AFIRE INVESTOR SURVEY Q3 2023 PULSE REPORT

UNDERWRITTEN BY HOLLAND PARTNER GROUP

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ABOUT AFIRE

AFIRE is the association for international real estate investors focused on commercial property in the US.

AFIRE is an essential forum for real estate investment thought leadership – AFIRE members gather throughout the year to help each other become Better Investors, Better Leaders, and Better Global Citizens through conversations, research, and analysis of real estate capital markets, cross-border issues, policy, economics, technology, and management. Representing the "who's who" in the global real estate investment industry, AFIRE membership is exclusive to principals and senior executives.

For more than thirty years, AFIRE has produced this annual international investor survey as a tool for investors, regulators, and the media to understand the goals, challenges and impacts of international investments on US real estate opportunities.

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NOTE FROM CEO

OCTOBER 9, 2023

For more than thirty years, the AFIRE International Investor Survey has gathered the opinions of AFIRE members, comprised of 185 institutional investors, pension funds, asset managers, and other leading global organizations from two dozen countries with approximately US$3 trillion AUM.

The results of this pulse report taken before the final few months of 2023 help clarify the goals, challenges, and issues facing the international commercial real estate investor in the US. The survey was administered by the PwC LLP research team and guided by the AFIRE Research Committee.

Geopolitical and economic forces have affected the portfolios of institutional real estate investors over the last year. Their outlook and concerns certainly reflect that new reality. This is a time of extraordinary challenge and meaningful change. Respondents told us that one-third of existing office properties will need significant upgrading to meet future occupancy expectations. Eighty-two percent of investors report rising insurance premiums and reduced availability in some regions may prevent investments.

To illustrate the level of change currently considered, 90% of investors forecast converting some of their US office assets to residential in the next five years. At the same time, they are also considering conversions to hospitality, industrial and potentially even vertical farming. ESG continues to be a strong driver of investment and governance strategies.

Collectively, these and other findings reported here illustrate that despite the uncertainties and volatility of our current economic and geopolitical environment, global institutional investors are continuing to work through this time of change, are committed to continuing their cross-border activities, and are preparing for a brighter future.

These may be difficult times, but not without opportunity for those who can focus on the long term.

Gunnar Branson
CEO
AFIRE

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EXECUTIVE SUMMARY

For more than thirty years, the AFIRE International Investor Survey has gathered the opinions of AFIRE members, comprised of 175 institutional investors, pension funds, asset managers, and other leading global organizations from nearly two dozen countries with approximately US$3 trillion AUM.

The results of this semi-annual process produce this benchmark report; a useful tool for understanding the goals, challenges, and long-term thinking underscoring the international view of commercial real estate opportunities in the US.

This latest survey was conducted by PwC Research from August 14 to September 3, 2023, and captured 100 responses from across the AFIRE membership (p. 4).

Responses show how significant uncertainties persist for the commercial real estate landscape, but institutional investors, who benefit from a long-term horizon, see opportunity to realign their portfolios to meet the shift in asset class demands—especially towards the continued need for a greater volume of residential properties in US cities (p. 6).

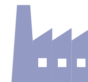
The "office question" is also top-of-mind for respondents, with nine in ten forecast converting existing office properties to residential in the next five years. In addition, survey respondents believe that more than a third of office assets within their US portfolios will require upgrading to meet future occupancy demands for enhanced health, sustainability, and work style amenities (p. 8).

In addition to questions around asset performance, respondents are increasingly citing rapid rises in insurance premia, alongside insurance pullbacks from several US markets at risk for climate-related events, as a significant factor in future investment decision-making (p. 9). But amidst these changes, gateway market central business districts (CBDs) and suburbs stand to fare better than secondary and tertiary markets (p. 7).

Importantly, questions around the governance side of environmental, social, and governance (ESG) performance are coming to bear in this context. Nearly half (43%) of US-based investors are Principles for Responsible Investing (PRI) signatories, rising to 53% among non-US investors, while a combined 27% adhere to Global Reporting Initiative (GRI) governance standards (p. 10). Fully 80% of all respondents believe their company has the skills needed to increase diversity and that acting on DEI requirements will deliver significant ROI (p. 11).

$3 TRILLION
Assets under management (p. 4)

34% NET INCREASE
US real estate allocation (p. 4)



32% NET INCREASE
portfolio value for alternative real estate (p. 6)

52% CONVERSIONS AND UPGRADES
for existing office assets (p. 8)

82% RISING INSURANCE PREMIA
To impact investment decisions (p. 9)

80% NECESSARY SKILLS
for implementing DEI standards (p. 11)

