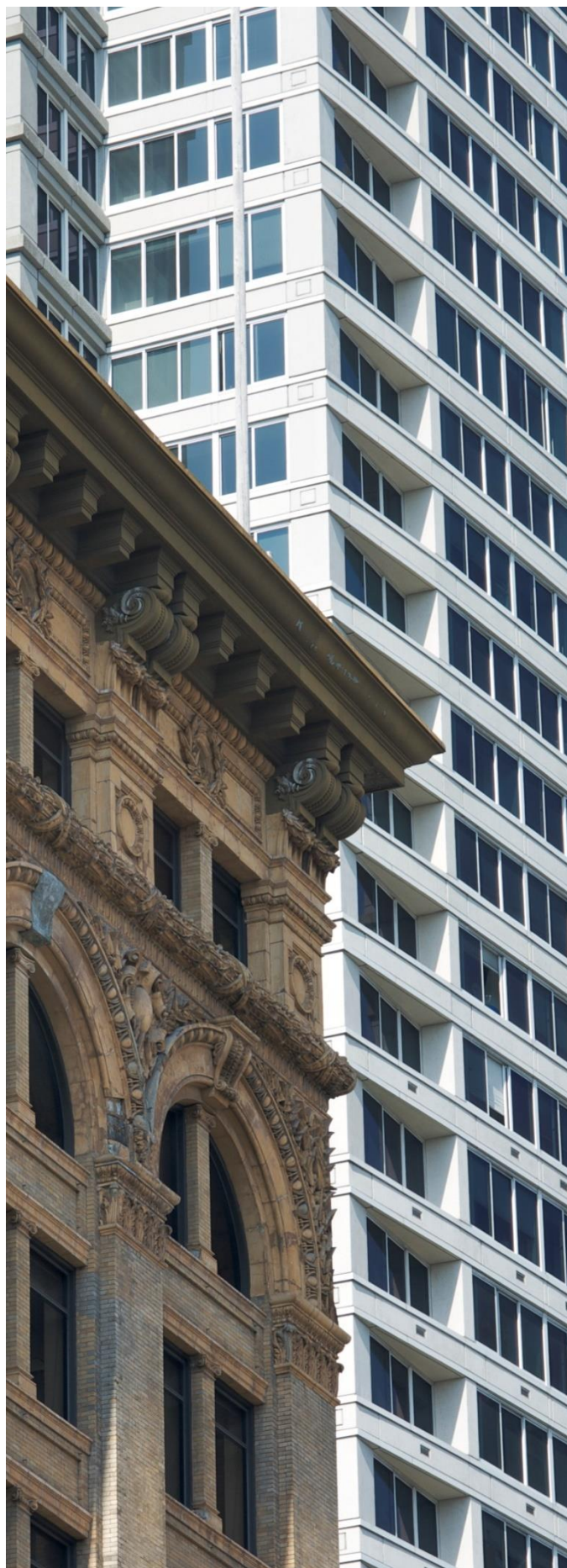


Approximately 23% of investors indicated that they do not have a target allocation to real estate; although it is important to note that many active investors in real estate do not have a target allocation to any asset class, including real estate. There is anecdotal evidence that for many investors that hold real estate within an alternatives allocation (vs. a target real estate allocation), there have been substantial flows to energy and other real asset investments last year, yet this had minimal impact on the overall survey results.

Demonstrating continued, albeit moderating, momentum for the asset class, institutions have indicated an intention to increase target allocations by an average of 24 bps from 9.38% in 2014 to 9.62% in 2015 (*Chart 4*).



This moderation is not surprising given that we are in the fifth year of a market recovery (see commentary on Investor Sentiment on page 9). There is also anecdotal evidence to support that between now and year-end 2014, institutions may face further pressure to increase their real estate allocation as fixed income returns remain low, and public equity market performance remains strong, which may portend the need to re-balance overall portfolio asset allocations. ♦

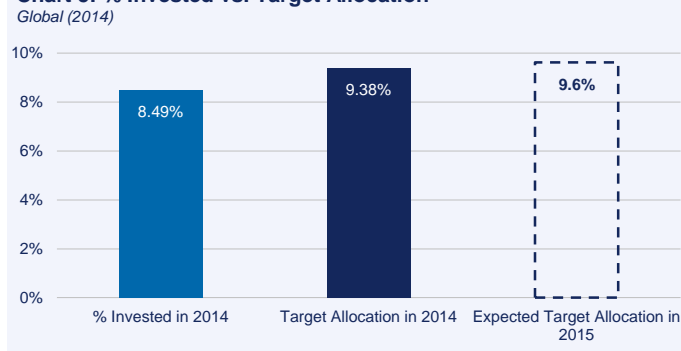


## PORTFOLIO INVESTMENTS VERSUS TARGET ALLOCATIONS

***Despite an increase in investment activity over the past 12 months, institutions remain significantly under-invested relative to target allocations.***

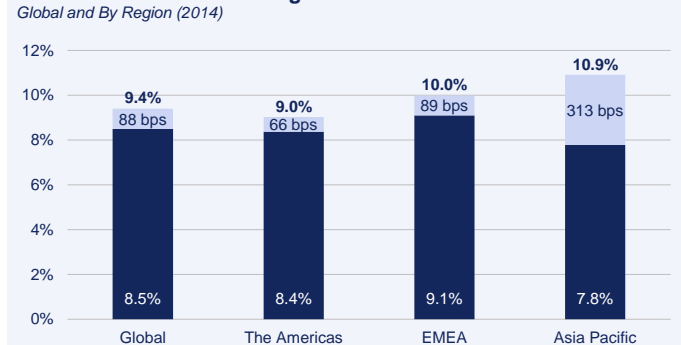
On average, institutional portfolios are 8.49% invested in real estate, or approximately 88 bps under-invested (i.e., under-allocated) relative to target allocations (*Chart 5*). This level of under-investment is consistent with the 2013 Allocations Monitor, when institutions were also approximately 89 bps under-invested relative to a then target allocation of 8.89%.

**Chart 5: % Invested vs. Target Allocation**



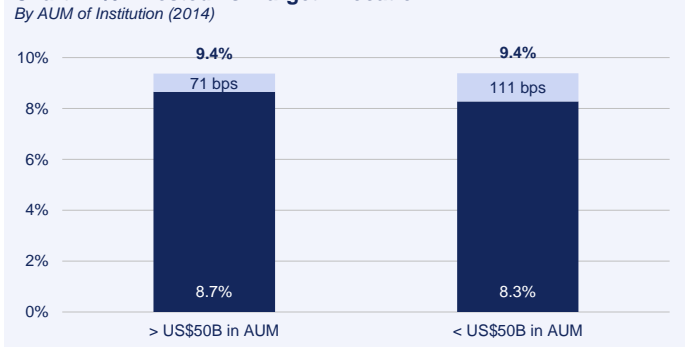
Institutions in every region of the world indicated that they are under-invested relative to target allocations. Institutions in the Americas have the lowest target allocation to real estate at 9.0% and are the closest to their target allocation (66 bps under-invested) (*Chart 6*). Institutions in Asia Pacific have the highest target portfolio allocation to the asset class at 10.9% and are the most under-invested (313 bps). Many institutions in the Asia Pacific region are newer entrants to the asset class so these results should not be surprising.

