

Capital flows

Analysis

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Vultures go hungry 14

Bargain-hunting funds may struggle to find stock in the US and Europe, tycoon Sam Zell warns NAREIT conference

Second *Capital Flows Survey* finds appetite for UK property but few sellers, reports *Jane Roberts*

Fund sponsors believe UK will be land of opportunities

The renewed interest in buying UK property since values started to fall last summer can be clearly seen in the second *EG Capital/Property Funds Research Capital Flows Survey*.

The survey collected data on 40 mainly European and Asian property funds raising capital in the past six months and found that they attracted €7.5bn of new equity and plan to buy assets with a €32.5bn gross value.

Key trends this time include a slew of funds targeting fair value in the cheaper UK market and successful private equity raisings by several pan-European opportunity funds. Most of the equity came from institutional investors, whose appetite for property shows no sign of diminishing.

Five of the 40 funds have been set up to target UK opportunities, while a sixth, Moorfield's second opportunity fund, is likely to buy almost entirely in the UK. These six have raised more than €900m of equity (see pie charts, p12).

When Trillium Partners' £1.13bn (€1.44bn) UK public-private partnerships fund – which raised about £550m from seven institutions by its final closing last month – is included, the seven UK-focused funds have a €7bn combined potential gross asset value.

Opportunity funds targeting UK

Four large private equity opportunity funds of the 40 are targeting the UK and mainland Europe. As well as Moorfield's and another UK-focused vehicle, Evans Randall's Central London Opportunity Fund, the other two sponsors are Apollo Real Estate Advisors and Resolution, which both plan to step up UK investment, perhaps up to 50% of total assets. This contrasts with the past four years, when they shunned the UK as relatively expensive.

The challenge for all funds looking to raise cash to spend in the UK this year will be finding assets. At the London conference of US REIT organisation NAREIT on 8 April, Land Securities' chief executive Francis

Salway said: "There are very few signs of distressed selling and it is less easy to see what will trigger those situations." (See analysis, p14).

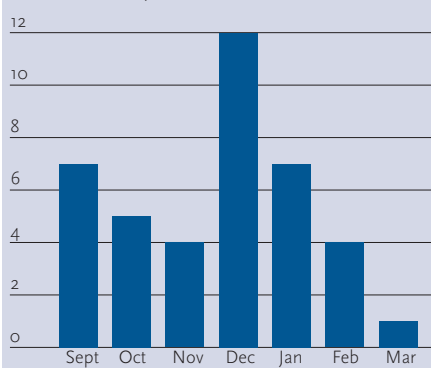
Other potential sellers are sitting on their hands, waiting to see what will happen to values in the second and third quarters of the year. Meanwhile, debt is becoming even harder to get and more expensive.

This is not deterring fund sponsors and investors, who feel that now is the time to raise money and get to the front of any queue to buy. More funds are backing up behind the six in this survey. Orchard Street Investment Management, run by Chris Bartram, is raising equity for a UK value-added fund seeded by Singaporean sovereign wealth fund GIC. LaSalle, Legal & General and Invista have raised UK funds, while AXA REIM and Threadneedle both report interest from investors in the UK.

"The UK was expensive relative to other markets and now it is relatively cheap," says

Fund launches Sept 07-March 08

Fund launches peaked in December

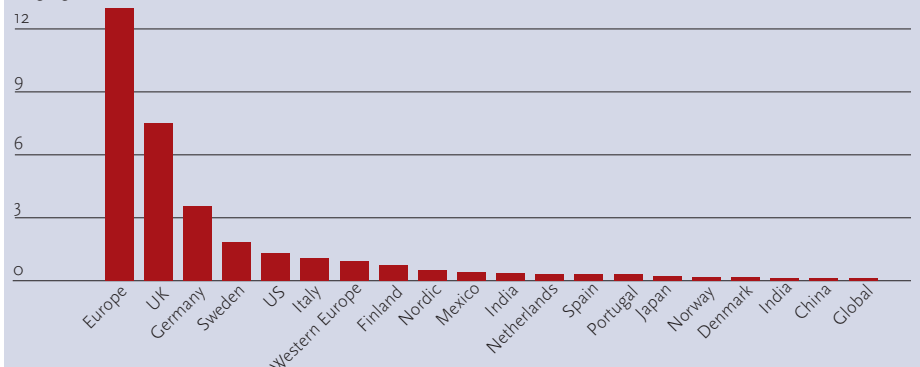


SOURCE: PROPERTY FUNDS RESEARCH/EG CAPITAL

Target countries for fund launches

Pan-European investment has attracted the most cash, followed by the UK, Germany and Sweden

Target gross asset value €bn



SOURCE: PROPERTY FUNDS RESEARCH/EG CAPITAL

Chris Morrogh, a director of Threadneedle Property Investment. "When fewer buyers are out there, buying imperfections appear." After de-leveraging all its geared funds by the end of 2006, Threadneedle plans to launch two geared funds to invest in the UK by the summer (see news).

