Preqin Research Report

PERE Fund Managers in 2010: Key Areas of Focus (1)

2009 will be remembered as particularly challenging for the real estate industry. Property prices fell dramatically and few transactions were completed, with sellers looking to avoid large losses and buyers hesitant to invest before the markets had reached the bottom. Private equity real estate fund managers suffered significant write-downs on their investments, and investors, cautious and stung by poor returns, made few commitments to the asset class. The result was the worst year for private equity real estate fundraising since 2004.

However, 2010 is set to see many private equity real estate fund managers that held off making new deals last year resume investment activity. Many firms have significant dry powder reserves and with 2010 potentially representing an ideal buying opportunity as real estate markets finally bottom out, the coming year should see far more deals being completed.

Dry Powder

Although fundraising was slow during 2009, the lack of deals made during the year means that, as of January 2010, private equity real estate firms have a total of $189 billion in dry powder available to invest.

In terms of regional focus, $99 billion of dry powder is focused primarily on North American opportunities, equating to 52% of the total dry powder available. $46 billion is available for Asia and Rest of World investments, while $44 billion is available for European investments. In addition to the dry powder already available, private equity real estate firms are currently marketing 366 funds, seeking aggregate commitments of $150 billion. The regional breakdown of funds in market is very similar to the dry powder breakdown. 55% of capital targeted will be focused primarily on North America, with 25% primarily focused on European investments and 20% on investments in Asia and Rest of World. This suggests that in addition to opportunities in the developed markets of North America and Europe, fund managers believe that there are still good prospects for real estate investments in emerging markets. However, fundraising for Asia and Rest of World focused vehicles was particularly poor in 2009, with 24 funds raising an aggregate $7 billion, representing 16% of all capital raised. This is partly due to a cautious investor universe in the US and Europe opting to invest closer to home. The allocation of dry powder to Asia and Rest of World may help to stimulate fundraising to these regions in 2010.

Fig. 1: Primary Regional Focus of Private Equity Real Estate Funds in Market

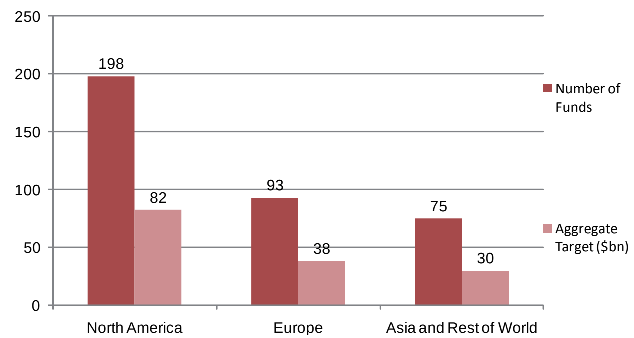
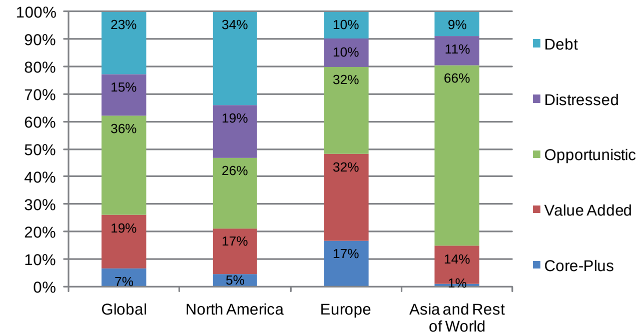


Fig. 2: Strategic Preferences of Private Equity Real Estate Funds in Market by Primary Regional Focus



Strategies Targeted

Fig. 2 shows the strategies employed by private equity real estate funds in market. Globally, opportunistic strategies are the most commonly utilised, with 36% of the total capital targeted focused on opportunistic investments. 23% is focused on debt investments and 19% on value added plays.

Many fund managers focused on North America believe that real estate debt investments offer excellent opportunities in the current climate. North American debt funds are targeting a larger percentage of total commitments than North American opportunistic or value added funds. 34% of capital targeted by North America-focused vehicles will be directed to investments in real estate debt, compared with 26% for opportunistic investments, 19% for distressed opportunities and 17% for value added investments.

