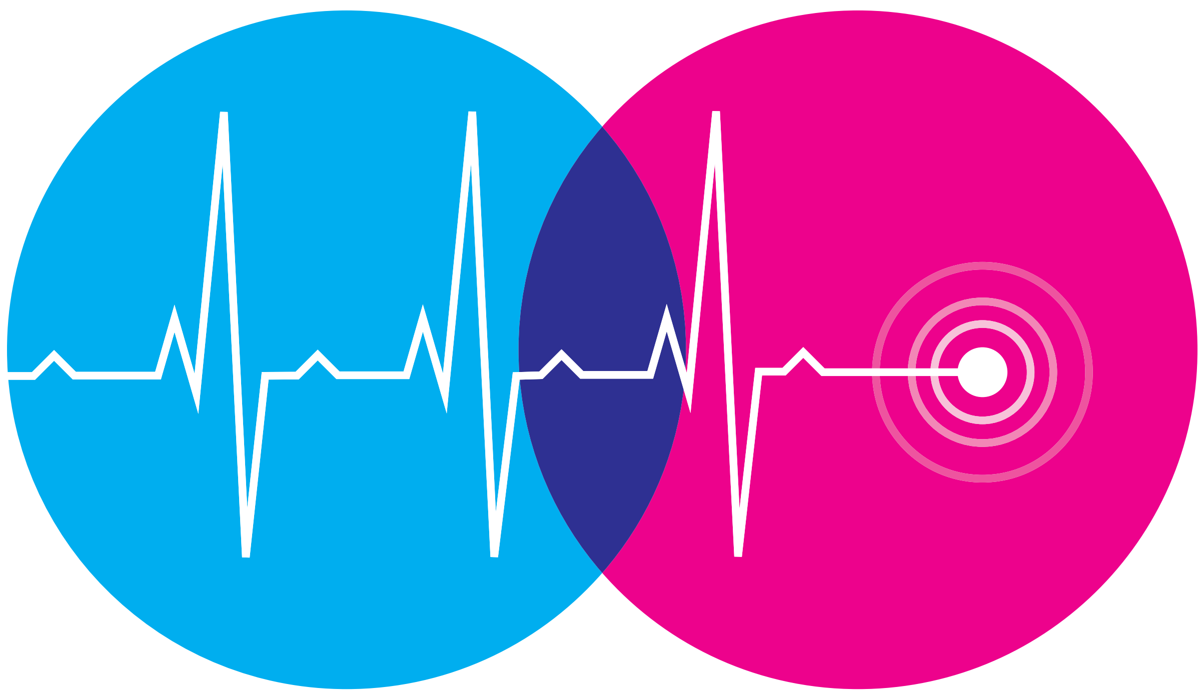
CHECKING THE PULSE



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No matter your age or experience, 2021 has shaped up to be a year that no one can forget. Findings from the AFIRE 2021 Mid-Year Pulse Survey detail a cautious road ahead.

On one hand, the past year has been guided by a modern miracle, with effective vaccines developed and deployed faster than ever to combat the ongoing pandemic. But this year has also been complicated with new virus variants, uneven vaccination rates, closed borders, and bitter politics.

People continue to adapt in creative ways. When AFIRE members were surveyed in March 2021 for the association's Annual International Investor Survey, they expressed an overall sense of optimism thanks to the adaptations and the hope that the pandemic might soon pass.[1]

Historically, AFIRE has only conducted this survey annually—but this year's survey research project was necessarily adapted to meet the needs of the "new normal," thus warranting a mid-year sentiment "pulse" survey, or follow-up to the March questionnaire.[2]

When this pulse survey was conducted in August 2021, the optimistic outlook explicated in Q1 2021 had evolved, reflecting a greater emphasis on risk aversion and more concern for critical issues across business, real estate fundamentals, and social and political trends.