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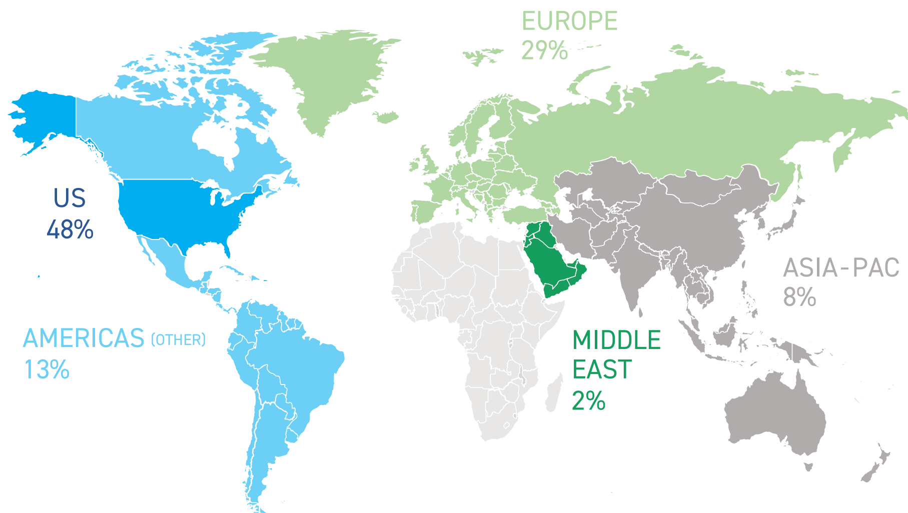
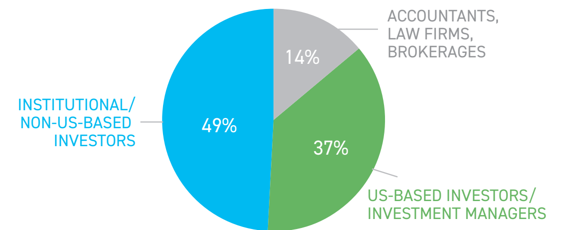
RESEARCH OVERVIEW

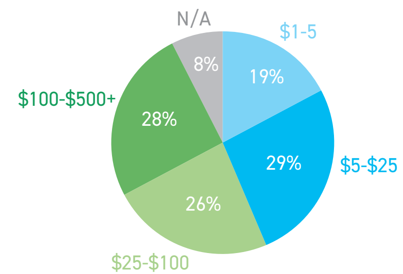
The findings in this report were collected from an online survey conducted by PwC Research from August 14 to September 3, 2023, employing a dual online methodology via direct invitation and open registration. The survey received 100 responses from AFIRE member representatives primarily responsible for real estate investment activities within their respective organizations.



COMPANY'S PRIMARY ACTIVITY



ASSETS UNDER MANAGEMENT
($ BILLIONS)



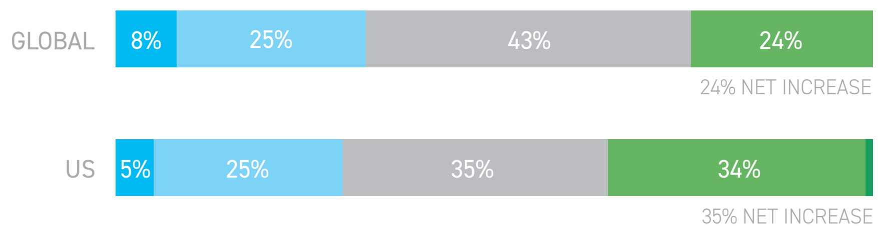
PORTFOLIO OUTLOOK

Respondents were asked to weigh their forecasted real estate investment allocations for 2023 against their actual deployment through the year. One in three respondents initially expected to increase US investment in 2023, though only one in five met this goal.

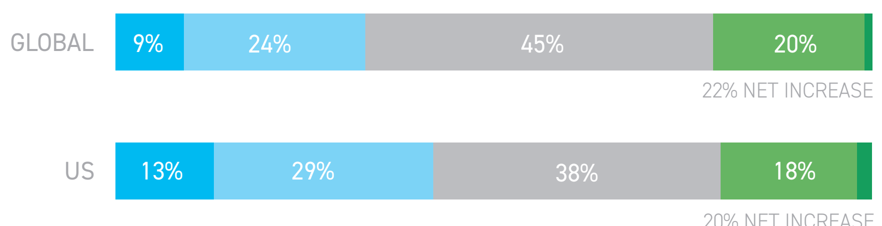
AFIRE's previous survey indicated that 25% of non-US-based investors forecasted a net decrease in their US portfolio compared to 36% of US-based investors, though as indicated here, 51% of non-US-based investors have decreased their US portfolio allocations compared to 31% for US-based investors.

HOW DO YOU EXPECT REAL ESTATE ALLOCATIONS TO CHANGE IN 2023 . . .

. . . IN THE OVERALL MARKETS?



. . . IN YOUR FIRM'S PORTFOLIO?



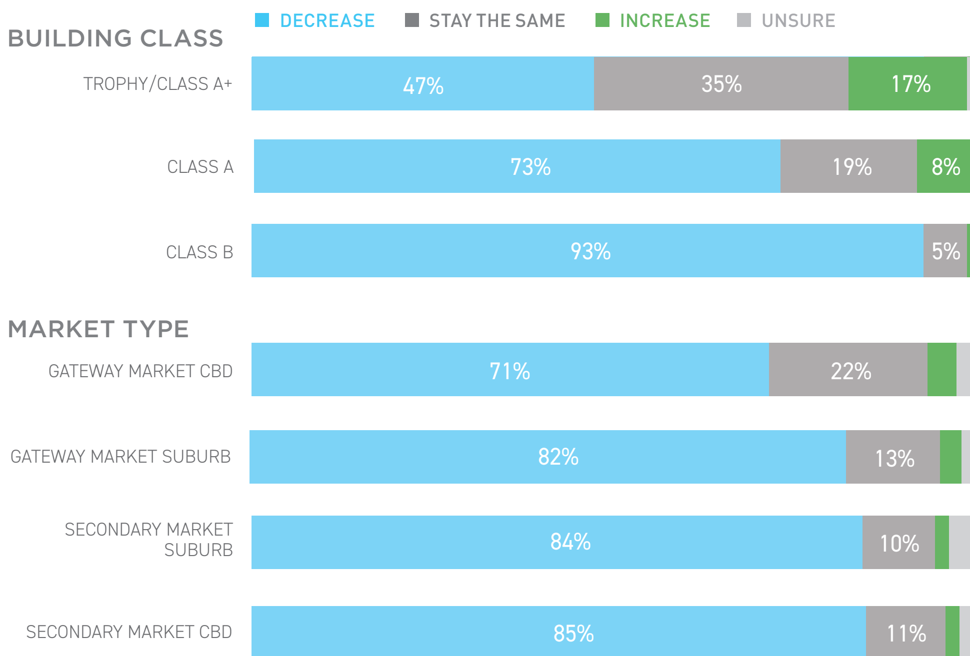
CHANGING VALUES

The question on the mind of all commercial real estate investors remains: what's next for **office**?

