



# The Return of Value Added Real Estate

With investor appetite for value added exposure increasing in recent months, Forena Akthar takes a look at the value added fund market and the outlook for the sector in the coming year.

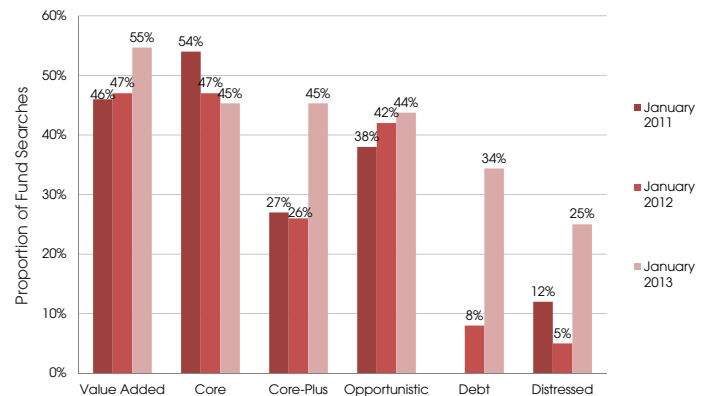
Investor appetite for value added real estate funds declined following the economic downturn in 2008, while interest in lower-risk core funds saw a marked increase. Although higher-risk strategies such as opportunistic and distressed remained attractive to institutions committing to private property funds, the dominant preference among active investors was to focus on lower-risk strategies. More recently, however, there has been renewed institutional investor interest in value added vehicles and a shift away from core investments. Improved fundraising for value added strategies in 2012 suggests that investors may be returning to what was previously one of the most commonly targeted strategies in the private real estate fund market.

## Increasing Investor Appetite for Risk

Investor sentiment towards private real estate continually changes with market conditions. When property valuations dropped in 2008-2009 and the performance of higher risk-return profile funds in particular suffered, many institutions pursued the perceived safety of lower-risk core vehicles and value added funds fell out of favour with many investors. We are now witnessing the opposite pattern: investor appetite for core funds declined between January 2011 and January 2013, whereas investor appetite for value added vehicles increased during the same period. Value added vehicles are the most sought after fund type by investors that will be investing in real estate funds in the 12 months from January 2013, with 55% of active investors looking to add value added funds to their portfolios in the coming year, up from 46% in January 2011 and 47% in January 2012 (Fig. 1). Fig. 2 presents a small sample of investors that are interested in making commitments to value added funds in the next 12 months.

Interest in opportunistic funds among investors is also returning, with 44% of investors looking to commit to these vehicles in the coming 12 months. This is an increase from 38% of investors that were

Fig. 1: Strategies Targeted in the Next 12 Months by Private Real Estate Investors, January 2011 - January 2013



Source: Preqin Real Estate Online

targeting these funds in the 12 months following January 2011 and 42% in the 12 months following January 2012. This suggests that appetite for higher risk-return profile investments is growing and it is not just the value added funds that may experience an increased appetite from investors.

Core-plus vehicles have also seen increased interest from active investors over the last year, with the same proportion of institutions targeting this strategy in the next 12 months as opportunistic funds. Forty-five percent of investors are seeking core-plus funds in the coming year, a significant increase from the 27% and 26% that were pursuing this strategy in the 12 months following January 2011 and 2012 respectively. Core-plus vehicles incorporate elements of both core and value added funds and growing interest in this strategy further illustrates that many investors are demonstrating increased interest in higher risk-return profile funds.

Fig. 2: Sample Investors Targeting Value Added Funds

Investor	Location	Summary Plans
Barmenia	Germany	Barmenia plans to invest €40mn in value added funds in the next 12 months. The insurance company is particularly interested in funds which invest in the logistics sector.
Employees' Retirement System of Texas	US	Employees' Retirement System of Texas has a \$285mn total real estate commitment target for the fiscal year 2013. This forms part of its plans to invest \$590mn in real estate in 2013-14. The focus of the near-term investments will primarily be on value added and opportunistic strategies.
Sparinvest Property Investors	Denmark	Sparinvest Property Investors anticipates committing €100-150mn across six private real estate funds in the next 12 months. It will focus predominantly on value added and opportunistic funds targeting Latin America, Europe and Asia.
Thrivent Financial for Lutherans	US	Thrivent Financial for Lutherans is planning to make new commitments in the next 12 months and will focus on diversified value added funds investing in the US.
YMCA Retirement Fund	US	YMCA Retirement Fund will commit up to \$100mn to five value added private real estate funds in the next 12 months. The pension fund will target opportunities in Europe, Asia and North America.

