

# Preqin Special Report

Overview of Private Equity Real Estate Funds of Funds

June 2011



# Overview of PE Real Estate Funds of Funds Market

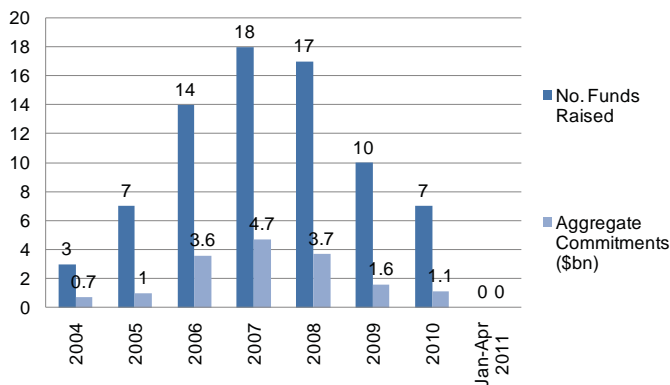
Funds of funds have traditionally been a significant source of capital for private equity real estate fund managers, as well as providing access to the asset class for investors that lack the resources, finance, knowledge or experience required for manager selection and committing to funds directly. In compiling the 2011 Private Equity Real Estate Funds of Funds Review, Preqin analysts have contacted hundreds of professionals active within the sector to gather information on fund managers, fundraising, fund terms and conditions, fund performance, institutional investors in funds of funds and funds of funds acting as investment consultants. This special report calls upon some of the key content from the Review to provide an overview of the latest industry developments.

## Fundraising

Private real estate fundraising remains a challenging prospect, with the difficult market conditions of 2009 and 2010 continuing into 2011. Managers are launching fewer funds, targeting less capital than when the industry was at its peak (2006-08), and the number of funds closing and the amount of capital raised has fallen dramatically. This same trend is also observed in fundraising for funds of funds (see Fig. 1), and between January and April 2011, no fund of funds vehicle was able to hold a final close, compared to 21 real estate vehicles of other strategies.

The market share of funds of funds, however, has been stable in the past five years, with these vehicles accounting for 3-4% of the overall capital raised by all private real estate funds. In April 2011, there were 26 real estate funds of funds in market targeting an aggregate \$5.4 billion in equity. 12 of these were North America-focused, seeking \$2.7 billion, eight Asia and Rest of World-focused funds were targeting \$1.9 billion and six Europe-focused vehicles were aiming to raise \$0.8 billion. Nonetheless, the amount of capital sought by funds of funds has been declining annually since 2008.

Fig. 1: Fund of Funds Fundraising, 2004 - April 2011

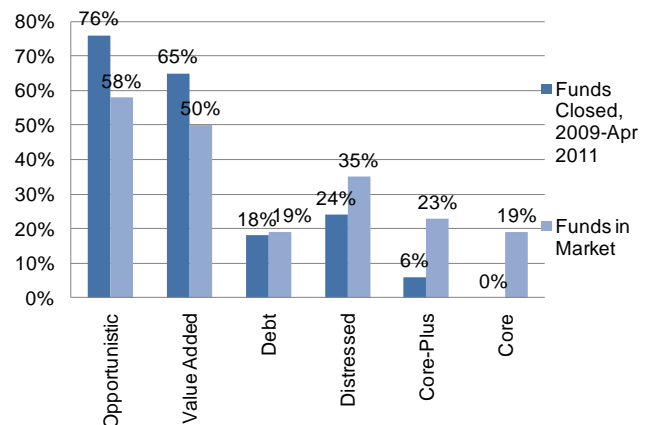


## Fund of Funds Managers: Changes in the Market

Fig. 2 illustrates the recent shift in strategy focus of funds of funds in response to changing investor sentiment and market demand. Increased interest in real estate debt and distressed property led to the launch of a number of funds of funds focusing on this area of the industry. Metropolitan Real Estate Equity Management raised \$162 million for Metropolitan Real Estate Partners 2008 Distressed Co-Investment and the firm is targeting \$150 million for MREP Distressed Strategies II. 2010 saw core and core-plus funds grow in prominence, with investors looking to minimize the level of risk in their portfolios, and as such, several funds on the road are looking to take advantage of this trend in the market. Pohjola Real Estate Fund of Funds II and Capital Dynamics Real Estate IV Asia-Pacific Core+ are two vehicles in market which will target underlying core and core-plus strategies.

Managers that closed their funds of funds in the last couple of years have yet to deploy a significant proportion of the capital raised, waiting instead for market conditions to improve. These firms are likely to become more active in the coming year however, with many firms indicating to Preqin that they will make underlying investments in the next 12 months.

