

REAL ESTATE CAPITAL

12 2011

Monthly intelligence
for the real estate
finance markets

Companies in this issue

Aareal Bank	4
Aviva	10-13
AXA REIM	16-17
Blackstone	10-13
CBRE	7, 10-13, 16-20
Colony Capital	22
DebtX	21
Deutsche Bank	2, 16-17
Deutsche Pfandbriefbank	4
DTZ Investment Man.	10-13
Duet Private Equity	18-20
Eurohyppo	8
Goodman	5
Hermes	10-13
Internos Real Investors	10-13
Invesco	6
Invista	10-13
LaSalle IM	18
Lone Star	5
Legal & General Property	8, 10-13
Longbow REC	18-20
M&G Investments	18-20
MSREF	4
Och-Ziff	18-20
Orchard St IM	10-13
Palatium Investment Man.	17, 28
Partners Group	18-20
Peakside Capital	17
Pramerica	4, 10-13, 18
Prupim	10-13
Rhino Investment Man.	17
Rothschild	8
RREEF	10-13
Savills Capital Advisors	16-17
Schroders	7, 10-13
SWIP	10-13
Threadneedle	10-13
Valad	10-13

Regulator believes 'inadequate' bank models must be revised or replaced with its 'slotting' system, implying a further squeeze on property lending

FSA pressures UK banks to reweight property loan risk

The Financial Services Authority is forcing UK banks to reassess the riskiness of their commercial real estate loanbooks or use its 'slotting' rules.

The Bank of England and the FSA are uneasy about banks' internal models for calculating the credit risks of commercial property loans and believe they are not setting aside enough regulatory capital to cover the risks.

"The FSA felt people are applying the regime relatively aggressively and getting capital weightings lower than they should be," said one banker. "All banks are being told their internal models are inadequate and the only alternative is slotting."

Industry insiders say the move to make all banks slot their loans according to the FSA's criteria mean risk weighting will inevitably be more conservative and require them to put more capital aside. This could reduce the amount and raise the price of lending to commercial real estate, they say.

But the FSA has backed off introducing new, more prescriptive guidance that could have forced banks to reclassify a huge swathe of loans as 'weak' and assign a penal 250% risk weighting to them. This could have dramatically increased the amount of capital banks had to hold against their portfolios, weakening their balance sheets, restricting new lending and increasing margins.

Slotting, first spelled out by the FSA in 2007 under the Basel II banking regime, classifies loans as 'strong', 'good', 'satisfactory', 'weak' and 'default', according to different criteria, attaching different risk weightings to these categories.

In June, the FSA began consulting the industry on draft proposals for revised slotting guidelines,

aiming to introduce more clarity and consistency.

"The main problem with the new guidance was that there was a high likelihood that any deal seen as weak in an individual category would be regarded as weak overall," said Alan Hilton, policy director of the British Bankers' Association.

'Market conditions' is one of the criteria that has to be rated, so lenders faced the prospect of having large parts of their loan portfolios branded 'weak', automatically attracting a higher risk weighting. The industry felt that other aspects of deals will mitigate market weakness, so banks could have strong transactions in a weak market.

As a result of its consultation, the FSA is still discussing the slotting criteria with the industry. "It's stepped back from being very prescriptive," reported one banker. For now, it is telling firms whose internal models are not working to its liking that they must do better or start slotting their loans according to the current regime.

Regulators are keeping a close eye on the industry's risk weightings and real estate loan provisioning. The FSA recently reported to the Bank of England on UK banks' 'extend and pretend' strategy on non-market terms; a June survey it carried out found the UK's six major banks were applying this to almost £50bn of loans.

UK banks' corporate loan books are heavily focused on real estate lending and "deleveraging has progressed more slowly than elsewhere, partly reflecting the large-scale forbearance on corporate real estate loans", the BOE's latest Financial Stability Review noted.

See: *News*, p2; *De Montfort report*, p3; *Analysis*, p15

Analysis Top 50 UK property fund managers

The big winners and losers in this year's table reflect a market in flux *page 10*

Special report Debt is the 2012 target

A growing range of investors aims to fill the gap left by retreating banks *page 16*

Contents

Mailbox mezzanine 4

Pramerica undercuts rival lenders by offering deal at just 8-9 % return

CBRE GMM expands 7

New US clients back Global Multi Manager business following ING REIM takeover

No sale for Uni-Invest 8

Eurohypo puts disposal on hold following low bids due to lack of financing

Top 50 turmoil 10

This year's top 50 UK real estate fund managers table reflects rapid changes of fortune for many managers

Valad's white knight 13

Blackstone rescues Valad's European business with arms-length takeover that keeps management on board

High-risk threat averted 15

FSA backs down from 'slotting' reform that would have forced banks to classify most property loans as 'weak'

Joining the loan hunt 16

New funds, insurers and fresh mezzanine debt players will broaden the range of real estate debt investors in 2012

Colony's borders spread 22



Mezzanine debt is the next target for Dilip Awtani, who has led Colony Capital's push into European debt buying

Market commentary 24

The latest data on property derivatives and secondary trading in UK unlisted funds

£210m CMBS closing on Dudley shopping mall pushed back to next year

Deutsche gives Merry Hill investors a few more weeks

Between 20 and 30 potential investors in Deutsche Bank's £210m Merry Hill CMBS have until early January to submit indicative offers, following the release of an offering circular.

Only four or five investors are thought likely to buy bonds secured against Westfield's and Queensland Investment Corporation's Dudley shopping mall, however, because it is a relatively small deal.

The second new CMBS this year was initially due to close before Christmas but investors said they wanted more time to consider it, according to one source. The issue is now going through the ratings process,

with Standard & Poor's, Fitch Ratings and DBRS working on the deal's tranching.

The deal reflects the same sort of capital structure as the CMBS that Deutsche Bank issued against Chiswick Park in June.

There are expected to be two or three classes of bonds, but there is no class X, while it will be offered to US investors as well.

One CMBS buyer said it could be hard to attract US investors, given uncertainty in the eurozone. In terms of pricing, "anything under 300bps sounds ambitious", said another.

The CMBS structure is unusual because it is not a

traditional mortgage loan – it is a loan to QIC, which owns a 50% stake in Merry Hill.

"The securitised loan doesn't actually have a mortgage attached to it; the borrower holds the mortgage over the property and then it gives a share pledge to Deutsche Bank, which is the securitised lender," explained the source.

This is why the loan couldn't be sold in the syndicated loan market, like the Milton Park and Chelsea Harbour loans Deutsche Bank had planned to package into a multi-loan CMBS: a direct mortgage is necessary to be eligible for German banks' pfandbrief programmes.

FSA warns of too much 'forbearance'

The Financial Services Authority has found that the UK's six biggest lenders are overlooking breaches of covenants and extending maturities on £50bn of commercial real estate loans – about a third of their total lending to the sector.

The Bank of England's financial policy committee requested the review in June, worried that banks were not making enough provisions on property loans, which account for around half of UK banks' corporate loan books (see graph).

In this month's *Financial Stability Report*, the Bank of England noted that deleveraging in this sector has been slower than elsewhere, partly due to "large-scale forbearance", or "extend-and-pretend" on commercial property loans.

"But inadequate, or opaque, provisioning of loans subject to forbearance may mask underly-

ing credit risks and heighten uncertainty among bank creditors about profit and capital positions," it warned.

The report noted that the forbearance "has contributed to a bulge in refinancing requirements over the next three years.

"It is difficult to judge whether banks have made sufficient provisions against losses on

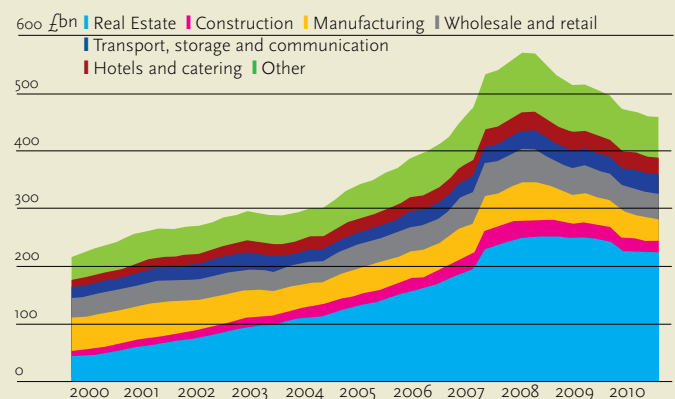
forborne commercial real estate lending," the report said.

Lenders' provisions for these exposures was five times higher than that on loans they had not needed to extend or overlook breaches.

The FSA estimated that this may understate the position by up to £5bn, but didn't think this was "systemically significant".

UK corporate bank lending by sector

Commercial real estate loans account for around half of total lending



SOURCE: BANK OF ENGLAND

De Montfort mid-year report shows just 29% of lenders are willing to finance secondary assets

Bank lending gets ever tighter in 2011

Bank liquidity for anything other than prime property continues to get scarcer.

Although the latest De Montfort report finds that 43% of lenders intend to increase loan originations, this is a decline from 57% at the end of 2010. Only 29% said they were prepared to lend on secondary assets and 41% made no new loans in the first half of 2011.

Since the *UK Commercial Property Lending Market* mid-year report was compiled in June, bank liquidity has got worse.

In the past six weeks, Eurohypo and Société Générale have announced their withdrawal from originating new loans as turmoil in the eurozone puts pressure on European banks to recapitalise.

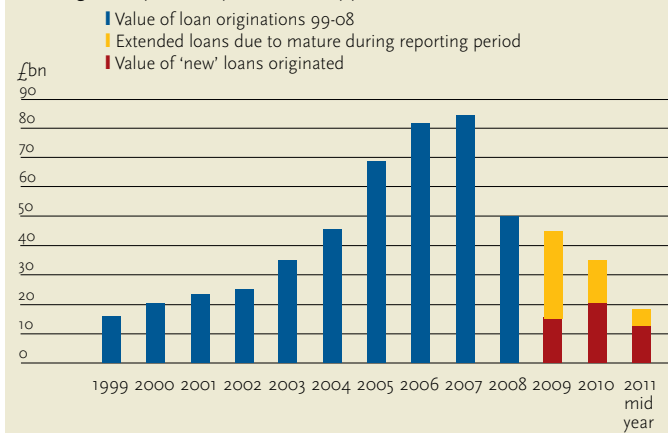
The European Banking Authority said banks needed to find €106bn, and some banks are lending less.

Borrowers say there are other banks that are not lending, but have not said so publicly.

De Montfort's report also confirms that business written in the first half of 2011 was

Gross value of annual lending

Lending in the past two years has dropped off in the second half



SOURCE: DE MONTFORT UNIVERSITY

concentrated in a small number of banks, with 63% of loans made by just six lenders.

Total new lending, including refinancings "on commercial terms", was £12.3bn – more than 50% of the total £20.2bn of new origination in 2010.

However, in both years lending appears to have dropped off in the second half, so the half-time figure this year doesn't necessarily imply a full-year increase.

Some 39% of respondents also said they had extended loans,

with a value of £3.2bn.

De Montfort estimates an additional £2bn of extensions were completed but not reported, taking the total gross lending to £17.5bn.

The report notes that more loans were reported as having been extended in the same period last year: last time, 48% of organisations reported £8.7bn of extensions, which might mean the practice of "extend and pretend" is slowing down.

However, the authors still

estimate that £48.4bn of maturing debt has been extended on "non-market terms" since 2009, consistent with the Financial Services Authority's work on forbearance (see p2).

The combined value of loans either in breach of covenants or in default was similar to at the end of 2010, at £41.3bn, although as in previous reports, some respondents (14%) did not submit data; if the average is multiplied up it is £46bn.

Authors Bill Maxted and Trudi Porter said this suggested loans were continuing to become delinquent and was further evidence that lenders were refinancing fewer loans "that do not form part of their longer-term business strategy".

They also warned that lenders reported "an increasing frequency of weakening cash flow due to tenants not renewing tenancies, renewing tenancies at lower rents and tenant default, all combining to cause further reductions in capital values and resulting in loans breaching financial covenants, or being declared in default".

Pressure from lenders is driving UK property sales

Brokers and investors estimate that up to 50% of the UK property that has been coming onto the market is a result of pressure from banks.

For the first time, De Montfort's research recorded the reasons for £16.7bn-worth of reductions in existing loan books over the six months and found that just over £4bn, or a quarter, was due to lenders insisting on sales.

The pressure to sell appears to have picked up in the second half (see Analysis, November pp10-12) and while this property

won't all sell by the end of this year, or in some cases at all, it implies at least £8bn of bank sales over the whole year.

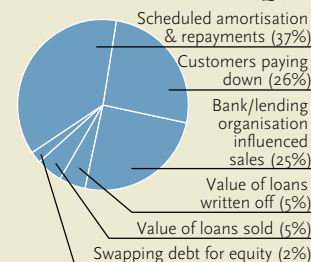
In another first, the research looked at how the £201bn of outstanding debt breaks down by loan-to-value ratio. Only 21% of loans had a current LTV of 60% or less, while 24% had LTVs over 100% and another 18.5% between 81% and 100%.

"Thus at least £85bn (42%) of outstanding debt is not refinancable by loan terms available in the market at mid-year 2011," the research says.

Adding in another £29bn that the authors estimate was written at LTVs over 65% takes this to £114bn.

Reasons for book size cut

Reduction from sales totalled £4bn



SOURCE: DE MONTFORT UNIVERSITY

Key numbers

- Outstanding property loans fell 3.4%, from £208bn to £201.3bn

- £12.3bn of new origination, including refinancings

- Six lenders made 63% of new loans; 24 lenders (41%) made no new loans

- £3.2bn of loans were extended

- 15% (17%) would lend on speculative development – but several of these only for residential schemes

Birmingham asset financed at just 8–9% return, with other lenders unwilling to go below 10%

Pramerica puts mezzanine in Mailbox

Pramerica Real Estate Investors has written a mezzanine loan secured against the Mailbox in Birmingham at a return of just 8-9%.

Sources said the deal – the fifth or sixth for the group's £492m European debt fund – was made at this level “because Pramerica wants to build its portfolio and is prepared to go below 10% for good, core assets”, according to one.

It is understood that other mezzanine lenders couldn't compete with the low pricing.

Pramerica declined to comment.

In March, Brockton Capital – the equity investor – teamed up with retail specialist Milligan, as a minor investor and asset manager, to buy the Mailbox for £127m from administrators after Lloyds foreclosed on the previous borrower. Aareal Bank provided the senior debt for the 641,000 sq ft office and retail scheme in April.

