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Survey: Investor confidence in RE continues to fall

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Institutional sentiment on the asset class has declined for the fourth year in a row, according to a new report from Cornell University and Hodes Weill.

Institutional investors have been feeling less confident about investing in real estate over the past four years, despite continuing to increase their allocations to the asset class, according to the fourth annual "Institutional Real Estate Allocations Monitor" from Cornell University's Baker Program in Real Estate and Hodes Weill & Associates.

The survey's Conviction Index asks investors to rate their view of the investment opportunity in real estate from a risk/return perspective on a scale of one to 10, with one being the least favorable and 10 being the most favorable. In 2016, the Conviction Index, standing at 5.4, showed an ongoing downward trend in investor sentiment, continuing a decline from 6.4 to 5.6 between 2013 and 2015.

Investor concerns about the asset class included too much capital pushing valuations above market conditions, the threat of rising interest rates, global capital market volatility and geopolitical risks. "Overall, rents are growing at a good pace, occupancies are increasing even in strategies or subsectors like suburban office; all those are good signs and indicative of economic growth," said Doug Weill (pictured), Hodes Weill managing partner, in an interview with PERE.

Real estate has generated an average annual return of 10.7 percent for institutions over the past four years, according to the survey. While 2015 annual returns declined from 2014, they were still significantly above the current average target return of 8.4 percent, the report said.

"As you've seen in 2016, there's really a moderation in returns, whether cap rates are trading off or flattening down," Weill said. "It will be hard to maintain double-digit returns over the next few years. Institutions are becoming less optimistic. I wouldn't say bearish, but it continues to trend down."

Despite diminished investor confidence, allocations to real estate continue to climb. The sector is approaching a 10 percent institutional portfolio allocation, with the average allocation now at 9.9 percent, up 34 basis points from 2015 and up approximately 100 basis points over the past four years. Overall, 32 percent of investors boost their target allocations in 2016, compared with just 17 percent that decreased their allocation targets.

"The relative risk return opportunity in real estate is more favorable than other asset strategies, so it's shifting dollars into the real estate allocation," said Weill. "Real estate has a low correlation to other asset classes, and it has an income component and a low inflation hedge."

Moreover, the percentage of investors allocating money to private equity real estate funds has risen significantly over the past year, with 82 percent of institutions actively investing in funds in 2016, up from 66 percent in 2015. Also, that increase was more prevalent among larger institutions, of which 96 percent were fund investors this year, compared with just 80 percent in 2016. By contrast, 79 percent of smaller institutions are currently actively investing in funds.

"There continues to be increase for funds, particularly as institutions become more global in their outlook as they go offshore," he said. "The more global these institutions become, the harder it is for these institutions to invest halfway around the world, the more likely they want to partner with a local manager through funds."

This year's Allocations Monitor was derived from research collected from 228 institutions in 28 countries. Participants hold total assets under management of $10.3 trillion, with aggregate real estate investments of $920 billion.