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PE Real Estate Fund Performance

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Feature Article

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PE Real Estate Fund Performance

As a result of the poor performance of the real estate asset class during the market downturn, many investors are re-evaluating their real estate strategies. For some, this means shifting their focus to core funds, one of the few real estate strategies producing positive returns. We examine this trend amongst investors and look at the long-term outlook for real estate managers raising funds with higher risk strategies

Fundraising Spotlight

page 7

The second quarter of 2010 saw the lowest fundraising total for a quarter since Q3 2004, with 20 funds raising an aggregate \$7.3 billion. Fundraising Spotlight examines the geographic breakdown of these funds and looks at the fundraising outlook going into H2 2010.

Fund Manager Spotlight

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We examine Asia Pacific-based real estate fund managers, looking at the capital they have raised for real estate and the capital they are currently targeting for investment in the asset class.

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Investor Spotlight

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Endowment plans are active investors in real estate, with an average target allocation to the asset class of \$179 million and an average actual allocation of \$120 million. In this article we look at the strategic and geographic investment preferences of these investors.

Conferences Spotlight

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Upcoming events in the real estate world, including Malaysia REITs 2010 and Real Estate Investment World Australia 2010.

Investor News

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All the latest news on real estate investors:

Including details of...

- San Francisco City & County Employees' Retirement System's latest fund commitment;
- MMA's decision to stop investing in private real estate;
- Korea Investment Corporation's \$31 billion private real estate mandate.

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PE Real Estate Fund Performance: UK Core Funds on the Up

There has been a severe decline in the performance of real estate funds, and consequently the performance of many institutions' real estate portfolios, since the onset of the economic downturn. This has led to a large number of investors re-evaluating their real estate strategy, with a number increasingly looking towards core investments.

Value added and opportunistic vehicles were worst affected by the declines in net asset value, especially funds of vintages 2006 and 2007, which invested capital when the property market was at its peak.

Fig. 1 shows the performance of private equity real estate funds by vintage year. 2006 vintage funds have a median IRR of -6.9% and a top quartile IRR boundary of -0.1%. Funds of 2007 vintage are even deeper in the red with a median IRR of -31.9% and a top quartile IRR boundary of -8.5%. 2008 vintage funds performed slightly better but most are still in the red, with a median IRR of -11.4%.

Private equity real estate IRRs are typically negative in the first few years of a fund's life, increasing over time as investments are exited, and then stabilizing in the final years of the fund's life. IRRs following this trend form a J-curve trajectory. Fig. 2 shows this trajectory by plotting the median IRR across various vintages for each quarter end.

For all vintage years performance declined over the two years to Q3 2009, with the median IRR of all but vintage 2003 funds dipping into negative territory. However, most vintage years have since shown an improvement with their median net IRRs increasing in Q4 2009. The median IRR for 2004 vintage funds, which reached a low point at -0.9%, is positive as of Q4 2009, standing at 6.7%. Funds of vintages 2005 and 2006 were significantly affected during this period, with the IRRs of both

Fig. 1:

