

Preqin Special Report:

Real Estate Funds of Funds

June 2010



Private Equity • Real Estate • Hedge Funds • Infrastructure

Real Estate Fund of Funds: Market Overview

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.

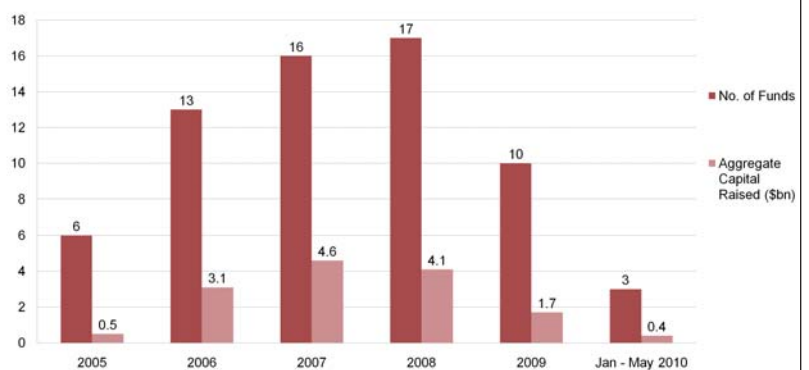
The first real estate funds of funds date back to the late 1990s, but it was not until several years later that a significant industry began to emerge. Preqin has identified 57 firms active in the fund of funds market, managing a total of 119 funds of funds. All 57 managers are profiled in detail within the body of the 2010 Preqin Private Equity Real Estate Fund of Funds Review.

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 fund 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

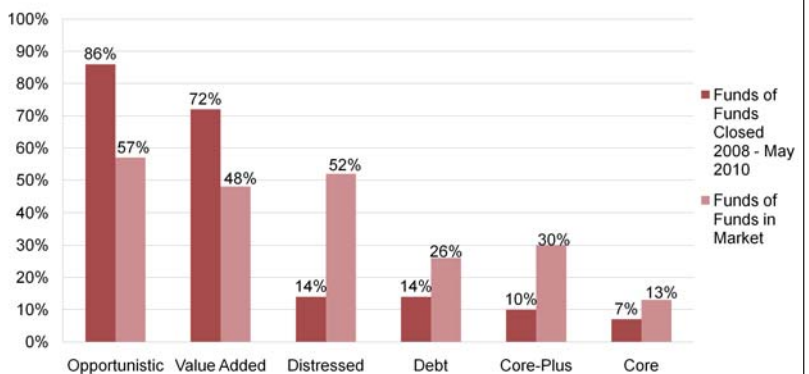
Funds of funds are key investors for managers raising their first vehicle, as they will typically have the knowledge and resources to carry out the extra due diligence required on this type of investment. 73% of funds of funds surveyed do invest with first-time fund managers, while a further 17% would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

Fig. 1: Funds of Funds Fundraising 2005 - May 2010



Source Preqin

Fig. 2: Underlying Strategies Targeted By Funds of Funds



Source Preqin

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 firms aim to give smaller investors exposure to some of the largest firms in the industry. The larger minimum

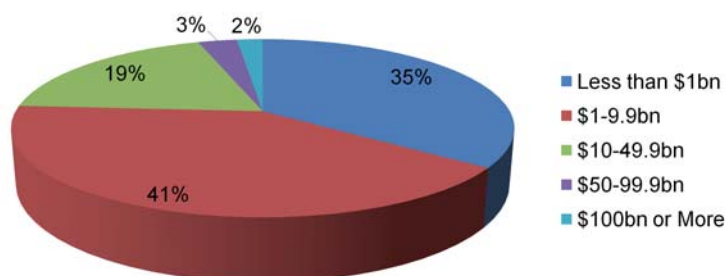
Real Estate Fund of Funds: Market Overview

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 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-ended 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 Eurosis 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.

Fig. 3: Breakdown of the Funds of Funds Investor Universe By Assets Under Management



Source Preqin

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 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 fund 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.

Real Estate Fund of Funds: Market Overview

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 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 were investors 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. The 2010 Preqin Private Equity Real Estate Fund of Funds Review includes profiles for over 100 investors that have an interest in funds of funds.

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, and 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 originally targeted.