Consensus from all respondents is a universal decline in **office** asset values over the next twelve months—starkest for Class B assets (93% agreement for declining values) but affecting Trophy and A+ assets, as well, with 47% forecasting a decline in such assets, tempered by a third (35%) expecting no changes.

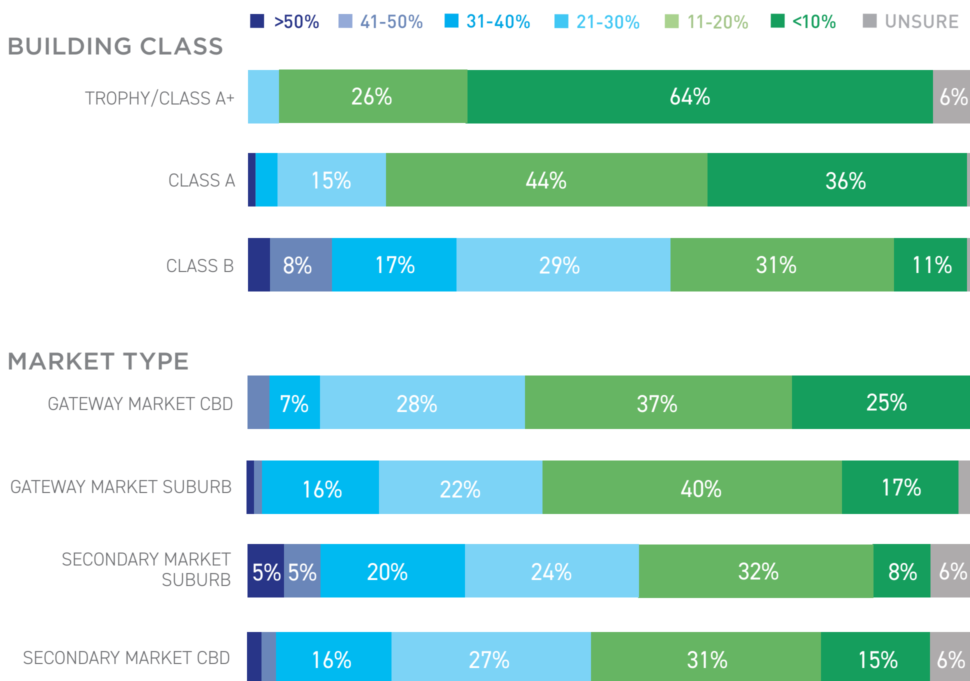
Of course, there are nuances to this loss. Specifically, investors expect slightly less value lost in **gateway market central business districts** (CBDs), with 71% forecasting a decrease, compared to 85% forecasting the same decrease in **secondary market CBDs,** which were previously saw an uptick in valuation and investor attention through the pandemic era.

HOW WILL OFICE VALUES CHANGE IN THE US MARKET OVER THE NEXT 12 MONTHS?



While the forecasts for lost or reduced value initially seem stark, the survey also asked respondents to rank the severity of the decline. As expected, Class B assets will see the greatest impact, with six in ten respondents forecasting a decline of more than 20%. Class A fares slightly better, while 64% of respondents expect a modest decline of *up* to 10% for Trophy and Class A+ assets, with assets located in secondary market CBDs and suburbs seeing the greatest loss of value. Gateway market CBDs and suburbs will be affected—but not to the same degree.

TO WHAT EXTENT WILL VALUES DECREASE?



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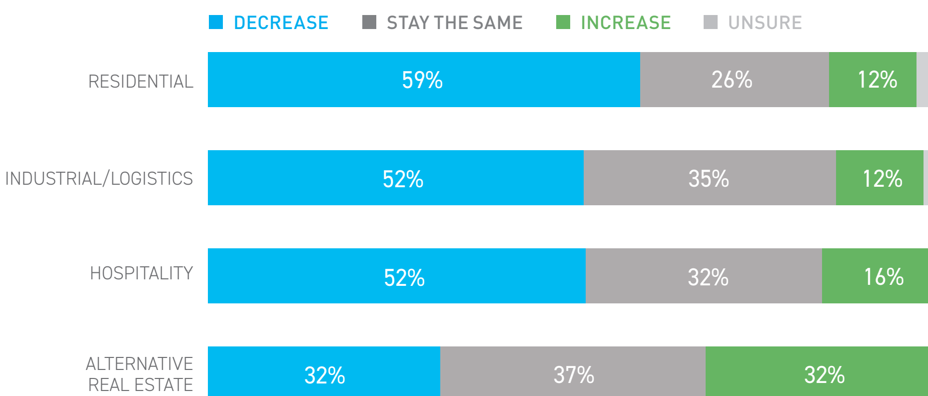
CHANGING VALUES

Just as investors are expecting a near-universal decrease in office values over the next twelve months, respondents are also offering a realistic forecast for how values might change in other asset types over this same period. For example, six in ten respondents who hold **residential** assets in their US portfolios expect those values to decrease over the next year.