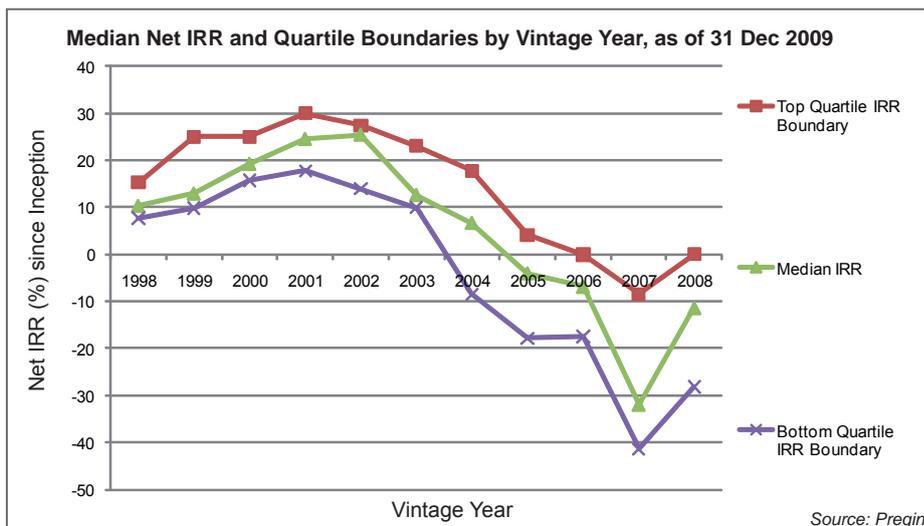
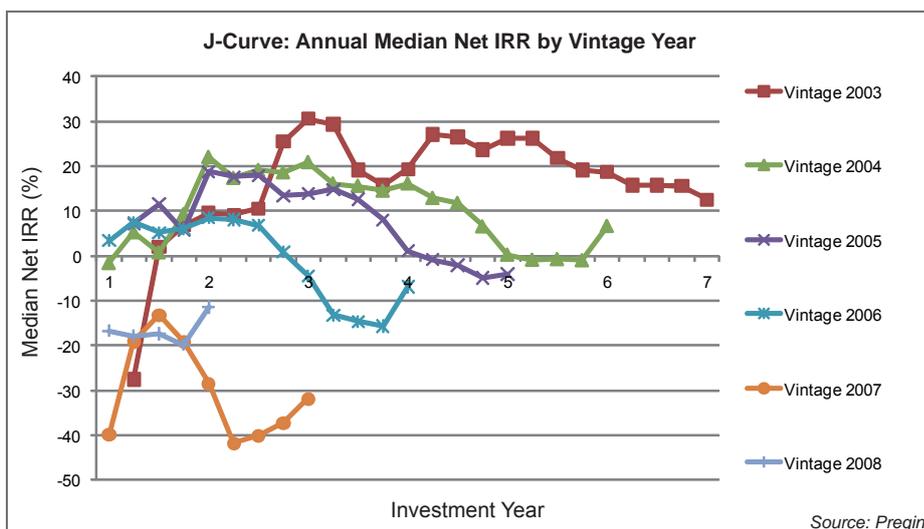


Fig. 2:



vintages falling into negative territory. As of Q4 2009, the median IRRs were still negative, standing at -4.0% for 2005 and -6.9 for 2006 vintage funds. Funds of 2007 and 2008 vintages also remain in negative

territory, with median IRRs of -31.9% and -11.4% respectively. Funds with more recent vintages have significant levels of uncalled capital, allowing for the possibility of an improvement in their performance.



Following the recent declines in real estate fund performance it is understandable that many investors in the asset class are re-evaluating their real estate portfolios. Fig. 3 shows the one-year returns that public pension funds have received from their real estate portfolios compared to their overall investment portfolios.

Although real estate performance is improving, with one-year returns to March 2010 standing at -7.9% compared to -21.3% to March 2009, returns are still in the red. Many other asset classes have seen their performance rebound at a faster rate than real estate and the median return of a public pension fund's entire portfolio is in positive territory as of November 2009.

It is worth noting that not all real estate fund strategies are producing negative median one-year returns. As can be seen in Fig. 4, the one-year median returns of core UK real estate funds are positive at 13.1% in March 2010. Core UK funds were by no means exempt from the declining property values; the median one-year returns of such funds reached a low point at -26.3% in June 2009. However, such funds have since recovered at a much faster rate than other real estate strategies, most probably because of the notable rebound in the UK commercial property markets that took place over the first half of 2010. It is important to bear in mind that these are relatively short-term performance measurements and there is no guarantee that another downturn in UK property prices will not occur.

California State Teachers' Retirement System (CalSTRS) is one example of an investor that is adjusting its real estate strategy to include a greater emphasis on core investments. The \$132 billion public pension fund recently announced plans to alter its real estate allocation, setting a target of 50% to core real estate, with 20% to value added and 30% to opportunistic. It had previously had a target of 35% to core, with the remainder in a tactical portfolio consisting of opportunistic and value added investments.