Real Estate Fund of Funds: Investors Overview

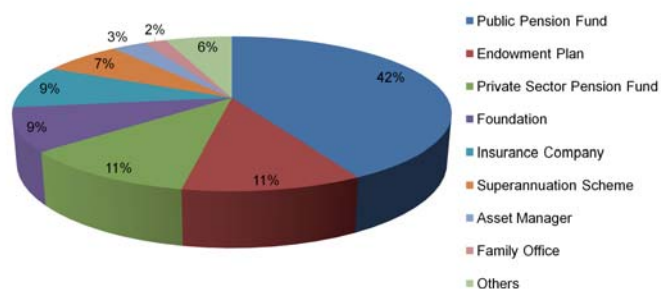
Investor Type

- Public pension funds are the most prevalent investor type in real estate funds of funds, making up 42% of the total investor base. The next largest groups of investors are endowments and private pension funds.
- Foundations and insurance companies both account for 9% of investors that have an interest in, or allocation to, funds of funds. Australian superannuation schemes account for 7% of fund of funds investors. Other investor types such as investment companies, government agencies and sovereign wealth funds together account for the remaining 6%.
- 76% of investors in real estate funds of funds have a total asset base of \$10 billion or less with the largest group being those with assets of between \$1 and \$9.9 billion.
- 70% of fund of funds investors allocate less than \$500 million to real estate. It is likely that investors that allocate smaller amounts to the asset class still seek diverse portfolios and so look to funds of funds to give them diverse exposure.

Investor Location

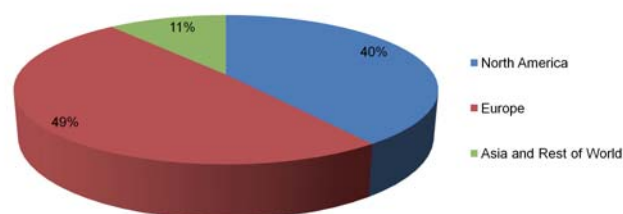
- Almost half of fund of funds investors are based in Europe and 40% are based in North America. This is different to the make up of investors in direct private equity real estate vehicles, as 58% of investors in direct funds are North American institutions, with 31% from Europe.
- The US is home to 38% of all fund of funds investors, making it the most populated country in terms of number of investors active in funds of funds. Just as with direct private equity real estate, the UK has the second-largest number of investors in funds of funds with 22%.

Fig. 4: Breakdown of Fund of Funds Investor Universe by Type



Source Preqin

Fig. 5: Breakdown of Fund of Funds Investor Universe By Location



Source Preqin

Real Estate Funds of Funds: Funds of Funds as Investors

Funds of Funds as Investment Consultants

- The nature of the consultancy services provided by firms varies but the majority offer both discretionary and non-discretionary services to their clients. 31% of such advisors provide discretionary services only and 15% offer advice solely on a non-discretionary basis.
- 30% of fund of funds managers that also act as investment consultants are based in North America and 62% are European firms.
- 69% of advisors have clients based in North America, 92% in Europe and 54% have Asia and Rest of World-based clients.

Funds of Funds as Investors

- Fund of funds managers remain an important investor type in private real estate funds, accounting for 5% of all private equity real estate investors.
- Funds of funds are able to provide diversification across the risk/return spectrum and balance the level of risk within the portfolio. 77% of funds of funds vehicles seek to utilize two or more strategies.
- 57% of funds of funds that closed between 2008 and May 2010 are investing in two or more continents.

