2019 Fundraising: Year in Review

Pension fund commitments to managed real estate vehicles

FPL Associates

Private real estate fundraising momentum continues in 2019

Commitments to private real estate managers from U.S. public pensions nearly matched the post-recession high seen in 2018

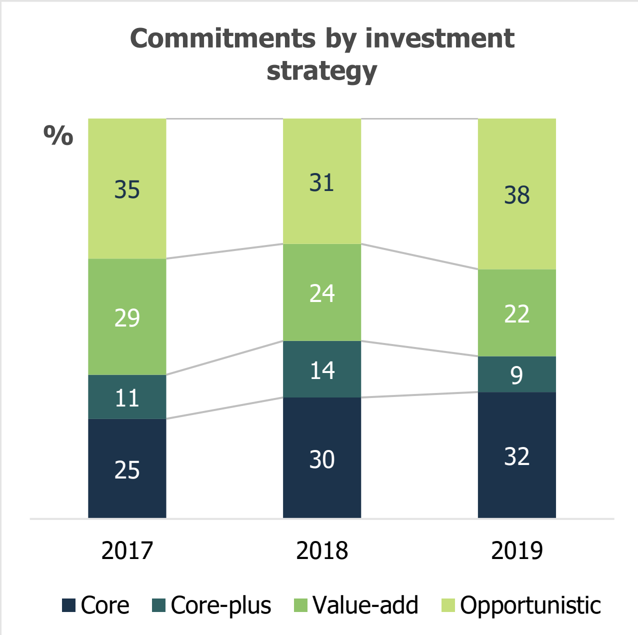
Capital commitments from U.S. public pension funds to privately managed real estate vehicles totaled $47.3 billion in 2019, the second highest annual fundraising volume since the inception of FPL's database in 2011. The 2019 volume decreased slightly from the post-recession high of $49.6 billion in 2018, but is approximately 12 percent higher than the average volume over the past five years. Fundraising for the year closed with fourth quarter commitments totaling $9.9 billion, which is roughly 11 percent higher than the fourth quarter average over the past five years. 2019 commitment volume was heavily driven by meaningful allocations from some of the largest U.S. public pension systems, including Teacher Retirement System of Texas, California Public Employees' Retirement System (CalPERS), California State Teachers' Retirement System (CalSTRS), New York State Common Retirement Fund (NYSCRF), and Teachers' Retirement System of Illinois, each of whom committed over two billion dollars to real estate managers in 2019. While the commitment volume in 2019 fell slightly when compared to 2018, it is worth highlighting that the number of unique commitments in 2019 was 7 percent higher than in 2018.

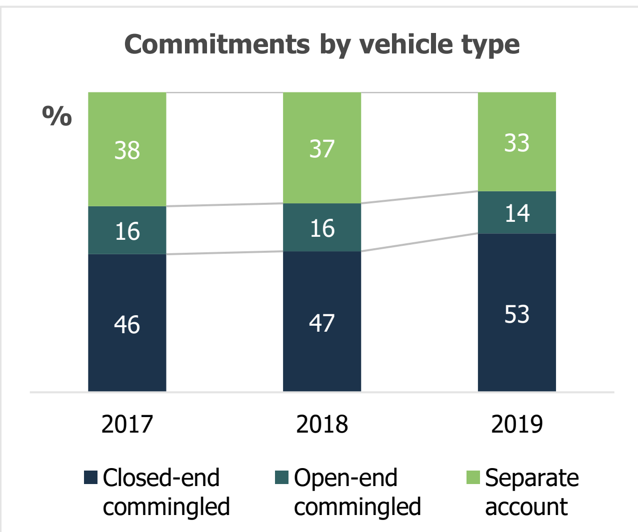
The strong fundraising results suggest that investors still view real estate favorably relative to other asset classes, in spite of the late cycle timing. A recent study from Hodes Weill & Associates and Cornell University found that investors' sentiment on the attractiveness of real estate investments from a risk-return perspective increased for the second consecutive year, with institutional investors in the Americas reporting the most significant increase in real estate "conviction."[1] The Hodes Weill & Associates conviction index is now at the highest level since 2014 as investors cite strong fundamentals, debt availability, and returns that have outpaced targets as rationale for the optimistic sentiment.

