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Private Equity Funds Battle for Capital

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By **Beth Mattson-Teig**

There have been plenty of headlines lately about institutional capital pouring back into private equity funds. Yet a proliferation of funds is creating stiff competition for the available money and making it difficult for some to meet fundraising goals.

The total number of funds actively raising capital has ranged from 430 to 470 over the past four years. During the first quarter of this year, there were 439 private real estate funds in the market seeking an aggregate $162 billion in investor capital, according to Preqin, London-based firm providing private equity data and research.

“That is a very high amount,” says Andrew Moylan, head of real assets products at Preqin. As a comparison, there were 238 funds in the market in 2008, with a target fundraising goal of $116 billion.

“The field is incredibly crowded,” adds Stuart Boesky, CEO of New York City-based Pembrook Capital Management LLC, an investment adviser that manages commercial real estate private equity funds that focus on debt strategies. “It is very hard to get attention from investors unless you can truly demonstrate that you have a product that is timely, a track record that supports the investment strategy you are putting forth and, finally, that you somehow have the ability to distinguish yourselves from the ten, 50 or 100 people that are doing a similar strategy.”

Pembrook reportedly raised $154 million in its PCI Investors Fund II, which closed last year. The company also launched its third fund in late 2013.

Rich man, poor man

The proliferation of funds is due to the recovery in the global economy and improving real estate fundamentals. Investors that moved to the sidelines in 2008 and 2009 are returning and are looking to put more capital to work in real estate funds. “That being said, I don’t think there is enough investor demand to satisfy the number of funds on the road,” says Moylan.

As a result, it’s taking longer for some funds to raise capital and some are struggling to meet goals. Prior to 2008, the typical time spent on fundraising to fully commit a fund was 12 months or less. Today, fund managers are spending an average of almost 18 months marketing their funds, according to Preqin. In addition, 62 percent of managers currently raising a fund have been on the road for over a year and 26 percent for over two years.

Although investor demand for private equity real estate is improving, it is still not as strong as it was in 2005, 2006 and 2007. “It’s a different market in terms of competition. For every fund out

there, there are more (funds) competing with them," says Moylan. Investors are being very selective. They prefer managers with a long track record that can prove that they have done well in the good times and the bad times. "The proportion of investors that will invest with emerging managers has steadily declined over the last few years," Moylan says.

As such, the private equity sector is seeing a bigger divide between the haves and the have-nots. The big names such as Blackstone and Lone Star are finding success raising large amounts of capital, while smaller players and emerging fund managers have to battle to attract investors in that very competitive environment.

In addition, investors are gravitating to funds that are "specialists" in a particular category or niche rather than just going with a mid-sized manager following a diversified strategy. If an investor is going to put money in a smaller fund, they want someone who is a specialist in a particular geographic market or property sector.

"So, I think there is a bit more of a split market than we used to see," Moylan notes.

Given the large field of funds in the market, it is inevitable that the weaker players will get weeded out. In fact, some people hold the view that only 15 to 20 percent of today's fund sponsors will actually succeed at raising the amount of capital they expect, notes Boesky.

However, the idea that the top 10 private equity real estate funds should control the vast majority of investment capital will likely reverse itself in the future. Investors will invest with fund managers that have experience, a deep track record and can deliver competitive yields. Ultimately, investment decisions will be a function of performance, and the smaller sponsors may have the ability to outperform these very, very large funds, adds Boesky.