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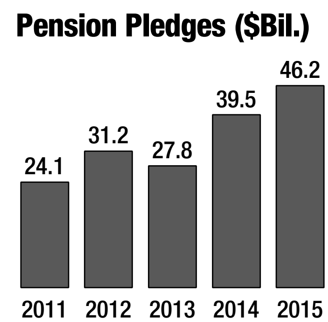
THE WEEKLY UPDATE ON THE INSTITUTIONAL MARKETPLACE

After Record Year, Pension Pledges May Ease

Public pensions set another post-crash record for equity commitments to real estate vehicles last year, but signs of a slowdown are emerging.

Some 102 systems committed a total of $46.2 billion to commingled real estate funds and separate accounts in 2015, according to **FPL Consulting.** That was a 17% increase from $39.5 billion in 2014 and 66% higher than the $27.8 billion tally in 2013.



Source: FPL Consulting

But the $8.2 billion fourth-quarter tally fell 35% from the average in the first three quarters and 7% from the fourth quarter of 2014.

"That tells me that people are starting to get a lot more cautious," said **Tim Kessler,** principal of Chicago-based FPL. "There's still a lot of interest and demand for real estate, but there are warning signs out there."

Kessler cited several reasons why institutional investors might slow commitments, including sky-high property valuations, the recent stock-market decline and the prospect of rising interest rates.

"I think you're going to see a step back in 2016, to somewhere in the $35 billion-to-$40 billion range," he said.

To be sure, interest in real estate remains high. London research shop **Preqin** has reported that 78% of investors expect to commit the same amount or more to real estate this year. As of September, institutional investors were shooting to have 9.6% of their assets in real estate on average, but had invested only 8.5%, leaving significant additional investment capacity, according to a report by **Cornell University's** Baker Program in Real Estate and advisory shop **Hodes Weill & Associates** of New York. The average allocation is expected to rise to 9.9% this year, the report said.

While commitments climbed significantly last year, the biggest investment managers benefited disproportionately. Five shops garnered a whopping 31% of the pledged dollars, up from 21% for the top five in 2014.

Managers with value-added and opportunistic strategies captured 67% of committed dollars, up from 62% last year. Core vehicles correspondingly dipped to 33%, down from 38%. However, Kessler said early indications are that core commitments will rise in the near term because of fears that it's too late in the cycle to pursue riskier strategies. He noted that **Oregon Public Employees** and **California State Teachers,** for example, upped their core allocations in recent months.

Closed-end funds corralled half of commitments last year, up from 47% in 2014. Open-end funds received 13% of pledges, up from 10% last. And commitments to separate accounts slipped to 38% from 42%.

Vehicles targeting a single property type garnered 26% of pledged dollars, down from 41% in 2014. Among those vehicles, multi-family strategies captured the lion's share of commitments — 40%, up from 25%. The rest went to the following categories: industrial (24%, up from 20%), retail (10%, down from 28%), office (8%, down from 16%) and "niche," such as student and senior housing, medical office and storage facilities (19%, from 12%).

Vehicles focused on North America garnered 65% of pledges, down from 72%. European funds dipped to 6%, from 8%. Asian vehicles attracted 4% of commitments, down from 6%. And funds investing globally captured the remaining 25%, up from 14%.

There were 470 total commitments last year, up from 416 in 2014, 386 in 2013 and 340 in 2012. The average commitment to separate accounts last year was $212 million, down from $274 million in 2014, and the average commitment to closed-end funds was $75 million, up from roughly $64 million the two previous years.

FPL tracks 181 pension systems with $251 billion of real estate assets and $3.3 trillion of total assets under management. They are believed to represent the vast majority of assets held by public pension systems. The research firm began tracking commitments in 2011, when the tally was $24.1 billion. It will release a report summarizing its findings this week. ❖