Capital flows

Analysis

Also in this section

Third survey shows more than €7bn raised but it's getting much tougher, writes *Jane Roberts*

Plenty of money – but less is going to new launches

Sponsors raised over €7bn of new equity for 40 unlisted property funds in the six months between April and September. They hope to have buying power of almost €50bn by the time more equity is raised and the funds are geared up.

The findings, revealed in the third six-monthly *EG Capital*/Property Funds Research Capital Flows Survey, are similar to the levels of equity recorded in the second survey, which covered the period September 2007 to March 2008 (see Key facts, opposite).

However, the healthy headline figures disguise the fact that the rate of new launches has slowed to a crawl, affecting all jurisdictions, including emerging markets.

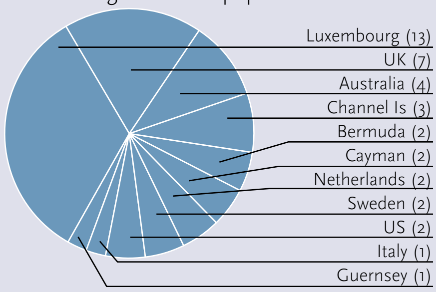
Most of the new funds that closed did so by the summer, with only three launched in September (see chart, below left). Far more of the responses this time were from sponsors which raised equity in second or subsequent closings than for new funds. Of the 40 funds which responded, only 18 were first closings and 22 were raising more equity for funds already launched. In the previous survey, 36 of the 40 funds which replied had a first closing.

The survey was sent by PFR to managers which had announced their intention to raise equity in the period for a possible 129 funds. While some of the 89 that did not respond will have achieved their target equity raises in that period, many of that number did not launch and were delayed, postponed or pulled altogether (see overleaf), making the survey a bigger subset of total equity raised than would appear.

The volume of equity recorded this time was also swelled by what may well turn out to be the last of a wave of successful

Domicile of funds

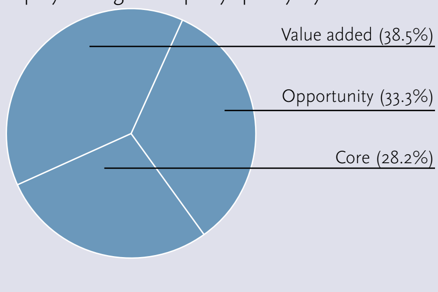
Luxembourg is the most popular domicile



SOURCE: PROPERTY FUNDS RESEARCH/*EG CAPITAL*

Style of funds

Equity raising was equally split by style



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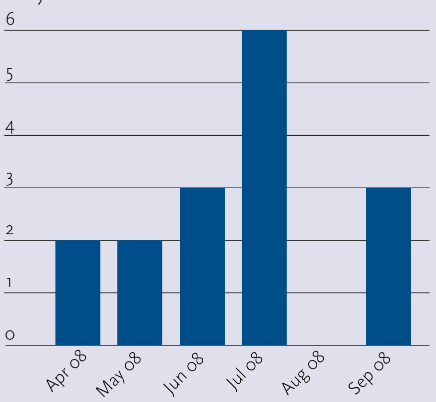
Fund launches by month 2008

Only three launches after the summer



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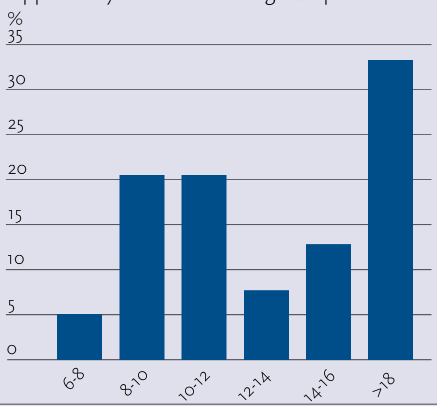
Target rate of return

Opportunity funds still seeking 18%-plus returns



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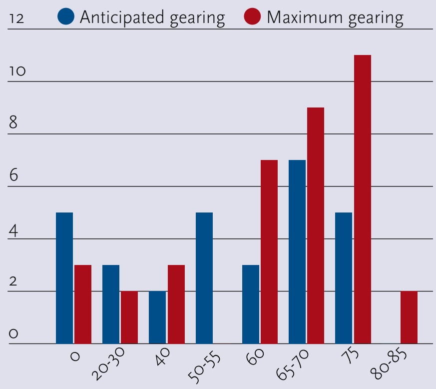
Anticipated and max gearing %