INVESTOR CONCERNS

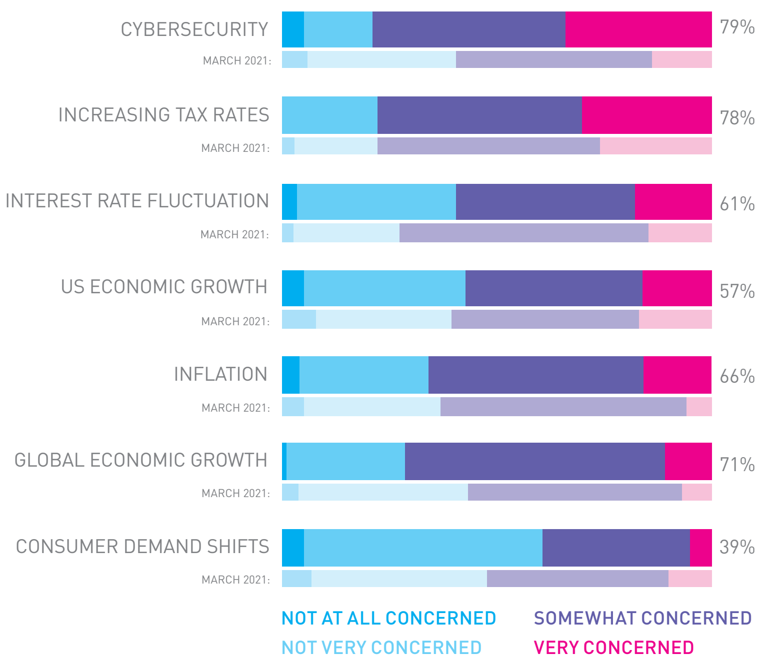
To compare changes in attitudes related to the general business climate, respondents were asked to rate their concern about seven key business factors. In March 2021, increasing tax rates ranked as a top concern (78% net concern), followed by interest rate fluctuation (73%), and inflation (63%).

While concerns about increasing tax rates have not meaningfully changed over the past several months (remaining at 78% net concern), and concerns about inflation have grown slightly (from 63% to 66%), cybersecurity has skyrocketed to the top of the list, ranking at 79% net concern, up from 60% earlier this year.

These concerns are interrelated. For example, concerns about economic conditions (e.g., interest rate fluctuations, inflation, and economic growth) have mostly subsided in recent months, perhaps reflecting the stabilization of pandemic-related uncertainties as the world becomes more organized in its fight against COVID-19.

Similarly, the subsidence of some of these uncertainties (e.g., shifts in consumer demand) has correspondingly heightened concerns in other related areas, especially around cybersecurity, which has become even more integral to consumer confidence through and beyond the pandemic.

EXHIBIT 1: HOW CONCERNED ARE YOU ABOUT THE FOLLOWING FACTORS ON YOUR US REAL ESTATE ACTIVITY?



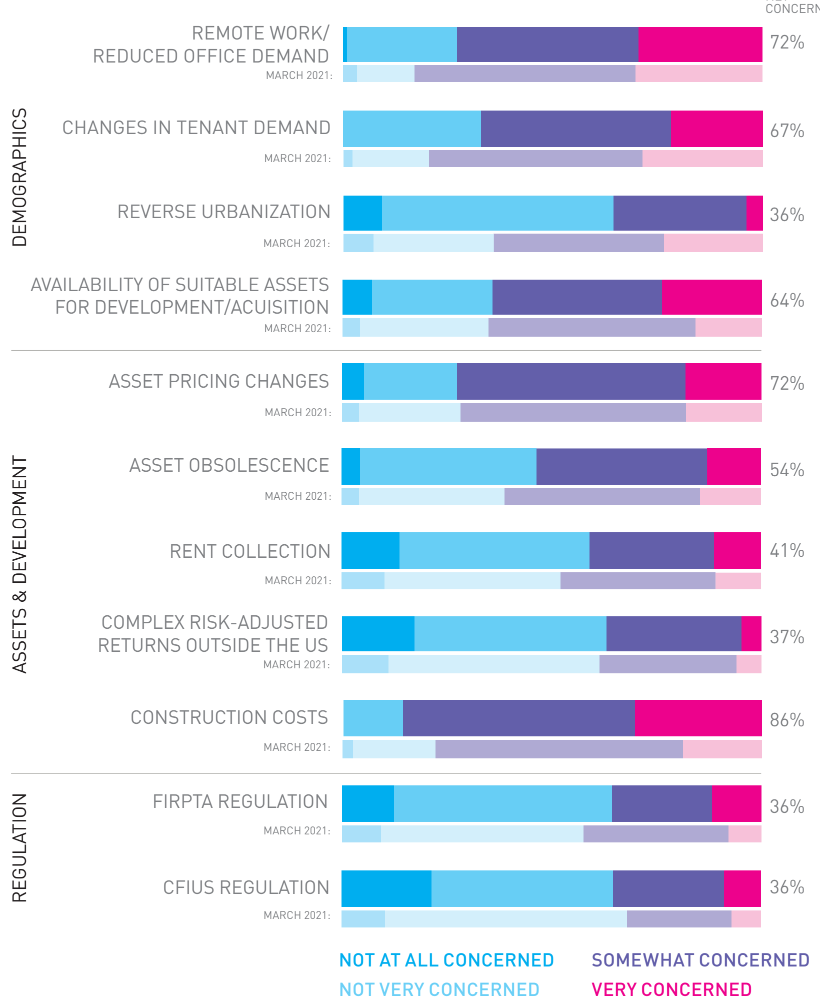
Construction costs have grown to the area of greatest concern (86%). This trend could continue, especially in the face of ongoing supply chain challenges.

