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Compensation and Employment: Spotlight on Real Estate

Jessica Sutro provides a summary of the findings from Preqin's latest review of current employment levels and remuneration practices in the private equity industry, including private real estate.

Real estate firms have certainly been impacted by the recent slowdown in the real estate fundraising market that followed the financial crisis in 2008; the number of funds closed fell from 311 in 2008 to 181 in 2009, with the capital raised falling by over half in the same time period, from $139.6bn in 2008 to $51.7bn in 2009 (Fig. 1). In 2011 the amount of capital raised by closed real estate funds reached a post-2008 high of $55.7bn raised by a total of 168 funds; however, in 2012 so far 122 funds have closed on an aggregate $49.9bn, still below the figures for 2011.

Although real estate fund managers looking to raise capital from investors will likely face challenges in the future, the number of active closed-end private real estate firms has continued to grow. Fig. 2 shows the number of new fund managers joining the private real estate sector each year (calculated using the vintage of their first fund to represent their year of establishment). There has been a consistent growth in the number of active firms despite the onset of the financial crisis in 2008.

However, there has been a decrease in the number of new closed-end private real estate firms launching in 2012 compared to 2011, with 45 new firms so far in 2012 compared to 63 in all of 2011. (The 2012 figure only includes firms that have reached one or more interim closes on their debut funds in order to begin making new investments.) Uncertain conditions in the private equity real estate fundraising market may be impacting the number of new real estate firms choosing to bring funds to market. In 2007, prior to the financial crisis, 113 new closed-end private real estate firms launched, a substantially larger figure than the number that have launched in 2012 to date.

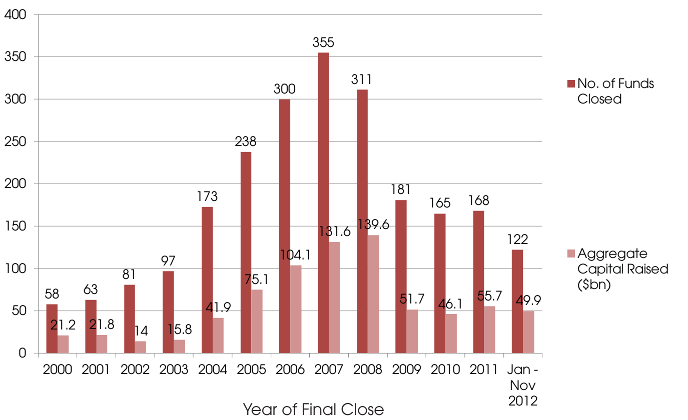
Compensation and Employment in the Private Equity Industry

The pool of over 4,800 active private equity firms, which includes real estate firms, grows to over 8,000 when private equity firms that do not raise, or have not yet raised, distinct private equity funds (i.e. those that manage corporate or personal capital and those that manage third-party capital without pooling into commingled private investment vehicles) are included. These 8,000 firms currently employ an estimated 89,000 individuals around the world.

The 2013 Preqin Compensation and Employment Review provides detailed analysis on the employment practices of over 200 leading private equity firms, almost a quarter of which are involved in investing in private real estate. Though the fundraising markets for both private equity and private real estate remain challenging, the results of Preqin's survey indicate that there have been minimal changes not only in the number of active private real estate (Fig. 2), but also to base salaries at participating firms. Fig. 3 shows that only 1% of participating firms reported a firm-wide decrease in base salaries between 2011 and 2012 and 42% reported no change over the same time period. The majority of changes made to base salaries were increases, with a significant 45% of participating firms reporting a firm-wide increase in base salaries of between 1% and 10%.

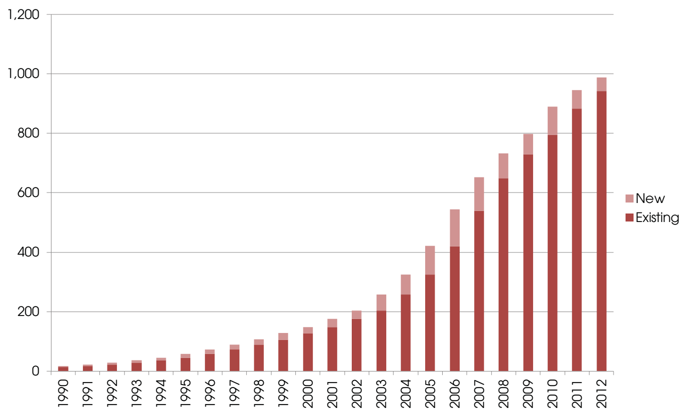
The Review also reveals that base salaries are likely to either remain consistent or increase slightly in the coming year. Fig. 4 shows the projected average firm-wide changes in base salaries for participating firms between 2012 and 2013, with the projections for changes in base salaries in the coming year mostly paralleling

Fig. 1: Annual Real Estate Fundraising, 2000 - November 2012



Source: Real Estate Online

Fig. 2: Number of Active Closed-End Private Real Estate Firms over Time (by Vintage of First Fund Raised)



Source: 2013 Preqin Private Equity Compensation and Employment Review

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changes recorded between 2011 and 2012. Participating firms expecting to see an increase in base salaries of 1-10% between 2012 and 2013 make up 46% of all participating firms, a similar proportion to the 45% of participating firms which saw increases of 1-10% between 2011 and 2012.