Fig. 2: Targeted Strategies of Funds of Funds



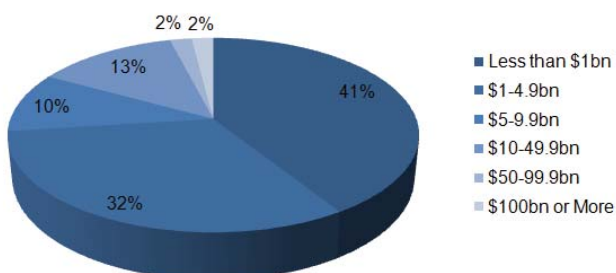
A select number of funds of funds act as investment consultants to institutional investors, and allocate client capital to real estate funds through managed mandates and separate accounts. The nature of the consultancy services offered varies, and is often tailored around the needs and preferences of clients. Through such mandates, investors acquire fund portfolios that meet their policy requirements and are managed by firms that specialize in multi-manager investments. This type of service is widely used by UK pension funds, and is likely to appeal to a growing number of investors in the asset class as they look to gain more control over their portfolios and apply a more proactive approach to investment.

There was further consolidation in the real estate fund of funds market following on from Capital Dynamics assuming HRJ Capital's fund of funds business in July 2009, and Aviva Investors Real Estate Multi-Manager taking over the operations of two real estate funds of funds previously managed by BlackRock Realty in November 2009. In February 2011, it was announced that CB Richard Ellis acquired ING Real Estate Investment Management. Both firms have significant real estate fund of funds divisions and the combined multi-manager business will manage approximately \$13 billion (€9 billion). As fundraising for funds of funds continues to struggle, further consolidation may occur in the next few years, with firms of all sizes seeing the benefits of integration and the potential for efficiency savings when serving their clients.

**Funds of Funds Investors: Changing Sentiment**

Funds of funds have historically been a popular choice for small and medium-size investors, but larger investors have committed to such vehicles to acquire exposure to unfamiliar markets or regions that they cannot, or are unwilling to, access through direct fund investments. Fig. 3 shows that 83% of investors in funds of funds have a total asset base of less than \$10 billion.

Fig. 3: Breakdown of Investors in Funds of Funds by Size



42% have assets of between \$1 billion and \$9.9 billion, and 41% have less than \$1 billion under management.

In the current market, however, some of the motivations for investing in funds of funds, such as accessing top tier funds and global diversification, are not as compelling or relevant as they have been in previous years. Investors are committing less capital to real estate funds, with some halting allocations altogether. Those that are willing to invest are favouring low-risk investments or targeting funds which they believe will provide the best returns in the current market rather than seeking global and strategic diversification.

Investor appetite for funds of funds has therefore declined, as has the number of new investors entering the fund of funds arena for the first time. Of the investors with historical fund of funds commitments that will be active in private real estate in 2011, only a small number are actually seeking fund of funds investments, with the rest preferring to invest in other fund types in the immediate future. Although the majority of institutional investors that Preqin recently spoke to as part of the research for this publication indicated that they will keep funds of funds as a long-term preference, a few have stated that they will no longer invest in such vehicles. This could be due to unsatisfactory returns of the funds of funds in their portfolio, or because they have now gained the necessary knowledge and experience to invest in funds directly. Those that have committed to funds of recent vintages are waiting to assess the performance of those investments, and because managers have made very few underlying commitments, with all firms deploying capital at a much slower rate, it may be a while before these investors are ready to make new fund of funds commitments.

## Investors in Funds of Funds

- \* Investors can obtain a diversified portfolio through a single fund of funds investment. Smaller investors in particular may be otherwise unable to achieve this level of diversification due to the capital requirements of investment in individual funds.
- \* 48% of investors with a preference for fund of funds vehicles have a real estate allocation of less than \$100mn. 27% have an allocation of between \$100 mn and \$499.9mn, and the remaining 15% have an allocation of \$1bn or more to the asset class.
- \* Of the investors with a preference for real estate funds of funds, 41% have total assets of less than \$1bn and 32% have total assets of between \$1bn and \$4.9bn. Investors with total assets of over \$50bn account for 4% of fund of funds investors.
- \* Public pension funds account for the largest proportion of real estate fund of funds investors, 39%. Foundations and endowments account for 14% and 13% of investors respectively, while 11% of those making commitments to fund of funds vehicles are private pension schemes.
- \* Almost half, 47%, of those that invest in real estate funds of funds are located in North America, closely followed by Europe-based investors, which account for 43% of investors. 10% of fund of funds investors are based in Asia and Rest of World.
- \* Value added is the most popular strategy pursued by fund

of funds investors; 60% of investors have either gained exposure to, or wish to gain exposure to, funds of this type through their investments. Opportunistic is the next most popular strategy, with 56% of fund of funds investors having a preference for such vehicles. 24% of fund of funds investors have a preference for core-plus strategies and 15% seek opportunities to invest in core vehicles. Distressed and debt strategies appeal to 12% and 9% of fund of funds investors respectively.

