PREQIN QUARTERLY UPDATE: REAL ESTATE Q1 2017
Insight on the quarter from the leading provider of alternative assets data

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Fundraising for private real estate slowed in Q1 2017 compared with recent quarters, with just 38 funds reaching a final close, raising an aggregate $16bn. Although these figures may increase as more data becomes available, at present, this is the lowest amount of capital raised in a single quarter since Q1 2013.

Despite fund managers holding record levels of dry powder, deal activity has fallen in comparison with recent quarters. The number of completed private equity real estate deals was around a third lower, with 568 deals completed in Q1 2017 compared with 853 in Q4 2016. Aggregate deal value was also lower at $38bn compared with $57bn in Q4 2016.

Despite some slowdown in these areas, private real estate continues to perform strongly for investors, with annualized returns of 14.9% for the three years to June 2016, the most recent data available. Private real estate funds have delivered 25 consecutive quarters of NAV growth to Q2 2016 and the PrEQIn Real Estate Index stands at 104.3 (rebased to December 2007), meaning that the fall in the Index from December 2007 to June 2010 has now been fully recovered.

The fundraising marketplace for real estate remains competitive: there are currently a record number (554) of funds in market, seeking $189bn in aggregate capital, the highest amount targeted since 2009. Although value added and opportunistic funds make up a large proportion of the vehicles coming to market, investors appear to be increasingly targeting core real estate funds for their future investments as they seek to use the asset class to generate income, with the strategy now the most frequently targeted among investors with active fund searches and mandates on Preqin’s Real Estate Online.

We hope that you find this report useful and welcome any feedback you have. For more information, please visit www.preqin.com or contact info@preqin.com.
Commentators on cross-border investment fund activity regularly refer to the impact of global regulatory and market shifts on business flows. The changes we have witnessed in the past 12 months have perhaps, though, seemed more significant than ever.

The fallout of the UK’s Brexit vote, combined with the US presidential election, in particular, have prompted fund professionals, including those in the real estate sector, to think about how they operate in a much more complex and potentially more fragmented landscape.

All this change, however, should not necessarily be daunting for those involved in cross-border real estate activity but could, on the contrary, offer smart and innovative players some fresh opportunities.

In fact, long-term macro trends suggest that global property investment will continue to rise in the coming years. In the alternative investments world, global trends such as the shift in wealth towards Asia-Pacific and the increase in cross-border investment flows are driving demand for sophisticated investment support, with estimates from PwC (Asset Management 2020: A Brave New World, 2014) indicating that the global asset management industry will grow to more than $100tn within the next five years.

With this comes a greater interest in property investment. Institutional and private investors in markets now stretching from the US to the Middle East and Africa to Asia are seeking efficient means of deploying investment capital into real estate funds, and fund managers in those markets are also looking to diversify their portfolios into non-domestic assets.

Figures from Preqin show that more institutional investors hold real estate assets (61%) than any other alternative asset class, and that 24% of institutional investors plan to increase their exposure to real estate assets this year (Preqin Investor Outlook: Alternative Assets, H1 2017).

Institutional investors around the world see property as a safe investment, and certainly it is Jersey’s experience that investors, increasingly from Asia, continue to be attracted to commercial real estate assets in major European hubs and, interestingly in light of Brexit, in London.

**ROLE FOR IFCs**

More than ever, cross-border investment flows require precise alternative fund structuring and servicing expertise, particularly against the backdrop of international regulatory change and the drive towards international standards, such as the OECD’s base erosion and profit shifting (BEPS) agenda.

The reality is that international finance centres (IFCs) like Jersey can play a key role in channelling and pooling investment capital from source to markets such as London, providing an excellent hub for establishing real estate holding structures for international investors.

In relation to the London and wider UK real estate market, there is a strong rationale for the appeal of those IFCs located in close proximity to the UK, like Jersey, particularly among Chinese, Malaysian and Singaporean private, institutional and sovereign wealth funds.

Jersey is independent yet has close connections with the UK and is a jurisdiction of substance, with the expertise of more than 13,000 professionals working in its finance industry. This is important as jurisdictions get to grips with the OECD’s BEPS agenda.

With a strong focus on high-end real estate fund business, Jersey has seen annual growth in real estate fund business of some 11% (as at September 2016), with property fund assets now representing almost a quarter of all Jersey’s alternative funds business.