But fund managers say raising equity is getting harder. High-net-worth investors are more cautious and retail investment has almost dried up. Several fund managers have raised equity more slowly than they had hoped for and have settled for less at first closings to get funds off the ground.

In the first *Capital Flows Survey*, covering January-August 2007, 10% of the €9.6bn of equity raised came from retail investors and

10% from private banking clients. This time, 97% of the €7.5bn equity raised came from institutional sources, including pension funds, insurance companies, endowment trusts and funds of funds. The dominance of institutions is reflected in the relatively low average number of investors per fund. If two small funds, each with more than 170 investors, are stripped out, the average number of investors per vehicle is 10.

Finnish, Danish and Dutch pension funds featured prominently in responses from fund managers and sponsors who were prepared to give details of their investors (see 'Top 15 investor types' table, below).

Not all respondents were prepared to detail the number and type of investors in

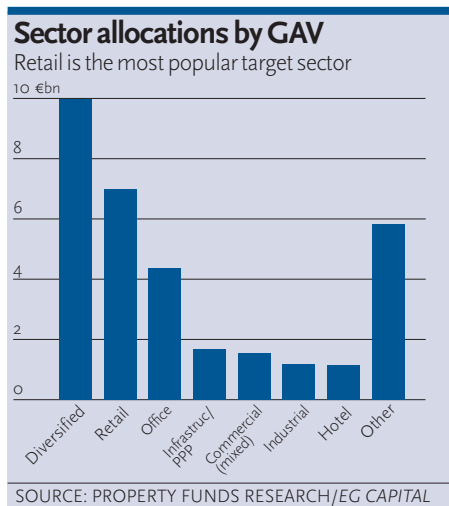
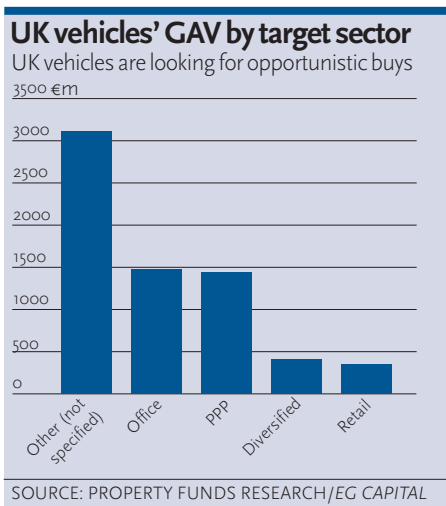
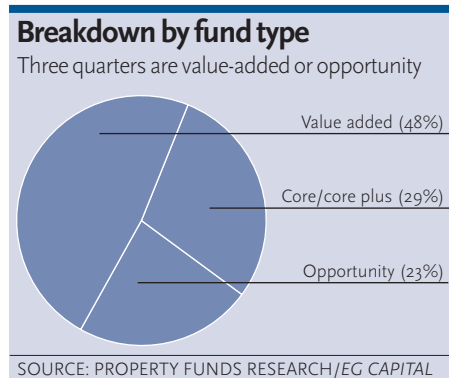
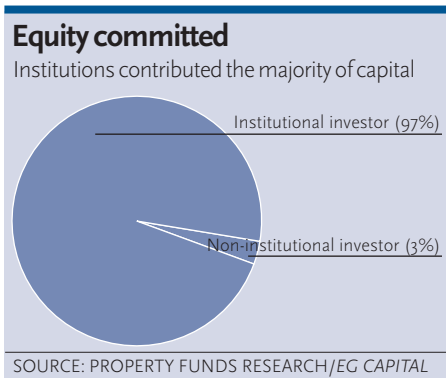
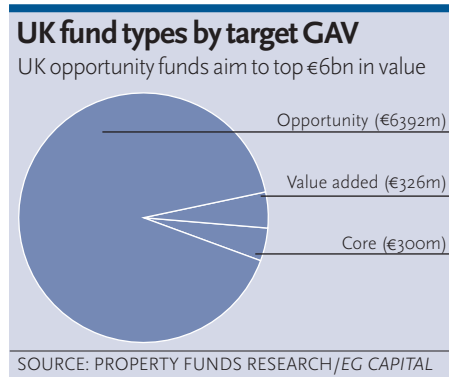
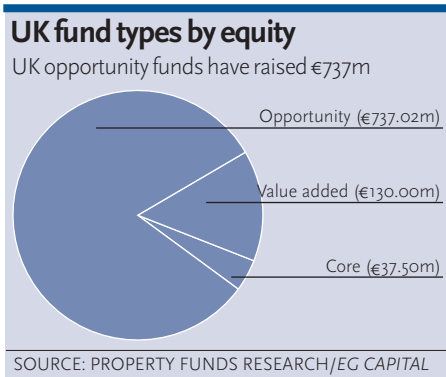
their funds, but managers of about €4.85bn did, documenting 39 different investor types, including: a Japan fund of funds and a Japanese insurance and pension fund; Middle East and Singapore government funds; US charities and pension funds; Swiss and Swedish pension funds; Dutch, Swedish and UK private equity; and hedge funds of funds.