- \* Europe is the most popular region targeted by fund of funds investors and 64% have a preference for Europe-focused funds. 56% have gained exposure to North America, or wish to do so. 46% of investors have a preference for funds of funds that target Asia and Rest of World and 43% hope to gain access to emerging markets through their fund of funds commitments.
- \* Of the investors with a preference for Asia-focused funds, 86% are located in North America or Europe, while those seeking opportunities in Europe and North America are predominantly domestic investors. 53% of investors with a preference for European-focused funds are based in the region, and 69% of those with a preference for North America-focused funds are North America-based.

Fig. 4: Breakdown of Investors in Funds of Funds by Type

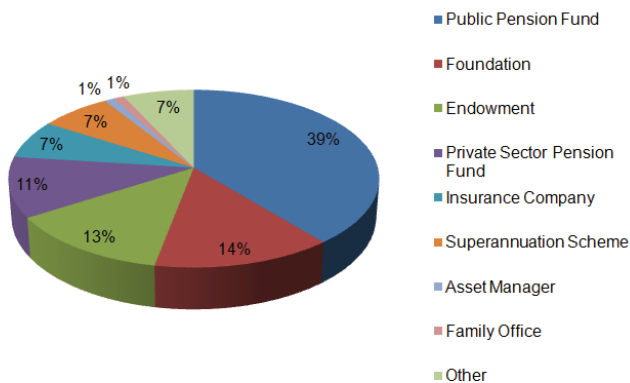
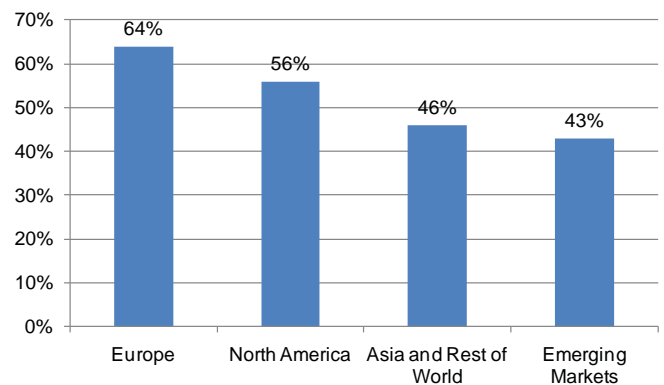


Fig. 5: Investors' Fund of Funds Location Preferences



## Fund of Funds as Investment Consultants

- \* Managers of real estate funds of funds provide a number of services to the private equity real estate industry. These firms invest in a range of managers through their fund of funds vehicles, allocate to funds through managed mandates and separate accounts, and also act as investment consultants to investors. Real estate fund of funds managers can undertake a range of advisory responsibilities for institutional investors, even if they do not manage a specific mandate for those clients
- \* 38% of such fund of funds managers are based in North America, whereas 62% are Europe-based, suggesting that European firms are more likely to offer advisory services than their North American counterparts. This could be because there is more demand from European investors, and particularly those based in the UK, for funds of funds to provide investment consultancy services.
- \* Fig. 6 indicates that 46% of real estate funds of funds that offer a consultancy business specialize on discretionary services, whereas the remaining 54% will offer both discretionary and non-discretionary advice.
- \* Real estate fund of funds managers appointed as discretionary consultants will often take ownership of decision making for the investment portfolio, determining the strategic and geographic focus of their clients' potential fund commitments. Alternatively, investors can provide a discretionary mandate for a specific amount of capital to be invested in a specific region, or in a particular risk/return profile, whereupon the fund of funds will source real estate fund managers that match the specified criteria and make the capital commitments on their behalf
- \* When acting in a non-discretionary capacity, the consultant will present its client with potential investment opportunities that are consistent with a predetermined investment policy; however it is the client that will make the final decision regarding investment. Institutions investing through managed mandates instead of funds of funds often do so due to the increased degree of control they can have over the underlying fund investments.
- \* As shown in Fig. 7, 92% of real estate fund of funds managers that offer consultancy services have clients that are based in Europe. Considering that a large proportion of these consultants are headquartered in Europe, this proportion is unsurprising.
- \* The majority of real estate funds of funds acting as consultants will offer their services to any type of institution. 85% of these firms provide property fund consultancy services to public pension plans, and 77% to private pension funds. A small proportion work on the behalf of insurance companies and superannuation schemes, and 31% advise other institutions such as foundations and sovereign wealth funds.

