



EUROPEAN PRIVATE  
PROPERTY VEHICLES  
**TAKING STOCK**

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## SUMMARY

### MARKET TENSIONS

The interviews highlighted possible mismatches between investors' needs and what vehicles offer in a number of areas:

### TARGET SECTORS

Our interviews highlighted the demand for specialised vehicles: nearly all investors sought sector-focussed funds, operating either across Europe or in single countries or small regions. Pan-European diversified vehicles, particularly opportunity funds, dominate the current vehicle universe, with single country funds representing only just over 15% of the universe.

Southern Europe was the region most favoured by questionnaire respondents; currently only two vehicles in our universe operate solely in southern Europe.

### OPEN- VERSUS CLOSED-ENDED VEHICLES

Closed-ended limited-life vehicles dominate the market, but there is clearly demand from investors for open-ended as well as closed-ended structures. A number of investors would prefer open-ended vehicles, but are resigned to closed-ended structures in the absence of liquidity.

### FEES

Investor and manager groups agreed that management fees should cover costs only, and that beating agreed hurdles justified generous performance fees. The balance between management and performance fees is important: if an absolute – and distant – hurdle becomes too testing, then management could become demotivated if management fees are too low.

### LIQUIDITY

Interviewees and questionnaire respondents broadly favoured increased market liquidity, which they thought was achievable – implying support for current initiatives to improve liquidity. Some investors claimed little need for liquidity themselves, but this could change if investors rebuild equity portfolios at the expense of property.

## THE PRIVATE PROPERTY VEHICLE MARKET

### MARKET GROWTH

The European private property vehicle ('PPV') market has grown rapidly since 1997, from a total value of around €6 billion in 1997. Our universe of cross-border PPVs includes 112 vehicles with a value of €84.5 billion. US opportunity funds led the growth, encouraged by the introduction of a common currency and favourable market conditions.

## THE MARKET IN CONTEXT

Our estimate of the total value of the cross-border and domestic institutional PPVs is around €170 billion (cross-border €84.5bn; domestic €85.5bn). Estimates of the total size of the European institutional property market average €1.4 trillion, implying a PPV market share of around 12%.

The size of the institutional private vehicle market compares with a total of €90 billion for public (retail) PPVs, with the German open-ended fund market by far the largest, at about €70 billion total value. The total market capitalisation of European listed property shares, as measured by EPRA, was €62.2 billion at the end of 2002 (with a higher gross value).

## VEHICLE NUMBERS AND SIZES

The PPV universe covered in this report is made up of 112 vehicles with a total value of €84.5 billion. Fifty-four are opportunity funds, with a total value of €55.9 billion; 31 are core-plus (or value-added) vehicles, with a total value of €13.2 billion; and 27 are core funds, with total value of €15.4 billion. The average size of opportunity funds is also the highest, at €1,035m against €427m for core-plus vehicles and €570m for core funds.

## CURRENT SIZE V TARGET

The current total value or buying power of the PPV market, €84.5 billion, compares with the estimated total target gross asset value of €102 billion. At the equity level, current equity raised of €32 billion compares with a target of €40 billion.

## LEVERAGE

Average target or maximum leverage, or gearing, across all vehicles is 62% (borrowing v value). Some vehicles have no borrowings (including opportunity funds where the borrowing is carried within the vehicle's corporate investments), while a few opportunity funds have target leverage of 100%.

## SPENDING

We estimate the total 'spending gap' at €28 billion: this is the difference between buying power and investments made to date. Opportunity funds make up by far the largest part of this: typically they obtain equity commitments first and then seek substantial acquisitions, through corporate acquisitions and direct portfolios. Core and core-plus vehicles, on the other hand, are often launched with properties already identified.

## GLOBAL, EUROPEAN OR SINGLE COUNTRY VEHICLES

Of the 112 vehicles covered in this report, 33 are global, with allocations to Europe totalling €35 billion. All are opportunity funds. Thirty-nine funds have the scope to operate across all or a large part of Europe; their total value is nearly €32 billion. Forty vehicles, with a value of nearly €18 billion, target a single country (or small region).

## GEOGRAPHICAL FOCUS WITHIN EUROPE

The degree of geographical focus of vehicles tends to increase from the opportunity end of the style spectrum to the core end.

- Opportunity funds are the least restricted in their geographical scope, seeking opportunities widely across western or all of Europe. Five opportunity funds focus on single countries, while three target central Europe.
- Core-plus vehicles' target locations range from pan-European to single-country. A total of 15 vehicles span Eurozone countries, western or all of Europe; 14 smaller vehicles target single countries; two target central Europe.
- Core vehicles typically focus on single countries: this is true of 21 vehicles, with a total value of €14 billion. Only six vehicles target Eurozone countries, western or all of Europe.

