2014 Fundraising: Year in Review

Pension fund commitments to managed real estate vehicles

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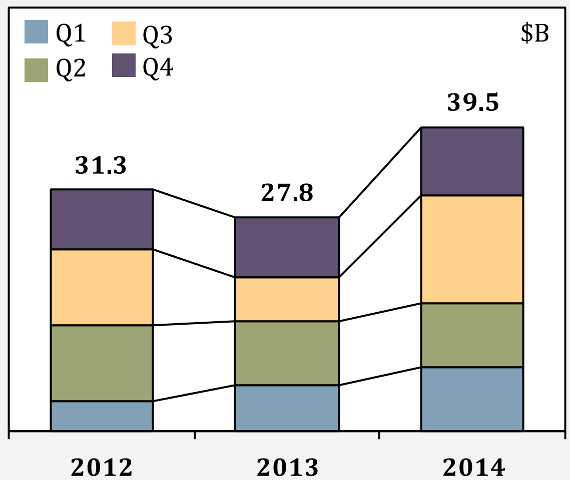
2014 Commitment Volume Up Significantly

Public pensions committed ~$40 billion to managed real estate vehicles in 2014, compared to $28 billion in 2013 and $31 billion in 2012

Aggregate commitments from U.S. public pension funds to managed real estate vehicles totaled $39.5 billion in 2014, according to data tracked by FPL Consulting. This represents a material increase over 2013 and 2012 where commitments totaled $27.8 and $31.3 billion respectively. FPL's database includes commitments to 240 managers from 160 U.S. pensions representing $3.1 trillion in assets under management.

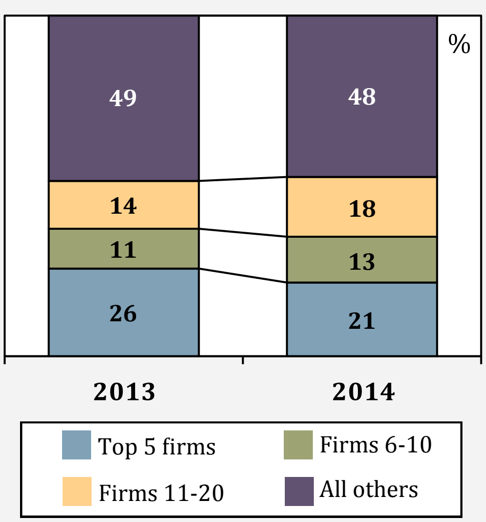
The magnitude of this year's increase was partially driven by CalPERS, which committed over $6.5 billion to real estate in the third quarter. That said, even without these commitments, aggregate volume would still have been up about 20 percent from 2013, reflecting the overall health of the capital raising environment.

Commitments to managed real estate vehicles



Unsurprisingly, Blackstone was one of the leading fundraisers in 2014, holding final closes on both its European and Asian vehicles, as well as pursuing capital for its new core-plus offering. Other high-yield shops raising significant capital in 2014 include Lone Star, Starwood, Carlyle, Oaktree, Rockpoint, and Westbrook, among others. In the value-add category, DRA, Shorenstein, and Carmel all held $1B+ fund closings, while the usual suspects (e.g. JP Morgan, Invesco, UBS, AEW, Principal, LaSalle, Heitman, Deutsche, PREI, Cornerstone, etc.) continued to dominate the core space.

