



PREQIN SPECIAL REPORT: **REAL ESTATE FUND** **MANAGER OUTLOOK**

H2 2017

FOREWORD

Our latest survey of private real estate fund managers in June 2017 revealed the key issues within this alternatives sector, in line with trends identified in previous surveys. The recurring issues are, namely, the continued competition for transactions and its corresponding effect on valuations, as well as the current difficult environment for vehicles seeking capital from institutional investors.

High valuations have made it an attractive time to be divesting assets, and opportunities are ripe for managers to continue to distribute capital back to investors. However, managers do not seem to be holding back in this environment, with private equity real estate deal flow remaining robust in 2017 so far. Driving this is the vast amount of capital at managers' disposal – which continues to surpass previous records – and firms are expecting to put more capital to work in the coming 12 months than they did in the previous year.

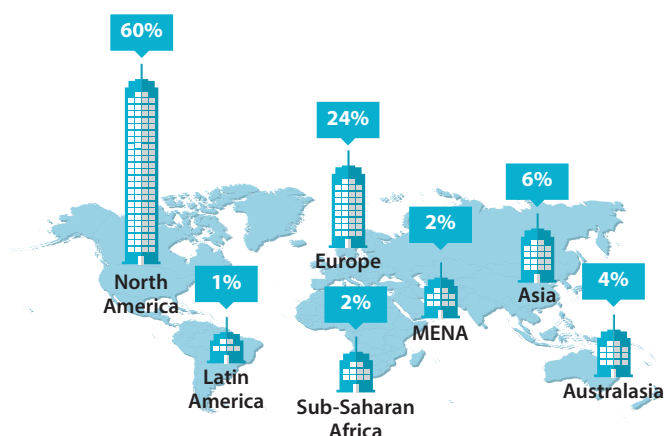
Investors are satisfied with their real estate portfolios and, as many now find themselves under weighted to the asset class, are looking for new fund investments. Investors face a challenge of trying to identify suitable vehicles, in a period when there are record numbers of funds to choose from – the result of which will mean unsuccessful attempts by some vehicles in market. This issue has been identified in our results, with three-quarters of surveyed managers seeing an increase in competition for investor capital over the past year, and institutions placing their faith in the largest managers at the expense of smaller firms. Managers are beginning to respond in creative ways to this pressure: some are choosing to adapt their strategies, others their geographic focus, targeted returns or even property types in order to create a unique value proposition for investors.

Bifurcation of the fundraising market could be a realistic outcome if these trends persist, and the common theme of recent years – capital concentration among the largest funds – only supports this view. However, surveyed firms are optimistic that the private real estate market will continue to grow and the vast majority predict that the industry will be larger in 2020 than it is today.

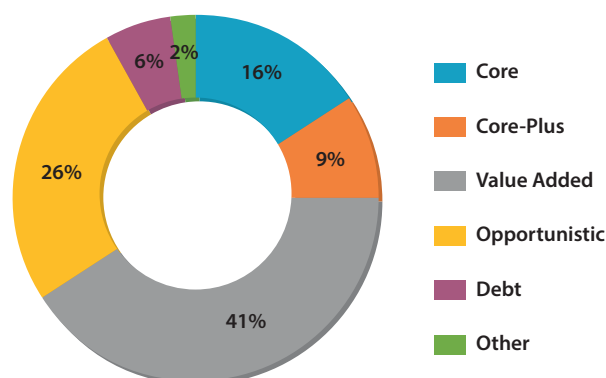
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Survey Respondents by Headquarters Location



Survey Respondents by Headquarters Location



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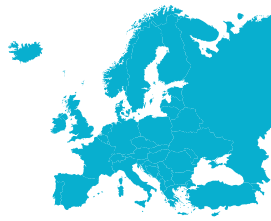


H2 2017 REAL ESTATE FUND MANAGER OUTLOOK – KEY STATS BY RESPONDENT LOCATION

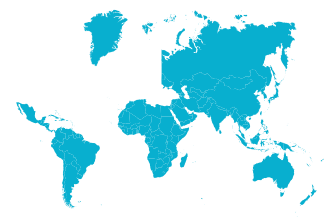
NORTH AMERICA



EUROPE



ASIA & REST OF WORLD



Fund Manager Views on the Biggest Challenges Facing the Industry in the Next 12 Months

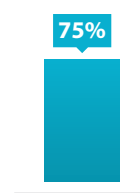
Asset Pricing	67%
Deal Flow	43%
Fundraising	21%

Asset Pricing	57%
Ongoing Volatility in Global Markets	52%
Deal Flow	48%

Asset Pricing	47%
Exit Environment	33%
Ongoing Volatility in Global Markets	33%

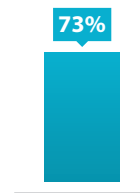
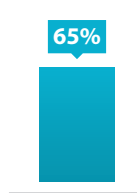
More information can be found on page 9

Proportion of Fund Managers Seeing Increased Competition for Assets than 12 Months Ago



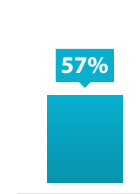
More information can be found on page 4

Proportion of Fund Managers Planning to Deploy More Capital in the Next 12 Months than in the Past Year



More information can be found on page 9

Proportion of Fund Managers Seeing Increased Investor Appetite for Real Estate over the Past 12 Months



More information can be found on page 7

Views on the Industry

“We are lending more on ground-up development, and considering investing in property types slightly outside the mainstream of the four main food groups
- \$5-9.9bn US-based Manager

“The level of competition is not altering our strategy, but we are targeting new markets for our value add investors, not as a function of competition but asset price in key locations
- \$500-999mn UK-based Manager

“We have implemented a more targeted deployment approach to accommodate higher pricing
- \$1-4.9bn Australia-based Manager

DEAL FLOW AND COMPETITION

With investors seeing strong performance from their closed-end fund portfolios, and fund managers distributing capital back to their LPs, the industry is attracting re-investment from liquid institutions which has helped maintain the high levels of capital secured each year.