"A healthy repricing"

Rory Hardick, a principal at investment bank and placement agent M3 Capital Partners, which advised on \$10.5bn of equity raised in 2007, says: "Pension fund allocations to real estate have increased around the world, which means there's a level of liquidity out there. We have had a healthy repricing and there will be more to come, but this demand will stop markets from falling through the floor."

As in the first *Capital Flows Survey*, UK institutions dominated, both in UK funds and overseas, this time accounting for about €1.5bn of equity raised. In one fund raised for German investment with a retail bias, for example, six of the nine institutional investors were UK pension funds, and one was a UK fund of funds.

The 40 funds' target gross asset value is €32.5bn, but this does not imply average gearing of 77%, as 34 of the vehicles will have subsequent closings or are open-ended. But average gearing is still high, skewed partly by the fact that only 29% of respondents were core or core-plus funds (see 'Breakdown of fund types' graph, left) with



Top 15 investor types by domicile
UK pension funds dominate the market

| Investor types by domicile | Equity committed (€m) |
|----------------------------|-----------------------|
| UK pension funds | 1,067.2 |
| Global institutional | 891 |
| UK other | 445.28 |
| Finnish pension funds | 271.25 |
| European institutional | 266 |
| Dutch pension funds | 199.55 |
| European pension funds | 165 |
| Danish pension funds | 161.25 |
| US other | 150 |
| US charity | 150 |
| German pension funds | 150 |
| Irish pension funds | 137 |
| Australian pension funds | 137 |
| Finnish insurance fund | 92 |
| Japan other | 89.38 |

SOURCE: PROPERTY FUNDS RESEARCH/EG CAPITAL

60% of vehicles planning to gear higher than 60% (see 'Anticipated gearing' graph, below).

Many fund managers are playing down investors' expectations about returns. One opportunity fund manager said: "In the past few years an opportunity fund would have expected to make internal rates of return well over 20%, but now we are promising returns in the high teens," (see 'Target rates of return' graph, below).

Cordea Savills and Valad raised fresh equity for the most funds, at three each, though not the most equity by value.

The growth in funds of funds, a trend in the past three years, has continued, with four more raising equity in the past six months. After pan-European exposure and

the UK, Germany and Sweden are both sought-after markets for investors (see 'Target countries' graph, p11). The survey includes six Nordic funds covering a range of sectors, including: a Swedish office fund; two Swedish housing vehicles; and Nordic retail and hotel funds. The four German funds include one retail, one residential and two opportunistic funds.

Equity was also raised for a Dutch opportunity fund, a Spanish and Portuguese shopping centre fund and an Italian retail fund. There were seven pan-European funds, two targeting retail, but little of the money is targeted at Central and Eastern Europe.

Among the more innovative strategies are two long/short property equities funds:

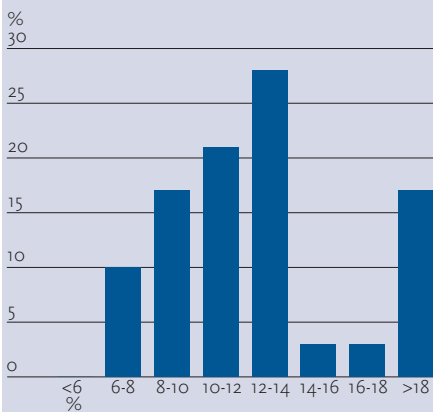
Trillium Partners, which owns the former Land Securities Trillium portfolio of public-private sector assets; and the first open-ended global fund of funds for retail investors.

