

Preqin Research Report

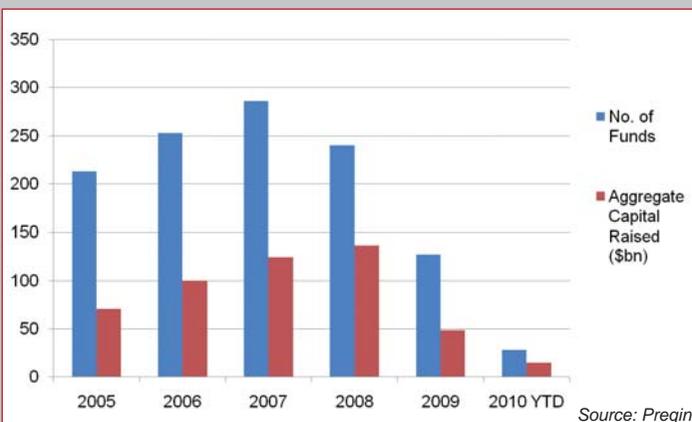
Real Estate Fund Terms and Conditions: Fluctuating Fees (1)

There has been a significant fall in the number and aggregate value of funds successfully raised in the private equity real estate market since the onset of the global economic downturn. Fig. 1 demonstrates how significant this decline has been, with just \$48.3 billion being raised in 2009, compared with \$136.7 billion in 2008. Investors that are making new commitments are carrying out even greater due diligence on potential investments and this extends to the terms and conditions of funds they are considering investing in. As a result of the slow fundraising market, there has undoubtedly been a change in the balance of negotiating power from General Partners (GPs) towards Limited Partners (LPs), which has precipitated shifts in certain areas of fund terms and conditions. Using data taken from our newly released publication, the 2010 Preqin Fund Terms Advisor, this month's feature article examines some of the key trends in this important area.

Management Fees

The management fee during the investment period is generally calculated as a percentage of the total commitments made by LPs to the fund. The rationale behind this is that the major part of the GP's workload at this stage is the search for potential investments, which is driven by the aggregate size of commitments to the fund and not the amount invested at this point in the fund's life.

Fig. 1: Private Equity Real Estate Fundraising, 2005 - 2010 YTD



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Fig. 2 shows the split of management fees charged during the investment period by real estate funds with a 2009 or 2010 vintage, or those still raising capital as of Q2 2010. Nearly half of all such funds have a management fee of 1.50-1.74%, and nearly a quarter have a fee of 2.00-2.24%. Just over one-tenth of funds have a 1.75-1.99% management fee, and 12% use a rate of 1.00-1.24%.

While the largest proportion of private equity real estate funds charge a management fee of between 1.50-1.74%, which is generally considered to be the industry standard, there has been some movement in the fees charged by the largest funds. Fig. 3 shows that the largest real estate funds of the most recent vintages have had significantly lower average management fees than vintage 2007 and 2008 funds. The mean management fee for vintage 2010 funds (including those still fundraising and yet to begin investing as of Q2 2010) of \$1 billion or more in size is 1.25%.

Fig. 2: Management Fee During Investment Period (Funds Raising and Vintage 2009/2010 Funds Closed)

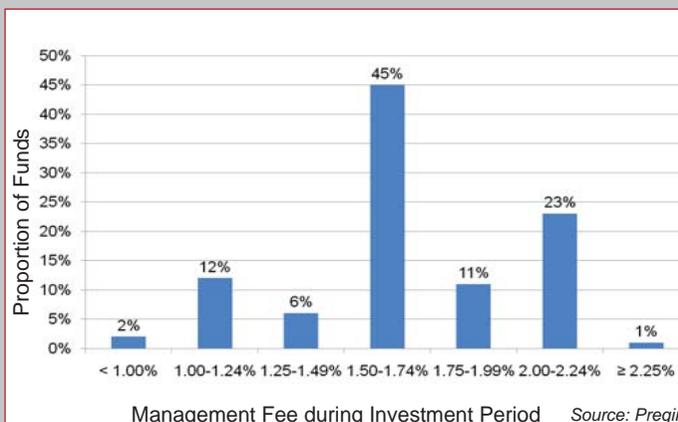
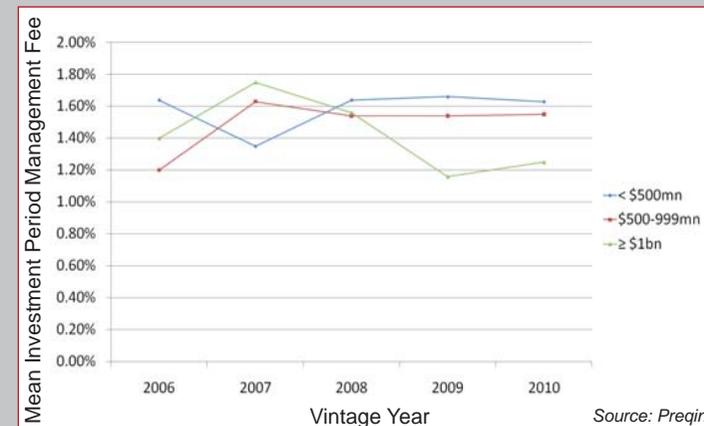