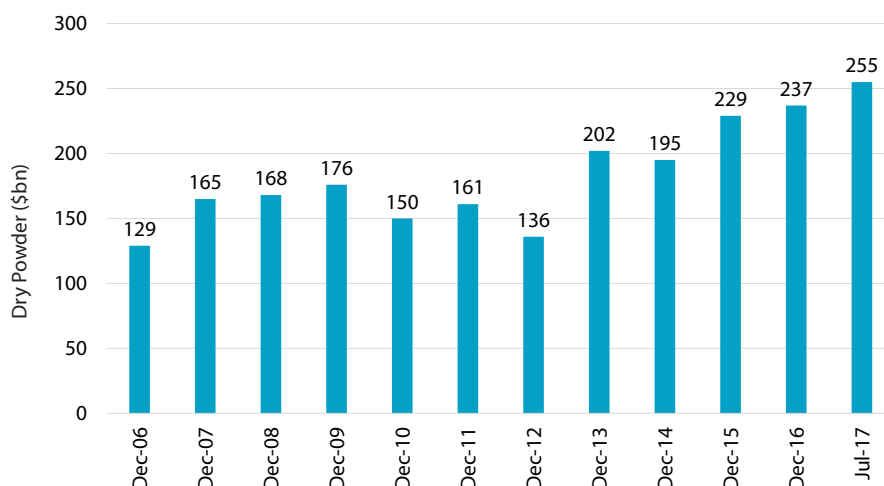
However, the level of uncalled capital available to private real estate fund managers continues to grow: as at July 2017, industry dry powder stands at \$255bn, marking an 8% increase since the start of the year and a record high for the asset class (Fig. 1). This, coupled with the rising number of participants in the industry, has presented challenges for fund managers which are now investing this capital in a competitive marketplace.

“Over two-thirds of managers reported that asset valuations have increased over the past year

COMPETITION IN REAL ESTATE

The majority (60%) of fund managers are seeing more competition in the current

Fig. 1: Closed-End Private Real Estate Dry Powder, 2006 - 2017



Source: Preqin Real Estate Online

real estate market than 12 months ago (Fig. 2); however, a significant proportion (41%) of North America-based fund managers are reporting no change in the level of competition for assets. Three in every four managers based in other regions are reporting increased competition, indicating a growing demand for assets located outside North America.

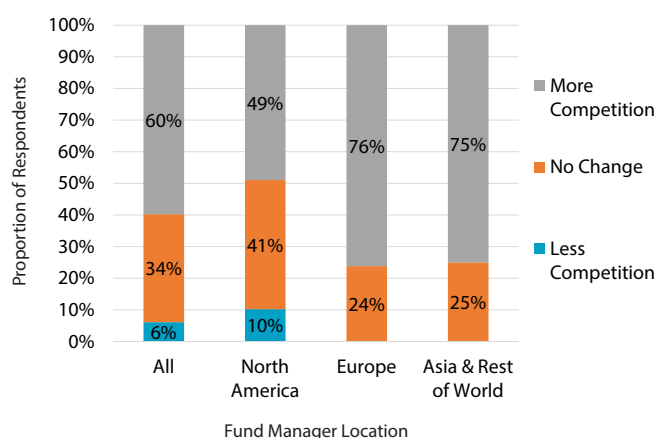
Fund managers have seen competition increasing across the asset risk/return spectrum (Fig. 3), a trend also present in

Preqin's 2016 survey. Smaller proportions of respondents are still reporting increased competition for value added and opportunistic assets, signifying a growing appetite for higher-risk strategies, as investors seek returns following yield compression in major markets.

VALUATIONS AND OPPORTUNITIES

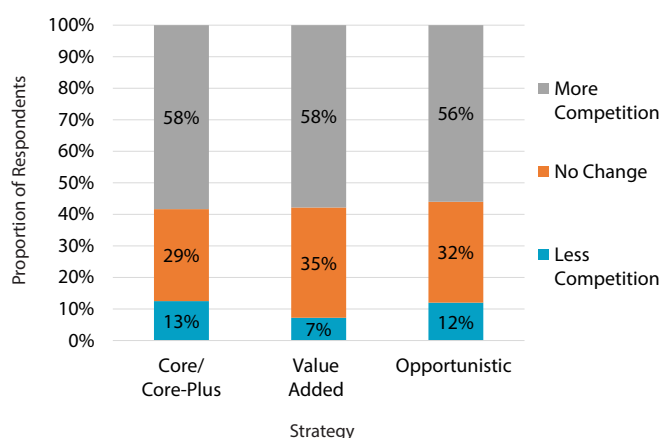
Mirroring the trend of increasing levels of competition seen by Europe-based fund managers, almost all of these managers (91%) are also seeing higher prices for

Fig. 2: Fund Manager Views on the Level of Competition for Real Estate Assets Compared to 12 Months Ago by Fund Manager Location



