

Small Private Real Estate Funds Outperform Larger Counterparts. Only 40% of \$1bn+ funds are producing returns exceeding the median compared to 54% of those which raised \$500mn or less.

Despite dominating the private real estate market in the years leading up to the financial crisis, North America-focused funds with \$1bn or more in commitments are being outperformed by funds of less than \$500mn in size, according to Preqin's performance quartile rankings. The rankings are calculated by allocating each fund a quartile based on its performance relative to other funds of the same vintage.

The rankings show:

- 54% of small funds (less than \$500mn) are outperforming the median; 30% are ranked as top quartile, and only 21% are in the bottom quartile.
- 23% of \$1bn+ funds are producing top quartile returns; 60% are producing returns below the median.
- 2001 vintage \$500mn+ funds have produced stronger returns than their smaller counterparts, with a median IRR of 30.2%.
- For each vintage year between 2002 and 2008, the median IRR of small funds exceeds that of \$500mn+ funds.
- There is little difference between the median IRRs for \$500mn+ funds and small funds of vintage years 2004 and 2005, but for vintage 2007 funds, the median IRR of small funds is -8.0% compared to a median of -20.0% for \$500mn+ funds.

Context: Fund Size in the Real Estate Market:

Although several \$1bn+ funds were brought to market in Q1 2011, there has been a general decline in their number since September 2008.

- In 2003, 15% of total capital raised was accounted for by \$1bn+ funds. This increased to 44% in 2006, and 56% in 2008.
- \$1bn+ funds contributed 47% of capital raised in 2010.
- Small funds accounted for 63% of capital raised in 2003, 35% of that raised in 2006 and 21% of capital raised in 2008.
- In September 2008, there were 59 funds in market seeking \$1bn or more, collectively targeting an aggregate \$125.7bn. In April 2011, these figures stood at 24 and \$46.3bn respectively.
- Of the 17 funds to close in Q1 2011, just one raised \$1bn or more.
- Eight \$1bn+ funds were launched between January and April 2011.
- Although fewer in number, the 54 real estate funds launched in Q1 2011 are targeting a larger amount of capital (\$34.7bn) than the 74 funds launched in the same period last year, which were targeting \$24.6bn.

The full report can be found here: <http://www.preqin.com/docs/newsletters/RE/Preqin Real Estate Spotlight MAY 2011.pdf>

Comment:

Given that many larger funds appear to have under-performed in recent years, investors might be expected to focus on the small to mid-size funds; the size of the funds which have been successful in raising capital in 2010 and 2011 certainly suggests that this is the case. A number of mega funds were launched in Q1 2011, so these managers clearly feel that investor confidence is returning, but while Preqin's conversations with investors do indicate that they are more likely to make new commitments, fundraising will remain challenging given the number of funds on the road.

Manager selection remains important, and there is a great deal of variation between the best and worst performing funds. As uncertainty remains in the real estate market, institutional investors are looking for managers that can prove that they can create value. Large, brand-name firms that have been successful in the past will no doubt continue to be successful in the future as

confidence returns to the asset class. For firms whose funds have not performed as well, raising capital in 2011 is likely to be far harder, as institutions increasingly look to funds with more focused strategies.

Andrew Moylan, Manager – Real Estate Data.

About Preqin:

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Note to Editors:

- Preqin is spelled without the letter 'U' after the 'Q'.

For more information on this release, please contact: Andrew Moylan: +44(0)20 7397 9430 or amoylan@preqin.com

For general press information, please contact Tim Friedman: +44 (0)20 7645 8880 or tfriedman@preqin.com