Source: Preqin Real Estate Online



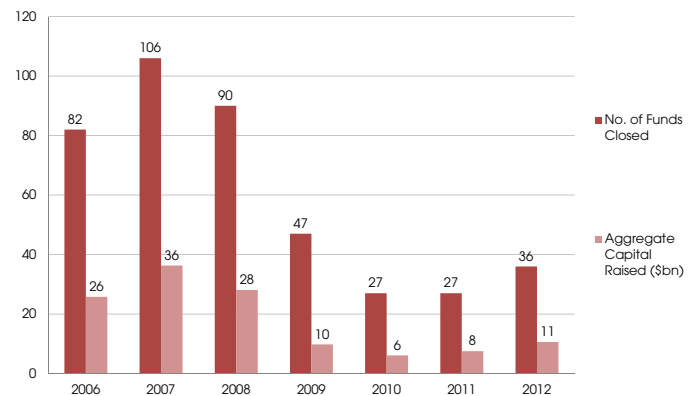
## Value Added Fundraising

Renewed investor appetite for value added funds has driven increased fundraising levels for the strategy in recent years. Fig. 3 shows that an aggregate \$11bn was raised by 36 solely value added vehicles that held a final close in 2012, the most successful year for value added fundraising since 90 vehicles raised an aggregate \$28bn in 2008.

One of the largest funds that closed in 2012 was Westbrook Real Estate Fund IX, managed by Westbrook Partners, which held a final close on \$1.6bn. The fund targets a range of property types in New York, Washington, San Francisco, Los Angeles, London, Paris and Tokyo. Another large value added fund that closed in the year was CBRE Strategic Partners US Value 6, which held a final close on \$1.1bn in December 2012. CBRE Global Investors exceeded the \$750mn fundraising target it set for this fund, which acquires underperforming commercial assets across all sectors.

In terms of market share, Fig. 4 shows that solely value added funds raised 18% of the total capital secured by all closed-end private real estate funds in 2012. This represents an increase compared to the 13% of aggregate capital raised by closed-end private real estate funds these vehicles represented in 2011. However, this is not as large a proportion as in 2007, when capital raised by solely value added funds accounted for 28% of the total raised by all private real estate funds.

Fig. 3: Solely Value Added Closed-End Private Real Estate Fundraising, 2006 - 2012



Source: Preqin Real Estate Online

Along with fundraising, the more recent performance of value added funds has been encouraging. As can be seen in Fig. 5, the median IRRs of value added funds with 2008 and 2009 vintages is greater than that of all private equity real estate funds of the same vintages. These figures may have helped boost investor confidence in value added real estate and could also serve to attract more investors to this fund type in the future. It is worth noting, however, that the median IRRs of value added funds have either matched or been lower than those posted by all private equity real estate funds for all vintages years between 2002 and 2007.

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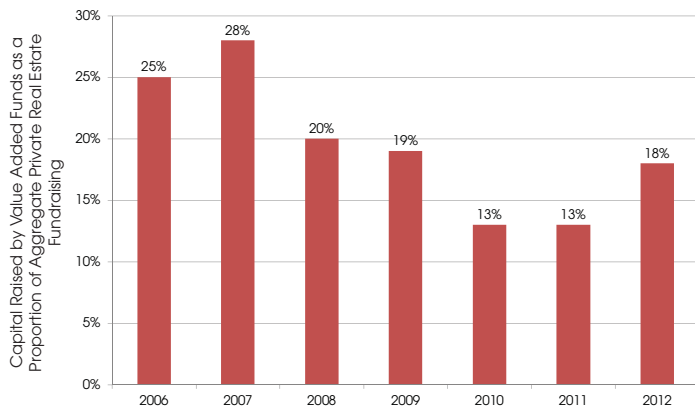
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Fig. 4: Solely Value Added Fundraising as a Proportion of All Closed-End Private Real Estate Fundraising, 2006 - 2012