Source: Preqin Fund Manager Survey, June 2017

Fig. 3: Fund Manager Views on the Level of Competition for Real Estate Assets Compared to 12 Months Ago by Strategy



Source: Preqin Fund Manager Survey, June 2017



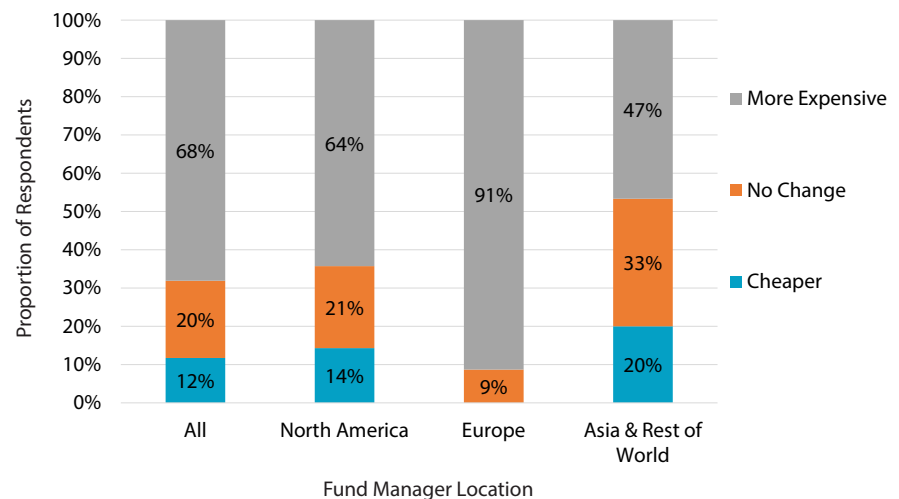
property (Fig. 4). Sixty-four percent of North America-based respondents are also reporting increased asset prices; however, the views of fund managers based outside North America and Europe are mixed: one-fifth of these managers reported that asset prices have fallen over the past year, while a third saw no change in valuations.

“Three-quarters of respondents have found it more difficult to find attractive assets in the past year than when surveyed in December 2016

With increased valuations reported across the global real estate market, it seems that finding attractive assets has become more challenging: three-quarters of respondents have found it more difficult to find attractive assets in the past year than in December 2016. As a result, the vast majority (91%) of fund managers are looking to review the same or a greater number of investment opportunities than 12 months ago. However, despite Europe-based respondents reporting increased competition and asset values, nearly half (47%) do not believe it has become more difficult to find attractive opportunities (Fig. 6).

While significant proportions of managers operating each top-level strategy are

Fig. 4: Fund Manager Views on Pricing for Real Estate Assets Compared to 12 Months Ago by Fund Manager Location



Source: Preqin Fund Manager Survey, June 2017

now finding it harder to source attractive investments, debt managers are more mixed in their responses: half are finding it harder and half have reported no change over the past year.

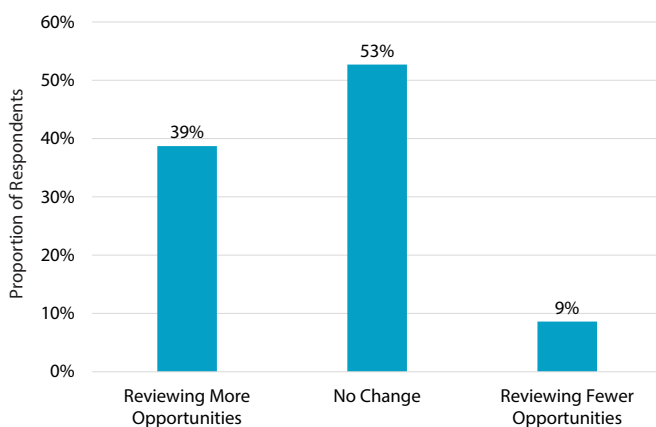
FUND MANAGER REACTION

Market conditions have forced real estate firms to adapt to the new environment, with significant proportions of fund managers of all sizes reporting that asset valuations have affected their targeted returns (Fig. 7). This impact is largely seen among larger managers (those with \$5bn or more in assets under management), with the majority (55%) reporting that asset valuations have reduced their targeted returns, perhaps due to the quantity of high-value assets managers

of this size seek to acquire. Conversely, managers at the opposite end of the size spectrum are more likely to report that their targeted returns have increased.

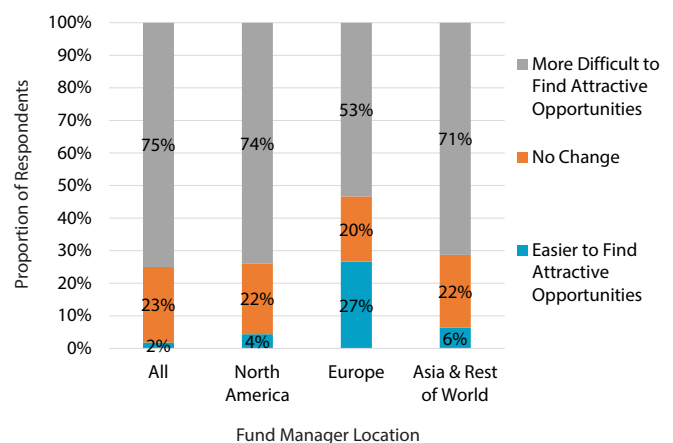
Furthermore, the level of competition in the current market has led some managers to alter the way their strategy operates, with firms managing core-plus funds most likely to have adapted their strategy in response to market conditions (Fig. 8). One Europe-based core-plus fund manager adapted their strategy to include opportunistic and value added components, while two North America-based core-plus fund managers moved into new markets in response to competition. Similar alterations were seen from fund managers adapting their

