PERE EUROPE

INVESTOR PERSPECTIVES 2019

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Headwinds, both of the economic and political ilk, are gaining momentum: the prospect of rising interest rates and slowing economic growth; looming trade wars between superpowers; the pending extrication of the UK from the EU and uncertainty surrounding what a final deal will look like, and the spread of populism. Likely, these just scratch the surface.

Risks and their potential impact on performance are beginning to prey on minds. And the first signs of investor caution, albeit very subtle, are duly revealed in this *PERE Investor Perspectives 2019* survey report. Only 16 percent of respondents intend to increase target allocations to private real estate in 2019, with 63 percent happy to keep target allocations at current levels. Now is not the time, it seems, to be experimental and shake up the status quo. The same applies to manager relationships, and 56 percent of our investor respondents do not allocate capital to first-time funds. Overall, sticking with those they know well is the order of the day.

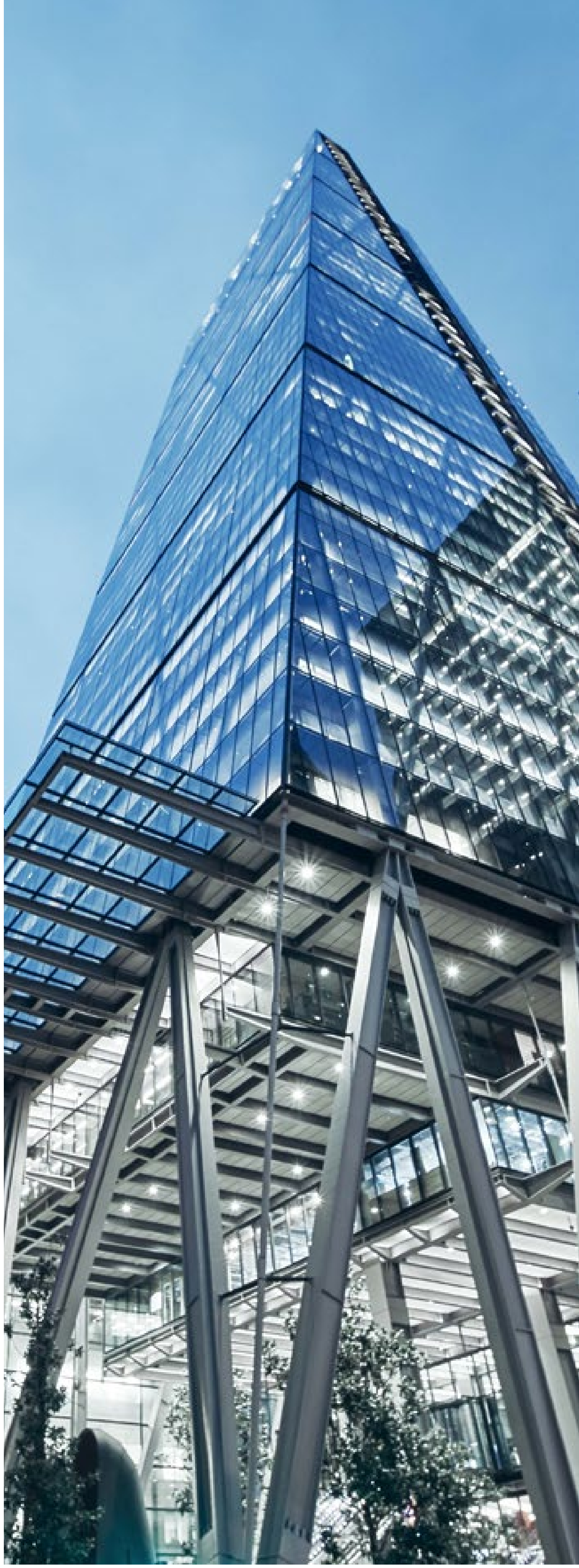
But the real estate story for 2019 is far from one of doom and gloom, as many of the commentators in this report emphasize. There are several positive themes to excite investors: growing urbanization, population growth and the march of e-commerce are just a few examples of trends presenting opportunities for growth and performance. If more people are living and working in major cities, it creates demand for more homes and office space. The rise in online shopping will require more logistics property. These mega-trends and their impact on real estate were key topics of discussion and analysis in *PERE* special reports in 2018, and this is set to continue in our coverage this year.

The pages that follow are packed with survey data offering a view of how investors intend to approach real estate investing in 2019, and the issues of concern to them at this point in the cycle. And for managers, the survey findings reveal, among other things, how investors feel about the fees you charge them, as well as the areas they are most likely to question you on when they are conducting due diligence.

We hope you find plenty of insights you can relate to, and even some that will surprise.

Enjoy the report.

Helen Lewer
Special Projects Editor



Six investor perspectives that matter

The survey reveals increasing investor caution as economic headwinds register higher

1

Treading carefully in 2019

Recent years have been kind to investors in performance terms, and there are positive themes on the horizon in 2019, with growth opportunities being driven by mega-trends like urbanization and population growth. Here comes the 'but.' A sense of caution is emerging as investors keep an eye on economic and political headwinds. Ambitions seem muted: 17 percent believe real estate benchmarks will exceed expectations, lower than for other alternative asset classes. And a greater number of investors intend to decrease their allocations to real estate compared with the other asset classes.

2

Red flags

Investors' antennae are particularly acute to potential economic headwinds. The survey indicates that extreme market valuations are top of mind for 66 percent of respondents, while rising interest rates dominate the thoughts of 56 percent, followed by an escalation of the US-China trade war. Although less evident from the survey findings, there are also political niggles that could cause twitchiness in the investor community in the months ahead, including a worrying rise in populism, as well as the UK's impending departure from the EU.