Investor concerns about real estate fundamentals across demographics, asset types, and regulation have declined over the past several months.

The most substantial declines have occurred around remote work/office demand (72% net concern, down from 83%) and changes in tenant demand (67%, down from 80%), reflecting market adaptation to prolonged pandemic conditions.

Concerns about migration out of cities has also seen significant decline (36% net concern, down from 53%), while concerns around rent collection, asset pricing, obsolescence, and/or availability have remained notably stable. And even as most concerns have declined or stayed the same, construction costs have grown to the area of greatest concern (86%). This trend could continue, especially in the face of ongoing supply chain challenges.

EXHIBIT 2: HOW CONCERNED ARE YOU ABOUT THE FOLLOWING FACTORS ON YOUR US REAL ESTATE ACTIVITY?



In March 2021, public health issues topped the list of social and political concerns for investors (79% net concern). COVID vaccines were beginning to roll out, and there was some collective optimism that the world was past the worst of the pandemic.

However, the Delta strain upended that optimism by mid-year, and markets battened down for a prolonged pandemic, as reflected by the increase to 91% net concern for pandemics—nearly universal.

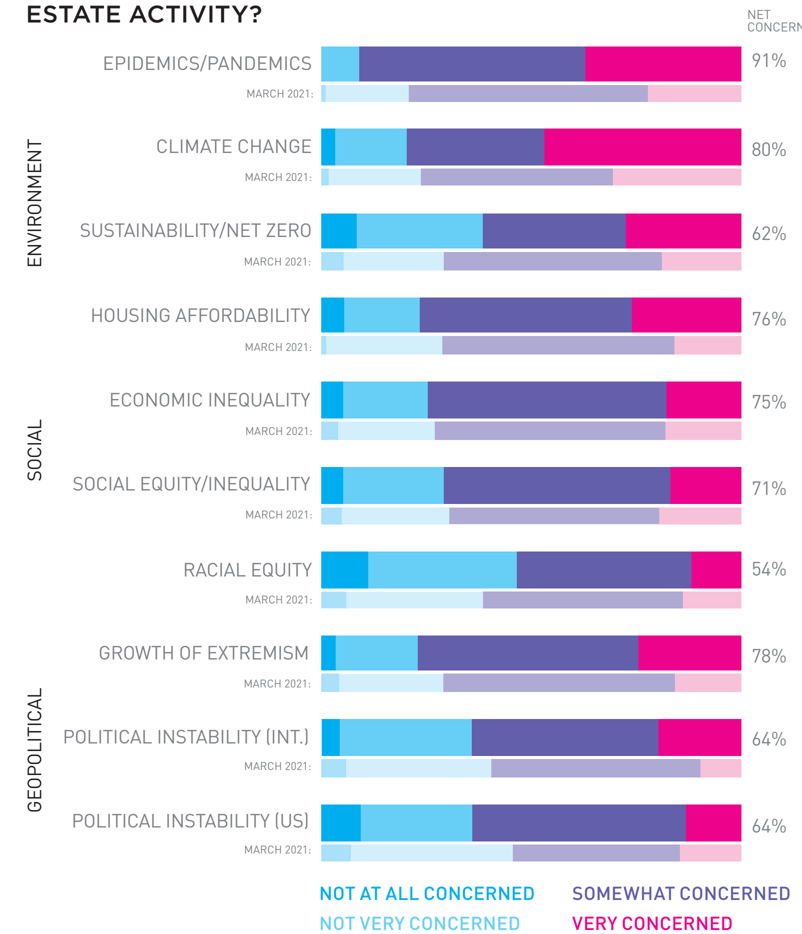
Concerns around climate change, affordable housing, and economic and social inequity also saw slight increases in concern, though concerns about pathways towards progress in these areas (e.g., sustainability and racial equity) saw moderate declines. However, concerns related to political instability and extremism, globally and in the US, have increased over the past several months.