Concentration of commitments



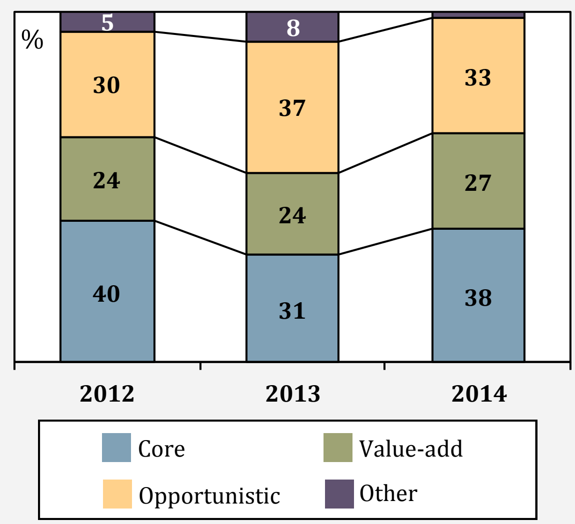
Despite the continuing improvement in the capital raising environment, and notwithstanding the success of the aforementioned managers, it is still a highly competitive market with many firms struggling to attract new capital. Analysis by FPL suggests that the global ratio of capital sought versus that being raised is about 2.5 to 1. This has led to a world of 'haves' and 'have nots' - those who are in favor with investors and are reaping the benefits of the current capital environment, and those who are not. This trend is illustrated by the concentrated nature of today's capital environment - in 2014 the top 20 managers accounted for over half of total commitment volume which is in line with 2013. This means that the remaining 100+ firms (or 80% of the population) for which we tracked a pension commitment in 2014 split the remaining half. This dichotomy is even greater when you consider the myriad number of firms that did not raise any capital at all in 2014.

Vehicle Structure and Investment Strategy

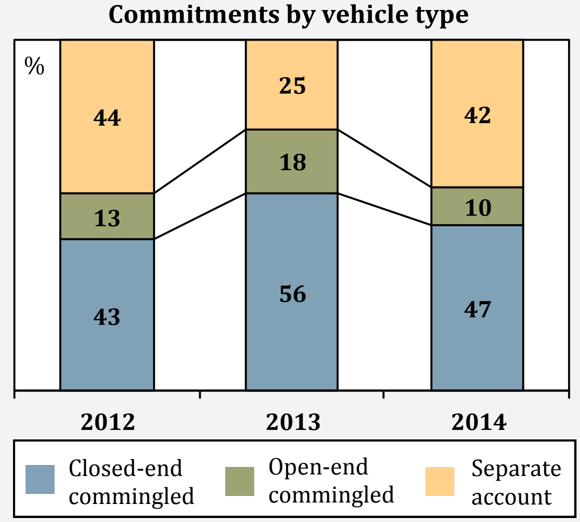
The story of risk profile was an interesting one in 2014. When measured by commitment volume, core strategies saw a resurgence in 2014, representing 38 percent of capital, up from 31 percent in 2013. However, this result was partially driven by a handful of very large commitments by some of the industry's most prominent pension plans, including CalPERS, CalSTRS, Wisconsin Investment Board, and Illinois Teachers. In contrast, when measured by <u>number</u> of commitments, core strategies represented only 23 percent of capital flows to real estate. This finding suggests that, for the majority of investors, higher yielding (i.e. opportunistic and value-add) strategies continue to be in favor. Such strategies represented 60 percent of capital flows to real estate by volume, and 75 percent in terms of number of commitments. This finding is consistent with qualitative market feedback that suggests appetite for high yield is strong and, if anything, grew stronger still in 2014.

A similar story exists when examining commitments by vehicle structure. Separate accounts rebounded in 2014, representing 42 percent of commitment volume on a dollarized basis. However, this too was driven by a handful of very large commitments; when measured by number of commitments, separate accounts represented just 14 percent of mandates. Conversely, closed-end funds accounted for 47 percent of dollar volume, and nearly 70 percent by number of commitments. This is not surprising given that a) high-yield strategies tend to be more closely associated with closed-end fund structures and b) that typically only fairly sizable investors can partake in separate account structures given the level of capital necessary to do so. The final chart on the right illustrates this point, with the average commitment size to a separate account reaching $274 million in 2014 (up from $117 million in 2013). In contrast, the average commitment to a closed-end fund was just $64 million, directly on par with 2013.