Pramerica is pursuing deals where the underlying assets are income producing. Its spend-

ing power comes from global institutions, including £150m of equity committed by APG and Prudential-managed accounts.

It is thought to be closing another mezzanine deal in Victoria – a transaction it beat LaSalle Investment Management to win.

One rival lender said that Pramerica was not putting covenants in deals. It is not known whether it put prepayment protection in place for the £38m of mezzanine debt it provided last year for Evans Randall's

purchase of Drapers Gardens in the City, for example.

That asset has since been sold to South Korean pension fund Samsung Life, resulting in Pramerica's investors being repaid.

Mezzanine funds are said to be vying to provide mezzanine for Blackstone's recent £266m purchase of a London & Stamford distribution portfolio in the Midlands, while LaSalle is closing three deals worth more than £100m in the UK.

See *debt investing feature*, pp16-21

€210m financing in the bag for Silesia mall

Deutsche Pfandbriefbank and Helaba have clubbed together to provide a €210m refinancing and development facility to Immofinanz for the Silesia City Center shopping mall in Poland. Both banks acted as joint mandated lead arrangers, and Helaba as agent.

The asset, which reopened in October after being extended by 20,000m² from 66,000m², was acquired by Immofinanz in 2005 and refinanced by Helaba in 2008.

Deutsche Pfandbriefbank also provided a €38.5m loan to the Pradera Central & Eastern Fund this month – its second financing for the vehicle. The facility will be used to refinance existing debt on the 37,000m² Pasaz Lodzki shopping centre in Poland.

The bank is set to be repaid €18m of senior debt it lent to central and eastern European investor Carpathian, after it sold the 22,400m² Babilonas shopping centre in Lithuania to Finnish private equity group Pontos for just over €24m.

Aareal flies in €367m Concorde deal

Aareal Bank has completed the €367.5m refinancing of a portfolio of four hotels in France.

The debt was lent to Groupe du Louvre – a Starwood Capital Group-owned company that Starwood is looking to sell. Aareal's special property finance team led the “Concorde” deal, headed by managing director Christof Winkelmann.

The portfolio is made up of: Hôtel du Louvre and Hôtel Concorde La Fayette in Paris; Hôtel Martinez in Cannes – well-known to MIPIM visitors – and Hôtel Palais de la Méditerranée in Nice.

The deal was underwritten by Aareal back in July, at the same time that a syndicate of five French banks including Natixis, Crédit Agricole CIB, Société Générale and BNP Paribas came together to lend €650m to refinance the group's budget hotels.

Aareal has been a consistent lender on big-ticket deals this year. Its London team backed Brockton Capital in Birmingham (see above), bought part of the £550m syndication secured on Westfield Stratford, and provided a £350m five-year loan to Hercules Unit Trust.

The bank closed two property deals in Paris this summer, teaming up with Helaba to provide Rockspring €219m of five-year debt for the O'Parinor shopping centre and providing €195m of senior debt for a joint venture between Beacon Capital Partners and Northwood Investors for Défense Plaza. It wrote a €400m loan for AXA to refinance a Euro-hypo loan on a portfolio of Metro-anchored assets in Poland. Last year Aareal refinanced London's Sanderson and St Martins Lane hotels for Morgans Hotel Group and Walton Street Capital.

MSREF global fund gets another year to spend its \$2.5bn

Investors in Morgan Stanley Real Estate Investing's latest global fund have voted to allow a 12-month extension of its investment period, to June 2013.

MSREF VII, whose investors include GIC of Singapore, Canada Pension Plan Investment Board and the China Investment Corporation, now has 18 months to deploy \$2.5bn of capital.

“It is still a huge amount of money to spend,” said one

source. MSREF VII closed in May 2010 with \$4.7bn of equity.

However, in return investors have called back \$700m of uncommitted capital and requested a reduction in fees – terms that are expected to be formally approved at the end of this month. One opportunistic investor said it seemed like a “meek set of investment terms”, although he couldn't be sure “how badly MSREI [had been] beaten up on the fees”.

MSREI is preferred bidder for a Santander portfolio of Spanish residential property that was once worth €3bn and UK development loans with a face value of £216m being sold by NAMA.

It is shortlisted to buy an NPL book being sold by Italian bank Intesa Sanpaolo and just bought 15 loans secured on about £430m worth of Australian property from Lloyds Banking Group.

Lone Star beats rivals to Project Royal debt portfolio

Lone Star has won the bidding for Lloyds Banking Group's Project Royal debt portfolio and expects to complete the acquisition before Christmas.

The US debt specialist will buy 30 mostly non-performing

Lloyds loans with a face value of just under £1bn at around a 40% discount, after the portfolio it originally bid on was adjusted and a couple of loans were pulled out or repaid.

Lone Star beat competition to

buy the UK loan book from short-listed finalists Cerberus Capital Management and Colony Capital, and will begin working through the secondary property-backed loans with the help of Hudson Advisors – its

loan servicing arm.

Its bid is financed by Royal Bank of Canada and Citigroup, which are each providing £150m of senior debt.

The cost to Lone Star is 600bps over Libor.

German bank tipped to quit asset management business altogether

Deutsche set to roll RREEF into asset manager sale

Deutsche Bank is expected to pursue a wholesale disposal of its €516bn asset management division, for which it could accept a discounted price.

The bank's other option is to sell off separate parts of the asset management business, including its global real estate arm, RREEF, which had €42bn of assets as of March 2011.

The bank is conducting a strategic review of its RREEF, DB Advisors, DWS Americas and Deutsche Insurance Asset Management subsidiaries because of regulatory changes and associated costs.

"Deutsche Bank has signalled that it is too small in asset management so it is going to get out of the business – the exact opposite of Credit Suisse and UBS," said one private equity real estate fund manager.

"It will either accept a knocked down price on the whole asset

management division or break it up into a handful of constituent parts and keep the residual."

The bank is said to have put a value of €1bn on its RREEF real estate arm. The business invests from core through to opportunity strategies in North America, Asia and Europe and is headed by Pierre Cherki.

Core investing is at the heart of the €16.6bn of European assets and Deutsche Bank's large German retail business, which manages the €5bn RREEF Deutschland open-ended fund, is believed to be included in the review.

So the right buyer for RREEF is likely to be someone with a retail distribution capability.

"Unless you want to kill the goose that lays the golden egg it doesn't make sense for anybody to buy RREEF that isn't interested in being part of the German open-ended fund

business, because it's too important a part of what they do," the source said.

The chances of Deutsche Bank breaking off the opportunistic business or of the team carrying out a management buyout "are somewhere between slim and none, because it is such a small part of an entity that is a small part of asset management", said the source.

RREEF's senior management face the challenge of keeping the team together, because the track record of core buyers successfully integrating opportunistic platforms is a poor one.

Potential third-party buyers for RREEF are expected to include the same large private equity groups, such as KKR and TPG, that ran the rule over ING Real Estate Investment Management, which was sold to CBRE earlier this year.

Investors shun unlisted vehicles

Most investors do not want to invest in unlisted funds, research by Nabarro has found.

Only 10.3% of 195 investors and managers polled in the law firm's *Fund Trends Survey* listed funds as one of the two most popular investment approaches.

Direct ownership, joint ventures and clubs were the most favoured, with investor sentiment stronger on this trend than fund managers.

The survey said that when they do invest in funds, "investors focus on co-investment, a clear exit route and debt management.

"Fee efficiency is also an important issue for a long-term investment strategy, but there is no 'one rule fits all' on investment models – all fees need to be justified and competitive."

Investors and fund managers both reported a greater appetite for core funds, particularly ungeared ones: just under 70% selected core or core ungeared as the styles they considered most popular for property investment in 2011/2012.

ING and BNP Paribas join Goodman fund lending club

ING Real Estate and BNP Paribas have joined Royal Bank of Scotland in a replacement €400m revolving facility for the Goodman European Logistics Fund.

GELF has also agreed a €400m loan secured on German and Polish properties in its

portfolio, with Aareal Bank and ING Real Estate.

The debt package replaces the trust's existing €700m facilities, which were due to mature by December 2012.

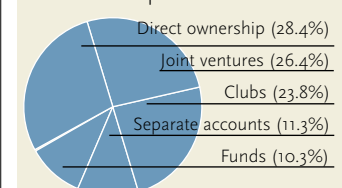
Goodman Group is also closing a €400m rights issue, which is majority underwritten

by the trust's largest investors (see November issue, p13).

• US insurer MetLife has provided £85m of senior debt to WelPUT, the central London office fund managed by Schroders. The debt is secured on part of the portfolio. Laxfield Capital was the arranger.

Favoured investment structures for investors

Respondents cited funds as their least favoured possible investment



SOURCE: NABARRO

People

Kiran Patel leaving AXA

AXA Real Estate is expected to announce a shake-up of its investment management distribution business early next year, which will include a replacement or replacements for real estate's global head of business development and research, Kiran Patel. Patel has decided to leave at the end of this month, after 11 years at AXA, "to seek alternative challenges and opportunities".

BlackRock replaces Shea

Richard Shea, the US-based debt specialist at BlackRock who launched Anthracite Capital, Europe's first commercial real estate collateralised debt obligation in 2006, left the company this month, along with Chris Milner. The CDO went into bankruptcy last year. BlackRock has appointed a new head of real estate debt, Bob Karnes, who joined last month.

Orchard plants six from Invista

Following its takeover of two former Invista REIM mandates for St James's Place, Orchard Street Investment Management has taken on six staff from Invista: Richard Walters and Michael Cecil have joined the asset management team and Lawson Shepherd takes a new role as head of distribution, reporting to John Humberstone. The three-strong St James's Place accounting team have also joined.

Invesco's Emson moves to NY

Invesco Real Estate is moving Tom Emson, head of transactions in France, to New York to advise global clients interested in expanding into Europe. His old role passes to Stephanie Bensimon, who joins from CarVal Investors. Sebastien Dagueneau also joins in Paris, from CNP Assurances, as local product and fund manager.

Ogden takes reins at Property Derivatives Interest Group

Paul Ogden has become chairman of the Property Derivatives Interest Group.

Ogden replaces Will Robson, head of derivatives at Prupim, who is leaving Prupim in February to work for the Abu Dhabi Investment Authority. Ogden

is co-founder of inProp Capital, which manages the eponymous IPD-tracking property derivatives fund.

Paul McNamara, Prupim's head of strategy and research, said Prupim remained committed to understanding develop-

ments in derivatives and helping internal funds to take advantage of them. "The market-facing aspect of Will's role will be covered by Adrian Little and Isabelle Brennan's indirect investing team and the analytical side by Emma Harding," he said.

Total is half 2010 figure but could rise by year-end, says Redman

Invesco raises \$500m for real estate funds in 2011

Invesco Real Estate raised over \$500m of capital in Europe this year and added 21 new institutional clients in the region.

The figure is lower than in 2010, when investors made \$1.1bn of commitments, but Simon Redman, head of product management, said that the figure might increase to \$650m by the end of December.

In a fundraising environment that is still very difficult, he said, the year "has been a good continuation of our 2010 achievements, when there was dramatic growth".

Last year Invesco acquired AIG's Asia property investment arm. "Our business is bigger than it has ever been," Redman continued, "with 42 new institutional clients globally, half of them here in Europe".



Redman:
"2011 has been a good continuation of 2010, which saw dramatic growth"

Andrew Hills, who joined IRE from Corestate in August as a client portfolio management director, said three new investors had come into Invesco's second hotel fund since it held its first close, with €85m from four investors in March. "In addition, two of the early investors have re-upped and we are in due diligence with others."

All the fund's investors are European and, with gearing, the fresh equity of €50m-€60m gives €100m to invest.

Invesco has 13 pan-European client mandates, including its flagship open-ended, pan-European fund, which is marketed globally. About 10 new investors are thought to have come into the fund this year. Some \$1.2bn of deals this year included €255m spent for the pan-European fund, on 1 Finsbury Circus, EC2, and assets in Hamburg and Jonkoping in Sweden.

Redman is looking at several new areas, one of which is investing in performing or non-performing debt for the first time outside the US. "Most people think there will be more opportunities coming out of the European banks."

IRE is also thought to be planning a core fund for Italian investors in partnership with asset manager Prisma.

Cash drains out of UK pooled funds

Capital flows into UK pooled funds have turned negative.

Some £481m flowed out while £471m of money came into funds in Q3 2011, which are the latest available figures published by the Association of Real Estate Funds.

The outflow was the highest for 10 quarters, since Q1 2009, just after Lehman Brothers collapsed. The quarterly average

for the previous 12 months was £248m net positive and £615m for gross inflows.

Capital inflows peaked in Q4 2009 and remained high until mid-2010.

For the first time in seven quarters, balanced funds outperformed specialist funds. On average specialist funds have higher leverage, at 47.8% (32.3% for balanced funds).

AREF said: "Leverage now acts as a drag on the performance of specialist funds rather than a boost to returns...The bottom quartile of specialist funds had an above-average weighting towards the underperforming segments of regional UK offices and industrials, which was the main reason for their poor performance."

\$12.3bn merged business has first US clients already signed up, with Asia next on the list

CBRE MM aims for global expansion

CBRE Global Investors' \$12.3bn multi-manager business will target global investing business for future expansion.

Head of GMM Jeremy Plummer said that before last month's merger with ING REIM, the CBRE GMM arm had signed up its first US clients – a corporate pension fund and an insurance company. One has invested in CBRE GMM's latest fund (see panel).

"We are having discussions in Asia. To date we have no Asia-origin clients, though we think that will change significantly," he said.

The merged business has 46 professional staff advising 70 separate MM accounts and seven funds of funds. Around 45% of assets under management is invested on behalf of UK clients.

Plummer said the division, part of CBRE's global \$94.8bn of AUM, would continue to invest in Europe for European clients, but added: "I think the big issue for investors in the last three years has been the global dimension. It became



Appointments: (l-r) Global chief investment officer Ian Gleeson, head of clients and investor communication Hannah Marshall, and Osiris fund manager Dugal Hunt.

our basic requirement and differentiates us from the pack."

Following the merger, Ian Gleeson has been confirmed as global chief investment officer for the enlarged GMM, and

Stuart Savidge the chief operating officer.

Hannah Marshall, who ran CBRE's European funds of funds, is moving to a new role running clients and investor

communication.

Sander van Riel is head of continental MM, Adrian Baker of Asia and Scott Brown the Americas, while Plummer intends to recruit a new regional head of the UK.

Following the departure of four of ING REIM's UK multi-manager team just before the merger – three to Kames (previously Aegon) Asset Management – Dugal Hunt has become fund manager of Osiris, one of the biggest fund of funds in the UK, previously managed by ING.

