KPMG RE-Invest Survey 2015

Expanding Horizons

March 2015

kpmg.com/uk/realestate

Content

Overview

The global real estate market has continued to surge ahead throughout 2014 driven by increasing economic stability and improvements in access to capital as investors increase their geographic reach. Access to investment opportunities is a major concern and is considered the greatest threat to growth by 48 percent of respondents. So what action have they taken?

Diversify, diversify, diversify:

Whether it be Geographical expansion, expanding investment strategies, new asset classes or new asset sectors; investors are widening their reach and building increasingly diverse investment portfolios. In 2015 only 64% of respondents employ a global strategy, compared with 39% in 2014.

Core remains King as 75% of respondents employ a core investment strategy, however there is an increasing trend towards opportunistic, value add strategies to drive returns and improve access to opportunities. Offices continue to dominate sector preferences with over 30% of respondents looking to gain further exposure, despite yields tightening across many markets.

Increases to allocations with 78% of respondents not expecting to alter their allocations:

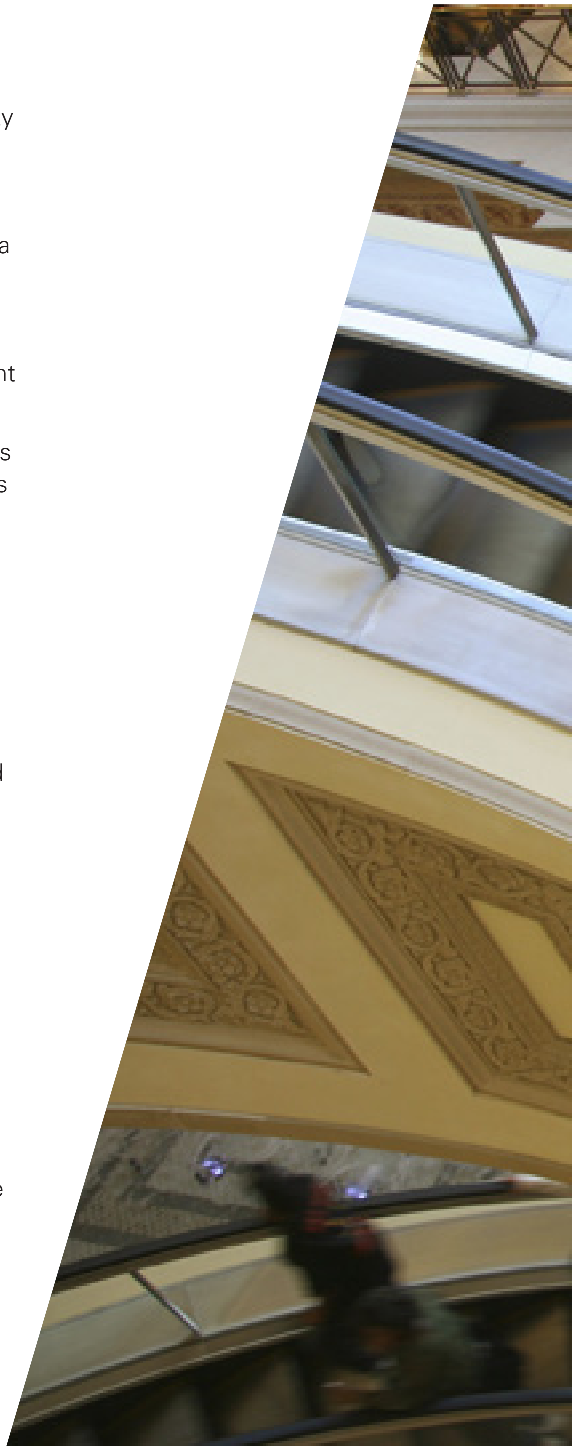
Real Estate is now largely embedded in many portfolios and not considered as 'alternative' as it once was. High profile increases in recent years have often involved investors expanding into real estate investment. Recent converts to real estate investment are busy building their platforms and gaining experience, and therefore may not be in a position to challenge themselves with increased targets. Competitive markets also mean it can be hard to deploy capital quickly and thus existing targets may remain illusive to even experienced teams. Capital needs to be generating a return, it can't be idle.

Increasing partnering:

As competition has grown to new heights KPMG member firms are noting increasing partnering and club deal activity through our day-to-day client activities and this is clear from the results as 84% of respondents employ these structures compared with 76% investing direct or via a separate account mandate; a reversal of 2014's results where direct/separate account mandates were employed by 81% versus 55% investing via club or joint venture structures.

Turning to the Hypotheses section what is striking is the complete lack of consensus across most of the statements: whether it's a question of continued commitment to core in the face of tightening yield; whether Europe's peripheral economies can deliver the real estate fundamentals to support investment appetite; or whether the traditional fund model is sustainable. Areas where there are signs of emerging consensus include: the need to shift up the risk-return curve to secure investment opportunities and the impact of political and regulatory changes – while 52% of respondents feel that their investment strategies are protected from political conflict; 69% expect to need to review their tax structures in the face of increasing reputational and regulatory pressure – what is apparent from these results is that survey respondents are keeping all options open and are evolving into more flexible and agile organisations to meet the emerging challenges that the real estate industry throws at them.

We do hope you enjoy this insight.