**Chart 6: % Invested vs. Target Allocation**



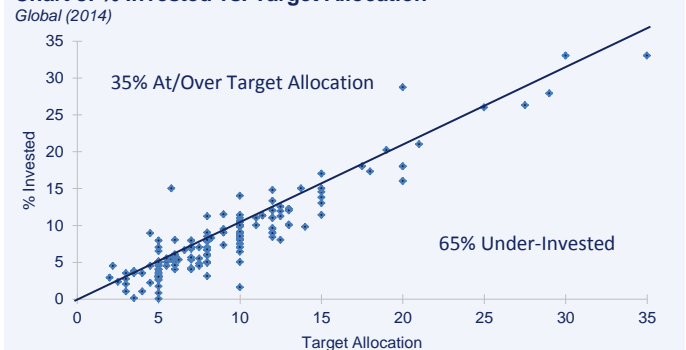
In general, larger institutions (with AUM greater than US\$50 billion) are closer to their target allocation than smaller institutions (with AUM less than US\$50 billion). Larger institutions are 71 bps under-invested relative to their target allocation, while smaller institutions are 111 bps under-invested (*Chart 7*). These results likely reflect that larger institutions have the ability to dedicated more organizational and human resources to their investment activities.

**Chart 7: % Invested vs. Target Allocation**

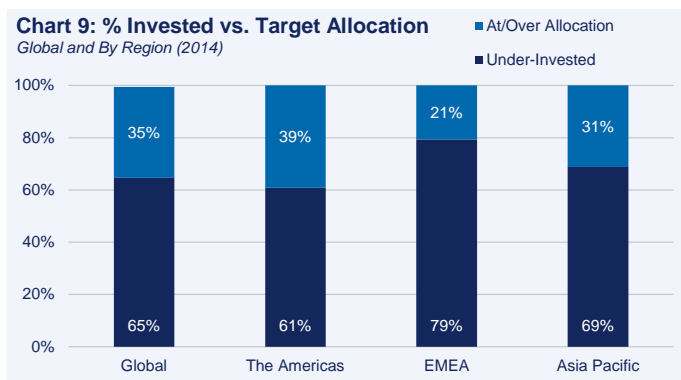


Approximately 35% of institutions are at or in excess of their target allocation, while 65% of institutions are under-invested relative to target allocation by an average of 183 bps (*Chart 8*). Moreover, 14% of institutions are under-invested by in excess of 300 bps.

**Chart 8: % Invested vs. Target Allocation**

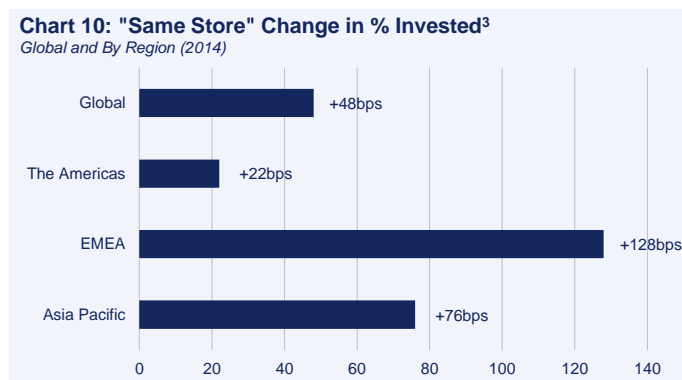






Approximately 79% of institutions in EMEA are under-invested relative to their target allocation, the most of any region globally, while 61% of institutions in the Americas are under-invested (*Chart 9*).

Between 2013 and 2014, the portion of institutional portfolios invested in real estate increased by approximately 50 bps from an average of 8.0% to 8.5% (*Chart 10*). It is important to note that while institutions indicated an accelerated pace of investment activity over the past 12 months, changes in investment percentages can be meaningfully impacted by a number of factors including investment performance of existing real estate holdings and realizations (i.e., the numerator effect), in addition to overall portfolio performance (i.e., the denominator effect).



Across regions globally, institutions increased their portfolio concentration in real estate between 2013 and 2014. Institutions in EMEA had the greatest increase in portfolio concentration, rising 128 bps. Institutions in the Americas had the lowest increase at 22 bps (*Chart 10*).♦

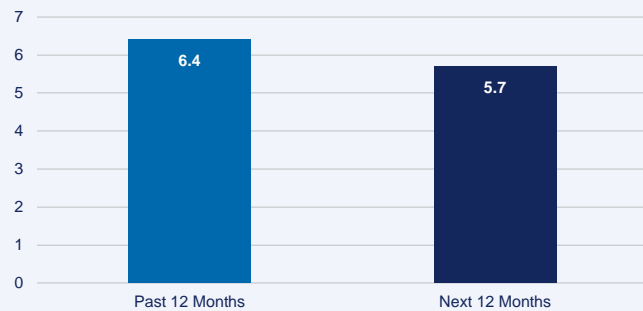
<sup>3</sup> Same-store analysis refers to the difference in % Invested in 2014 as compared to the % Invested in the 2013 for institutions that completed the Allocations Monitor in 2013 and 2014.

***Investor conviction regarding the investment opportunity in real estate is moderating after several years of positive sentiment.***

This year we included survey questions regarding investor sentiment. Specifically, we asked Participants to rate on a scale of one-to-ten their view of the investment opportunity in real estate from a risk/return perspective (one being lowest, ten being highest). Approximately 60% of institutions indicated a decline in conviction, while just 19% indicated an increase in conviction (*Chart 11A*). This shift in sentiment is further supported by commentary provided by investors. Institutions consistently cited concerns with respect to the potential for rising interest rates, slow economic growth, new supply and too much capital pushing valuations ahead of fundamentals. At five years into a market recovery, this shift in sentiment is not surprising. Further, we expect that these results would vary across different investment strategies, risk targets, geographies, etc.

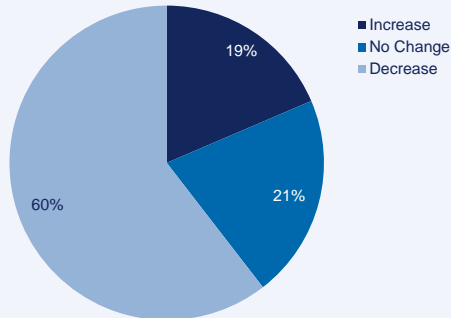
**Chart 11: Conviction Index**

Global



**Chart 11A: Conviction Index**

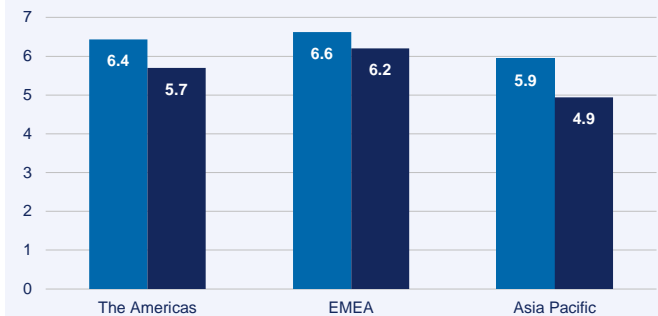
Global: % Increased, Unchanged, Decreased



Investors in EMEA remain the most optimistic towards the asset class while institutions in Asia Pacific, as well as larger institutions, exhibited the greatest decline in conviction (*Charts 11B and 11C*).♦