Respondents also forecast nearly equivalent declines (52%) and predicted stabilities (around 33%) in both **industrial/logistics** and **hospitality** assets. But alternative real estate—which includes **data centers, self-storage, senior housing,** and other niche real assets—offers a rosier outlook, including 32% forecasting an increase in such assets.

Indicatively, non-US investors are more optimistic about the value of their current US alternative real estate holdings (40% forecast an increase in value in the next twelve months, compared to 22% for US investors). However, the reverse is true for their current US industrial/logistics portfolio (59% of non-US-based investors forecast a decrease in value, compared to 43% for US investors).

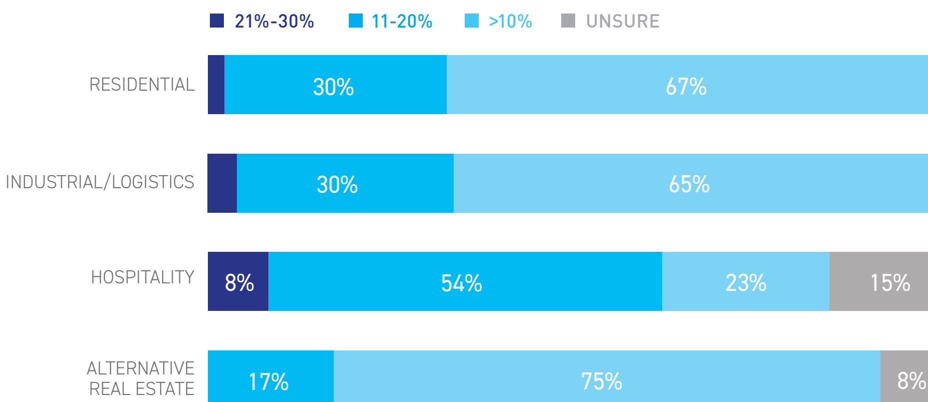
WHAT CHANGE DO YOU PREDECT IN YOUR PORTFOLIO VALUE OVER THE NEXT 12 MONTHS?



Of those anticipating a decline in value in their company's current US residential or industrial/logistics portfolios, one in three forecast this to be more than 10%.

Respondents generally agree that hospitality will see the greatest loss of value—but this class also offers the greatest amount of uncertainty, with 15% unsure on the outlook for the sector.

TO WHAT EXTENT WILL THESE VALUES DECREASE?



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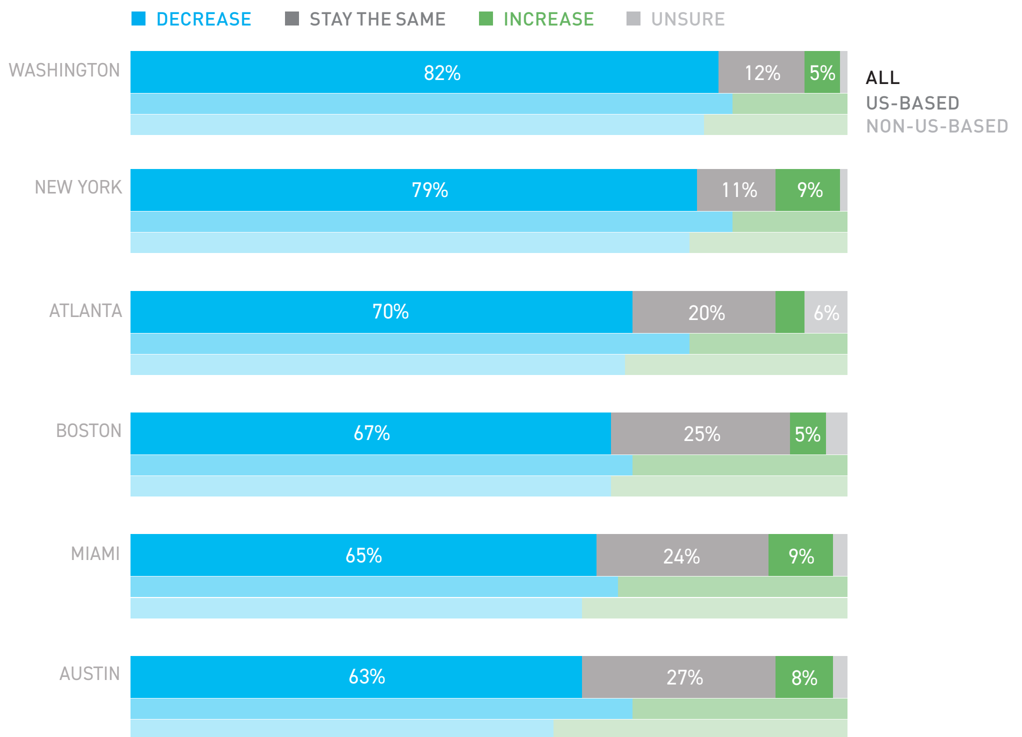
US CITIES

Diving deeper on the nuances between **gateway and secondary market forecasts,** the survey asked respondents to rank the impact on valuation in several **US cities** identified in the most recent AFIRE survey as the top destinations for commercial real estate investment.

As such, eight in ten forecast a decline in office values in Washington and New York over the next twelve months, with 70% forecasting similar decline in Atlanta, 67% in Boston, and the Sun Belt cities of Miami and Austin being similarly affected.