Asia Alpha Plus II launched with \$250m from five investors

CBRE Global Multi Manager has raised \$250m for a second Asia fund, Asia Alpha Plus II, from five investors, including two that invested in AAP I and one of the division's new US investors.

The fund, managed by Adrian Baker, has made six investments and invested 60% of the equity: four secondary

investments in existing funds targeting Japan and south-east Asia, and two "pre-specified" deals, where CBRE has matched investor capital with a direct investment acquisition with a local operating partner.

Asia funds of funds face the problem of having few new funds to choose from, but CBRE GMM chief executive

Jeremy Plummer said AAP II's strategy also offered investors "a higher-value activity that requires more direct real estate skills" combined with lower leverage and lower fees.

Earlier this year, the manager drew together 10 clients to invest €550m in buying nine Polish shopping centres from GE Real Estate.

Schroders looks at PAIF for flagship...

Schroder Property is to invite investors in its flagship UK exempt property unit trust to convert to a property authorised investment fund (PAIF).

Head of property William Hill said the move to "modernise" the £1.2bn, onshore SEPUT was "aimed at opening it up to a variety of other investors", including overseas institutional investors, smaller UK insurance companies and some defined contribution pension schemes.

The intention is not to switch to daily pricing, which would rule out the fund for many DC schemes which require it.

Hill said the change would

exempt the vehicle's investors from corporation tax; as an onshore PUT, SEPUT has to deduct tax from dividends, leaving investors to reclaim it. The tax transparency would allow investors to accumulate units.

Unitholders will vote on the proposed change early next year.

• Schroders has one more hurdle to clear before taking on the management of the Invista Foundation Property Trust. Noteholders of the £152m securitisation of debt in the UK-listed trust will vote on 22 December on whether to approve the change of manager. *See UK fund managers survey, pp 10-13.*

...and draws £100m to hybrid fund

A "hybrid" fund of funds launched by Schroder Property has raised £100m of committed capital this year.

Schroders' Real Income Fund was launched in Q1 2011 with equity and investments from existing multi manager clients.

William Hill, head of property, said the fund aimed to provide returns of 5% over inflation by investing for income through a "hybrid approach of a fund of funds strategy and some direct investment".

Its first three investments were in Unite's student accommodation fund, Schroders' own motor retail property unit trust

and MedicX Healthfund, via the medical property fund's £55m second equity raise, which closed in September.

The Real Income Fund also hopes to invest in key worker "intermediate" housing, where, Hill said, a local authority would contribute land and the fund would finance the housing development.

The houses would be rented for an agreed period, with the fund collecting the rent, then sold on the open market with the profit shared.

Schroder Real Income Fund will be opened to external investors next year.

Eurohypo shelves sale of going concern owing to time pressure and lack of available finance

Uni-Invest auction fails on low bids

Eurohypo has suspended the sale of Uni-Invest as a going concern after it received no acceptable bids, partly owing to a lack of finance for Dutch secondary assets.

A workout of the debt now looks unlikely to be completed by the notes' legal maturity in February 2012, although this deadline could be extended

while the business is sold. The time pressure may also have prompted low bids, with bidders hoping to pick up a bargain.

RREEF and Patron Capital with TPG are thought to have been the final two in the auction process, at bids of less than €400m.

Uni-Invest was put up for sale by Eurohypo, special servicer to the €751m of debt

secured against the secondary property portfolio owned by the Dutch fund, after it breached its debt covenants in February and subsequent refinancing talks with noteholders collapsed.

Eurohypo provided a €609m senior loan, which it securitised in the €1bn Opera Finance CMBS in 2005, as well as a €142m mezzanine loan.

Fitch Ratings expects about €3m of excess rental payments to be allocated to the class A notes, which are likely to receive significant recoveries eventually.

However, even before the auction was suspended, Moody's said it expected all other classes of notes to suffer substantial losses.

L&G cuts cost of debt by 2% with £71m Leisure Fund refinancing

Legal & General Property has secured a £71m refinancing for its Leisure Fund from Royal Bank of Scotland.

The new five-year facility reduces the cost of debt by 2%, and provides an option for LGP to draw down an additional £40m for future investments.

With an average unexpired lease term in excess of 15 years, 47% of the fund's income has fixed or inflation-linked increases. Earlier this year, LGP completed a £42m equity raise from existing investors and extended the fund's life by six years, from 2014 to 2020.

Fund manager Andrew Ferguson said the combination of the refinancing with RBS and the previous equity raised gave the unlisted fund a strong platform from which to grow. The fund's strong performance helped the deal stack up for the bank, with whom LGP has a longstanding relationship.

It has £250m of assets under management, comprising seven prime out-of-town leisure assets across the UK, and one major in-town scheme. Additionally, it is forward funding the 170,000 sq ft Westgate complex in Aldershot.

Rothschild delays Alburn sell-down

Rothschild has suspended action to sell down the 45 secondary UK properties in Noel Smyth's Alburn Real Estate portfolio until the junior lender asserts its right to appoint a special servicer.

Rothschild, the primary servicer to the £188.05m REC 6 CMBS secured on the properties, has requested that a special servicer be confirmed by 21 December, after an earlier deadline of 7 December passed.

Brookland Partners, which

was appointed financial adviser by Rothschild, has recommended a managed sell-down to minimise losses for bondholders in the defaulted loan, and that in the absence of a consensual solution, enforcement steps should be taken.

CBRE, the property adviser, said £140.43m would be generated if 80% of the properties were sold within six months, with the remainder to be sold in 2015. A fire sale would net £121.22m, while holding on to

the assets for the next five years would return £122.36m.

The junior debt is now owned by Pearsanta, which bought the loan from the Co-operative Bank in November.

Pearsanta is thought to be affiliated with Alburn, which tried unsuccessfully to buy back the CMBS bonds last December and which wants to asset manage the portfolio to improve its value and extend the loan out to the bond's final legal maturity of 2016.

£217m financing deal struck for Green Park purchase

Eurohypo, Deutsche Pfandbriefbank and Bayern LB have completed the £217m acquisition financing of Green Park in Reading for Oxford Properties.

Eurohypo and Deutsche Pfandbriefbank acted as joint arrangers, while Bayern LB joined as an original lender. Eurohypo is also the agent to the facility and each lender provided an equal share of the transaction.

Michael Acratopulo, managing director of origination within Eurohypo's London team, said: "We have been in detailed discussion with Oxford Properties for some months. We were committed to this transaction before our temporary lending suspension was



Green Park: bought by Oxford

announced and have provided Oxford our continued support through to completion."

The deal for the real estate

arm of Canadian pension fund Ontario Municipal Employees Retirement System marks one of the largest single asset acquisitions in the UK this year, according to Harin Thaker, head of real estate finance international at Deutsche Pfandbriefbank.

Thaker added that Oxford was one of the bank's core clients. It bought the 2.2m sq ft business park from Prupim.

Chris Carter-Keall has joined Oxford as head of UK asset management, working alongside head of European acquisitions Simon Marriott. Carter-Keall was a director in investment management at BNP Paribas Real Estate.



Jane Roberts Editor

Editor

Jane Roberts
0203 411 5875
j.roberts@realestatecapital.co.uk

Consultant editor

Alex Catalano
0203 411 5876
a.catalano@realestatecapital.co.uk

News editor/writer

Lauren Parr
07540 124545
l.parr@realestatecapital.co.uk

Production editors

Phil Petty
Robynn Weldon

Art editor

David Harkness

Subscriptions manager

Jonathan Bain
0203 411 5877
subscriptions@realestatecapital.co.uk

**Real Estate
PUBLISHING**

Real Estate Publishing Ltd
32 Balfour Road
London N5 2HE EG

Real Estate Capital subscription rate
£499

Printed by Williams Press
ISSN 1754-1832

Quiet end to 2011 may be the calm before a perfect real estate storm

There is no question that 2011 was a year of two halves. It started with many hoping to shake off some of the uncertainty of 2010. Economies, including the UK's, had started to pull out of recession and the economic data pointed to a gradual recovery.

There were hopes that the sovereign debt crisis would be confined to the smaller eurozone countries: Greece, Ireland and Portugal. In property, capital values were still rising, leverage had a positive effect on returns and Eurohypo was lending. Could it be that things were getting better?

Fat chance. In August, the twin blows of poor GDP growth in Europe and fears of a deeper euro crisis set off a slump in confidence that shows no sign of ending.

After the euro contagion spread to Spain, Italy and even France, governments were toppled and banks feared they could be back in the post Lehman days when they couldn't get funding. *The Economist* ran a cover that summed up the only issue that seemed to matter and from which we'd all probably love to escape.

There now seems to be a feeling that property could be approaching some sort of perfect storm. While prime values will probably be OK, values for the really secondary stuff could be about to fall off a cliff. As one chief executive said: "This is the first time I can remember when, if I sell assets below valuation, no one cares."

A similar view has rippled through the banks, which are now unloading unwanted real estate loans in greater amounts, pleasing the opportunistic funds that have



spent the past three years feeling like banks 'owed' them.

The latest De Montfort report (see p3) is akin to the 60 participants collectively throwing their

hands up. It makes the best fist yet of getting to the bottom of the problem property loans still on banks' books.

The report says that half of all UK real estate loans, worth around £100bn, "could not be refinanced on current market terms". Of course, banks could off-load this debt – if they were prepared to take the real market price, as Paul Rivlin points out in Viewpoint (p28).

Distressed loan buying is picking up in Germany, the UK, Spain, Italy and France. The amount is underestimated because few deals are made public, but US investors are out in force, from broker/auctioneers such as DebtX to Blackstone, Lone Star and the other big guns (pp16-23).

In this environment, risk-averse investors have become even more cautious. They want income and they don't want leverage, any leverage. Few are in any hurry to do deals. In that respect at least, 2011 is set to go out quietly.

We would like to thank all of our subscribers for your support this year and wish you a relaxing Christmas break.

Top 50 UK fund managers

Analysis

Also in this section

Blackstone buys Valad 13

European manager gains access to capital without losing independence

Slot of bother 15

Banks resist FSA plan to reweight real estate loan risk via 'slotting' reform

Aviva still tops the table, but fortunes of many fund managers have changed, writes *Jane Roberts*

Shake-up in the ranks, but old guard is unchanged at the top

If institutional fund management was once considered dull, the past few years have proved it anything but – especially if spotting emerging winners (and losers) is your game.

Overall, the value of assets under management has hardly changed for the top 50 UK fund managers in Property Fund Research's latest survey, inching up by 2.8% to £156bn in the 12 months to June 2011. This is pretty much in line with the flattening off in capital value rises in the wider market, which had risen just 2%, according to IPD.

But what the headline assets under management figure masks is how many of the managers ranked in the survey have experienced significant changes to their business, both during the period and since.

Scottish Widows Investment Partnership (SWIP) leapfrogged from 11th in PFR's table last year to fifth after bulking up its managed assets by £2.3bn to £8.15bn, at the expense of Invista REIM. SWIP took over the in-house funds of parent Lloyds Banking Group when the mandate was reviewed.

Invista's loss is other managers' gain

Invista still operates but is close to being wound up. Its demise has also benefited three other managers: Orchard Street Investment Management, which won the former Invista mandate to manage £800m of UK property assets in two funds for St James's Place; Schroders, which has signed an investment management agreement to manage Invista Foundation Property Trust; and Internos Real Investors, which has taken over the Invista European Real Estate Trust.

The new business means Orchard Street is now a top 20 fund manager in the UK,

within seven years of launch; Internos does not appear in this survey, as almost all of the assets it manages are in continental Europe.

One position above Orchard Street is DTZ Investment Management, which boosted its managed assets from £2.3bn to £3.2bn, mainly on the back of winning the mandate to manage the £750m Strathclyde Pension Fund portfolio in July 2010 from Aberdeen Property Investors. The value of Aberdeen's UK managed assets fell from around £6bn to just under £5bn.



“We stuck to our beliefs and focused on core and core-plus, which wasn't the most fashionable place to be. But given people's aversion to risk now, it's where investors want to be”

Martin Moore, Prupim

But little in this market is plain sailing. More recently, Chris Cooper's well-regarded team at DTZ IM have had to deal with the uncertainty surrounding their parent. How stable will their platform be now that DTZ has been sold to Australian services company UGL in a pre-pack administration that wiped out the shareholders?

UBS Asset Management's managed assets have fallen in value from £1.86bn last year to £1.5bn, after it lost clients to aggressively expanding UK newcomer Pramerica Real Estate Investors, the US firm appearing for the first time in PFR's table this year.

Hermes has had notable successes, including its UK property trust, which is one of the best performing UK balanced

funds and continues to attract new capital.

But it slid back three more places to 12th as the value of its managed assets fell from £5.7bn to £5bn; two years ago, before it lost the Post Office pension fund to rival LaSalle, it was fourth in PFR's rankings.

UK investing pays off for Threadneedle

Threadneedle is another top-performing fund manager that has attracted more capital by sticking to its knitting – value investing in the UK.

Its managed assets have increased in value faster than the average 2.8%, rising from £5.53bn to £6.07bn and since the table was compiled it has swallowed up the £470m property investment management business of 35th-placed LVAM, formerly Liverpool Victoria.

The year was also anything but dull for the management of the European platform at Valad Property Group. To stabilise the business, the team attempted a management buyout from their weakened Australian parent; that failed, but they ended up part of private equity giant Blackstone (see p13).

