property funds research

EuroRating services

the indirect property market

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The Feri property funds research report

Feri Property Funds Research universe exceeds 2,500 funds

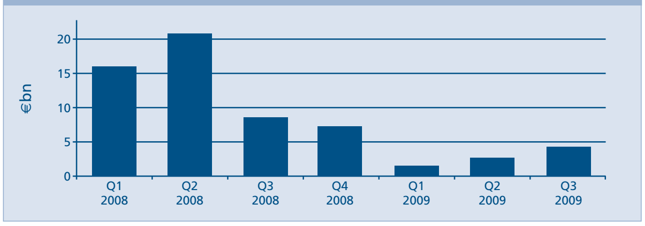
The global universe of unlisted (rarely traded) real estate vehicles currently stands at over 2,380 (excluding funds of funds) with an estimated gross asset value of €1.22 trillion. This reflects an increase of over 200 vehicles in 2009, over half from fund launches, representing a fall of 73% (by number) since the height of the market in 2007. In addition to the wide variety of real estate vehicles held by Feri PFR, we have information on 121 fund of funds vehicles with an estimated GAV of €25.6 billion.

The lack of investor confidence, the shortage of available equity and a vastly reduced supply of credit will continue to have a substantial impact on the fund industry over the coming years. Investor sentiment has seen a marked change in the risk and return characteristics of funds invested in. The value-added strategy has seen the greatest hit, resulting in a 37% decline in the number of funds launched globally, from over 45% in 2005 to 29% to date in 2009. Core fund launches have remained relatively stable, accounting for 23% by number (although they did dip to 13% in 2008). Interestingly, at a time of market turmoil, there has been a 55% increase in the number of opportunistic funds launched since 2005. Opportunity funds account for just under 50% of the vehicles launched in 2008 and 2009. Not surprisingly, North American, Asian and Global funds account for the "lion's share" of these funds.

Diversified funds account for over half the funds in all regions, with the exception of Australasia where they account for 47%. After diversified funds, residential funds account for 8.3% of the universe by target sector. Europe (inc UK) as a target location accounts for 50% of all residential funds, followed by North America and Asia with 26% and 16% respectively. The rest of the sector specific universe is broken down into office, retail, development, infrastructure and industrial funds which account for 7%, 6.5%, 5%, 4% and 4% respectively.

The level of equity committed to funds has, as expected, seen a dramatic decline from the beginning of 2008 although the last two quarters of 2009 have seen amounts committed to funds pick up slightly. Since the beginning of 2008 Feri PFR has recorded €27 billion being invested in global funds (42% of the total equity committed), followed by €13 billion and €10 billion to Asian and European funds respectively. Key fund raisings in the last six months have been Brookfield Real Estate Turnaround Consortium at €3.5 billion, Blackstone Real Estate Partners Europe III at €3.1 billion, Goldman Sachs Real Estate Mezzanine Partners at €1.9 billion and Macquarie-SBI Infrastructure Fund at €782 million.

Figure 1: Equity committed to funds launched in 2008-9



Feri PFR has information on over 50 funds which are coming to the market, many more have been scrapped due to a lack of investor appetite. Of the pending/capital raising funds, 27 are European and UK focused, 11 target Australasia and a further five focus on North America. The remainder have a global or Middle Eastern focus. By target sector, diversified funds account for 43% of the pending fund universe, followed by residential funds at 12% and retail funds at seven percent. Commercial and infrastructure funds are also significant.

Table 1: Fund launches June - August 2009 (sample)

Vehicle	Manager	Type	Target GAV (m)	Target Sector	Target Location
AC Agri Opportunity Fund	Aquila Capital	SICAV	US$200	Agriculture	Global
CDL China Real Estate Opportunity Fund	CDL Management Company	LP	US$1,000	Diversified	Greater China
Pramerica Real Estate EuroMezz Fund 1	Pramerica Investment Management Limited	LP	£500 (target equity)	Mezzanine	Europe
Southern Residential Unit Trust	Southern Properties Group	PUT	£100	Residential	UK (London & SE)
Forum Asian Realty Income III	Forum Partners	LP	€705	Diversified	Asia

Information on new launches, equity raisings, manager activity and mandate searches are published in the fortnightly Feri PFR news bulletin. For a free trial contact Joanna Gliddon (jg@propertyfundsresearch.com).