3

Faith in trusted partners

Mindful of this year's potential disruptions – which could take the wind out of the sails of real estate market performance – investors are weighing up if now is the best time to forge new manager relationships. Our survey reveals investors in real estate remain loyal to their current managers: the ones they trust and have worked with over the long term; 56 percent of respondents will not consider investing in first-time funds, suggesting established managers are more likely to attract available capital. This is a tricky time for new market entrants and managers seeking to grow their investor base.

4

Focus on Asia

Investors have one region on the brain as they consider which emerging markets offer the best potential for growth: Asia-Pacific. A whopping 84 percent of respondents declared it the emerging market in which they are most likely to consider investing in 2019, with Central and Eastern Europe a distant second for 39 percent. Demographic fundamentals are underpinning the region's attractiveness, with rising population and urbanization fueling growth and investment opportunity. Transparency is also improving in core markets like India, making investing an altogether less risky venture than in years past.

5

Money mindfulness

Investors' primary goal is to capitalize assets that will make them good returns. Their second is to minimize costs that could eat into profits. So it is unsurprising to see that the issues of fees and fee transparency are very much on investors' radars: 64 percent of respondents either strongly agree or agree that the fees currently charged by their managers are difficult to justify and 65.5 percent are seeking greater fee transparency and disclosure from their managers in 2019. And the fund term causing most disagreement with managers during diligence? Management fees.

6

Room for improvement

Some survey findings may surprise, and no more so than in the critical area of investor due diligence. ESG, sustainability, equal pay and gender diversity have become major talking points in recent years. Yet the survey shows they are, in relative terms, low on the list of investor priorities. Nearly 57 percent of respondents report that the gender pay gap at the GP level forms no part of their diligence efforts, and 41 percent consider ESG to be a minor consideration. And despite more data breaches, just 3.1 percent see cybersecurity as a factor that could impact performance in 2019.

How we conducted our investor survey

Investor Perspectives 2019 is *PERE*'s study of institutional investors' approach to alternative asset classes.

More specifically, it aims to provide a granular view of the alternatives market, both current and future, by gathering insight on investors' asset allocation, propensity to invest, and performance predictions.

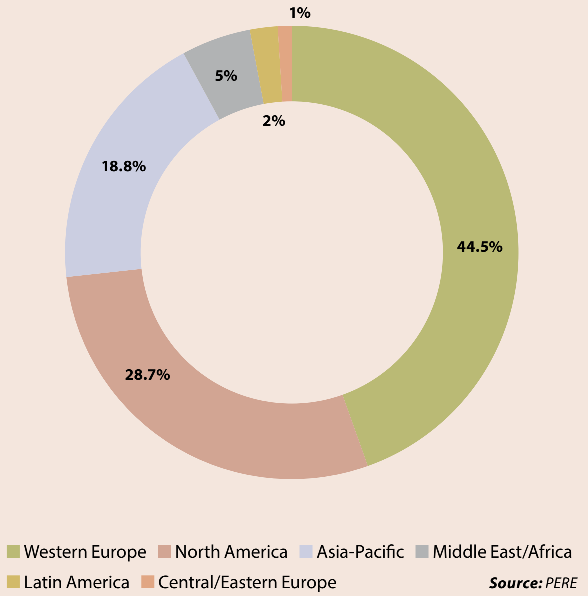
Investor Perspectives is a global study, reflected in the question-set and the respondents, which allows for meaningful worldwide views and cross-regional comparisons across alternative asset classes.

The question-set for *Investor Perspectives* is reviewed annually, with the objective of reflecting market developments and shifts in sentiment.

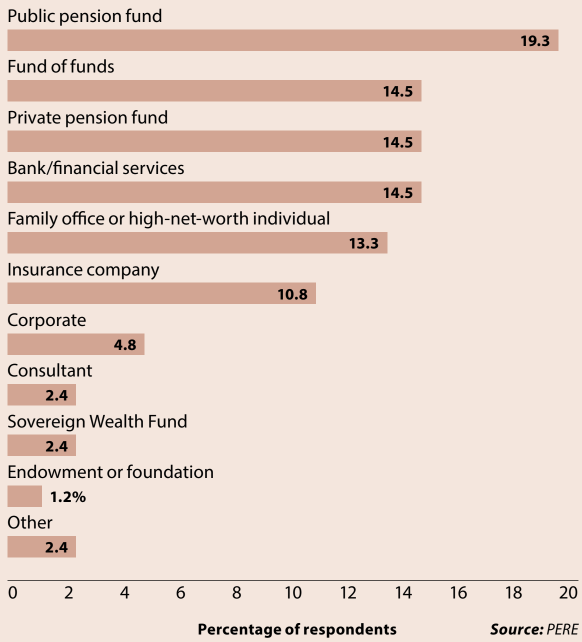
For this 2019 study, fieldwork was carried out from August to October 2018.

Participation in *Investor Perspectives* is anonymous,
with the findings amalgamated and presented in this supplement. ◻

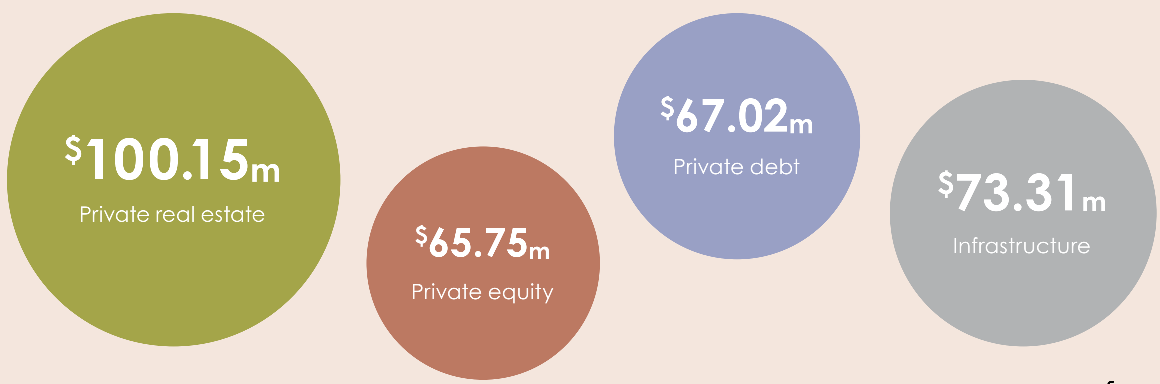
In which region is your institution headquartered?