About the survey

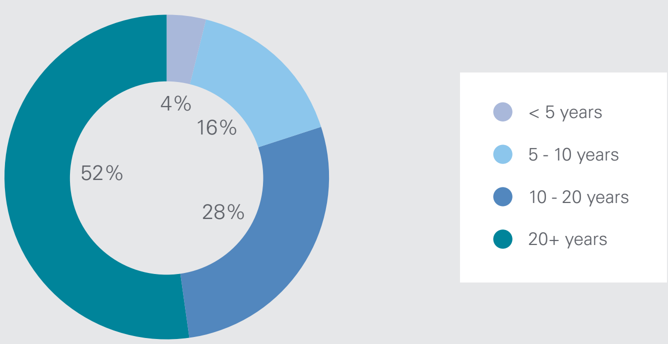
KPMG RE-Invest Survey, now in its fourth year, has been designed as a preamble to the annual RE-Invest Summit, held in Cannes in 2015. KPMG member firms and MIPIM RE-Invest surveyed select investors and asked for their assessment of the global real estate investment environment and their investment strategies for 2015. Respondents were asked to complete the survey either face-to-face, by telephone interview or remotely and are drawn from a range of organisations which together control Real Estate Assets valued in excess of €580 billion.

Results

1. Experience in the industry

There is much talk of a shift to alternatives and clear signs that many major institutions are considering risk and portfolio diversification more actively in this 'new age'. With over half of the respondents organisations having over 20 years experience of investing in real estate it is clear that this asset class is not considered 'new' to many. It is also somewhat comforting to note that this experience should bring with it some stability to the volume of capital flowing into real estate than maybe certain industry commentators allude to when discussing the cross-border trends and new entrants. While these new entrants may be new to the region they may not be new to the game.

HOW LONG HAVE YOU INVESTED IN REAL ESTATE?



Source: KPMG International, Re-Invest Survey, March 2015.

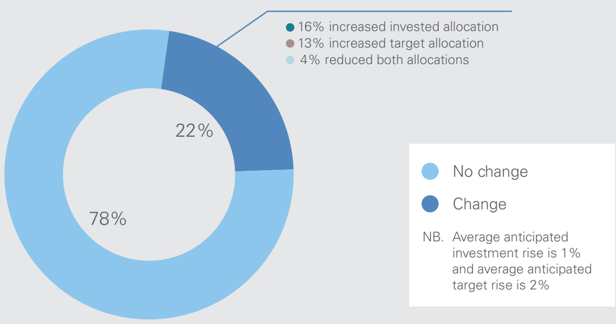
2. Allocations to real estate

Respondents are drawn from right across the global market place, however, respondents derived from an organisation running a multi-asset strategy, are responsible for managing an average of 10% of invested allocation and are seeking an average target allocation of 13%.

While 78% of respondents are not expecting to alter their allocations, generally those with allocations at the lower end of the spectrum do expect to increase these over the next twelve months. 16% of respondents expect to increase their invested allocation; by 1% on average. 13% expect to increase their target allocation; by an average of 2%.

While 4% expect to reduce their allocations this is restricted to above average allocation rates and does not signal an exit from the sector.

ALLOCATIONS TO REAL ESTATE



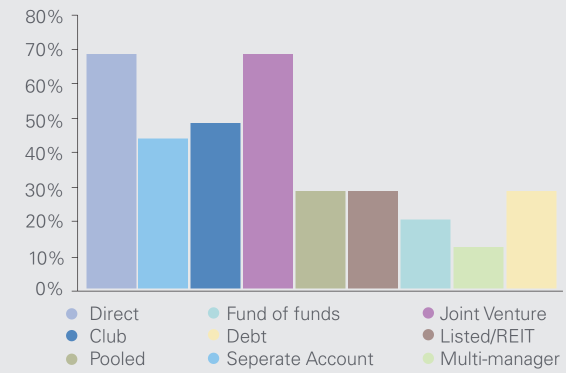
Source: KPMG International, Re-Invest Survey, March 2015.

There is a marked step-change when we compare these results with those seen in 2014 when 81% expected to increase their allocations and there appears to be a number of factors at play here. Firstly is the familiarity with real estate. For many organisations real estate is no longer fundamentally ‘alternative’; it has become ‘normal’ and the asset class is understood and accepted. For other more recent additions to the market there is a steep learning curve during which organisations are unlikely to take significant additional bets on the market until they are familiarised and the supporting structures and processes fully tested. Finally a critical factor is the ability to put this capital to work. As is discussed later in this document the challenge of sourcing investment opportunities is ever present.

But what is the route to investment?

