Preqin Investor Outlook: Real Estate, H2 2013

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Foreword

Fundraising for private real estate funds looks set to remain a tough prospect in the coming year. While there are investors that expect to put a significant amount of capital to work in the coming year, many others are not expecting to make any new commitments.

Only 42% of respondents made commitments in the past year, and just 40% of investors plan to invest in the in next 12 months. While there are numerous factors affecting investor attitudes, the wider economic environment and the impact it will have on real estate appears to be the biggest factor, with 42% naming this as a key issue affecting the private real estate market.

However, there are investors set to allocate significant amounts of capital to the asset class. Of all investors expecting to be active, 48% plan to commit at least $100mn to private real estate in the next 12 months. As would be expected, larger investors are more likely to be investing, with 64% of investors with assets under management of $10bn or more planning new commitments.

Asia-based investors are also more likely to be investing than those based in Europe or North America, with 71% planning new commitments in the coming year. What is also notable is the scope of their planned investments, with a large proportion set to invest in Europe- or North America-focused funds. Of Asia-based investors searching for new funds, 39% are targeting North America, with the same proportion targeting Europe.

Appetite for higher risk-return profile investments is now increasing among institutional investors. Opportunistic funds are now the most widely targeted strategy, with 54% of investors actively searching for new funds seeking opportunistic exposure, while 51% are targeting value added funds. There is still significant appetite for core however, with 47% of investors targeting the strategy.

While fundraising in the coming year looks set to remain extremely difficult, the long term outlook is far more positive. The majority of investors are below their target allocation to real estate and 40% expect to increase their allocations to the asset class in the longer term.

Key Facts

42% of real estate investors have invested in the asset class in the last 12 months.

40% of real estate investors plan to make new investments in the next 12 months, down from 53% in December 2012.

76% of investors interviewed will be deploying $50mn or more to private real estate funds in the next 12 months.

54% of active real estate investors will target opportunistic vehicles in the next 12 months, up from 44% in December 2012.

87% of investors interviewed plan to maintain or increase their allocations to the asset class in the next 12 months.

72% of investors interviewed either agree or strongly agree that fund managers' and investors' interests are properly aligned.

Contents

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Investor Activity in the Last 12 Months

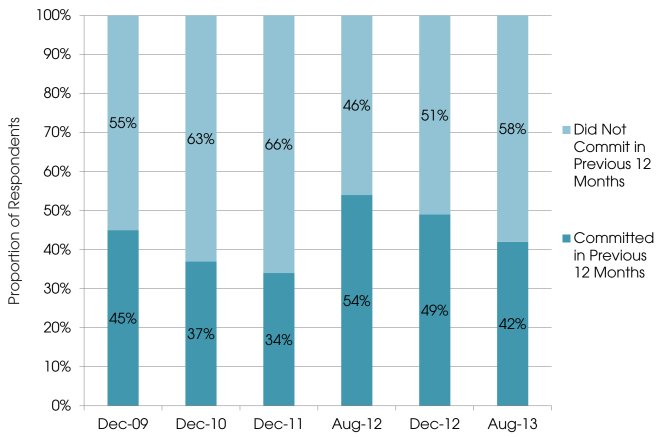
The proportion of investors making new private real estate commitments decreased in the last year, with smaller investors less likely to have made commitments. There were also significant regional variations, with Asia-based investors the most active and North America-based institutions the least.

A smaller proportion of investors have made commitments to private real estate funds in the previous 12 months compared to those interviewed in December and August 2012. Fig. 4.1 shows that 42% of investors interviewed made private real estate fund commitments in the last 12 months, a substantial drop from both the 54% of investors that stated they had made commitments in the previous year when interviewed in August 2012 and the 49% that did so in December 2012. While these figures may suggest a decrease in investor appetite for private real estate funds, it should be noted that the 42% of respondents that have made commitments in the last 12 months is still an increase on the 34% of investors interviewed that stated the same in December 2011.

With the continuing economic challenges in Europe and North America, many real estate fund managers are seeking to widen their search for capital to include Asia-based investors. Recent changes in regulations have encouraged many institutions based in Asia to shift their focus from traditional investments to alternative asset classes in order to diversify their investment portfolios. As a result, investors based in Asia were the most active in the private real estate market in the last 12 months compared to their North America- and Europe-based counterparts, with 62% committing to at least one private real estate fund (Fig. 4.2). In comparison, 41% of Europe-based investors committed to funds in the last 12 months, followed by 38% of North America-based institutions.

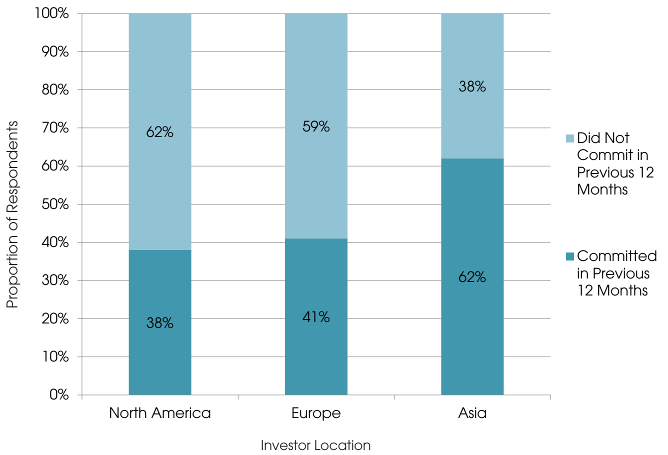
Institutional investors with $10bn or more in assets under management were more likely to have committed to private real estate in the last 12 months, with 67% of these larger institutions being active in the private real estate market. Conversely, the majority of respondents with less than $10bn in assets under management (65%) did not make a commitment to a private real estate fund in the previous 12 months.

