2016 Preqin Global Real Estate Report

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The 2016 Preqin Global Real Estate Report - Contents

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Real Estate in 2015 - Key Stats

Real Estate Highlights

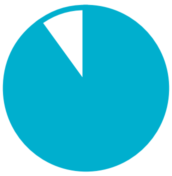
$743bn
Real estate assets under management reach $743bn as of June 2015, up from $605bn in December 2012.

$107bn
Aggregate capital raised by the 177 private real estate funds closed in 2015.

$103bn
Total capital distributions in H1 2015. Momentum continues from the record $187bn distributed in 2014.

$15.8bn
Capital raised by Blackstone Real Estate Partners VIII, the largest private real estate fund of all time, which closed in 2015.

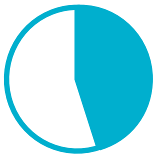
Investor Satisfaction



90%
Proportion of investors that feel their real estate investments have met or exceeded their expectations.

52%
Proportion of surveyed investors that have a positive perception of real estate, up from 37% in December 2014. Only 12% have a negative perception.

Capital Concentration



45%
Proportion of total capital raised in 2015 secured by the 10 largest funds to close.

$627mn
Average size of a private real estate fund closed in 2015, a record high.

Competition for Assets

67%
Proportion of surveyed fund managers that say it is more difficult to find attractive investment opportunities than one year ago.

56%
Proportion of surveyed real estate fund managers stating that finding attractive investment opportunities is their biggest challenge in 2016.

Performance

16%
Annualized real estate fund returns in the three years to June 2015.

22
Number of consecutive quarters to Q2 2015 that have seen an average positive increase in net asset value (NAV).

Club Deals – The Convergence of Commingled Funds and JVs

- Matthew A. Posthuma, Partner and Walter R. McCabe, Partner, Ropes & Gray LLP

Two of the traditional means for institutional investors to privately invest in commercial real estate are the commingled fund and the joint venture (JV) with an operating partner. The commingled fund typically has a large number of investors. The general partner or investment manager has the discretion to purchase, finance, manage and sell a portfolio of properties that it selects at its discretion, according to some fairly broad investment criteria. The general partner customarily receives a management fee of up to 2%, and carried interest distributions of 20% of profits after the investors receive some preferred return.

In contrast, a real estate JV usually consists of a single "money" partner and an operating partner, and invests only in properties that have been pre-approved by the money partner. The money partner also has veto rights over financings, business plans, dispositions and other major decisions. The operating partner often puts in a larger percentage of the capital than in the commingled fund context, and management fees and performance compensation vary considerably.

Over the past few years, larger institutional investors have been seeking alternatives to the traditional commingled fund model. Large investors are placing larger amounts of capital with a smaller number of real estate managers, and in exchange are looking for more customized products from their managers. These investors want more tailored investment strategies with more input on asset management decisions. They also seek more flexible (usually lower) pricing and larger co-investments from their managers. The large investors see the value of diversification that a pure JV does not provide, but want greater control than a fund. They may also not want to be part of a vehicle with a large number of smaller investors, who were selected by the manager without their input. Instead, these investors want to invest alongside a small number of other "like-minded" investors who are committing substantial amounts of capital.

As a result, "club deals" are becoming a much more prevalent vehicle for real estate investing. Club deals are in essence a hybrid that combines many of the benefits of a commingled fund and a JV. Clubs typically contain a handful (for example, two to four) of sophisticated, similarly situated, institutional investors who are funding larger amounts of capital ($50mn-$100mn or greater). Each club investor is able to invest in a much broader set of deals, or larger deals, than if it had invested solely in a JV with the manager. From the manager's perspective, a club deal can allow it to attract more capital than it could from a single JV partner without much of the work involved in raising a commingled fund from a widely dispersed network of target investors.