This growth is made possible by offering a comprehensive range of fund structuring options, including company, limited partnership and separate limited partnership vehicles, all backed up by high-quality infrastructure and a range of regulatory regimes catering to a full spectrum of investor types, including those tailored to the needs of professional and institutional investors.

**NEW-LOOK EUROPE**

There is no doubt that Brexit and the prospect of a new-look Europe have thrown up some uncertainty, particularly in terms of asset values and access to the European and UK investor market. Nevertheless, Preqin’s interviews suggest that a significant proportion of institutional investors (63%) still see Europe as offering the most attractive real estate investment opportunities at the moment. The Brexit vote does not seem to have dampened demand for European exposure, either on the continent or in the UK.

Within the context of the UK and wider Europe, Jersey has earned a strong reputation as a real estate structuring centre for a diverse investor base, including funds, individual private clients and sovereign wealth funds.

This has particularly been the case for property investment in the UK and primarily London; recent months have illustrated the depth and breadth of overseas real estate activity being structured through Jersey into the UK, involving investment and regeneration projects in student accommodation, industrial units, shopping centres, residential developments and major landmark city-centre prime premises.

In fact, one of the biggest ever single-asset London real estate deals and by far the largest since the Brexit vote – the ‘Cheesegrater’ acquisition by Hong Kong-based firm CC Land – was structured through Jersey.

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Further underlining the high-end, high-value nature of Jersey’s real estate fund business is an analysis of UK Land Registry data, which shows that around a third of the total purchase value of all UK property held by foreign corporates was attributable to Jersey companies (£85bn out of a total of £263bn).

Interestingly, the redemption issues faced by some open-ended real estate funds in the UK immediately following Brexit actually served to highlight the benefits of closed-end funds for real estate structures, such as the type available in IFCs like Jersey.

With Brexit fresh in their minds, managers are now showing greater preference in establishing closed-ended funds. This is good news for centres like Jersey, which are well experienced in structuring closed-ended structures specifically for small numbers of sophisticated institutional investors.

It was with that in mind that Jersey recently introduced a new and enhanced Jersey Private Fund vehicle following an extensive consultation process, specifically for sophisticated, experienced investors. The feeling is that this could prove an attractive platform for cross-border real estate activity, particularly in enabling overseas investors to access UK commercial property assets.

**MARKET ACCESS**

Market access, of course, also remains a key factor in the decisions made by fund managers, particularly against the backdrop of Brexit and an increasingly fragmented Europe, and the concept of ‘passporting’ under the Alternative Investment Fund Managers Directive (AIFMD).

Jersey is in a strong place in the context of Brexit and helping to facilitate seamless foreign investment into UK-focused commercial real estate. As a Crown Dependency, its constitutional relationship with the UK remains unchanged in relation to Brexit. It is also already outside the EU – a ‘third country’ – and retains market access in member states for financial services thanks to existing directly negotiated agreements, which will not change.

With change a major theme across the UK and Europe this year, it is inevitable that stability and certainty will prove increasingly valued qualities for those committed to globally focused investments. These are qualities that Jersey can clearly demonstrate, thanks to the optionality and flexibility of its AIFMD private placement routes into EU member states, and its ability to distribute to non-EU markets completely outside the scope of the directive.

Despite Jersey having received once again the strongest possible support from the European Securities & Monetary Authority (ESMA) in July 2016 for the effectiveness and appropriateness of its regulatory regime, ongoing delays with the implementation of the EU-wide funds passport under the AIFMD for third countries has frustrated many. It is disappointing that, following Brexit, third-country passporting has become something of a political football.

However, what the market is showing us is that actually the National Private Placement Regimes (NPPR), under which Jersey funds are distributed across Europe, continue to be highly regarded and in many cases preferable to the full passport option, being used increasingly by real estate fund managers in the US and Asia.

As at December 2016, almost 130 Jersey fund managers had received private placement authorization and more than 250 Jersey funds were being marketed into Europe through NPPRs. That is up 22% and 10% year on year respectively, and there is good reason that private placement is working well.

Preqin data suggests that just under one third of the total $3.83tn invested in real estate globally is derived from investors in Europe. Of that, just over half of the investor base is situated in the UK, Switzerland and the Netherlands. With Switzerland located outside the EU, the UK about to leave the EU and the Netherlands proving to be easily accessible through private placement, private placement looks very attractive alongside the AIFMD marketing passport option, and its usage looks likely to increase.