What type of institution are you?



What is your average fund commitment size for the following asset classes?



Source: PERE

Preparing for choppier waters

Investors are wary that macroeconomic factors could threaten their performance in private real estate, writes Marine Cole

Private real estate investments performed well in the past year, but if the findings of the *PERE Investor Perspectives 2019* survey reveal anything it is that investors are bracing themselves for tougher times ahead as several potential risks could threaten performance.

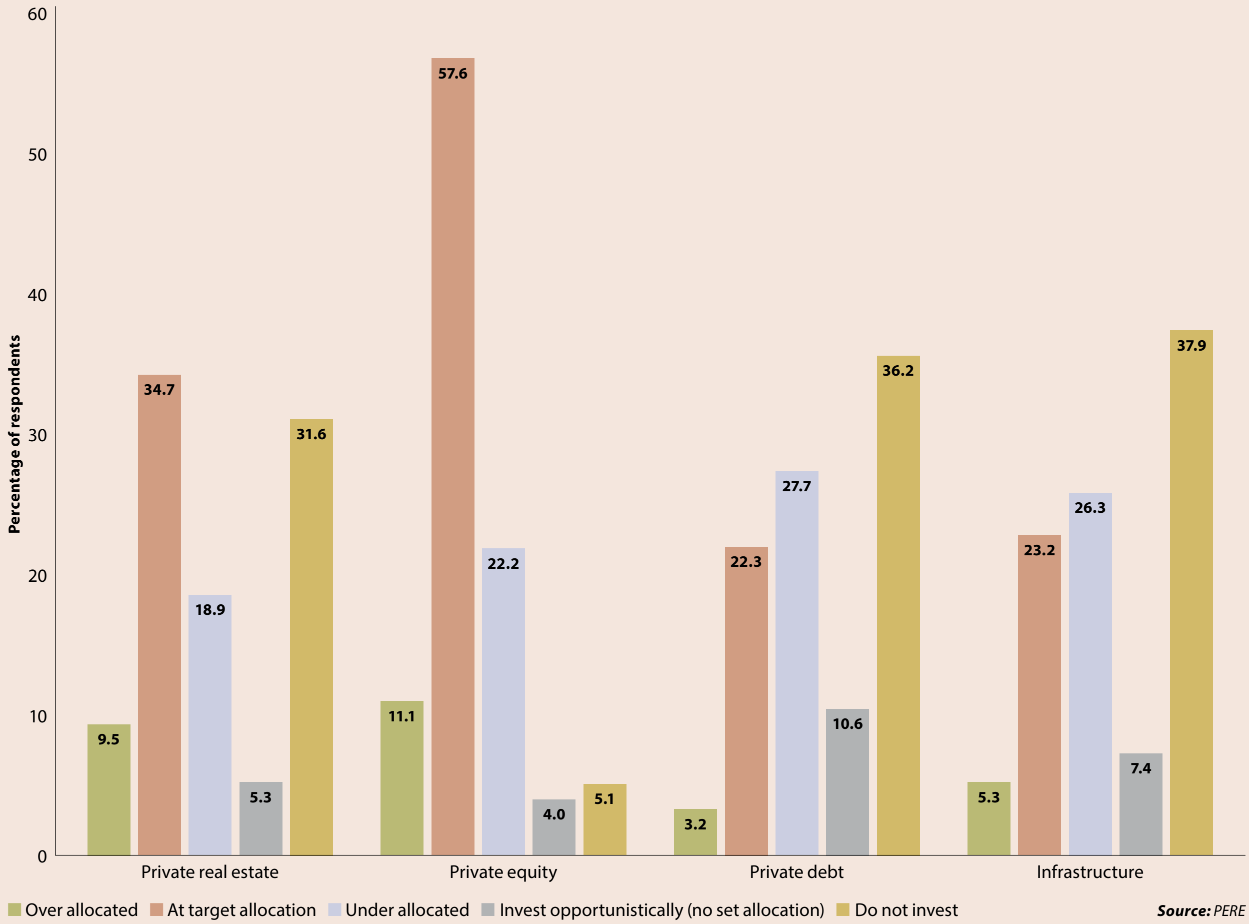
Nearly half – 46.8 percent – of investor respondents say their private real estate investments have met benchmarks over the past 12 months, while 41.9 percent say benchmarks were exceeded.

Core concerns

With an economic downturn likely to happen in the next few years, investors are wary of potential risks that could threaten performance. When asked which factors could slow down returns, 66.3 percent of respondents cited extreme market valuations, 56.1 percent are concerned about rising interest rates, and 33.7 percent are keeping a watchful eye on a US/China trade war. Cybersecurity threats and natural disasters, now well documented as growing global threats for all business sectors, are at the bottom of the list of concerns.