Fig. 6: Breakdown of Investment Consultants by Service Type

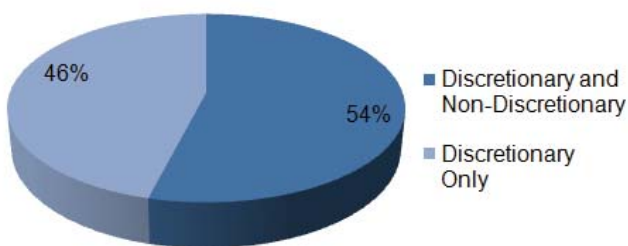
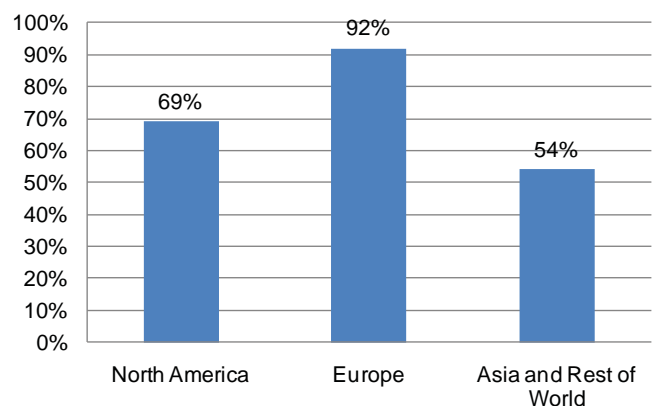


Fig. 7: Investment Consultants' Client Locations



## Fund of Funds Fundraising

- \* As of Q2 2011, there are 26 real estate funds of funds in market seeking to raise \$5.4 billion from investors. While the aggregate amount of capital sought by real estate funds of funds has decreased from \$6.1 billion in Q2 2010, there are three more vehicles currently fundraising than at this time last year. The amount of capital sought by real estate funds of funds on the road has decreased year-on-year since 2008.
- \* While Asia and Rest of World-focused funds account for a large portion of all real estate funds of funds in market, the managers of these funds are typically based in either North America or Europe. A breakdown of funds on the road by geographic focus is shown in Fig. 8
- \* Six funds of funds currently raising capital are first-time funds. These include vehicles managed by firms new to the real estate fund market and established firms raising their first fund of funds. In Q2 2009, first-time funds accounted for 26% of the total capital sought by funds of funds; by Q2 2010 it had increased to 40%, but by Q2 2011 it had declined again to 30%.
- \* Fig. 9 shows the status of fund of funds vehicles that were raising capital in Q2 2010. The majority of funds that were raising capital in Q2 2010 are still fundraising as of Q2 2011. 9% of funds that were raising capital in Q2 2010 have been abandoned in the course of the year, compared to 34% in the previous 12-month period. The reduction in the number of funds being abandoned may indicate an improvement in manager sentiment as to their chances of successfully raising a fund.
- \* Over 60% of funds of funds in market have been on the road for more than 12 months, but out of all funds, 12 have held at least one interim close. The length of time funds are spending in market does highlight that the current fundraising environment is slow, but as 46% of vehicles have held at least one interim close, it is clear that there are still investors willing to commit capital. A quarter of funds of funds have been raising capital for 0-6 months, indicating that there are also significant numbers of new funds being brought to market.
- \* While the number of funds of funds in market has increased over the past 12 months, the amount of capital sought has decreased by 12%. The number of vehicles being abandoned over the course of the year has also decreased significantly compared with the number that were abandoned between Q2 2009 and Q2 2010, but over 60% of vehicles have still spent over a year in market. The drop in the number of abandoned vehicles could be seen as a sign that the fundraising market for funds of funds is improving; however other evidence would suggest that the overall environment remains depressed.