While views on the sector are generally favorable, there are complicating factors that are causing investors and managers alike to consider defensive strategies. A recent Preqin survey suggests that alternative investors largely agree that the market is at its peak.[2] Additionally, concerns regarding asset pricing, the prospect of rising interest rates, slowing economic growth, and geopolitical uncertainty are causing many market participants to take a cautious approach to their investment decisions.

1 Jones, D., & Weill, D. (2019). 2019 Institutional Real Estate Allocations Monitor. Ithaca, NY: Cornell University's Baker Program in Real Estate and Hodes Weill & Associates, LP, October 2019

2 Preqin Investor Update: Alternative Assets H2 2019





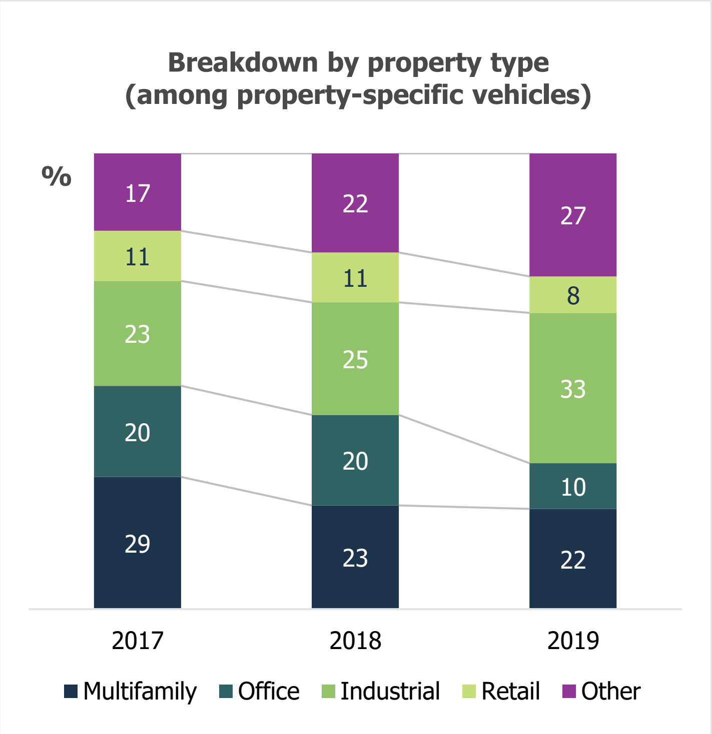
Vehicle Structure and Investment Strategy

High-yield strategies continue to attract the majority of capital, with commitments to opportunistic and value-add vehicles representing roughly 60 percent of total 2019 volume. Commitments to opportunistic vehicles saw a material year-over-year increase, accounting for 38 percent of total volume in 2019, while the share of commitments to value-add vehicles decreased slightly when compared to 2018. The increase in the share of high-yield commitments represents a departure from a two-year trend away from these strategies. On the other end of the risk-return spectrum, the share of commitments to core-oriented vehicles increased slightly relative to 2018, continuing what is now a three-year growth trend, while core-plus vehicles saw their share fall year-over-year.