Fig. 5: Amount of Investment Opportunities under Review by Fund Managers Compared to 12 Months Ago



Source: Secondary Fund Manager Survey, January 2017

Fig. 6: Fund Manager Views on the Level of Difficulty of Finding Attractive Investment Opportunities Compared to 12 Months Ago by Fund Manager Location



Source: Preqin Fund Manager Survey, June 2017

value added strategies, with one manager (which manages over \$10bn) expanding its range of asset types targeted by including niche assets such as student housing and medical office buildings.

EXIT ENVIRONMENT

The high valuations and increased demand for real estate assets has created a strong seller's market and an attractive period for divestment. As seen in Fig. 9, 40% of respondents plan to increase the number of exits they complete over the coming year, and the exit environment remains less of a concern than the price of assets or deal flow (see page 9).

Fund manager views on how best to manage their assets and capital over the coming year differ slightly from region to region; however, the majority (59%) of fund managers plan to make more investments than exits in the coming year (Fig. 10). This being said, North America-based fund managers represent the smallest proportion of managers that are looking to make more investments than exits.

PROPORTION OF FUND MANAGERS THAT BELIEVE IT IS HARDER TO FIND ATTRACTIVE OPPORTUNITIES THAN 12 MONTHS AGO BY PRIMARY STRATEGY

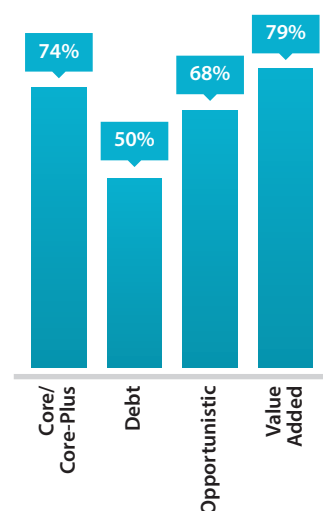
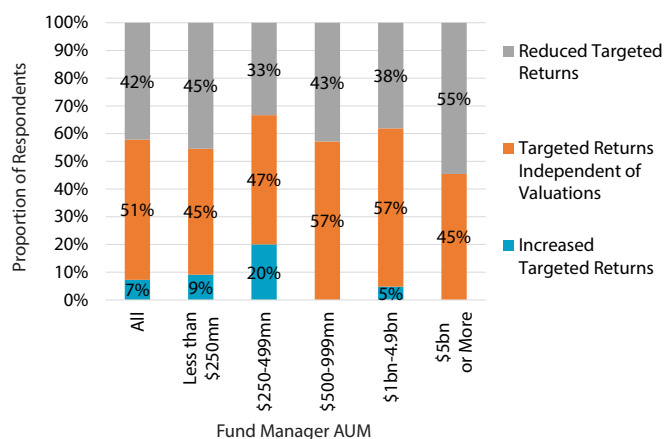
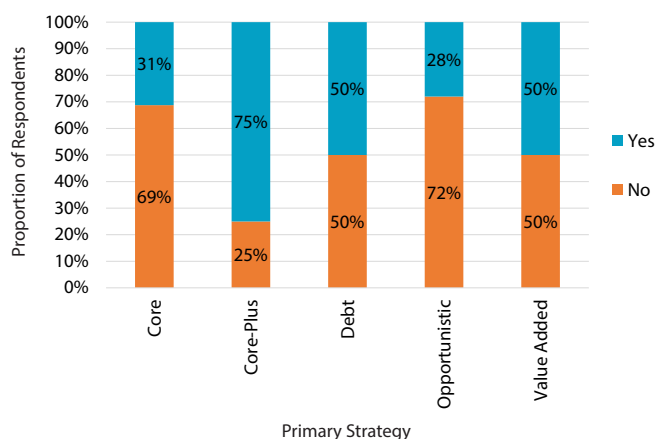


Fig. 7: Impact of Asset Valuations on Targeted Returns of Funds in Market by Fund Manager AUM



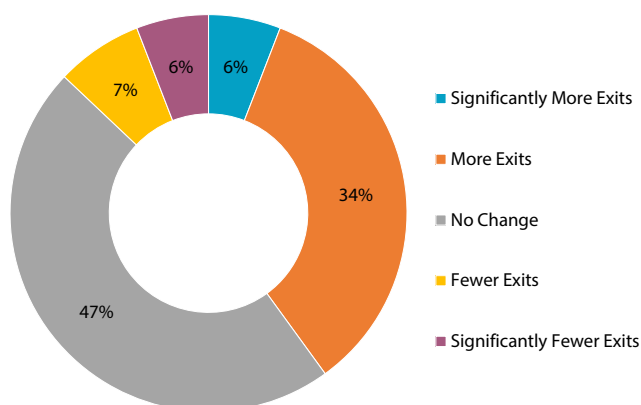
Source: Preqin Fund Manager Survey, June 2017

Fig. 8: Fund Manager Views on whether the Level of Competition Has Led Them to Alter their Investment Strategy by Primary Strategy



