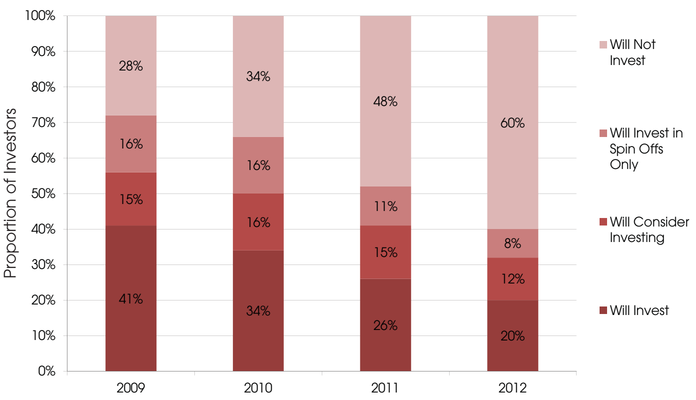
The Changing Real Estate Investor Universe

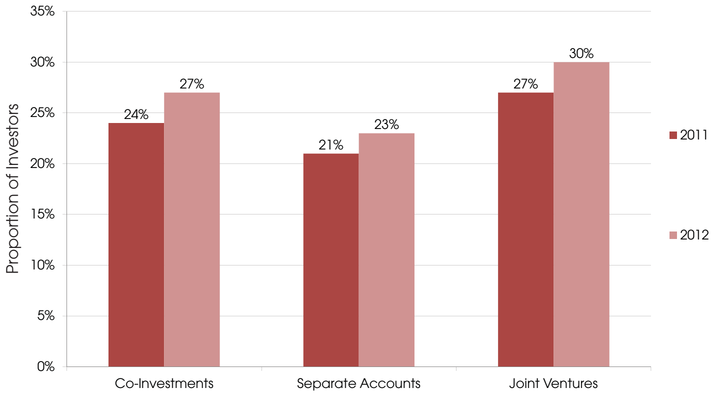
Real estate fundraising has become increasingly challenging for fund managers in recent years. Carla Henry takes an in-depth look at how investor attitudes to real estate are changing.

Fig. 1: Real Estate Investor Appetite for First-Time Funds, 2009 - 2012



Source: Preqin Real Estate Online

Fig. 2: Real Estate Investor Appetite for Co-Investments, Separate Accounts and Joint Ventures, 2011 - 2012



Source: Preqin Real Estate Online

First-Time Funds

In recent years, increased caution among institutional investors has seen attitudes to first-time funds change, with the number of investors willing to make capital commitments to new managers rapidly declining. In 2011, 26% of surveyed by Preqin said that they would invest with first-time managers, compared to 34% open to committing to first-time funds in 2010, as shown in Fig. 1. Only 20% of investors surveyed in 2012 said they would invest in first-time funds, reflecting increased caution among investors. There is a clear reluctance among many investors to commit capital to a manager with no proven track record, with the result being a fall in the number of first-time funds reaching a final close. In 2011, 53 first-time funds reached a final close whereas 68 did so in 2010. Just 23 first-time funds have successfully reached a final close to date in 2012.

Institutional investors now scrutinize potential new investments more closely than ever, with many looking to invest with firms which can prove they are specialists in their particular market. Many of the managers that have been fundraising successfully in recent months are managing funds which are focused narrowly on a particular sector or location where the team is able demonstrate expertise. First-time managers may become more attractive to investors if they can demonstrate that they offer a unique opportunity, even if they have not previously managed a fund.

Co-Investments, Joint Ventures and Separate Accounts

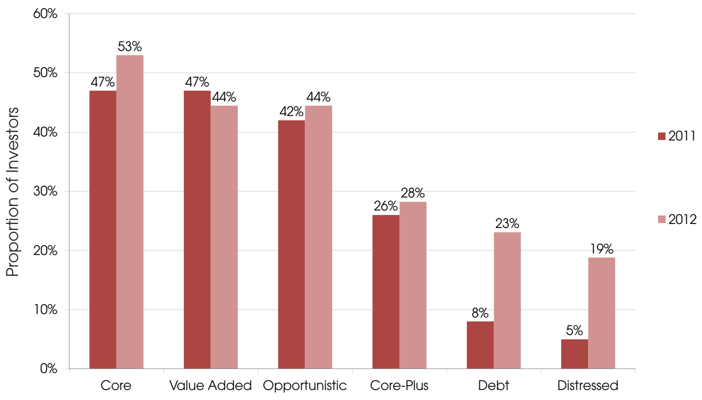
Investor appetite for co-investment opportunities, joint ventures, and separate accounts has increased since 2011, with many investors choosing to invest through these structures as an alternative to pooled fund commitments. Many investors believe they can benefit from the lower fees, direct control and unique opportunities that these alternative structures can offer. In 2012, 27% percent of investors were interested in co-investment opportunities, an increase from 24% in 2011. Similarly, 23% of investors expressed an interest in separate accounts in 2012 compared to 21% in 2011, and 30% of investors had a preference for joint ventures in 2012 compared to 27% in 2011.

