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Real Estate Funds of Funds and Their Contribution to Market Recovery

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Real Estate Funds of Funds and their Contribution to Market Recovery

Fundraising for funds of funds has declined since the onset of the global economic downturn; however, they still play an important role in the private real estate market as a whole.

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Each month Fund Manager Spotlight examines a particular group of fund managers, using Preqin's Real Estate Online database. This month we look at US-based fund managers.

You can now download all the data in this month's Spotlight in Excel.



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- London Borough of Brent Pension Fund
- CPP Investment Board

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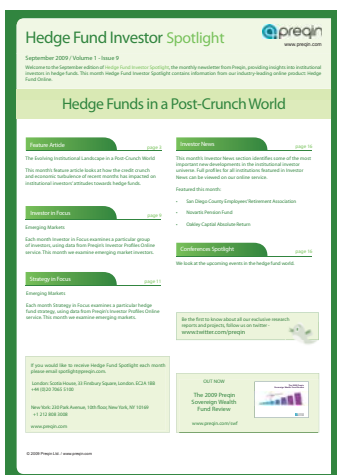


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Real Estate Funds of Funds and Their Contribution to Market Recovery

Real estate funds of funds play an important role in the private real estate market as a whole, acting as key investors for fund managers and allowing smaller institutions, which lack the capital or resources to construct their own fund portfolios, to gain real estate exposure diversified by strategy, geography and property type.

Fundraising for funds of funds has declined since the onset of the global economic downturn. Funds of funds raised just \$1.7 billion in 2009, compared with \$4.1 billion in 2008 and \$4.6 billion in 2007. This decline is in line with the whole private real estate fund market, which saw a significant fall in the amount of capital raised in 2009.

The first real estate funds of funds date back to the late 1990s, but it was not until several years later that a significant industry began to emerge. Preqin has identified 57 firms active in the fund of funds market, managing a total of 119 funds of funds.

There was some consolidation in the fund of funds market during 2009. In November 2009, Aviva Investors Real Estate Multi-Manager announced it had taken over the management of two real estate funds of funds previously managed by BlackRock Realty and in July 2009, Capital Dynamics assumed the management of HRJ Capital's fund of funds business, including its private equity real estate fund of funds platform.

There is potential for further consolidation as the larger players within the market look to cement their positions as market leaders.

Diversity in the Fund of Funds Market

Funds of funds are key investors for managers raising their first vehicle, as they will typically have the knowledge and resources to carry out the extra due diligence required on this type of investment. 73% of funds of funds surveyed do invest with first-time fund managers, while a further 17% would consider doing so. There are several funds of funds designed solely to provide exposure to emerging managers.

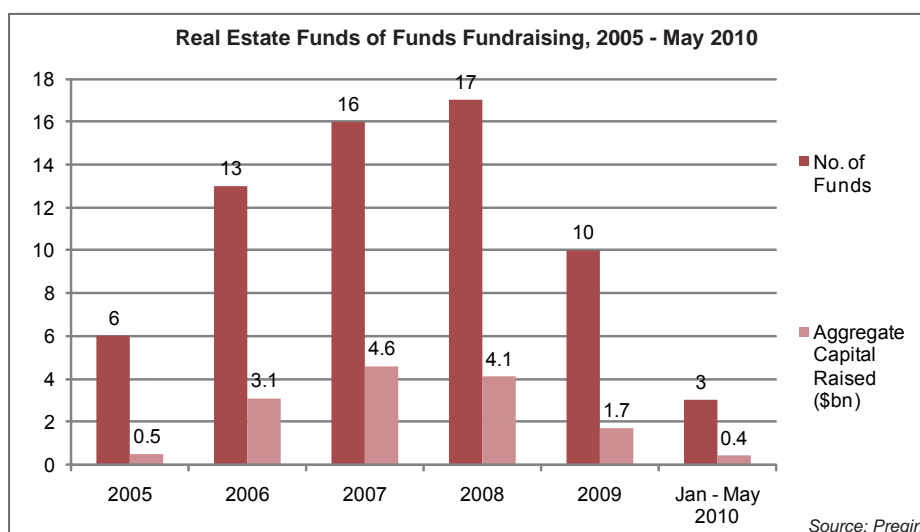
These include AVP Advisors' \$400 million American Value Partners Fund I, which targeted newer managers that demonstrated a competitive advantage in a specified property type or geographic market. Hawkeye Partners also targets newer firms, although its investments are typically structured as joint ventures rather than fund commitments.