Now a far mightier outfit than Valad is in play: RREEF looks likely to be shaken out of Deutsche Bank after the investment bank

Top 50 fund managers by total value of UK assets under management

Aviva has been top for eight consecutive years and leads a top-four group of insurance company subsidiaries that account for a third of the market by value

Rank 2010	Rank 2011	Manager	Total UK AUM £m	Discretionary mandates (no)	Value of discret. mandates £m	No of advisory mandates	Value of advisory mandates £m	Value in vehicles £m
1	1	Aviva Investors	19,695	48	10,093	–	–	9,601
2	2	PRUPIM	13,260	10	8,916	7	861.7	3,482
3	3	Legal & General Property	10,300	3	2,999	–	–	7,257
4	4	Standard Life	8,265	3	1,851.7	1	285.8	6,128.1
11	5	SWIP	8,147	8	4,524.6	–	–	3,622.1
5	6	LaSalle Investment Management	7,200	22	6,600	–	–	655
12	7	Henderson Global Investors	6,793	10	1,652	–	–	4,849
6	8	Schroder Property Investment Man	6,247	29	1,791	–	–	5,615
8	9	ING Real Estate Investment Man.	6,080	3	2,253	5	1,505	2,364
10	10	Threadneedle	6,073	4	2,841	–	–	3,232
14	11	F&C REIT Property Asset Man.	5,160	5	1,099	22	2,904	1,157
9	12	Hermes REIM	5,062	1	2,706.7	–	–	2,355.7
7	13	Aberdeen Property Investors	4,955	7	2,082.7	8	2,165.2	676
13	14	CBRE Investors*	4,777	28	3,921	1	305	398
16	15	AXA REIM	4,515	6	3,145	–	–	1,370
23	16	Ignis Asset Management	3,250	2	550	–	700	2,000
20	17	DTZ Investment Management	2,512	11	2,411	2	795	–
27	18	Orchard Street Investment Man.**	2,500	2	2,380	–	–	132
22	19	RREEF	2,391	–	–	2	157	2,232.1
18	20	Royal London Asset Man.	2,371	3	2,163.3	–	–	208.1
21	21	BlackRock	2,300	–	–	–	–	2,300
17	22	Rockspring	2,275	3	497	1	295	1,483
26	23	Grosvenor Fund Management	2,071	1	50	–	–	2,021
–	24	JP Morgan Asset Management	1,906	–	–	–	–	1,906
25	25	UBS Global Asset Management	1,511	5	117	–	–	1,394.3
30	26	Highcross Strategic Advisers	1,300	–	–	–	–	1,300
29	27	BNP Paribas REIM	1,286	1	853	3	393.8	39.5
33	28	Cordea Savills	1,263	1	318	4	59	886
34	29	Cushman & Wakefield Investors	977	5	841	1	136	–
35	30	Lothbury	883	–	–	2	19	864
32	31	Valad Property Group	827	–	–	–	–	827
–	32	Pramerica Real Estate Investors	712	–	–	–	–	331.2
45	33	Invesco Real Estate	700	1	55	1	100	712
37	34	Knight Frank Investors	683	–	–	4	683	–
36	35	LVAM	650	4	350	1	100	100
38	36	Colliers Capital	530	2	270	1	200	58
40	37	Cluttons	500	1	24	4	476	–
50	38	MGPA	400	–	–	–	–	247.4
41	39	Cornerstone Real Estate Advisers	399	1	70	2	274	31.6
44	40	Grainger Group	384	–	–	–	–	384.3
46	41	Doughty Hanson & Co	362	–	–	–	–	362
47	42	Franklin Templeton	305	7	1,84.7	1	11.8	109
48	43	Mountgrange Investment Man	300	–	–	–	–	300
49	44	Palmer Capital Partners	271	–	–	–	–	271
–	45	Pradera	240	1	160	–	–	80
–	46	Russell Investments	227	–	–	–	–	227
51	47	Rugby Asset Management	160	–	–	–	–	160
53	48	Evolve	135	–	–	–	–	134
56	49	Patron Capital	100	–	–	–	–	100
54	50	First Property Asset Management	85.00	1	80	1	5	–

SOURCE: PROPERTY FUNDS RESEARCH * Excludes assets held by multi-manager business ** September 2011 figures

Fund managers by value of UK assets under management in vehicles

SWIP has moved up the table after taking over the mandate to run the in-house funds of parent Lloyds Banking Group from Invista, while LGP takes third place after increasing its AUM by 10%

Manager	Value of UK vehicles plus UK assets in multi-country vehicles £m	Value of UK vehicles £m	Number of UK vehicles
Aviva Investors	9,601	9,558	25
SWIP	3,622.1	3,622.1	6
Legal & General Property	7,257	7,257	15
Standard Life	6,128.1	6,082.9	11
Schroder Property Investment Man.	5,615	5,615	14
Henderson Global Investors	4,849	4,849	14
PRUPIM	3,482	3,482	8
Threadneedle	3,232	3,232	7
ING REIM	2,364	2,364	8
Hermes REIM	2,355.78	2,355.78	4
BlackRock	2,300	2,300	1
Grosvenor Fund Management	2,021	2,021	6
Ignis Asset Management	2,000	2,000	2
Rockspring Property Investment Man.	1,483	1,356	4
Highcross Strategic Advisers	1,300	1,300	3
AXA REIM	1,370	1,285	4
F&C REIT Property Asset Man.	1,157	1,157	3
UBS Global Asset Management	1,394.3	1,072.6	2
Lothbury	864	864	3
Valad Property Group	827	827	6
Cordea Savills	886	687	7
RREEF	2,232.1	677.3	6
LaSalle Investment Management	655	655	5
Aberdeen Property Investors	676	451	5
CBRE Investors	398	398	2
Grainger Group	384.3	384.3	1
Mountgrange Investment Man.	300	300	1
Pramerica Real Estate Investors	331.2	287.8	2
Palmer Capital Partners	271	271	4
Royal London Asset Management	208.1	208.1	1
Rugby Asset Management	160	160	1
Orchard Street Investment Man.	132	132	1
Evolve	134	134	12
LVAM	100	100	1
Reech CBRE Alternative Real Estate *	70	70	1
Colliers Capital	58	58	3
Cornerstone Real Estate Advisers	31.6	31.6	1
JP Morgan Asset Management	1906	0	0
BNP Paribas REIM	39.5	0	0
Invesco Real Estate	712	0	0
MGPA	247.4	0	0
Doughty Hanson & Co Managers	362	0	0
Franklin Templeton Real Estate Advisors	109	0	0
Pradera	80	0	0
Russell Investments	227	0	0
Patron Capital	100	0	0

SOURCE: PROPERTY FUNDS RESEARCH NB. Some managers have UK assets in multi-country vehicles only

* Would be number 51 in main table with £70m of assets under management

announced a review of four subsidiaries. RREEF's £2.4bn of UK managed assets are a tiny part of the £42bn it manages globally.

As these shakeouts grind on, the top four property managers – all part of major UK insurance groups – look more stable than ever. Between them they have a third of the entire domestic investment management market – exactly the same as last year. Aviva is number one by some distance, and for the eighth successive year.

However, all eyes are now on Prupim, where a successor will soon step into the shoes of head of real estate, Martin Moore. Moore has been managing director of Prupim for 17 years and on his watch the group has successfully built up its retail funds, driven by the M&G distribution channels, complementing its management of the internal life funds.

But Prupim is seen as less strong on the institutional side, where Aviva has expanded rapidly. “We have less institutional money under management in the UK than Aviva and we think it is an area of significant opportunity for us,” Moore says.

On the other hand, having not expanded rapidly into specialist closed funds for institutional clients in the noughties, neither was Prupim caught out when the market crashed four years ago, with “exotic, geared funds” which for many managers and investors performed poorly. “We stuck to our beliefs and focused on core and core-plus, which wasn't the most fashionable place to be,” he says. “But given people's aversion to risk now, it is where investors want to be.”

He points to additional growth outside the UK, including the open-ended M&G European Property Fund, which has taken in about €200m this year in challenging conditions. “We have ambitions for that to become bigger. I am very happy with that and I am very happy with our platform in Asia, where we have a well-established team and we are running institutional money in the only open-ended fund in the region.”

Global giant emerges

Since the survey, the merger of ING REIM and CBRE Investors has created the world's largest real estate investment manager, and CBRE Global Investors, with around £12bn of assets under management in the UK, will probably rank third here next year.

While the UK remains a key market for the clients of the next tier of UK-based institutional managers, companies such as Aberdeen, LaSalle and Henderson have all seen opportunities to expand internation-

ally and all have more assets under management overseas than Standard Life or Legal & General Property.

LGP is the largest UK institutional manager with no overseas business, but it has been one of most successful at raising capital for the domestic market and has a number of overseas clients in its investor base. The value of its assets under management has increased by close to 10% since the last survey.

LGP achieved this growth against a backdrop of slowing capital flows into UK property, particularly in the second half of the period covered by the survey. By Q3 2011, net capital flows were broadly flat, at least as measured by the Investment Management Association and AREF statistics.

Pete Gladwell, business development manager at LGP, says his colleagues saw net flows into its balanced funds from defined contribution pension scheme clients (£36m) overtake defined benefit clients (£17m) for the first time in Q3.

Another trend he notes is momentum away from balanced UK exposure to funds offering liability-matching via long-dated income streams with inflation-linkage, attracting capital from index-linked gilt/bond allocations. When liability-matching mandates are included, gross inflows from defined benefit pension schemes amounted to more than £50m during Q3.

"Whether this figure represents an inflexion point or is simply indicative of a growing trend, we see no let up in the growing demand from defined contribution clients, supported by research evidence and recommendations from leading investment consultancies," Gladwell says.

"The trend requires new fund models, designed to provide the liquidity and diversification that defined contribution clients require."

Of course, increasing assets under management doesn't automatically add to the bottom line. Pressure on fees is set to continue – Schroders' successful bid to take over Invista's listed UK trust is based on a fee of 1.1% of net asset value, which will result in annual cost savings for the company of about £1.8m.

"I've never in my career been through such a challenging period as the last four years," says Moore. "And we are in for a challenging time for a few years yet."

The eighth UK Property Fund Management Survey was compiled by Property Funds Research. For more information, contact Jane Fear at: jf@propertyfundsresearch.com

Valad future secured by Blackstone takeover

Stability and independence assured with arm's-length deal that sees Real Estate Partners VI fund back European management

"We have met with a lot of investors and it's fair to say they are pleased with the stabilisation of Valad Europe," says Marty McCarthy.

The chief executive of the pan-European, value-added fund management firm says that its future has been secured by setting up Valad Europe as an arm's-length business with a degree of independence, following Blackstone Group's A\$806m takeover of parent company Valad.

Furthermore, the management is locked into the ownership. The European business is now majority owned by Blackstone's Real Estate Partners VI fund plus the local team. McCarthy, Christian Bearman, David Kirkby, Fraser Kennedy and Michael Bruhn are the same line-up that tried and failed to agree a management buyout last March.

McCarthy declines to say what value the BREP partnership deal puts on the business, which manages €4.2bn of mainly secondary industrial and office assets. "We made a bid under the MBO of £52m and it is not dissimilar," he says.

Retaining independence

"Blackstone is a fantastic financial partner, but we can't just pull money from them at any time and I didn't want it that way," he continues. "We wanted to be in a position where we could transact with any of our partners or limited partnerships in the future. To be independent was of paramount importance. We don't want them to think we're influenced by an outside party."

The other priority was having access to capital to co-invest. "We have our own capacity to invest," he says. "Plus, one of the important things is that key staff will be required to put money in."

For Blackstone, buying the whole company – including Europe – for A\$208m (and assuming \$598m of debt) was a tiny deal, but McCarthy outlines its attraction: "They did their due diligence on us. What they do is big shiny offices and hotels; what we do is different. They looked at the troubles with the banks and the kind of assets the banks have on their balance sheets, and they are not



McCarthy:
"Blackstone did their due diligence. What they do is big shiny offices and hotels; what we do is different"

set up to asset manage that – but Valad is."

What happens when Blackstone's fund nears the end of its eight-year life? "BREP VI is trusting us to deliver a return to them. The fund will look for an exit at some point and there are option agreements for sale down the track, but this deal doesn't even have to be sold for them to make OK money, because we are making good income."

In the immediate future, however, income won't be coming from new funds. "We won't be launching any co-mingled funds because blue-chip investors don't want them," McCarthy states bluntly.

Instead the business will pursue two broad strategies: bank workouts and recapitalisations, an area where the team has already had some success; and single mandates, club deals or joint ventures with its existing 60 or so LPs or with new mandates or partners.

The first deal after the business was sold was in September, when Valad Europe acquired 49% of the equity from two of the four investors in European Commercial Real Estate Limited. This refinances the distressed portfolio that Valad was brought in to work out by Lloyds last year, following Kenmore's administration. The bank has provided new debt and taken a writedown in exchange for a share of any profits.

McCarthy says they are readying themselves to buy more distressed assets, hopefully more with stapled debt, and he sees the German banks "becoming more receptive". "We want to get set up now to buy through the trough that's coming. Values today for non-prime are cheaper than in 2008."



**REAL ESTATE
CAPITAL**

Special features list, 2012

JANUARY	Debt restructuring
FEBRUARY	Capital flows into UK and European property
MARCH	Residential
APRIL	REITs
MAY	Debt investing
JUNE	Real estate lending
JULY/AUG	Fund management + Top 100 managers survey
SEPTEMBER	Opportunities in Germany
OCTOBER	Property company finance and Treasury
NOVEMBER	Co-investment
DECEMBER	Property derivatives

Real Estate Capital goes to press on the third Wednesday in the month.

The deadline to submit editorial information is two weeks before press day.

For more information, contact editor Jane Roberts at j.roberts@realestatecapital.co.uk or visit our website at www.realestatecapital.co.uk

For information about advertising, contact Jonathan Bain at j.bain@realestatecapital.co.uk

Slotting review could have classified majority of property loans as weak, reports *Alex Catalano*

FSA fears banks are under-weighting real estate risk

The way banks calculate their risk-weighted real estate assets has come under scrutiny by regulators including the FSA, which are worried that they may not be setting aside sufficient capital to cover the risks.

Earlier this month, the Bank of England's Financial Policy Committee noted: "Methods used to calculate risk weights, particularly banks' internal models, were opaque to investors and regulators. Investors have expressed doubts over the extent to which risk weighted assets accurately reflect the risk of different banks' portfolios."

Another potential flaw is that different banks can assign significantly different risk weights to identical portfolios of assets.

Commercial property is a problematic asset class for financial regulators, as it is lumpy and heterogenous, making it hard to build predictive statistical models – but that is what many banks use to justify the amount of capital they need to hold against property.

They do this because it means they can fine-tune risk weightings to reflect loan portfolio characteristics, rather than rely on the one-size-fits-all standard approach, or 'slotting' (see box). This can result in their having to set aside less regulatory capital.

The FSA feels banks' internal models do

not reflect reality. A year ago, it put out a paper about this, which recognised that "income-producing real estate is a particularly challenging asset class to build compliant internal rating systems for".

Banks' models fall short

In the coded language of regulators, the FSA also signalled that it felt many banks' internal models fell short of the requirements for regulatory capital calculation. One source told *Real Estate Capital*: "The FSA felt people are applying the regime relatively aggressively and getting capital weightings lower than they should be."

The FSA also said: "Where firms have used slotting for income-producing real estate, we have concerns that the assets have been placed into inappropriate slots."

"The FSA felt people are applying the regime relatively aggressively and getting capital weightings lower than they should be"

Consequently, the FSA revised its guidelines on slotting for commercial real estate loans earlier this year and started consulting the industry in the summer.