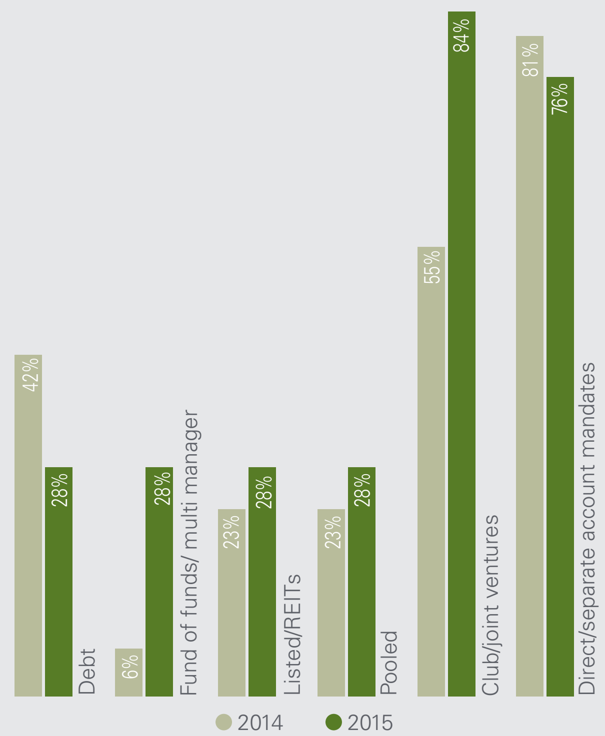
A clear preference for investment structures that provide higher levels of control over either the asset or the strategy dominates the chart below. Nearly all of the routes to investment have seen growth, driven by the need to diversify in a highly competitive market. Only Debt had seen a significant drop off which is surprising given the columns dedicated to Debt funds seen in the industry’s media. However, it is a fundamentally different product which requires additional specialist skills and resources and in the past respondents have highlighted concerns regarding the additional risks associated with such products which are not purely real estate driven. However, players have articulated in recent years that they fear additional risks on the debt side which are not purely real estate driven. While Direct/separate account mandates have seen a small decline this is set against a significant increase in joint venturing and club deals. In KPMG’s view there are potentially two key drivers for this: 1) competition and avoiding a race to the top price; and 2) the desire to tap into local knowledge and expertise through partnering.

STRUCTURES EMPLOYED



Source: KPMG International, Re-Invest Survey, March 2015.

STRUCTURES EMPLOYED 2015 VS 2014



Source: KPMG International, Re-Invest Survey, March 2015.

3. Investment strategy

When posed the question: "What is your primary investment strategy?" it was interesting to note that a number of the respondents were really split. Given the options of i) core or income focus; or ii) Opportunistic or Capital growth focus, 28% of respondents were unable to come down on one side of the fence. As a result 75% of respondents employ a Core strategy while 54% take an opportunistic approach. Again, this demonstrates the difficulty clients and other industry participants are finding in sourcing and securing investment opportunities. As a result many are having to consider alternative risk profiles when revisiting or diversifying their investment strategies whether it be geography or asset type.

However, while there is much talk of "shifting up the risk curve" the proportion of respondents utilising a core strategy has actually increased from 61% in 2014 (67% in 2013) so it would seem that an asset led, more flexible approach is being adopted in the face of a low supply environment.

PRIMARY INVESTMENT STRATEGY

Source: KPMG International, Re-Invest Survey, March 2015.

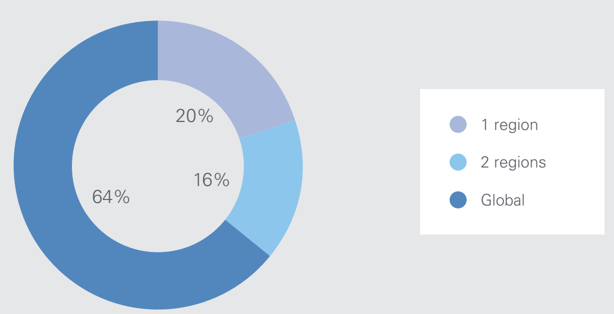
Key principles that underpin strategy

Respondents were asked to share with us what the key principles that underpin their strategy are. While no one would be surprised to see 'Stable income' take the top spot the themes that run through these responses demonstrate further the appetite for more opportunistic activities. The focus on partnering and skills is also worth a mention. While the respondents employ a variety of structures (in-house vs outsourced), skills and demonstrable track records have been under increased scrutiny since the global financial crisis. Active asset management, tapping into local knowledge and alignment of interests are all key.

4. Geographical exposure to real estate

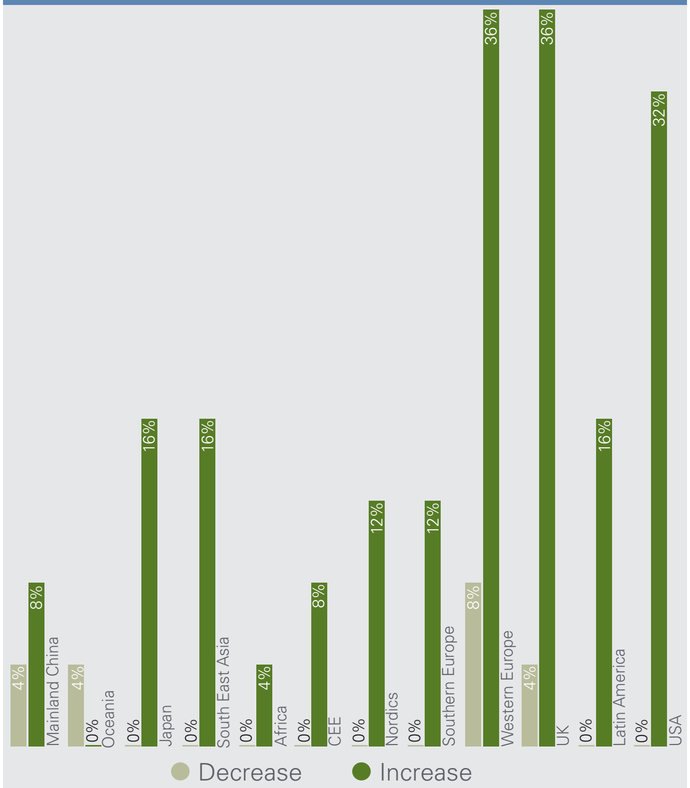
While 64% of respondents employ a global strategy to real estate investment, of those adopting a regional strategy most are investing in EMEA (36%) with 12% having exposure to ASPAC and 4% having exposure to the Americas. None of respondents are currently investing in a pure domestic manner in contrast with the 2014 results where 16% of respondents were pursuing a domestic strategy. While the proportion of regional investors has declined slightly from 45% in 2014 the shift to a Global strategy is marked increasing from 39% in 2014.

