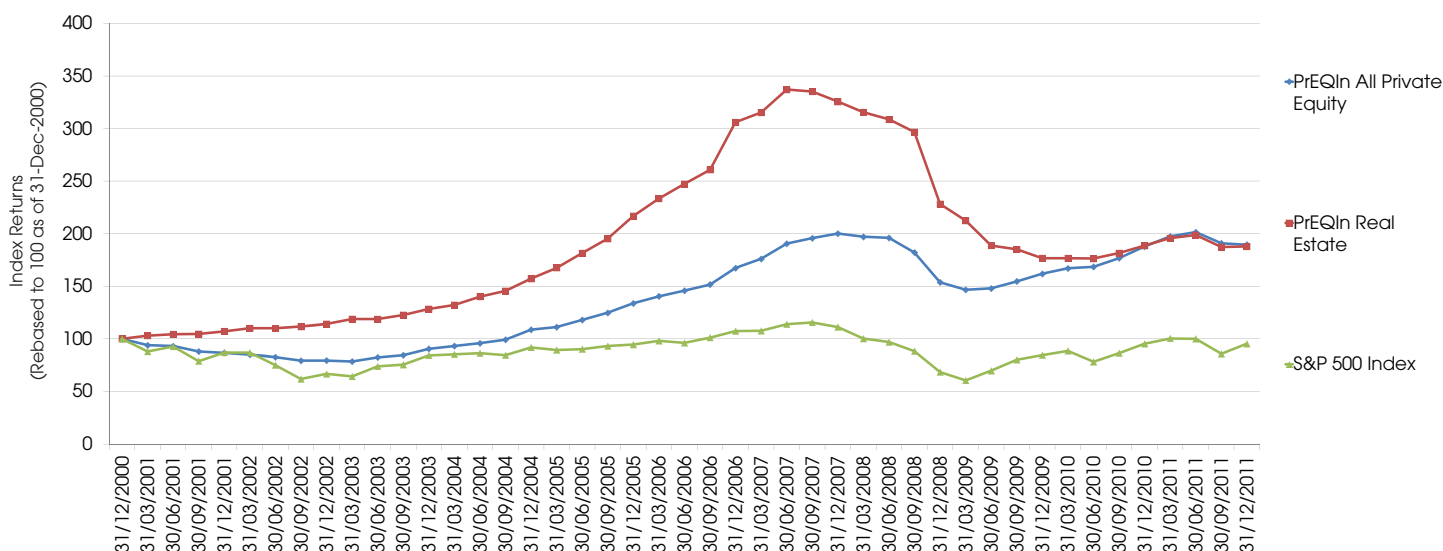




Preqin Investor Network: Challenges Facing Real Estate LPs

Andrew Moylan looks at the main issues that are facing investors in private real estate funds today and the primary concerns for institutions looking to build a real estate portfolio.

Fig. 1: PrEQIn Index: Real Estate vs. Private Equity & S&P 500



Source: Preqin Investor Network

Recent years have been extremely challenging for the private real estate fund industry, with both fund managers and institutional investors facing a range of difficulties. Fundraising is very challenging for fund managers, but there are also many obstacles investors face when looking to construct a successful real estate fund portfolio. With a record number of funds on the road and a vast difference between the best and worst performing funds, manager selection can be tough.

Investors in private real estate are now more sophisticated than ever, with a detailed understanding of the asset class. Increasingly, they are seeking to have more control over their portfolios. However, access to unbiased, up-to-date, and accurate intelligence can be difficult to source. This information can be key to ensuring a successful portfolio and long-lasting, fruitful partnerships with fund managers.

Can Private Equity Real Estate Offer Outperformance?

Real estate remains attractive to many investors for several reasons. Real estate portfolios can offer diversification, act as an inflation hedge, and provide a steady income stream. Most investors, however, will still expect real estate, and in particular private equity real estate funds, to offer strong performance compared with traditional investments. The financial and liquidity costs associated with getting access to private equity real estate funds mean that returns above and beyond other asset classes are required to justify investors' commitments.

Since December 2000, the PrEQIn Real Estate Index has outperformed Standard and Poor's free-float capitalization-weighted index of 500 US-based large cap stocks (S&P 500), and has remained above the

S&P 500 in every quarter shown in Fig.1. For the latest data available the PrEQIn Real Estate index stands at 187.8, just below the PrEQIn All Private Equity Index which stands at 189.6, but significantly above the S&P 500 which stands at 95.3.

While the private real estate fund industry delivered very strong returns in the years prior to the global economic downturn, performance has weakened since. While the PrEQIn All Private Equity Index has returned to the levels seen in 2007, the PrEQIn Real Estate Index remains well below its peak of 337.0 from June 2007. Investors that invested large amounts of capital in 2005-2007 were significantly affected by the downturn.

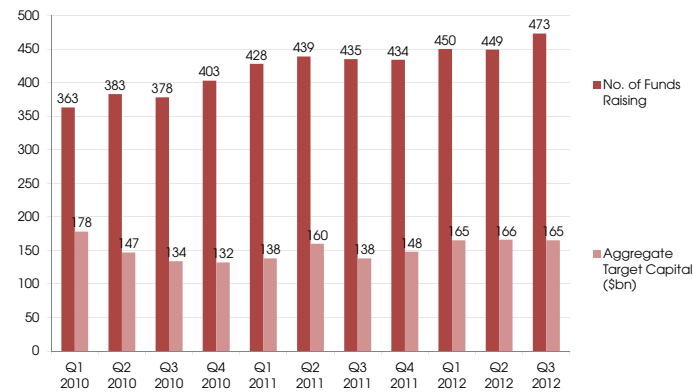
There are some positive signs in the performance of the most recent vintage funds, however, with the median IRR for 2009 vintage funds standing at 13.9%. It is very early in the life spans of these vehicles, and the performance of these funds is likely to change a great deal, but it does indicate potential for private equity real estate funds to provide investors with strong returns in the future.