Half of funds will be geared at 60% or less



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real estate private equity fund closings that started in 2007. In May and June this year, MGPA, Curzon/AEW Europe, Europa Capital Partners and Carlyle Group all closed real estate opportunity funds. MGPA's third fund raised €345m for Europe and $390m for Asia in its final closing, while Curzon closed the European Property Investors Special Opportunities LP with €800m. Europa Capital raised €750m to spend in Europe, including central Europe, and Carlyle Group raised €2.2bn for its third European fund. All are included in this survey.

At €50bn, the target gross asset value is also surprisingly high in relation to the equity raised and more ambitious than the €32.5bn target in the previous survey. But it does not imply that most sponsors expect to be highly geared. Although 13 funds could be geared at 75% or higher (see chart opposite), only five actually anticipated taking on that level of debt. About half expected to be geared at 60% or less.

It appears that rather than employing very high gearing, sponsors hope to raise more equity, reflecting the fact that many investment managers did not hit their original equity targets, especially for smaller funds.

Summer cash drought

"Getting money now is more and more difficult," says Elliot Caldwell, chief executive of Colliers Capital, the fund structuring and placement division of Colliers CRE. "Earlier in the year there was still an element of optimism about how deep and nasty this recession was going to be. Then we were looking at raising an opportunistic fund for the UK because we thought this year was going to be the year to buy; now we think it is deep into 2009."

Everyone agrees that it became much more difficult to raise equity from the summer onwards. Andrew Williams, head of the London-based residential business of Cushman & Wakefield, says wryly: "Probably from the beginning of Q3, July or August, it was clearly not a climate where you could sensibly stand up in front of anybody and predict what will happen."

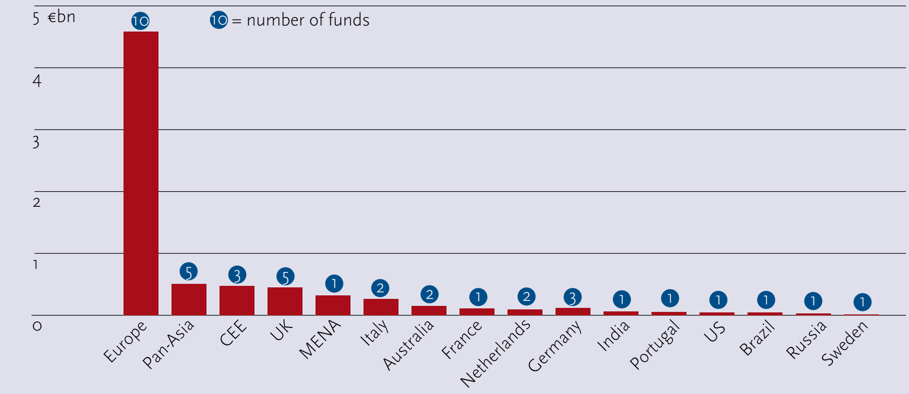
"It is definitely harder to raise money than two years ago," agrees Threadneedle Property Investment's managing director Don Jordison, whose team has successfully launched two geared UK funds this year. The UK Opportunities Property Fund closed in March with £150m of available funds, and is backed by institutional investors, while in September the Threadneedle UK Property Select Fund closed (see profile, pp20-21). The latter has £183m of money to spend, from high-net-worth clients of Citigroup wealth management based in the Middle and Far East.

However, Jordison argues that current conditions are merely the market reverting to trend. "Two years ago, the market was not normal and we were not raising because it was a silly time to do it. Usually the best time to raise funds is when its hardest to achieve," he observes.