Fig. 3: Mean Management Fee by Fund Size and Vintage Year



The information contained in this factsheet is based on data from [The 2010 Preqin Fund Terms Advisor](#)

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Preqin Research Report

Real Estate Fund Terms and Conditions: Fluctuating Fees (2)

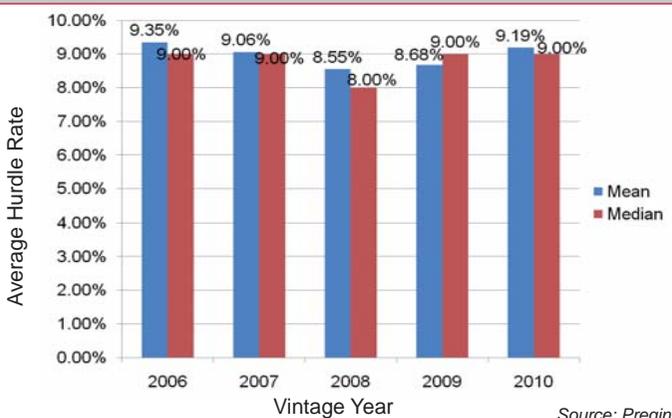
Managers of the larger funds are most likely to be in a position to reduce management fees, or to have come under pressure to do so from investors because of the economies of scale involved. A firm that raises a \$1 billion fund is unlikely to have twice the costs in terms of wages and other expenses that a firm managing a \$500 million fund does. It is clear that for these funds, there has been a shift in the balance of negotiating power towards LPs. For funds under \$1 billion however, there has been very little movement in management fees. Funds which raised under \$500 million have a mean management fee of just over 1.6% for 2008, 2009 and 2010 vintage years, while funds which fall into the \$500-\$999 million bracket, have management fees just under the 1.6% mark.

Performance Fees

The performance fees charged by private equity real estate funds are in the form of carried interest. The carried interest charged by funds shows little variation, with 91% of private equity real estate funds in market or with 2009 or 2010 vintage years charging 20% carried interest. Where there may be a shift however is in the hurdle rate (or preferred return), the threshold after which GPs start earning carried interest.

As Fig. 4 shows, real estate funds with a 2008 vintage have

Fig. 4: Average Hurdle Rate by Vintage Year



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the lowest average hurdle rate of all real estate fund vintages considered, with a mean of 8.55% and a median of 8%. The median hurdle rate has since moved back up to 9% for vintages 2009 and 2010. Interestingly, the hurdle rate moved in favour of the GP for funds of 2008 vintage, but has subsequently moved back to similar levels to funds of 2006 vintage. It may be that GPs adjusted their return targets and hurdle rates in line with declining property prices. The recent shift in negotiating power towards the LP however, has resulted in hurdle rates increasing for funds of 2009 and 2010 vintages.

Conclusions

Preqin data clearly demonstrates that the difficult fundraising environment has resulted in a change in the terms of private equity real estate funds. Fund managers that have recently launched funds have responded to LP calls for a change in fund terms. The largest funds have reduced management

fees and hurdle rates have increased for funds of more recent vintages. With the private equity real estate fundraising market remaining very competitive, LPs will continue to wield influence when negotiating fund terms. Additionally, with increased investor interest in the range of fund terms, it is more important than ever to ensure that all proposed fund terms, not just the headline management fee and carried interest rates, are aligned with the latest industry standards.

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