One insider says: "They had some very fixed views about how the slotting criteria should be interpreted. That caused a lot of concern, as it looked like it would result in a lot of property lending attracting a very high capital weighting – 250%, in fact."

The major concern was that under the new guidelines, a loan that is 'weak' on just one criteria out of many has to be slotted into the 'weak' category. According to one banker, as the UK commercial property market is by no means 'strong', this would mean that the majority of loans would have to be reclassified as 'satisfactory' or 'weak'.

Lenders would have to dramatically increase the capital they put aside to cover the risk of these loans going bad in another financial crisis. Bankers argue that this reweighting would suck liquidity out of the property market at the worst possible time.

The FSA is now considering the feedback and a less prescriptive revision of its guidelines. But it is also telling individual banks that their models aren't good enough and they must shape up or slot.

Slotting spelled out: how banks determine commercial real estate risk

Banks can either use standard risk weightings for commercial real estate loans or their own models. The standard risk weighting the FSA applies under Basel II is 50% on the part of the loan that has a 50% LTV ratio and 100% on anything above that. Internal models apply the bank's weightings based on how its past loans have performed and these must be approved by national regulators like the FSA.

There is a half-way house banks use if they cannot or do not want to develop their own model. This involves 'slotting' loans into five categories: strong, good, satisfactory, weak and in default. The FSA's Basel II guidance spells out the criteria lenders should use to classify loans, including

market conditions, location, loan-to-value and debt service coverage ratios, tenant quality and cash-flow predictability, the strength of the sponsor/developer and the security package on the loan.

Each slot carries a different risk weighting. The FSA's current risk weights are 70-250% of the loan amount for income-producing (ie investment) property and 95-250% for 'high

volatility' commercial real estate (land and developments). Both types of defaulted loans are weighted at 1,250% (see table).

So for every £100m of 'strong' investment lending, a bank has to hold £5.6m of capital, while if it is a 'weak' loan, the capital it must hold shoots up to £20m (eg 70% of £100m = £70m and under Basel II, banks must hold 8% of capital, so £70m x 8% = £5.6m).

FSA slotting: risk weights for commercial real estate lending

Commercial real estate	Strong	Good	Satisfactory	Weak	Default
Investment	70%	90%	115%	250%	1,250%
Development/land	95%	120%	140%	250%	1,250%

SOURCE: FSA

Debt funds & debt investing

Special report

Also in this section

Mezzanine's movers and shakers 18
Junior debt market grows crowded as banks' retreat causes higher demand

Breaking down debt on the block 21
Debt auction platform DebtX offers loans in easily accessible packages

Insurers and new private equity funds are set to target property debt in 2012, writes *Lauren Parr*

Field widens in race to scoop banks' property debt prizes

Real estate debt investment opportunities are luring investors across the spectrum, which are pursuing tailored strategies (with varying returns) to gain exposure.

Several US private equity houses are targeting non-performing loans (NPLs) via funds (see table), as interest mounts in what European banks have to offload. Insurers, meanwhile, are eyeing origination to take advantage of favourable treatment of debt under Solvency II legislation and the gap left as traditional bank lenders retreat.

For secondary CMBS buyers, distressed pricing, particularly in lower-rated mezzanine tranches, has led to a number of deals, while mezzanine providers are busy deploying capital and may raise new funds next year (see pp18-20).

For a long time, banks were reluctant to take writedowns and there was a big gap between sellers' and buyers' price expectations. The deterioration of the eurozone is also likely to have stifled sales by banks.

But now more loan portfolios are coming onto the market, driven by banks' need to deleverage, given Basel III and other capital requirement rules, which start coming into force next year. In the most recent deal, Lone Star won the bidding for £900m of UK NPLs from Lloyds Banking Group.

Other loan sales nearing completion include Royal Bank of Scotland's £1.4bn Project Isobel and Orion Capital Managers' purchase of a portfolio with a face value of €600m from NAMA, mainly secured against development sites in the UK, France and Italy.

NAMA is also preparing to sell a £500m debt portfolio lent by Anglo Irish Bank to a developer of US and Portuguese golf courses.

Elsewhere, Italian bank Intesa Sanpaolo

has shortlisted Deutsche Bank, Goldman Sachs Whitehall Funds, Morgan Stanley Real Estate Investing and Fortress Investing Group for a large NPL portfolio sale, while Société Générale has received bids on a €500m portfolio of mainly French loans, secured largely against offices and shops.



“As maligned as CMBS is, it is not so much credit distress driving investment opportunities as pricing distress. CMBS now often offers better risk-adjusted returns than direct real estate”

Hugo Headicar, Rhino IM

Simon Dunne, director of Savills Capital Advisors, says loan buying involves a lot of work for both the buyer and the selling bank: “Before the crisis, large volumes of loans were originated at a fast pace. The information and documentation surrounding these loans must be brought up to date to conform with today's market norms. The problem may be compounded if there has been staff turnover at the borrower or lender level.”

“Scrubbing down” loan information

He adds: “It's a lot of work for the bank to scrub down the information to get it ready for sale, plus some loans have legacy documentation that the buyer has to dissect.”

The due diligence process can be time consuming and costly for investors. For example, each of the three bidders on Lloyds' Project Royal deal are believed to have spent several hundred thousand pounds on working out the documentation.

Originating loans is probably the simplest way to buy debt, as lenders can make the documentation more robust than it would have been before the financial crisis. “That's not only with the borrower; it could be an inter-creditor agreement if there were another lender in a club,” says Dunne.

The lending landscape is changing rapidly, with banks such as SocGen, Eurohypo, DG Hyp and WestImmo out of the market: Basel III is driving banks away from property lending, just as Solvency II pulls insurers in.

“Solvency II rewards diversification,” says Isabelle Scemama, head of commercial real estate finance at AXA Real Estate, which plans to originate more loans next year, particularly in France and Germany, given banks' retreat. AXA co-underwrites loans and also buys debt on the secondary and syndication markets.

Scemama says: “It is easier to buy on the secondary market, as you know what you're getting. But it can be hard to find the right exposure to satisfy our expectations. On new loans, we can be clear on our constraints.”

New entrants including Legal & General, Allianz, AEW Europe and Invesco Real Estate Europe are trying to reallocate internal funds or raise new capital to buy property debt.

“Insurance companies are starting to look at this asset class in their own countries, as there are strong barriers to entry owing to the regulatory environment,” says Scemama. “The key to managing this type of business is having the right asset management platform, which requires real estate skills.”

German pension funds including BVK, BVV and AVWL are also exploring the real estate debt market, which offers higher returns than fixed-income investment, as obtainable interest rates rise toward 4% – the benchmark required to service future pension fund liabilities. BVK recently provided €200m to IVG to part-finance its acquisition of a Frankfurt office tower.

A similar trend can be seen in corporate lending, driven by lack of senior bank debt availability. Intermediate Capital Group and BlueBay Asset Management plan to raise senior debt funds to lend to European firms.

However, margins above Libor plus 300bps on low-leveraged senior, secured lending can represent “great relative value” compared with the corporate bond market, with the best opportunities on offer where bank funding is the most scarce, says Stewart Booth, co-founder of Chalkhill Partners.

CMBS, another investment outlet for debt investors, “is the one real estate area

“The degree of financial distress is sufficiently high [among portfolio lenders] that they can no longer say ‘no, I don’t want to sell’”

Roger Barris, Peakside

benefiting from broader market turmoil,” says Hugo Headicar, a managing partner at Rhino Investment Management.

CMBS cash prices peaked around April, before the eurozone crisis intensified and have fallen since, particularly for lower-rated mezzanine bonds. Since September, Rhino has bought some bonds at cash prices 20% below their 2011 peak.

Better returns from CMBS

“As maligned as CMBS is, it is not so much credit distress driving the investment opportunity as pricing distress. CMBS now often offers better risk-adjusted returns than direct real estate investing,” Headicar adds.

Spreads on Deutsche Bank’s £210m Merry Hill CMBS, due for launch in January, could be as wide as 300bps; it sold AAA bonds secured against Chiswick Park

for 175bps over Libor in June.

While CMBS can offer investors attractive risk-adjusted returns, one of the biggest difficulties is getting access to product, compared with in early 2009, now that most deals have been well picked over. There is a limited amount of bonds investors might want to buy at a price they would want to pay. What’s more, once an investor has bought a bond there aren’t a huge number of levers it can pull to get the required result.

The ongoing REC 6 deal is an example of a CMBS investment that didn’t work out as anticipated, after bond holders rejected the borrower’s initial attempt to buy back all the bonds on the grounds of price.

Discounted payoffs (DPOs) by borrowers could climb as “the degree of financial distress is sufficiently high [among portfolio lenders] that they can no longer say ‘no, I don’t want to sell’”, says Roger Barris, one of Peakside Capital’s founding partners. Investment banks “are pretty much cleaned up”, he adds, but portfolio lenders have not been willing to take writedowns.

DPOs are a viable way for lenders to get money out of troubled loans quickly, while the owner is typically willing to pay most for the assets, partly because it knows the property better than anyone else.

European banks’ debt sales draw private equity players from across the pond

Large US private equity houses are knocking on banks’ doors every week to get access to loan portfolios they might be preparing to sell, while other institutions are investing in debt funds to get a piece of the action.

Townsend Group, for example, invests some of its pension fund clients’ money in

M&G’s mezzanine fund and may invest in Apollo’s vehicle to buy non-performing loans.

CBRE Global Investors has also invested in debt for multi-manager clients. Last year, its Asia Alpha Plus fund of funds made two Japanese non-performing loan investments. In the UK, it was the cornerstone investor

in Longbow’s UK Real Estate Debt Investments II mezzanine fund.

Jeremy Plummer, head of global multi-manager, says: “We are looking for more mezzanine opportunities and there are quite a lot of funds. In terms of NPLs, we would like to invest alongside others.”

Selected US managers targeting property debt through funds

Lone Star, MSREI and Blackstone have been the biggest US buyers of debt, while previous buyers Apollo and Perella Weinberg are raising new funds

Manager	Fund	Amount	Deals
Lone Star	Real Estate Fund II	\$5.5bn	Bought \$5.1bn of distressed US real estate loans from Anglo Irish
Apollo Global Management	European Principal Finance Fund I & II	€1.5bn	Bought European real estate loans from Credit Suisse for around €900m. Raising €2.5bn for second fund
Blackstone	Real Estate Special Situations Fund II	\$3.5bn*	Purchase of a 25% stake in RBS’s £1.4bn Project Isobel expected to close by the end of the year
MSREI	MSREF VII	\$4.7bn	Bought €3bn of Spanish housing from Santander
Colony	Distressed Credit Fund/Investors VIII	\$885m/\$4bn	Bought €370m of German NPLs from four-bank syndicate
Westbrook Fund	VIII/IX	\$1bn to invest	Bid for Project Isobel and Project Royal
Perella Weinberg	Real Estate Fund I & II	€1.2bn	Bought €286m of Spanish assets from RBS. Raising €1.25bn for second European real estate fund
Starwood Capital	Opportunity Fund VIII	\$1.83bn	Bid for Project Isobel and Project Royal
Orion Capital Managers	European Real Estate Fund III	€650m to invest	Close to buying €600m loan portfolio from NAMA
Goldman Sachs	Whitehall International 2008	\$2.3bn	Shortlisted to buy Intesa Sanpaolo NPL portfolio

SOURCE: REAL ESTATE CAPITAL * Total commitments in BREDS funds

Mezzanine lenders report high demand to fill debt gap left by banks' retreat, reports *Lauren Parr*

Borrowers' appetite increases for mezzanine slice of the pie

Mezzanine lending may have been a 'slow starter', but mezzanine providers say enquiries have been coming thick and fast lately, especially over the past four months.

US opportunity fund CrossHarbor, which is looking to enter the development sector in Europe through the mezzanine market by the end of next year, says the phone has been ringing non-stop since investors caught wind of the group's intentions.

One of this year's earliest mezzanine/preferred equity deals was Duet European Real Estate Debt Fund's and Partners Group's investment in the refinancing of 17 Columbus Courtyard at Canary Wharf. The pair teamed up again for the acquisition of the Magasin du Nord department store in Copenhagen.

In June, Singapore sovereign wealth fund GIC wrote a £61m junior loan for Blackstone's purchase of west London business park Chiswick Park, lending with Deutsche Bank, which provided a £302m senior loan for the deal.

Hedge fund Och-Ziff provided about £30m of mezzanine debt for Marcol Group in July (see panel).

By October, there was talk of more term sheets floating around that included mezzanine debt, and more of the reduced number of senior debt lenders being happy to lend alongside mezzanine providers.

Several of the latter are eyeing some of the potential big City of London office transactions that could be 'mezzable', depending on the type of buyer (see November issue pp10-12).

Deal pipeline "growing daily"

"We've seen a steady increase in new deal enquiries from all parts of the market, and our active deal pipeline continues to grow on an almost daily basis," says Cyrus Korat, senior investment manager of Duet Private Equity's fund, which reached a final closing of more than £300m at the end of August.

The fund has completed nine deals in the UK, Germany, France and Denmark, for assets in the retail, office, hotel and healthcare sectors.

Its latest investment was providing £75m of mezzanine debt as part of the total £380m financing for Blackstone's Mint hotel portfolio acquisition.

The mezzanine market remains opaque but other recent deals include Pramerica Real Estate Investors' debt fund investing in the Mailbox in Birmingham, thought to be the fund's fifth or sixth deal, where Brockton Capital is the equity investor.

LaSalle Investment Management and Swiss-based SAFANAD provided £40m and £60m of mezzanine debt respectively for the redevelopment of 20-21 Grosvenor Square, alongside senior lenders RBS, Deutsche Bank and United Overseas Bank.



"We have seen a steady increase in enquiries about new deals from all parts of the market and our active deal pipeline continues to grow on an almost daily basis"

Cyrus Korat, Duet Private Equity

LaSalle is currently closing three mezzanine deals worth more than £100m in the UK, according to a source.

Longbow Real Estate Capital alone has completed seven mezzanine and high-yield senior UK debt deals this year, mostly in the past four months, and has a further £80m of deals going through the legal process.

Longbow's UK Real Estate Debt Investments II fund focuses on good secondary deals, lending £10m-25m of junior debt. One such deal was a £11m-12m senior and mezzanine loan for the purchase of the Granite portfolio, a mixed secondary property portfolio sold by Aberdeen. Another was a retail and multi-let office transaction in W1.

Longbow recently held the final closing for the fund, netting £242m of commitments from institutional investors, and expects to start 2012 with £80m-100m of dry powder.

