PART II: ALLOCATING TO ALTERNATIVES

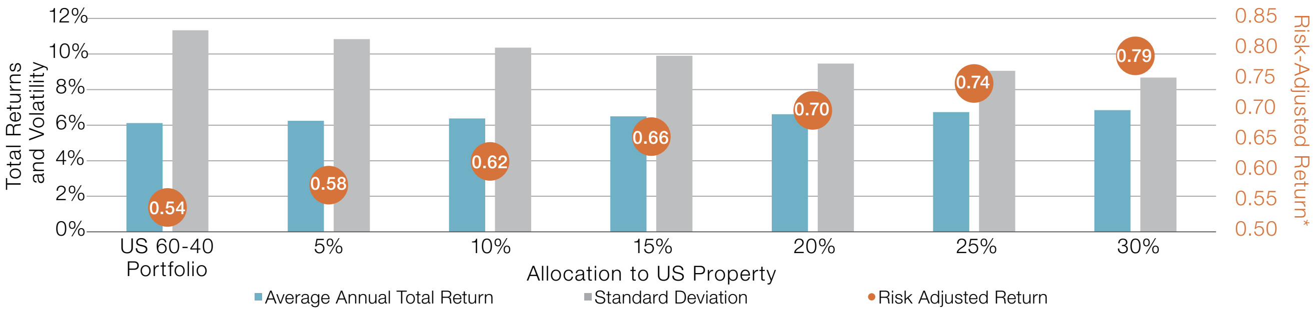
Diving into the Data

While investment allocation is an inexact science, there is a view that private wealth portfolios could soon have as much as 30% allocated to alternatives, with equities and bonds making up the other 70%.[1] The bucket known as alternatives is quite broad, and generally will include private market corporate equity, real estate debt and equity, and infrastructure. Certainly, not all investors adhere to the traditional 60%/40% mix of stocks and bonds, and many are likely to have already invested in some form of alternatives. However, this analysis begins with the 60/40 split as a reasonably illustrative portfolio. In this exercise, real estate will be competing with other alternatives, but the question to be answered is whether a real estate allocation historically has enhanced portfolio performance and what would have happened if the allocation were expanded.

Using return data from a single source to make all analyses comparable, we calculated the impact of adding U.S. direct-owned private real estate, as represented by the MSCI US Annual Property Index, to the traditional 60/40 portfolio. Annual returns were used in an effort to avoid understating the normal volatility of private real estate (i.e. to "de-smooth" the results). We found that because private real estate has historically recorded lower volatility (including to the downside), and competitive total returns, the data showed that every 5% incremental increase in U.S. property allocation both increased returns (real estate's equity-like characteristics supplanting the poorer return performance of bonds) and decreased volatility (real estate's more bond-like stability supplanting the higher volatility of equities) all the way up to 30%, the aforementioned assumption for an alternatives allocation, as shown in Exhibit 7. Risk-adjusted returns, here defined as return divided by risk, so "return per unit of risk," understandably increased every step up as well.

Exhibit 7

A 60/40 U.S. Stock and Bond Portfolio with U.S. Direct-Owned Private Real Estate added in 5% Increments



Past performance cannot guarantee future results.
Source: MSCI, Standard & Poor's, Bloomberg, Hines Research. As of Q4 2022 for the period from 2001 – 2022. We are using an annual index (MSCI Global Annual Property Index) of direct-owned private real estate total return performance from a single source to maintain comparability. For all country level indices provided by MSCI and included by MSCI in the Global Property Index, including the US (MSCI US Annual Property Index) utilized here, data is not yet available for 2023. *Risk-adjusted returns are calculated by dividing the total return by the standard deviation of rolling annual returns over the same period.

IN THIS PAPER, "WE" AND "OUR" REFERS TO HINES PROPRIETARY RESEARCH ("HINES RESEARCH").

[1] The Case for the 40/30/30 Portfolio, wealthmanagement.com, January 2024.

OUR TAKE ON A PRIVATE REAL ESTATE ALLOCATION

Notwithstanding the findings of Exhibit 7, we would not suggest adding a 30% allocation to private real estate. There are many other investment ideas under the alternatives umbrella to be considered in addition to a property allocation. To arrive at what might be considered a rational allocation, we triangulated by examining what a passive market weight allocation would be. This is a market-sizing exercise in which the total value of investible real estate relative to other asset classes would serve as a guide. Market size is a measure of a market's relative importance to investors – the scale of any given asset class is driven by the balance of supply (investible investments) and demand (investor flows). In effect, this is the allocation as determined by market forces. In a global context, the total value of invested direct-owned private commercial real estate is equal to just under 15% of the sum of global equities, bonds, and property itself as shown in Exhibit 8. This suggests that a 15% allocation might be appropriate.

