

Preqin Research Report: Private Equity Real Estate Investor Survey: Plans for the Next 12 Months

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Preqin carried out a survey of 166 institutional private real estate investors between June and August 2010. Preqin spoke to investors of varying size, type and geographic location about their private real estate portfolios and how they will approach the market in the next 12 months. This article reports the results of that survey and discusses whether the market is likely to see increased investor activity in the coming year.

Fundraising in the first two quarters of 2010 has been particularly poor. Q2 2010 saw 20 private equity real estate funds raise an aggregate \$7.3 billion, the lowest quarterly fundraising total since Q3 2004. This steep decline in fundraising comes as a direct result of continuing investor uncertainty regarding the state of the industry and the estimated timescale for recovery. In order to assess whether a turnaround in fortunes was forthcoming, what the key issues are for investors in the current market and where the best opportunities are perceived

to be, Preqin conducted a survey of 166 institutional investors in private equity real estate funds. What follows are the key findings of this survey.

Investor Inactivity in H1 2010

Preqin's survey shows that investors in the asset class have not altered their cautious and prudent approach to investment. As can be seen in Fig. 1, of all private real estate investors surveyed, only 24% made new fund commitments in H1 2010.

A number of factors have contributed to this prolonged fundraising drought. Investors feel that there is still uncertainty in the market and are concerned about the varying issues that remain. Even if many have resolved their liquidity issues, largely owing to the rebound in the stock markets, real estate portfolio values have failed to show the same levels of improvement, leaving many institutions focusing on asset classes that are generating stronger returns.

One of the key determining factors governing investor fund commitment levels is the cash flow situation for their existing portfolios. In past years with activity levels at a high, investors were continually having capital called up, and receiving capital back to them in the form of distributions. As a result, it was necessary to be constantly reinvesting capital in new funds in order to maintain a stable allocation. In recent times fund managers have been calling up committed capital at a slow pace, and with transaction levels low, investors have not been seeing distributions from previous investments. As a result, investors have not needed to make new fund investments in order to maintain their allocations to the asset class. Many institutions Preqin spoke with indicated that they have a number of unfunded commitments and therefore expect outgoing capital in the next 12 months to be mainly in the form of call-ups.

Fig. 1:

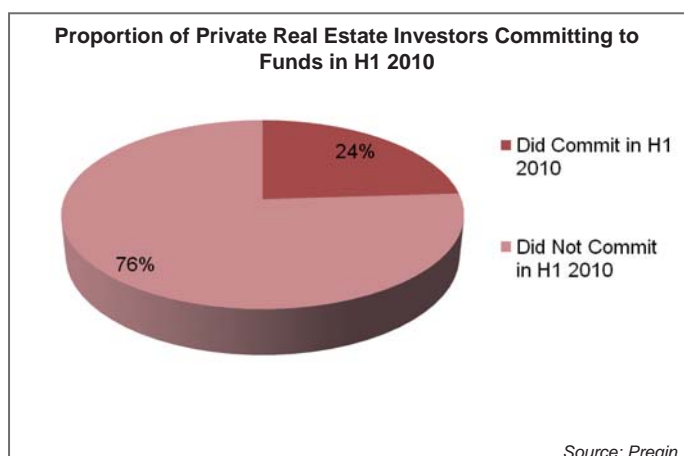


Fig. 2:



Fig. 3:

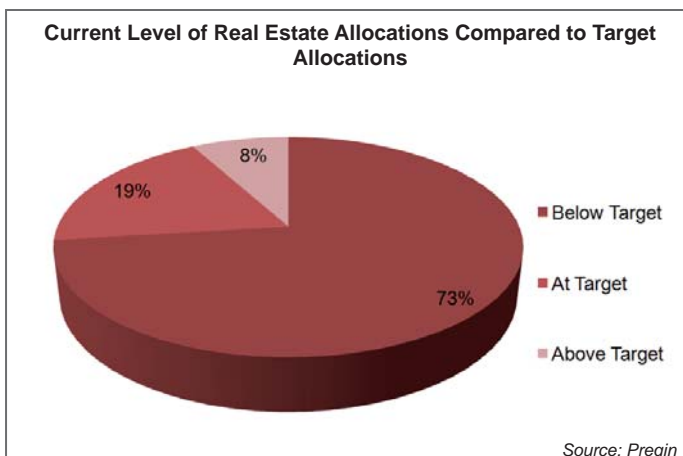
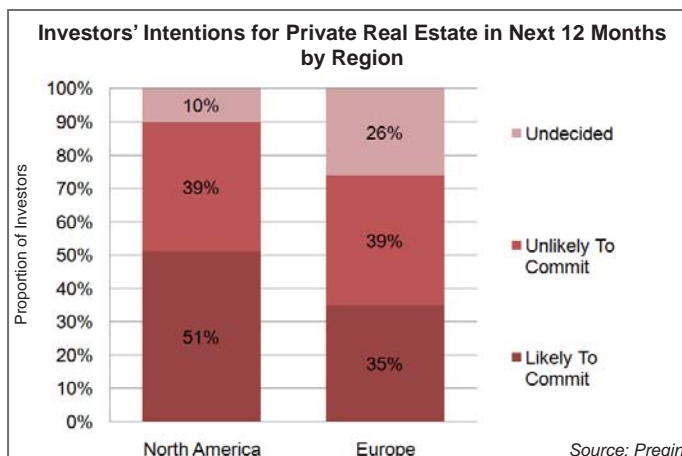