Private equity manager Wainbridge is pursuing a short-term mezzanine strategy

in the US, having recently been repaid on \$6m of bridge financing for a residential development in New York.

The financing, which delivered an internal rate of return of around 25%, enabled the developer to protect its equity investment and make progress on the project while it negotiated a construction financing package.

Payback for Pramerica

Pramerica, meanwhile, has been repaid the £38m of mezzanine debt it provided only last year for Evans Randall's purchase of Drapers Gardens in the City. Evans Randall has sold the prime investment to South Korean pension fund Samsung Life.

Given the scope of potential opportunities, the mezzanine financing market is a crowded one. The most active players have been Duet, Longbow, Pramerica, Partners Group, M&G Investments, LaSalle and Starwood Capital, while AEW Europe is working on the launch of a mezzanine debt fund for next year.

CBRE recorded 13 mezzanine funds in the making back in May. Two of these planned to target junior loans up to a 75% loan-to-value ratio; at least seven would focus on value-added deals up to 85% LTV ratios; while the other four would go after opportunistic situations with LTV ratios of up to 90%.

The Cairn Property Debt Fund – a partnership between Eurohypo, Cairn Capital and Schroders – fell into the first camp, but has since been shelved as a result of Eurohypo's suspension of new lending.

By and large, those mezzanine vehicles that are already up and running are

beginning to focus their attention on raising follow-on funds next year.

Duet's Korat says: "We are focused on investing our current fund right now," which is just over half invested. The group cannot close a new fund until the first is 75% invested, although "the volume of deals we're looking at right now will likely demand that we raise more capital going forward," he adds.

So what has driven this recent rise in activity? In part, banks' increasing retreat from new lending has ratcheted up demand for pricier mezzanine capital, which ranks between senior bank debt and equity in the capital stack in terms of risk profile.

"We're finding the number of investment opportunities has increased very dramatically over the past couple of months, in part driven by the fact that most banks in Europe



"A lot of larger, family-owned property companies are thinking: 'if I take mezzanine, I can retain control, but if I form a joint venture with a third party, then my impact may be diluted'"

Kevin Cooper, Longbow

are having to get much more serious about deleveraging," Korat says. "This means banks are doing two things: forcing their borrowers to actually react and deal with debt maturities; and selling loans.

"We're looking at a mix of different opportunities – the same type of transactions with regard to new acquisitions, as well as more deals involving refinancing and acquisitions of existing loans than before,

as banks get more realistic about the price at which loans need to sell for."

Longbow is backing acquisitions by equity participants and property companies. "The banks have realised that the market can go down as well as up and that a holding strategy is a two-way bet," says the group's managing director and co-founder, Kevin Cooper. "Banks are now making real estate loan disposals at, or close to, what we

Notable 2011 mezzanine deals

Columbus Courtyard, Canary Wharf, refinancing

- Transaction size: £134m
- Sponsor: Vico Capital
- Senior lender: MetLife, loan-to-value ratio around 65%
- Mezzanine lenders: Duet, Partners Group
Duet's fund provided mezzanine finance just in excess of £15m, bringing the loan-to-value ratio to 80%. The internal rate of return on Duet's mezzanine portion is believed to be around 14%. Partners Group provided preferred equity capital at an LTV ratio above 80%.

Chiswick Park, London, acquisition

- Transaction size: £480m
- Sponsor: Blackstone Group
- Senior lender: Deutsche Bank
- Mezzanine lender: GIC
Deutsche Bank placed a £302m CMBS to fund Blackstone's acquisition of the west London business park. The £61m mezzanine loan, at a 75.6% loan-to-cost ratio, came from GIC, Singapore's sovereign wealth fund, as a structurally subordinated debt piece, remunerated at 10% annual interest, paid current.

Design centre, Chelsea Harbour, London, refinancing

- Transaction size: Not disclosed
- Sponsor: Marcol Group
- Senior lender: Deutsche Bank

- Mezzanine lender: Och-Ziff
Och-Ziff provided £30m of mezzanine debt to refinance the Design Centre in July, at a cost of around 600 basis points. The hedge fund has made other mezzanine loans, one of which is believed to be a 10% slice of a €403m Banco Sabadell sale-and-leaseback deal for Moor Park in 2010.

Mint hotel portfolio, acquisition

- Transaction size: £600m
- Sponsor: Blackstone Group
- Senior lender: Deutsche Bank
- Mezzanine lenders: Duet, Partners Group
Portfolio of high-quality hotels in the UK and the Netherlands bought from Lloyds, which took control after a covenant breach. Duet and Partners Group provided £75m of mezzanine debt at a loan-to-value ratio below 65% with the majority of interest paid current and residual payment in kind (PIK), providing an overall return of around 15%.
Deutsche Bank's margin on the £305m senior debt was said to be 400bps over Libor and the debt has been syndicated to GE Capital Real Estate, GIC and M&G Investments.

In 2010, Blackstone carved out a €150m mezzanine facility from an original senior loan secured on assets in its hotel fund as part of a refinancing of the fund. Morgan Stanley Real Estate Fund VII bought the mezzanine portion.

Shopping centres in Hammersmith and Fulham, London, refinancing

- Transaction size: £200m
- Sponsor: William Ewart Group
- Senior lenders: M&G Investments, Bayern LB
- Mezzanine lenders: M&G Real Estate Debt Fund, Partners Group
M&G arranged a package of senior, mezzanine and preferred equity to refinance loans from Ulster Bank secured on the Broadway retail schemes at London's Hammersmith and Fulham underground stations.
M&G's fund took the mezzanine position – the largest its €343m fund has made this year – and Partners Group the preferred equity investment.

Mailbox, Birmingham, acquisition

- Transaction size: £127m
- Sponsor: Brockton Capital, Milligan
- Senior lender: Aareal Bank
- Mezzanine lender: Pramerica Real Estate Investors
Pramerica's mezzanine fund came in with a mezzanine loan in October, believed to be at a loan-to-value level of up to about 80% and at an 8-9% return.
Brockton Capital Fund II, with Milligan as a minor investor and asset manager, bought the 641,000 sq ft office and retail scheme after Lloyds foreclosed on the previous borrower.

SOURCE: CBRE/REAL ESTATE CAPITAL

consider to be fair prices.”

Demand for all forms of debt has increased, with mezzanine in particular becoming “an even more important piece of the pie”, Korat says, owing to the reducing leverage available in the senior debt market.

For this reason, Duet is looking at a couple of possible senior debt deals “where the borrowers have really struggled to get bank financing, yet the economics are such that it still makes sense for them to borrow at rates that we would lend at” – those rates being in line with the fund’s overall mid-teen return target.

Finance has become more restricted and where it is available, senior banks are becoming more picky and willing to provide less leverage. With senior debt provision often limited to 50% loan-to-value ratios, even on the best quality property, there is a requirement to at least top up that capital to slightly higher levels.

Therefore a combination of 50-55% senior debt and 70-75% mezzanine finance can make commercial sense. For Korat and Duet, this means that “the thickness of the tranches we’re looking at is increasing; which means the size of our investments is increasing; which means the speed at which we can deploy capital is increasing”.

At the same time, there isn’t a huge amount of choice for those that need to refinance existing debt. “If a borrower needs 70% or 80% of the current asset value it is likely that mezzanine can help fill the gap, as very few senior banks, if any, go to that level,” Korat points out.

Mezzanine finance is not appropriate for every deal, however: exploratory discussions with a number of hedge funds, including Och-Ziff and Strategic Value Partnerships, to provide shorter-dated debt for Blackstone’s purchase of Royal Bank of Scotland’s Project Isobel loan book, proved unworkable in the end, given the higher funding costs.

Competition from equity providers

Longbow’s Cooper believes pricing is not the only factor for those seeking mezzanine finance. “Our competition has come from people putting more equity in, rather than other mezzanine providers,” he says. “We think this feature will continue next year.

“However, a lot of larger, family-owned property companies are thinking: ‘if I take mezzanine debt, I can retain control, but if I form a joint venture with a third party, then my impact may be diluted’.

“Furthermore, if a specialist property company forms a partnership with an

LTV ratios up to 80% are found on mezzanine level

Mezzanine transactions are stabilising at around 75-80% loan-to-value ratios, with a minimum return on equity guaranteed for the mezzanine partner in the case of any prepayment, says Eleonora Pulci, a director in CBRE’s debt advisory team.

For example, a £10m facility at 15% interest generates £1.5m annually and to reach an equity multiple of 1.5, the money needs to be lent for at least 3.5 years.

The majority of the interest is usually paid current (generating at least an 8-10% return), with the remainder being accrued, including upfront and exit fees, resulting in an average overall return around 15%.

However, a few players, including

Pramerica, have provided facilities below 10% for core assets in prime locations.

“There seems to be a pocket of capital available for very long lease, new central London office buildings in the high single digits/low double digits zone,” says Cyrus Korat, Duet Private Equity’s senior investment manager.

“Other than that, there is no one else out there that can lend at a significantly cheaper price, because that’s where investors come off the sidelines.”

Duet sees potential for asset yields to weaken as overall costs of debt rise. So to maintain return on equity, the borrower will have to pay lower prices for property.

opportunity fund, it risks sharing its niche and valuable skills and information with a party that could become a future competitor. It they form a partnership with us, they can be confident we will never enter their space.”

Shortage of senior debt looks as if it will be one of the biggest challenges next year.

The experience of Joe Froud, value-added fund manager of Columbus UK Real Estate Fund, is typical: “In February 2010 we went to six banks and had six proposals to borrow £25m of senior debt, at 195 basis points over Libor,” he says. “Recently, on another similar sized deal, we had only one offer, at 225bps, which the bank re-negotiated to 240bps during due diligence.”

“That deal was touch and go and [only happened] because we had an existing relationship with the lender. The debt market is as difficult as it has ever been.”

bridging the senior debt with a view to refinancing at a later stage and retaining the mezzanine piece,” says Eleonora Pulci, a director in CBRE’s debt advisory team.

M&G offers the full package

Insurance group M&G Investments is one player offering whole loan lending. In October it lent both senior and mezzanine debt to William Ewart Group, alongside Bayern LB, to refinance two of the property company’s London shopping centres.

Head of real estate finance John Barakat says the group experienced “overwhelming demand” for senior debt and has invested £450m in senior and junior mortgages since the summer.

Pulci says that pure mezzanine lenders “will charge up to low double digit interest for such facilities.



“The lack of senior debt anticipated for next year could challenge the execution of mezzanine deals until new players permanently enter the market and fill the void left by banks”

Eleonora Pulci, CBRE

His fund has made two large leisure deals using equity only, because no bank would finance them.

This shortage of senior debt can create openings for mezzanine lenders, but it also continues to hinder the flow of deals.

“Several mezzanine lenders are resorting to providing whole loan facilities or

“The lack of senior debt anticipated for next year could challenge the execution of mezzanine deals until new players permanently enter the market and fill the void left by banks.”

However, mezzanine providers claim to be increasingly active and are preparing to raise further capital for mezzanine deals in 2012.

Auction platform offers more widely accessible debt market than big-ticket loan portfolio sales

DebtX finds lots of potential as loan auction market grows

Debt auction platform The Debt Exchange (or DebtX) is 10 years old in Europe and is getting busier here. It is selling two German performing loans with a €170m face value, having recently marketed €104.2m of performing and non-performing loans in Europe on behalf of Deutsche Postbank.

UK banks are starting to use DebtX's service with increasing regularity, according to the Boston-based group's chief executive, Kingsley Greenland, who expects to see "many times more activity in Europe next year", given banks' need to delverage and the requirements of Basel III.

The online market for whole loan sales serves commercial and investment banks, insurance companies and government bodies as well as global hedge funds (on both the sell and buy side), and competes against the likes of auction.com – which sells both loans and properties in the US. However, DebtX is by far the largest seller for the US Federal Deposit Insurance Corporation.

In Europe, DebtX operates in Germany, Italy, the UK, Spain and the Netherlands, with staff in Frankfurt, London, Birmingham, Milan and Madrid. Its coverage in Ireland comes from a joint-venture partnership.

The auction platform's services are typically used to trade smaller portfolios or to 'flip' loans that are non-strategic following purchases of wholesale portfolios.

A more granular offer

"Our model tends to build local liquidity," Greenland says, and DebtX offers debt at a more granular level rather than through a large-scale, bilateral transaction. "Let's say you have a worldwide hedge fund that buys a billion dollars [of debt] and they take the pieces they want and sell off the other pieces. Many of them hire us to sell off the other pieces."

Some of the larger outfits continue to favour bilateral trades, primarily to access greater pools of assets. What's more, large debt packages generate greater press coverage – plus there are more fees at stake, usually for investment banks.

Gifford West, managing director and



Greenland: "A model like ours will prosper by having a broader distribution of participants. It's not limited to a couple of the largest hedge funds"

head of DebtX's European operations, describes the platform as a proven way for European institutions to maximise the price of hard-to-sell assets. It acts as a highly liquid market that provides access to institutional investors of all sizes, including the smaller investment and hedge funds that are now the keenest buyers of bank loans, says West.

"European banks that need to sell loans are recognising that contacting the same few investors neither satisfies their fiduciary responsibility nor demonstrates that the best price was achieved," he adds.

As the market evolves, Greenland believes "a model like ours will prosper because it has a broader distribution of participants. It's not limited to a couple of the largest hedge funds. Rather than just saying 'I'm going to call Cerberus, Perella and one other firm', we'll go much wider than that."

The company is executing a growing number of loan sales for banks across Europe, including the latest German offering, comprising a €40m loan secured by an office complex in Leipzig and a €130m loan secured by more than 30 office buildings mostly in Frankfurt.

Greenland says: "We would not sell a billion-dollar transaction with 100 tickets as a single pool; we'd probably break it into many pools, somewhere between 10 and 100."

"Our goal is to try and offer granular, homogeneous assets so that bidders who are willing to pay for that particular asset or assets will do so and not discount assets that they don't want just because they're part of a larger pool."

Past DebtX deals remain private and the participants mainly confidential, but in the

past four months it has marketed debt ranging from a €49.9m performing, syndicated loan secured by UK hotels, to a €36.9m performing syndicated loan secured by four German inner-city retail centres, and a €17.3m non-performing syndicated loan secured by office and retail properties in the Netherlands.

In Italy, it has marketed €172.2m of non-performing consumer debt, although its main expertise is in the commercial real estate debt market.

Drilling down to loan details

"We are not a poster board or a retail site," Greenland insists – only investors vetted by DebtX can take part in auctions. They range from hedge funds or opportunity funds that typically purchase non-performing loans, to institutional investors that want a steady revenue from performing debt.