Fig. 8: Funds of Funds on the Road by Primary Geographic Focus

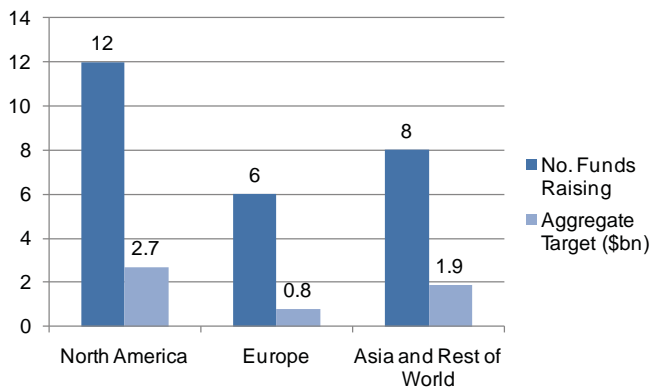
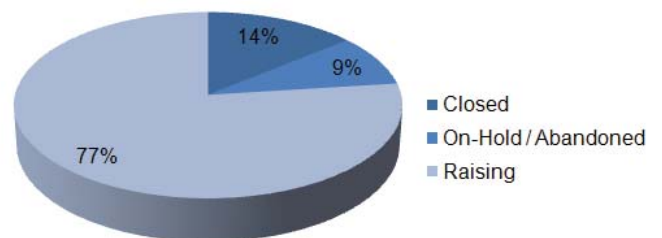


Fig. 9: Status of Funds of Funds That Were Raising Capital in Q2 2010



# The 2011 Preqin PE Real Estate Funds of Funds Review

Private equity real estate fund of funds vehicles perform a vital function within the PERE industry, providing a way for smaller and newer investors to gain exposure, while also providing important advisory services and acting as a vital source of capital for real estate managers raising new funds. Gaining a good understanding of this growing industry is vital for all professionals operating in or investing in private equity real estate - especially those seeking investors for new vehicles.

Now in its fourth year, The 2011 Preqin PERE Fund of Funds Review is the most comprehensive guide to the private equity real estate fund of funds industry ever created. Preqin Real Estate has contacted managers, investors and real estate professionals from around the world in order to ensure that this year's 140-page publication is as accurate and detailed as possible, featuring exclusive information not available anywhere else.

### Key features of this publication include:

- \* Comprehensive profiles for all 59 PERE fund of funds managers, including contact details, history, sample investments, plus detailed investment plans at a fund specific level.
- \* Also includes profiles for 10 private equity fund of funds managers with a significant allocation to real estate.
- \* Full listings for funds closed and currently in the market.
- \* Profiles for over 120 current institutional investors in PERE fund of funds, with contact details, sample investments made and investment plans for the future.
- \* Detailed analysis on all aspects of the market, identifying trends in fundraising, performance, fund terms and conditions, investors, fund focus and much more.

### Benefits of this year's publication include:

- \* Wide-ranging analysis will help you understand the latest market trends and is essential for producing reports, presentations and marketing materials.
- \* Our detailed profiles will save hundreds of research hours looking for firm or investor backgrounds and contact details.
- \* Most comprehensive report available today, with exclusive information all compiled by our team of dedicated multi-lingual analysts via direct contact with firms and investors.

**More information:**  
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<p>1..... EXECUTIVE SUMMARY</p> <p>2.....DATA SOURCES/METHODOLOGY</p> <p>3.....HISTORY AND DEVELOPMENT OF THE MARKET</p> <p>4.....FUNDS OF FUNDS AS INVESTMENT CONSULTANTS</p> <p>5.....LISTINGS OF FUNDS CLOSED 2009 - MAY 2011</p> <p>6.....CURRENT FUNDRAISING MARKET</p> <p>7.....LISTINGS OF FUNDS CURRENTLY RAISING</p> <p>8.....FUNDS TERMS AND CONDITIONS ANALYSIS</p> <p>9.....LISTINGS OF FUND TERMS AND CONDITIONS</p> <p>10.....FUNDS OF FUNDS AS INVESTORS</p> <p>11.....PERFORMANCE ANALYSIS</p> <p>12.....LISTINGS OF FUND PERFORMANCE</p>	<p>13.....SERVICE PROVIDERS</p> <p>14..... FIRM INVESTMENT PREFERENCES</p> <p>15.....REAL ESTATE FUND OF FUNDS MANAGERS PROFILES</p> <p>16.....PRIVATE EQUITY FUND OF FUNDS MANAGER PROFILES</p> <p>17.....INVESTORS IN FUND OF FUNDS</p> <p>18.....KEY INVESTORS IN REAL ESTATE FUND OF FUNDS PROFILES</p> <p>19.....INDEX</p>
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# 2011 Preqin PE Real Estate Fund of Funds Review

The [2011 Preqin PE Real Estate Fund of Funds Review](#) is the ultimate guide to the real estate fund of funds market, with data, analysis and profiles on fundraising, firms, performance, terms and conditions and investors.

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