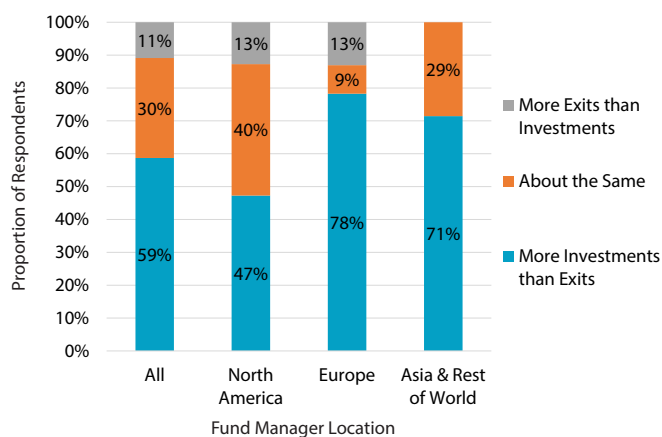
Source: Preqin Fund Manager Survey, June 2017

Fig. 9: Fund Manager Views on the Amount of Investments They Will Be Exiting in the Next 12 Months Compared to the Past 12 Months



Source: Preqin Fund Manager Survey, June 2017

Fig. 10: Fund Managers' Plans for Their Investment/Exit Activity in the Next 12 Months by Location



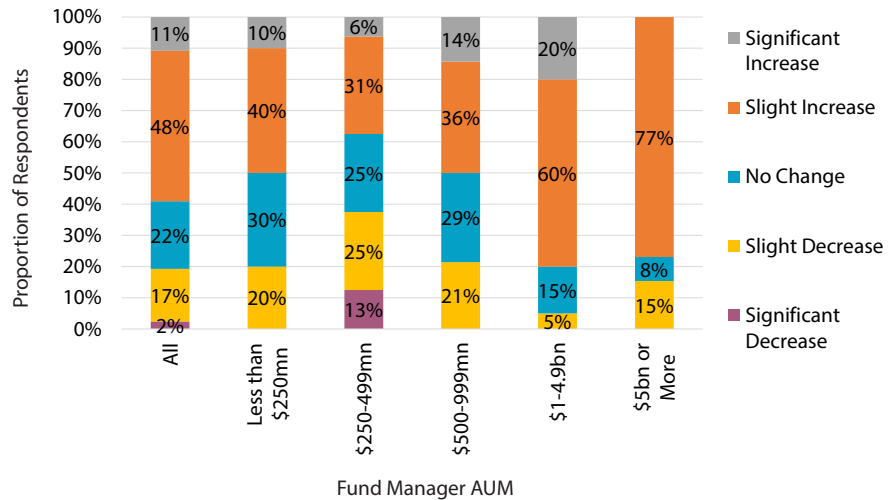
Source: Preqin Fund Manager Survey, June 2017



FUND MANAGER VIEWS ON INVESTOR APPETITE

As investors continue to see strong performance from their private real estate investments as well as capital distributions from their GPs, appetite for the asset class has increased. The majority of respondents have witnessed increased investor appetite for real estate over the past 12 months; however, this has not been experienced by all firms, with significant proportions of mid-market managers reporting a decrease in appetite (Fig. 11). Investors increasingly seek recognized brand names, with the vast majority (79%) of managers operating \$1bn or more in AUM seeing an increase in investor appetite over the past year.

Fig. 11: Fund Manager Views on How Institutional Investor Appetite for Real Estate Has Changed over the Past 12 Months by Fund Manager AUM



Source: Preqin Fund Manager Survey, June 2017

“Investors are increasingly seeking recognized brand names, at the expense of small emerging managers

Conversely, most respondents that saw a decrease in investor appetite were smaller managers; one Asia-based fund manager, operating less than \$100mn in AUM, stated that investors are focusing on large

fund managers at the expense of small emerging managers.

INVESTOR TYPE

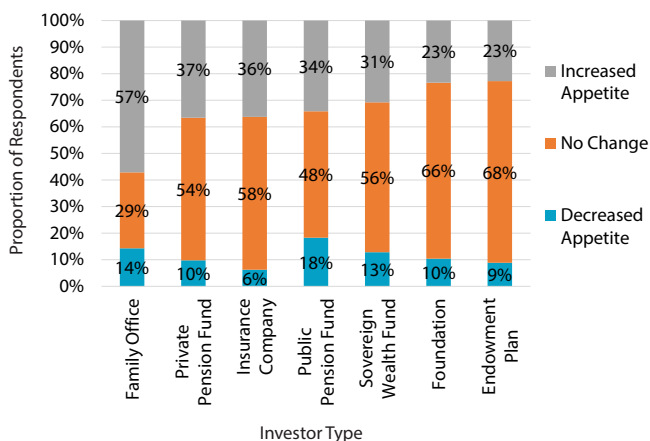
Across all investor types, a greater proportion of fund managers are seeing more appetite from institutions than less appetite (Fig. 12). Furthermore, over half (57%) of all respondents have seen an increase in the appetite of family offices for real estate in the past 12 months,

perhaps due to the increasing number of high-net-worth individuals seeking to access private markets this way.