Of capital being sought by funds focused primarily on Europe, 32% is focused on value added investments, with the same percentage targeting opportunistic real estate plays. Core-plus funds, which account for 17% of the capital

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targeted by European vehicles, are relatively more prevalent amongst Europe-focused vehicles than amongst North America- or Asia and Rest of World-focused funds. Debt and distressed funds each account for 10% of capital targeted.

Outside North America and Europe, the majority of capital sought will be invested in opportunistic deals, with 66% of capital targeted by Asia and Rest of World funds focused on opportunistic investments. 14% of capital is being targeted by value added funds, 11% by distressed funds and 9% by real estate debt funds.

Property Types

The property types being targeted by North America-focused funds in market are shown in Fig. 3. Residential assets are the most commonly targeted, with 53% of funds expecting to make residential investments. Office assets will be targeted by 47% of North American funds on the road, and industrial properties by 36%. Of the four main property types, retail is the least frequently targeted, with 30% of funds targeting these assets. Land development is targeted by a relatively small 16% of funds in market. 13% of funds are targeting mixed-used assets and 9% hotels.

Retail assets are the most frequently targeted property type by European funds in market. 41% of funds in market plan to make retail investments. 37% of funds are targeting office investments, while 29% target residential and 27%

Fig. 3: Property Types Targeted by North America-Focused Private Equity Real Estate Funds in Market

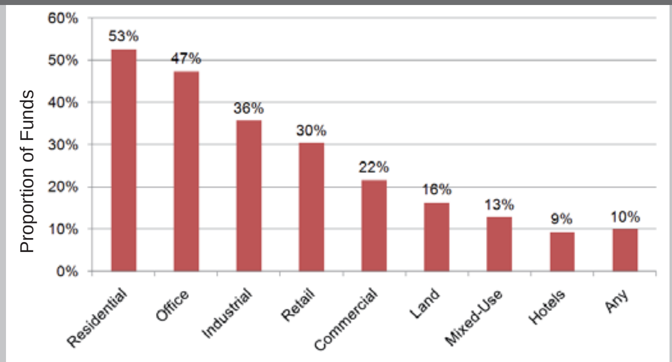


Fig. 4: Property Types Targeted by Europe-Focused Private Equity Real Estate Funds in Market

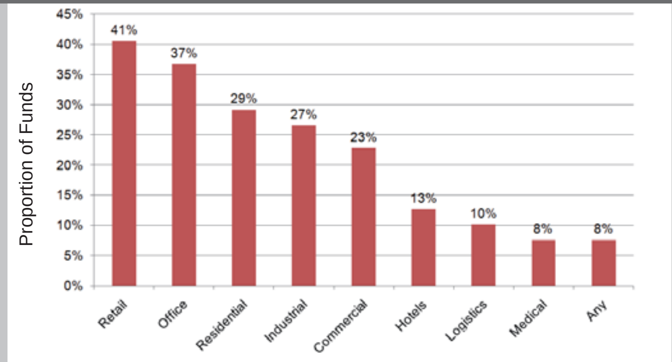
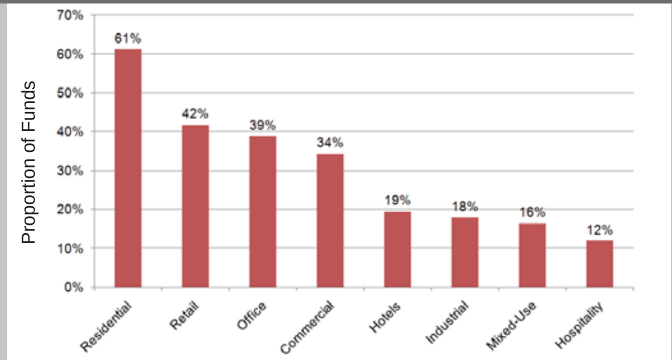


Fig. 5: Property Types Targeted by Asia and Rest of World-Focused Private Equity Real Estate Funds in Market



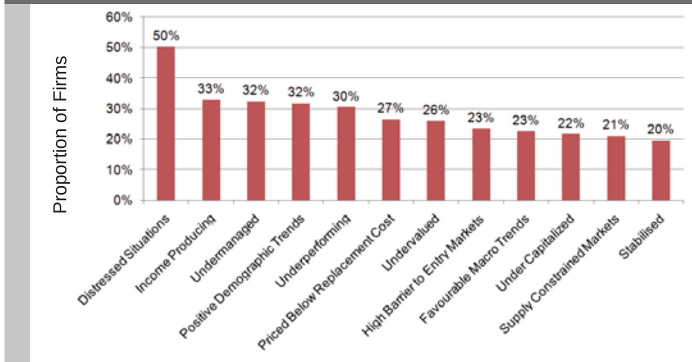
industrial. Other notable areas of focus for European fund managers are hotels, which are targeted by 13% of funds, and logistics assets, which 10% of funds will invest in.

