Glastonbury Capital, LLC
alternative, diversified, real estate

GPS Glastonbury Property Solutions LLC

THE NAVIGATOR

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Asset Reallocation Suggests Increased Real Estate Investment in 2014

Introduction

On nearly the same day that the Dow Jones Industrial Average hit all-time highs in November 2013, Citi Private Bank released a survey of family offices indicating that wealthy families are sitting on enormous amounts of cash. Their portfolios are heavily weighted against equities while their position in cash continues to grow. The survey of more than 50 large family offices from across 20 countries reveals that wealthy families have almost 40% of their assets in cash and a historically low allocation in stocks. Yet the Dow Jones Industrial Average crossed the stratospheric 16,000 mark just recently, and continues to flirt with this all-time high. In this Year's End issue of THE NAVIGATOR we explore this dichotomy and what it might portend as an important trend for commercial real estate (CRE) during 2014.

Running from High Returns?

The Citi survey of wealthy families with $5 million or more of investible income found that stocks represent about 25 percent of the average portfolio; bonds about 17 percent; and alternative investments, like commercial real estate, about 19%. Traditional asset allocation among this group is more heavily weighted towards stocks, with as little as 5% to 7% held in cash.

Citi's Global Chief Investment Strategist, Steven Wieting, commented in a client note that "Using these weightings, our own return expectation for the portfolio … comes to just 4.4 percent. This matches what we at Citi Private Bank observe generally among high end investors: very high cash holdings, with a current asset allocation unlikely to achieve return targets."

Wieting speculates that wealthy families still feel the burn of the Great Recession, and are reticent to move too heavily back into stocks.

But there may be more to it: savvy investors with the resources to manage complex portfolios, including dedicated in-house fund managers, are eschewing the stock market's high returns in favor of safer asset allocations, even at the expense of dismally low returns. This, despite that fact that 60% of those surveyed believe that stock averages will continue to grow through 2014. It suggests a squeamishness fueled by fears of a stock bubble that has grown less by value and more by speculation made possible by easy money through Quantitative Easing. Economic uncertainty driven by Sequestration, the Affordable Care Act, and historic U.S. debt levels are likely a cause for concern, as well. Less wealthy investors are driving the stock market frenzy while high-end investors are sitting on the sidelines, waiting for new opportunities to buy into the market while exploring alternative investments, including commercial real estate.

Positive Implications for Commercial Real Estate: Cash Returns in 2014

Wealthy investors took a wait-and-see approach to the commercial real estate market at the beginning of 2013, but investment levels are starting to increase heading into the New Year. As noted in the Urban Land Institute's 2013 forecast published a year ago, "Hungry for capital gains and less motivated by income, high net-worth investors temporarily display less enthusiasm for commercial real estate. They tend to recoil from all the negative 'never-in-my-life-have-I-seen' economic indicators and stockpile cash." However, the Institute's 2014 forecast strikes a markedly different note, just twelve months later: "The availability of debt and equity capital is on the rise in 2014…Equity capital will come from wealthy investors, institutional investors, global investors, sovereign wealth funds, real estate investment trusts (REITs), and family offices… The difference in 2014 is that providers of capital are looking to increase their allocation or are willing to look at investments that they have previously avoided."

As recently reported by Costar: "With the return of institutional investors and lenders to the commercial real estate arena, there are signs that high net worth investors are also beginning to return." This is corroborated by a 2013 survey of 500 high-net worth investors by the Investment Program Association, indicating that 80% of respondents believe commercial real estate will match or surpass equity markets in the next five years. "After the significant downturn in the real estate market, investors are now saying that the market has turned a corner," said Kevin M. Hogan, president and chief executive officer of IPA who administered the survey.

High net worth investors are responding to positive fundamentals, driving the recovery further along: "The real estate recovery will gain momentum in 2014. This should be good news to an industry that has experienced a recovery of fundamentals that has been much slower than it is used to after a recession. The difference for 2014 is that the market has progressed further through the economic and real estate cycles and we are now seeing real evidence that the trends have the momentum to finally make an impact on the real estate market. The real estate market continues to move through the recovery phase of this cycle," reports the ULI 2014 survey.