In contrast, some funds of funds aim to give smaller investors exposure to some of the largest firms in the industry. The larger minimum commitment size required would normally stop many smaller institutions from committing to these funds. Syndicated Equities' Syndicated Access Fund II has committed to funds managed by Blackstone Real Estate Advisors, Morgan Stanley Real Estate and RREEF Real Estate. Granite Hall Partners' SVP RE I has a similar approach and its underlying investments included commitments to Walton Street Capital, Carlyle Group and JP Morgan Asset Management.

There have also been a number of funds of funds launched with a specific regional focus and most notably, a number of funds of funds target Asian real estate funds. Aberdeen Property Investors raised \$600 million for AIPP Asia in 2007 and closed AIPP Asia Select in Q2 2009 with commitments of \$221 million. CBRE Investors Global Multi Manager's CBRE Asia Alpha Plus Fund raised \$250 million and invests in value added and opportunistic funds across the Asia Pacific region. Franklin Templeton Investments raised \$383 million for its Franklin Templeton Asian Real Estate Fund and began raising capital for Franklin Templeton Asian Real Estate Fund 2 in the first quarter of 2010.

As a result of the increased interest in distressed real estate and real estate debt, a number of funds of funds focused on this

Fig. 1:



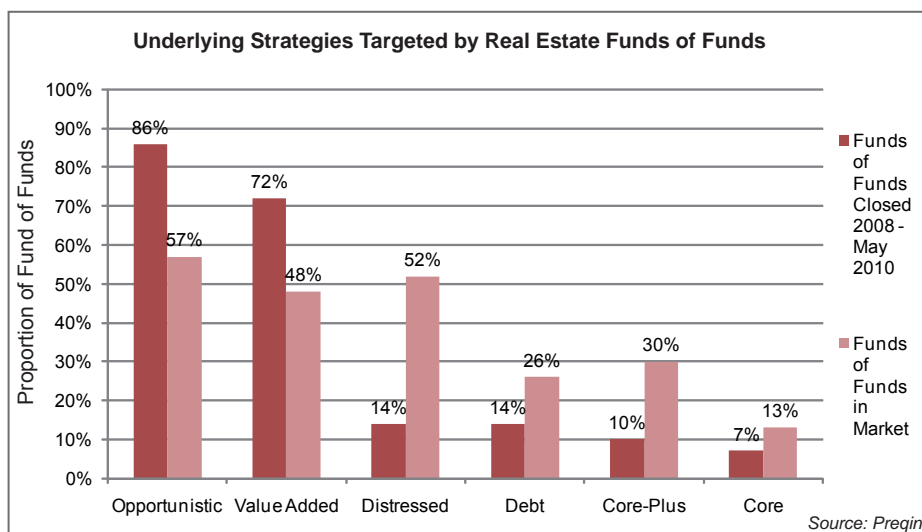
sector have been launched. Metropolitan Real Estate Equity Management raised \$162 million for Metropolitan Real Estate Partners 2008 Distressed Co-Investment and is marketing MREP Distressed Strategies II. Investors Diversified Realty is marketing the Investors Diversified Realty Fund, which will allocate its initial capital to funds that are originating first mortgages and mezzanine debt positions.

In terms of structure, 82% of funds of funds are private closed vehicles. A further 15% are private open-ended funds. These include Henderson Indirect Property Fund (Europe), a €450 million fund that targets underlying European core-plus, value added and opportunistic vehicles, and the €732 million ING Eurosiris Fund of Funds, which targets core and core-plus funds across Europe. There are also a small number of listed funds of funds that target underlying private equity real estate funds. These account for 3% of all funds of funds.