GEOGRAPHIC INVESTMENT STRATEGY



Source: KPMG International, Re-Invest Survey, March 2015.

CHANGES TO GEOGRAPHIC EXPOSURE



Source: KPMG International, Re-Invest Survey, March 2015.

So where are respondents looking to increase …or reduce their exposure in the next 12 months:

Western Europe, the UK and US remain the most popular while Southern Europe has lost some ground having had 35% of respondents in 2014 pick it as a market showing the best opportunity.

In this year's survey, the UK has been split from Western Europe, due to the high volumes of capital that flow to this market and while these two markets dominate the graph above, the combined interest in increasing exposure to the UK & Western Europe (44%) has not managed to exceed the massive 81% interest it received in 2014. These markets have enjoyed significant investor appetite for some time now and there are a number of factors combining, including lack of supply, renewed Eurozone concerns and FX risk, that could explain this slow down in appetite.

Set against this though is the volume of respondents looking to reduce their exposure to these markets. We believe this is largely driven by organisations seeking to realise the gains available given the volume of inbound cross-border capital seeking opportunities in the region. Other investors may also find themselves being forced to reduce their allocation to these high performing markets given the high competition for assets if they are unable to meeting or justify the pricing levels. We don't believe that the 'Decreases' signal any major shifts in attraction to real estate but rather a housekeeping exercise to realise and protect value.

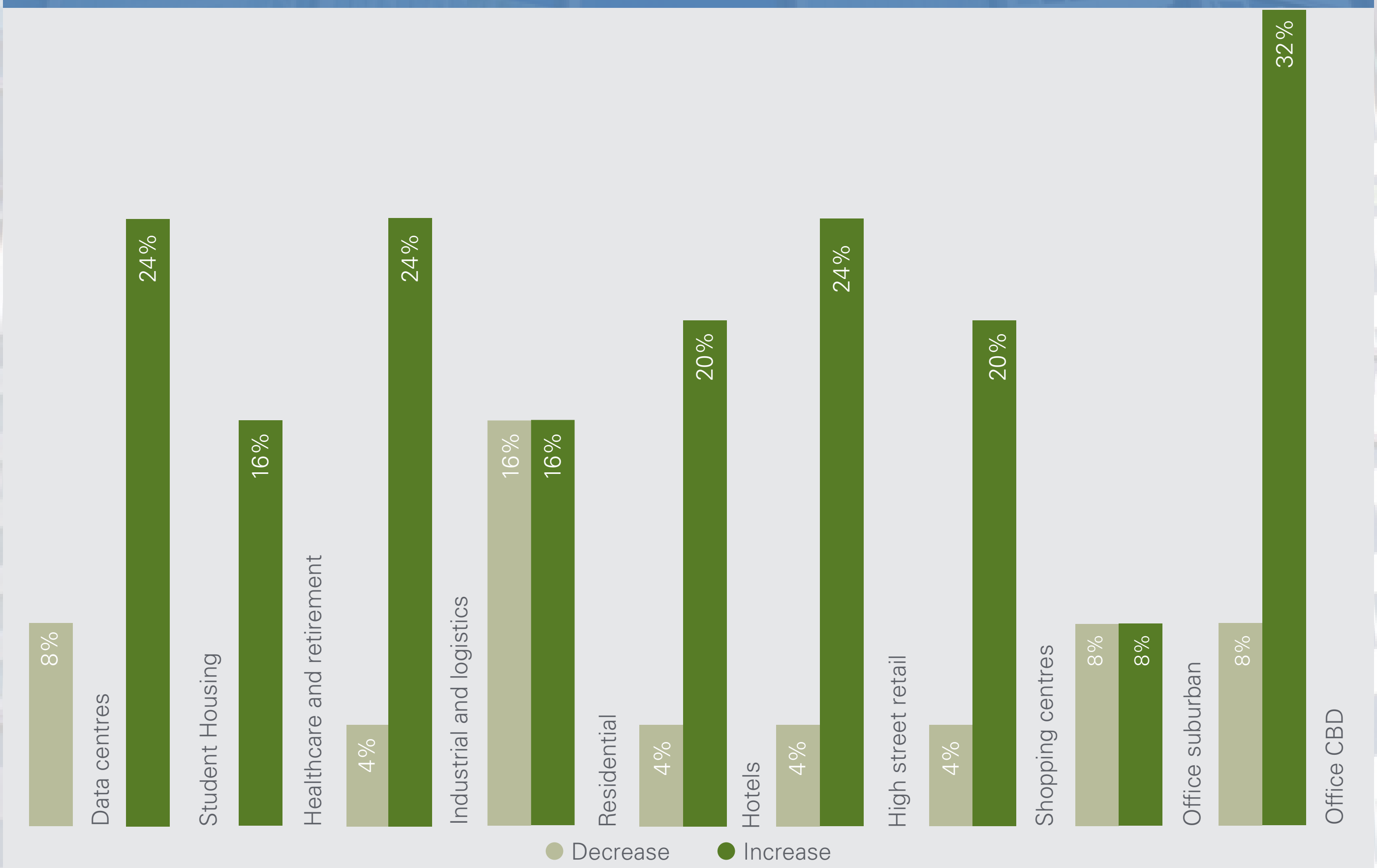
Turning to the Americas, North America received 32% of the vote for the market with the best opportunities in 2014 and exactly the same volume of respondents are expecting to increase their allocation to the US over the next twelve months. None of the respondents signalled an increased interest in Canadian real estate. Latin America is of interest to 16% of our respondents, versus 10% signalling that it was a region offering the best opportunities in 2014. This interest is not restricted to North American investors but encompasses participants with appetite from each of the three key regions.