The resources and knowledge required for these investments mean that it is typically larger investors that most frequently look to gain exposure through these structures, with appetite for these investment structures growing with increasing investor size. Seventy-one percent of institutions with $10bn or more in assets under management invest in joint ventures, with 68% utilizing separate accounts and 58% interested in co-investments opportunities. In contrast, among investors with less than $1bn in assets under management, just 20% invest in joint ventures and co-investment opportunities respectively and 16% consider separate accounts.

Strategies Targeted

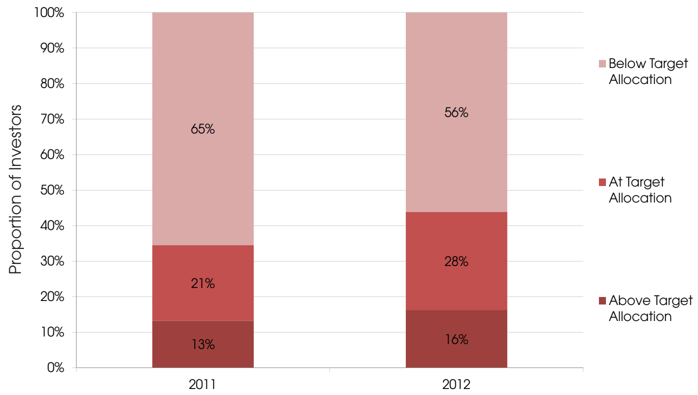
Current market conditions have caused a shift in the strategic preferences of institutional investors in private real estate. Core, value added and opportunistic strategies are attracting the most interest from investors planning to commit to funds in the next 12 months, as shown in Fig. 3. Fifty-three percent of investors interviewed said that they planned to invest in core funds in the next 12 months, compared to 44% expressing an interest in value added opportunities and the same proportion naming opportunistic funds as attractive. Core-plus,

Fig. 3: Strategies Targeted by Real Estate Investors in the Following 12 Months, 2011 - 2012



Source: Preqin Investor Outlook: Real Estate, H1 2012 and H2 2012

Fig. 4: Investors' Level of Real Estate Allocation Relative to Target, 2011 - 2012



Source: Preqin Real Estate Online

debt and distressed funds will be targeted by a smaller proportion of investors, with 28%, 23%, and 19% of respondents intending to invest in these strategies respectively.

Many investors are focusing on funds with a lower risk/return profile that provide access to high-quality assets and deliver stable income. Core real estate funds, which are frequently open-ended, may also be seen as attractive as they offer investors a greater degree of liquidity. There has been a small increase in appetite for opportunistic funds, with 44% of investors targeting opportunistic investments in 2012, compared with 42% in 2011. The proportion of investors targeting value added funds has declined from 47% to 44%.

Traditionally, debt and distressed funds made up a small proportion of the real estate fund market; however, following the economic downturn such funds have attracted increasing attention. Real estate developers and buyers turned to debt funds when they found it increasingly difficult to raise capital and finance projects. Debt funds can bridge the financing gap that has emerged post-financial crisis, as traditional lenders such as banks restrict their financing to real estate projects. Twenty-three percent of active investors are planning to invest in debt funds in the next 12 months, with 19% targeting distressed funds, a significant increase from 2011, when 8% and 5% of investors were targeting debt vehicles and distressed funds respectively.

Investor Allocations

As shown in Fig. 4, during 2012, 56% of institutional investors in private real estate were below their target allocations to the asset class, compared to 65% of investors below their targets in 2011. This suggests increased activity among investors, with more moving towards their target allocations. Very few investors are reducing their target allocations to real estate, and with 56% of investors still below target, there is potential for significant amounts of capital to enter the asset class in the future.

Outlook

Given the competitive fundraising market, fund managers will have to work extremely hard to stand out from the crowd and raise capital in the coming months. With investor appetite for new firms declining, first-time managers may find fundraising particularly difficult. Core funds continue to be viewed as attractive by investors, but there is also increased appetite for debt and/or distressed offerings. Investors are also increasingly investing in separate accounts and joint ventures, suggesting that firms looking for investor capital will need to be open to utilizing a range of structures, rather than solely using the blind-pool fund model. Fund managers marketing vehicles in the coming months will need to remain aware of the changing preferences of investors and ensure their offerings are attractive to those seeking to commit to the asset class.