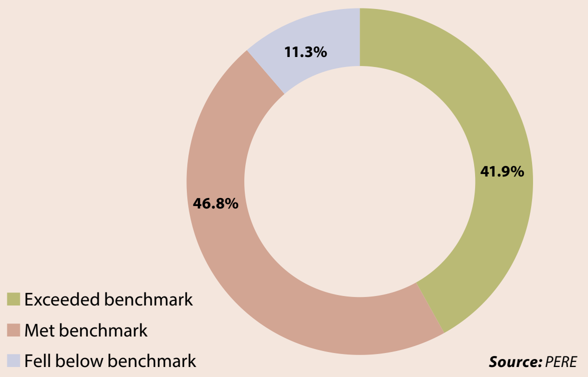
This is impacting the way investors see their real estate portfolios performing in the coming year with more respondents expecting their performance to fall below rather than exceed benchmarks. Only 17 percent think their real estate benchmarks will exceed expectations in the next 12 months, the lowest of all the asset classes surveyed, which include infrastructure, private equity and private debt. Some 20 percent of respondents believe performance will fall below benchmarks in real estate, higher than in any of the other alternative asset classes.

Please indicate your current allocation position for the following asset classes:

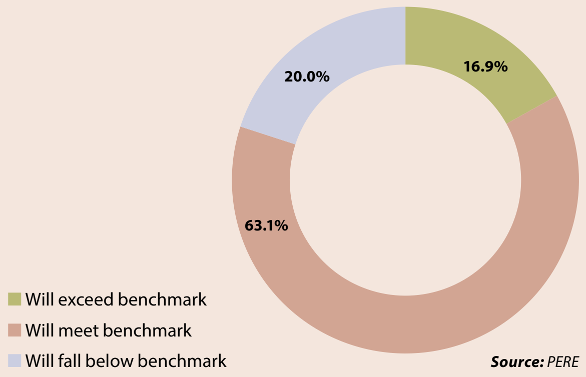


Source: *PERE*

How has private real estate performed against its benchmark over the past 12 months?



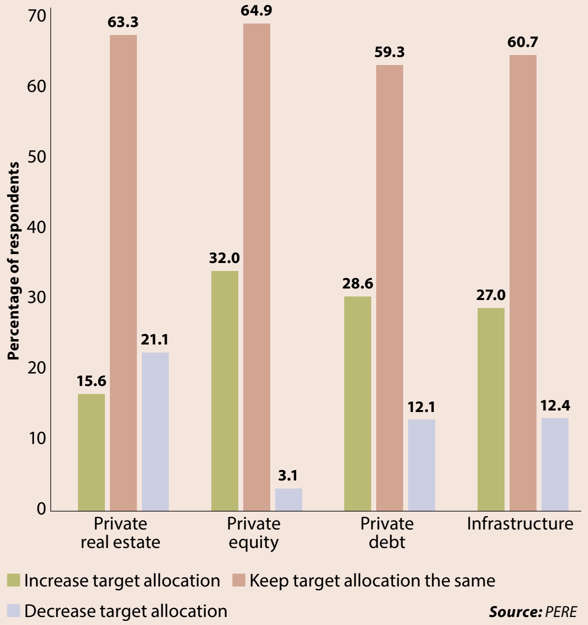
How do you feel private real estate will perform against its benchmark in the next 12 months?



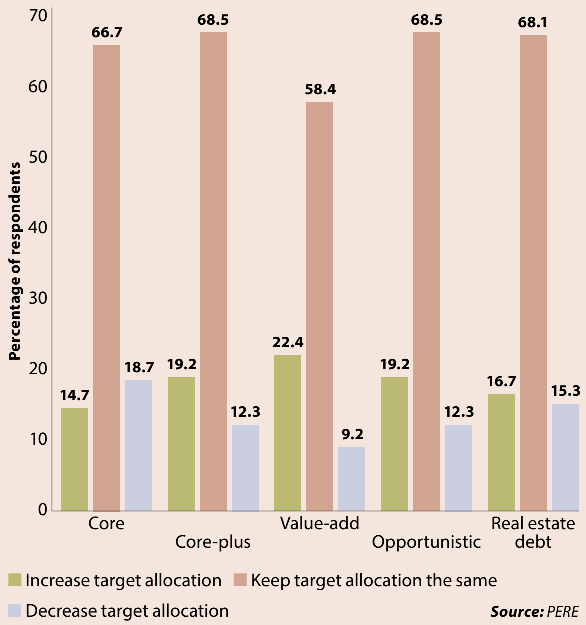
And although 63 percent of investors are anticipating benchmarks will be met in the next year, overall, the expectations for private real estate are the lowest of all alternative asset classes. Investors are the most enthusiastic for their private equity portfolios; 50 percent feel private equity will meet their benchmarks and 41.5 percent that it will exceed benchmarks. A total of 87 percent think private debt will meet or exceed their benchmarks.

Maybe because of a somewhat pessimistic outlook, more investors responding to the *Investor Perspectives 2019* survey are planning to decrease their target allocation to private real estate than to any other asset class. Within private real estate, most investors plan to maintain their target allocations to the different sub-strategies.

How do you plan to change your target allocation to the following asset classes over the next 12 months?



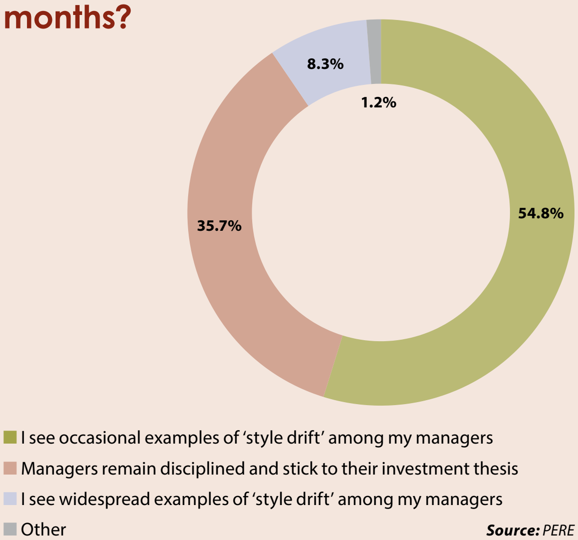
Regarding private real estate, how do you plan on allocating to the following strategies over the next 12 months?