Fig. 4.1: Proportion of Investors that Committed to Private Real Estate Funds in the Previous 12 Months, December 2009 - August 2013



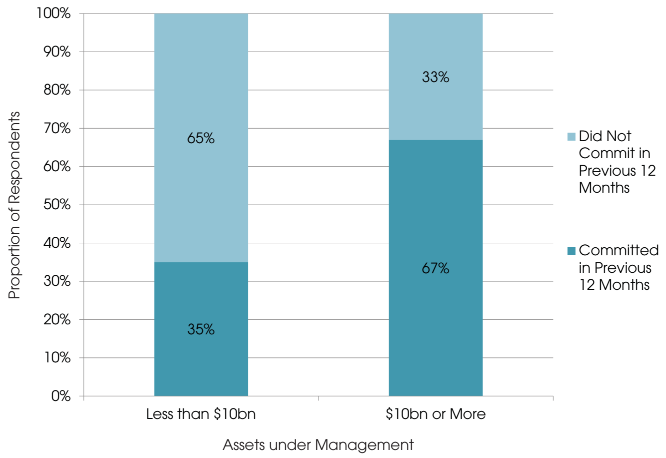
Source: Preqin Investor Interviews, December 2009 - August 2013

Fig. 4.2: Proportion of Investors that Committed to Private Real Estate Funds in the Previous 12 Months by Investor Location



Source: Preqin Investor Interviews, August 2013

Fig. 4.3: Proportion of Investors that Committed to Private Real Estate Funds in the Previous 12 Months by Assets under Management



Source: Preqin Investor Interviews, August 2013

Investor Activity in the Coming 12 Months

Fundraising looks set to remain challenging in the coming year, with a smaller proportion of investors interviewed looking to make commitments in the next 12 months. Regionally, Asia-based institutions are again set to be the most active, and smaller investors are less likely to commit to the asset class.

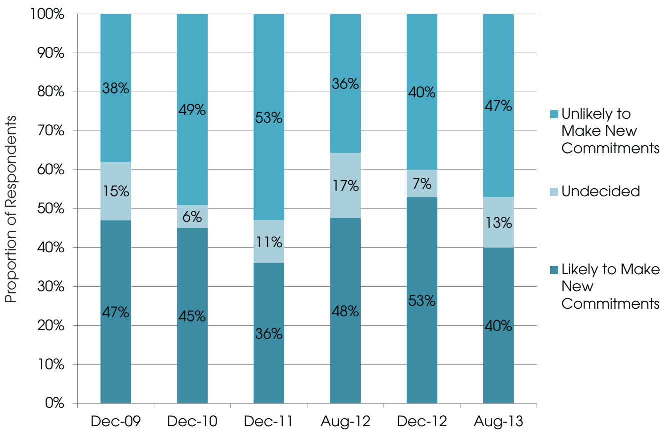
The proportion of investors planning to make new private real estate fund commitments in the following 12 months has decreased substantially, from 53% in December 2012 to 40% in August 2013 (Fig. 4.4).

Investor appetite for new commitments varies considerably by location, with Asia-based institutions overwhelmingly set to be the most active in the next 12 months; 71% of investors based in this region are likely to make new commitments in the coming year (Fig. 4.5). In comparison, only 35% of investors based in North America and 24% of Europe-based investors are likely to commit to private real estate in the next 12 months. Concerns over the economic climate in the eurozone may have affected the appetite of Europe-based investors as well as recent regulatory changes and proposals.

Institutions with more than $10bn in assets under management are twice as likely to make new commitments in the coming 12 months compared to those with less than $10bn in total assets (Fig. 4.6). Smaller institutions will typically make fewer commitments and, therefore, a significant 59% are unlikely to make new real estate investments in the coming 12 months.

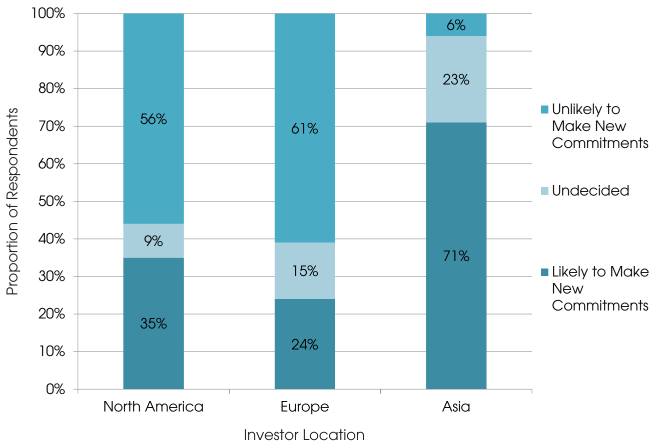
When asked to state the key factors investors assess when seeking real estate fund managers, an established track record was the most commonly cited factor, with 32% of respondents stating it as a key attribute. Management experience and background followed, cited by 30% of investors interviewed. With a manager's track record and experience the most important factors for investors when considering new relationships, first-time fund managers are likely to continue to find the fundraising environment extremely challenging.