Forty-three percent of participating firms expect to see no changes in base salaries between 2012 and 2013, and only 1% expect to see a decrease in the same time period. A small proportion of participating firms anticipate a more substantial increase in base salaries between 2012 and 2013, with 9% expecting an increase of between 11% and 20%, and 2% an increase of 21-50%.

Participating firms also largely reported either an increase or no change in their bonus pool size in the calendar/fiscal year 2011 compared to 2010, as shown in Fig. 5. Thirty-four percent of participating firms reported that bonus pool sizes increased at their firm compared to the previous year, but 19% reported a decrease in their bonus pools in the calendar/fiscal year 2011 compared to 2010. Almost half (47%) of firms reported no change over the same time period.

Compensation on an Individual Level

The Review also features detailed benchmark individual compensation figures for different positions at participating firms, including figures for base salary, total annual cash compensation, long-term incentive/carried interest award and total remuneration data. Forty different positions are featured in the Review, including 15 real estate-specific positions.

When looking at individual compensation, some important trends can be identified based on a firm's assets under management, geographic market and the type of fund they are raising. For example, the operating economics of the largest funds, with higher income from management fees, are often more favourable for their managers. For example, a managing general partner at firms participating in the survey conducted for the 2013 Preqin Private Equity Compensation and Employment Review could have a median base salary at a firm with assets under management of $1bn or more that is almost double the same position at a firm with assets under management of $150mn.

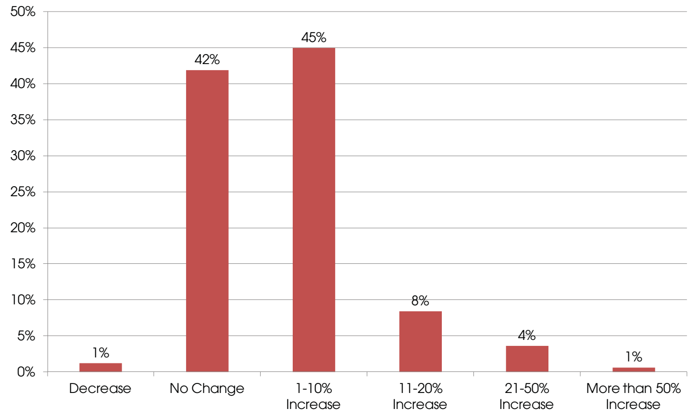
Data Source:

This article features data and analysis taken from Preqin's latest publication, the 2013 Preqin Private Equity Compensation and Employment Review.

Compiled in collaboration with FPL Associates, the publication provides an insight into the current compensation practices within the private equity industry, including real estate, and analysis of growth and employment levels for private equity globally.
For more information, please see p.8 or visit:

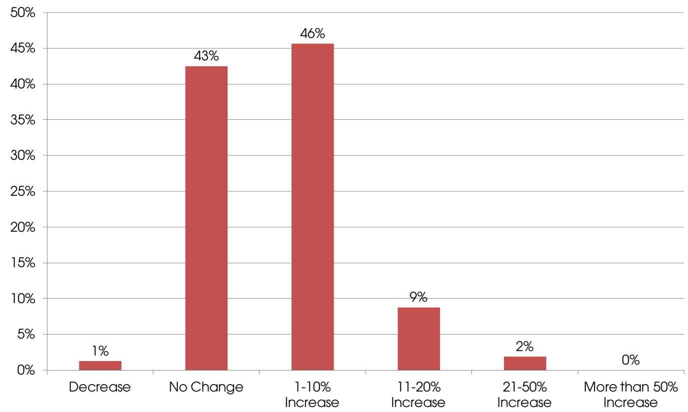
www.preqin.com/compensation

Fig. 3: Breakdown of Average Firm-Wide Changes in Base Salaries at Participating Firms between 2011 and 2012



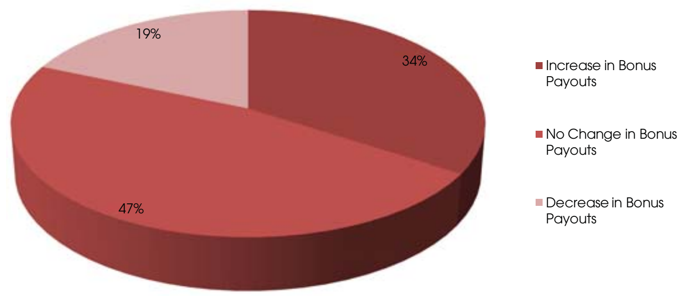
Source: 2013 Preqin Private Equity Compensation and Employment Review

Fig. 4: Breakdown of Projected Average Firm-Wide Changes in Base Salaries at Participating Firms between 2012 and 2013