Meanwhile, by far the largest proportion of investors in Jersey alternative funds historically (around 90%) have been located outside continental EU, meaning that Jersey’s ability to offer a regime outside the scope of AIFMD for structures targeting non-EU investors is making Jersey a compelling option for managers wanting a jurisdiction within the European timezone that can cater for funds targeting both assets and investors in non-EU growth markets.

**RETURNS**

In a complex world where wealth patterns are driving demand for institutional-level real estate investment expertise in all corners of the world, Jersey is well placed to provide robust cross-border investment platforms and demonstrate a mature response to regulatory change.

Its robust regulatory framework, world-leading approach to managing beneficial ownership information, simple and transparent tax neutral environment, readily available real estate expertise and range of flexible structures mean that, as well as attracting foreign investment into the UK, Jersey acts as a quality filter that helps ensure the legitimacy, robustness and legality of funds entering the UK commercial property market.

International investment is important to the UK property market, too. Many recent and high-profile additions to the London skyline have been funded by international investors, using Jersey structures. Without the benefit of those investors, key developments would have been less likely.

Jersey’s fund industry is proud of the work it, its asset management clients and its investors do to facilitate cross-border investment, finance the growth of real estate and infrastructure developments and, crucially, enlarge pension fund and savings returns for a growing ageing population.

By placing an emphasis on providing a premium, quality service, centres like Jersey can continue to play a key role in channelling global capital into the London, UK and European commercial property markets.
Private real estate fundraising had a slow start to 2017, with only 38 funds reaching a final close in Q1, raising an aggregate $16bn (Fig. 1). This is the lowest amount of capital raised in a single quarter since Q1 2013. Capital raised in Q1 fell by 41% compared to Q1 2016, while the number of funds closed more than halved.

Value added funds had the strongest quarter: 17 value added funds reached a final close, raising an aggregate $6.9bn, representing 44% of total capital raised (Fig. 2). Funds pursuing opportunistic strategies were also relatively successful when compared with other strategies during the quarter, with 10 vehicles raising $4.0bn, 26% of total capital raised. However, the largest fundraise during the quarter was achieved by a fund with a focus on distressed investments. Cerberus Institutional Real Estate Partners IV raised $1.8bn and will invest in distressed real estate, including the purchase of non-performing loans, commercial and residential mortgage-backed securities in the US and Western Europe.

In Q1, 27 funds closed with a primary focus on North America, securing a combined $12.2bn (Fig. 3). This represents 79% of the total capital raised during the quarter.
The number of private real estate funds in market continues to surpass previous records, with 554 funds in market as at the beginning of Q2 2017 (Fig. 5). These funds are collectively targeting $189bn in capital commitments, the highest level since 2009. Sixty percent of funds currently in market have already held at least one interim close, raising $70bn towards their respective targets.

More than half (58%) of funds in market will primarily invest in North America, seeking $107bn from institutional investors (Fig. 6). This is more than the combined capital targeted ($82bn) by funds focused on other regions.

Fundraising remains competitive in 2017 as the number of funds in market continues to increase. Sixty-four percent of funds in market have now been on the road for more than a year; among funds that have not held an interim close, 47% have been raising for more than 12 months (Fig. 7).

Funds with a primary focus on value added investments make up the largest proportion (35%) of funds in market, followed by opportunistic funds (25%). However, among the largest funds in market, opportunistic and distressed strategies are the most commonly used (Fig. 8). The largest of these is Blackstone Real Estate Partners Europe V, targeting €7bn in investor commitments. The Europe-focused vehicle will look to invest 60% of its capital in the UK, Germany and France, as well as in distressed markets across Ireland, Spain and Italy. It will target opportunistic investments in office, industrial, residential, retail and hotel assets.
Jersey for Funds

Jersey was the first ‘third country’ to offer a fully functional opt-in regime under the EU’s Alternative Investment Fund Management Directive (AIFMD).

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* Stats as at September 2016

US$308bn total net asset value of regulated funds under administration

70% of fund assets in alternatives

1,245 funds administered or managed from Jersey

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The number of private equity real estate deals completed in Q1 2017 was substantially lower than the previous quarter: 568 deals were completed, a 33% decrease compared to Q4 2016 (Fig. 9). This has translated into a $19bn drop in aggregate deal value, from $57bn to $38bn.