Targeted Strategies

Fig. 2 shows the underlying fund strategies that are targeted by funds of funds that closed in the period 2008 to May 2010, and those that are currently in market. This shows that fund of funds managers are altering their strategies in light of the opportunities within the current real estate

Fig. 2:



market. While opportunistic and value added funds remain commonly targeted strategies, the proportion of funds targeting these strategies has fallen. In contrast, the turbulent market conditions have led to an increase in the proportion of funds of funds seeking to invest in distressed vehicles. 52% of funds of funds in market plan to make this type of commitment. Furthermore, many fund of funds managers now believe that the best market opportunities are presenting themselves in core and core-plus investments. This

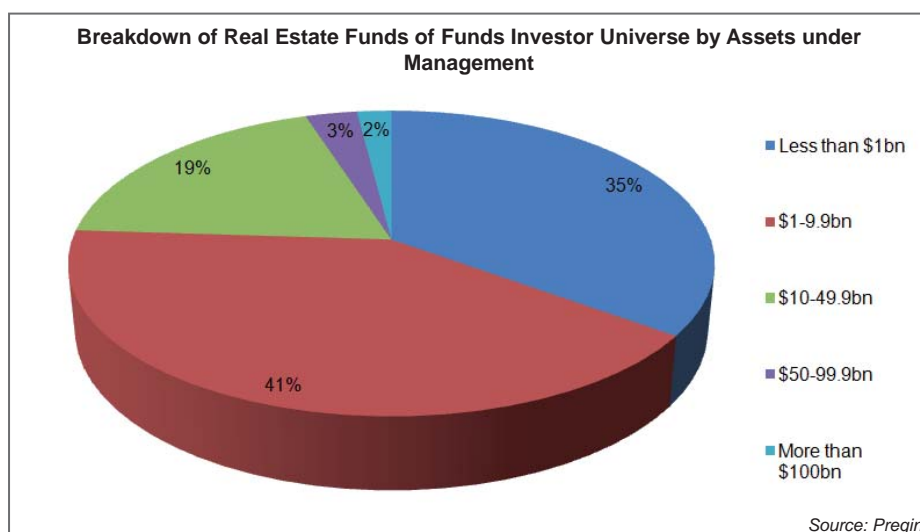
explains the 20 percentage point increase in funds of funds investing in core-plus vehicles, as investors seek to reduce the level of risk in their portfolios and target returns through income, rather than appreciation.

Fund of funds managers were largely inactive during the past 12 months. They were either reluctant to commit before the market bottomed out or delayed new investments at the request of investors keen to avoid additional capital calls. Many firms do have capital available to invest and most expect to be far more active in the coming year.

Funds of Funds as Investment Consultants

Fund of funds managers do not just manage the capital raised through funds of funds, many also act as investment consultants to a number of investors and allocate to funds through managed mandates and separate accounts. These firms are therefore responsible for an even greater proportion of the capital that is allocated to the private equity real estate asset class. Many manage segregated multi-manager mandates on behalf of institutional investors, creating a real estate fund portfolio based on the investor's

Fig. 3:



geographic preferences and appetite for risk. Aviva Investors Real Estate Multi-Manager is one such firm. It has invested over \$6 billion in private real estate funds on behalf of its institutional clients.

Who Invests in Funds of Funds?

Fund of funds investments are a popular option for small to medium-sized investors. Fig. 3 shows that 76% of investors in funds of funds have a total asset base of less than \$10 billion. 41% have total assets of between \$1 billion and \$9.9 billion, with 35% managing less than \$1 billion in assets. However, it is not exclusively the smallest investors that commit to funds of funds. Larger investors may commit to these vehicles to gain exposure to a market they have little knowledge of or a region that they might not be able to reach through direct fund commitments.

Diversification is one of the key reasons investors commit to funds of funds. One commitment provides the investor with a fund portfolio diversified by geography, strategy and property type. This is achieved at a fraction of the cost required if the investor were to invest in individual funds. The due diligence and research is all carried out by the fund of funds manager,

which is likely to have a greater degree of expertise and contacts than most smaller investors.