RISK MANAGEMENT

In the face of evolving concerns across business, real estate, and socio-political conditions, risk management has become increasingly critical, especially as our dominant areas of risk—including those related to political, social, climate, and technological concerns—also threaten to be novel in their manifestation (e.g., large-scale climate events, malicious ransomware, disease strains, etc.)

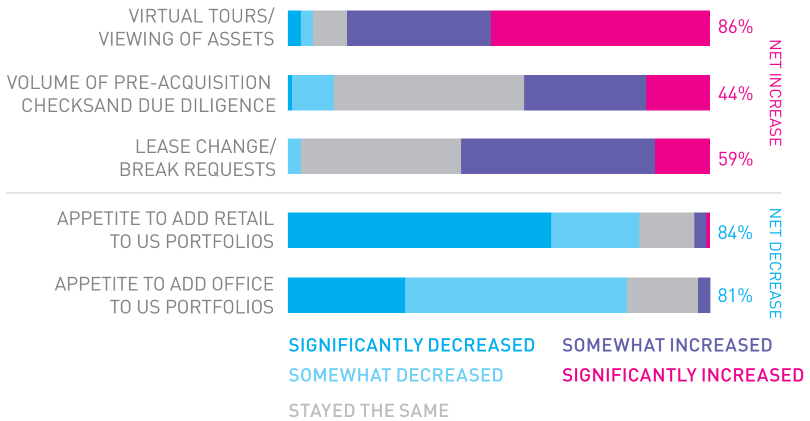
This prioritization of risk management has seen notable changes in standard real estate practices, such as due diligence and lease negotiation processes, as well as appetites for adding retail and office assets to US portfolios (net decrease of 84% and 81%, respectively). Similarly, political and economic risks are forecasted to have the greatest impact on US real estate over the next decade.

EXHIBIT 3: HOW CONCERNED ARE YOU ABOUT THE FOLLOWING FACTORS ON YOUR US REAL ESTATE ACTIVITY?



Risk management has become increasingly critical, especially as our dominant areas of risk—including those related to political, social, climate, and technological concerns.

EXHIBIT 4: HOW HAVE YOUR PRACTICES OR APPETITES CHANGED RE: US REAL ESTATE OVER THE PAST TWO YEARS?



The primary risks detailed in this survey focused on four key areas:

(1) *environmental risk* (e.g., rising sea levels, weather events, etc.)

(2) *technological risk* (e.g., phishing, malware, ransomware, etc.)

(3) *political risk* (e.g., changing tax landscape, regulatory changes, etc.)

(4) *societal risk* (e.g., civic unrest, labor issues, etc.)

Environmental risks rank the highest almost universally across all three areas, with 83% stating that these risks will affect potential investment value and nearly 60% forecasting climate-related threats to their assets and operations. And consistent with sentiments expressed elsewhere, political issues pose similar degrees of risk, with 87% finding value affected and 75% forecasting a threat to assets and operations.