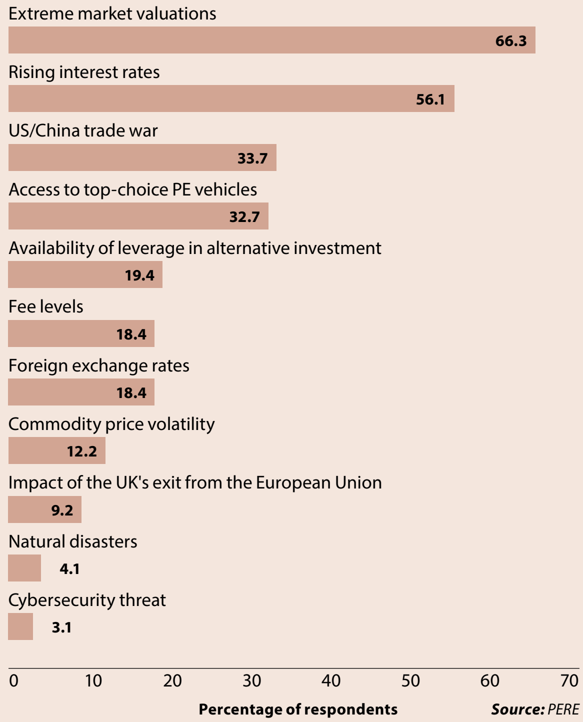
Value seekers

Real estate investors are shunning core-plus, with 18.7 percent planning to decrease their target allocation to it. There is slightly more confidence in value-add with 22 percent of investors planning to increase their target allocation to the strategy over the next 12 months.

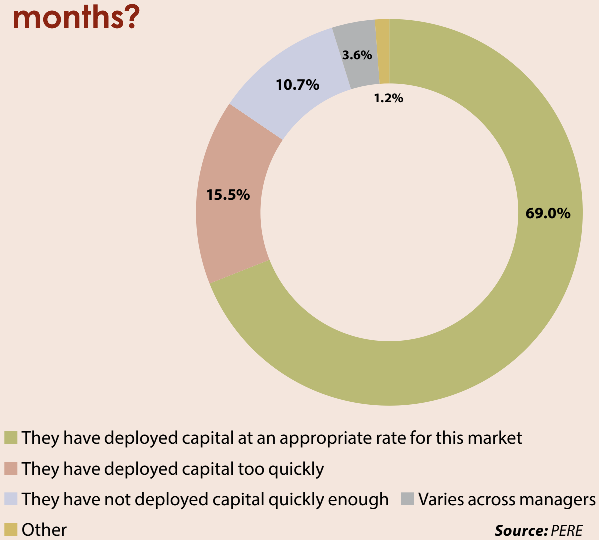
Which of the following best describes your assessment of manager investment behavior in the last 12 months?



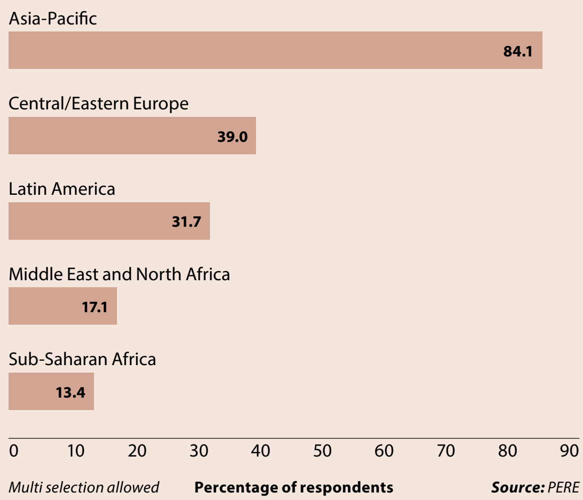
Thinking of your private markets portfolio, which three factors will have the greatest impact on performance over the next 12 months?



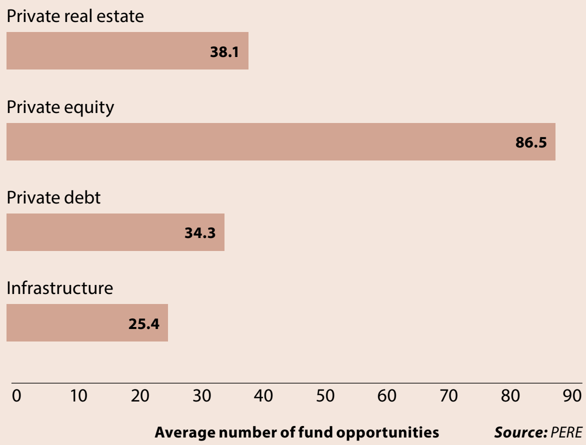
Which of the following best describes the rate of capital deployment by your managers over the past 12 months?



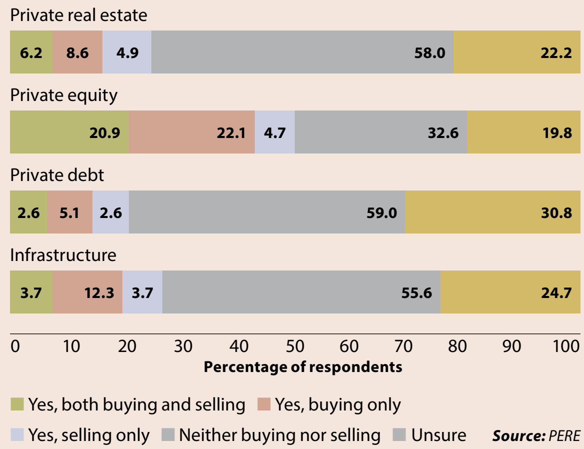
Which of the following emerging market geographies will you consider for investment over the next 12 months?