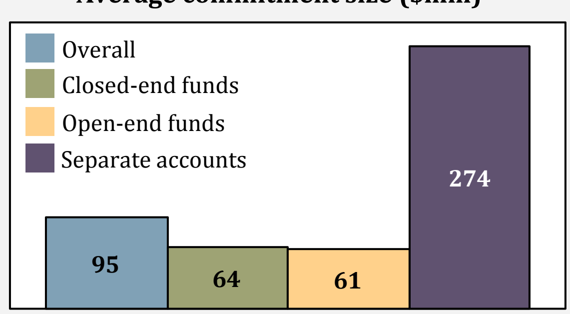
Commitments by investment strategy



Commitments by vehicle type



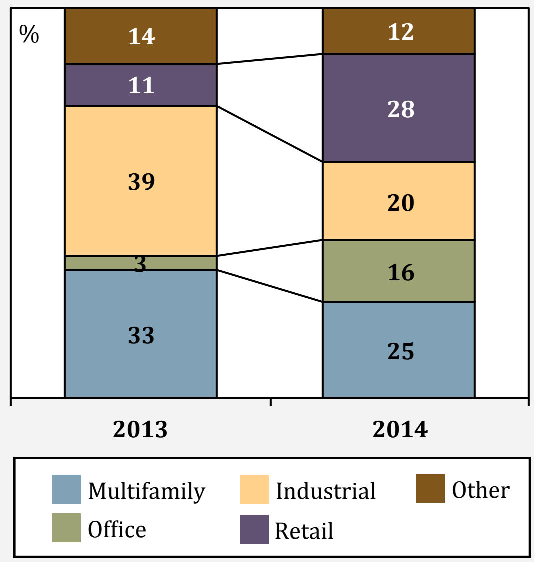
Average commitment size ($mm)



Property Type

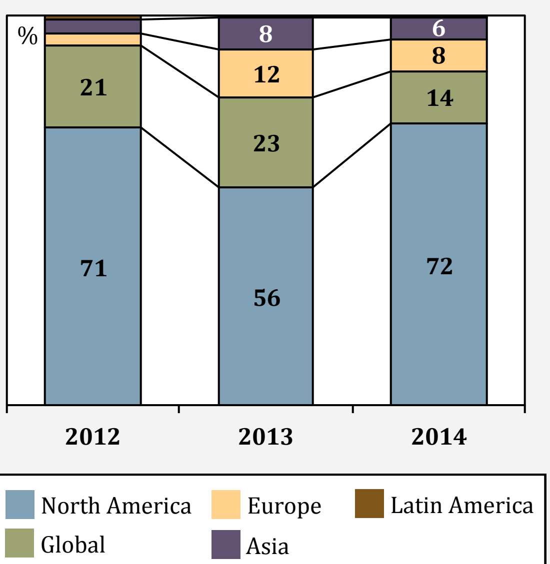
Vehicles focused on a single property type attracted 41 percent of commitments in 2014, compared to 25 percent in 2013. Among these vehicles, commitments were much more spread out amongst the major product categories than in 2013, where multifamily and industrial were by far the most prominent. Instead, no property type represented more than 30 percent of commitments in 2014. Retail led the way with 28 percent, followed by multifamily (25%) and industrial (20%). Notable managers raising money for focused property -type mandates in 2014 include Prologis (industrial), Carmel (multifamily), Meyer Bergman (retail), and Prudential (senior housing), among others. Looking forward, the industrial sector is expected to continue to offer the most attractive prospects for both investment and development in 2015, according to the 2015 ULI Emerging Trends in Real Estate report, followed by apartments, then hotels. Note that "Other" includes property types beyond the four major food groups, including hotels, senior housing, data centers, etc.

Breakdown of commitments by property type (among property-specific vehicles)