Fig. 4.4: Investor Intentions for Private Real Estate Investments in the Following 12 Months, December 2009 - August 2013



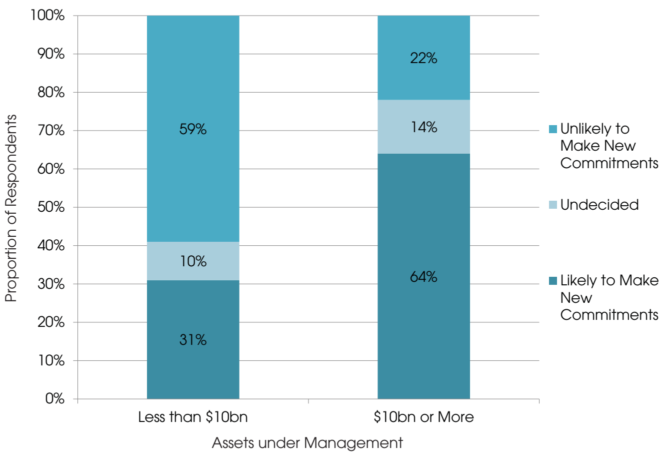
Source: Preqin Investor Interviews, December 2009 - August 2013

Fig. 4.5: Investor Intentions for Private Real Estate Investments in the Next 12 Months by Investor Location



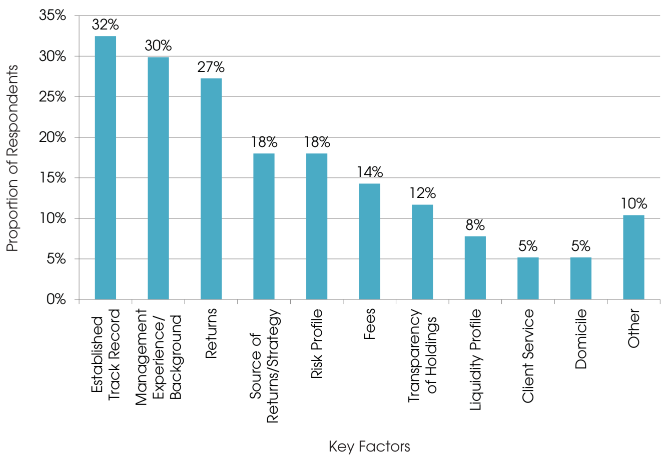
Source: Preqin Investor Interviews, August 2013

Fig. 4.6: Investor Intentions for Private Real Estate Investments in the Next 12 Months by Assets under Management



Source: Preqin Investor Interviews, August 2013

Fig. 4.7: Key Factors Investors Assess When Searching For Private Real Estate Fund Managers



Source: Preqin Investor Interviews, August 2013

Capital Outlay

A significant proportion of investors will commit more capital to private real estate over the coming year, with the majority of active institutions deploying $50mn or more.

While many institutions are not planning new commitments, there remains a significant proportion of investors active in private real estate that are increasing their outlay to the asset class. Thirty percent of respondents expect to commit more capital to private real estate in the next 12 months compared to the last 12 months, and 12% expect to commit the same amount of capital in the next 12 months as they did in the 12 months to August 2013 (Fig. 4.8).

However, a sizeable 19% of respondents will commit less capital to private real estate in the next 12 months, and 39% of investors interviewed that did not commit in the previous 12 months will not commit in the next 12 months; this demonstrates that fund managers are likely to have continuing difficulties in raising capital for private real estate funds going forward.

Forty-one percent of investors planning to be active in the next 12 months will be committing to one real estate vehicle, while 23% plan to commit to two real estate funds (Fig. 4.9). Encouragingly, a sizeable 36% expect to make commitments to three or more funds in the next 12 months. In terms of capital, 76% of respondents will be deploying $50mn or more to private real estate funds in the next 12 months, whereas only 24% of investors will be making commitments totalling less than $50mn over this period (Fig. 4.10). While fundraising looks set to remain challenging in the coming months, it is clear there are investors that are planning to put a significant amount of capital to work in 2013 and 2014.

Data Source:

Preqin's Real Estate Online service contains details on over 1,700 private real estate fund managers, including past fundraising data, performance and known investors.

Subscribers can also view league tables of real estate fund managers, which can be ranked by dry powder or capital raised in the last 10 years, and filtered by location.