Fig. 6: Investment Consultants' Clients Types

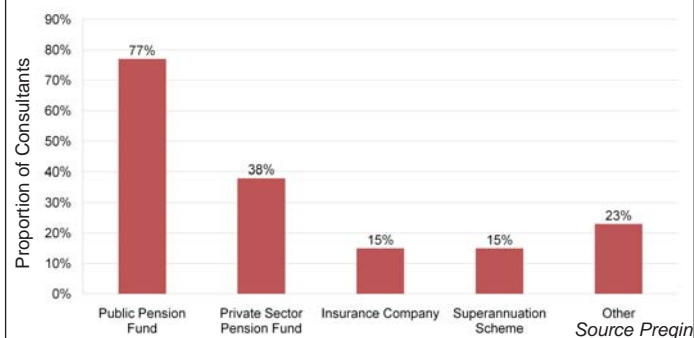
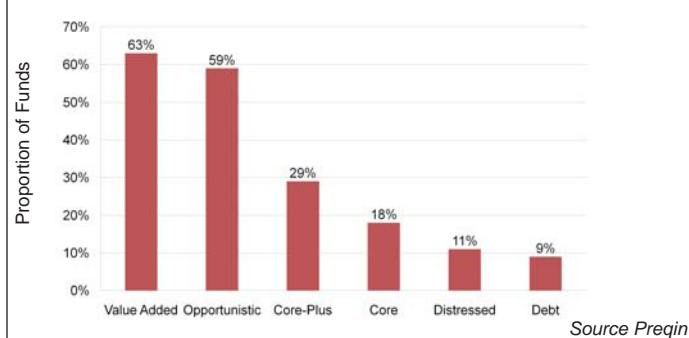


Fig. 7: Investors' Fund of Funds Strategy Preferences

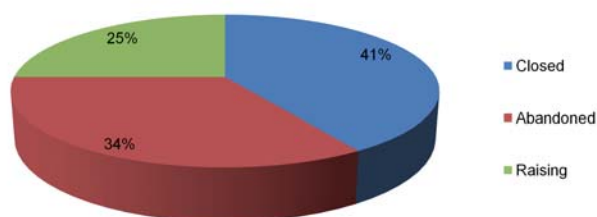


Real Estate Funds of Funds: Funds Currently Raising

Funds Overview

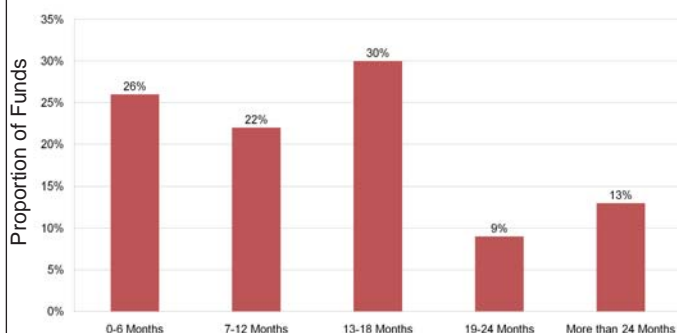
- There are currently 23 real estate fund of funds vehicles in market seeking to raise \$6.1 billion of capital from investors. This is a decrease from Q1 2009, when there were 35 funds in market seeking aggregate commitments of \$9.8 billion.
- 48%, or 11, of the funds on the road are North America-focused. Europe and Asia and Rest of World are each the focus of 26% of funds in market.
- Europe-focused funds of funds have the highest average target size, \$417 million, while North America-focused funds are targeting \$212 million on average and Asia and Rest of World-focused funds \$200 million.
- All funds in market are managed by firms headquartered in North America or Europe and the majority of fund managers are based in Europe.
- A significant 35% of the funds of funds in market are first-time vehicles. These include funds being managed by new firms making their first foray into the real estate market as well as established firms in the real estate sector that are raising a commingled fund of funds for the first time. The high proportion of first-time managers reflects the fact that the fund of funds industry is relatively new.
- Of the 23 funds of funds currently raising capital, more than 50% have been in market for over a year. 13% of vehicles have been raising capital for over two years, while 26% have been in market for six months or less. The average time already spent in market by a fund currently on the road is 12 months.
- The number of funds of funds currently in market is down 34% from last year, with a number of managers experiencing difficulty in obtaining commitments from investors and abandoning their fundraising plans.

Fig. 8: Current Status of Funds That Were Raising Capital in Q1 2009



Source Preqin

Fig. 9: Length of Time Spent In Market By Vehicles on the Road



Source Preqin

The 2010 Preqin Private Equity Real Estate Fund 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 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 Real Estate has contacted managers, investors and real estate professionals from around the world in order to ensure that this year's page 180 page publication is as accurate and detailed as possible, featuring exclusive information not available anywhere else.

This year's edition includes:

- Comprehensive profiles for all 57 PERE fund of funds managers, including contact details, history, sample investments, plus detailed investment plans at a fund specific level.
- Profiles for nine private equity fund of funds managers with a significant allocation to real estate.
- Full listings for all funds closed and currently in the market.
- Profiles for over 100 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, fund terms and conditions, investors, fund focus and much more.

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