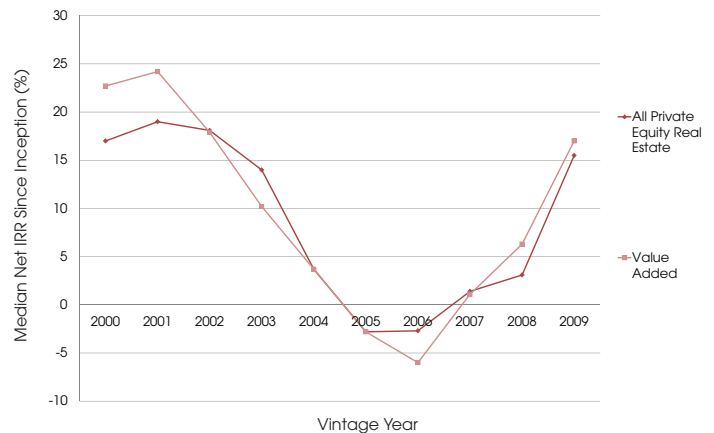
Source: Preqin Real Estate Online

## Value Added Funds in Market

The number of value added funds in market has increased over the last three years, which may be a reflection of increased confidence among fund managers that they can successfully raise capital for value added investments. Fig. 6 shows there were 82 solely value added funds on the road in February 2011 targeting an aggregate \$23bn in investor equity; this increased to 95 funds targeting an aggregate \$32bn in February 2012. The number of value added funds in market increased again as of February 2013 to 107 vehicles, but the aggregate capital sought by these funds fell slightly from \$32bn in February 2012 to \$30bn in February 2013. Although there is growing investor appetite for value added funds, the increasing number of funds in market utilizing the strategy could also serve to make the fundraising market more competitive for these vehicles in the future.

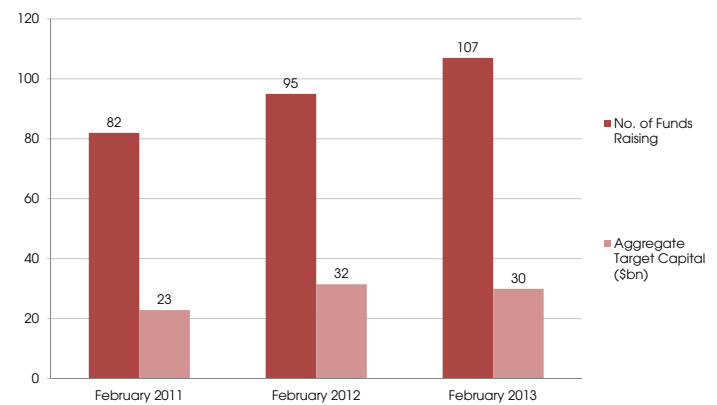
The largest value added fund currently in market is TA Realty Associates X, a US-focused fund looking to raise \$1.25bn. TA Associates Realty's tenth fund in this series invests in office, multi-family, industrial and retail assets across the US. Alpha Asia Macro Trends Fund II is the second largest value added fund currently in market (Fig. 7). This vehicle is targeting \$1bn in capital commitments

Fig. 5: Median Net IRR by Vintage Year: Value Added vs All Private Equity Real Estate



Source: Preqin Real Estate Online

Fig. 6: Solely Value Added Closed-End Private Real Estate Funds in Market, February 2011 - February 2013



Source: Preqin Real Estate Online

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Fig. 7: Largest Value Added Closed-End Private Real Estate Funds in Market

Fund	Manager	Geographic Focus	Size (mn)
TA Realty Associates X	TA Associates Realty	US	1,250 USD
Alpha Asia Macro Trends Fund II	Alpha Investment Partners	Asia	1,000 USD
Paramount Group Real Estate Fund VII	Paramount Group	US	1,000 USD
Crow Holdings Realty Partners VI	Crow Holdings Capital Partners	North America	750 USD
AREA Value Enhancement Fund VIII	AREA Property Partners	US	750 USD
KTR Industrial Fund III	KTR Capital Partners	North America	750 USD
Rockwood Capital Real Estate Partners IX	Rockwood Capital	US	750 USD
Tishman Speyer Real Estate Venture VIII	Tishman Speyer	US	750 USD
LaSalle European Value Add Fund III	LaSalle Investment Management	Europe	500 EUR
Cabot Industrial Value Fund IV	Cabot Properties	US	600 USD
CITIC Capital China Retail Properties Investment Fund	CITIC Capital	China	600 USD
LaSalle Income & Growth VI	LaSalle Investment Management	US	600 USD

Source: Preqin Real Estate Online



and makes investments across the more developed markets in Asia such as Singapore, Japan, Taiwan, South Korea and Hong Kong. Paramount Group's Paramount Group Real Estate Fund VII, which invests in class A CBD office properties primarily located in New York, Washington DC, and San Francisco, is also targeting \$1bn. The largest Europe-focused value added fund in market is LaSalle European Value Add Fund III. LaSalle Investment Management is hoping to secure €500mn for the fund, which invests primarily in France, Germany and the UK.

#### Outlook

Appetite for higher risk-return profile investments is increasing among institutional investors, and for value added funds in particular. This may be a result of the improving performance of such funds, combined with concerns over the pricing of core assets. In addition, many investors in private real estate are looking to target higher returns in order to meet their overall returns target. With 55% of active investors looking to invest in value added vehicles over the next 12 months, it seems likely that fundraising for value added funds will continue to improve in the coming months. Nonetheless, with a large number of funds on the road and many investors still holding back on fund commitments, real estate fund managers with

value added funds in market will likely still find raising capital for their vehicles challenging, even with increased investor appetite for value added funds.

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