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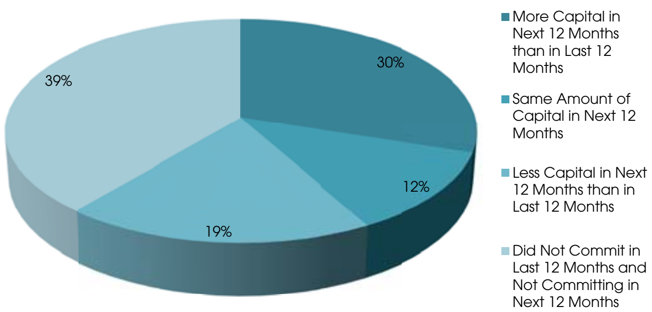
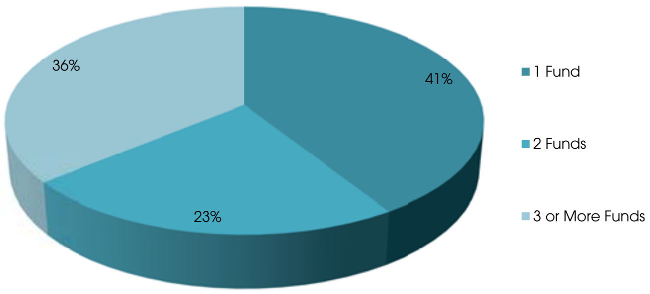
Fig. 4.8: Investors' Expected Capital Commitment to Private Real Estate Funds in the Next 12 Months Compared to the Previous 12 Months



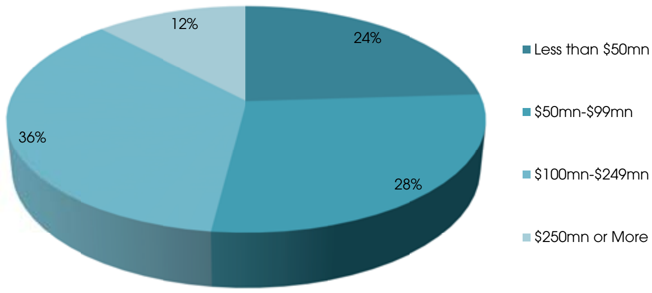
Source: Preqin Investor Interviews, August 2013

Fig. 4.9: Investors' Expected Number of Private Real Estate Fund Commitments in the Next 12 Months



Source: Preqin Investor Interviews, August 2013

Fig. 4.10: Investors' Expected Capital Outlay to Private Real Estate Funds in the Next 12 Months



Source: Preqin Investor Interviews, August 2013

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Strategies and Geographies Targeted

Investor appetite for high-risk real estate strategies has seen a recent resurgence, with opportunistic and value added funds the most sought after in the next 12 months.

Appetite for opportunistic funds has risen significantly since December 2012. Fig. 4.11 shows that 54% of active investors will target opportunistic vehicles in the next 12 months, up from 44% in December 2012. Value added vehicles are sought by 51% of institutions in the coming 12 months. These figures are reflective of the shift in general investor sentiment towards a return to higher risk/return profile investments. Appetite for core funds has remained stable in recent years but investor interest in core-plus, debt and distressed real estate has decreased after a peak in appetite in December 2012.

The proportion of investors based in North America and Europe that will invest in domestic markets is much higher than the proportion of Asian institutions that will allocate domestically. Sixty-nine percent of North America-based investors and 79% of Europe-based investors will commit to funds targeting their domestic markets, but only 44% of Asian organizations will seek domestic funds in the next 12 months. Due to changes in regulations allowing more Asia-based institutions to invest indirectly as well as internationally, a growing number of investors in the region are looking to overseas real estate in the coming year.

In terms of which regions investors view as the best investment opportunities for real estate funds, North America is thought to be presenting the best opportunities by a significant 71% of respondents. Only 30% of respondents felt that Europe was presenting the best opportunities, with Asia and emerging markets outside Asia listed by 16% and 13% of investors respectively.

Data Source:

Preqin tracks the future investment plans of investors in private real estate funds, allowing subscribers to Real Estate Online to source investors actively seeking new real estate commitments via the Fund Searches and Mandates feature.

This feature contains detailed investment plans of over 450 real estate investors for the next 12 months, including strategy and regional preferences, the timeframe of their next investment and the estimated number of future investments.

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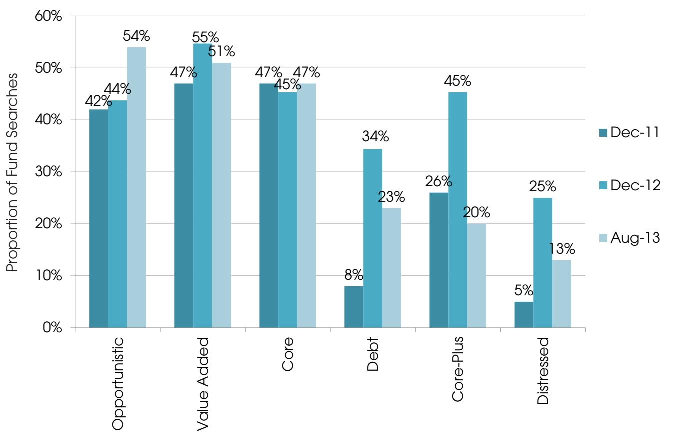
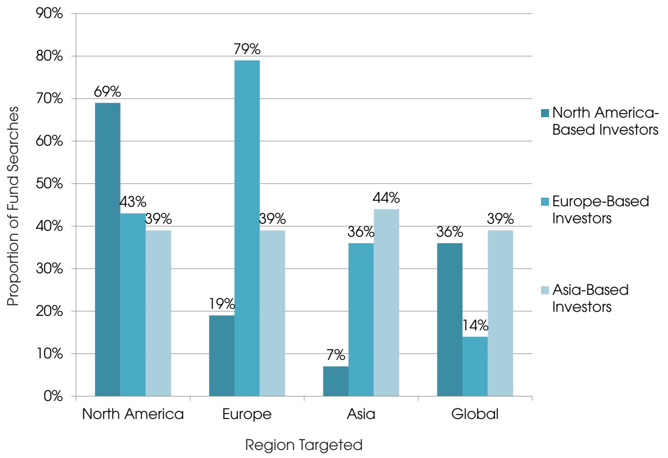
Fig. 4.11: Strategies Targeted in the Next 12 Months by Private Real Estate Investors, December 2011 - August 2013