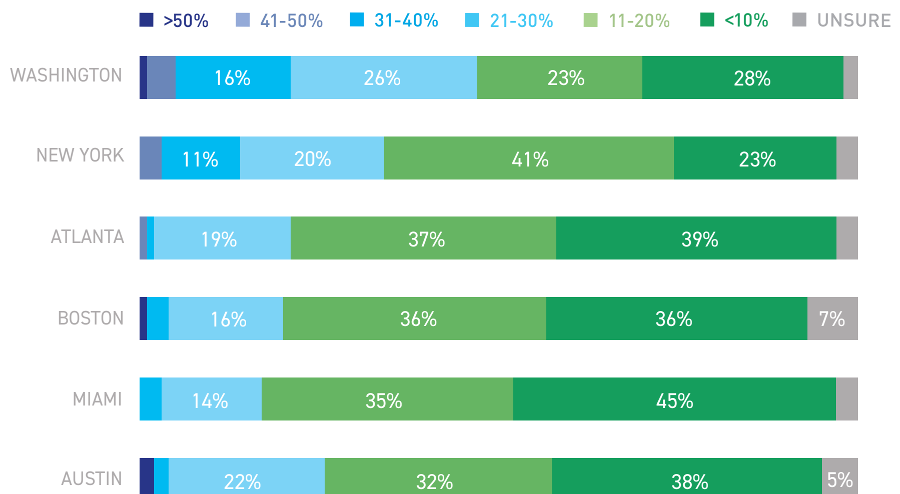
US-based investors appear more likely than their international peers to expect a decrease in office values—particularly Austin (70% vs 59% overall). And when asked if there are any other key US cities they wished to comment on relating to a change in office value, many respondents pointed to the west coast, noting that Seattle, Los Angeles, and San Francisco are under similar threat.

OF THE TOP US CITIES FOR INSTITUTIONAL INVESTMENT IN THE US, HOW WILL OFFICE VALUES CHANGE OVER THE NEXT 12 MONTHS?



The level of such decline largely depends on conditions within a particular geographic market. For example, investors anticipate the level of decline in office value to be higher in Washington, DC (>20%) than in other geographies—because the region has a high concentration of government tenants that continue to struggle with occupancy and return-to-office policies.

TO WHAT EXTENT WILL THESE VALUES DECREASE?



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THE CONVERSION QUESTION

The decline in **office** valuation—which some investors have been forecasting for years—belies a more fundamental force at play: history.

As much as "office" represents a distinct type of real asset, it also emblemizes a centuries-old philosophical concept around building design and use: you live your life at home, and you work at the office. But now, the rapid technological evolution that has transformed our physical and social world over the past few decades—exacerbated by pandemic-era policies and attitude shifts—is finally playing out in the built environment. Offices built to suit twentieth century attitudes and lifestyles (that is, the majority of US office stock) are already philosophically obsolete, with real and forecasted valuations signaling the same.

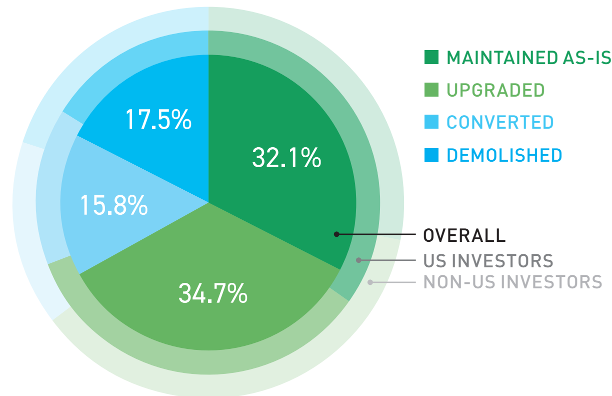
In this way, the "future of the office" question simultaneously becomes a **conversion** question. We can't turn back the clock philosophically, so how can these assets—including formerly emblematic trophy assets in many cities—continue to generate value for a new historical era?

Respondents already believe a third of office portfolio in the US needs to be **upgraded,** with US-based investors slightly inching out international colleagues in the need for **demolition,** in some cases.

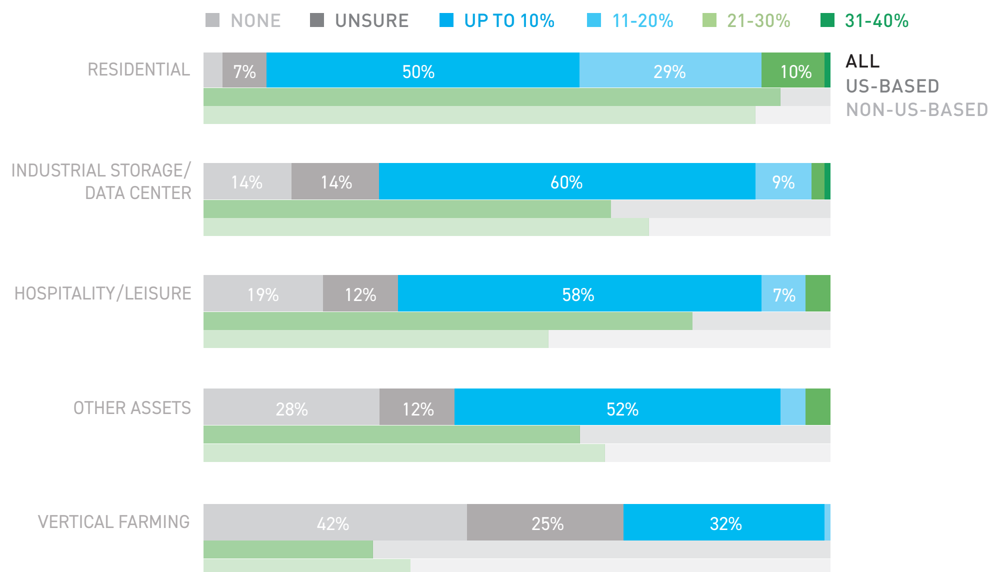
And of those office assets slated for transformation, nine in ten respondents forecast that the majority will be converted to residential over the next five years. Office assets are also more likely to be transformed into industrial storage and data center purposes, or other hospitality and leisure purposes.