GEOGRAPHIES

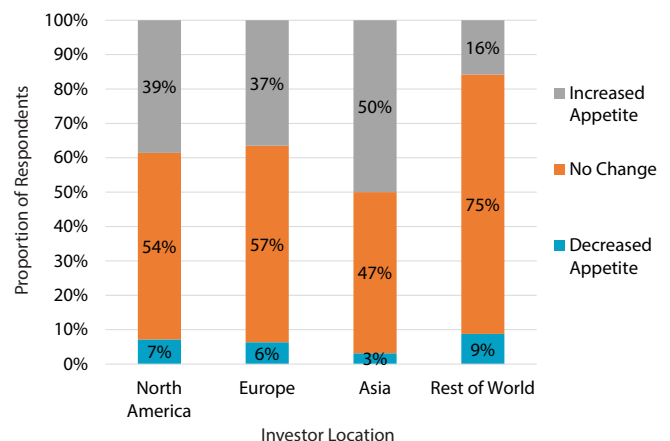
Half of all respondents noted that Asia-based investors' appetite for real estate has increased over the past 12 months (Fig. 13); with their assets continuing to grow and regulation surrounding outbound investment relaxing, it seems

Fig. 12: Fund Manager Views on How Institutional Investor Appetite for Real Estate Has Changed over the Past 12 Months by Investor Type



Source: Preqin Fund Manager Survey, June 2017

Fig. 13: Fund Manager Views on How Institutional Investor Appetite for Real Estate Has Changed over the Past 12 Months by Investor Location



Source: Preqin Fund Manager Survey, June 2017

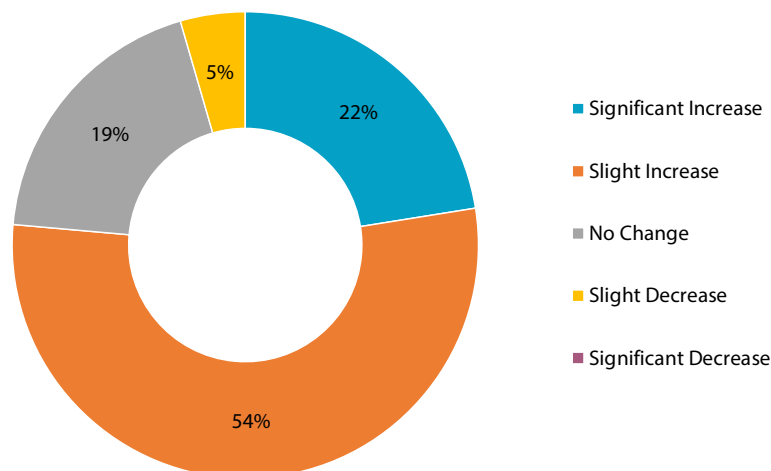
investors in Asia are becoming an important source of capital. Furthermore, significant proportions of fund managers experienced an increase in appetite from North America- (39%) and Europe-based investors (37%) and, encouragingly, few reported a decrease.

“The number of funds in market continues to reach record highs, and competition for investor capital looks set to continue

CAPITAL COMPETITION

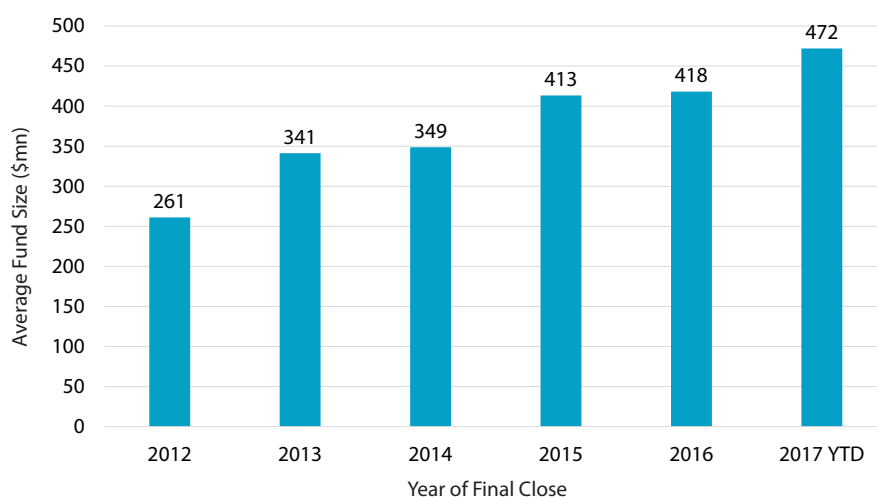
While this demand is encouraging for fund managers looking to raise funds in the current market, over three-quarters of respondents are seeing increased competition for investor capital (Fig. 14). As managers look to raise larger vehicles and the number of funds in market continues to reach record highs (557 funds are currently targeting \$177bn as at the beginning of Q3 2017), the competition for investor capital looks set to continue.

Fig. 14: Fund Manager Views on the Level of Competition for Investor Capital Compared to 12 Months Ago



Source: Preqin Fund Manager Survey, June 2017

Fig. 15: Average Size of Private Real Estate Funds, 2012 - 2017 YTD (As at August 2017)