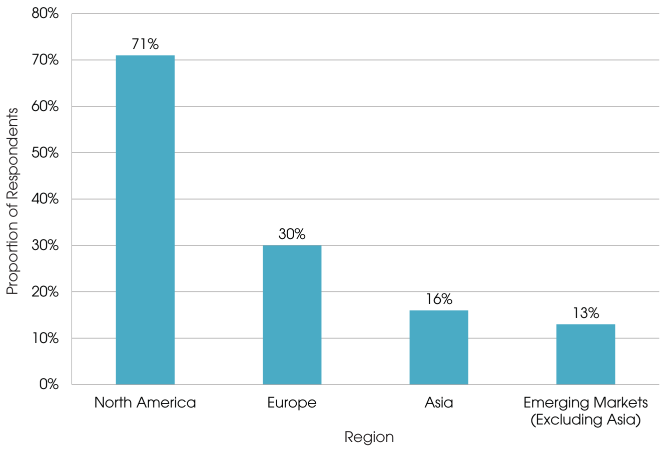
Source: Preqin Real Estate Online

Fig. 4.12: Regions Targeted in the Next 12 Months by Private Real Estate Investors



Source: Preqin Real Estate Online

Fig. 4.13: Geographies Investors Believe Are Presenting the Best Opportunities in the Current Market



Source: Preqin Investor Interviews, August 2013

Allocations and Confidence in the Asset Class

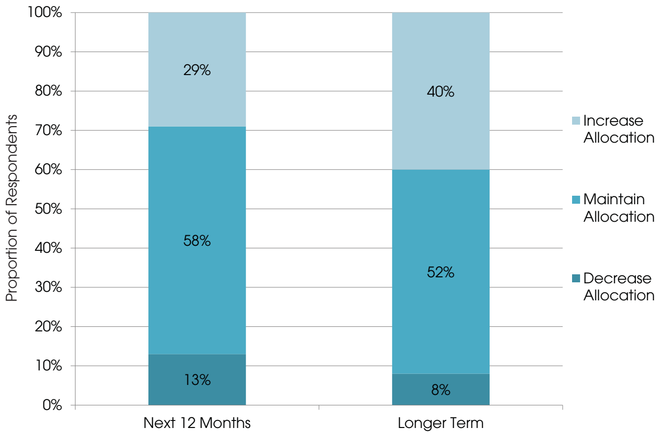
Investors remain committed to the real estate asset class in the medium to longer term, with the vast majority planning to either maintain or increase their allocations, and private real estate fund investments are either exceeding or meeting expectations for most respondents.

Property remains an important part of many sophisticated investors' portfolios. Eighty-seven percent of investors interviewed plan to maintain or increase their allocations to the asset class in the next 12 months, with only 13% of investors expecting to scale down their exposure to the asset class. Ninety-two percent of those interviewed expect to maintain or increase their allocations to real estate in the long term. Even more encouraging for fund managers is the finding that 40% of investors interviewed expect to increase their allocations to real estate in the longer term.

The majority of investors interviewed (65%) stated that the performance of their real estate fund investments had met their expectations in the last 12 months. These results could be attributed to the improving performance of real estate funds in the last couple of years; there has been a positive average change in NAV of closed-end real estate funds in each of the 11 quarters to December 2012. These results may also reflect changing attitudes of investors, which may accept more modest returns in the current environment. Twenty-five percent of those interviewed felt that their real estate investments had fallen short of their expectations. While only 10% of investors interviewed felt that the performance of their private real estate fund investments had exceeded their expectations, this is a significant increase on the 3% of investors that stated the same when interviewed in December 2012.

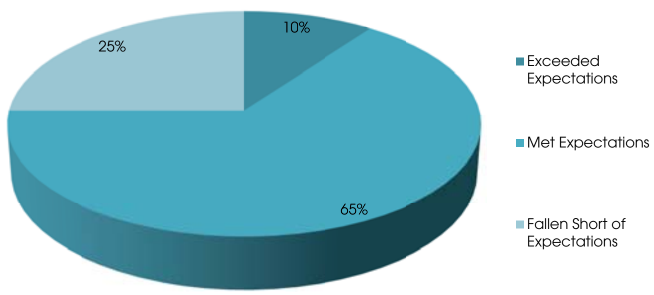
Real estate can perform a number of roles within an investor's portfolio, offering a range of risk/return profiles, providing diversification and steady income streams, and acting as an inflation hedge. When asked whether their confidence in real estate to achieve these objectives had changed in the last 12 months, a significant 69% of investors interviewed stated that their confidence in real estate to achieve portfolio objectives had remained unchanged in the last 12 months. Twenty-two percent of interviewees reported that they have increased confidence in their property investments to achieve portfolio objectives, compared to only 11% stating reduced confidence in the real estate asset class.