Club deals often invest in a pre-identified portfolio of assets. When capital is available for additional investments, the manager may have discretion "in a box", with much more detailed parameters than a commingled fund. In other cases, the manager has no discretion to make new investments without the consent of the club investors. One possible variation on this is to allow a consenting investor to "opt-in" (or not) to an investment and invest separately through a side vehicle.

After a property is acquired, similar to a JV, financings, business plans, dispositions and other major decisions by clubs are typically subject to the approval of the investors. One tricky area of negotiations is whether it is possible for some majority of the investors to drag other investors along in a decision. The manager obviously would prefer to not have its decisions subject to the veto right of a single investor. On the other hand, club investors are often reluctant to give up these rights. While club investors may be similarly situated, they still may have differences of opinion, which can make it more difficult to arrive at a course of action than with a fund or JV vehicle. Dispositions, buy-sells and other exit mechanisms are another area that can sometimes be more complicated to structure for a club.

Club deals can be an effective way of deploying a large amount of capital in a diversified portfolio while giving large institutional investors the enhanced discretion they desire. However, clubs require a greater degree of trust, between the manager and the investors, and within the investor group. Finding a group of truly like-minded investors is critical to a successful club investment.

Ropes & Gray

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Matthew Posthuma is a real estate funds partner, and **Walter McCabe** is a real estate transactions partner, at Ropes & Gray LLP.

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Funds in Market

The private real estate fundraising market remains competitive, with an all-time high of 492 funds being marketed as of January 2016, collectively targeting $174bn in institutional investor capital (Fig. 5.10). Fund managers will continue to find it challenging to stand out from their peers in such a crowded market, despite strong institutional appetite for real estate exposure.

Moving up the Risk/Return Spectrum

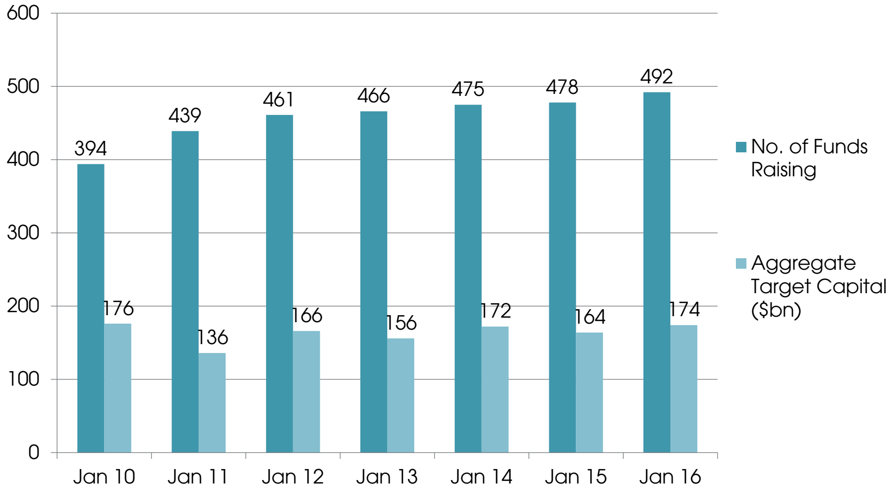
As demonstrated by strong fundraising for opportunistic and value added funds in 2015 (see pages 31 and 32), there is considerable investor appetite for exposure to opportunities further up the risk/return spectrum. As shown in Fig. 5.11, there are many opportunities available to investors, with value added and opportunistic funds representing approximately two-thirds of funds in market and total capital targeted. Value added funds are seeking the greatest amount of institutional capital, with 181 funds seeking $56bn, although many of the largest individual offerings follow primarily opportunistic or debt strategies. Core and core-plus funds are less numerous, with only 84 such vehicles in market, collectively targeting $24bn.

Fund Manager Experience

Examining funds on the road by manager experience shows that the most experienced fund managers (those that have raised nine or more funds previously) make up 30% of the aggregate capital targeted in January 2016, despite representing only 15% of funds seeking capital (Fig. 5.12). Conversely, while first-time funds in market make up 28% of all funds on the road, due to the lower fundraising targets set by newer managers they account for only 16% of all capital targeted.