"Inaction will be advocated in the present even though it means deep trouble in the future" – John Kenneth Galbraith

In his 1955 account of the Great Crash of 1929, Galbraith also said that crashes may be attributed to "men who know that things are going quite wrong (but) say that things are fundamentally sound". Fifty years later, he was proved right again.

The global financial crisis of 2007-8 had its very roots in property speculation, facilitated by the packaging and repackaging of equity, debt and risk. Professional responsibility appeared to take a back seat to the profit motive. The previously objective became self-interested and boardrooms lacked the detached yet experienced voice that advances in information and research should have made available.

But to argue that this was a failure of those engaged in objective analysis presumes that there were obvious warning signs. Is this true? Was the over-pricing in 2007 evident? Was the crash predictable?

Lesson 1: too much bank lending to property is dangerous

The Thatcher boom of 1986-1989 produced huge levels of bank liquidity. The apparent security of property for lenders enabled property companies to increase their borrowings – and financial gearing – to capture the fruits of the property boom. Bank lending to property reached all-time record levels in 1989-1991 – a five-fold increase in 10 years. This peak marked the end of the bull market in UK property and fuelled a crash fed by over-development. The coincidence of geometric increases in lending and a following crash is not accidental. By 2008 the already committed, but now drawn, lending was five times the 1991 level.

Lesson 2: yields are mean reverting

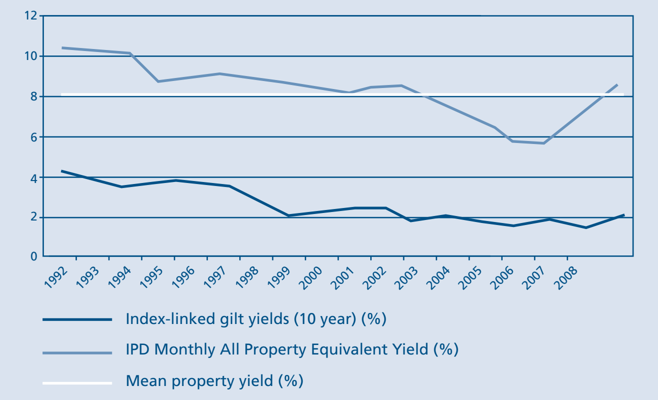
By the late 1990s minimal new development meant that stable 5-year returns of 10-15% were the consensus view at the beginning of the year 2000. The total return on UK property in 2004 was 18.3% with a real return of 17.1%. In 2005, the IPD Index showed returns of 19.1%, equal to over 16% in real terms, and returns in 2006 were again in excess of 18%, well over the average total return on the annual UK IPD Universe. What was driving these returns?

Over the period 1981 to 2006, an average property return of around 10.5% can be split into income return (around 7%); and nominal rental growth at roughly the rate of inflation (3.5%). In this context the return breakdowns in 2004, 2005 and 2006 appear to be something of an anomaly. In each year returns in excess of 15% were driven mainly by what became known as yield compression.

Since 1981 changes in yields from one year to the next have rarely exceeded plus or minus 0.5%. By the end of 2006, many market participants were keen to ask whether the fall in yields experienced in 2004, 2005 and 2006 was sustainable. Were we to expect further yield falls – or was this a bubble waiting to burst?

It is easy to conclude, from Figure 2, that there is a mean property yield of 8% or so and that when yields stood below 6%, as they did in 2006, a rise back towards 8% is predictable.

Figure 2: Property and index-linked yields, 1992-2009



Source: IPD, Datastream

Lesson 3: look at yields on index-linked

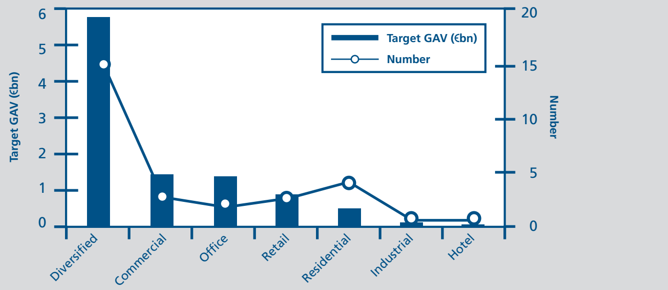
It is tempting to compare yields on gilts and yields on equities with property cap rates. Equivalent yields have moved in line with index–linked yields (see Figure 2), since 2001 the two series have been strongly correlated (presumably, the capital markets see property as an inflation hedge). But by the end of 2006 the difference between equivalent yields and index-linked yields had closed from a mean of 4.5% to a new level of around 2.5%. This suggests property yields were already too low.