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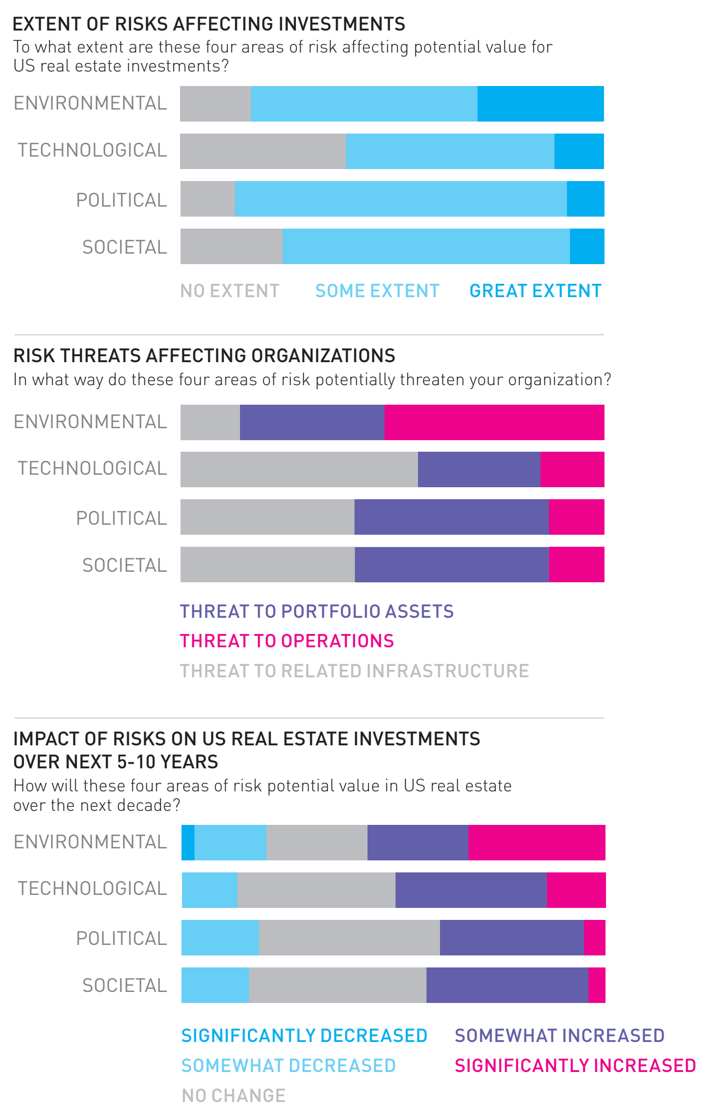
EXHIBIT 5: EXTENTS AND IMPACTS OF KEY RISKS

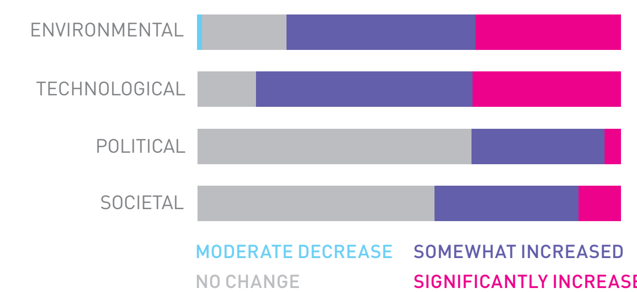


85% of respondents anticipate an ever-accelerating application of technology in the industry, as well as a greater demand for technology.

Because environmental risks rank among the highest areas of concern for investors, respondents also signaled an 78% net increase in risk management expenditures over the next decade. This is led by a forecasted 86% increase in technology and cybersecurity-related spending over that same period. Alternately, anticipated extra spending for political and societal risks is more modest, perhaps reflecting their more immaterial nature.

These increased expenditures are an extension of how respondents are forecasting broader technological, cultural, and consumer changes over the next decade. For example, 85% of respondents anticipate an ever-accelerating application of technology in the industry, as well as a greater demand for technology. And no matter the nature of risk, most respondents (79%) also expect higher insurance premiums in all areas.

EXHIBIT 6: CHANGE IN EXPENDITURE TO MANAGE RISK



FUTURE TRENDS

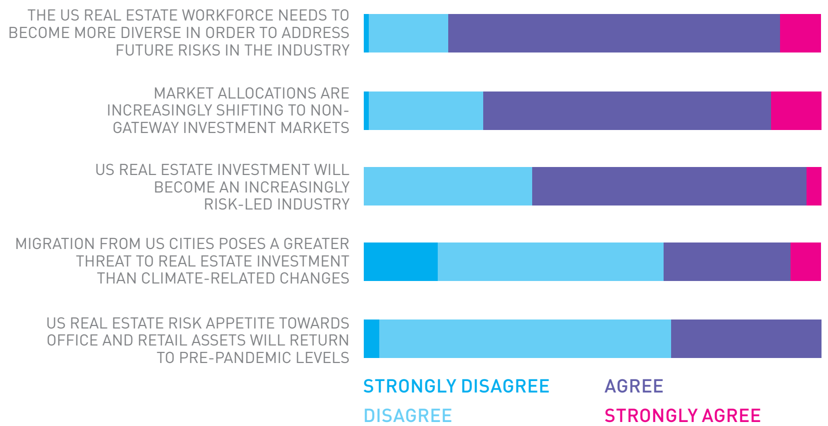
AFIRE's Future Committee is comprised of leaders within the association's global membership and focuses on trends that will help understand the future of real estate investing beyond the visible horizon. For this section of the survey, respondents rated "future factors" likely to have the most significant impact on their investments for the next decade.