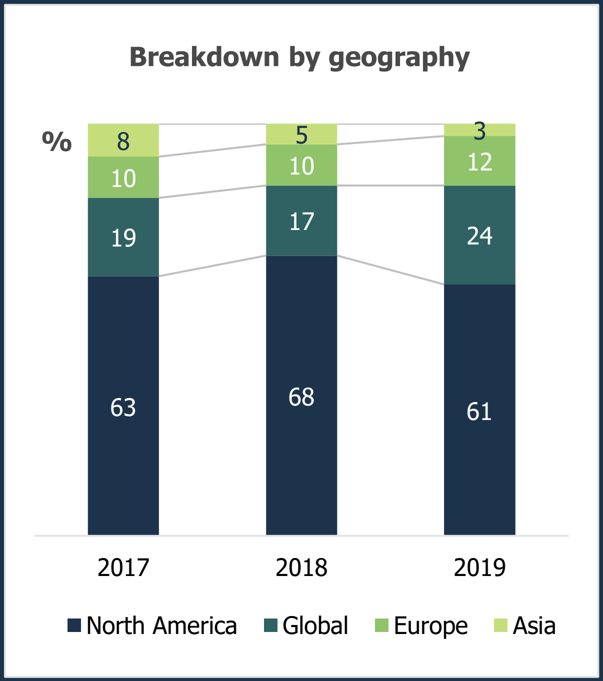
Similar to years past, fundraising for opportunistic vehicles was dominated by some of the industry's blue chip names. Blackstone topped the list, closing its ninth global opportunistic fund in 2019 at over $20 billion, while its sixth European opportunistic fund had its first close at $8.4 billion. Similarly, Lone Star Funds closed two major funds in 2019: Lone Star Fund XI at over $8 billion and Lone Star Real Estate Fund VI at $4.7 billion. Other managers garnering substantial commitments to their opportunistic strategies include Westbrook Partners, Rockpoint Group, Fortress Investment Group, and Brookfield, among others. In the value-add space, numerous prominent managers closed sizable funds, including TPG Real Estate, Angelo Gordon, Bain Capital Real Estate, Carmel Partners, Phoenix Properties, Pennybacker Capital, and AXA. Within the core space, material commitments were made to the major multi-line players such as BentallGreenOak, Clarion, and PGIM. Moreover, firms such as GID, CommonWealth, GI Partners, and Pacific Urban Residential successfully garnered significant commitments for their core JVs/separate accounts.

With regards to vehicle structure, the mix in 2019 saw a slight shift toward closed-end commingled funds. These closed-end vehicles remain the vehicle of choice for investors, accounting for more than half of all commitments in 2019. Separate accounts saw a slight decrease relative to 2018, but still made up one-third of the total volume. Open-end commingled funds garnered the smallest percentage in 2019, making up 14 percent of total volume.

Property Type

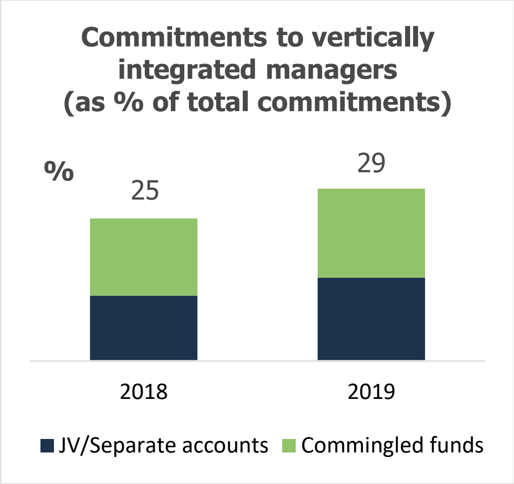


Vehicles focused on a single property type attracted 37 percent of commitments in 2019, roughly in-line with 2018 (38%) and well above 2017 (27%). Among commitments to property specific vehicles, industrial was the most popular property type, representing 33 percent of volume in 2019. This trend toward industrial-specific investments aligns with the strong returns seen across the industrial sector over the past several years. Interestingly, commitments to other niche strategies now represent over a quarter of all property-specific commitments. These include commitments to senior housing, student housing, hotels, medical office, self-storage, single family homes, and data centers, among others. Commitments to multifamily vehicles were the third most common, although the share has fallen over the past several years. The share of commitments to office-specific vehicles decreased materially in 2019, while retail saw a slight decrease year-over-year. Notable managers raising capital for property-specific vehicles in 2019 included GID and Pacific Urban Residential (multifamily), BentallGreenOak and Exeter Property Group (industrial), DivcoWest and CommonWealth (office), First Washington and Asana (retail), and Harrison Street and GI Partners (other/niche).



Geography

The majority of commitments from U.S. pensions continue to flow to North America-focused vehicles (61%). This represents a decrease from 2018 where 68 percent of commitments were made to North America-focused vehicles. This decrease was offset by increased commitment activity to global and Europe-focused funds. Asia-focused vehicles made up only 3 percent of total 2019 commitments. Prominent Europe-focused and Asia-focused vehicles, which together made up 15 percent of commitment volume in 2019, include those managed by Pacific Alliance Group, Angelo Gordon, Blackstone, Ares, KKR, Barings, and Aevitas Property Partners, among others.