For funds focused outside North America and Europe, it is residential assets that are most commonly targeted. A significant 61% of funds in market focused on Asia and Rest of World will invest in residential properties. Other important areas of focus include retail properties, which are targeted by 42% of funds and office properties, which are targeted by 39%. 19% of funds will invest in hotels, a higher proportion than in the other two regions, while just 18% of funds will look to invest in industrial properties, a lower percentage than for Europe or North America-focused funds.

Property Situations

Fig. 6 shows the situations that private equity fund managers currently on the road are targeting. Half of firms

Fig. 6: Property Situations Targeted by Firms with Private Equity Real Estate Funds in Market



are looking to take advantage of distressed situations. Many owners will be forced to sell at considerable discounts as projects struggle to complete and financing options remain scarce. With many fund managers believing markets to be bottoming out, a number of transactions for distressed property could take place. 33% of fund managers see income-producing assets as important, perhaps encouraged by the possibility of significant increases in property prices in the near future.

Other situations targeted by fund managers include undermanaged assets and properties in areas with positive demographic trends, which are both targeted by 32% of firms. 30% of firms target assets that are underperforming and 27% will look for deals involving assets priced below replacement cost.

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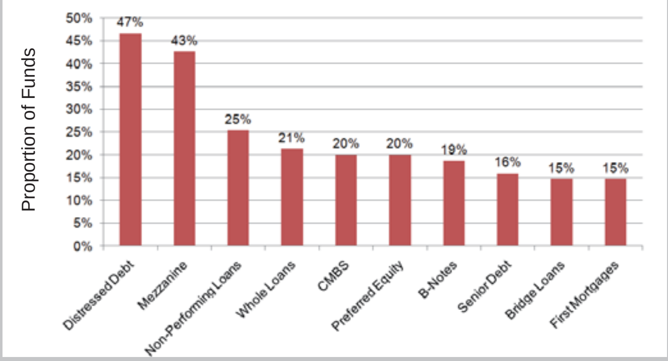
Debt Strategies

With such a large percentage of North America-focused capital targeted for investments in real estate debt, it is important to analyse which are the most commonly sought debt investments. Fig. 7 shows the debt strategies targeted by North America-focused debt funds currently in market. Distressed debt is the most commonly targeted strategy, with 47% of debt funds making this type of investment. 43% of funds plan to invest in mezzanine loans. Other strategies commonly targeted by fund managers surveyed include non-performing loans, targeted by 25% of firms, whole loans (21%), CMBS (20%) and preferred equity (20%).

Fig. 7: Strategies Targeted by North American Debt Funds in Market



Conclusions

Despite the slow fundraising market in 2009, many fund managers are coming to the market with new vehicles. The coming year should see many private equity real estate fund managers with dry powder available making new investments, capitalizing on the low prices of property markets. Fund managers in North America in particular believe that there are excellent opportunities to invest in real estate debt, with distressed debt being of notable interest. Despite a decline in fundraising for Asia and Rest of World funds in 2009, many firms still believe that there are excellent opportunities in which to invest in emerging markets. There is still a great deal of dry powder available to invest in Asia and Rest of World as well as a good stock of funds in market hoping to raise capital to invest in the region.

Fund managers also believe that 2010 will be an ideal opportunity to take advantage of sellers or developers in distress, with 50% targeting distressed situations. Additionally, some fund managers also placing a greater emphasis on income rather than appreciation, given the depressed market. For North America-focused vehicles in market, residential property will be the most targeted this year, with the same applying to managers with funds focusing on Asia and Rest of World. However, European focused vehicles are most keen on retail properties.

A number of troubling issues clearly remain active within real estate markets worldwide, but with many predicting that the slide in property prices to be at or close to reverse, that large stock of dry powder, which has been the consequence of market inactivity, is likely to be exposed to the market in 2010. Private equity real estate firms with capital available to invest feel that the market presents many opportunities. Those raising and investing in funds with 2010 vintage could be the ones to benefit from the real estate market's recent difficulties.