Interestingly, respondents also suggest other types of conversion could include building transitions to focus on **life science** applications, **event venues, self-storage,** and even **vertical farming,** which also offers notable potential for job creation and food accessibility—two significant challenges outside the real estate sphere presently impacting quality of life in many US cities.

WHAT NEEDS TO HAPPEN WITH THE MAJORITY OF US OFFICE STOCK?



WHAT TYPES OF OFFICE CONVERSIONS WILL WE SEE THE MOST OVER THE NEXT FIVE YEARS?



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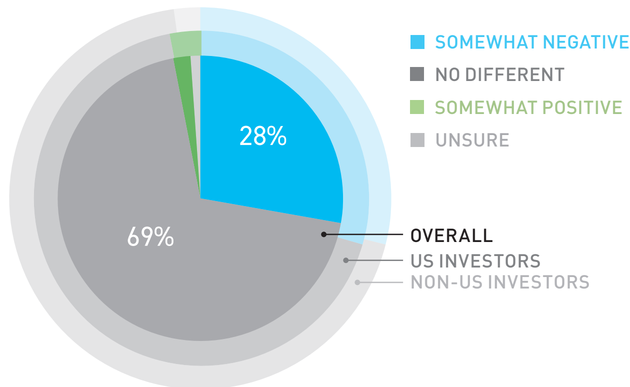
CREDIT AND INSURANCE

In summer 2023, Fitch Ratings downgraded the long-term **credit rating** of the US government from AAA to AA+, citing several economic and social factors, including "soft" influences, such as ongoing political turmoil.

The downgrade initially saw a ripple of uncertainty spread across various business media, so the survey asked respondents to rank the impact of this downgrade on their US investment strategies. More than two thirds of the respondents believe that the downgrade will have no impact on foreign investment into US real estate.

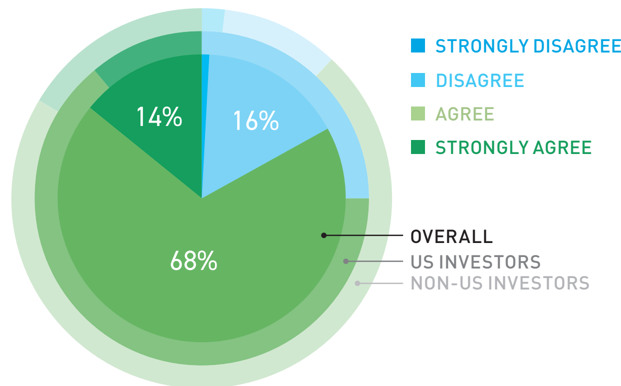
WHAT IMPACTS WILL WE SEE ON US INVESTMENT DUE TO RECENT DOWNGRADES OF THE US LONG-TERM CREDIT RATINGS?



Credit is far less of a concern for investors than **insurance.** Notably, four in five respondents agree that **rapidly rising insurance premia and/or declining insurance availability** may prevent their company investing in certain US regions. Non-US investors are more likely to agree on this point (88%), compared to US-based investors (75%).

According to recent research from First Street Foundation, nearly 39 million homes and commercial properties in the US—more than a quarter of all properties in the lower 48 states—are at risk of rising insurance costs, especially as insurers face a growing deluge of post-disaster expenses.

RISING INSURANCE PREMIUMS AND/OR DECLINING INSURANCE AVAILABILITY MAY PREVENT INVESTMENT INTO CERTAIN US REGIONS



39 million homes and commercial properties in the US—are at risk of rising insurance costs

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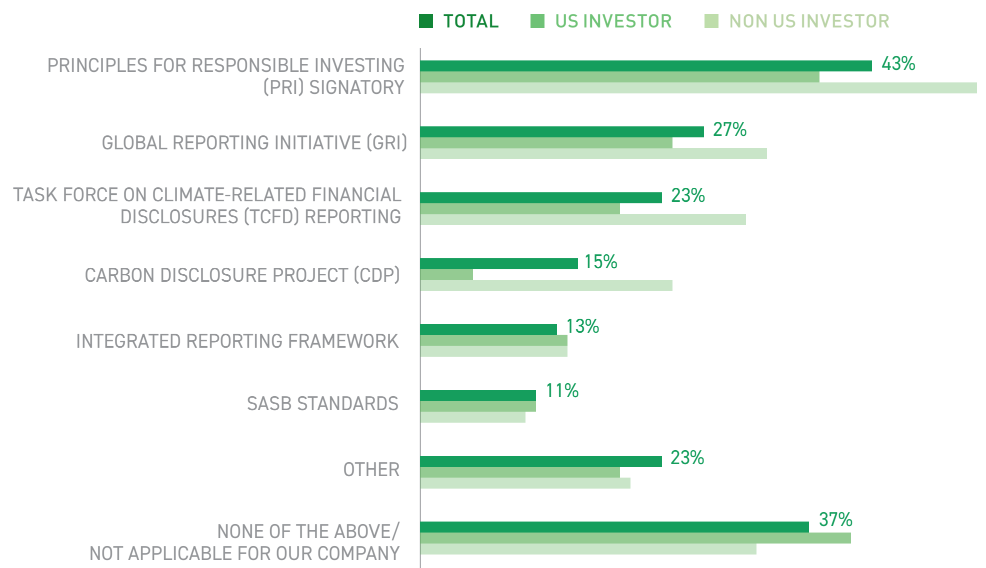
ESG
GOVERNANCE

While the environmental aspect of environmental, social, and governance (ESG) performance has been well documented in commercial real estate, and while questions remain around quantifying social metrics, there is less research on how companies approach **governance**—arguably the least appreciated but most influential pillar of the ESG foundation.