Fig. 4.14: Investors' Intentions for Their Real Estate Allocations in the Next 12 Months and Longer Term



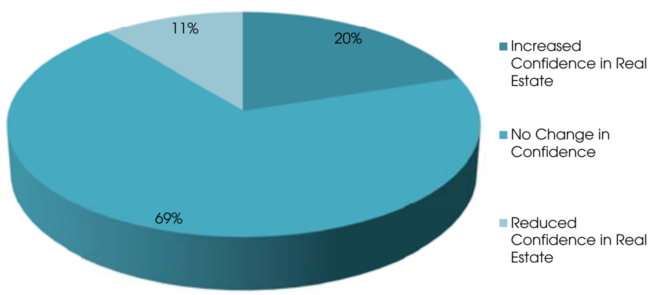
Source: Preqin Investor Interviews, August 2013

Fig. 4.15: Proportion of Investors that Feel Their Private Real Estate Fund Investments Have Lived up to Expectations over the Past 12 Months



Source: Preqin Investor Interviews, August 2013

Fig. 4.16: Investors' Confidence in Private Real Estate to Achieve Portfolio Objectives in the Past 12 Months



Source: Preqin Investor Interviews, August 2013

Fees and Alignment of Interests

With fees and other fund terms remaining a point of contention within the private real estate industry, we asked investors whether they felt that fund managers' and investors' interests were aligned, and which areas of real estate fund terms could most be improved.

Encouragingly, Fig. 4.17 reveals that the overwhelming majority of investors interviewed either agree or strongly agree that fund managers' and investors' interests are properly aligned (72%). When investors were asked which areas could most be improved concerning fund terms, the largest proportion of respondents stated management fees as a key area for improvement (41%). Performance fees were also a key issue for investors, with a notable 59% of respondents stating that the size of fee charged and the structure utilized were areas for improvement collectively. The fund manager's commitment to the fund was a key area for improvement for 27% of investors interviewed.

The general satisfaction displayed by real estate investors concerning the alignment of interests with fund managers may result from the fact that 30% of investors believe that there has been a significant or slight change in the alignment of interests in favour of the investor (Fig. 4.19); conversely, only 10% of respondents have seen a change in favour of fund managers. Although management fees remain an area for improvement for many investors, 71% of respondents stated that this was the area where they feel that terms have changed the most, with performance fees stated by a much lower 24% of investors.

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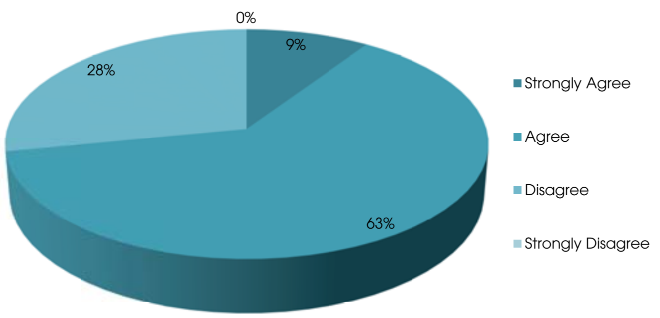
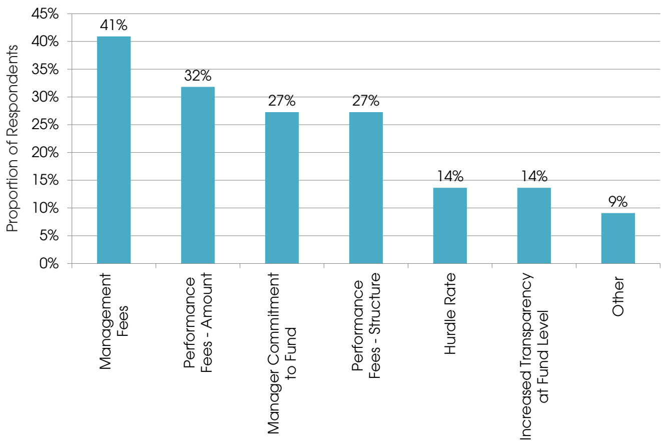
Fig. 4.17: Proportion of Investors that Feel Fund Manager and Investor Interests Are Properly Aligned



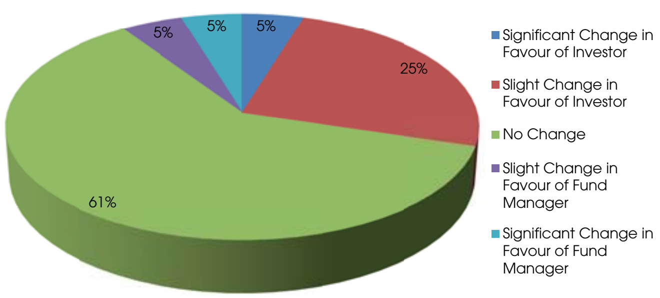
Source: Preqin Investor Interviews, August 2013

Fig. 4.18: Investors' Views on Areas Where Alignment of Interests Can Be Improved