Source: 2013 Preqin Private Equity Compensation and Employment Review

Fig. 5: Proportion of Participating Firms Reporting an Increase, a Decrease, or No Change in Bonus Payouts for Performance in Calendar/Fiscal Year 2011 Compared to Previous Year



Source: 2013 Preqin Private Equity Compensation and Employment Review

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2013 Preqin Private Equity Compensation and Employment Review

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Produced in collaboration with leading compensation specialists FPL Associates, the 2013 Preqin Private Equity Compensation and Employment Review is the industry's most comprehensive guide to compensation practices, featuring detailed benchmark remuneration data for 40 positions, including 15 real estate-specific positions, incorporating information from over 200 leading firms globally. A source of reliable and accurate information on the latest trends in private equity compensation and employment is a vital tool enabling decision-makers and advisors to examine existing compensation practices against wider industry benchmarks.

Key content includes:

- Compensation data by position, including base salary, bonus, carry, and quartile splits.
- Compensation data split by firm type, region and size where possible.
- Survey of compensation practices at private equity firms.
- Current employment within the private equity industry.
- Growth of the industry.

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Preqin Industry News

Olivia Harmsworth explores the latest data on core private real estate funds, featuring exclusive data from Preqin's analysts. Real Estate Online subscribers can click on the investor/firm/fund names to view the full profiles.

Investor interest in core funds remains high, despite recent fundraising figures indicating that appetite for this strategy is declining. As shown in the Chart of the Month, the number of core funds closing each year has been in decline since 2010, when the number of funds closed reached a peak of 20, falling to 15 in 2011, with 13 funds closed in 2012 to date. Aggregate capital commitments to these funds over this period have also declined, from a high of $3.9bn in 2010 to $2.7bn in 2012 to date. Nonetheless, investors still display interest in increasing or making fresh capital commitments to core strategy funds.

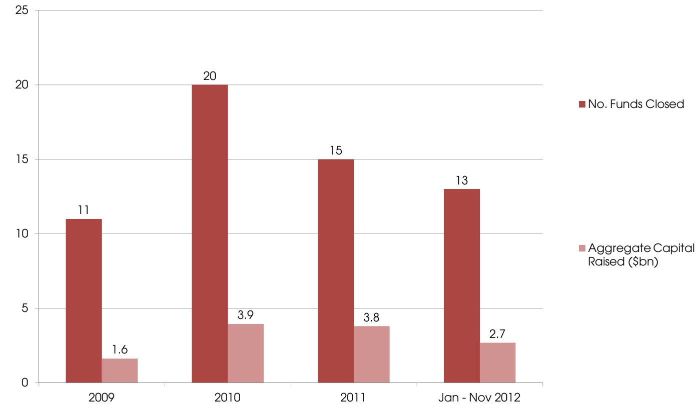
A number of public pension funds are looking to make commitments to core funds in the next year. One such example is Caisse de Pensions CFF, a public pension fund which may return to the private real estate market in the coming year despite not making any real estate fund commitments in the last 12 months. It has a bias towards core and core-plus strategies, with a preference for highly experienced fund managers, although it will consider first-time Swiss managers.

Despite a clear preference for the core strategy, a number of investors are flexible concerning the size or geographic focus of their investments. Bavarian Chamber of Supply Pension has plans to make new real estate commitments in the next 12 months; however, it is unsure as to the amount of capital commitments and will invest on the basis of arising opportunities. It maintains a preference for core vehicles, and currently has an 11.5% allocation to real estate, with 55% of this in private real estate funds. Environment Agency Pension Funds is also planning to make new commitments to the real estate asset class; it has a preference for UK-focused core funds. It is searching for a multi-manager to oversee a £90mn sustainable property mandate. It has a target range of 3-6% to property and currently allocates 3.2% to the asset class.

A number of investors make commitments to core funds as part of a broader strategy. Korean Federation of Community Credit Cooperative is open to most strategies, but will not invest in opportunistic private equity real estate funds. It is planning to increase its allocation to private real estate funds, especially in those investing in overseas markets in the coming year. It intends to make at least two fund commitments in 2013, and will consider all geographical regions except Japan.

Elsewhere, Indiana Public Retirement System has recently made a commitment of $100mn to Harrison Street Core Property Fund, a core vehicle which will cap its leverage at 40% across the portfolio and will seek to provide investors with annual average gross returns of 9-10%. The open-ended US-focused core vehicle seeks to acquire stabilized, income-producing properties in the student housing, senior housing, medical office and storage segments of the market.

Chart of the Month: Closed-End Core Private Real Estate Fundraising, 2009 - November 2012



Source: Preqin Real Estate Online

Among the core funds that have recently closed is Delin Capital Asset Management's Capital Preservation Portfolio I, which focused on investments in the UK, Belgium and the Netherlands. The fund held a final close in November 2012 with aggregate capital commitments of €200mn. Another such fund is Next Estate Income Fund; a core real estate investment vehicle managed by BNP Paribas Real Estate Investment Services targeting newly developed or recently delivered office buildings in Europe. The fund will invest no greater than 35% of its capital in any one given country. It held a final close in October 2012 on €230mn.

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