5. Asset sector exposure

While all sectors appear to have secured the interest shown in 2014 (and more!) what is worth noting is the diversification of investments held by these institutional investors. While the 'on-trend' alternative classes such as Student Housing, Healthcare and Data Centres are all represented, perhaps more surprising is the significant interest in less traditional investment sectors such as suburban offices and high street retail, as one respondent highlighted, it can be difficult to find institutional funds for high street retail.

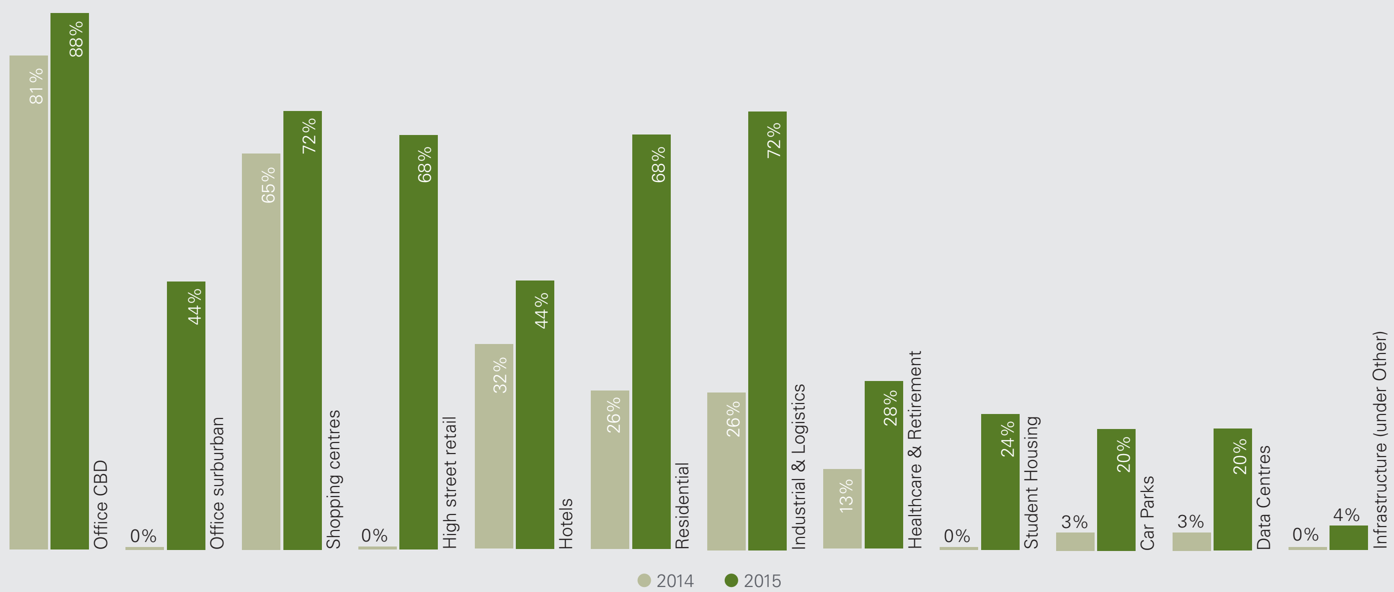
While the trend towards increased exposure across the sectors is understandable, driven by the competitive environment and the desire for diversification, the results show further increases in appetite for asset classes such as Offices and Shopping Centres where the core end of the market is seeing yields tightening. However, these results are somewhat consistent with the responses to the first Hypothesis (see page 14 for more details) where the results indicate that a significant percentage of respondents will continue to seek prime assets providing income security even if expensive.

SECTOR EXPOSURE CHANGES IN THE NEXT 12 MONTHS



Source: KPMG International, Re-Invest Survey, March 2015

ASSET SECTOR EXPOSURE IN 2015 VERSUS THE SECTORS DEEMED MOST APPEALING IN 2014



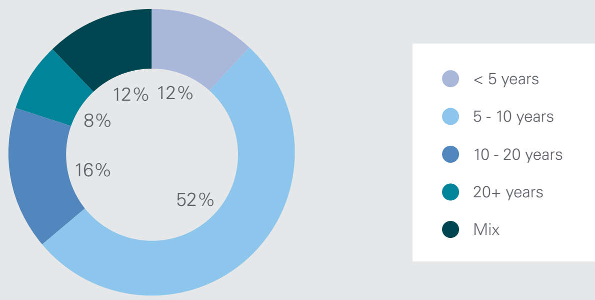
Source: KPMG International, Re-Invest Survey, March 2015.