To venture a deeper dive into governance, the survey asked respondents to rank, broadly, how they demonstrate adherence or leadership in governance standardization. Two in five respondents meet this by serving as signatories for Principles for Responsible Investing (PRI). This number rises to more than 50% for non-US-based investors.

The Global Reporting Initiative (GRI) and reporting to the Task Force on Climate-related Financial Disclosures (TCFD) also serve as leading standards, while other respondents also cited WEF Stakeholder Capitalism Metrics, GRESB, Energy Star, and others—even as more than a quarter of respondents cited either no governance standards or indicated non-applicability for such standards.

CURRENT ADHERENCE TO GOVERNANCE STANDARDS

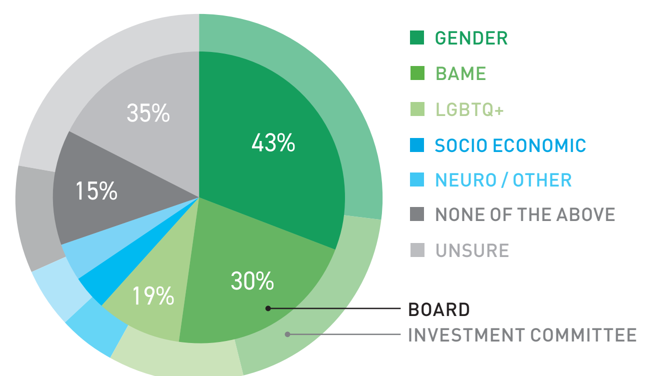


Governance is ultimately about leadership, and the past few years have seen questions around the diversity of leadership (i.e., economic, racial, educational, and other types of diversity) emerge into mainstream conversation. For example, there is general agreement that the leadership of an organization should look like the people it serves—especially for leaders of the built environment—but how this agreement plays out in reality varies widely.

The survey asked respondents if their companies have specific policies or efforts to ensure more **diverse representation** on their **boards** and **investment committees.** The findings show that respondents are more likely to have policies supporting gender and Black, Asian, and minority ethnic (BAME) diversity, compared to LGBTQ+, socio-economic, neurological or other types of diversity policies.

Non-US investors are more likely to have specific diversity policies or have representation of these categories on their board, particularly with regards to gender (47% compared to 35% for US investors). Non-US investors are also more likely to have a specific LGBTQ+ policies or have such representation in their investment committees (20% compared to 3% for US investors).

POLICIES/EFFORTS FOR REPRESENTATION ACROSS DEI CATEGORIES



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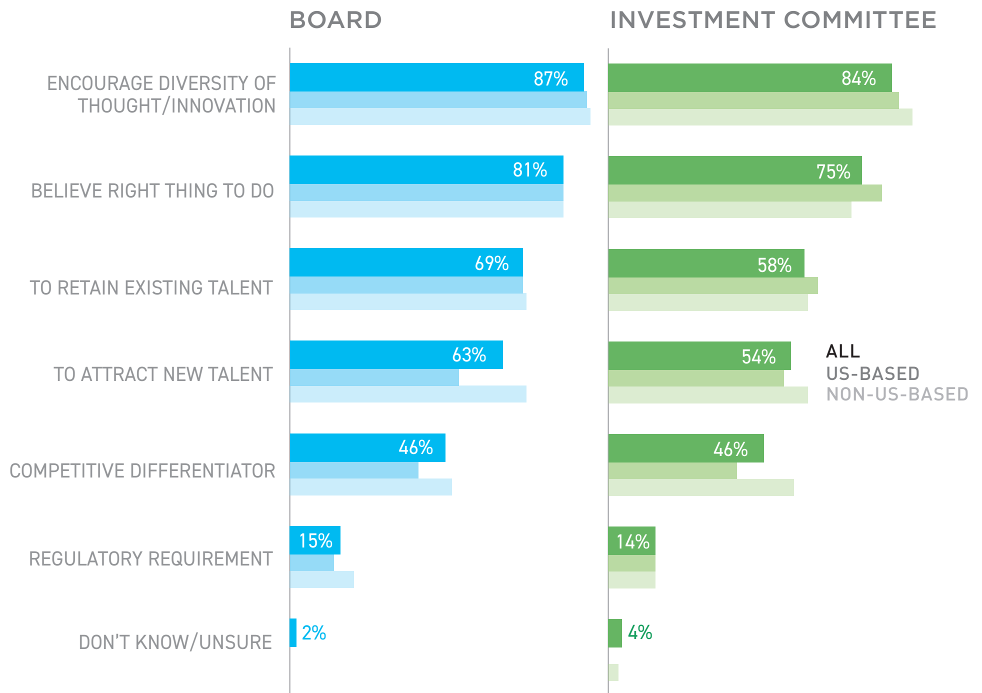
ESG
DEI TRENDS

Drilling deeper on diverse representation in leadership (i.e., governance), the survey asked respondents to state why they do or do not have **policies for supporting board and investment committee diversity.**

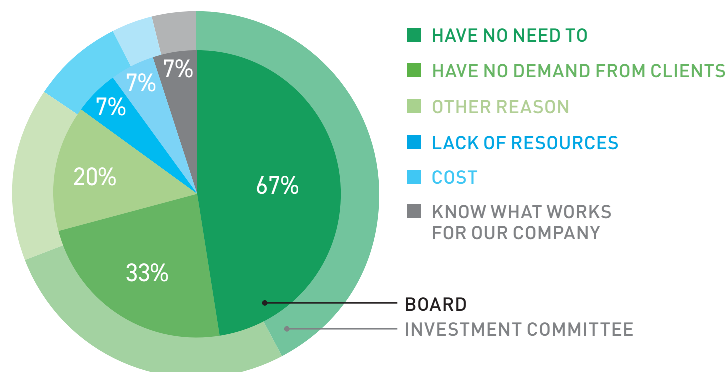
The majority of respondents (80%+) agree that encouraging diversity of thought and innovation is a primary driver for DEI policy implementation in boards and investment committees. Increasingly, these policies are also important for attracting new talent, but moreso on boards (63%) than investment committees (53%).