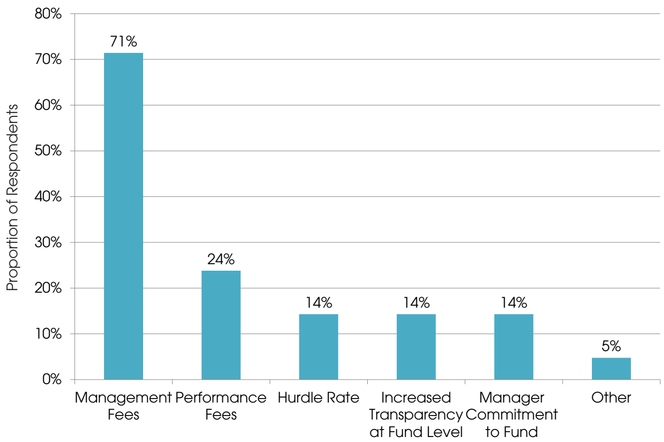
Source: Preqin Investor Interviews, August 2013

Fig. 4.19: Proportion of Investors that Have Seen a Change in Private Real Estate Fund Terms over the Last 12 Months



Source: Preqin Investor Interviews, August 2013

Fig. 4.20: Areas in Which Investors Have Seen a Change in Private Real Estate Fund Terms over the Last 12 Months



Source: Preqin Investor Interviews, August 2013

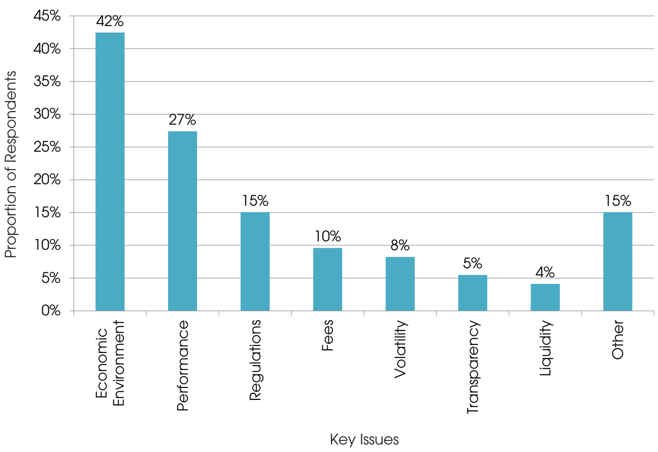
Key Issues and Regulation

With the private real estate market witnessing a number of incoming and proposed regulatory changes in 2013, we asked investors what they believed the key issues are in the current real estate market, and the impact that recent regulation has had on their allocations.

For investors in the private real estate asset class, the economic environment continues to be the key issue affecting the market in 2013, with 42% of respondents stating that this was the most important factor, increasing from 40% in December 2012. Despite real estate demonstrating encouraging performance in recent years, performance is a key issue for 27% of investors interviewed in August 2013, increasing from 20% in December 2012. As a result of new regulation coming into play in the first half of 2013, regulation and its impact on the private real estate market is a key issue for 15% of respondents. With the majority of investors satisfied with the alignment of interests with fund managers, as demonstrated on page 33, fees were a key issue for only 10% of respondents.

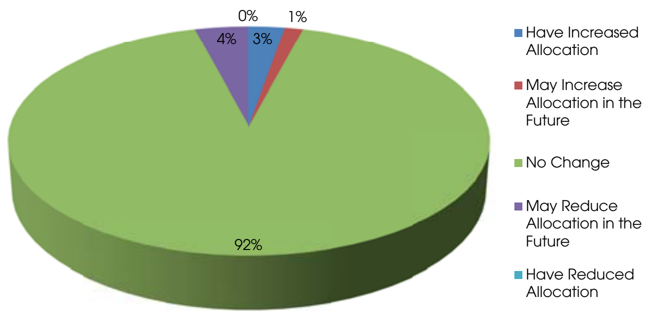
When investors were asked whether recent regulatory changes and proposals, such as AIFMD and Solvency II, had had an impact on their private real estate investments, the overwhelming majority (92%) responded that it had not caused them to make any change in their allocations to the asset class. With 92% of investors interviewed stating that they would be maintaining or increasing their allocations to real estate in the longer term, as shown on page 32, this demonstrates the confidence investors have in the asset class going forward, with recent regulation having little impact on their investments so far. Nonetheless, Fig. 4.23 reveals that the majority of respondents (52%) are unsure whether regulations introduced in the last three years are beneficial to the private real estate industry, indicating that the impact on respondents' investments is as yet unclear, and may be felt more in the coming months.

Fig. 4.21: Investors' Views on the Key Issues Facing the Private Real Estate Market in 2013



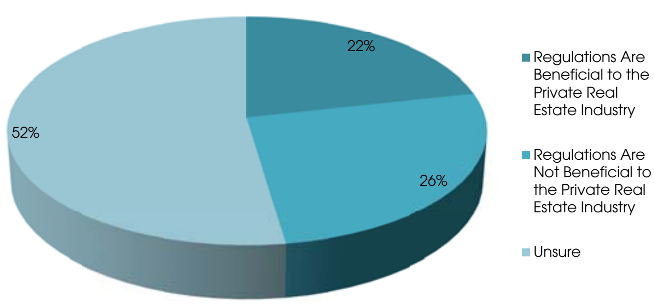
Source: Preqin Investor Interviews, August 2013

Fig. 4.22: Ways in Which Recent Regulatory Changes and Proposals Have Affected Investors' Real Estate Investments



Source: Preqin Investor Interviews, August 2013

Fig. 4.23: Investors' Views on Whether the Regulations Introduced in 2011, 2012 and 2013 Are Beneficial to the Private Real Estate Industry



Source: Preqin Investor Interviews, August 2013

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Alternative Methods of Accessing the Asset Class

Recent years have seen institutions often seeking the additional control provided by alternative routes to private real estate, such as co-investments, joint ventures, or separate accounts. Appetite for these methods has remained stable, with larger investors the most likely to target investment via alternative routes.