The investors who backed the 40 funds in the survey put their money into a very wide range of sectors and property markets numbering 16 different countries and

Target countries by equity committed

Funds targeted at emerging markets raised relatively little equity



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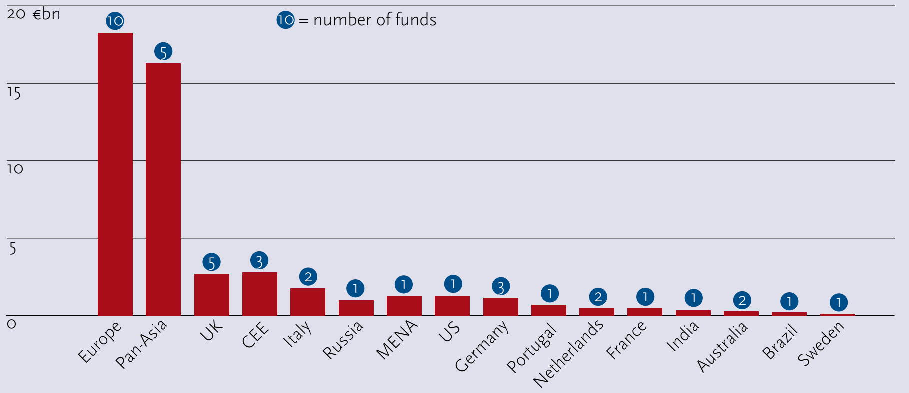
Target countries by gross asset value

The pan-Asian funds are large, reflecting the scale needed for investing there



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Key facts

- **The data covers 39 unlisted funds and one listed fund**
- **The managers of these funds all raised new equity between April and September 2008.**
- **18 of the equity raisings were first closings for new funds; 22 were subsequent closings for existing funds**
- **Total equity raised was €7.3bn, while total target gross asset value is €49.12bn**
- **In the previous six months (September 2007–March 2008), total equity raised was €7.5bn, with target GAV of €32.5bn**
- **The largest fund this time raised €2.2bn of equity**
- **The smallest amount of capital raised was €3m**
- **Twenty-one funds are country-specific; five target Asia and 10 are pan-European**
- **One is a debt fund**
- **Two are funds of funds**
- **The market remains dominated by UK, US, Australian and Dutch pension funds**

regions (see below). The funds were pretty equally split between core, value-added and opportunity styles, reflected in the spread of target rates of returns.

While pan-European funds were the largest category, this encompasses several specialist sector funds, including one newly launched pan-European debt fund and a substantial second closing from a pan-European retail fund. Three funds are targeting Central and Eastern European property and one had its first close for Russia, including the Ukraine and Kazakhstan. Among the emerging market funds were one fund already investing in Brazil, which brought in three new European investors, and a very successful first close for a $2bn opportunity fund targeting commercial and residential investments in the Middle East and Africa.

There were two pure residential funds, in Germany and Sweden; a French industrial fund first close; and a Portuguese shopping centre fund that brought in two more fund of funds investors.

After pan-European funds, the next biggest chunk of gross capital is destined for pan-Asian property – about €16bn, although in only five funds, reflecting the scale necessary for successful investing in the region. One of these five is a securities fund. Two Australian funds responded to the survey, both raising relatively small amounts of additional capital.

BRIC countries fall out of favour

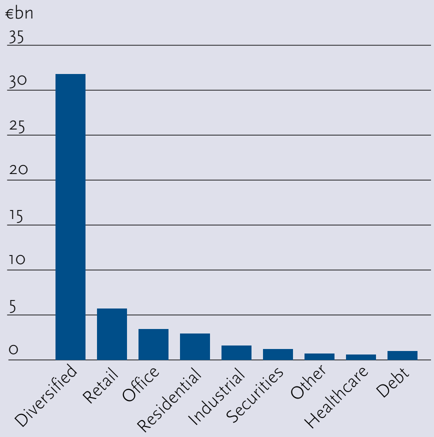
Although a lot of funds targeting India and China were being mooted a year ago, there is only one in this survey. It is likely that some were pulled after the BRIC countries (Brazil, Russia, India and China), which had been star performers in 2007 and Q1 2008, took a downward spin in Q2. In their equity markets, property shares had fallen by almost 80% in India by October and 74.5% in China. According to Macquarie Securities Group's last monthly global property securities report, 12 months ago BRIC country property companies had an aggregate market capitalisation of £144bn. At the end of October it was only £47bn.

There was also less money raised specifically for UK opportunities than last time, when it was a clear trend.

Some types of specialist funds also found it hard going. In the UK, plummeting property values and worries about tenant defaults have put paid to a string of proposals for green building funds, with the notable exception of Climate Change Capital's fund, which achieved a €50m first close last month. At least 10 new European property debt funds are proposed, but most of them have not had equity closings yet.