Fig. 4:



Investor Activity in Private Real Estate in Next 12 Months

Of the investors surveyed, 42% stated they were likely to commit to private real estate funds in the next 12 months. Fig. 2 shows that 39% are unlikely to invest and the remaining 19% are undecided. Although these figures are somewhat disappointing compared to previous years when a large proportion of investors would be committing in any one 12-month period, it does show that there is momentum in the market and that there are institutions open to new fund proposals in the current environment.

The 19% undecided figure highlights the fact that many investors remain cautious in their attitudes towards new private real estate fund commitments. They are opting to analyze the market and monitor

opportunities on an ongoing basis rather than actively seeking investments and formulating concrete investment plans. This contrasts with previous years when the majority were able to predict both the number of funds and the amount of capital they would commit in the following 12 months.

One of the most interesting findings of the survey was regarding the current position of investors' portfolios relative to their targets. 73% of investors are below their targeted real estate allocations, which shows just how pronounced the current feeling of uncertainty towards the asset class is, with even those below target reluctant to commit to new vehicles. However, the fact that these investors are maintaining their targets indicates that over the longer term the

industry is due to receive an influx of new capital, with many investors not needing to wait for distributions before making commitments once confidence returns.

Investor Plans by Region

Fig. 4 shows that a higher proportion of North American investors are likely to commit to funds in the next 12 months compared to European institutions, with Fig. 5 showing that a higher percentage of North American investors are below their target allocations to real estate compared to their European counterparts. This suggests that investors based in North America may be most active in the coming 12 months.

It is interesting to note that more European investors are undecided regarding investment in the next 12 months than North

Fig. 5:

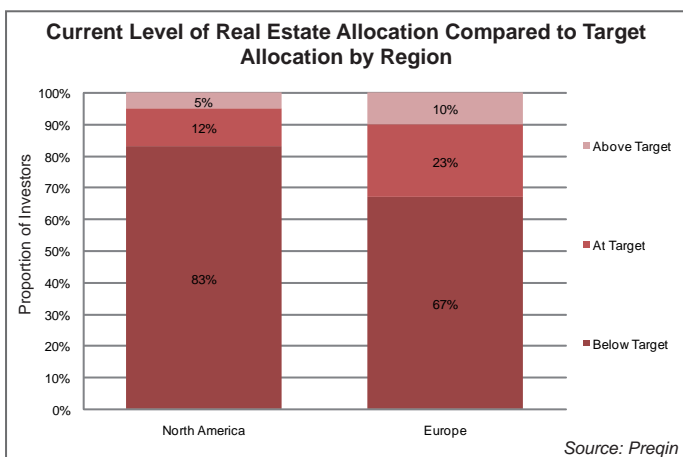
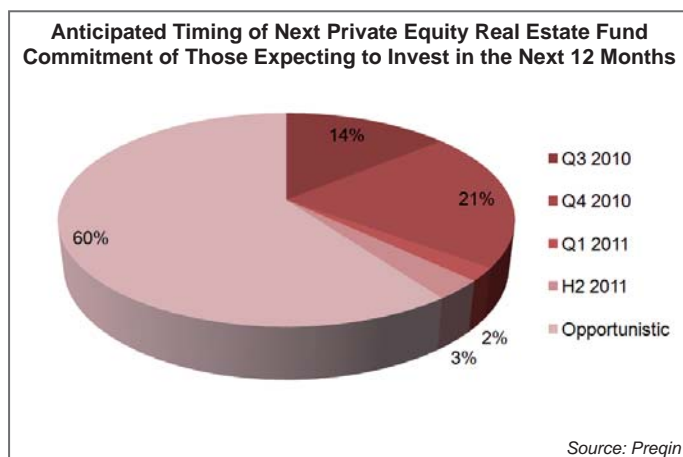


Fig. 6:



American institutions. This suggests that the European investor universe is showing a greater degree of caution with regards to the private real estate market.

