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THE WEEKLY UPDATE ON THE INSTITUTIONAL MARKETPLACE

Pension Pledges Set Record in Third Quarter

Commercial real estate commitments by public pension funds surged to $17.3 billion in the third quarter, a post-crash high and nearly double the previous quarter's level.

The activity put the sector on pace for the highest annual total since **FPL Associates** of Chicago began tracking pledges in 2011.

The massive quarterly tally was driven by huge equity commitments by the country's two largest pensions. **Calpers** pledged just under $5 billion, and **California State Teachers** allocated $4 billion. Including its $4.8 billion of first-half commitments, CalSTRS alone accounted for nearly one-quarter of the nine-month total for the 231 pension systems followed by FPL.

The third-quarter tally was up 84% from $9.4 billion in the previous quarter and up 83% from a year earlier. The previous quarterly high was $14.3 billion in the third quarter of 2015. The nine-month total of $38.5 billion puts the sector well within reach of the $47.2 billion post-crash high, set in 2015.

"It's such an active environment," said FPL senior director **Erin Green.** "There's so much interest from LPs."

The inflow has continued even though the level of uninvested capital continues to reach new highs because of the difficulty of finding suitable investments. Dry powder hit $294 billion on Sept. 30, up 4% from $282 billion at yearend 2017, according to **Preqin.**

The capital backup doesn't seem to be worrying participants in the latest annual survey of institutional investors by **Cornell University's** Baker Program in Real Estate and advisory shop **Hodes Weill & Associates.**

The survey of 208 institutional investors in 29 countries, released this week, found that allocation targets for real estate continue to rise. The level climbed to 10.4% this year from 10.1% in 2017 and is projected to increase again next year, to 10.6%. But the surveyed investors have actually invested only 9.5% of their assets in the sector, leaving significant additional investment capacity.

"It would not be surprising to see an increase in actual allocations versus target allocations over the coming years" given the amount of capital that institutions need to invest, said **Doug Weill,** co-founder of New York-based Hodes Weill.

At the same time, Weill noted that investors are being cautious. "They have shifted their focus to more defensive strategies, including niche sectors and credit," he said.

FPL's figures demonstrate that cautiousness. By committed dollars, 54% of pledges to real estate funds and separate accounts have gone to value-added and opportunistic strategies so far this year, down from 64% in full-year 2017 and 70% in 2016. Less-risky core strategies attracted 34% of pledges, up from 25% last year. Core-plus strategies were roughly flat, at 12% of commitments.

FPL's Green said that the largest high-yield fund managers have adapted to late-cycle concerns over the past few years by adding lower-risk vehicles. **Blackstone, Carlyle Group** and **Rockpoint Group,** for example, now offer limited partners the option of plowing capital into core and core-plus investments. "It allows the managers to adjust and react to the market," Green said.

The top five investment managers garnered 21% of committed dollars over the three quarters, down from 28% for full-year 2017. The top 20 firms have captured 54% of pledged dollars, compared to 57% last year.

Investors are showing increased interest in funds and separate accounts dedicated to a single asset class. Such vehicles have received 42% of committed dollars this year, up significantly from 27% last year and 17% in 2016.

"It goes to investors getting more specialized in the investments they're making," Green said. "Those specialist [managers] are often also operators. They're close to the asset, they drive value at the asset-level . . . there's a growing appeal for those types of operating platforms."

Multi-family investments continued to be the most-popular focus of single-asset vehicles, accounting for 27% of such commitments, down from 29% last year. Industrial-focused vehicles tallied 25% of total dollars, up slightly from 23%. Retail, office and other property types were roughly even with their 2017 shares. Debt-focused vehicles have collected 17% of committed dollars so far this year, down from 19% last year, but well above 2015, when they garnered just 10% of pledged capital.

The pension systems tracked by FPL have $348 billion of real estate assets and $4.3 trillion of total assets under management. They are believed to represent the vast majority of assets held by public pension systems. FPL will release a report summarizing its findings this week. ❖