Investors may bid on any individual loan that is listed, or on investor-defined pools of loans and can drill down to see the income and operating statements, rent rolls and legal documents. "In essence, investors can do full due diligence on a property before they bid," adds Greenland.

DebtX sets a reserve price by comparing similar assets that have traded globally, taking into account the liquidity situation and the local economy. "It's a bit of an art, a bit of a science," says Greenland. "We try to equate it to an Initial Public Offering, where an investment bank will try to set ranges and go out and get a lot of people to commit and fit the price up."

Vendors pay DebtX commission on a sliding scale, ranging from around 2% to 5% or 6%, depending on the assets and how liquid the market is. "It's generally less than what you'd pay to sell the underlying real estate, so if your local market is 7% we tend to be less than that," Greenland says.

What sets DebtX apart is its focus on price transparency, as well as its accessibility to a wide spectrum of investors. The company hopes to grow in Europe on the back of increasing loan disposals and sees a place for its operation alongside large, bilateral trades.

Colony Capital

Profile

The US private equity house, which has previously focused on buying US loans, has mined a rich seam of German non-performing loans and is now targeting mezzanine deals, *writes Lauren Parr*

Colony expands borders into Europe and mezz territory

Colony Capital may have lost out to Lone Star in its bid to buy Lloyds Banking Group's £900m Project Royal loan portfolio, but the US private equity firm is hoping to close its first mezzanine deal in Europe by the first quarter of next year.

This follows Colony's recent purchase of a batch of non-performing loans from four German banks – its fourth such deal in Germany since the end of 2009. All were led by London-based Dilip Awtani, head of Colony's European debt strategies, who has built up Colony's European debt platform over the past two years.

Up against Lone Star and Cerberus in its bid for Project Royal, Colony is said to have held talks with UBS to help finance the deal. Lone Star's winning bid was backed by £300m of senior debt from Royal Bank of Scotland and Citigroup, while also supported by its loan servicing arm, Hudson Advisors. Colony has no affiliated loan servicing platform at its disposal in the UK.

The US has been the focus for Colony's past loan acquisitions, where the group often has access to subsidised financing. It dominates the Federal Deposit Insurance Corporation's (FDIC) structured sales programme, which offers finance of 50% of the initial outlay for bidders, with a seven-year, interest-free loan.

The California-headquartered US arm has bought 6,200 commercial real estate loans with an unpaid principal balance of \$6.2bn from the FDIC over the past three years. Its latest deal is the acquisition of a 40% equity

stake in 758 sub- and non-performing loans with a book value of \$607m.

The group has acquired some particularly impaired construction and land loans for as little as 20 cents on the dollar, but most of its purchases have cost between 50 and 75 cents on the dollar.



“We’re trying to build our business in an opportunistic way. Europe is an active arena for underperforming and distressed assets and we are pursuing many real estate opportunities”

Dilip Awtani, Colony Capital

Colony's return target on these non-performing investments, which it converts into performing loans through asset management, is a minimum mid-teens yield.

Europe offers the opportunities

But now, like other compatriots, Colony is seeing increasing opportunities in Europe as the market opens up and activity increases.

With large loan portfolios for sale in the UK, Germany and Italy (see news), Colony aims “to find the most effective capital deployment opportunities”, says Awtani.

Colony's debt strategies are funded via its global funds, including the \$885m, top-performing, 2008-vintage Colony Distressed Credit Fund and the \$4bn, 2007-vintage, opportunistic Colony Investors VIII fund.

Through these funds the group has bought four loan portfolios, from Düsseldorf-based IKB Deutsche Industriebank; Tokyo-headquartered Shinsei Bank; German banking group BAG Bankaktiengesellschaft; and Spanish property company Inmobiliaria Colonial (see table).

For the latter, Colony teamed up with Orion Capital Managers at the end of 2009 to assume control of the previously Goldman Sachs-held debt.

Around the same time, Colony pulled out of a deal to inject €80m into Central European developer Orco Property Group after the company failed to refinance €411m of debt with its lenders.

Colony entered Europe's debt market two and a half years ago with the appointment of German national Awtani from GE Capital. Its debt investments comprise two sets of products: loan acquisitions – performing, sub-performing or non-performing – and the lending business. The group's strategy is to help banks reduce non-performing loan exposure and to monetise illiquid assets.

Awtani says: “Single loans or portfolios interest us; we are constantly reviewing opportunities in that space.”

Colony is in talks on deals in all the markets it targets, including the UK, Germany, Poland, Italy and Ireland.

“We’re trying to build our business in an opportunistic way,” he adds. “Europe is an active arena for underperforming and distressed assets and we are pursuing many commercial real estate opportunities across the region to put our capital to work. We’re looking at deals where there is an attractive trade by a willing seller, at a price that delivers returns and a risk profile we like.

“We mainly acquire portfolios, or large single loans, from financial institutions; loans that are distressed, orphaned or not of interest anymore to the original lender.”

In Germany, Colony is seeing a wave of non-performing loan trading and thinks the asset class presents a good investment opportunity despite debt market turmoil.

The first wave of loan sales in 2003/04 was followed by a second in 2006/07 – neither of which Colony was part of, as there was no real debt crisis. “At the end of 2009, we determined where to employ capital safely and there were few debt deals going on in Germany. It had not suffered a huge bubble in real estate values” and, as such, it was unlikely there would be a large contraction there.

Awtani says the group is different to a lot of other funds that jumped on the band wagon when they saw a lot of investors succeed in one particular strategy and market. “We tend to be a front runner and like to look at opportunities when there is less competition,” he adds.

Now that Colony has critical mass in Germany, it has set up a loan servicing arm to manage its investments.

Buying from a bank syndicate

The group’s latest non-performing loan buy, in August, was €370m of debt to one very large borrower, believed to have been bought for just over €65m from a syndicate of Eurohypo, Landesbank Hessen-Thüringen, Berlin Hyp and Archon Capital Bank. Colony does not comment on the price it pays for deals.

One of the lenders approached Colony, but the group was reluctant to consider a partial purchase, as buying part of a syndication would not give it full control of the investment. The bank negotiated with the others to sell the entire portfolio in one deal, although it took 12 months to pull off.

Unconventional deals stretch to Neverland and beyond

Colony Capital is best known for its big real estate investments, but the private equity house, headed by Tom Barrack, has made other interesting bets.

Last year, for example, it struck a deal to become *Rolling Stone* photographer Annie Leibovitz’s sole creditor and help manage her assets and business. In 2008 it bought a loan that left it with the rights to Michael Jackson’s Neverland ranch in California.

Barrack founded the Los-Angeles-based private equity firm 20 years ago and the

company manages \$30bn of assets.

Not all its investments are performing well: with Groupe Arnault, Colony is the main shareholder in Carrefour. The world’s second largest retailer has issued five profit warnings in the past 12 months and the two shareholders are sitting on a €2bn paper loss on their 16% stake.

According to the *Financial Times*, the two invested at between €47-€51 a share in 2007 – which turned out to be a five-year high. The shares closed at €19.85 on 2 December.

The complication was that each of the four banks involved had various stakes in the loans Colony acquired, which were backed by five institutional-quality properties mainly in Berlin and Frankfurt, developed by the same borrower.

Dividing up the deal price between the banks was a complicated process, because the writedowns for each bank were very different. There was a lot of negotiating to get all the banks to first of all agree on a price for the whole loans, and second to make sure they agreed on the same legal documents to make the deal happen.

The deal was the first sale of non-performing, syndicated loans as a package in Germany, and possibly in Europe.

A further focus of Colony’s European debt business is lending. “We try to find a way to lend more on a mezzanine or a preferred equity basis to refinancings where the new loan-to-value ratio might be much lower than the original leverage and there’s a huge financing gap,” says Awtani.

The group also considers new lending for sponsors on acquisitions where the maximum senior debt loan-to-value ratio might be 60%, topping up the remaining part of such loans.

Colony has no preference for which national market its next big deal will be in;

however, a mezzanine deal it is working on won’t necessarily be in the UK.

The group would like to get some type of mezzanine investment done, possibly by early next year. Like other mezzanine players, Colony is targeting returns in the low to mid teens, but this depends on the deal’s risk profile and the amount of leverage it takes on the mezzanine.

Understanding the assets

The company also tries to understand the risk profile of the underlying assets and doesn’t mind if they are bulky or if there is a concentration, because it is solely focused on commercial real estate.

Appetite is increasing for sponsors and lenders to get into the mezzanine debt market, yet a lot of mezzanine deals have not closed because the sponsor has realised that the returns the mezzanine investor would require are pretty much in line with what they were going to get at the end anyway.

Colony may have missed out on breaking into the big league in the UK property debt market through its failed bid for the high-profile Project Royal portfolio, but it remains well equipped to target the deals that are increasingly starting to come from banks, with US firepower and its ample experience of buying and managing distressed debt.

Selected Colony Capital loan portfolio acquisitions

Germany’s debt market has been a fruitful hunting ground for the US private equity group

Vendor	Vendor base	Description
IKB Deutsche Industriebank	Germany	18 non-performing loans
Shinsei Bank	Tokyo	211 German non-performing real estate loans
BAG Bankaktiengesellschaft	Germany	€90m portfolio of German non-performing loans at a discount of around 20%
Inmobiliaria Colonial	Spain	€1bn of performing debt at a big discount with upside potential via equity-linked instruments

SOURCE: REAL ESTATE CAPITAL

Indirect investment market

Jones Lang LaSalle market commentary

UK market overview

The Jones Lang LaSalle Balanced Fund Index increased by just 0.15% in November, writes Ashley Marks. The index has increased by 2.99% over the past 12 months – 4.65% when including secondary market pricing.

The UK secondary market continues its strong year, with a number of transactions in balanced funds and in the retail sector. The year 2011 is set to be one of the most active on record, but driven by activity during the first six months of the year. There has been a slowdown in the second half owing to uncertainty in the wider financial climate.

Pricing generally has seen a decline relative to fund valuations, with all sectors experiencing negative movements in pricing and an average movement of -0.55% across the most frequently transacted funds.

Balanced funds

The JLLCF balanced fund secondary market pricing index continues to show a decline in premium levels, moving from a 0.93% premium to October NAV to a more modest 0.66% to November NAV. Indeed, the number of funds that continue to transact at above NAV remain limited to a small but familiar group, including BlackRock UKPF, Threadneedle PUT and Hermes PUT.

Open-ended funds have struggled to attract capital. This reflects investor uncertainty and a freezing of decision making, rather than perception of the funds themselves. Indeed, only a small number of funds have seen increased redemption requests. As mentioned last month, those investors seeking to exit the more illiquid funds are, in many cases, having to do so at below bid price.

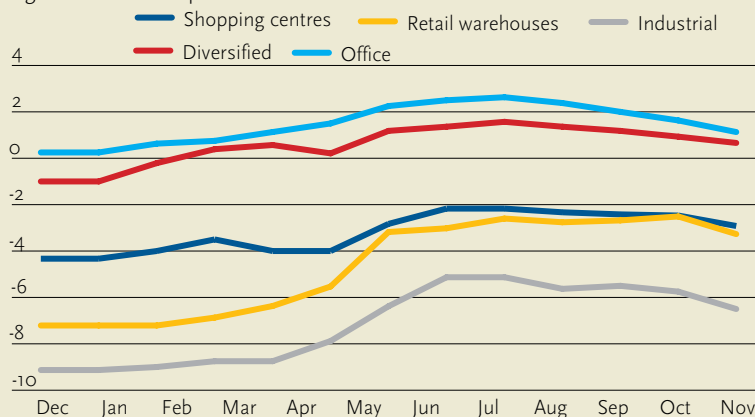
Shopping centre funds

The shopping centre subsector continues to show its buoyancy, with transactions occurring in the Mall, Lend Lease Retail Partnership and Standard Life Shopping Centres. Pricing for low- or ungeared and more prime vehicles remain at small discounts, albeit slightly larger than last month, of between -2% and -6% to NAV.

Pricing has slipped since last month for retail warehouse funds. Transactions have

Secondary trading premiums (discounts) in UK private closed funds

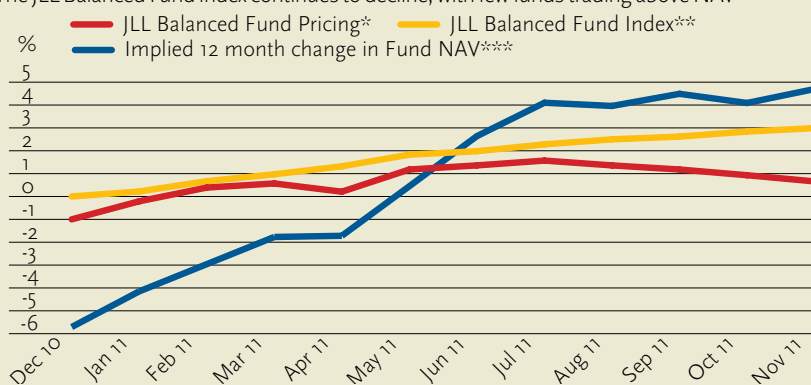
Pricing has fallen for all specialised sectors and for diversified funds



SOURCE: JONES LANG LASALLE Data is based on actual trades and quoting prices

Balanced funds' performance and discounts over 12 months

The JLL Balanced Fund index continues to decline, with few funds trading above NAV



SOURCE: JONES LANG LASALLE * 1. The estimated obtainable price (relative to prevailing net asset value) for balanced funds ** 2. An average sample of the largest UK balanced funds' performance *** 3. Combines 1 and 2 (reflects 12-month total return)

occurred in Hercules Unit Trust at discounts of below -5%, albeit for lot sizes of sub-£2m. Pricing for Hercules, as well as for funds managed by Standard Life and Henderson, have declined to between -2.5% and -5.5%.

Office and industrial funds

There have been few deals in office and industrial funds this month. Demand for central London office exposure has dropped, pushing premiums closer to NAV. Units in WelPUT and HCLOF are available at around 1% premium to November NAV.

Units in SWIP AIPUT and L&G IPIF remain the most frequently quoted, with availability at a 5% discount to September NAV.

Other funds

A number of transactions have occurred outside the traditional core sectors. Units have been traded this quarter in Cordea Savills Student Hall Fund, L&G Leisure, Unite Student Accommodation Fund and Columbus Opportunity Fund, with pricing very close to net asset value for all of these with the exception of Cordea, which was closer to a discount of 5% to September NAV.