Investor Appetite

Market conditions have led to many investors halting their real estate investments, and the small to medium-sized institutions that invest in funds of funds have been affected by the decline in property valuations. Many investors that had hoped to return to the market this year are postponing further, and many are as yet undecided as to when they will resume commitments. Most investors are not abandoning the fund of funds route however, and will continue to make this type of commitment.

Outlook

The real estate fund of funds market has grown into an important part of the private real estate fund industry as a whole. The industry saw significant growth between 2005 and 2007, with funds of funds raising increased amounts of capital. 2009 was a difficult year for fundraising. The aggregate capital raised fell to \$1.7 billion, just 37% of the capital raised in 2007. Seven funds of funds made their first investments in

2009, the lowest number since 2003. Raising capital for new funds of funds during 2009 was an extremely challenging prospect in a market in which most investors were extremely cautious and reluctant to make new fund commitments. As a result some firms were forced to abandon their funds, while those firms that did close funds often raised less capital than they had originally targeted.

The fundraising market remains extremely competitive, as many investors remain reluctant to make new commitments. These institutions still see the value of funds of funds and are likely to return to the market, but it may not be until 2011 that the rate of fundraising improves. There has been some consolidation within the fund of funds market and this is a trend which seems likely to continue as the larger firms seek to further cement their position as leaders within the industry.

Despite the slow fundraising environment, funds of funds do have capital available to commit and while they may have spent the past 12 months on the sidelines, most have indicated to Preqin that they will look to make new investments in the coming year. These firms are experienced investors and are adapting their approach in order to take advantage of the prevailing opportunities in the current market. Fund of funds managers that invest wisely in the coming months could well secure strong returns for their investors.

Andrew Moylan

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The information contained within this article is based on data from [The 2010 Preqin Private Equity Real Estate Fund of Funds Review](#)

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Now in its third year, The 2010 Preqin PERE Fund of Funds Review is the most comprehensive guide to the private equity real estate fund of funds industry ever created. Preqin has contacted managers, investors and real estate professionals from around the world in order to ensure that this year's publication is as accurate and detailed as possible. This year's edition includes:

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Fundraising Spotlight

Fig. 1:

Funds on the Road				
	North America	Europe	ROW	Total
Number of Funds	215	106	76	397
Aggregate Target Size (\$bn)	77.8	41	30.6	149.5
Average Target Size (\$mn)	376	436	438	403

Fig. 2:

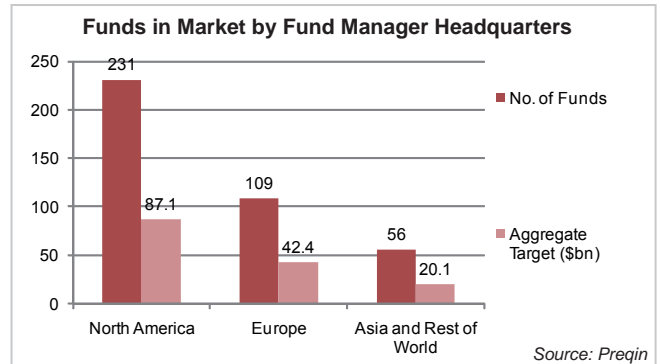


Fig. 3:

10 Largest Solely North America-Focused Real Estate Funds on the Road			
Fund	Manager	Target Size (mn)	Strategy
Carlyle Realty Partners VI	Carlyle Group	3,000 USD	Opportunistic, Debt
TA Realty Associates IX	TA Associates Realty	1,850 USD	Core-Plus, Value Added, Debt, Distressed
MacFarlane Urban Real Estate Fund III	MacFarlane Partners	1,500 USD	Opportunistic
AREA Real Estate Opportunity Fund VI	AREA Property Partners	1,000 USD	Opportunistic, Debt
Vornado Capital Partners	Vornado Realty Trust	1,000 USD	Distressed
LNR Archetype Real Estate Debt Fund	LNR Commercial Property Group	850 USD	Debt
CrossHarbor Institutional Partners II	CrossHarbor Capital Partners	750 USD	Opportunistic, Debt
JP Morgan US Opportunistic Property Fund	JP Morgan Asset Management	750 USD	Opportunistic, Debt
Och-Ziff Real Estate Fund II	Och-Ziff Real Estate Advisors	750 USD	Debt, Distressed
Murray Hill Properties Real Estate Investment V	Murray Hill Properties	750 USD	Core, Value Added, Opportunistic, Distressed