Source: Preqin Fund Manager Survey, June 2017

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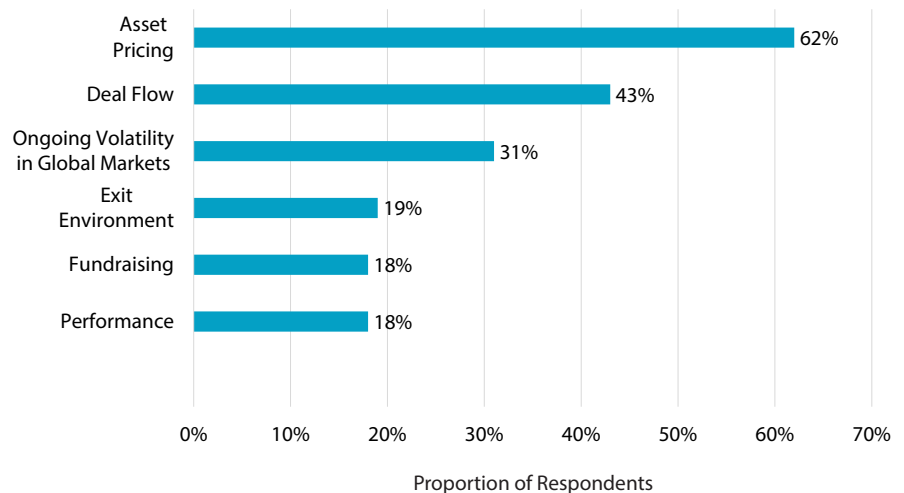
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OUTLOOK AND FUTURE PLANS

As private real estate managers look to the year ahead, asset prices and deal flow are their key concerns (Fig. 16). With 68% of respondents witnessing increased prices for real estate assets over the past 12 months, it is unsurprising that they think valuations will be their biggest challenge in the coming year. While the proportion of fund managers concerned by market uncertainty and volatility remains high at 31%, this proportion has fallen since Preqin's June and December 2016 surveys (from 41% and 37% respectively) as markets over the course of the coming 12 months react to the shock economic and political events of the past year.

Fig. 16: Biggest Challenges Facing Real Estate Fund Managers in the Next 12 Months



Source: Preqin Fund Manager Survey, January 2017

“ Nearly two-thirds of managers see valuations as the biggest challenge facing them in the next 12 months

CAPITAL DEPLOYMENT

Given that the level of private real estate dry powder is currently at a record high, and asset valuations look set to remain high if not increase further, it is unsurprising to see that the majority of fund managers plan to deploy more

capital in the real estate market in the coming 12 months than the previous year, with 29% planning significantly more investments (Fig. 17).

ALTERNATIVE STRUCTURES

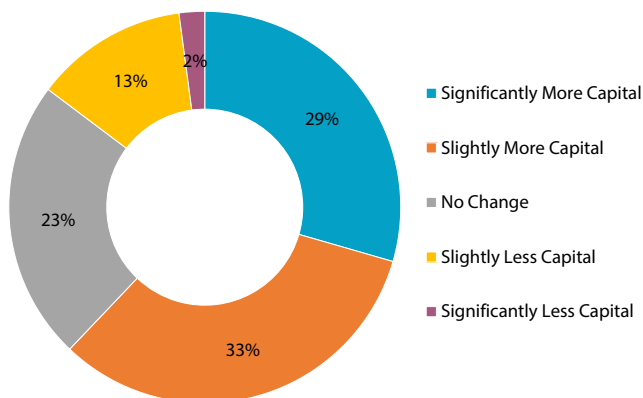
As seen on page 4, there is much competition for investor capital in the current market and, in an attempt to help secure investor allocations, fund managers are looking to expand their product offering through alternative routes to market. Nearly half of respondents plan to increase the co-investment opportunities

they offer to investors as they look to provide direct access to attractive assets, while 36% expect to increase the amount of joint ventures they offer (Fig. 18).

FUND LAUNCHES

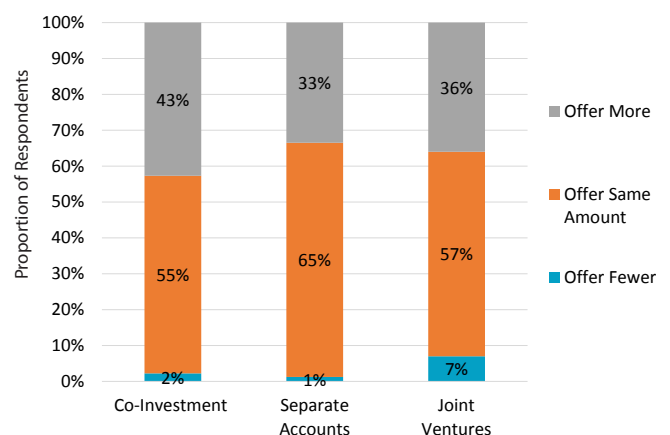
Despite fund managers' concerns over valuations and global market uncertainty, as at June 2017, over two-thirds (69%) of respondents are either currently raising a private real estate vehicle or are planning to launch one in H2 2017.

Fig. 17: Amount of Capital Fund Managers Plan to Deploy in Real Estate Assets in the Next 12 Months Compared to the Past 12 Months



Source: Preqin Fund Manager Survey, June 2017

Fig. 18: Fund Managers' Plans to Offer Alternative Structures to Investors in the Next 12 Months Compared to the Past 12 Months



Source: Preqin Fund Manager Survey, June 2017

PREDICTIONS FOR REAL ESTATE IN 2020

As the private real estate market continues to grow, and fund managers look ready to deploy increasing amounts of capital into the market over the next 12 months, we asked our respondents how they see the industry developing over the coming years.