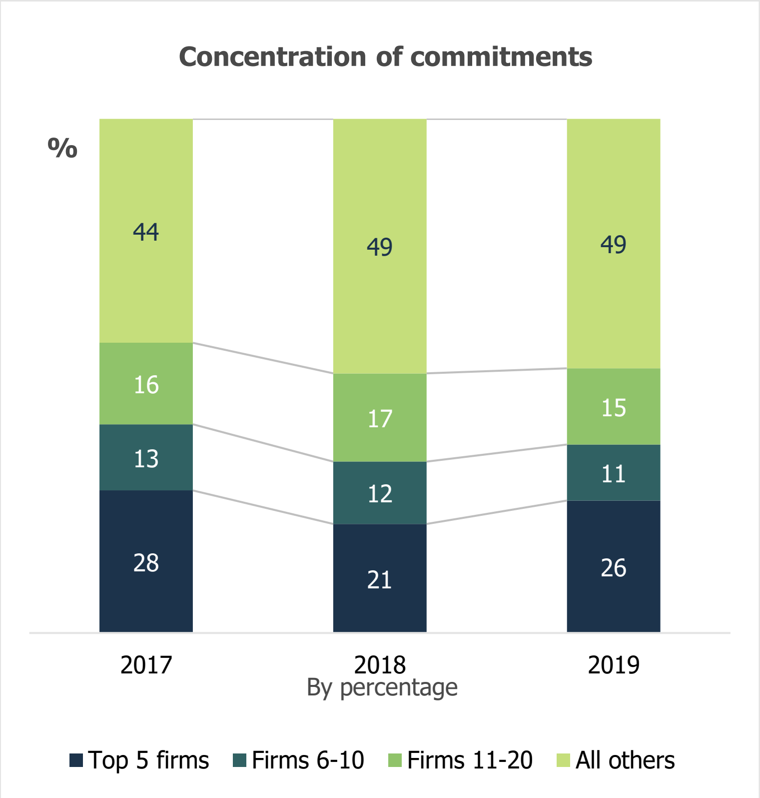


Vertical Integration

Vertically integrated managers attracted 29 percent of commitment capital in 2019, up from 25 percent in 2018 and 22 percent in 2017. Commitments to vertically integrated managers in 2019 were split relatively evenly between commingled funds and separate accounts. It is notable that nearly 50 percent of commitments to separate accounts went to vertically integrated managers in 2019 compared to 34 percent in 2018. Among the major investment strategies, core and core-plus mandates were most likely to be committed to vertically integrated managers, with over 40 percent of commitments made to these strategies flowing to vertically integrated managers in 2019.

Manager Concentration

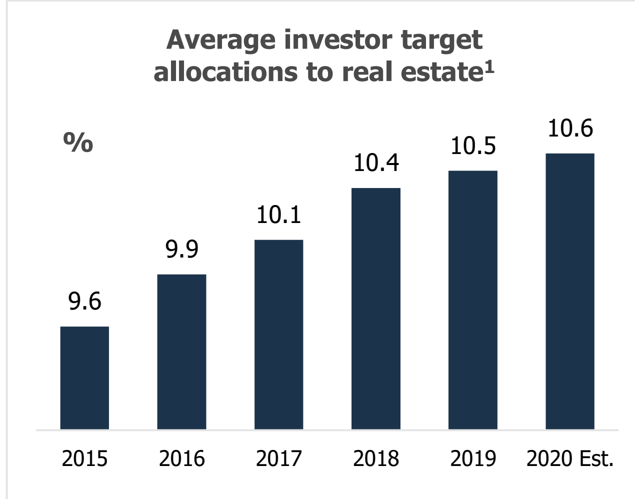
Despite the steady flow of capital into the private real estate market, the fundraising environment remains highly competitive. Similar to 2018, the top 20 managers captured just over half of all commitments from U.S. public pensions. Additionally, the top five managers in our database received 26 percent of all allocations, up from 21 percent in 2018. However, compared to prior years, the concentration of commitments among the top 20 managers is lower than that in 2016 (59%) and 2017 (56%). While the top managers still garner an outsized share of total volume, those managers outside the top 20 have seen their share increase when compared to three years ago. Further, we found that the number of unique managers receiving commitments in 2019 increased by 4 percent over 2018, despite a decrease in total commitment volume.