Exhibit 8

Global Real Estate – A Key Asset Class[1]

POTENTIAL TO CONTRIBUTE TO:[2]

Income	Growth	Reduced Volatility	Inflation Protection	Portfolio Diversification	Risk Reduction

Sources: Bank of International Settlements, Hines Proprietary Research ("Hines Research") and World Federation of Exchanges.

[1] Market capitalizations: as of Q3 2022 for fixed income; global real estate and equities.

[2] There is no assurance that real estate investments will achieve capital appreciation, provide regular distributions or protect against inflation. The value of an investment in global real estate may seem less volatile because its value is not subject to the market pricing forces to which publicly traded investments are subject. An investment in global real estate is significantly less liquid than publicly traded investments and is not immune to fluctuations. Diversification does not guarantee a profit or eliminate the risk of loss.

LEARN MORE

Interested in further insights from Hines Research on real estate as an investment solution? Download our full whitepaper, Real Estate Investment Solutions, available at Hines.com/privatewealth.

ABOUT HINES' PROPRIETARY RESEARCH TEAM

Josh Scoville and his team, including Michael C. Hudgins, Senior Managing Director, the lead author on this paper, are responsible for constructing the Hines macroeconomic view and outlook for commercial real estate market fundamentals and pricing. Hines Research is also responsible for assisting with the development of investment strategies for the firm's investment programs; working closely with the local and fund management teams, clients and partners; and supporting U.S. regional and international country heads in identifying market/submarket opportunities and risks. The views of the local and fund management teams on the latest market developments are exchanged regularly via biweekly conference calls and quarterly market updates and are essential for reviewing investment strategies and fund portfolio allocations.

Additional members of Hines' Proprietary Research team include Ryan McCullough, James Purvis, Tim Jowett, Erik Thomas, Michael Spellane, and Anthony Witkowski.

Disclaimer

Past performance is no guarantee of future results. Investing involves risks, including possible loss of principal. The opinions presented herein cannot be viewed as an indicator of future performance.

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Endnotes

This paper contains information in the form of charts, graphs and/or statements that we indicate were obtained by us from published sources or provided to us by independent third parties, some of whom we pay fees for such information. Hines considers such sources to be reliable. It is possible that data and assumptions underlying such third-party information may have changed materially since the date referenced. You should not rely on such third-party information as predictions of future results. None of Hines Interests Limited Partnership ("Hines"), its affiliates or any third-party source undertakes to update any such information contained herein. Further, none of Hines, its affiliates or any third-party source purports that such information is comprehensive, and, while it is believed to be accurate, it is not guaranteed to be free from error, omission or misstatement. Hines and its affiliates have not undertaken any independent verification of such information. Finally this information should not be construed as investment, tax, accounting or legal advice. An investment cannot be made directly in an unmanaged index.

U.S. Unlevered Real Estate is represented by the NCREIF NPI, short for the NCREIF Property Index -- is a quarterly index tracking the performance of core institutional property markets in the U.S. The objective of the NPI is to provide a historical measurement of property-level returns to increase the understanding of, and lend credibility to, real estate as an institutional investment asset class. The universe of investments: (1) is comprised exclusively of operating properties acquired, at least in part, on behalf of tax-exempt institutions and held in a fiduciary environment; (2) includes properties with leverage, but all returns are reported on an unleveraged basis; and (3) includes apartment, hotel, industrial, office and retail properties, and sub-types within each type. The database fluctuates quarterly as participants acquire properties, as new members join NCREIF, and as properties are sold. Sold properties are removed from the index in the quarter the sales take place (historical data remains). Each property's market value is determined by real estate appraisal methodology, consistently applied.

FTSE Nareit Equity REITs Index contains all publicly-listed and traded equity REITs not designated as Timberland REITs or Telecommunications REITs. Prior to December 2010, the index included Timberland REITs and Telecommunications REITs.

Stocks/U.S. Equities are represented by the S&P 500 Index, widely regarded as the best single gauge of large-cap U.S. equities. The index includes 500 leading companies and captures approximately 80% coverage of available market capitalization.

Global Equities are represented by the MSCI World Index, a global equity benchmark that represents large and mid-cap equity performance across 23 developed markets countries. The index is reviewed quarterly with the objective of reflecting change in the underlying equity markets in a timely manner, while limiting undue index turnover.

US Property – MSCI U.S. Annual Property Index is the U.S. component of the MSCI Global Annual Property Index.

R squared: Coefficient of determination ranging between 0 -1 (0 -100), reflecting percentage of the response variation reflected by the linear model/factor. The higher the number the higher the correlation with 1 (100) reflecting a complete correlation.