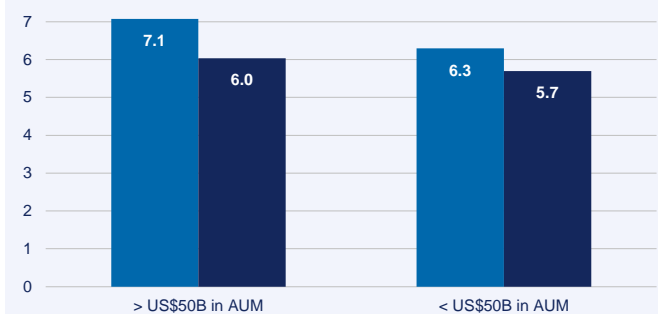
**Chart 11B: Conviction Index**

By Region



**Chart 11C: Conviction Index**

By AUM



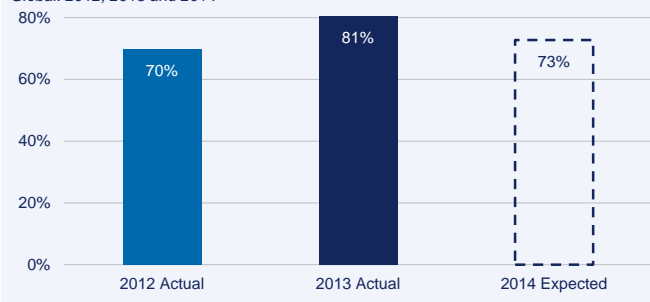
## Investment Pace

*While investor conviction towards the asset class declined slightly, the majority of institutions are actively pursuing investments in 2014, albeit at a slower pace.*

The percentage of institutions actively investing in real estate declined from 81% in 2013 to 73% in 2014, after increasing for several years following the GFC (*Chart 12*). In part, this may be attributed to a decline in conviction over the past 12 months, as discussed previously.

**Chart 12: Allocations to New Investments in Real Estate**

Global: 2012, 2013 and 2014

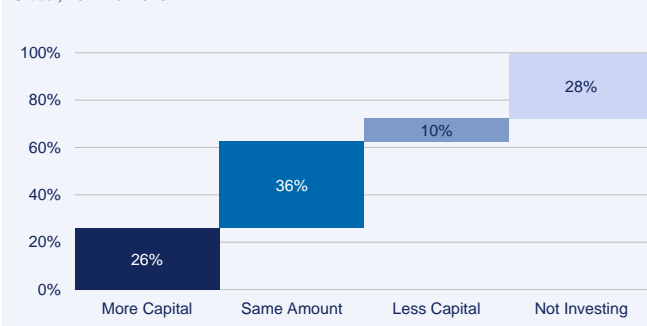


While larger institutions have experienced the biggest decline in conviction, they remain the most active investors in the industry, with over 90% investing in 2014. Public Pensions and Sovereign Wealth Funds, Superannuation and Government-Owned Entities (“*SWFs & GEs*”) are the most active types of institutions, while Endowments & Foundations remain the least active. Institutions in the Americas and Asia Pacific are the most active in the asset class, while institutions in EMEA have shown the greatest decline in activity from 2013 to 2014. However, it is important to note that investor sentiment in the Americas and Asia Pacific is moderating faster than in EMEA, which may result in a reversal of this trend.

In terms of investment pace, 26% of institutions indicated that they expect to invest more capital in 2014 than in 2013; whereas in 2013, 39% of institutions indicated that they expected to invest more capital in 2013 than in 2012 (*Chart 13*). Approximately 46% of institutions indicated that they expect to invest the same amount or less capital in 2014 as compared to 33% in 2013. Approximately 28% of institutions indicated that they are not investing in 2014, the same as 2013.

**Chart 13: Investment Pace in Real Estate**

Global, 2014 vs. 2013

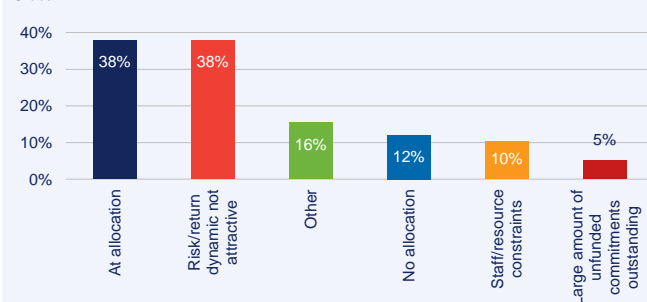


For institutions that are inactive in 2014, 38% indicated that they are at or over allocation, while 38% indicated that they are inactive because they view the risk/return dynamic as “not attractive” (*Chart 14*).

The interpretation of this specific data could provide important insights into the future liquidity and performance of the real estate markets. During the later stages of the run up to the GFC, many institutions expressed significant reservations about valuations, yet continued to invest. While we do not expect that a near-term correction (either due to specific real estate market conditions or an exogenous factor) would have as significant an impact on flows as during the 2008-2009 period, this does suggest that the growing concern about the real estate opportunity (i.e., declining conviction) could quickly reduce the volume of capital flows to the asset class (the “kill switch”).♦

**Chart 14: Reasons for Not Investing in 2014<sup>4</sup>**

Global



<sup>4</sup>Other cited reasons include: real estate policy under review, reducing exposure to be in-line with industry peers, liquidity and size of balance sheet



## Geographic Focus

*Cross-border investment activity continues to increase, as investors allocate additional capital to non-domestic strategies.*

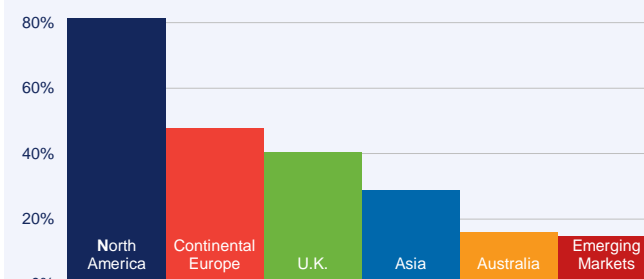
While institutions remain most interested in making investments in their home country markets, appetite for international investments is on the rise. Following North America, Continental Europe and the U.K. are the most desired destinations for new investing, with 44% of institutions actively pursuing investments in these markets (*Chart 15*).

Institutions in the Americas and EMEA are most interested in strategies focused on their home markets, but have increasing appetite for cross border strategies (*Chart 15A*). In terms of target geographies for capital deployment, North America is the preferred destination for institutions based in Asia Pacific, with 61% actively investing in 2014, followed by Asia and the U.K. This is despite the fact that tax efficiency is challenging for offshore investors entering the US market. Not surprisingly, institutions in Asia Pacific are more interested in allocating capital to the Emerging Markets (28% of survey participants), as compared to 18% and 12% for institutions in EMEA and the Americas, respectively.