Sector allocations

The largest sums are for diversified funds



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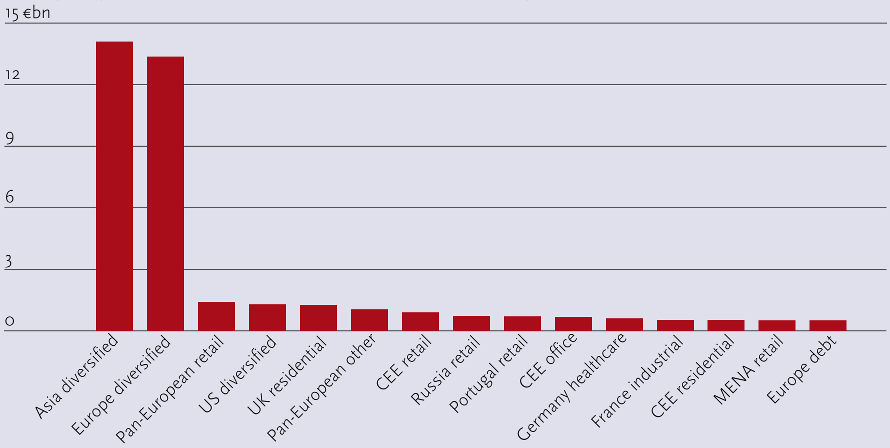
Top 15 target sectors and locations

Though regional funds take the most cash, there were a range of specialist vehicles



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Top 13 investor types by equity

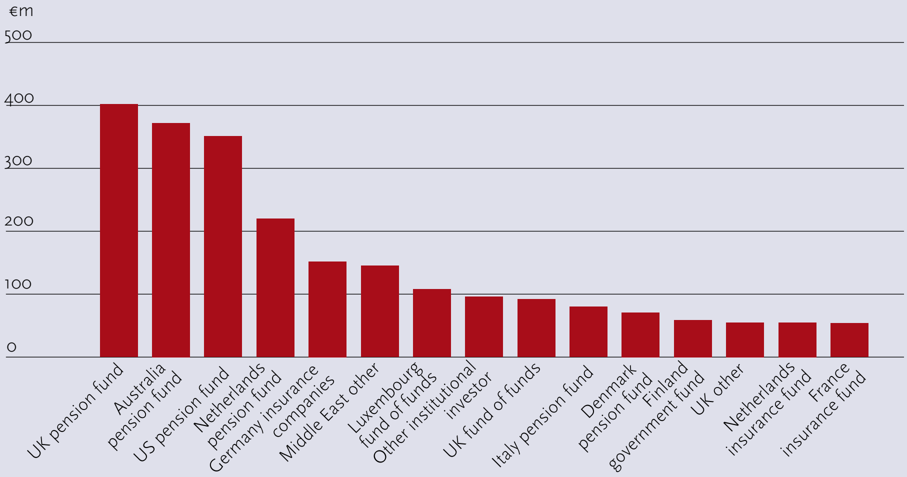
Pension funds remain the dominant investors

Investor types	Equity committed (€m)
Pension funds	1,643
Other	393
Insurance	323
Fund of funds	263
Government fund	122
Other institutional	96
Investment company	58
Private bank	50
Australia other	35
Wealthy individuals	24
Retail	14
Endowment fund	3
Charity	2

SOURCE: PROPERTY FUNDS RESEARCH/*EG CAPITAL*

Domicile of top 15 investor types by equity commited

Investors are widely spread with UK, US, Dutch and Australian pension funds prominent



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Not all the respondents would give details of investors. But of those which did, it is clear that pension funds remain the dominant investors in unlisted property funds, particularly UK, US, Dutch and Australian pension funds (see charts below). Significant investment was also made by fund of funds, German insurance groups and Middle Eastern investors.

In future investors are expected to become even more selective and demanding. Caldwell believes: "You have to have something pretty special now to raise money, and demands from investors are much, much greater. There have been lessons learned by everybody and investors are very cautious about how funds are structured and the alignment of interests. There's a new eyes-wide-open view from investors."