Recently Closed Funds

Starwood Global Opportunity Fund VIII

Manager: Starwood Capital Group
Strategy: Opportunistic, Distressed
Property Types: Any
Geographic Focus: Global
Target IRR (Net): 20%
Final Close: 1,800 USD (April 2010)
Sample Investors: CalPERS, CalSTRS, New Mexico Public Employees' Retirement Association, North Carolina Department of State Treasurer, Pennsylvania State Employees' Retirement System, State of Connecticut Retirement Plans and Trust Funds, Teachers' Retirement System of Louisiana

Starwood Capital Global Hospitality Fund II

Manager: Starwood Capital Group
Strategy: Opportunistic, Distressed
Property Types: Hospitality
Geographic Focus: Global
Target IRR (Net): 20%
Final Close: 965 USD (April 2010)
Sample Investors: CalPERS, CalSTRS, Los Angeles City Employees' Retirement System, Los Angeles County Employees' Retirement Association, Maryland State Retirement and Pension System, Oregon State Treasury



Fund Manager Spotlight: US-Based Fund Managers

Fig. 1:

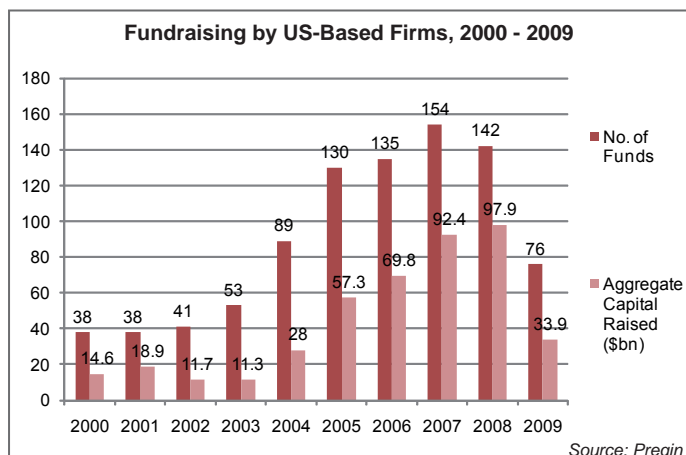


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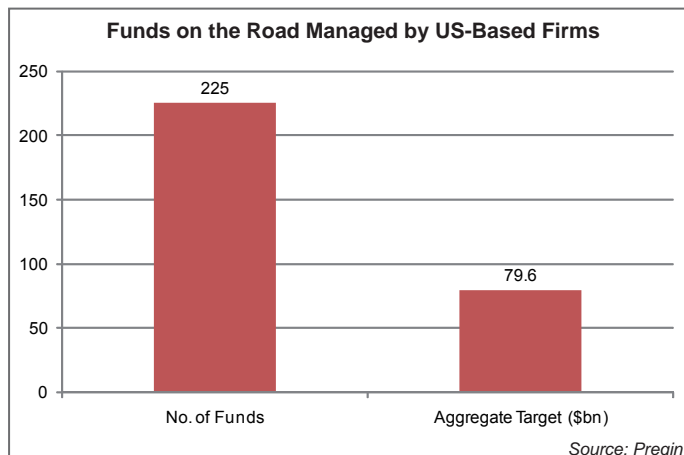


Fig. 3:

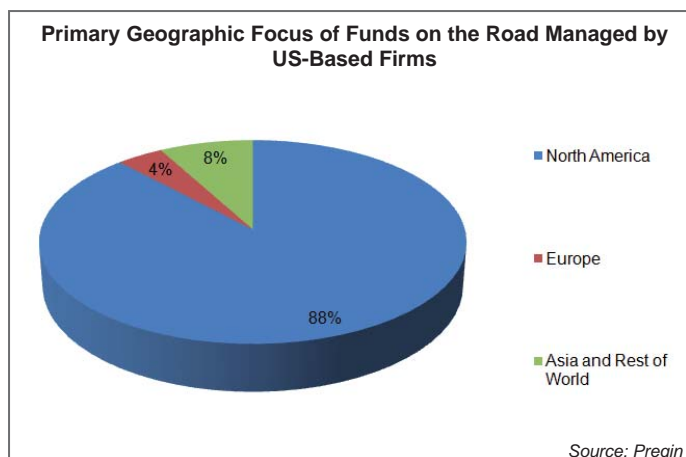
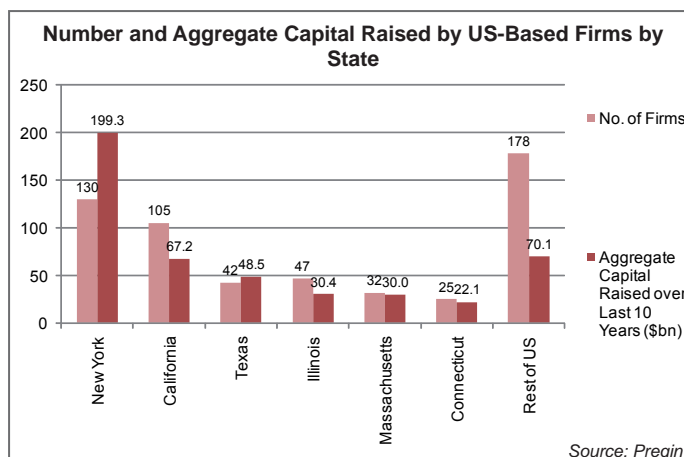


Fig. 4:



The information in Fund Manager Spotlight is taken from Preqin's Real Estate Online product. There are currently profiles for over 577 fund managers based in the US.

To find out more information about this product, or to arrange a demo, please visit:

www.preqin.com/realstate

Andrew Herman



Investor Spotlight: UK-Based Investors

UK institutions are an important source of capital for real estate managers on both a domestic and international basis. In 2010 they account for 10% of all investors worldwide by number. Fig. 1 shows that a considerable proportion of such investors are pension funds: 38% are public pension funds and 21% are private pension plans. 8% are real estate fund of funds managers. Real estate fund managers that commit some of their own, or their client's capital to third-party funds, account for 6% of UK investors. 15% are other types of institutional investors, such as banks and investment companies.

UK-based institutions will invest across the risk/return spectrum, although the most targeted strategies are value added and opportunistic. This is consistent with the entire real estate investor universe. There is also a strong preference for low-risk open-ended core funds, with 31% allocating to such vehicles. 30% seek fund of funds vehicles; these investors may not have the resources to diversify their portfolios through a series of direct commitments.

96% of UK-based investors allocate to European funds, and 31% have a

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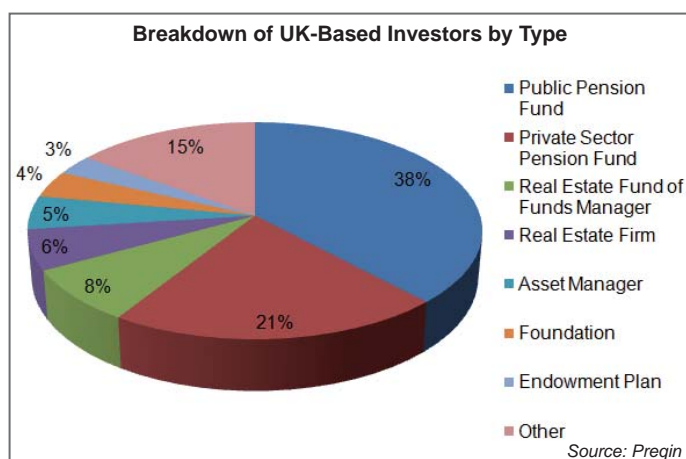