Notably absent from the 2014 Allocations Monitor are Chinese developers, who accounted for over 70% of an estimated US\$27 billion of direct investments and capital commitments from China in 2013 through August 2014.<sup>5</sup> These flows have been primarily targeted at North America and the U.K. It is anticipated that with ongoing regulatory liberalization in China, a greater number of Chinese institutional investors may seek to make investments in North America and Europe over the next several years, where the majority of these institutions have no existing exposure. In particular, Chinese, Taiwanese and other Asian institutions may emerge as a potent force in the international markets over the next decade as they look to establish overseas investment programs.♦

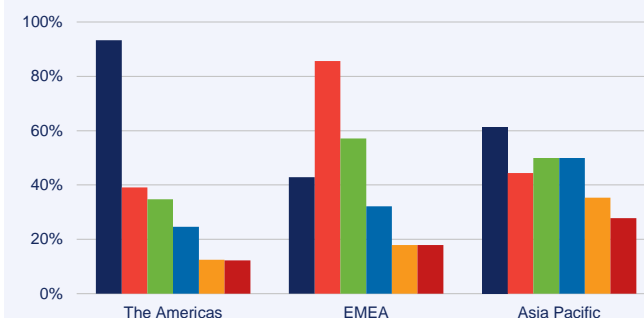
**Chart 15: Geographic Strategy Focus in 2014**

Global



**Chart 15A: Geographic Strategy Focus in 2014**

By Regional Location of Institution

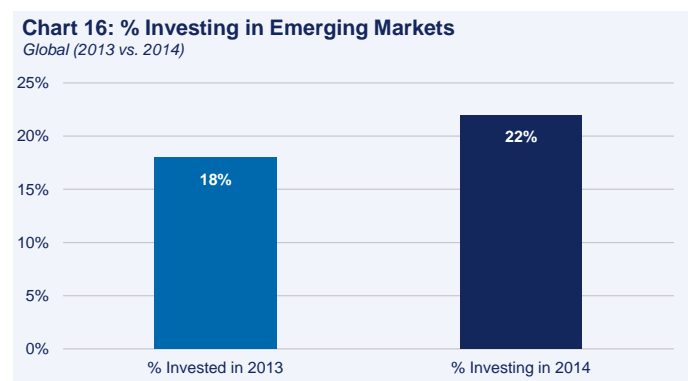


<sup>5</sup> Hodes Weill, public announcements.

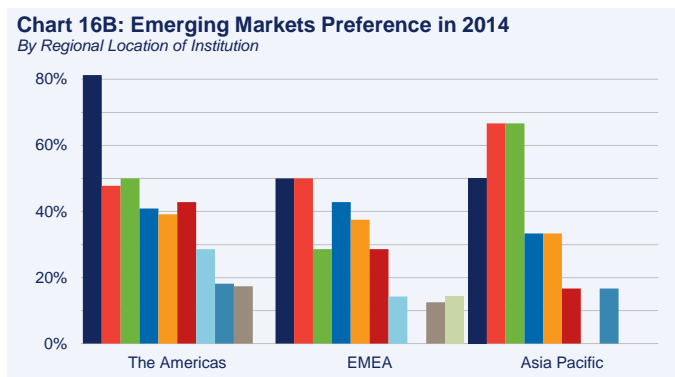
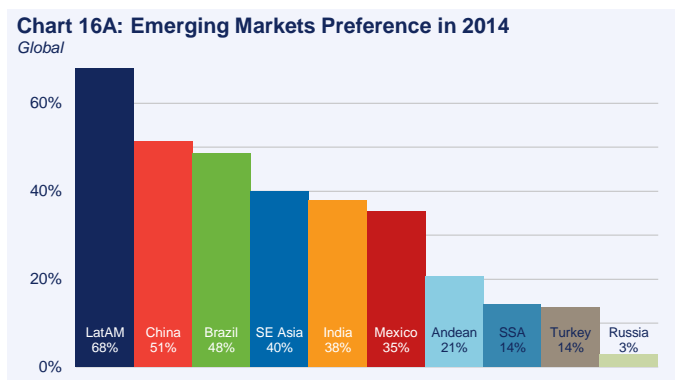
## Emerging Markets<sup>6</sup>

*While cross-border flows continue to increase globally, interest in strategies in the Emerging Markets remains relatively modest.*

Approximately 22% of institutions are actively investing in the emerging markets in 2014, as compared to 18% in 2013 (*Chart 16*).



For those allocating capital to the Emerging Markets in 2014, institutions are most interested in Latin American strategies, followed by China (*Chart 16A*). It is important to note that India has gained favor, with nearly 40% of institutions that are actively allocating capital to Emerging Markets indicating that they are interested in strategies in India. Institutions in the Americas and EMEA are most interested in Latin American strategies, while institutions in Asia are focused on China and Brazil (*Chart 16B*). Given the uncertainty of the political situation in Ukraine and health and security concerns in Sub-Saharan Africa, it is no surprise that these regions are currently attracting the least amount of investor interest.



Investor commentary indicated that many institutions that participated in emerging markets in the past maintain continued interest in these often more aggressive strategies, but the perceived opportunities in more developed regions are resulting in the requirement for higher risk premiums in emerging markets. This is especially true when the more developed market in question is the investor's home market; since domestic investments generally offer fewer concerns involving geopolitics, currency fluctuations and issues related to managing investments in distant locations.

Given similar concerns, investors seem to find it easier to invest in emerging markets which are geographically closer to their domestic markets and may even consider making core investments on occasion. For instance, Scandinavian and other Continental European institutions continue to show interest in core and non-core investments in Eastern Europe, particularly Poland. Given the geographic proximity and historical perspective, they seem more comfortable with the perceived risks and find such investments easier to monitor. ♦

<sup>6</sup> Emerging Markets is broadly defined and for the purposes of our survey included the following countries/regions: China, India, Russia, Turkey, Latin America, Brazil, Mexico, the Andean Region (i.e., Colombia, Peru, Chile), Sub-Saharan Africa (SSA) and Southeast Asia.

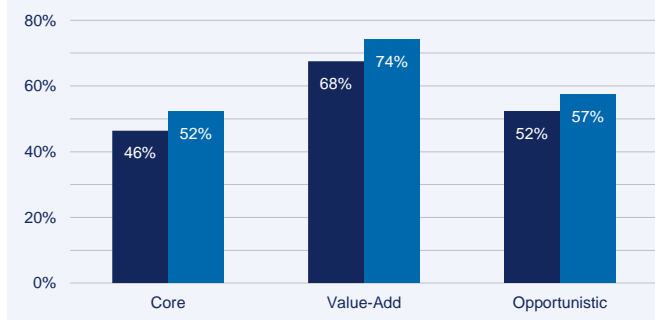
## Risk/Return Objectives

***Institutions are increasingly focused on higher return value-add and opportunistic strategies.***

Approximately 66% of institutions are actively pursuing value-add and/or opportunistic strategies in 2014, as compared to 52% for core strategies (*Chart 17*).

For several years following the GFC, many institutions had a strong preference for lower risk strategies including core and real estate securities. As pricing for core assets has reached or exceeded prior peaks, investors have increasingly sought out higher return strategies. However, core real estate investments remain in favor with a subset of institutions (most notably insurance companies), that seek longer dated income generating assets, along with the diversification benefits of lower risk strategies. Investors cited concerns about current valuations, and as such interest in core may be expected to moderate in the future.

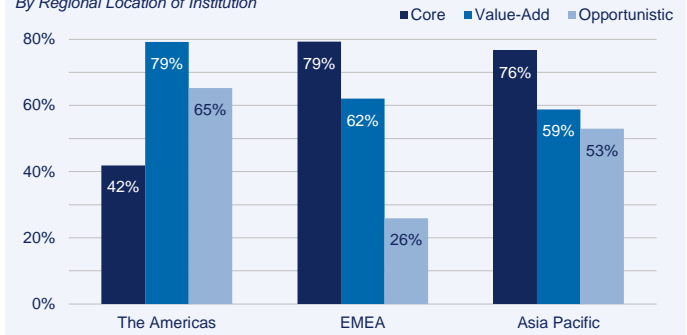
**Chart 17: Risk Preference**  
Global (2013 vs. 2014)



Institutions in the Americas continue to favor value-add and opportunistic strategies, while institutions in Asia Pacific and EMEA favor core strategies (*Chart 17A*). Larger institutions are more interested in value-add and opportunistic strategies than smaller institutions (*Chart 17B*).