However, the decline in acquisitions has not stopped some large deals taking place. The five largest single-asset deals accounted for over $3.6bn, and included the acquisition of Ballantyne Corporate Park by Northwood Investors from Bissell Companies for $1bn in March (Fig. 11). The 10 largest deals completed in the quarter together account for $8.6bn or 22% of aggregate deal value.

In terms of the specific properties being targeted, the largest proportion (39%) of capital is focused on office assets, in line with recent quarters (Fig. 10). The proportion of capital committed to residential properties dropped to 10% from 20% in Q4 2016, with industrial and retail increasing their share over the same period.
Private real estate investors are increasingly favouring core funds over other strategies: in Q1 2017, 52% of fund searches were for core funds, up from 41% at this time last year (Fig. 13). With many investors looking to real estate to generate income, core vehicles are now the most targeted strategy, ahead of value added and opportunistic funds, which fell from representing 61% of fund searches in Q1 2016 to 38% and from 50% to 37% respectively. Distressed funds have also fallen out of favour, with just 3% of fund searches targeting these vehicles, down from 11% in Q1 2016.

Europe remains the most targeted region, with 52% of fund searches for Europe-focused vehicles, while the proportions targeting North America and Asia-Pacific fell from 46% to 34% and from 28% to 15% respectively (Fig. 14). Investors are increasingly looking to diversify their holdings outside these regions, with the proportion of fund searches targeting the Rest of World region increasing from 1% to 8%, and the proportion targeting funds with a global mandate increasing from 34% to 39%.

The trend towards greater capital concentration in the private real estate asset class continues, as investors increasingly look to commit larger sums of capital to fewer funds. Thirty-one percent of investors plan to commit $300mn or more over the next 12 months (Fig. 15), compared with only 13% this time last year. Meanwhile, the proportion of investors that plan to commit to three or fewer real estate funds in the next 12 months has increased from 41% to 72% over the same time period (Fig. 16).
The amount of dry powder held by private real estate funds continued to break records in the quarter, reaching $247bn as at March 2017, marking a $10bn increase from $237bn in December 2016 (Fig. 17). Dry powder levels have now increased 82% from the $136bn held by private real estate funds in December 2012.

North America-focused funds accounted for most of the growth in dry powder over the quarter, with dry powder focused on the region increasing by $9bn from $133bn in December 2016 to $142bn in March 2017 (Fig. 18). Other regions have maintained dry powder at similar levels to recent quarters, with $63bn held by Europe-focused funds, $32bn by Asia-focused funds and $9bn by funds focused outside these regions.

Value added and debt funds have seen the greatest increase in dry powder over the quarter, from $55bn to $60bn and from $35bn to $39bn respectively (Fig. 19). Opportunistic funds continue to hold the greatest amount ($103bn) of dry powder, up slightly from $102bn in December 2016, while core ($19bn), core-plus ($13bn) and distressed ($13bn) funds also hold similar levels of dry powder to those seen at the end of the year.

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**Fig. 17: Closed-End Private Real Estate Dry Powder, 2008 - 2017**

**Fig. 18: Closed-End Private Real Estate Dry Powder by Fund Primary Geographic Focus, 2008 - 2017**

**Fig. 19: Closed-End Private Real Estate Dry Powder by Strategy, 2008 - 2017**

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Closed-end private real estate funds continued to deliver strong performance in Q2 2016 (the most recent quarter for which data is available). The net asset value (NAV) of these funds increased 2.5% over the quarter, marking the 25th consecutive quarter of increase in NAV (Fig. 20).

The PrEPIn Real Estate Index stands at 104.3 as at June 2016 (rebased to 100 as of 31 December 2007), meaning that the fall in index points between December 2007 and June 2010 has now been fully recovered (Fig. 21). Real estate debt, despite being the most successful strategy over the period since December 2007, was the only strategy for which the index fell over the quarter, declining from 122.7 to 122.0.

Real estate funds generated an annualized 14.9% in the three years to June 2016 (Fig. 22). Recent vintages are proving to be strong performers, with median net IRRs of at least 13% for all vintages since 2009; 2011 vintage funds have the highest returns among recent vintages, with a median IRR of 17.1% (Fig. 23).
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