The timing of a correction is notoriously difficult to predict. But, as Galbraith said, the threat is there when those who know that things are going quite wrong say that things are fundamentally sound. Myopia, the desire to be popular and a lack of economic education may all explain poor judgement, but an expert view distorted by financial incentives is much more dangerous. May the compensation structures put in place from here on more fairly reward those who remain objective.

Full text will appear in IPE Real Estate December 2009, author Andrew Baum

During 2009 there have been a significant number of new 'recovery' funds launched targeting UK prime and/or distressed properties. The assets targeted by these funds are generally characterised by long-term income streams that can be acquired at historically discounted values. The 29 UK funds that have been, or are due to be launched this year, have a combined target gross asset value of €10.3 billion (this includes the listed vehicles of Max Property and NewRiver Retail). If a proportion of, say 5%, is allocated from the pan-European and Global funds launched this year, then the potential buying power within the fund market is likely to be in excess of €11 billion.

Figure 3: 2009 new and pending UK fund launches by target sector (€bn)



The increase in demand for UK assets has not only come from domestic, but also international investors who aim to take advantage of the fall in the value of Sterling against the US Dollar and Euro. Transactional evidence suggests that the UK is currently the favoured location for real estate investment, with €9.61 billion of commercial property acquisitions made during the first half of 2009.

Table 2: Top 5 markets by value of commercial transactions (excluding development) H1 2009

Rank	Market	Value of transactions (€bn)
1	UK	9.61
2	US	8.82
3	Japan	6.74
4	Germany	3.29
5	France	3.18

Source: Real Capital Analytics, 2009

With this increase in demand for UK assets there are two key questions. Firstly, are there enough available assets to match demand? And if not, will this create an unsustainable short term pricing bubble?

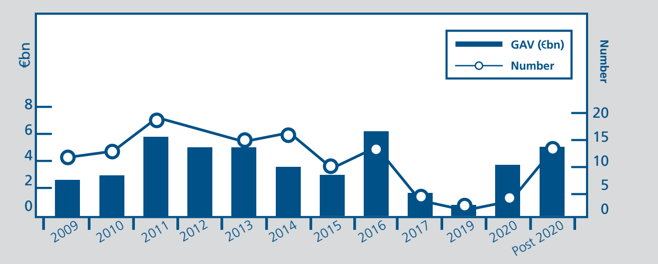
Are there enough assets to meet demand?

A recent study carried out by Knight Frank revealed that there were €747 million of Central London office properties for sale compared to €3.2 billion for the same period in 2008 and €3.3 billion in 2007 suggesting a shortfall of some €715 million when compared to the estimated buying power of the newly launched and pending UK office funds (Figure 3).

Will there continue to be limited supply or is this a short term blip which is creating a 'pricing bubble'? It is unlikely that investors, who have seen the value of their real estate investments fall, will want to sell at the bottom of the market incurring possible loses. Instead, they are likely to hold onto assets as long as possible to capture any increase in value.

The same is likely to be true for funds. Closed-ended unlisted funds that are nearing the disinvestment stage of their life are likely to want to utilise fund extension provisions, investors permitting, to capture any increase in value. Extending the life of funds could postpone asset sales from vehicles due to terminate in the coming years. A recent INREV survey of funds due to terminate between 2009 and 2011 found that 59% of managers were planning to extend the life of their fund. The profile of UK unlisted vehicles by end year (Figure 4), indicates that there will be a significant increase in the value of assets for sale in 2011-2013 without factoring in those due to terminate in 2009-10 extending their lives.