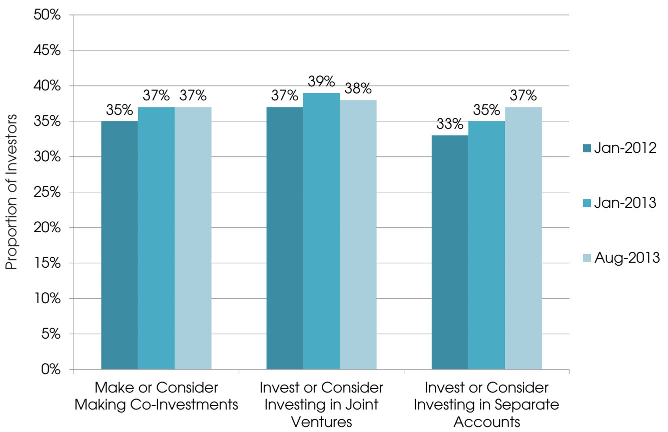
Interest in co-investments and joint ventures has remained stable over the last few years, with appetite for real estate separate accounts increasing. Thirty-seven percent of investors are now interested in separate accounts, increasing from 33% in January 2012 and 35% in January 2013 (Fig. 4.24). However, the resources and knowledge required to make these investments means that it is typically the larger investors that will look to gain exposure through these routes. Fig. 4.25 shows that 67% of institutions with \$10bn or more in total assets invest or consider investing via joint ventures, and 62% utilize or would consider utilizing separate accounts. In contrast, only 21% of investors with less than \$1bn in assets under management invest or consider investing in joint ventures and 20% invest or consider investing via separate accounts.

Appetite for separate account structures also differs across investor types. Of the six investor types listed in Fig. 4.26, asset managers are the most likely to invest via separate accounts; 65% of such institutions utilize, or consider utilizing separate accounts to access the real estate market. Asset managers often have sophisticated investment teams and, as a result, are more able to evaluate and monitor this type of investment.

Forty-three percent of public pension funds will invest, or consider investing in separate accounts. Public pension funds often have large ticket sizes and therefore separate account investments are a particularly viable option for many of these investors. Endowment plans and foundations are the least likely investor types to award separate accounts to real estate managers, with 78% and 80% of these investors unwilling to invest through this route respectively.

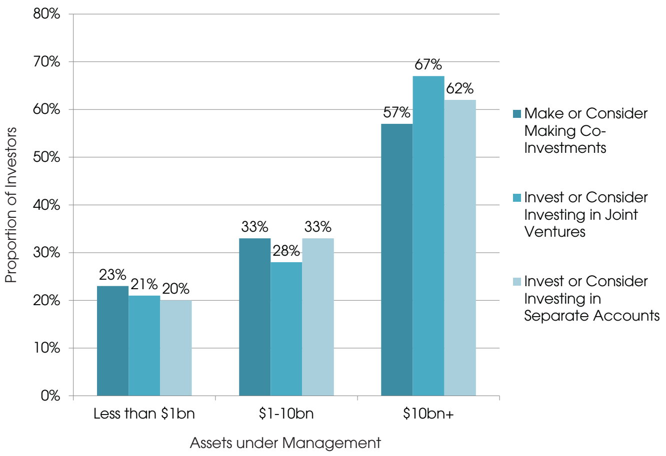
In terms of investor location, institutions based in North America are more likely to seek separate account relationships, with 33% of these investors utilizing or considering utilizing this investment method. In comparison, 26% of European investors form or consider forming real estate separate accounts.

Fig. 4.24: Investor Appetite for Co-Investments, Joint Ventures and Separate Accounts, January 2012 - August 2013



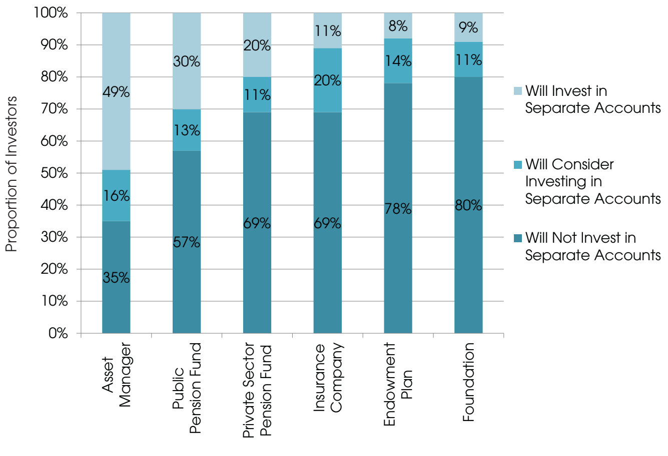
Source: Preqin Real Estate Online

Fig. 4.25: Investor Appetite for Co-Investments, Joint Ventures and Separate Accounts by Investor Size



Source: Preqin Real Estate Online

Fig. 4.26: Investor Appetite for Separate Accounts by Investor Type



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