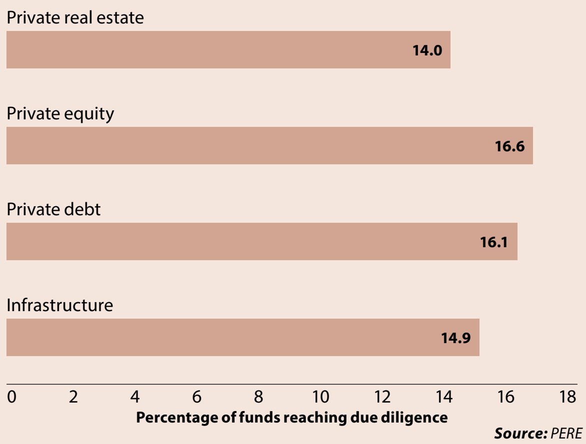
On average, how many fund opportunities are presented to you per year?



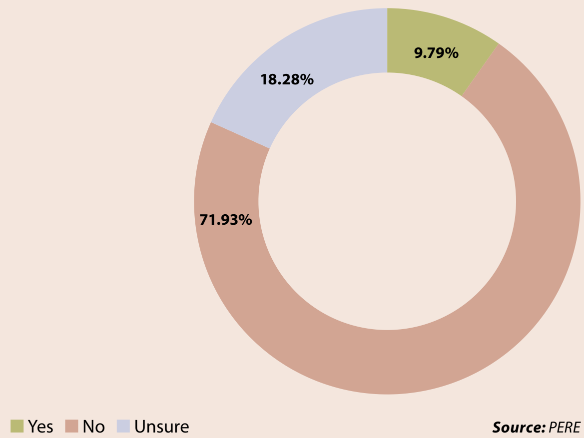
Do you plan to buy or sell fund stakes on the secondaries market in the next 12 months?



Of those fund opportunities, what percentage reach the due diligence stage?



Do you plan to commit capital to secondaries funds in private real estate in the coming 12 months?



Exploring secondaries

While the secondaries market is reaching new proportions, with $80 billion in volume in 2018, up 31.3 percent from the previous year, real estate deals have dropped 8.3 percent to $5.8 billion, according to Setter Capital. This more subdued embrace of real estate secondaries is showing in the survey, too.

Less than 10 percent of investor respondents plan to commit to real estate secondaries funds in the next year, far lower than to private equity funds (47 percent). Nearly three-quarters of investors do not plan to commit to real estate secondaries funds at all over the next 12 months.

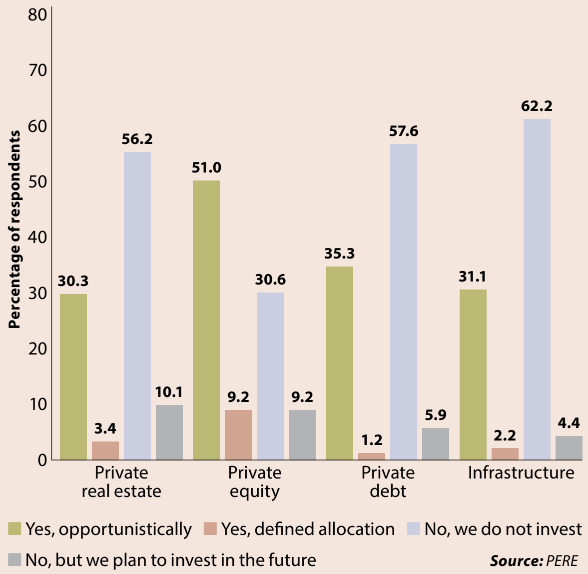
Similarly, the overall participation of investors in the private real estate secondaries market as sellers or buyers remains lower than in private equity secondaries. Fifty-eight percent of respondents plan neither to buy nor sell real estate secondaries in the next 12 months. Only 6 percent plan to both buy and sell real estate fund stakes, compared with 21 percent planning to buy and sell private equity stakes.

One final interesting wrinkle to highlight from the survey results is that investor respondents say they will be the most active sellers when it comes to private real estate fund interests, at 4.9 percent, compared with 4.7 percent in private equity. ◻

More of the same in 2019

Investors seem happy about the way their real estate portfolios currently look, with only small tweaks likely to be made in the year ahead, writes Marine Cole

Do you invest in first-time funds?



Investors in private real estate are some the most content across the alternative asset classes, along with those in infrastructure, according to the results of the *PERE Investor Perspectives 2019* survey.

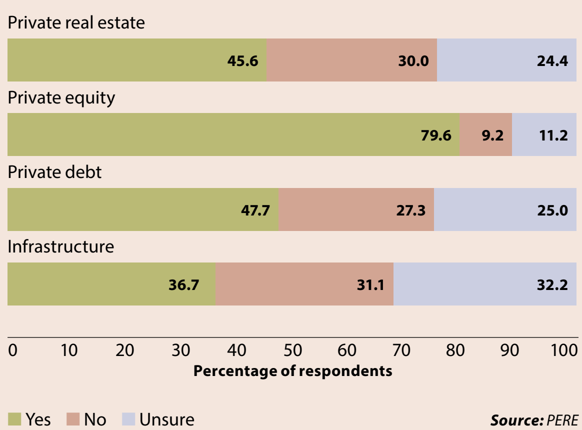
This is especially true when it comes to the number of managers they currently work with – 37 percent say they are satisfied with the number, higher than in private equity, where 30 percent want to maintain the current number of relationships with managers.

In addition, just less than half of the survey respondents – 45.6 percent – say they are planning to make fresh commitments to existing real estate managers in the next 12 months, with 24.4 percent unsure about their plans. The remainder report they do not plan on making fresh commitments to their existing real estate managers.