An Overcrowded Market

The private real estate fundraising market is extremely crowded at present and, given the mixed appetite among investors in private real estate funds, the supply of investor capital is not large enough for all of these funds to be successful. The aggregate target of funds currently in market, which currently stands at \$165bn, represents more than three years' worth of fundraising at the levels seen in 2011. Despite the tough environment, the number of vehicles in market continues



Fig. 2: Closed-End Private Real Estate Funds in Market over Time, Q1 2010 - Q3 2012



Source: Preqin Investor Network

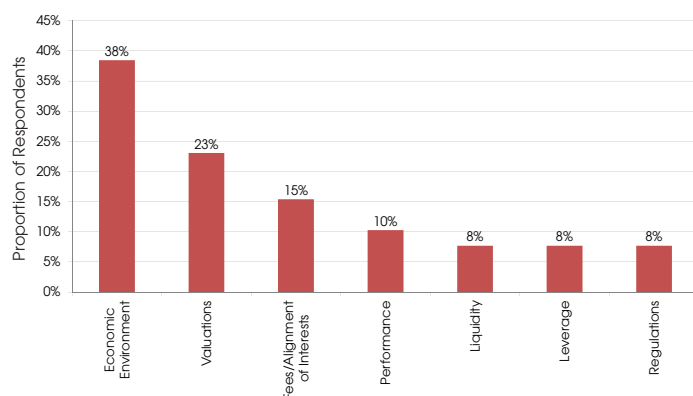
to increase, from 363 in Q1 2010 to 473 in Q3 2012. For investors, identifying the best opportunities can be difficult, particularly given the sheer number of funds being marketed. Investors may also have to decide whether to re-up with existing managers or, alternatively, consider other funds on the road which may be attractive.

Importance of Fund Selection

Identifying top performing fund managers is one of the hardest tasks facing institutional investors. As shown in Fig. 3, there is a significant difference in the performance of the best and worst performing funds, demonstrating the importance of picking those firms most likely to achieve the strongest returns. Though top quartile funds have never produced negative IRRs for any vintage year, many third and fourth quartile offerings with 2004 – 2008 vintage years are generating negative IRRs.

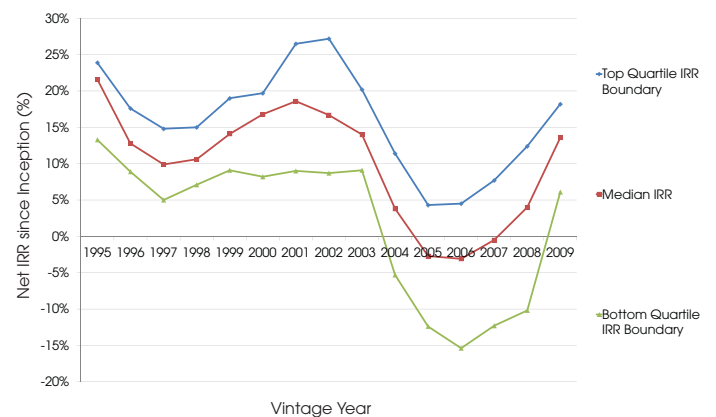
Track record is often one of the most important considerations for investors looking to identify the strongest managers. Past performance is no guarantee of future success, but it can be an indicator of the skill of the investment team. In particular, many investors want to see evidence that fund managers can succeed in tough markets and that they have weathered the crisis well.

Fig. 4: Investor Outlook: Key Issues Affecting the Real Estate Fund Market



Source: Preqin Investor Network

Fig. 3: Closed-End Private Real Estate Funds: Median Net IRRs and Quartile Boundaries by Vintage Year



Source: Preqin Investor Network

Key Issues for Investors

Preqin's most recent study of institutional investors found a number of key issues which investors feel are affecting the private real estate fund market. As shown in Fig. 4, for 38% of respondents the wider economic environment was a key concern. Many investors feel that valuations are an issue, with 23% naming this area. Fifteen percent considered fees and the alignment of interests between investors and fund managers to be a key issue, suggesting that fund managers still have work to do to structure their funds in a way that ensures investors are convinced that their interests are aligned with those of the fund manager.

Preqin Investor Network

With all of these issues in mind, Preqin has launched the Preqin Investor Network – a free online resource available to accredited investors and qualified purchasers across the globe. The Network provides subscribers with free access to in-depth and up-to-date information on private real estate performance, fundraising conditions, and fund terms and conditions. We feel that it is vital to provide investors with intelligence to help them navigate the crowded market environment and identify the best options for their portfolios. Preqin Investor Network also provides investors with free access to our fund benchmarking resource, the PrEQIn Index and our Research Centre, which contains all the most relevant Preqin research reports to help investors stay on top of the latest trends and interesting prospects.

Data Source:

This article draws upon information from the [Preqin Investor Network Special Report](#). Click [here](#) to download your free copy.

[Preqin Investor Network](#) is a free online data service for accredited investors and qualified purchasers that provides information on funds in market, performance, track record, fund terms and conditions and more, all of it designed to help investors find and research the best investment opportunities for their real estate and alternative assets portfolio.