The 10 largest funds in market are shown in Fig. 5.13. The largest is Brookfield Strategic Real Estate Partners II, an opportunistic vehicle targeting $7bn for investment in commercial property and real estate operating companies globally. Targeting $4bn, Blackstone Real Estate Debt Strategies III is the next largest and focuses on high yield lending on commercial real estate through new loan originations and purchases of new loans and securities.

Fig. 5.10: Closed-End Private Real Estate Funds in Market over Time, January 2010 - January 2016



Source: Preqin Real Estate Online

Fig. 5.11: Breakdown of Closed-End Private Real Estate Funds in Market by Primary Strategy Focus

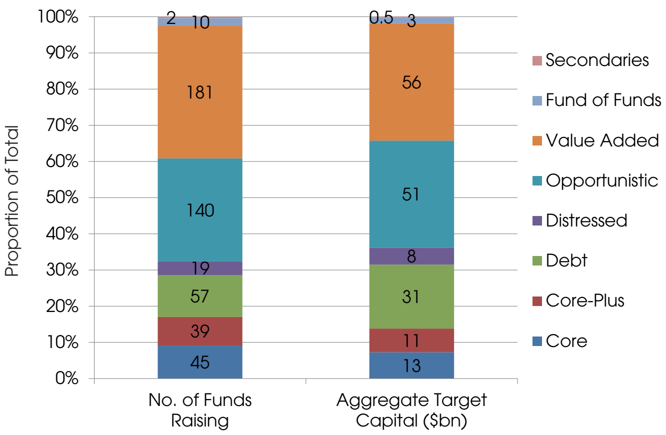


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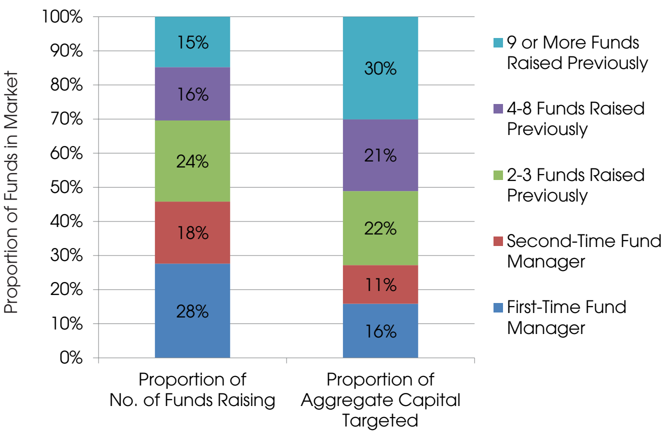
Fig. 5.12: Breakdown of Closed-End Private Real Estate Funds in Market by Manager Experience