Global Property – MSCI Global Annual Property Index ("MSCI Global Annual"). The constituents of the MSCI Global Indexes are real estate investments that are held in professionally managed portfolios. They therefore may include properties held in insurance and pension funds, sovereign wealth funds, listed property companies including REITs, unlisted pooled funds, charitable trusts, traditional landed estates, and by other large private property owners.

The MSCI Global Annual reports the market rebalanced returns of the 25 most mature markets (including the U.S.). The index began tracking markets in 2001 and reporting results starting with the year ended December 31, 2001. Results are reported annually. The MSCI Global Annual Indexes measure unlevered total returns of directly held standing property investments from one valuation to the next. The returns are based solely on directly held standing investments in completed and lettable properties, often described as operating properties. The index tracks performance of 58,827 property investments, with a total capital value of USD 2,079.7 billion as of December 2022 and is comprised of all property sectors (retail, office, industrial, residential, hotel and other), direct ownership structures and interests. The index is computed at the building level and excludes properties held indirectly through investment in other funds, the impact of debt, fund management fees, taxation and cash. The MSCI Global Annual is used to gauge the performance of the global real estate market. The countries included in the MSCI Global Annual will be subject to change as their coverage extends to more countries and as more accurate estimates of the value of each investment market become available. The Indexes reflect the impact of entity level expenses.

Endnotes - continued

US Bonds are represented by the Bloomberg US Aggregate Bond Index is a broad-based flagship benchmark that measures the investment-grade, U.S. dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, fixed-rate agency MBS, ABS, and CMBS (agency and non-agency).

Global Bonds –are represented by the Bloomberg Global Aggregate Index which is a measure of global investment grade debt from a multitude local currency markets. This multi-currency benchmark includes treasury, government-related, corporate and securitized fixed-rate bonds from both developed and emerging markets issuers.

Investments in direct real estate may be subject to more expenses than a direct investment in bonds, including management fees and entity-level expenses.

US Property Returns are represented by the NFI ODCE, short for NCREIF Fund Index Open End Diversified Core Equity, is a capitalization weighted, gross of fee, time weighted return index with an inception date of December 31, 1977. Other supplemental data such as equal weight and net of fee returns are also provided by NCREIF for information purposes and additional analysis. To be eligible for NFI ODCE membership, each member fund must be marketed as an open-end fund with a diversified core investment strategy primarily investing in private equity real estate. All members funds must adhere to the following index inclusion criteria: (1) At least 80 of market value of net assets must be invested in real estate 20 cap on cash and equivalents); (2) At least 80 of market value of real estate net assets must be invested in private equity real estate properties 20 cap on real estate assets invested in but not limited to, property debt, public company equity/debt or private company equity/debt; (3)At least 95 of real estate net assets must be located in U S markets; (4) At least 80 of market value of real estate net assets must be invested in office, industrial, apartment and retail property types; (5) No more than 65% (+/- for market force)s of market value of real estate net assets in one property type or region as defined by NCREIF Property Index; and (6)No more than 40% leverage. Each member fund must also comply with the NCREIF PREA Reporting standards. Please note that when returns are computed for the NPI, the returns for the levered properties are computed on a de-levered basis, i.e., the impact of financing is excluded.

UK Property Returns are represented MSCI UK Quarterly Property Fund Index, which represents the performance of U.K. unlisted pooled property funds. The Index is value-weighted, denominated in Great Britain Pound Sterling (GBP) and based on the Net Asset Value (NAV) of its constituent property funds each quarter.

Opportunistic are investments characterized by high risk/high return, including development, redevelopments, or acquisition projects where most of the expected return is from value appreciation, have significant leasing risk or high leverage, and are typically under a shorter-term tactical investment.

Core investments are separated into two categories: (1) Traditional Core and (2) Core-Plus. Traditional Core are investments characterized by low risk/low return, are generally institutional quality operating properties with most of the return derived from income with little expected volatility of that income and are typically a long-term strategic investment. Core-Plus are investments characterized by lower risk/lower return (relative to value-add or opportunistic strategies), are generally institutional quality operating properties with most of the return derived from income with some expected volatility of that income and are typically long-term strategic investments. Core-Plus presents somewhat more risk than Traditional Core because of higher leverage, leasing risk, or moderate capital expenditures. Value-add investments are separated into two categories: (1) Traditional Value-Add and (2) Long-Term Hold Value-Add.

Traditional Value-Add are investments characterized by moderate risk/higher return, generally operating properties or properties in lease-up, may require some renovations, have a significant portion of return expected from the appreciation of the property, and are a shorter-term tactical investment. Long-Term Hold Value-Add is the same as above but with the intention of holding for the long term.