Geography

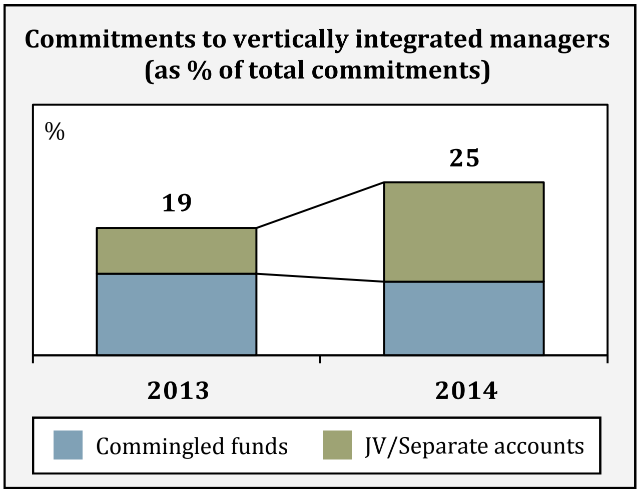
Breakdown of commitments by geography



The majority of commitments from U.S. pensions continue to flow to North America focused vehicles (72%). However, there remains a strong interest in international opportunities with Europe and Asia focused vehicles representing eight and six percent of commitment volume respectively. This is a continuation of a trend that began in 2013 and marks a stark disparity with 2012 where only seven percent of capital flowed to vehicles focused on Europe or Asia. Notable vehicles include Blackstone's Europe and Asia-focused funds which closed with over $14 billion combined, Kildare European Partners ($2 billion), Ares European Real Estate Fund IV ($1.4 billion), Tristan Capital Partners' EPISO III ($1.3 billion), Meyer Bergman European Retail Partners II ($1 billion), and SC Capital's RECAP IV (in market), among others.

[1] PwC and the Urban Land Institute. Emerging Trends in Real Estate® 2015. Washington, D.C.: PwC and the Urban Land Institute, 2014.

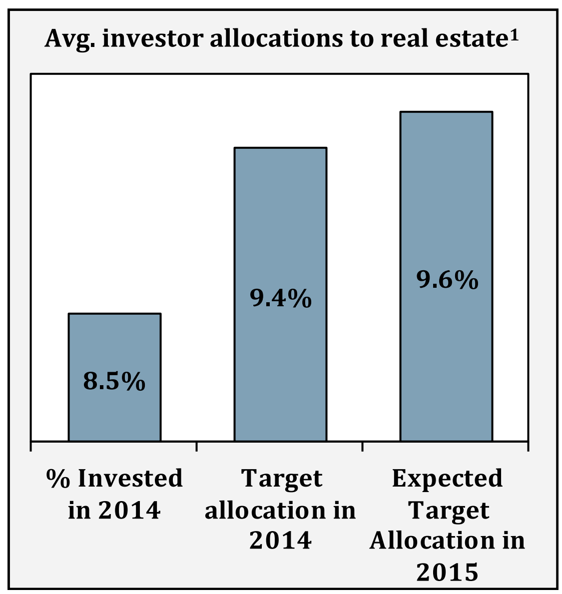
Vertical Integration



Vertically integrated managers received 25 percent of commitments in 2014, up from 19 percent in 2013. The increase was particularly apparent among separate accounts; in 2013, 29 percent of all commitments to separate account vehicles went to vertically integrated managers. In 2014, the same was true for 37 percent of separate account commitments. The increase in commitments to vertically integrated managers is perhaps unsurprising given the increase in commitments to single property focused vehicles, as many vertically integrated managers tend to focus on a particular asset type.

Looking Forward

The outlook for continued growth and prosperity in the real estate sector is positive for 2015. The economy and real estate fundamentals continue to strengthen and investor demand for real estate remains robust both domestically and from foreign capital looking to find a home. From an allocation perspective, many institutional investors are still underallocated to real estate relative to targets, and many are expecting to further increase their target allocation in 2015 (see chart at right). In recent conversations with several of the industry's largest, most prominent REIMs, many indicated that they are expecting relatively flat capital raising figures for 2015 as compared to 2014. Most suggest that they expect the relative strength of capital availability to remain consistent with 2014, but not necessarily increase materially. Of course, any unexpected changes to the market or major global events could upturn the market and upset the cautious optimism most managers are expressing today.



For more information on FPL Consulting, please contact Tim Kessler, Principal, at tkessler@fplassociates.com.

[1] Funk, D., & Weill, D. (2014). *2014 Institutional Real Estate Allocations Monitor.* Ithaca, NY: Cornell University's Baker Program in Real Estate and Hodes Weill & Associates, LP, September 2014.

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