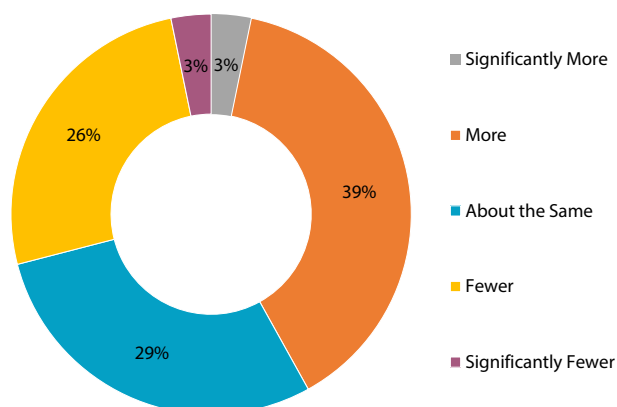
“Nearly three-quarters of managers predict a larger private real estate industry in 2020

Given the current high levels of investor appetite for real estate (see page 7), it is unsurprising that the majority (71%) of managers are predicting the industry of 2020 will be larger than it is today (Fig. 19).

FUND MANAGERS IN 2020

Views on the fund manager landscape in 2020 are more mixed. While the largest proportion (42%) of respondents believe that more fund managers will operate in the market in 2020, a significant proportion (32%) see the number of managers decreasing (Fig. 20). This is perhaps explained by the fact that a significant majority (87%) of respondents believe that the level of consolidation in the industry will increase over the coming years.

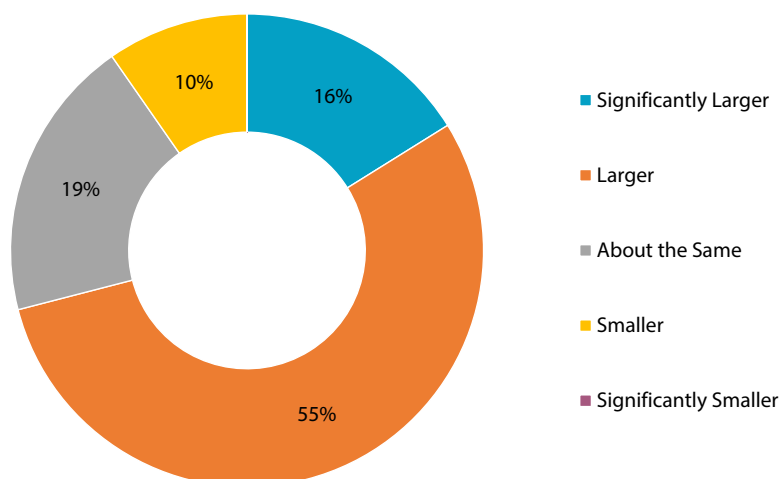
Fig. 20: Fund Manager Predictions for the Number of Active Private Real Estate Fund Managers in 2020 Compared to Today



Source: Preqin Fund Manager Survey, June 2017

*As at June 2017.

Fig. 19: Fund Manager Predictions for the Size of the Private Real Estate Industry in 2020 Compared to Today



Source: Preqin Fund Manager Survey, June 2017

INVESTORS IN 2020

The majority of fund managers expect to see family offices (60%) and sovereign wealth funds (54%) account for a greater proportion of industry capital in 2020 than they do currently (Fig. 21). With the family office model becoming more widely used throughout Asia, fund managers may be expecting to see this growth result in allocations from this type of investor.

TIMEFRAME WITH WHICH FUND MANAGERS INTEND TO LAUNCH THEIR NEXT PRIVATE REAL ESTATE FUND

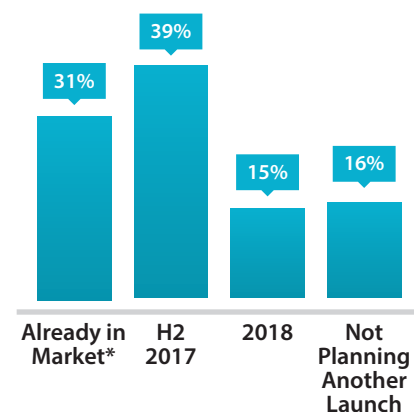
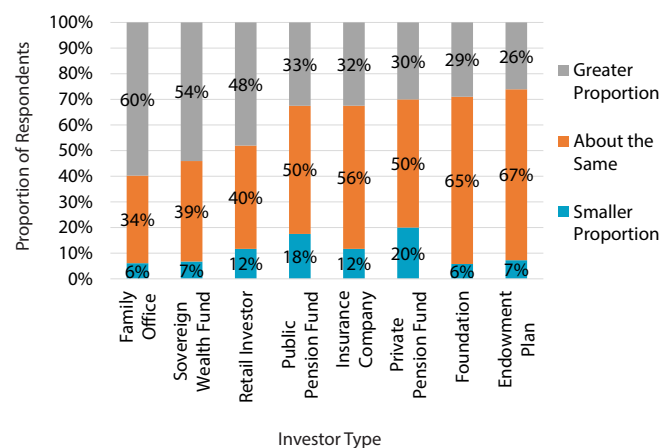


Fig. 21: Fund Manager Predictions for How the Level of Capital Sourced from Investors Will Differ in 2020 by Investor Type



Source: Preqin Fund Manager Survey, June 2017

An aerial photograph of Central Park in New York City, showing the lush green trees and the surrounding dense urban landscape of Manhattan. The Hudson River and the Manhattan Bridge are visible in the background.

SOURCE

new investors for funds and separate accounts

IDENTIFY

new investment opportunities

CONDUCT

competitor and market analysis

COMPARE

fund performance against industry benchmarks

DEVELOP

new business

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H2 2017

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