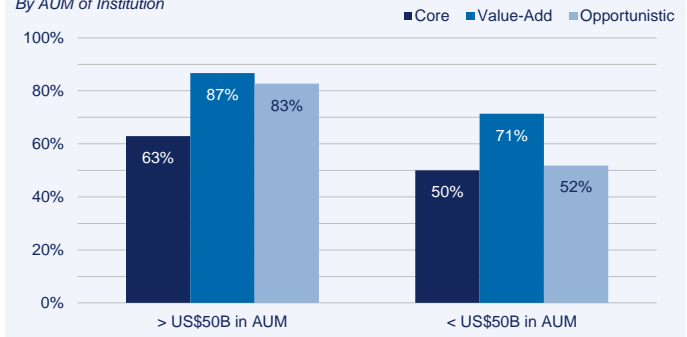
**Chart 17A: Risk Preference in 2014**

By Regional Location of Institution



**Chart 17B: Risk Preference in 2014**

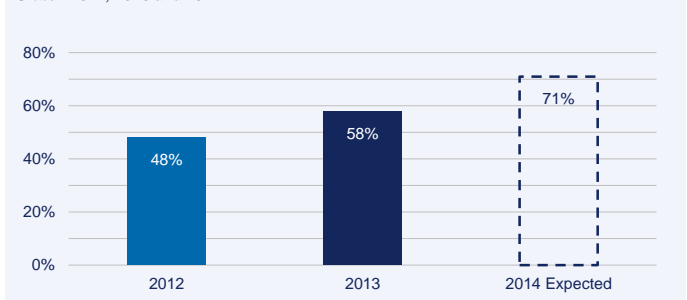
By AUM of Institution



A further indication of a shift in allocations towards higher return strategies is that 71% of institutions expect to invest in private funds in 2014, up from 58% and 48% in 2013 and 2012, respectively (*Chart 18*). Institutions in the Americas remain the largest allocators to private funds in 2014, with approximately 73% actively investing. Likewise, larger institutions remain significantly more active in allocating to private funds (85% of institutions), as compared to smaller institutions at 68%.

**Chart 18: % of Institutions Investing in Private Funds**

Global: 2012, 2013 and 2014





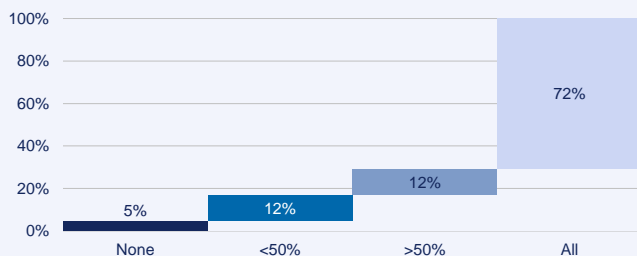
## Outsourcing to Third-Party Managers

*Institutions continue to shift from direct investing to outsourcing management to third-parties.*

Approximately 95% of institutions outsource at least a portion of their investments to third-party managers (*Chart 19*). Over 70% have all of their real estate managed by third-parties and 83% have more than half of their real estate managed by third-parties. Roughly 28% of institutions manage a portion of their real estate portfolio in-house.

Following the GFC, many institutions increased their focus on governance rights and liquidity, with a view towards taking more control of investment decisions and results. As liquidity has returned to the markets, and institutions have come to the realization that internal management is man-power 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.

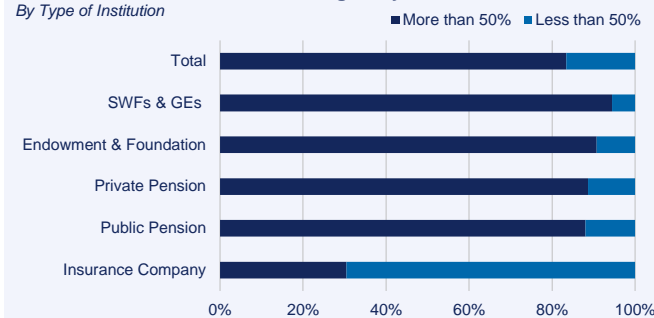
**Chart 19:**  
% of Real Estate Portfolio Managed by Third Parties  
Global (2014)



SWFs & GEs have the largest overall percentage of their portfolios managed by third-party managers (*Chart 20*). Endowments & Foundations are the second most active users of third-party managers, with a substantial majority outsourcing 100% of their assets to third-party managers. This is likely due to human resource constraints to size of AUM and a global investment focus.

Insurance companies are much more likely to manage assets internally, as they generally have larger staffs and focus more on core and lower yield investments, as well as direct lending programs.

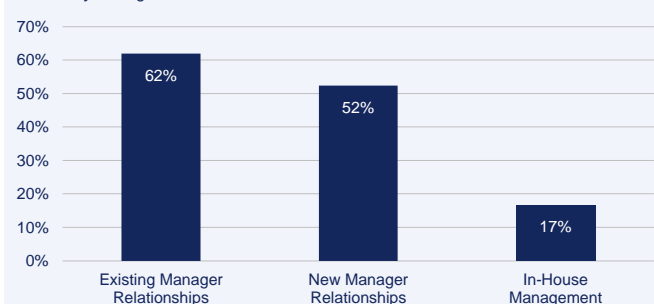
**Chart 20:**  
% of Real Estate Portfolio Managed by Third Parties  
By Type of Institution



Institutions in the Americas are most likely to use third-party managers, while institutions in EMEA are most likely to manage assets internally. Surprisingly, all institutions, regardless of size, are consistent in the use of third-party managers.

Institutions allocating capital to new real estate investments in 2014 are three times more likely to allocate capital to third-party managers than in-house management (*Chart 21*). Approximately 52% of participants allocating new capital to real estate are investing with new third-party manager relationships. SWFs & GEs and Public Pensions are the most likely to invest with new manager relationships, while Insurance companies are the most likely to manage new investments in-house.

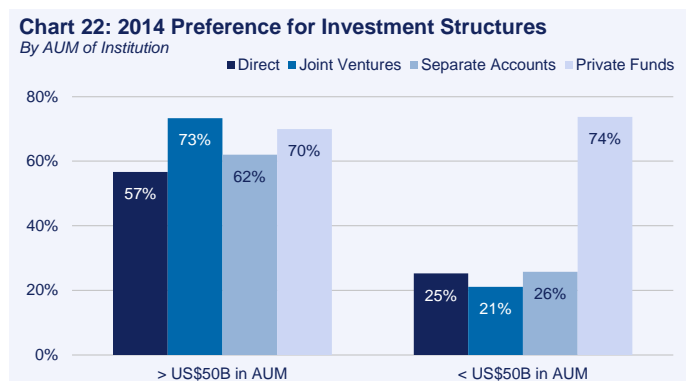
**Chart 21: Allocations of New Investments in 2014**  
Third Party Management vs. In-House



While third-party managers continue to rise, it is interesting to note that some investors remain less likely to invest with a first-time fund manager (approximately 14%).♦

## Investment Vehicles and Structures

Most large institutions have adopted a pragmatic approach to achieve their investing targets, by using the breadth of investment structures, including direct investments, separate accounts, joint ventures, programmatic ventures and the full array of private funds. It should also be noted that even investors that are long-time direct investors and maintain a large staff and have considerable resources, often prefer to use external managers when investing in markets where access can prove more challenging and local knowledge is critical. This is often the case in emerging markets or markets which are geographically distant.