Fig. 3:

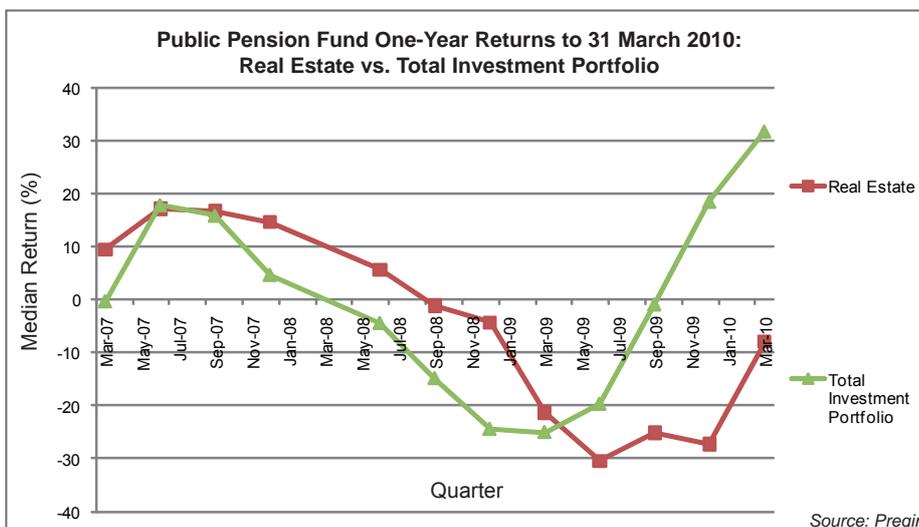
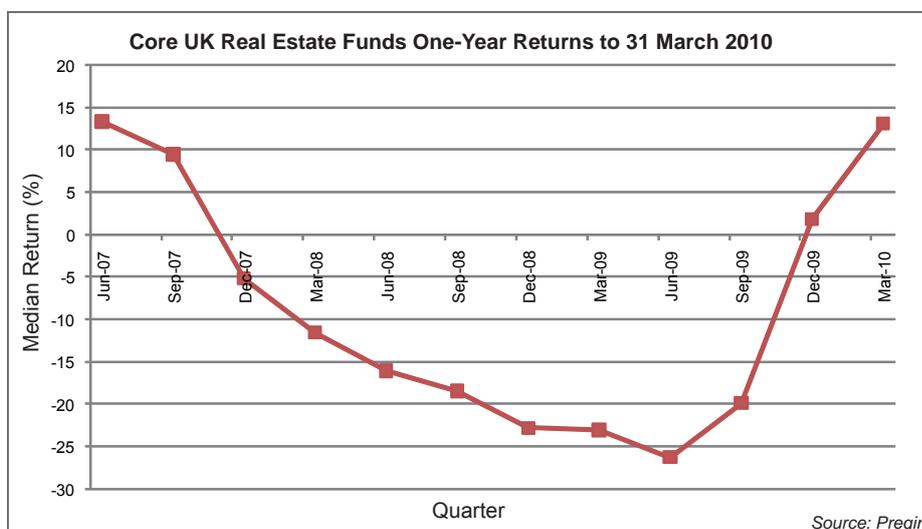


Fig. 4:



While many institutions are indicating in their conversations with Preqin that they expect to focus on core investments in the immediate future, this is by no means the only strategy that investors are targeting. Several investors have stated that they feel core real estate may be overpriced and instead feel that greater opportunities are to be found in opportunistic, debt or distressed real estate.

The desire of investors to target lower risk real estate is understandable considering the losses incurred by investments in opportunistic and value added funds. Given the declines in property valuations, many also see it as a good time to gain exposure to high-quality real estate at a lower price. Some would argue, however, that this move to core has come too late, and that now would be the time to invest in funds with



higher targeted returns. Certainly many managers of opportunistic or distressed funds on the road would suggest that the current market offers one of the best buying opportunities of a generation.

The age of multi-billion dollar global funds may be coming to an end, but firms raising vehicles targeting opportunistic or value added returns, with a strong track record investing in a particular marketplace, could offer a better opportunity for investors to secure strong returns in the coming years. It is clear that the global mega funds are not experiencing the same fundraising success that they did a few years ago. Nevertheless, there have been some encouraging signs for firms raising private equity real estate funds. 20% of funds to reach a final close in 2010 have exceeded their fundraising targets. In contrast, just 6% of funds to close in 2009 exceeded their targets. These have typically been the small to mid-sized funds. The largest fund to exceed its target was Mesa West Real Estate Income Fund II, which raised \$615 million, significantly more than its \$400 million target. JBG Fund VII is another such fund, it raised \$77 million more than its \$500 million target.

Going forward it seems likely that many investors will look to build balanced portfolios. Many see the value of core funds in terms of secure stable returns, but are also looking for strong performance and clearly there is still appetite for real estate funds targeting higher returns.