Figure 4: GAV of unlisted vehicles targeting the UK by end year



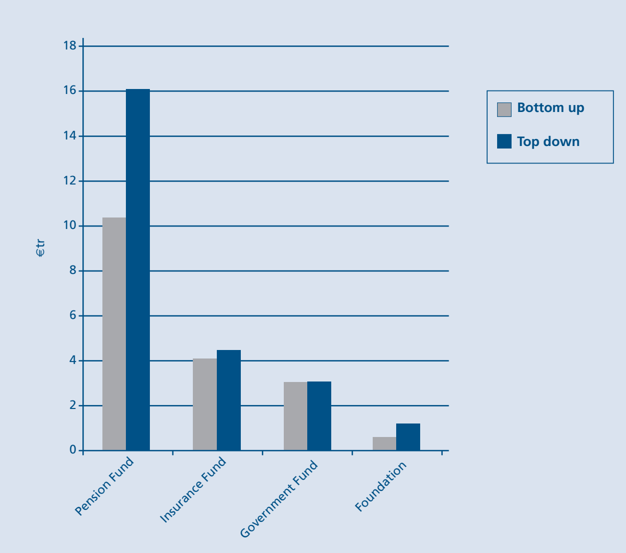
Many analysts are predicting that the UK real estate market still has a significant level of deleveraging to experience and this could result in an increasing supply of assets for sale from 2010 onwards. Similarly, a study by Pramerica Real Estate Investors estimated that there will be a cumulative debt shortfall of €50 billion between 2009 -2011 created by banks and other lending bodies as they reduce the amount of loans they are willing to originate and refinance. In addition, it is estimated that €144 billion of new equity would be required to repair loan to value ratios of 80% if banks were to change their current strategy on LTV breaches and start foreclosing on existing loans. The behaviour of banks will have a significant part to play in the supply of 'distressed' assets to the real estate investment market.

Sale and leaseback transactions are another source of investment assets as Government and other corporate entities sell properties to sure up their balance sheets. For example, Tesco plc has completed several sales of assets worth over €500 million in sale and leaseback transactions. Evidence suggests that by 2011 there could be an increase in the supply of assets for sale which could have the effect of slowing the rate of capital growth.

With the possible appearance of the so called 'green shoots' of recovery, the number of new fund offerings designed to take advantage of opportunities in the UK market may soon find themselves constrained by the lack of assets they are trying to exploit. Market evidence suggests that there could be a significant shortfall in available debt and equity in 2010-2011 and this could have the result of an increase in 'distressed' investment opportunities flooding the market. Implied total returns calculated from transactions in the derivatives market suggest that the UK could see a short term 'bubble' form with an implied total return of 10.37% in 2010 followed by returns of approximately 8.5% in 2011 and 2012.

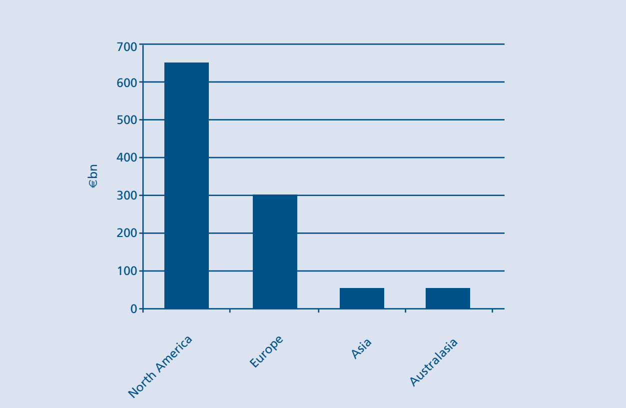
Feri PFR holds information on 3,200 investors including; pension, insurance, endowment and sovereign wealth funds, with a market value of €18.3 trillion. Top-down market sizing exercises by Feri PFR have seen the estimated value of the global investor market rise to a figure closer to €26 trillion.

Figure 5: Investor universe breakdown (€tr)



The pension fund universe is by far the most significant source of capital to the global real estate market (Figure 5). Feri PFR estimates that the pensions market could have invested over €1 trillion in real estate. North American and European funds are currently the most active investors.

Figure 6: Pension fund real estate investment by region (€bn)



Feri PFR research into future real estate investor trends has identified that pension funds will remain the largest net investors in real estate over the medium term, with many funds planning to increase their allocations. In fact, forecasts for the North American and European markets suggest that they will increase their combined real estate assets under management by over €500 billion in the next five years.

Table 3 shows the top ten European countries, by pension assets, and how these are expected to grow their real estate allocations over the next five years. In Europe the mature pension fund markets will continue to be the most significant investors in real estate with UK pensions seeing the largest growth in real estate assets with an increase of €46 billion. Other significant net investors are the Nordic countries with a combined growth in assets of over €14 billion. Switzerland has had the highest allocation to real estate in Europe for many years and this level is likely to continue, hence the relatively low expectation for growth in that market.