Source: Preqin Real Estate Online

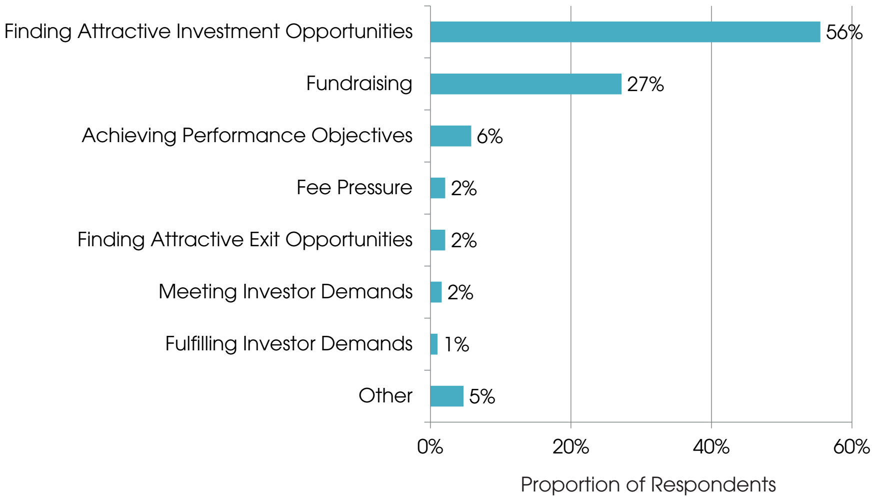
Fund Manager Outlook for 2016

In November 2015, Preqin conducted an in-depth study of over 210 real estate fund managers to gain an insight into the issues affecting their business, plans for investment and expected staffing levels, as well as to determine their outlook for real estate in 2016.

Key Issues

Competitive pricing is clearly making sourcing deals a difficult prospect for many firms, with finding attractive investment opportunities named as the single biggest challenge faced in 2016 by the majority of respondents (56%, Fig. 6.1). With a crowded market, fundraising was named by just over one-quarter (27%) of firms, while other issues were named by just small proportions of respondents.

Fig. 6.1: Biggest Challenges Facing Private Real Estate Managers in 2016



Source: Preqin Fund Manager Survey, November 2015

Deal Flow

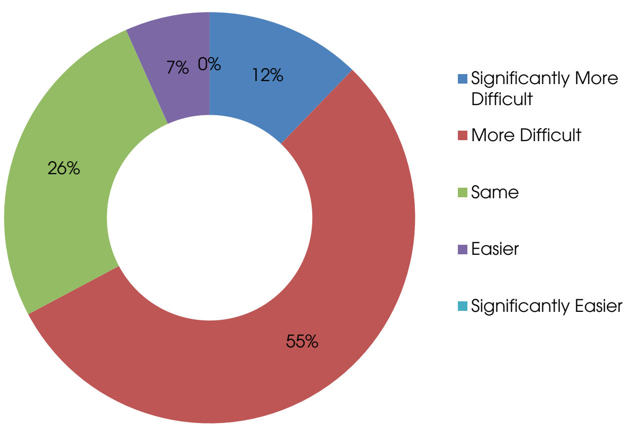
With improved fundraising in recent years, managers of private equity real estate funds now have a large amount of dry powder at their disposal ($202bn). This, coupled with more institutional investors making direct investments, means competition for assets is growing: 67% of fund managers are finding it more difficult to find attractive investment opportunities in the current market compared to a year ago (Fig. 6.2). One UK-based fund manager stated that “crazy pricing” was making it hard to put capital to work.

Consequently, managers have to review more opportunities than 12 months ago: 53% of respondents now conduct due diligence on a greater number of opportunities for every investment made. To cope with the increased workload, many fund managers will be growing their investment teams over 2016: 49% of surveyed managers stated they will be increasing the size of their investment team in the next year, with only 2% expecting to reduce staffing levels.

Furthermore, the level of competition has intensified across a variety of asset types. Fig. 6.3 reveals that 71% of respondents believe that competition for core assets has grown in the last 12 months, while 78% have seen competition for value added and opportunistic assets increase.

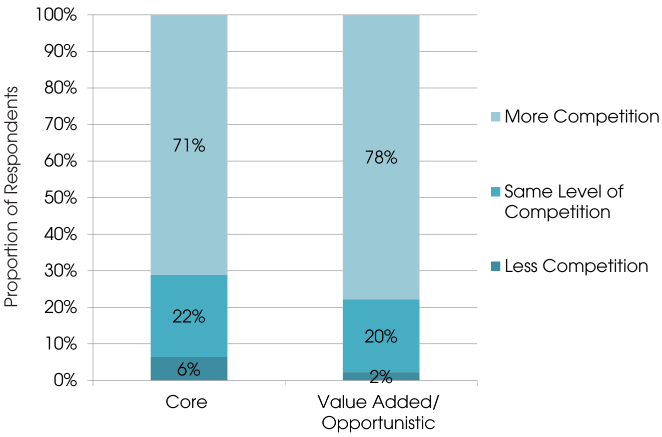
However, despite this increasing competition, most fund managers are confident they can put sizeable amounts of capital to work in the coming year. Fig. 6.4 reveals that that 60% of surveyed fund managers plan to deploy more capital in

