



## Investors keep faith in European non-listed real estate funds despite downturn

Institutional investors in European real estate continue to remain committed to increasing their allocations to the asset class, and particularly through non-listed real estate funds, despite the downturn in the market, a survey carried out by industry body INREV shows.

Over 70% of the institutional investors who responded to the survey said they intended to increase their allocation to real estate in the medium term, mainly through non-listed vehicles, but also listed property companies.

A total of 28 institutional investors and 16 fund of funds managers responded to the INREV Investor Survey on investment allocations and the poll's findings were presented at the association's Investor-Only Seminar held in Paris on September 17-18.

Investors' continuing confidence in real estate suggests that the challenging market conditions are perceived as a general phenomenon across investment markets stemming from the financial market crisis. This can also be derived from the survey results where 70% of the institutional investors indicated that the case for real estate in comparison to other asset classes had remained the same over the past year, while 20% even felt that the case for real estate had improved.

"I think this indicates that the long-term trend of increasing institutional allocations to real estate is still intact despite the impact of the credit crunch, although the survey also shows evidence of technical changes in investment strategy in the short term in the current difficult market," commented Marie-Claude Gleize, Director for Non-listed Real Estate Funds and Active Property Investments at French investor Caisse des Dépôts.

More than 70% of institutional investors said that the real estate "denominator effect" was causing them to raise their allocations to other asset classes in the short term at the expense of real estate. This denominator effect is where property increases as a proportion of a total investment portfolio due to relative declines in the value of other asset classes such as equities and bonds.

The denominator effect is not yet, however, impacting on non-listed real estate funds for over 70% of the investor group surveyed, although 25% of investors did say they were considering reducing their fund holdings due to this phenomenon. From the minority group considering cutting their real estate funds' exposure, 44% said this would be through the repatriation of capital from terminating funds, followed by 31% who were considering sales through the secondary funds market.

Market conditions are also having an effect on investors' management processes. Nearly half said that the time taken to make a decision to invest in a non-listed real estate fund had increased compared with a year

ago, although most fund of funds managers said this had remained unchanged. The main reason for the extended decision making was a longer due diligence process.

The credit crisis also appears to have tilted the balance of power in negotiations over fees and terms in favour of investors and fund of funds managers, relative to fund managers. Some 60% of investors and 73% of fund of funds managers said their negotiating positions for fees had improved, while 50% of investors and 63% of fund of funds managers said the same for terms. No respondent said their negotiating position had deteriorated.

Half of the fund of funds managers polled said they now required more detailed reporting from the fund managers they have invested with, compared with just 29% of investors. This may be partly due to the fact that fund of funds managers generally have shorter investment horizons than institutional investors and need to put the capital they receive to work as quickly as possible to underpin future performance.

To a large extent this demand for increased reporting may be relate to valuations; 75% of fund of funds managers and 65% of investors responding have indicated that they think that current values do not reflect fair value or mark to market levels.

“With the volume of real estate transactions declining significantly in Europe, there is a shortage of pricing reference points in the market. In this environment, it is extremely important that fund managers and investors spend time on communication, so there is a full understanding of the performance of funds,” Christian Delaire, Global Head of Fund Management at AXA Real Estate Investment Managers said.

“More generally, we have to make sure that the level of transparency reached by the market in the last few years is maintained. The non-listed real estate funds sector has benefited strongly from this and it is essential transparency continues to develop,” he added.

Current market conditions support some shifts in the real estate asset allocation, as both institutional investors and fund of funds managers are showing more interest in opportunity funds. They seem particularly interested in mezzanine financing and real estate debt, as well as in markets outside the EU. South America in particular was mentioned, as well as Asia, as areas where investors want to increase their allocations in the short term.

“It is interesting to note that despite the more uncertain and volatile market environment, with the greater difficulty in raising financing, investors are considering acquiring debt-related products and are also increasing their exposure to the higher end of the risk spectrum, by investing relatively more in opportunistic fund strategies. This contrasts somewhat with INREV’s Investment Intentions Survey published at the beginning of this year, in which investors intended increasing their exposure to value-added strategies,” commented Mahdi Mokrane, Head of Research and Strategy at real estate investment manager AEW Europe.

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