Larger institutions remain focused on control and liquidity, which is best accomplished through direct investing or the use of joint ventures and separate accounts. But it is notable that their appetite for private funds has increased in 2014, with 70% actively investing in funds. Smaller institutions are significantly more focused on private funds than direct investing, joint ventures and separate accounts.♦



## THE REAL ESTATE PORTFOLIO SUB-ALLOCATIONS

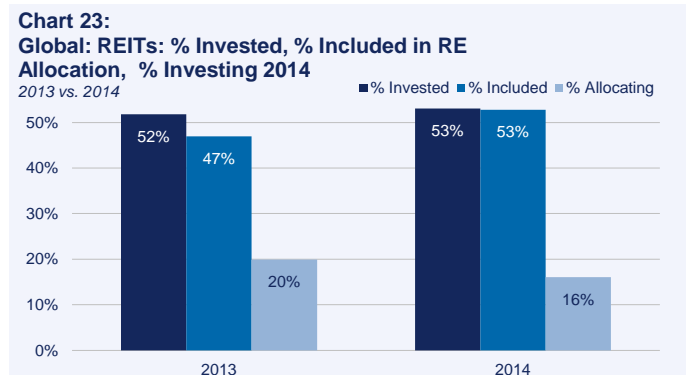
Consistent with our findings from the 2013 Allocations Monitor, real estate sub-allocations vary widely among institutions. There is no “one-size-fits-all” approach as REITs and real estate securities, real estate debt and other hard assets straddle the real estate allocation.

### REITs and Real Estate Securities

*While REITs and Real Estate Securities are an important part of institutional portfolios, new capital allocations are moderating.*

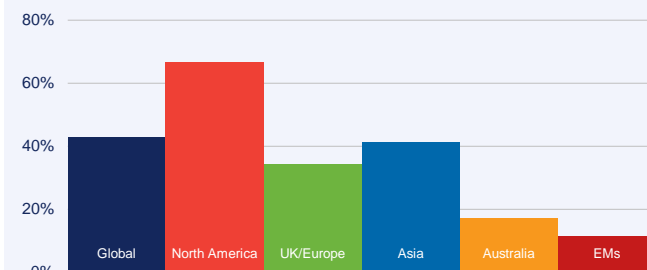
Over 50% of institutions are invested in REITs and real estate securities, but just 16% of institutions expect to allocate additional capital in 2014 (down from 20% in 2013) (*Chart 23*).

Approximately 53% of institutions include real estate securities as part of their real estate allocation. As expected and consistent with our findings in 2013, larger institutions with AUM greater than US\$50 billion have greater exposure to REITs than smaller institutions and were more likely to allocate capital to new REIT investments in 2014.



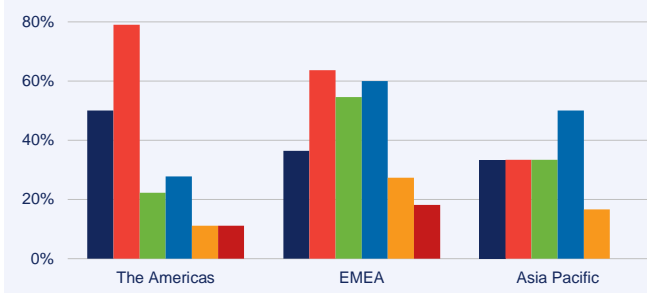
**Chart 24: Geographic Strategy Focus in 2014**

Global, REITs and Real Estate Securities



**Chart 24A: Geographic Strategy Focus in 2014**

By Regional Location of Institution



North America REITs remain the preferred strategy for institutions deploying capital to the sector followed by global strategies, while interest in Asia-focused strategies increased from 2013 (*Chart 24*). Institutions in Asia Pacific are most interested in REIT strategies in Asia (*Chart 24A*).♦

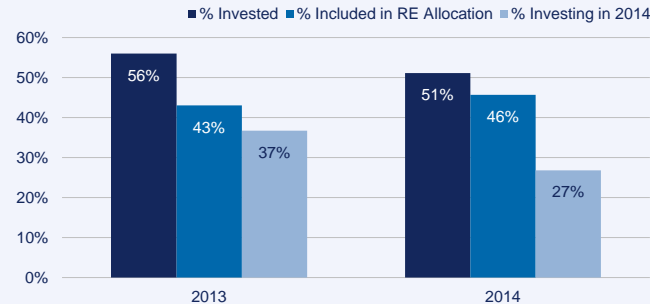


## Real Estate Debt

Over 50% of institutions are currently invested in real estate debt, with approximately 46% of institutions including real estate debt as part of their real estate allocation (*Chart 25*). Only 27% of institutions are actively allocating capital to new real estate debt investments in 2014, down from nearly 40% in 2013. Private funds remain the preferred vehicle for debt strategies among the majority of institutions globally, especially among the smaller institutions, consistent with our findings from the 2013 Allocations Monitor.

**Chart 25: Real Estate Debt**

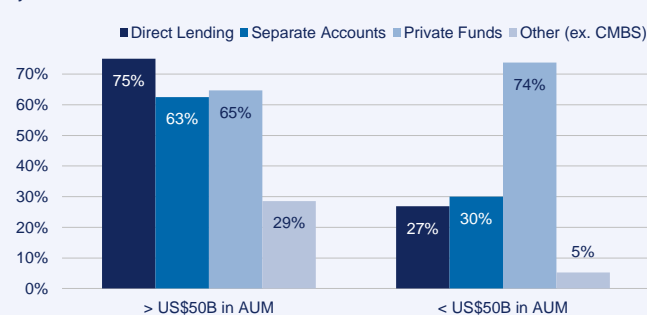
% Invested, % Included in RE Allocation, % Investing in 2014  
2013 v. 2014



Insurance companies remain the most likely to invest in real estate debt given their comfort with debt products and need for strong current income, as well as historical focus on direct lending. Endowments & Foundations remain the least likely to invest in real estate debt, given their focus on higher-returns from real estate in their portfolios.

**Chart 26: % Allocating Capital to Debt in 2014**

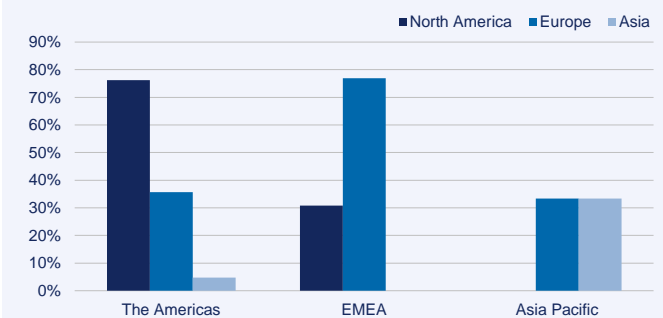
By AUM of Institution



Approximately 53% of larger institutions intend to invest in real estate debt in 2014, down from 67% in 2013 (*Chart 26*). Larger investors indicated that they are attracted by the strong current income that is provided by real estate debt. Larger investors are also much more interested in accessing debt strategies through separate accounts and/or direct lending than smaller institutions, which have stronger preference for private funds.