Table 3: Pension fund real estate asset growth 2009-2015

Country	Property allocation 2015	Property assets 2015 (€bn)	Growth in property assets (€bn)
UK	10.00%	146.92	46.54
Sweden	8.00%	23.21	9.41
Germany	8.00%	28.46	8.84
Netherlands	10.00%	67.41	8.81
France	6.00%	9.77	4.18
Switzerland	18.00%	70.45	3.99
Denmark	10.00%	23.00	3.00
Spain	4.00%	3.77	2.04
Italy	3.00%	1.68	1.17
Norway	10.00%	6.27	0.99

Source: Feri PFR, Watson Wyatt, IMF, UN Population Division, 2009

European investment market analysis - vehicle 'hot spots'

As pension funds have significant amounts of money to invest in real estate, Feri PFR has attempted to analyse the existing unlisted and listed vehicle markets and forecast where new investment products should be targeting within Europe. The research identified the direct markets that have had an under-supply of investment vehicles (under-supply is defined as being a low percentage of institutional investment grade property held in listed, or targeted by current unlisted, funds).

At the aggregated level, the analysis of the investment market shows that the European market has an under-supply of funds that target the industrial sector (see Table 4) with only 8.81% of the total European industrial stock held or targeted by funds. However, there are significant variations in supply at the country level of the analysis. Other under-invested areas are Belgium retail and office markets, central Europe retail, Ireland, Denmark and Switzerland retail and office.

Table 4: European commercial investment market

European sector	Investable universe (€bn)	Unlisted (€bn)	Listed (€bn)	% of total stock
Retail	1,606,393	137,685	130,344	16.69%
Office	1,281,720	94,435	94,756	14.76%
Industrial	1,311,624	95,451	20,100	8.81%

Source: PFR, DTZ Research, EPRA, Macquarie Securities 2009

Another year of significant declines in assets under management

Feri PFR has just completed its fifth UK Fund Manager Survey. This year, 59 fund managers took part (one more than last year), accounting for £129 billion in total assets under management. This represents a 32% decline in assets compared to those recorded in 2008, for those managers that took part in both surveys. The top three fund management houses have maintained their position, with Aviva Investors, PRUPIM and Standard Life taking the first, second and third positions respectively by total assets under management.

Table 5: Top 10 vehicle managers by total GAV of vehicles under management

Rank 2009	Rank 2008	Manager	Total GAV £m	% Change
1	1	Aviva Investors	8,792.00	-31.81
2	2	Standard Life	6,368.00	-44.70
3	3	Henderson Global Investors	3,771.00	-30.17
4	4	Schroder Property Investment Management Limited	3,674.90	-31.82
5	5	Legal & General Property Limited	3,621.00	-21.71
6	7	RREEF	2,634.00	-17.89
7	6	ING Real Estate Investment Management	2,301.75	-38.50
8	9	UBS Global Asset Management (UK) Ltd	1,775.80	-28.98
9	n/a	Brandeaux Managers Limited	1,709.00	n/a
10	12	BlackRock	1,682.90	-24.94

52 vehicle managers responded to the survey with a combined fund asset value of £61 billion, with the top ten vehicle managers shown in Table 5. This translates into a 30% decline in total value of vehicles under management for fund managers that responded in 2008.

The UK's ten largest funds have a combined gross asset value of £13.4 billion, which is a decline of 35% compared to last year's figures. Table 6 shows the ten largest funds by gross asset value.

Table 6: UK's 10 largest indirect real estate funds

Rank 2009	Rank 2008	Vehicle name	Manager name	GAV (£m) 2009
1	3	Hercules Unit Trust	Schroder Property Managers (Jersey)	1,653
2	5	BlackRock UK Property Fund	BlackRock (Channel Islands)	1,636
3	2	Standard Life Pooled Pension Property Fund	Standard Life Investments	1,489
4	1	Mall Fund	Aviva Investors	1,469
5	6	UBS Triton Property Fund	UBS Global Asset Management (UK)	1,360
6	9	Arlington Business Parks Partnership	Legal & General Property	1,327
7	4	Aviva Investors Property Trust	Aviva Investors	1,303
8	7	Standard Life Investments UK Shopping Centre Trust	Standard Life Investments	1,131
9	8	Schroder Exempt Property Unit Trust	Schroder Property Investment Management	1,125
10	n/a	Unite UK Student Accommodation Fund	The Unite Group	894

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