Fig. 6.2: Fund Managers’ Views on the Difficulty in Finding Attractive Investment Opportunities Compared to 12 Months Ago



Source: Preqin Fund Manager Survey, November 2015

Fig. 6.3: Fund Managers’ Views on the Level of Competition for Assets Compared to 12 Months Ago: Core vs. Value Added/Opportunistic



Source: Preqin Fund Manager Survey, November 2015 distinct institution, real estate does offer opportunities for investment across the risk spectrum, with 13% of respondents seeking high absolute returns of 14% or more.

With most routes to real estate being illiquid, real estate investment is particularly suited to institutional investors with long-term investment horizons. Fig. 8.3 illustrates how pension funds account for over a third of real estate investors, with private wealth institutions, foundations, endowment plans and insurance companies collectively representing a further 50%. The population of active real estate investors has a wide range of assets under management (AUM) as illustrated in Fig. 8.4, with the largest proportions holding between $1bn and $9.9bn (36%) and less than $500mn (32%).

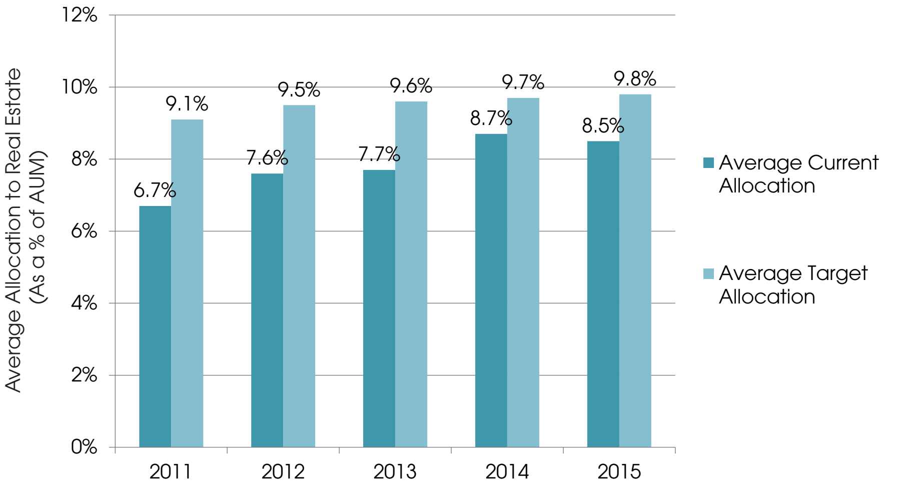
Allocations

The prominence of real estate within an institutional portfolio has increased over recent years, with the average current allocation rising from 6.7% of AUM in 2011 to 8.5% in 2015, while the average target allocation rose from 9.1% to 9.8% over the same time period (Fig. 8.5). Record distributions to investors from private real estate funds in 2014 may have contributed to the slight fall in the average current allocation from 8.7% in 2014.

The top three investor types by average current allocation are all pension funds, of which public pension funds have the highest current and target allocations to real estate (Fig. 8.6). Sovereign wealth funds, which have long-term investment horizons, are also suited to investment in real estate, which is reflected in their relatively high average current and target allocations to the asset class.