6. How long do they hold their investments?

Given the desire for long-term stable income by many institutional investors it would be natural to assume that hold periods would be far longer than the traditional fund model. However, the results indicate that this would be an unfair assumption.

Having touched on the potential for portfolio churn and realising gains above, the results for the target hold period show that the bulk of respondents hold their investments for less than 10 years. Drilling down to consider any themes it appears that the results show little correlation between investor type or domestic location. We feel that many institutional investors are evolving to become more agile in their approach. While there are traditional examples still available it is clear that no one size fits all.

TARGET HOLD PERIOD

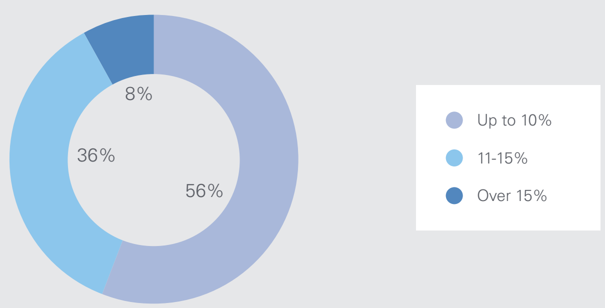


Source: KPMG International, Re-Invest Survey, March 2015.

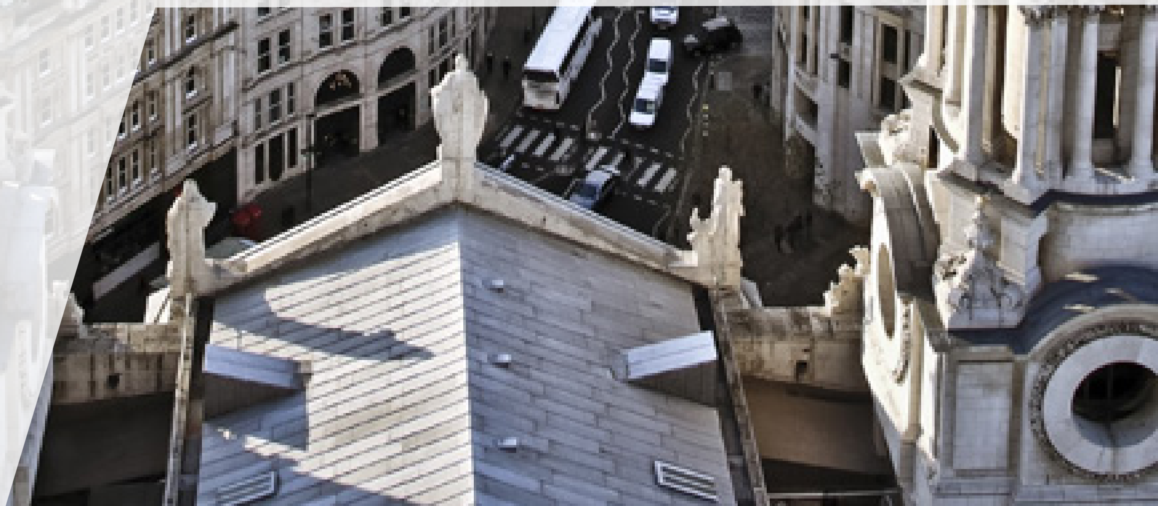
7. Target IRRs

Unsurprisingly target IRRs are towards the lower end of the spectrum given the appetite for core assets in a highly competitive market. While there is strong correlation between the investors that employ a core strategy versus those that opt for opportunistic only 8% of respondents anticipate a change in IRR in the forthcoming year, equally split between rise and falls. Essentially it is 'business as usual' for the real estate industry regardless of competition and yield compression widely muted in the market forecasts.

TARGET IRR

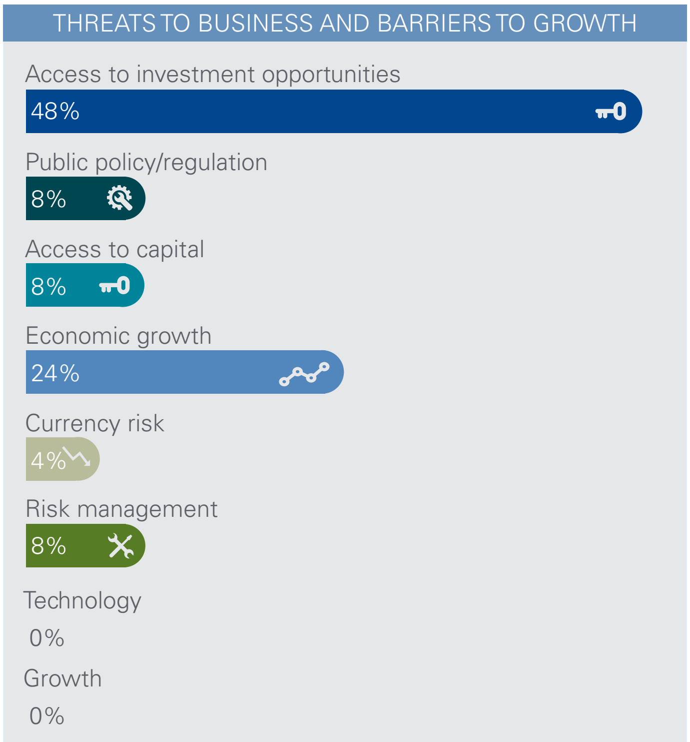


Source: KPMG International, Re-Invest Survey, March 2015.