Andrew Moylan

Preqin's Real Estate Online product now includes profiles for 109 UK-focused core funds. The product also includes individual fund performance data for 41 core UK-focused real estate funds.

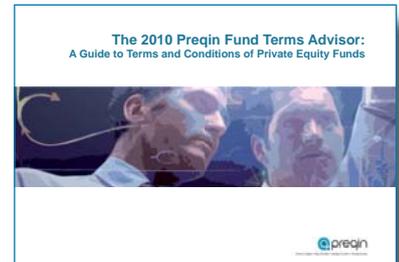
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- Data and analysis on the actual fees and costs incurred by LPs, with listings showing costs for 1,200 named vehicles.
- Full access to our updated Fund Terms Advisor Online product, which enables you to model the real economic impact of fund terms and conditions, and download detailed fund terms for further analysis.
- Comprehensive analysis on all aspects of private equity fund terms and conditions including how conditions have changed over time and what variations exist amongst funds of different type, size and region.
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Fundraising Spotlight: PERE Fundraising in Q2 2010

Fig. 1:

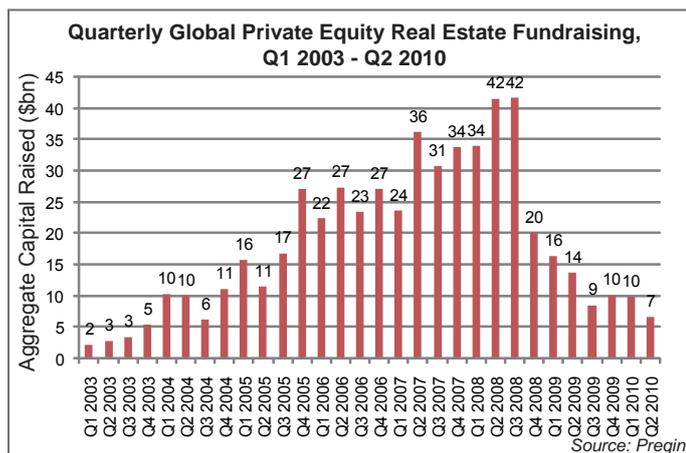
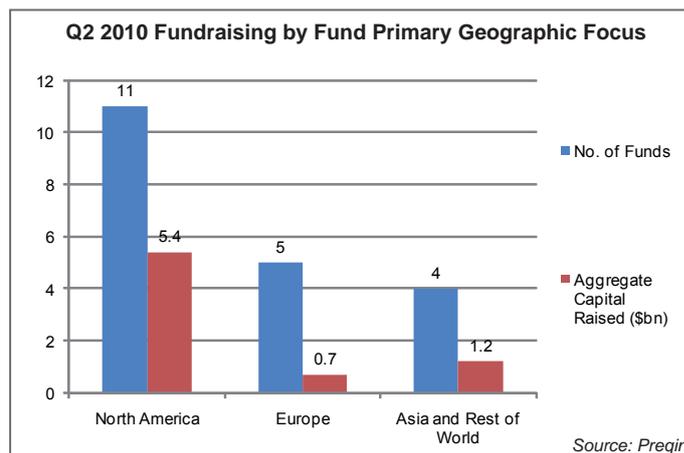


Fig. 2:



The second quarter of 2010 saw 20 private equity real estate funds hold a final close, raising an aggregate \$7.3 billion. As can be seen in Fig. 1, this was the lowest quarterly fundraising total since Q3 2004, when 30 funds raised an aggregate \$6.1 billion. It is clear that the fundraising environment remains extremely competitive and that the recovery many predicted is yet to occur.

Largest Funds to Close

As shown in Fig. 3 the two largest funds to close in the quarter are both managed by

Starwood Capital Group and account for a significant 38% of the total capital raised. Starwood Global Opportunity Fund VIII raised \$1.8 billion to invest opportunistically on a global basis in all property types. Starwood Capital Global Hospitality Fund II raised \$965 million and focuses on international real estate markets, investing in the North American, European and Asian hospitality sectors. Fortress Japan Opportunity Fund was the third-largest fund to close in the quarter, having raised JPY 75 billion. The vehicle is managed by US-

based Fortress Investment Group, and is primarily targeting real estate-related debt in Japan. The largest fund closed by a firm headquartered outside of North America was Perennial Chinese Shopping Mall Fund, which raised CNY 1.2 billion for a vehicle focused on Chinese shopping centres.