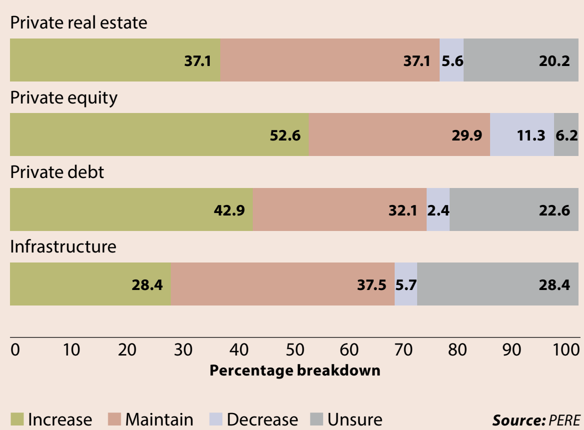
Not only are investors highly reliant on their current fund managers, 56 percent are also shunning first-time funds, and only 3.4 percent report a defined allocation to it. About 10 percent of investors do not currently invest in first-time real estate funds at all, but plan to do so in the future. In private equity, by contrast, 51 percent invest in first-time funds and 9.2 percent have a defined allocation to it.

Despite being somewhat satisfied with their current portfolios, there are some small changes investors in private real estate are hoping to make in 2019. For example, nearly 38 percent of respondents to the *PERE* survey plan to increase their number of manager relationships. This is some way short of the 52 percent of respondents looking to increase the number of manager relationships in private equity.

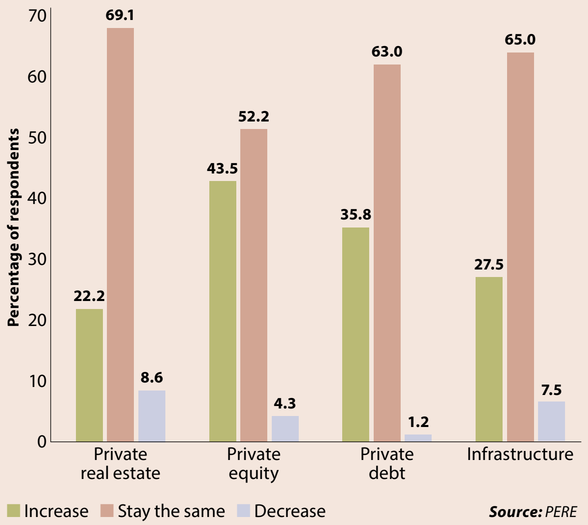
Thinking of your current fund manager relationships, do you plan to make fresh commitments to these managers over the next 12 months?



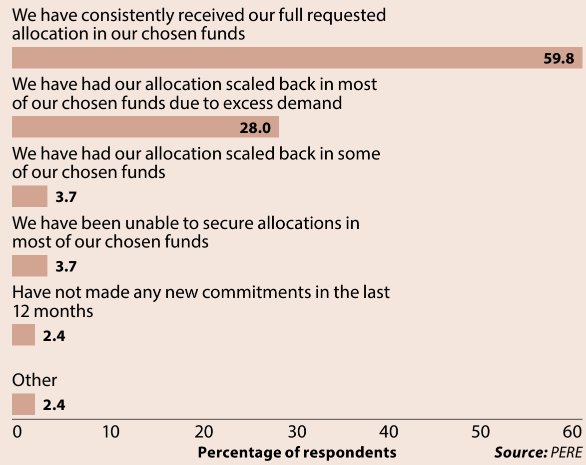
Thinking of your current fund manager relationships, would you like to increase, maintain, or decrease the number of relationships?



How will your average commitment size change over the next 12 months?



Thinking of your fundraises in the last 12 months that you expressed interest in, which of the following describes your experience?

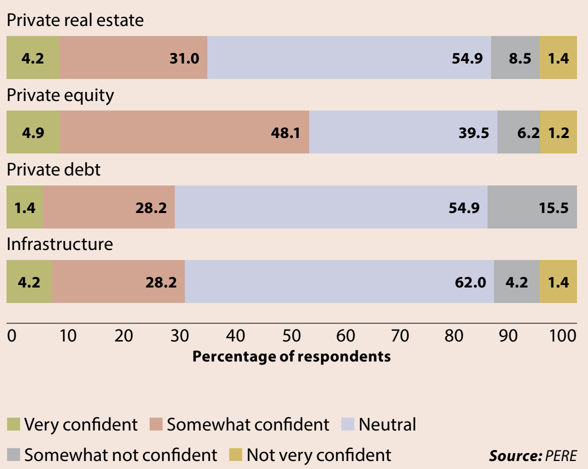


Writing big checks

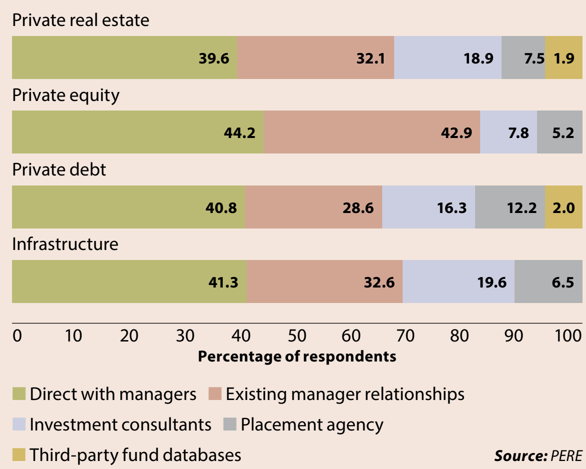
As far as the fundraising environment goes, investors across asset classes seem satisfied with their experience committing to funds in the past 12 months. Nearly 60 percent say they have constantly received their full requested allocation in their chosen funds. At the other end of the spectrum, 28 percent said they have had their allocation scaled back in most of their chosen funds due to excess demand. That question was not broken down by asset class.