8. What is keeping these investors awake at night?

Unsurprisingly Supply and Economic Growth are the fundamental concerns for participants. So many of the trends demonstrated are driven by competition and a race to secure investment opportunities but clearly for real estate to generate a total return and add value to an investor the economic fundamentals are vital. With a recent slowdown in GDP growth across a number of the key real estate markets it is only natural that this would be of concern to survey respondents



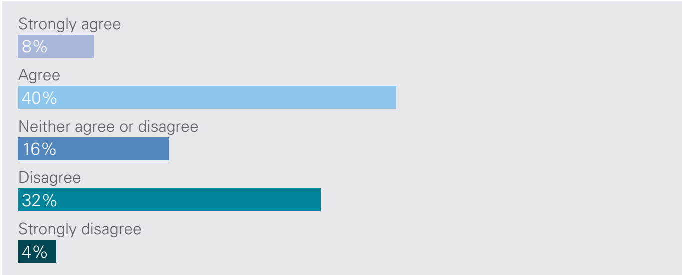
Source: KPMG International, Re-Invest Survey, March 2015.

Hypothesis
Results

The overriding theme of the results in this section is a lack of consensus!

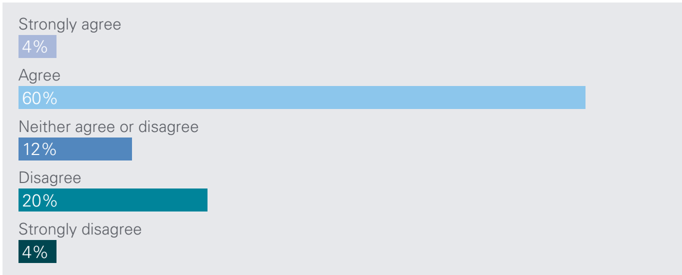
I will continue to invest in Prime assets providing income security even if expensive

While the spread is largely consistent with the breadth of primary investment strategies deployed by respondents, the commitment to the prime/core strategy is significantly lower than the 75% discussed earlier in this publication. This would indicate the potential for further shifts to more opportunistic investments or other alternatives such as infrastructure in the foreseeable future.



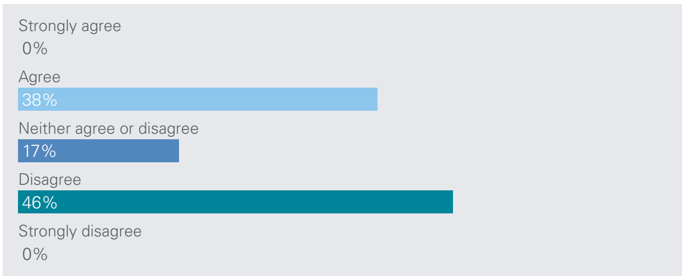
I will look for value in higher risk (compared to my current risk profile) asset classes and geographies as prime is too expensive

Again these results demonstrate the increased adaptability that is becoming key to performing at the institutional end of the real estate investment market. It also shows some caution being exercised as they consider their options. Again there is little correlation between the type of investor and the approach to this potential strategy.



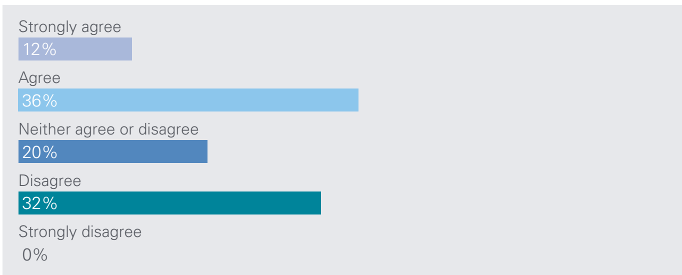
Europe's peripheral economies (Ireland, Spain, Italy and Portugal) lack the real estate fundamentals to support the current appetite for investment opportunities

While potentially concerning that the perceptions around these real estate fundamentals is not more aligned across survey respondents we believe this is a further sign of the increasingly opportunistic approach taken by many of these investors. With few European markets out of bounds investors appear to be confident that opportunities can be found.



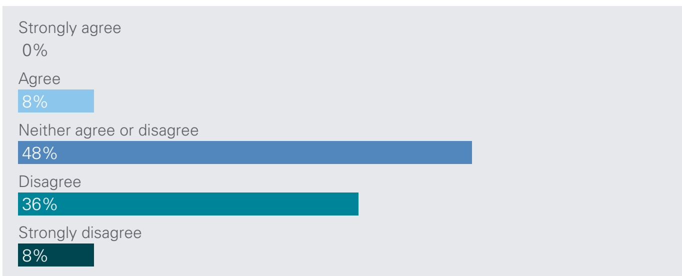
Prime cities (London, Paris, New York, Hong Kong, Singapore) cannot avoid a bubble given the wall of capital targeting investment opportunities

While skewed in favour of general agreement, again there is a significant proportion that are not concerned about bubbles. Yet again the respondents opting for 'disagree' represent a cross-section of the respondent base.