Regional Focus

Funds with a primary focus on North America accounted for a significant proportion (74%) of capital raised during the quarter as shown in Fig. 2. 11 North America-focused funds

Fig. 3:

Five Largest Real Estate Funds to Close in Q2 2010					
Fund	Firm	Type	Amount Closed (mn)	Manager Country	Location Focus
Starwood Global Opportunity Fund VIII	Starwood Capital Group	Distressed, Opportunistic	1,800 USD	US	Global
Starwood Capital Global Hospitality Fund II	Starwood Capital Group	Distressed, Opportunistic	965 USD	US	Global
Fortress Japan Opportunity Fund	Fortress Investment Group	Debt, Opportunistic	75,000 JPY	US	Japan
Mesa West Real Estate Income Fund II	Mesa West Capital	Debt	614 USD	US	Western US
AEW Partners VI	AEW Capital Management	Debt, Distressed, Opportunistic	575 USD	US	North America

Source: Preqin



Fig. 4:

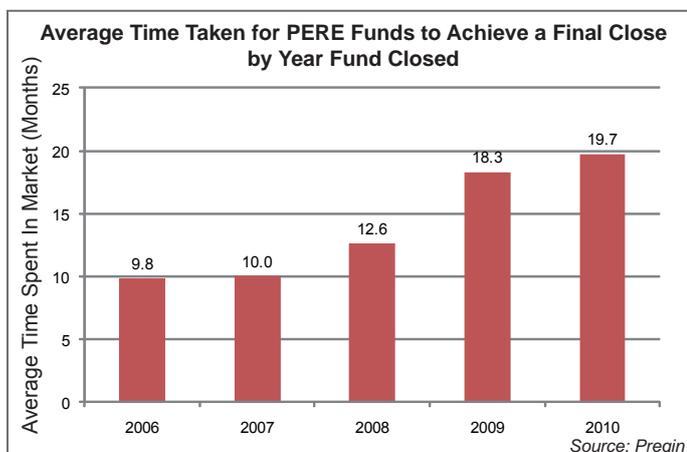
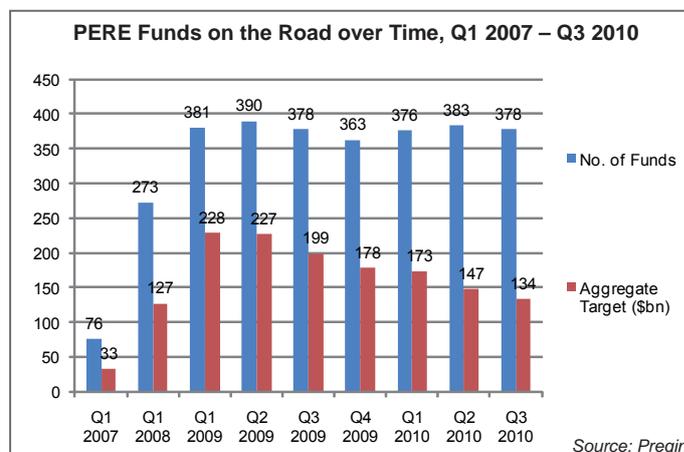


Fig. 5:



closed, raising \$5.4 billion. Four Asia and Rest of World funds raised \$1.2 billion and five European funds reached a final close, raising \$0.7 billion.

Time Spent in Market

The length of time it is taking fund managers to close funds is a good indicator of how competitive the fundraising environment is and Fig. 4 shows the average time taken for funds to achieve a final close by year. Funds that have held a final close during 2010 spent an average of 19.7 months in market. This is a steep increase from 2006, when fund managers spent, on average, less than 10 months marketing their funds.

Funds on the Road

There are currently 378 funds in market seeking aggregate capital commitments of \$134 billion. Fig. 5 shows how the number and aggregate value of funds in market has changed since Q1 2007. The number of funds currently in market has fallen since Q2 2010; this is due to a number of fund managers abandoning their fundraising efforts because of difficulty in garnering investor commitments. The aggregate target of funds in market has also steadily fallen in recent quarters, as fund managers begin to set more modest fundraising targets.