Although not included in the data, one of the first 'green' vehicles, Landid's and O&H Properties' Veridian was launched, targeting institutions to raise £250m to buy sustainable UK office buildings. Green funds will be a feature of future surveys, with Climate Change Capital and others looking to raise equity for such vehicles this year.

Among the 40 funds are one targeted at Mexico and one each at Japan and India. The sums raised for Asia are likely to be significant in the next report as several sponsors are raising capital there, especially for India.

Target rates of return

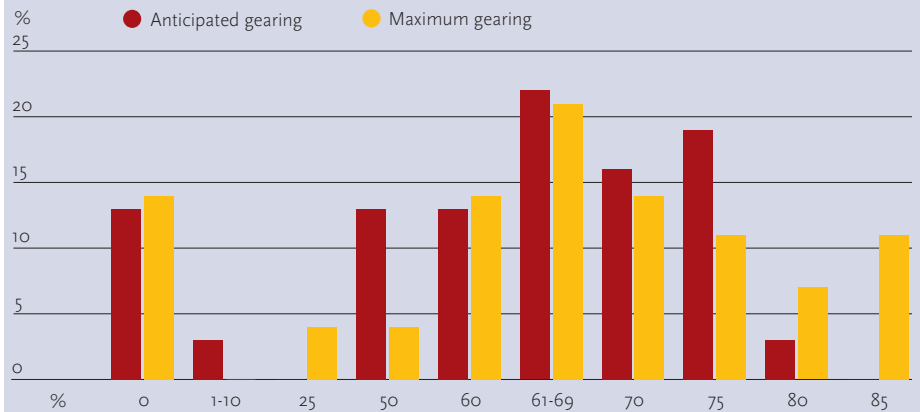
Most funds expect returns in the low teens



SOURCE: PROPERTY FUNDS RESEARCH/EG CAPITAL

Anticipated maximum gearing

Few funds anticipate leverage above 75%, but 60% will gear over 60%



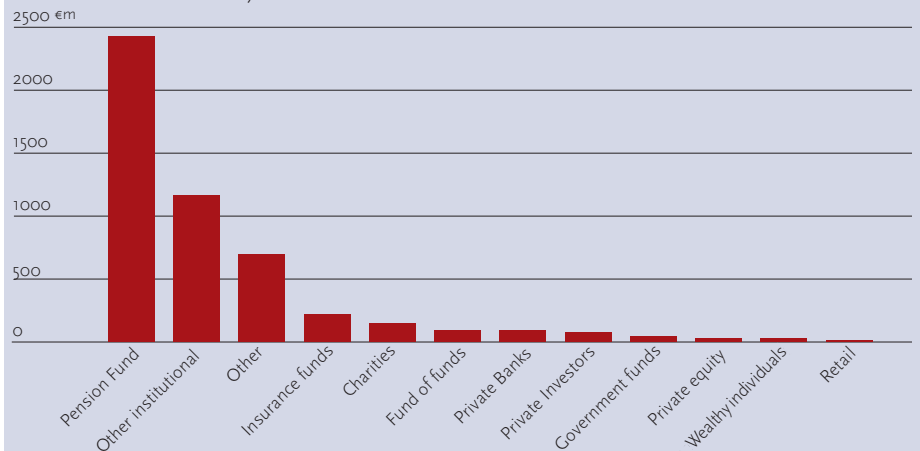
SOURCE: PROPERTY FUNDS RESEARCH/EG CAPITAL

Key facts

- The data covers 40 mainly unlisted funds;
- the managers of these funds all raised new equity in either first or subsequent closings during the six-month period between mid September 2007 and mid March 2008;
- total equity raised was €7.5bn, while total target gross asset value is €32.5bn;
- the largest fund raised €880m, while four funds each raised more than €500m;
- the smallest amount of capital raised by a fund was £5m (€6.21m);
- there are 10 funds that raised between €6m and €100m of equity and nine of these plan further closings, or are open-ended;
- 20 funds are country specific, 15 are pan-European, five are global and two are Asian;
- Institutional investors contributed 97% of the funds' equity.

Investors' sources of equity

Retail investors and wealthy individuals have cut back their investment



SOURCE: PROPERTY FUNDS RESEARCH/EG CAPITAL

This is EG Capital's and Property Funds Research's second Capital Flows Survey. The first was published in last September's EG Capital. Property Funds Research estimates that the 40 funds that took part this time represent just under half the total number of global property funds that raised capital between September 2007 and March 2008.