Latin America will tempt opportunistic investors away from Europe and Asia

It would appear that the supply issues facing investors in many of the prime real estate markets of Europe and Asia are insufficient to push respondents further afield to Latin America. This, for now, seems to be a step too far up the risk-return curve with demand for geographical exposure still favoring the more politically stable and transparent markets.



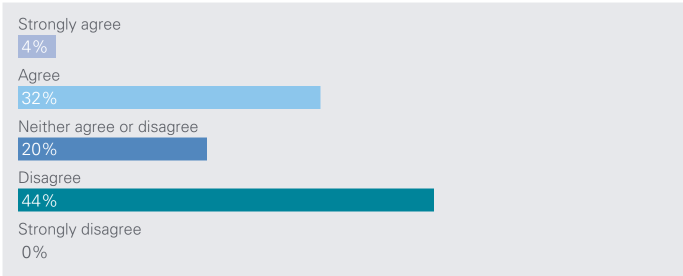
Source: KPMG International, Re-Invest Survey, March 2015

Asian capital will dominate global capital flows in the next 5 years

While the results are unsurprising given the rapid rise in allocations from Asia this relatively new source of capital can quickly have a major impact on local real estate markets. Take London as an example, where large scale developments are now owned, funded and are being developed by Asian players. Watching the ripple effect of the capital being deployed will be of interest and concern to many operating and competing in today's markets.

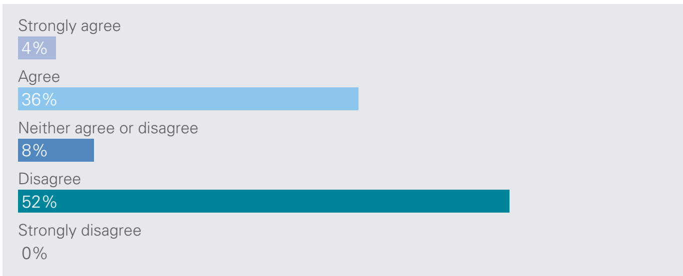
The traditional real estate fund model is unsustainable in the face of increasing capital allocations by more adaptable investors

The vote of confidence from 44% of respondents is less comforting when compared with the 60% of respondents that currently utilise a fund vehicle in some format. Funds and fund managers are facing an increasing volume of challenges (demand for different products, margin pressure, regulatory changes just to name a few) and need to adapt to the 'new normal'. However, they also are a great source of knowledge and experience and are finding new ways to put this to work.



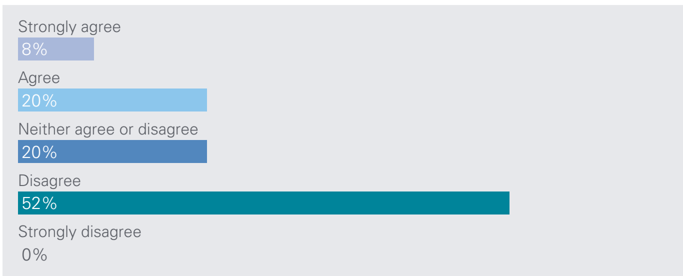
Investment opportunities in core cities will decline as the large global investors take longer hold periods

Comparing these results to the target hold periods considered earlier in this document there is a clear correlation between the two sets of results with the volume of 'disagrees' equalling the volume of respondents holding assets for 5-10 years. The increasing trend towards opportunistic or mixed strategies is likely to lead to more flexible investment plans for particular investments, enabling realisation of capital growth if the price is right.



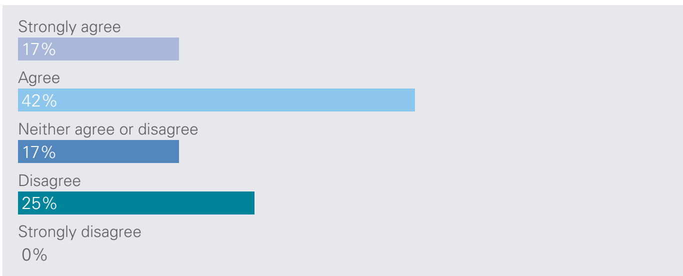
Political conflict is having an increasing impact on our investment strategy

Given the extent of political conflict prevailing one might have expected a rather different result. However, a core strategy hinges on security and stability and therefore relative to the wider world the exposure of our respondents to political uncertainty is indeed limited.



We will need to review our tax structure in the face of increasing reputational and regulatory pressure

As the OECD continues to work on its Base Erosion and Profit Shifting project and governments around the world place increasing focus on their country's tax take, the tax and regulatory landscape is becoming increasingly complex. The complexity is likely to correlate with the geographical spread of investments and your own tax status. Respondents include Sovereign Wealth Funds (SWFs), Pension Funds and Insurance Funds amongst others and it is arguable that a number of these will have already engaged with the new regulatory landscapes. The tax transparent status of the SWFs is also likely to limit the impact of the closing of potential loop holes compared with other traditional investors.



Source: KPMG International, Re-Invest Survey, March 2015

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