And once investors are ready to commit, private real estate funds receive the biggest checks from investors at $100 million on average, followed by a $73.3 million average fund commitment in infrastructure, $67 million in private debt, and a $65.7 million in private equity (see p. 7). The average commitment size is likely to remain steady in the next year, according to the survey, as 69 percent of investor respondents said it will stay the same over the next 12 months, the highest of all asset classes. Less than a quarter, or 22.2 percent, said it will increase.

How confident are you that your managers' deals have been structured to withstand a downturn?



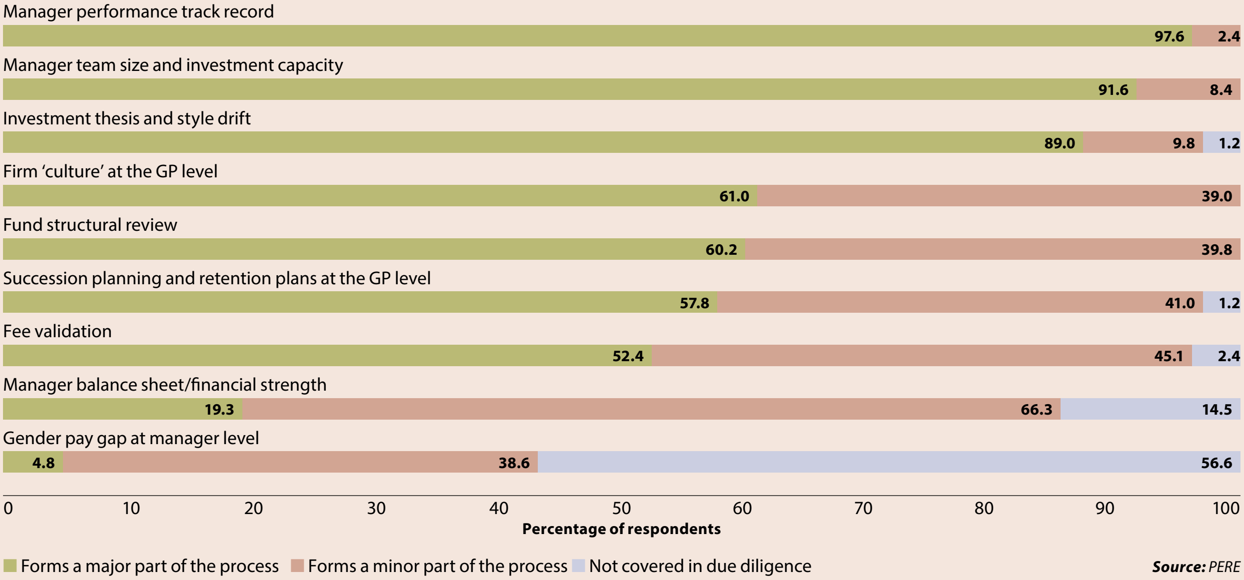
What is your primary source of fund opportunities for the following alternative asset classes?



Diligence focus areas

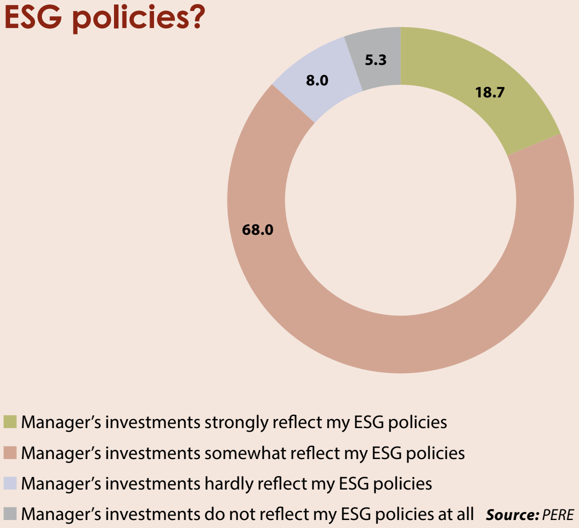
The top three factors representing a major part of investors' due diligence during fundraising are the manager's team size and its investment capacity, the investment thesis and whether the manager has drifted from it, and the firm's culture at the manager level. There has been, of course, much emphasis in 2018 on equal pay across all business sectors. The alternative asset space has been no exception, but the survey results indicate that this is still not top of mind for investors when conducting their due diligence – only 4.8 percent report this issue to be a major part of the diligence process while nearly 57 percent do not cover it at all. On ESG, another theme growing in importance for the industry, almost 37 percent of respondents consider it to be a major consideration in real estate fund due diligence while 41 percent see it only as a minor consideration. □

How significant a part do the following play in due diligence?



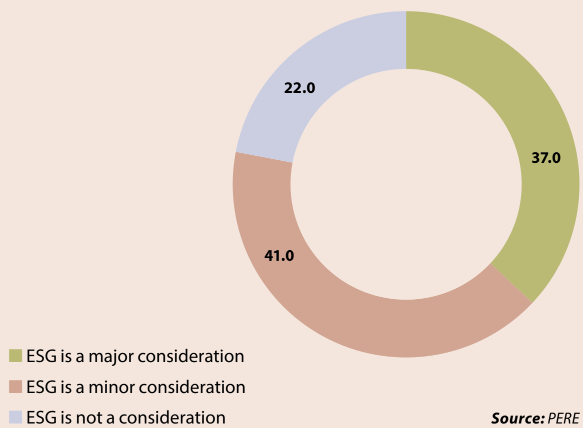
Source: *PERE*

To what extent do you believe your manager's investments reflect your ESG policies?



Source: *PERE*

How much emphasis do you place on environmental, social and governance issues throughout fund due diligence for private real estate?



Source: *PERE*

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