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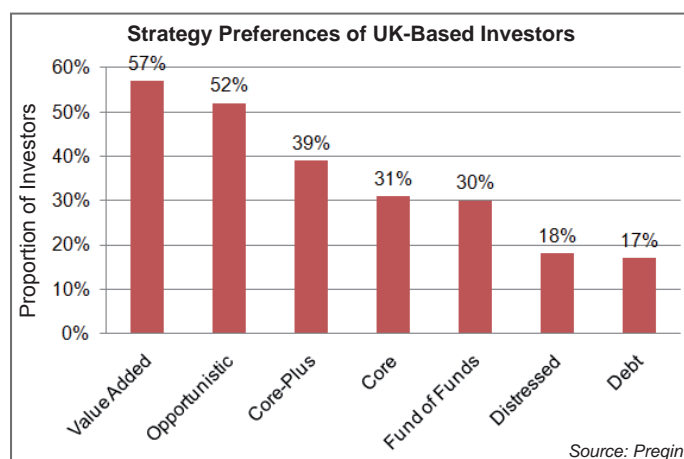
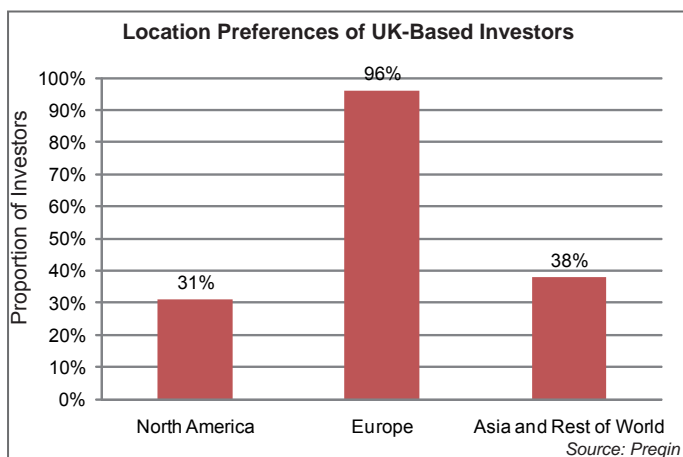


Fig. 3:



preference for funds focused on North America. The proportion of investors interested in Asia and Rest of World is slightly higher than the proportion interested in North America. This suggests that investors from the UK are keen to gain exposure to emerging markets.

Forena Akthar

The information in Investor Spotlight is taken from Real Estate Online. There are currently profiles for 253 UK-based investors with an active interest in real estate.

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Conferences Spotlight: Forthcoming Events

Annual US Real Estate Opportunity & Private Fund Investing Forum

Date: June 3-4

Location: Sheraton, New York, NY

Organiser: IMN

IMN's upcoming 11th Annual Real Estate Opportunity & Private Fund Investing Forum is scheduled for June 3-4 at the Sheraton in New York. This is IMN's flagship Real Estate event, annually attended by 1,200-1,500 delegates including a "Who's Who" of Real Estate General Partners, Limited Partners, and Industry Service Providers.

Information: www.imn.org/usoppfunds2010

2nd Global Distressed Debt Investing Summit 2010

Date: 16 June

Location: New York

Organiser: iGlobal Forum

iGlobal Forum 2nd Global Distressed Debt Investing Summit will once again unite the leading Distressed Fund Managers, Private Equity Fund Managers, Hedge Fund Managers, M&A and Turnaround Advisors, Investment Bankers, Bankruptcy Advisors, Loan Originators, Debt Providers, and Rating Agencies. The event will provide the perfect platform to network with the leading dealmakers who will address the most pressing issues within the industry.