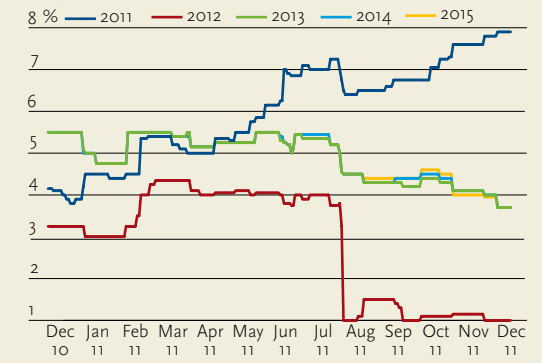
Jones Lang LaSalle Corporate Finance Limited is authorised by the Financial Services Authority. The descriptions and calculations shown are for information purposes only. No liability can be accepted by JLLCF for their use in any circumstances connected with actual trading or otherwise.

Falling contract pricing implies prolonged slide for capital values

IPD figures point to first negative capital return since mid 2009, as fears of long-term downturn hit post-2012 contract pricing

All-property swaps: implied calendar-year annual returns

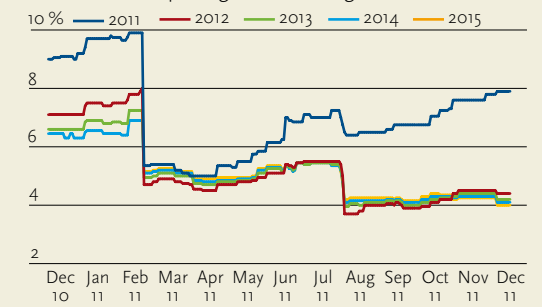
Pricing for 2012 contracts fell to an all-time low last month



SOURCE: CBRE-GFI

Implied annual total returns since Dec 2010

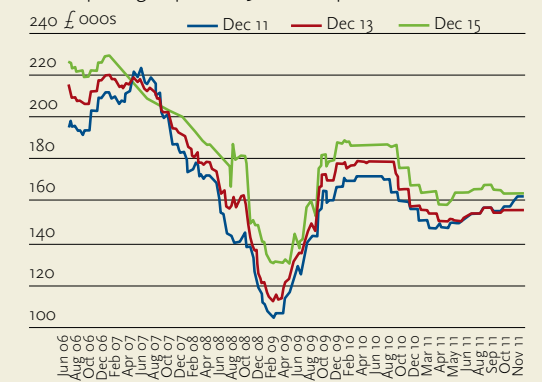
Post 2012 contract pricing reflects a long-term bearish outlook



SOURCE: CBRE-GFI

Halifax House Price Index: implied annual returns

Contract pricing implies a 1.5% house price fall in December



SOURCE: CBRE-GFI

CBRE-GFI is a trading style of GFI Brokers Ltd which is authorised and regulated by the Financial Services Authority. Any projections, opinions, assumptions or estimates used are for example only and do not represent the current or future performance of the market and must not be relied upon as such.

CBRE-GFI market commentary

IPD's Annual Property Index Estimate total return of 0.45% for November included negative capital growth of 0.05% – the first fall in capital values since mid-2009, writes Sam Whitham.

While the actual fall may be small, the fact that capital value growth has dipped into negative territory is far more significant. Income return, which has been relatively stable, also fell, from 0.54% to 0.51% – a level last seen in September 2008.

Office capital values did improve in November, up 10bps on October at 0.17%, but income returns dipped 5bps to 0.48%. Retail and industrial capital values fell 0.2% and 0.04% respectively and followed suit with falling income returns.

When IPD capital growth figures fell below flat in mid 2007, 25 consecutive months of negative capital returns followed. With lower than expected UK economic growth and austerity measures expected to bite next year, a prolonged fall for capital values isn't out of the question. This is before factoring in the huge instability in the eurozone.

Derivatives pricing reflects a bearish outlook for the next four years, backing the view that commercial property capital values are in for a prolonged fall. Contract prices for 2012, 2013, 2014 and 2015 all forecast falls in capital values on an annual basis. Assuming annual income of around 6%, present pricing predicts a 5% fall in capital values next year and a fall of just above 2% for each of the subsequent three years.

Pricing for 2012 contracts fell 15bps to 1% total return last month – the lowest level since

inception. But CBRE forecasts a 2.4% fall in total return next year, so pricing may fall further.

At the back end of the curve, pricing fell to its lowest levels this year, annual contracts for 2013, 2014 and 2015 all falling to 3.7% and losing roughly 30bps over the month.

Over the past six months, only 2011 contract pricing has risen, with all other contracts reflecting a fall in expectations for total returns. The 2012 contract crashed from 4% in early August along with the financial markets and has since wavered around 1%. Contracts for 2013, 2014 and 2015 have gradually slipped from just below 5.5% to 3.7%.

Interestingly, in Q3 2011, Eurex exchange volumes were greater than over-the-counter trades for the first time (see November issue, p4). It remains to be seen whether this points to preference for tighter regulation of the product and more market transparency, or whether Q3 2011 was simply an anomaly.

Non-seasonally adjusted Halifax House Price Index figures showed a big decline of 2.14% for November, turning year-to-date returns negative. In the first 11 months of the year the index fell 0.44%. Contracts for 2011 have a 98% mid-price, which, if priced correctly, would mean a fall of around 1.5% in the final month of the year.

But Halifax is relatively comfortable with the short-term house price outlook, housing economist Martin Ellis saying: "We expect the market to remain broadly unchanged in terms of pricing and sales over the coming months as demand and supply conditions alter little."



Subscription Order Form

To purchase a subscription to Real Estate Capital
(11 issues per year) please complete and return this form

1 year £499 **2 years for £948 (5% discount)** **3 years £1,347 (10% discount)**

Prices exclude VAT*. All rates valid until 31 December 2011

YOUR DETAILS

Please type your details in the boxes or print off and complete

Name	Title Mr / Mrs / Ms
Job title	
Company	
Delivery address	
Post code	Country
Billing address (if different)	
Post code	Country
Telephone number	
Email	
Your reference / purchase order number (if applicable)	

* VAT does not apply to printed publications

Please ensure you supply your telephone number and email address

PAYMENT DETAILS

(Please choose one of the following options)

**1 Cheque made payable to
Real Estate Publishing Limited** **2 Invoice me at
the above address** **3 Please provide BACS details**

RETURN FORM EITHER BY POST OR EMAIL TO

Real Estate Publishing
16 Shaftesbury Road, Richmond, TW9 2TD
Telephone +44 (0) 203 411 5877
email subscriptions@realestatecapital.co.uk

Thank you for your subscription

**Real Estate
PUBLISHING**

Company Registration Number 6975972
Registered office: 32 Balfour Road London N5 2HL

Real Estate Capital 2010/2011 features index

Real Estate Capital's major 2010/2011 features are listed below. For back issues, contact Jonathan Bain at: j.bain@realestatecapital.co.uk

You can read past blogs and email alerts at www.realestatepublishing.wordpress.com

Analysis features

Allianz's property strategy	March 2011, p15
ArbreIM move to AEW	Jan 2011, p12
Capita buys BCMS	March 2011, p14
Capital markets	Sept 2010, p16
CMBS	Feb 2011, p12
	June 2011, p10
	July/Aug 2011, p10
CMBS restructurings:	
Fleet Street Finance Two	March 2010, p12
The Mall Fund	Sept 2010, p13
Opera Germany Two	Jan 2010, p13
CMSA conferences	May 2010, p10
	Nov 2010, p10
CREFC Europe autumn conference	Nov 2011, p10
Debt funding gap	April 2010, p8
Debt portfolio sales	Oct 2011, p10
Defined contribution pension schemes	May 2011, p13
Delancey bank work-outs	April 2010, p10
De Montfort lending report	June 2010, p12
Derivatives and EMIR	Jan 2011, p9
Development finance	June 2010, p14
<i>Emerging Trends in Real Estate</i> report	Feb 2010, p12
Europa Capital sale	Oct 2010, p11
Fund fees	Jan 2010, p10
Fund raisings	July 2011, p12
Fund terminations	Sept 2011, p14
German banks	Oct 2010, p13
German listed sector	June 2011, p15
German open-ended funds	Nov 2010, p13
Goodman European Logistics Fund	Nov 2011, p13
Green metrics	June 2011, p12
Hotel sales	Oct 2011, p12
Inflation	April 2011, p10
Lending trends	Feb 2010, p10
London Business School Conference	May 2011, p10
London office sales	Nov 2011, p10

Market volatility	Sept 2011, p11
Mezzanine debt	Jan 2011, p10
Morgan Stanley Real Estate Funds	Sept 2010, p17
Pfandbrief	May 2010, p12
Project Isobel	July/Aug 2011, p13
ProLogis European Properties	Oct 2010, p12
Property lending	June 2010, p12
Review of the year	Dec 2010, p10
Slotting and bank risk	Dec 2011, p15
Solvency II	Mar 2011, p17
	April 2011, p13
Sustainability	Sept 2011, p15
Swap problems	Oct 2011, p13
Top fund managers	July/Aug 2010, p10
	Dec 2011, p10
WestImmo sale	March 2010, p14

Special reports

Bank lending	June 2011, p16
Covered bonds	Jan 2010, p14
Debt investment	May 2010, p14
Debt funds & debt investing	Dec 2011, p16
Debt refinancing	Jan 2011, p13
Derivatives	April 2010, p12,
	May 2011, p14
European Pension Funds	Sept 2010, p19
Financial regulation	April 2011, p14
Fund managers	July/Aug 2011, p14
Fund structures	March 2010, p16
Insurance firms	Oct 2010, p14
Islamic finance	Nov 2010, p16
Private equity	June 2010, p18
Property company finance	Oct 2011, p14
	July/Aug 2010, p15
Rating Agencies	Feb 2010, p14
REITs	Dec 2010, p16
Sustainability	April 2011, p20
UK & European capital flows	Feb 2011, p15
Value-added investment & asset management	Nov 2011, p16
Wealth management	Sept 2011, p16

Company profiles

Aerium Properties	March 2011, p20
APG	Feb 2011, p26
AEW Europe	Oct 2010, p21
Barclays Real Estate	April 2010, p18
Bawag	April 2011, p26
Beaubridge	Sept 2011, p25
Brookfield Asset Management	July/Aug 2010, p23
Colony Capital	Dec 2011, p22
Columbus Capital Management	June 2010, p22
	March 2010, p20
DG Hyp	Feb 2010, p18
Duet Group	Feb 2010, p18
Grosvenor FM	July/Aug, p24
Hansteen	Jan 2010, p18
Internos Real Investors	May 2010, p22
	Sept 2010, p28
IPD	Sept 2010, p28
M&G Real Estate Finance	Feb 2010, p21
Orion Capital Managers	June 2011, p22
Oxford Properties	Sept 2010, p26
Pacific RECP	May 2011, p22
pbb Deutsche Pfandbriefbank	March 2011, p18
SWIP	Sept 2011, p22
Thames River Capital	Jan 2011, p20
Treveria	Oct 2011, p20

Data features

Investor pricing survey:

March 2010	p22
July/Aug 2010	p26
Dec 2010	p24
March 2011	p22
November 2011	p22

Capital into UK Property:

Jan 2010	p22
April 2010	p24
October 2010	p23
Jan 2011	p22
October 2011	p25



Why there's no need to mind the funding gap

DTZ recently produced a further report on 'The funding gap'. But what gap? There have always been gaps between what borrowers want and what lenders will provide. Just as relevantly, there have always been gaps between what sellers ask and buyers will pay – perhaps we should call this the first funding gap, as the buyer's decision to buy an asset comes first, while we can call the debt position the second funding gap.

Most market values in Europe are lower than three years ago. So the first funding gap must be far bigger than the second funding gap. Can you imagine the headline: 'First funding gap exceeds Italian national debt'. Quick, call in the technocrats.

Of course it is ridiculous to consider real estate this way. Market fluctuations are inevitable. Falls in market value are good, up to a point, as they sort out the best real estate from the ordinary and the real property professionals from the Johnny-come-latelies. You must review each property on its own merits and the solutions will be individual ones.

Returning to the second funding gap, the lenders on a large number of loans and securitisations due for renewal either won't renew them or will only advance a smaller amount, so the gap is between what they advanced last time and what they will advance this time.

How is this different from the first funding gap? The buyer last time is now the seller and there is a funding gap between the seller and a willing new buyer. If the new buyers won't pay what the seller paid, the seller will make a loss. If the seller decides not to sell, the asset continues to be held and the seller may have to recognise a loss of value.

Similarly, if a bank's loan is not refinanced and the bank decides not to sell, the loan continues to be held and the bank may have to recognise a loss of value. That's tough, but in the real world, it doesn't bring on a crisis, let alone a catastrophe.

But isn't it a problem because the second funding gap is a big number? Not as big as the first funding gap but, more importantly, the second funding gap, like the first, doesn't get aggregated at any point. Each financing has to be worked through,

just as each property investment must be reviewed.

When the second funding gap was first raised in 2009, some said the huge amount of securitisation due to mature would lead to disaster. That hasn't happened yet. Our analysis then was that about 40% of the issues would repay, 40% would result in insolvencies and the rest were too close to call.

And so it has proved. Securitised loans have been taken out by new equity, owners selling assets and a combination of new equity and new debt. There has been plenty of good news for bond holders and where bonds have been underwater – such as the White Tower issue class E's – assets have been sold through insolvency proceedings.

There is no second funding gap in banks' books, because a bank that can't refinance a loan or sell it is in exactly the same position as an investor facing a first funding gap deficit: if there's no willing buyer at an acceptable price, it has to hold the loan and perhaps recognise a loss. A bank can call in a receiver to do what receivers do, but that's not news.

So the real issue behind the funding gap is that some prospective property buyers would like funders to provide, say 80% of the old value, but a new funder is only willing to lend 60% of the new. There is a gap between what banks would do before 2005 and what they would do after 2005. What is more, there is always a gap between what a borrower would like and a funder will provide.

No DTZ survey, appeal to the Bank of England or wringing of hands will change the fact that there are no absolutes in the price a buyer should pay for a property nor the amount of debt a funder should provide for that purchase. Today's successful buyers recognise the market realities and adjust accordingly. Buyers that want to use other people's money to fund acquisitions will have to go further to find mezzanine/preferred equity/partnership equity to fund their capital stacks.

Get over it and let's have no more talk of the funding gap.

Paul Rivlin is joint chief executive of Palatium Investment Management

No DTZ survey or wringing of hands changes the fact that there are no absolutes in the price a buyer should pay for a property nor the amount of debt a funder should provide