Andrew Herman

Fund Manager Spotlight: Asia Pacific-Based Fund Managers

Fig. 1:



Fig. 2:

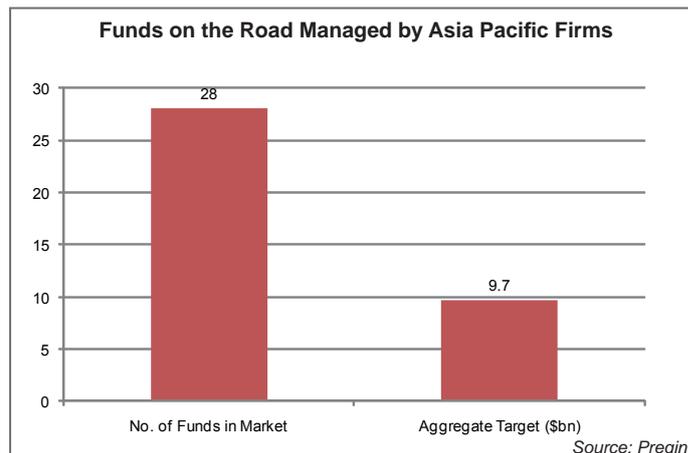


Fig. 3:



Fig. 4:

Firm	Total Capital Raised for Private Equity Real Estate Funds in Last 10 Years (\$bn)	Country Headquarters
Capitaland	5.9	Singapore
KK DaVinci Advisors	4.4	Japan
BAML Real Estate Principal Investments	2.7	Hong Kong
Winnington Capital	2.1	Hong Kong
Secured Capital Japan Co.	2	Japan
Alpha Investment Partners	1.8	Singapore
Ascendas	1.8	Singapore
ARA Asset Management	1.7	Singapore
IL&FS Investment Managers	1.4	India
Harvest Capital Partners	1.4	Hong Kong

Source: Preqin

The information in Fund Manager Spotlight is taken from Preqin's Real Estate Online product. There are currently profiles for 72 fund managers based in Asia Pacific.

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Andrew Herman



Investor Spotlight: Endowment Plans

Fig. 1:

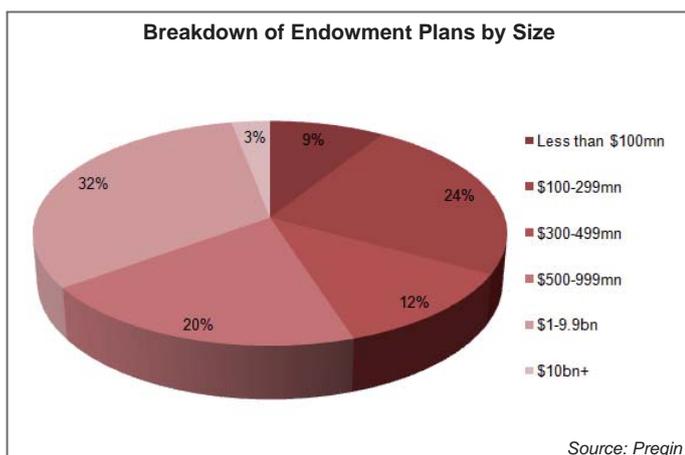
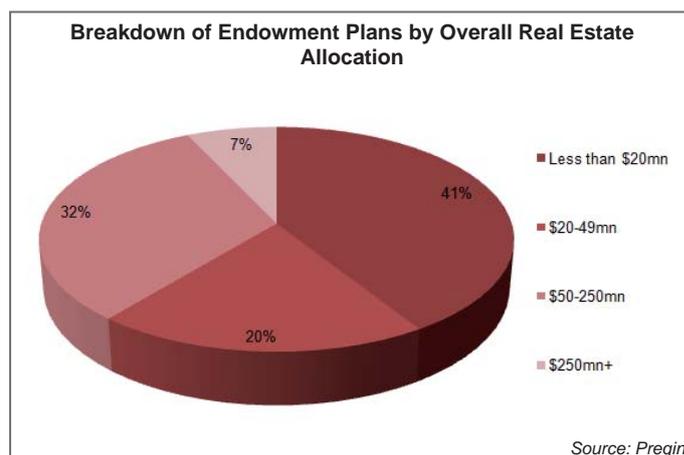


Fig. 2:



Endowment plans are active investors in real estate, and as of July 2010, the average real estate allocation of these institutions is \$120 million. The average target allocation to real estate is \$179 million.