The Growth of Family Offices

The CRE market represents a solid investment opportunity for high net worth families in 2014 at a time when family offices are increasing in number and value. A 2013 annual report by Capgemini and RBC Wealth Management notes that the number of people in the world with at least $1 million of investable assets rose 9.2% to a record 12 million in 2012, while the number of millionaires in North America rose 11.5%. Total assets held by the super rich grew 10% to $46.2 trillion, driven by gains among families with $30 million or more.

Pension Funds & Endowments Get In Line

Institutional funds factor into the mix of likely equity sources to invest in CRE during 2014, as well. Pension Funds and Endowments are heavily underweighted in real estate, but are looking to make additional investments in 2014, as reported by NREI in December 2013. Public pension funds currently have 7.4% of their total assets, an average of $950 million, allocated to real estate; private pension funds have 6.1%, an average of $381 million, allocated to real estate; and endowment plans have 6%, an average of $129 million, so allocated. For 2014, these groups plan to upwardly adjust their investments in real estate: public pension funds aim to allocate 8.4% of total assets; private pension funds aim for a 7.2% investment; and endowments plan to allocate a total of 8% of total assets to real estate.

Canadian and Chinese Investors Contribute

Sovereign investment and direct foreign investment by wealthy families in U.S. commercial real estate is on the rise. As reported by the Real Estate Center at Texas A&M University, "Foreign investment in real estate is still rolling in at a rapid clip. Money is flowing into American real estate from countries all over the world… America has long been viewed as the international "safe haven."

The Texas A&M survey notes, "International capital still favors the U.S., and year-to-date, Canadian buyers lead foreign investment by far." A 2013 market survey by Jones Lang LaSalle of Canadian real estate investments found that Canadian investors made more direct acquisitions in real estate outside of Canada than they did inside its border. Total investments by Canadians in international commercial real estate are on-track to exceed the previous record of $11 billion established in 2011. The JLL survey notes that the entire commercial office market in Canada is about the same size as the Manhattan market. There simply are not sufficient opportunities to invest in the country as outside it; and the United States represents a market and culture without language barriers and with a shared border.

Chinese investments are on the rise, also. To date, in 2013 Chinese investors have plowed $1.7 billion into U.S. properties, up from $22 million in 2008. Bank of China Ltd. had $3.7 billion in commercial property loans outstanding in its U.S. branches at year's end 2012. This is almost four times the level for the same period of 2009. In October of this year, State-owned property developer Greenland Holdings of China acquired a major stake in a 15-tower apartment project in Brooklyn, representing the largest-ever real estate acquisition in the U.S. by a Chinese state-owned company.

Conclusion

As market fundamentals improve during the recovery phase of the U.S. Commercial Real Estate market, lenders and investors are increasing their exposure to real estate. Wealthy investors are consolidating their equity allocations in favor of cash, in what appears to be at least a partial repositioning towards alternative investments like commercial real estate. Equity investments by family offices, institutional funds, sovereign funds, and high net worth investors in the U.S. are increasing. This is a trend likely to continue into 2014. Family offices are a bellwether, shying away from record stock market returns, consolidating cash, and repositioning to invest in commercial real estate.

More and more, the U.S. commercial real estate market has the eye of savvy investors. Improving fundamentals and the availability of equity will continue to drive investments in the face of greater concerns of a stock market bubble.

A Note of Thanks for a Great Year and Best Wishes for 2014

As always at this time of year, we want to thank our business associates for an exciting year filled with rewarding opportunity. As we look forward to 2014, we wish you a peaceful New Year.

To learn more about Glastonbury, please view our website at www.glastonburygps.com. To learn more about our own portfolio of properties, and to access archived copies of THE NAVIGATOR, please view the Glastonbury Capital LLC website at www.glastonburyllc.com.

As always, thank you for allowing us the opportunity to share our work and perspectives. Wishing you the very best,

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