Political issues and climate change will be top-of-mind for investors in over the next decade. The connection between workforce diversity and risk management (with 81% agreed) will be critical to future performance, as will the ongoing prioritization of allocations in non-gateway investment markets (74% agreed).

EXHIBIT 7: FUTURE TRENDS AND KEY FACTORS FOR THE NEXT DECADE OF COMMERCIAL REAL ESTATE

FUTURE TRENDS IN REAL ESTATE

To what extent do you agree or disagree with the following statements?



KEY FACTORS FOR US REAL ESTATE OVER THE NEXT TEN YEARS

What changes will shape US investor risk policies over the next decade?
(Number of respondent mentions by theme:)

POLITICAL ISSUES 24
"Increasingly aggressive tax policies or government overreach/regulation may affect real estate income, but these issues have always been with us."
"Growing political instability may increasingly de-stabilize both fiscal and monetary policy."

CLIMATE CHANGE 23
"Investors who are behind on climate-related risks will face disproportionate insurance burdens, losses, and asset obsolescence."
"Regions experiencing sustained economic growth will dominate the thinking of most smart investors over the next decade."

ESG 12
"ESG will become a prime driver of capital flows, as opposed to a checklist item today."
"There will be a need for stronger governance and transparent reporting, including ESG matters."
"Risk policies will evolve based on the adoption of ESG mandates, and managing tax burdens."

DEMOGRAPHICS 10
"Changing behaviors of customers and workforce will have the greatest impact on investor risk policies."
"The biggest issue will be the lasting effects of work from home and general reduced office demand. It will have negative ripple effects for major coastal cities and CBDs."

CYBERSECURITY 7
"Increasing cyber attacks, climate change, increasing social and economic inequality, increasing regulation."
"Better cybersecurity, better actions to combat global warming, and better ESG standards."
"The main risks include potential tax regimes, and cyber crimes."

In the various Venn diagrams that could be construed for many of the risk categories and future outlooks detailed in this survey, a four-dimensional model would be needed to fully articulate the interrelationship of the issues affecting long-term value commercial real estate within and beyond the US. For example, as detailed in *Exhibit 7*, respondents overwhelmingly agree that the US real estate workforce needs to become more diverse to address future risk—including simple reputational risk that could affect a company that lacks a diverse workforce.

But at the same time, the calculus for diverse talent development, recruitment, and retention is related to (and informed by) the same economic conditions, political attitudes, and technological trends that are otherwise fanning uncertainties at other tiers of the commercial real estate ecosystem.

Such complexities are inherent in real estate, and savvy investors are those able to find clarity amidst uncertainty. As such, this close-in look at the subtle changes in investor attitudes over the past year ultimately provides an up-to-date snapshot of how the global institutional real estate investor community is thinking about the future: still optimistic, still focused, but even more careful—a shift that is certainly warranted during these challenging times.

> Savvy investors are those able to find clarity amidst uncertainty.

ABOUT THE AUTHORS

Gunnar Branson is the CEO of AFIRE and the publisher of Summit Journal. Benjamin van Loon is Communications Director for AFIRE, and Editor-in-Chief of Summit Journal.

NOTES

The 2021 AFIRE International Investor Survey Report and Mid-Year Pulse Report are underwritten by Holland Partner Group.

[1] AFIRE. "2021 International Investor Survey Report." AFIRE (April 2021), https://www.afire.org/of-note/2021afiresurvey/

[2] Members of AFIRE represent nearly 190 organizations from 23 countries, with approximately US$3 trillion in assets under management (AUM). The mid-year pulse survey collected insights from 76 executives representing unique organizations within and beyond the AFIRE membership. Regional participation in the data collection was broadly in line with AFIRE's overall membership profile, which includes institutional investors, fund and investment managers, family offices, publicly listed companies, and related services. More than half of the respondents to the August 2021 pulse survey also participated in the annual survey, conducted in March 2021.