Information: www.terrapinn.com/2010/vis/

Conference	Dates	Location	Sponsor
US Real Estate Opportunity & Private Fund Investing Forum	3 - 4 June 2010	New York	IMN
Vietnam Investment Summit 2010	7 - 9 June 2010	Vietnam	Terrapinn
Russian Real Estate Summit	7 - 9 June 2010	Moscow	Adam Smith Conferences
Real Estate Investment World Asia 2010	21 - 23 June 2010	Singapore	Terrapinn
New York Non-Traded REIT Industry Symposium	24 - 25 June 2010	New York	IMN
Real Estate Investment Latin America	28 - 30 June 2010	Miami	IQPC
Property Investment Conference 2010	29 - 30 July 2010	Cape Town	IPD
Malaysia REITs 2010	2 - 5 August 2010	Kuala Lumpur	Asia Business Forum
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
Real Estate Investment World Japan 2010	25 - 27 October 2010	Tokyo	Terrapinn
European Real Estate Opportunity & Private Fund Investing Forum	8 - 9 November 2010	London	IMN



Investor Spotlight: Investor News

Kuntien Eläkevakuutus looking to continue investing in real estate in 2010

The EUR 26 billion pension fund has already invested in private real estate in 2010, committing GBP 35 million to a fund making core-plus and value added investments in UK property. The pension fund has set aside approximately EUR 150 million to invest in three to five funds in 2010. Kuntien Eläkevakuutus will seek investments across the risk/return spectrum, specifically targeting vehicles making core-plus and value added investments. The pension fund will continue to commit to funds making investments in Asian and European markets, and could make its maiden commitment to a US-focused vehicle in 2011. The pension fund may choose to invest in real estate via a fund of funds vehicle in 2010, in order to maintain diversification in its portfolio.

San Joaquin County Employees' Retirement Association to allocate USD 40 million to real estate

The USD 1.7 billion pension fund is looking to allocate USD 40 million to real estate in the next 12 months. It is likely to make commitments to one to two real estate funds, although its advisor ORG Portfolio Management could establish a separate account for the pension fund to make purchases of real estate fund stakes on the secondary market. ORG set up similar accounts for Arizona Public Safety Personnel Retirement System and New Mexico Educational Retirement Board last year. San Joaquin County Employees' Retirement Association has a 10% target allocation to real estate, with 9.9% committed to the asset class; only 5% is actually invested.

London Borough of Brent Pension Fund will not be making new real estate fund commitments in the next two to three years

The GBP 450 million pension fund is satisfied with its 8% target allocation and

is not looking to increase this. It is also satisfied with the two funds of funds it is invested in, and is not looking to allocate to further vehicles in the next two to three years. In order to reach its 8% target allocation, London Borough of Brent Pension Fund will allocate an additional GBP 9 million to its existing fund of funds investment, Aviva Investors UK Real Estate Fund of Funds.

CPP Investment Board enters second joint venture agreement with Goodman

The CAD 123.9 billion CPP Investment Board has formed another joint venture with Australian firm Goodman. The two organizations have established a new investment vehicle, Goodman Australia Development Fund (GADF) to purchase development projects in Australia, particularly in the logistics and warehouse sectors. The vehicle will be seeded with the purchase of a distribution centre in Melbourne that Goodman began developing for Kmart in January, at the cost of AUD 66.3 million. AUD 250 million of initial equity will be committed to GADF, although the vehicle is targeting a gross asset value (GAV) of AUD 400 million. Goodman will be the asset manager for GADF, which is 80% owned by CPP Investment Board and 20% owned by Goodman.

Illinois Municipal Retirement Fund to commit USD 250 million to real estate funds

The USD 22.2 billion public pension fund has announced that it plans to invest USD 250 million in real estate funds during the course of the year. It is believed that USD 150 million will be invested in core fund strategies, and USD 100 million in non-core strategies. This follows an announcement in Q1 2010 that the fund was seeking to allocate across two or three vehicles. The pension fund also plans to redeem USD 60 million from Morgan Stanley Prime Property Fund and has announced that it will no longer

seek redemptions of USD 50 million from Sentinel Real Estate Fund as it was hoping to do.

Government Pension Fund – Global appoints head of real estate

The NOK 2.8 trillion sovereign wealth fund has appointed Karsten Kallevig as head of its real estate team, a position which he will take up on 1 September 2010. He has been head of Grove International Partner's office in Japan since 2006 and prior to that worked in their London office. The sovereign wealth fund has a target allocation of 5% to real estate, which it hopes to reach in the next 5-10 years.

Forena Akthar

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