Timing of Next Fund Commitment

Investors that stated they were looking to make new fund commitments in the coming 12 months were asked when they expected to make their next commitment. 35% expected to by the end of this year. 14% are close to committing to funds this quarter while 21% expected to do so in Q4 2010. 5% stated that their next commitment was likely to be in 2011.

The remaining 60% were unsure, or had not decided the exact timing of their next commitment. This further underlines that many investors are waiting for the right opportunities to present themselves rather than setting timeframes for fund commitments.

Geographic and Strategic Focus in Next 12 Months

Fig. 7 shows that 42% of the investors that will be active in private real estate in the next 12 months will be targeting both domestic and overseas markets and 37% expect to invest only in domestic markets. 12% will invest only in property markets abroad, perhaps because they have significant domestic allocations and are looking to diversify or expand their international portfolios. A significant 45% stated an interest in Asia and Rest of World vehicles, showing that investors are still eager to

benefit from the rapid growth in emerging economies.

In terms of the fund strategies that investors are hoping to commit to in the next 12 months, Fig. 8 shows that 43% will be looking to allocate to core vehicles and 38% to opportunistic strategies. Value added strategies are not favoured as much as they have been in the past, with only 28% stating an interest in investing in these funds in the coming year. Distressed and debt funds will be targeted by 22% and 18% of these investors respectively. 20% of investors were interested in committing to funds utilizing core-plus strategies while only 3% were interested in other fund types such as funds of funds and secondaries. 15% were still unsure as to which fund types they will be focusing on in the next 12 months.

The Best Opportunities in the Market

As well as being the most targeted strategies in the next 12 months, core and opportunistic funds are also considered the most appealing fund types. As can be seen in Fig. 9, 38% and 34% of investors surveyed believed that opportunistic and core strategies are presenting the

best opportunities in the current market respectively. Distressed and debt funds were chosen by 26% of investors and 11% reasoned that direct investments in the asset class were the most appropriate strategy in the current climate.

Those interested in investing in core and core-plus vehicles in the next 12 months were asked to explain their motivations for focusing on these strategies. 49% stated that the low risk associated with such investments were central to their decision in committing to these vehicles. Investors are looking to limit the level of risk in their portfolios in light of the losses suffered from some higher-risk investments. 40% were attracted to the stable returns and income generated by these funds. 26% wanted to stabilize their portfolios with these funds

Fig. 7:

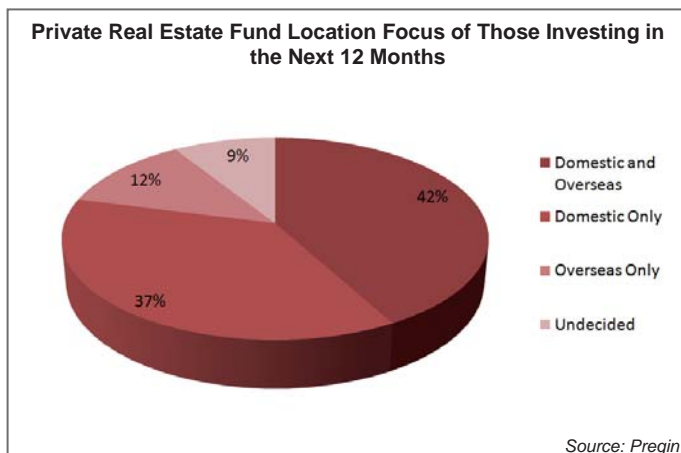


Fig. 8:

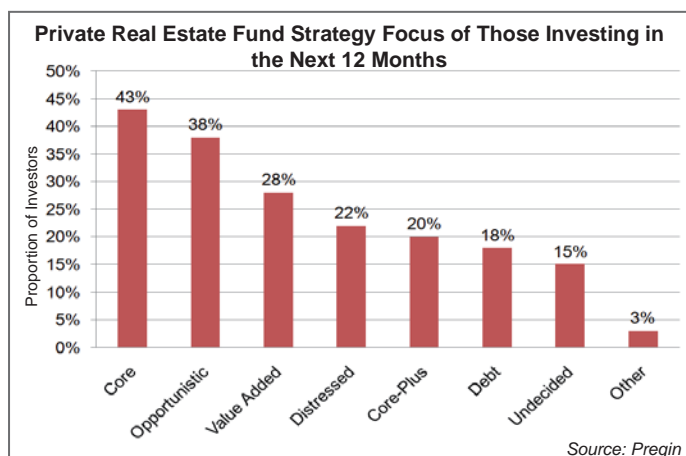


Fig. 9:

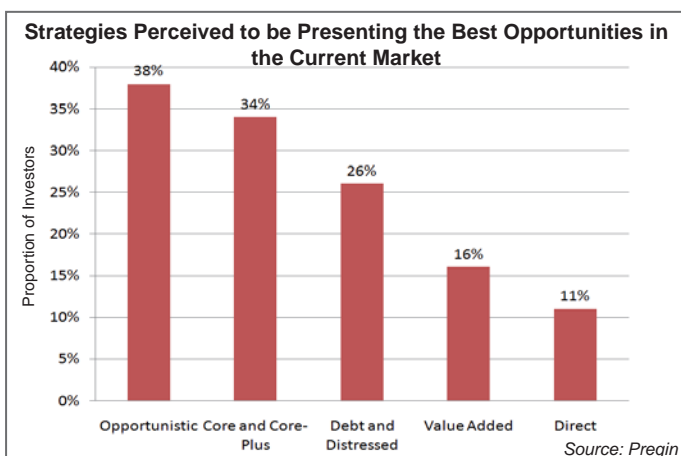
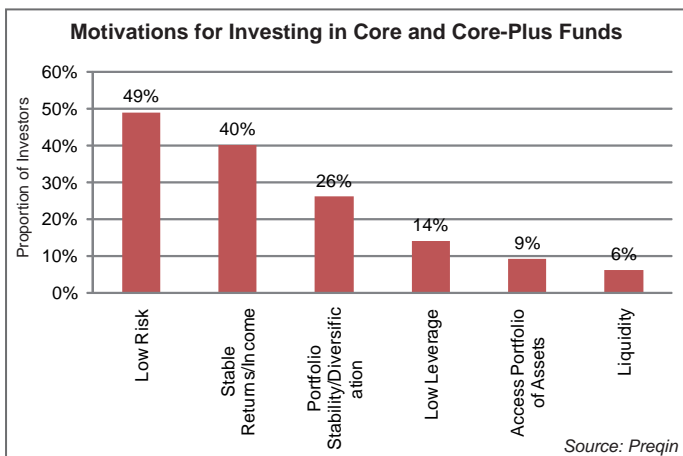


Fig. 10:



as well as diversify their high-risk portfolios with vehicles lower down in the risk/return spectrum. Another reason, given by 14% of investors, was that these vehicles utilize little or no leverage, and many investors are concerned about the large amounts of leverage employed by the higher-risk strategies. 9% stated that being able to access an existing portfolio of assets and assessing the portfolio before making an allocation, was also an incentive. 6% felt that the additional liquidity offered by these funds was important to them.

Looking Ahead

The survey reveals a number of important issues affecting the asset class at present, with the low proportion of respondents that have allocated to funds so far this year underlining the extent to which uncertainty and caution is influencing investor appetite for new funds. For some investors, the fact that they have so many unfunded commitments and very limited levels of capital being returned to them in the form of distributions has caused them to halt new investments as they need to do little to maintain current allocations. However, the proportion of respondents shown to be below their target allocations reveals that for a large proportion of institutions it is market uncertainty rather than cash flow constraints that is the primary factor in the low commitment levels that we are seeing in the current market.

Looking forwards there are encouraging signs. Although many investors are below their target allocations, there is little evidence of target allocations being revised downwards, indicating that over the longer term investors will once again be looking to commit to funds. Although less than half of respondents are likely to commit to new vehicles in the next 12 months, it certainly shows that there is some momentum within the market, and that investors are slowly beginning to return.

For those that are investing, there are some clear preferences in terms of strategy and regional focus. We are seeing a big shift towards emerging markets investments, while in terms of strategy core and core-plus funds, which were until recently relatively rare strategies for private equity real estate funds to pursue, are once again finding favour with investors. Opportunistic funds are still popular, but value added funds have certainly lost much of their attraction for institutions in the current market.

The message for fund managers is clear. Investors are still keen on private equity real estate, but are holding serious reservations about making commitments in the current climate. In order to be successful in the fundraising market, it is necessary for fund managers to successfully convey how they intend to overcome market conditions, and why their strategy is suited to achieve successful returns. Managers will need to take note of the current regional and

strategic preferences, and should expect the fundraising process to take significantly longer than in previous years. Many firms have already taken the concept of fundraising to a new level, essentially remaining in fundraising mode on an almost perpetual basis, ensuring that existing investors are well informed on future plans and that potential future investors are also kept up to date with the firm's activities and successes, whether the firm is currently in fundraising mode or not.

About Preqin

Preqin provides information products and services to real estate firms, funds of funds, investors, placement agents, law firms, investment banks and advisors across the following main areas:

- Fund Performance
- Fundraising
- Investor Profiles
- Fund Terms
- Fund Manager Profiles
- Employment and Compensation

Our customers can access this market intelligence in four different ways:

- Hard copy publications
- Online database services
- Consulting and research support
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Preqin regularly releases research and information on fundraising and all other aspects of the real estate industry as both research reports, and as part of our monthly Spotlight newsletter. To register to receive more research and analysis, please visit www.preqin.com/spotlight

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