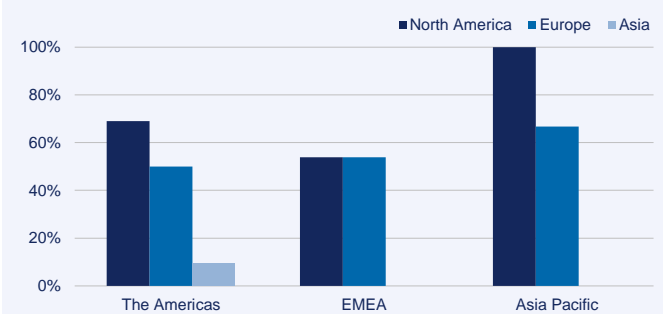
**Chart 26A: % Allocating to Senior Debt in 2014**

By Regional Location of Institution



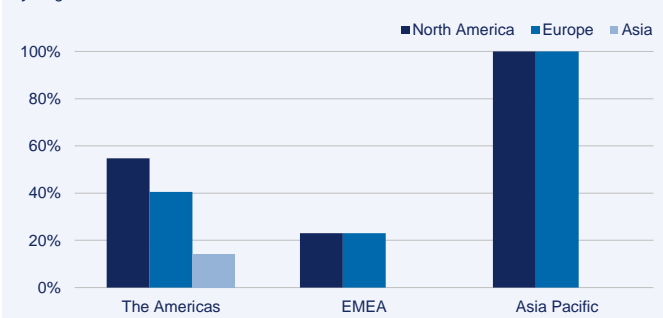
**Chart 26B: % Allocating to Junior/Mezz Debt in 2014**

By Regional Location of Institution



**Chart 26C: % Allocating to Distressed Debt in 2014**

By Regional Location of Institution



Institutions are most interested in mezzanine/junior debt strategies in the U.S. Globally, institutions remain most interested and tend to favor domestic strategies for senior debt. Institutions are more willing to focus their distressed debt investments abroad. Institutions in Asia Pacific remain the most interested in mezzanine and distressed debt in the U.S. and Europe, more so than institutions in the Americas and EMEA.

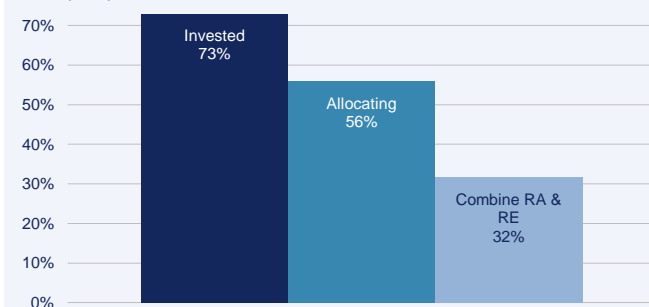
We believe it is worth noting that when considering institutional allocations to debt, we need to take into account that debt by type and purpose is often viewed in many different ways by different investors. Distressed debt and mezzanine strategies, which are often an “equity equivalent”, are very different and perform a different function in a portfolio, than senior debt strategies. We are, however, clearly witnessing an increase in allocations to senior, traditional RE debt strategies across a wide variety of investment vehicles, through both public and private formats.♦

## Real Assets

***The substantial majority of institutions are actively investing in real assets, with an average target allocation (excluding real estate) of approximately 4.0%.***

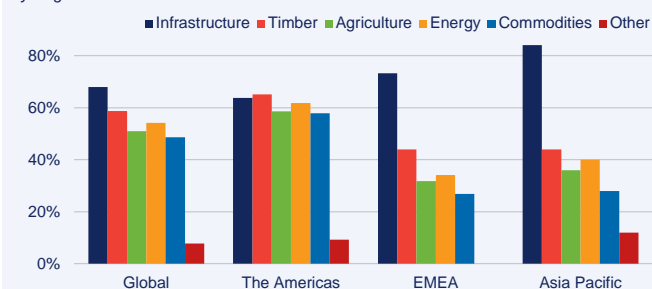
While the approach to investing in real assets (including infrastructure, agriculture, timber and energy) varies by type and location of institutions, 73% of institutions are invested in real assets (excluding real estate) and 56% are allocating capital to new real asset (excluding real estate) investments in 2014 (*Chart 27*).

**Chart 27: Real Asset Allocation in 2014**  
*Global (2014)*

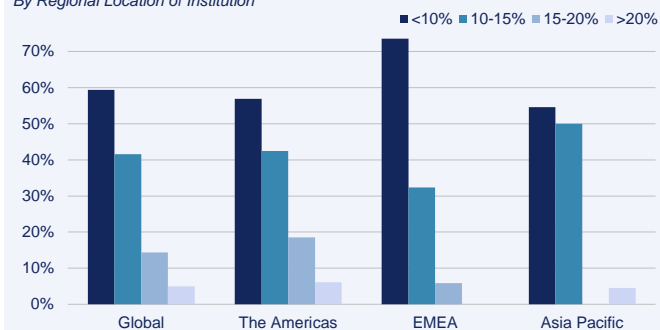


The definition of the real asset allocation continues to vary and the types of investments that straddle the allocation range among institutions by type, by region and by size. Investments in infrastructure, real estate, timber, agriculture, energy, commodities and other assets (e.g., mining and minerals) are often included in the allocation. Institutions in the Americas are more likely to include energy and commodities as part of their real assets allocation than institutions in EMEA and Asia Pacific, while institutions in EMEA and Asia Pacific are more likely to include infrastructure, which is most consistently seen as the typical real asset.

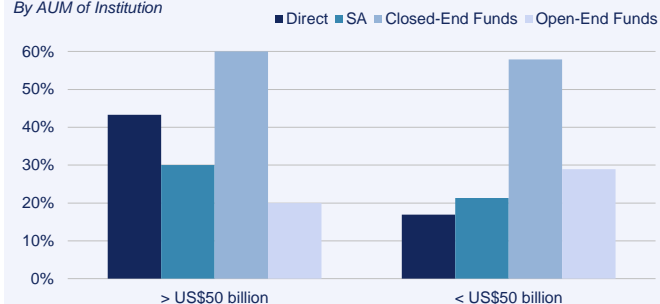
**Chart 28:**  
**Types of Investments included in RA allocation**  
*By Regional Location of Institution*



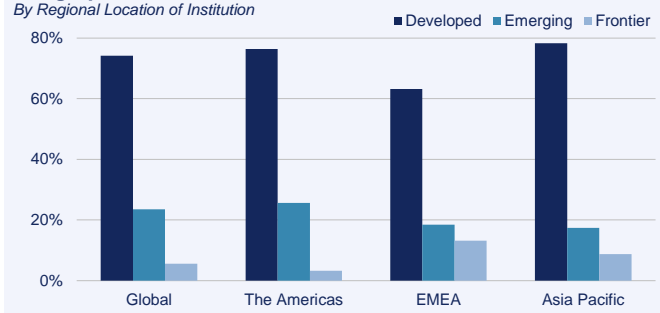
**Chart 29: Return Profile of Real Asset Investments**  
*By Regional Location of Institution*



**Chart 30:**  
**Preferred Investment Vehicle for Real Assets**  
*By AUM of Institution*



**Chart 31:**  
**Geographic Focus of Real Asset Investment**  
*By Regional Location of Institution*



Approximately 68% of institutions have separate allocations to both real estate and real assets, with the balance combining real assets and real estate under a single allocation. Institutions with separate allocations to real assets have an average target allocation to real estate of 7.0% and an average target allocation to real assets of 3.1% for a combined 10.1% allocation to both real estate and real assets. For the 32% of institutions that have a combined allocation to real assets, the target allocation is 14.1%. Therefore, it is reasonable to conclude that a rough estimate of the average combined target allocation to real assets (including real estate) is approximately 11.4%.