Alternately, companies cite a lack of need or demand for having any such board and investment committee policies in place. Cost and lack of resources also impact the development or implementation of such policies, but to a far lesser degree.

REASONS FOR HAVING A SPECIFIC POLICY OR MAKING EFFORTS TO HAVE REPRESENTATION ACROSS DEI CATEGORIES



REASONS FOR NOT MAKING EFFORTS IN REPRESENTATION ACROSS DEI CATEGORIES



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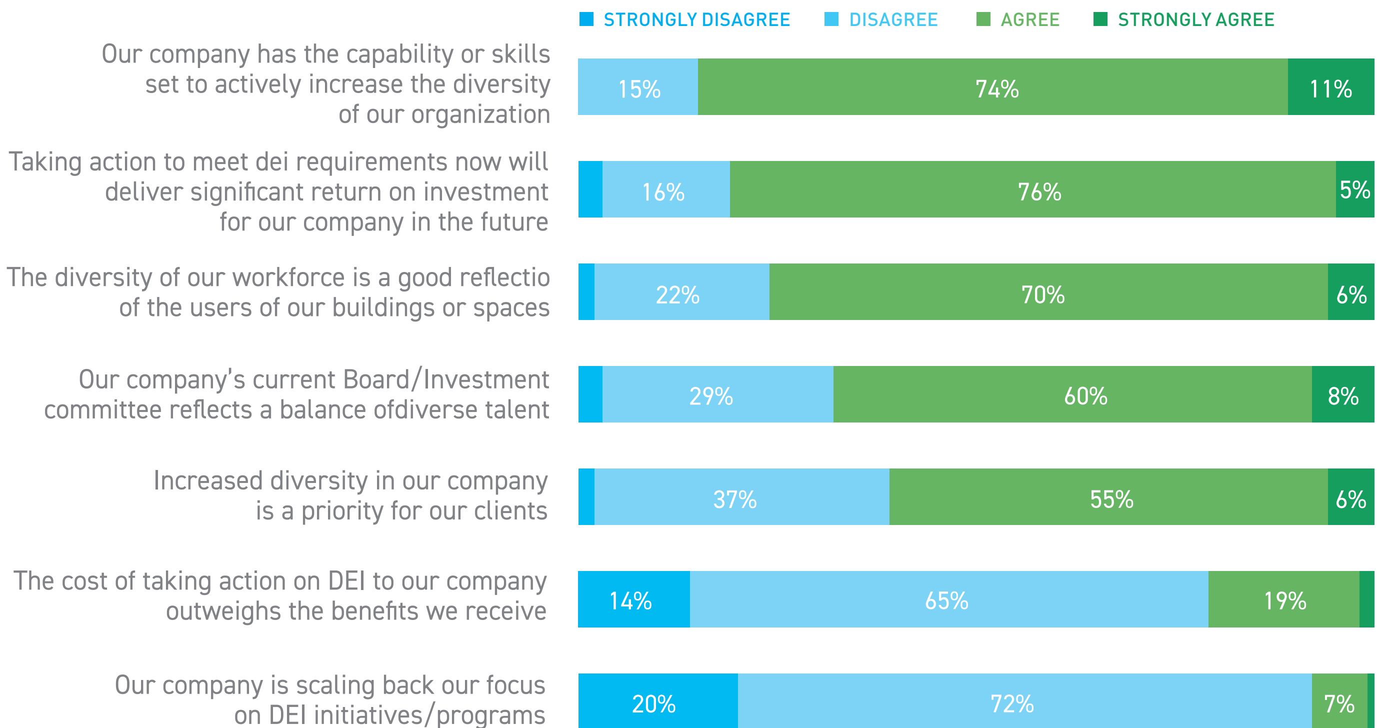
ESG
DEI TRENDS

DEI practices and policies are continually evolving, such that the findings from this survey will ultimately serve as a snapshot of this particular period in commercial real estate, highlighting how **attitudes around DEI continue to evolve.**

For example, eight in ten agree their company has the skill set to actively increase diversity of their organization and taking action to meet DEI requirements will deliver a significant ROI.

ATTITUDES TOWARDS DEI



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ABOUT

ABOUT HOLLAND PARTNER GROUP

Founded in 2000, Holland is a fully integrated real estate investment company developing high-quality investment properties in the Western United States, with expertise in development, construction, acquisition, redevelopment and property management. Holland creates sustainable, socially connected and vibrant communities to work, live and enjoy life. The company's seasoned 750-plus-member team creates innovative, quality, and value-driven residential and commercial projects, championing every phase of development and construction of its mixed-use properties, including residential, office, parking garages and retail assets. Headquartered in Vancouver, Wash., Holland has offices in Denver, Seattle, Southern California, Northern California, and San Diego. Learn more at hollandpartnergroup.com

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ABOUT AFIRE

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Dialogue fostered by AFIRE is designed to help members gain competitive advantage through strategic and operational thought leadership, and to help improve the global real estate investment industry.

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