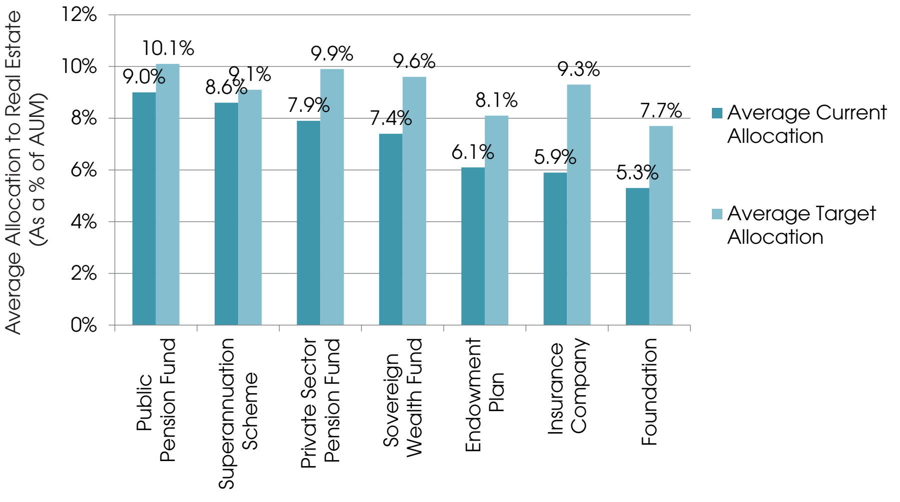
In December 2015, the majority (53%) of investors were still below their target allocations to the asset class, as shown in Fig. 8.7. This proportion has steadily fallen from two-thirds of investors as of December 2011, as institutions have committed capital and more have reached their long-term strategic targets. Further evidence of more capital flowing into real estate in the coming years is shown on page 64, with 29% of investors planning to increase their allocations to real estate over the longer term.

Fig. 8.5: Investors' Changing Current and Target Allocations to Real Estate, 2011 - 2015



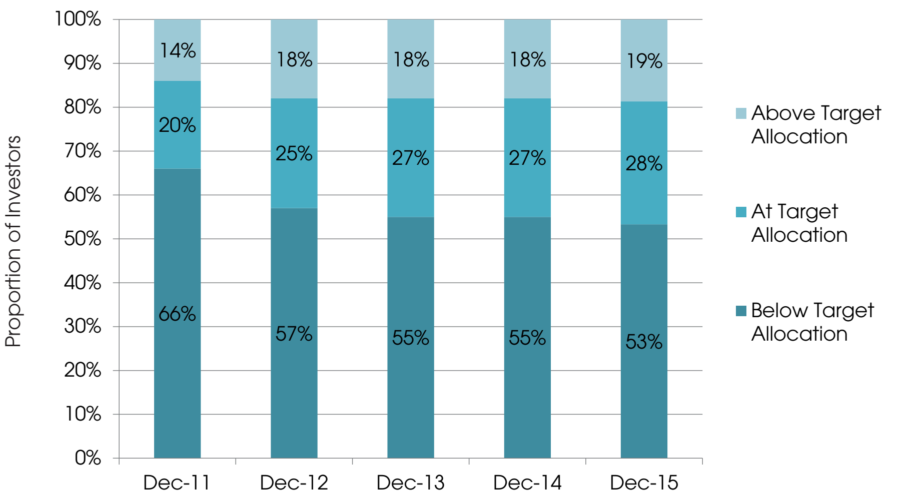
Source: Preqin Real Estate Online

Fig. 8.6: Investors' Average Current and Target Allocations to Real Estate by Investor Type



Source: Preqin Real Estate Online

Fig. 8.7: Proportion of Investors that Are At, Above or Below Their Target Allocations to Real Estate, December 2011 - December 2015



Source: Preqin Real Estate Online

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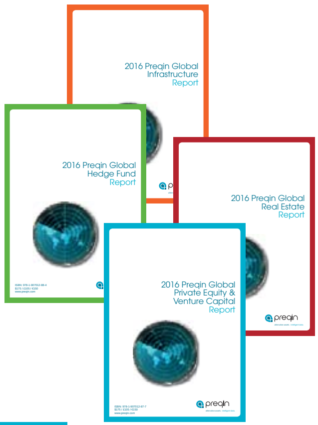

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