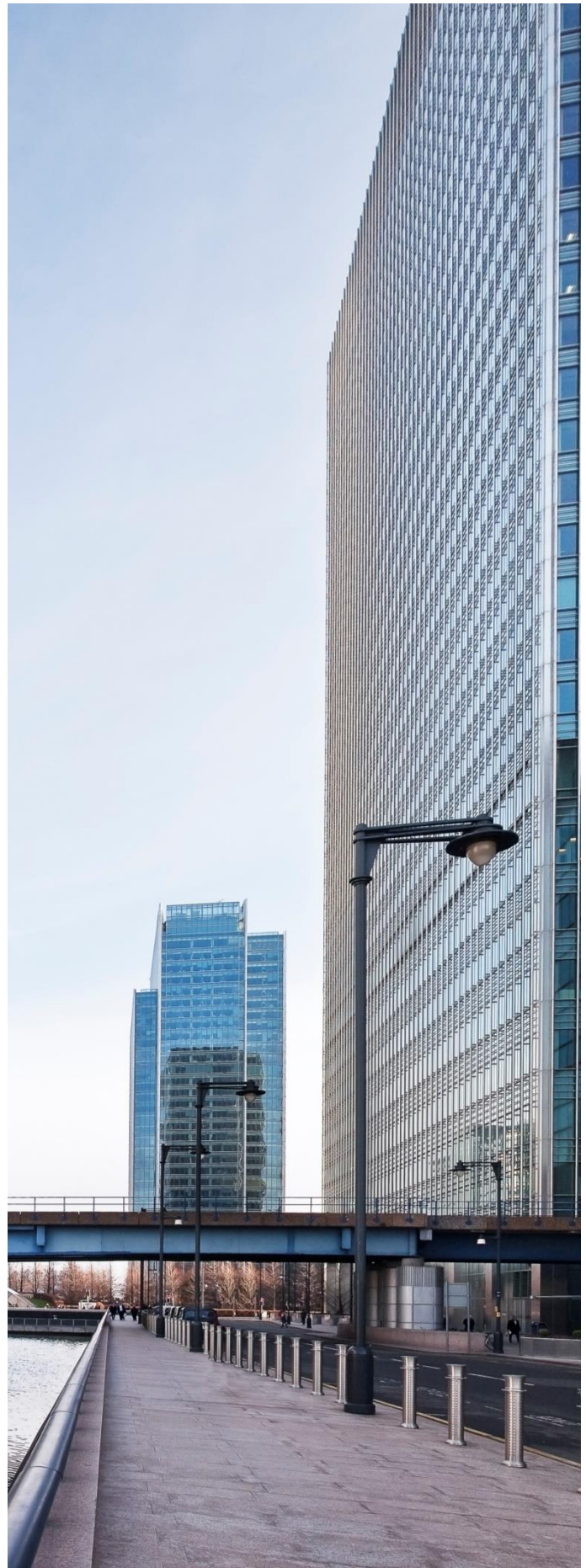
Institutions targeting real asset investments were most interested in strategies offering core and core-plus type returns. Private funds remain the preferred investment vehicle to access real assets with 58% of institutions preferring private funds to direct and separate accounts. We do note, however, larger institutions have more of an interest in accessing real assets directly and via separate accounts than smaller institutions. Consistent with a core allocation, institutions globally were most interested in real asset investments in developed economies and not emerging and frontier markets.♦

## CONCLUSION

Institutional allocations to real estate and real assets continue to grow and evolve. Real estate is now the fastest growing allocation in institutional portfolios. At the same time, institutions remain significantly under-invested relative to target allocations. This is driving new investment activity across regions and strategies.

However, while additional capital is supporting liquidity, transaction volumes and valuations, investor sentiment appears to be moderating after several years of growing optimism. This may result in a slowdown in allocations to new investments over the coming years – which may be a welcome outcome for those concerned about valuations potentially getting ahead of fundamentals.

The definition of the allocation varies significantly throughout the industry. Real estate is a unique asset class in terms of the range of strategies and products available for investments, from core to opportunistic, equity to debt, private investments to public equities, and other real asset alternatives. We expect that more institutions will evolve their allocation to a broader scope of real assets over the coming years, given common return metrics and objectives for hard asset investments. For institutions and investment managers, these trends are important to monitor.♦







## Cornell University Baker Program in Real Estate

Cornell's Baker Program in Real Estate is home to the Masters of Professional Studies in Real Estate degree, a comprehensive, graduate-level curriculum that educates the next generation of real estate industry leaders. Cornell is also home to the Cornell Real Estate Council, an extensive network of over 1,400 real estate industry leaders, as well as the annual Cornell Real Estate Conference.

Cornell boasts the largest full-time, on campus real estate faculty in the country, including three endowed positions in real estate, with its nineteen full-time real estate field faculty selected from seven colleges at Cornell to create a unique interdisciplinary structure. The core courses in the Program in Real Estate are drawn from each of the colleges to create a multidisciplinary educational experience that utilizes the full resources of Cornell. Students at Cornell receive broad exposure to real estate, from architectural design, construction management, real estate finance/investment, real estate development to deal structuring and on, as part of their core coursework. The ability to specialize in one of ten real estate niches during their second year, furthermore, creates the opportunity to maximize Cornell's extensive real estate offerings in sculpting a concentration ideally suited to the individual student's interests.

## HODES WEILL & ASSOCIATES

Hodes Weill & Associates is a real estate advisory boutique with a focus on the investment and funds management industry. Founded in 2009, Hodes Weill\* provides institutional capital raising for funds, transactions, co-investments and separate accounts; M&A, strategic and restructuring advisory services; and fairness and valuation analyses. Clients include investment and fund managers, institutional investors, lenders, property owners and other participants in the institutional real estate market. Our firm is headquartered in New York and has additional offices in Hong Kong and London.

The Partners of Hodes Weill have 100+ years of institutional real estate experience across many disciplines including investment banking, restructuring, advisory, institutional capital raising and principal investing. The senior principals leverage their deep skill set and a global network of relationships to provide advice and solutions that are applicable to a wide range of complex situations impacting the real estate investment and funds management industry.

Through Tunbridge, an affiliate of Hodes Weill, the company makes investments alongside its clients in transactions, fund recapitalizations and investment management businesses.

*Note: All U.S. regulated capital market and securities advisory services are provided by Hodes Weill Securities, LLC, a registered broker-dealer with the SEC, and a member of FINRA and SIPC, and internationally, by non-U.S. Hodes Weill affiliates.*

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The 2014 Allocations Monitor results presented herein are based on the subset of institutional investors that participated in the Allocations Monitor. If a greater number of institutional investors had participated in the Allocations Monitor, the Allocations Monitor results may have been different and contrary to the findings presented herein. Information contained herein is also based on data obtained from recognized statistical services, market reports or communications, or other sources, believed to be reliable. No representation is made and no attempt was made to verify its accuracy or completeness. Neither Cornell University nor Hodes Weill & Associates, LP has any obligation to update the Allocations Monitor.

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## DEFINITIONS

"Asia Pacific" includes institutions located in Asia and Australasia.

"EMEA" includes institutions located in Europe, the Middle East, and Africa.

"GFC" is the Global Financial Crisis of 2007 to 2009.

"SWFs & GEs" includes sovereign wealth funds, superannuation plans, and government owned-entities.

"The Americas" includes institutions located in North and South America.

"Total Assets Under Management (AUM)" represents the summation of the estimated total AUM for each Allocations Monitor Participant. AUM was calculated by using the mid-point of the listed ranges (e.g., if an institution responded that its total AUM was between US\$10B to US\$25B, US\$17.5B was estimated) and then multiplied by the number of institutions within a given range to arrive at total AUM for each range. For 18 institutions that reported AUM of greater than US\$100 billion, the greater of US\$100 billion or the estimate of AUM by industry sources believed to be credible was used.





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