As shown in Fig. 1, 45% of endowments that invest in real estate have total assets of less than \$500 million. 20% have between \$500 million and \$999 million in assets under management and 32% have \$1-9.9 billion. Only 3% of endowments in the asset class have assets under

management of over \$10 billion. Fig. 2 shows a breakdown of endowment plans allocations to real estate: 41% have less than \$20 million allocated to the asset class, 20% have \$20-49 million, and 32% have \$50-250 million. 7% have over \$250 million allocated to real estate.

Fig. 3 shows that the most favoured fund strategies are opportunistic and value added, with 69% and 68% of endowments targeting such vehicles respectively. Debt and distressed funds have grown in prominence, with investors looking to take

advantage of the opportunities created in a dislocated market, and 42% and 38% of endowments have a preference for such vehicles respectively. Lower-risk core and core-plus funds have also garnered increased investor interest with 24% and 15% of investors showing an interest in such strategies respectively. 16% of endowments are interested in fund of funds vehicles. Fig. 4 shows the geographic preferences of the endowments active in real estate: 88% invest in North America, 60% in Europe and 43% in Asia and Rest of World.

Forena Akthar

Fig. 3:

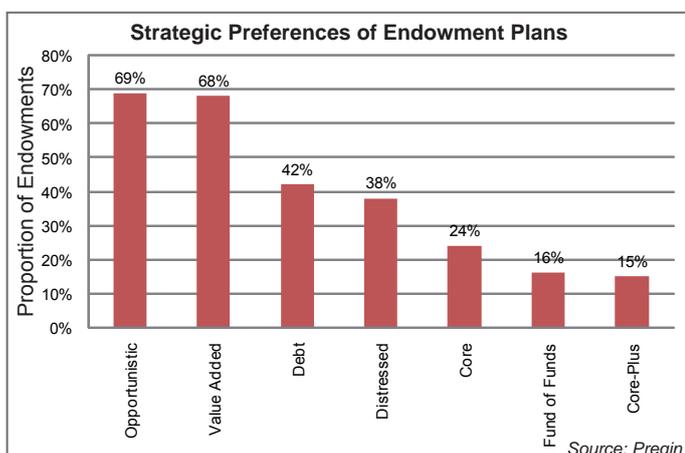
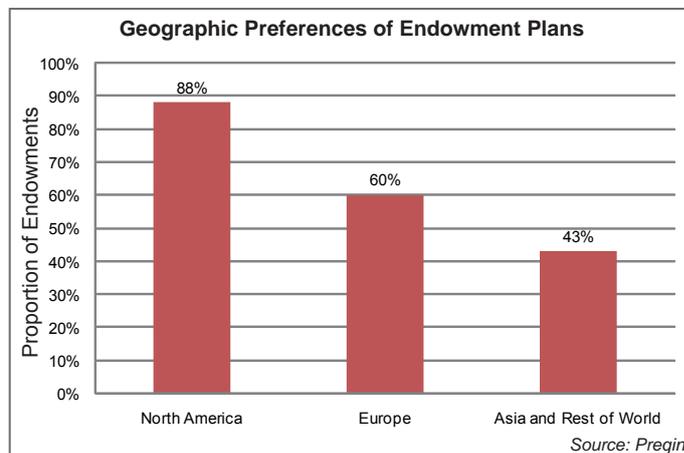


Fig. 4:



Conferences Spotlight: Forthcoming Events

Conference	Dates	Location	Sponsor
Malaysia REITs 2010	2 - 5 August 2010	Kuala Lumpur	Asia Business Forum
Real Estate Investment World Australia 2010	10 - 12 August 2010	Sydney	Terrapinn
3rd Distressed Commercial Real Estate EAST	13 - 15 September 2010	New York	Infocast
Real Asset Investing Forum	15 - 16 September 2010	San Francisco	Opal Financial Group
IPD RealWorld Conference	22 - 23 September 2010	Cambridge	IPD
The 2nd Annual Distressed Commercial Real Estate Forum	23 - 24 September 2010	New York	IMN
Expo Real 2010	4 - 6 October 2010	Munich	Messe Munchen
Real Estate Investment World Australia 2010	6 - 8 October 2010	Sydney	Terrapinn
CEE Real Estate 2010	14 October 2010	Warsaw	EastEuro Link
Real Estate Investment World Japan 2010	18 - 19 October 2010	Tokyo	Terrapinn
4th Real Estate Private Equity Summit	20 October 2010	New York	iGlobal Forum
Real Estate Investment World Latin America 2010	25 - 27 October 2010	Coral Gables, FL	Terrapinn
PERE Forum: New York	26 - 27 October 2010	New York	PEI Media
AIS 2010 Abu Dhabi Showcase of Alternative Investment Funds	3 - 4 November 2010	Abu Dhabi	Leoron Events
European Real Estate Opportunity & Private Fund Investing Forum	8 - 9 November 2010	London	IMN
Real Estate Investment World India 2010	22 - 24 November 2010	Mumbai	Terrapinn