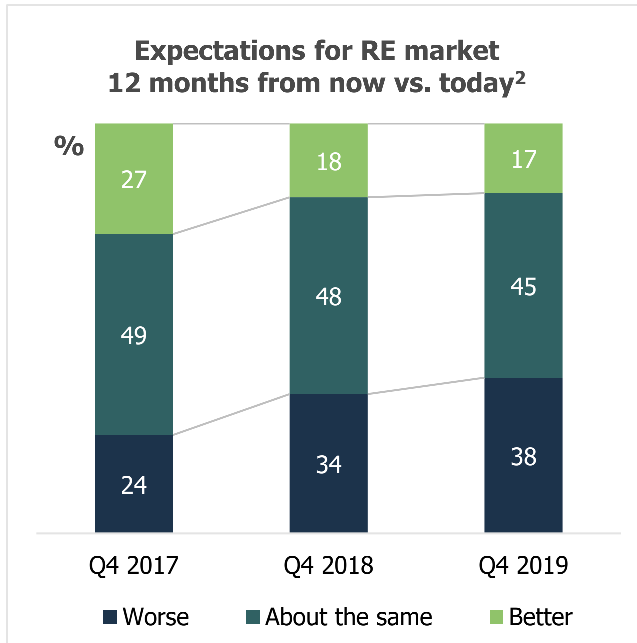
While the decrease in concentration is good news for smaller managers and newly formed funds, it also means increased competition for capital among managers favored by investors in recent years. All firms must bring a strong investment thesis, track record, and team to the table to continue securing meaningful commitments.

Looking Forward

In 2019, many of the encouraging trends seen over the past few years have continued. For one, the commitment volume tracked in FPL's database suggests continued strong investor demand for real estate. A recent report by Hodes Weill & Associates and Cornell University found that institutional investors are still under-allocated to real estate relative to targets, with investors located in the Americas falling 70 basis points below their target allocations on average. Additionally, investor target allocations continued to trend upward in 2019, and are expected to increase again in 2020 (see chart at right). Further, institutions that are actively investing in real estate reached a seven-year high (96%) according to the study.[1] On top of this, cap rates and vacancy rates remained at all-time lows, and transaction volume was strong relative to the five-year average.



That said, market participants acknowledge the late-cycle timing and must consider the implications of a turn in the market. The Q4 2019 Real Estate Roundtable sentiment survey conducted by FPL indicates that more real estate executives expect market conditions to worsen over the next 12 months than at year-end 2018 and 2017 (see chart at right). Survey participants cited political uncertainty and persistent talk of a coming economic downturn as reasons to be cautious. However, numerous other participants highlighted the solid real estate fundamentals, robust tenant demand, and the availability of debt and equity capital as strong market indicators. One survey participant had an interesting view on the state of the real estate market, "The market feels pretty good to us. My biggest fear is that we're going to talk ourselves into a recession."[2]



While there are valid reasons to proceed with caution, investors appear to be staying the course. Looking toward 2020, the vast majority (>90%) of institutions surveyed in the Hodes Weill & Associates study indicated that they expect to maintain or increase target allocations to real estate.[1] Similarly, a recent Preqin survey of alternative investors found that nearly 90 percent of participants intend to invest the same amount or more capital into their private capital portfolios in the future, despite 74 percent of participants indicating that they believe the market is at its peak.[3]

Given these considerations, investors and managers continue to refine their strategies to incorporate products and geographies that will produce yield, while also positioning them to weather less favorable market conditions. Capital flows to private real estate in 2019 were undeterred by talks of a looming recession, but it will be interesting to see if this continues as we begin a new decade.

1 Jones, D., & Weill, D. (2019). 2019 Institutional Real Estate Allocations Monitor. Ithaca, NY: Cornell University's Baker Program in Real Estate and Hodes Weill & Associates, LP, October 2019
2 Q4 2019 Real Estate Roundtable Sentiment Survey conducted by FPL
3 Preqin Investor Update: Alternative Assets H2 2019

About the Database

FPL's database, tracked by FPL Associates since 2011, includes commitments to 413 managers from 263 U.S. pensions representing $4.3 trillion in assets under management. Data comes from a variety of sources including pension websites and industry news sources.

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