Richard Games is head of ING Real Estate's European infrastructure fund, which targets big institutional investors. The infrastructure fund is on track to have its first close by early in 2009, when it is expected to raise about €250m from European investors. Games then plans to widen the net of investors to the Middle East, Asia, the US and Australia in subsequent closings that could build a €1bn fund. He observes: "There are a number of investors which have been heavily hit, particularly since September, by things such as volatile currencies, falling equity values and the collapse of hedge funds. Liquidity has suffered and they are looking at their books." He says these investors are holding back for the time being.

"But looking further forward to next year I think it will be good for our fund, because there is a flight to quality and stability and some investors will switch out of gilts, or equities or hedge funds and into assets with a strong yield. Infrastructure fits that."

Threadneedle's Jordison adds: "Professional-quality investors are being selective about what they choose to do. You can raise money – if you've got a track record, the credentials and you are not dragging any baggage with you." He believes that investors interested in UK real estate now recognise that the market is "resetting" and are probably happy with a mean of high single returns. "Which is what everyone always wanted from property."

This is EG Capital*'s and Property Funds Research's third* Capital Flows Survey. *The first was published in* EG Capital *in September 2007; the second in April 2008. If you would like more information, please contact Joanna Gliddon at jg@propertyfundsresearch.com.*

"Wait and see" becomes the watchword

The 28 funds listed below are likely to be just some of the vehicles that were conceived in easier, more exuberant times and then pulled this year as global property market values started to fall and investors became much more cautious.

Many of their sponsors started trying to raise funds in the first half of the year and then threw in the towel when fundraising became increasingly difficult after the summer.

"We are pretty much in a deep freeze for capital raising now," says Nick Harvey-Jones, who works in fund structuring and placement at Strutt & Parker Real Estate Financial Services (SPREFS).

SPREFS is advising on products in the UK, Germany and India which have been cancelled for the time being. The two funds in India were for Old Mutual and local private bank ICICI.

"India has fallen off a cliff and we've put a stop to both funds," he says. Old Mutual had bought four shopping centres with its initial cornerstone capital to seed the Triangle Real Estate Fund, which it will continue to manage.

Cushman & Wakefield was advising RealKapital Partners on a fund that earlier this year intended to raise €600m to invest in residential property in Central and Eastern Europe. "There was no first close, and we have adopted a wait-and-see strategy," says Andrew Williams of Cushmans.

"That market experienced a condensed two- to three-year period of accelerated growth, which has pretty much outstripped local affordability."

Cancelled or postponed fund launches 2008

Investor caution has put paid to a raft of planned vehicles so far this year

Manager/fund name	Comments
Aberdeen Property Fund Russia	No equity raised
Aberdeen Sustainability Fund	Cancelled
Assetz Property Development Fund	Not launched
Aviva's Hexagone	No equity raised
Realkapital Partners/Cushman & Wakefield CEE Residential Fund	No equity raised
Colliers Capital UK Opportunity Fund	Postponed to 2009
Cordea Savills German Property Fund	Launch cancelled
Cordea Savills Turkish Property Fund	Launch cancelled
Cushman & Wakefield Investors UK Recovery Fund	Not launched
DTZ Brazilian Fund	Wound up as didn't raise enough capital
DTZ Aurora Asia Property Fund	Not launched
GPT Halverton UK Light Industrial Fund	Launch cancelled
GPT Halverton SA Fund	Launch cancelled
Hermes/L&G UK Logistics Fund	New fundraising pulled in March
Hermes MEPC Business Park Fund	Fundraising pulled in March
ICICI Bank India Fund (with SPREFs)	Cancelled
ING France Belgium Value Added Fund	Cancelled
Kenmore German Care Home Fund	No equity raised
Landid Green Fund	Delayed
LNR Europe Investors II debt fund	Postponed to 2009
Palmer Capital Partners' Green Property Fund	Put on hold in June
Palmer Capital Partners' Institutional UK Opportunity Fund	On hold
SPREFs Property Development Fund 3	Cancelled
Rutley Capital Partners India Residential Fund	Delayed
Rutley East Africa Property Fund	Delayed
Rutley Brazillian Fund	Not launched
Triangle Real Estate Fund (Old Mutual/SPREFs)	Cancelled

SOURCE: PROPERTY FUNDS RESEARCH/*EG CAPITAL*