Investor Spotlight: Investor News

Korea Investment Corporation awards Partners Group a private real estate mandate

The USD 31 billion sovereign wealth fund has appointed Partners Group to assist with its private real estate investments. Partners Group believes that one of the most attractive real estate opportunities in the current market is recapitalization, particularly in developed markets. The sovereign wealth fund has a 2% allocation to real estate and commodities, and made its first investments in real estate in 2009.

San Francisco City & County Employees' Retirement System commits to two funds

The USD 13 billion San Francisco City & County Employees' Retirement System has made two separate commitments of USD 25 million to Bristol Value II and Harrison Street Real Estate Partners III. Bristol Value II is a diversified property fund aiming to raise USD 250 million. The fund is expecting a first close by the end of September, and is seeking a return of 14-18%. Harrison Street Real Estate Partners III is focused on buying and developing properties in niche sectors. It is aiming to raise USD 500 million, and held a first close on USD 165 million last month, with a second close expected this summer. The fund seeks a return of 18%.

Baylor College of Medicine Endowment to make maiden real estate fund commitment by end of the year

The USD 867 million endowment plan is in the process of finalizing its investment plans for the next 12 months. It will invest through private real estate funds, and is interested in both closed-ended and open-ended vehicles. It will initially invest in the US, but hopes to gain global exposure in the long term. The endowment is interested in open-ended core vehicles due to the semi-liquid properties of these funds and the fact that it is possible to analyze the portfolio and the assets in the fund before making a commitment. The endowment hopes that by allocating to

an open-ended fund initially, it will benefit from stable returns and will then be able to invest in higher-returning fund strategies such as opportunistic and value added in the future.

Composition Capital Partners announces three senior appointments

The real estate fund of funds manager, which manages Europe- and Asia-focused funds of funds, has expanded its teams in Amsterdam and Hong Kong. It has appointed Morag Beersb as director of business development and investor relations. Maarten Vermeulen has been appointed as director of Europe. Both will be based in Amsterdam. Vermeulen will be responsible for the management of Composition's European team and its investments in Europe, including strategic planning and investment allocations, deal sourcing, deal structuring and monitoring of investments. Lionel Low has been appointed as a vice president in the firm's Hong Kong office and will be responsible for the sourcing and due diligence of potential new investments and monitoring of current investments.

MMA no longer investing in private real estate funds

The EUR 60 billion French insurance company is no longer investing in the alternative asset classes, and will therefore make no further commitments to private real estate funds. MMA's decision to stop investing in private real estate is partly due to the Solvency II regulations, which place stricter guidelines on the level of risk insurance companies are allowed to take in regards to their investments. The insurance company also feels that the management fees of such funds are too high, and it believes that it can achieve better returns from investing directly in property. It will hold on to its unlisted fund investments until they are liquidated.

Stichting Pensioenfonds Unilever Nederland 'Progress' makes maiden allocation to private real estate funds

The EUR 3.5 billion pension fund has agreed to commit EUR 70 million to ING Real Estate Investment Management's Dutch fund series. It has already committed to ING Dutch Residential Fund and is expected to allocate to ING Dutch Retail Fund towards the end of this year. The pension plan is interested in investing with experienced managers with strong track records and is believed to be conducting due diligence on other funds managed by ING. The pension fund has been reducing its direct allocation since the beginning of last year, selling its assets and raising capital to re-deploy through real estate funds.

Forena Akthar

Each month Spotlight provides a selection of the recent news on institutional investors in real estate. More news and updates are available online for Real Estate Online subscribers.

In the last month, Preqin analysts have added 39 new investors and updated 180 existing investor profiles.

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