## FAVOURED LOCATIONS

Among single-country vehicles the UK is the most popular location, followed by France and the Netherlands. (European vehicles tend to favour the same countries, together with Italy and Spain.)

## TARGET SECTORS

By far the majority of vehicles have the scope to invest in all sectors. In practice, many of these focus on the office sector, which is also the target of the most single-sector funds.

- Opportunity funds are generally unfettered in their choice of sectors; only three have a sector focus. Diversified funds tend to favour the office sector.
- Core and core-plus vehicles offer investors access both to all-sector and sector-specialist vehicles. Again offices dominate, although there are retail, industrial and residential vehicles.

## COMBINING LOCATIONS AND SECTORS

Looking at the geographical and sector focus of vehicles together highlights the dominance of pan-European diversified funds: sixty-nine vehicles with a total value of €63 billion are diversified, and invest in all or most of Europe. Industrial vehicles do offer exposure across Europe, but, with few exceptions, other sector-specialist vehicles focus on individual countries.

## VEHICLE STRUCTURES

Closed-ended limited life vehicles dominate the European PPV universe: over 90% of the vehicles in our universe are closed-ended, including 75 limited partnerships valued at a total of €57 billion. Opportunity funds have short limited lives, while core and core-plus vehicles are in a variety of formats, both closed- and open-ended, and limited and indefinite life.

The opportunity fund model has largely followed that of equity buy-out funds – indeed, many of the investors and fund managers are common. The vehicles used, structuring of management and performance fees and other key terms and conditions – including the use of internal rates of return (IRR) as the principal measure of performance – have therefore been mapped straight from the private equity world. Core and core-plus vehicles are far less uniform and arrangements straddle the different forms of private equity and traditional separate account fund management.

## VEHICLE MANAGERS

US managers dominate the European PPV market, followed by the British. Twenty-seven US managers run over 50 vehicles, worth €54 billion. Eighteen managers in the UK manage 34 vehicles, with a total value of €15 billion.

Opportunity fund specialists – most, but not all, American – and investment banks dominate the market. Insurance-based managers are also significant players: following the rationalisation of the insurance industry across Europe, many large financial services groups have stand-alone fund management businesses, often with a separate identity.

## INVESTORS

Pension fund investment in property averages about 7% across Europe, with insurance company investment generally estimated at a similar level.

The extent of non-domestic property investment, both direct and indirect, has not yet been measured. German institutional investors achieve international exposure through closed-ended PPVs and some *spezialfonds*. The Dutch have long been significant cross-border investors, and recently large institutions in the UK, Denmark and Norway have announced PPV investment strategies.

## INVESTOR AND MANAGER SURVEY

### REASONS FOR INVESTING IN PPVS

The lack of local market knowledge and infrastructure was the main reason behind most investors' decisions to invest in PPVs. A number saw private vehicles as a way of avoiding the mistakes of the early 90s when cross-border investors lost large sums on direct investments.

Many investors sought to reduce risk through diversification: in the first instance by investing outside their domestic markets, and secondly by using PPVs to access large pools of assets. Investors also noted the attractions of private vehicles versus listed property shares: these are primarily the better correlation with direct investment and the opportunity to influence management.

### **DRIVERS OF MARKET GROWTH**

Interviewees saw the access to expert local management afforded by PPVs as a key factor behind the PPV market's rapid growth, together with the introduction of the single currency, and increased capital flows, particularly from the US. The good returns delivered by PPVs over the last few years have also attracted more investors. Some interviewees questioned whether managers' efforts rather than investor demand had been the main driver of market growth.

### **ATTRIBUTES OF SUCCESSFUL VEHICLES**

A clear majority of interviewees thought the success of a vehicle depended far more on the quality of the vehicle manager than on the vehicle's strategy or properties. Other factors rated as important were sector focus, clear strategies and underlying assets, but very few interviewees thought these as important as manager quality.

'Manager quality' covered a number of aspects: alignment (beyond co-investment); the ability to execute; local offices or partners; a good investment process; and manager integrity. Investors also needed to like their managers.

### **CLOSED- OR OPEN-ENDED VEHICLES? LIMITED LIFE?**

Nearly all interviewees preferred closed-ended, limited life vehicles, but this preference was generally premised on the lack of liquidity in most markets today. Investors who clearly preferred limited life structures emphasised the need for a credible exit strategy. A number of investors were attracted by open-ended formats, but had been unable to pursue this preference fully because the market is dominated by closed-ended structures.

On the appropriate life-span of limited life vehicles, the consensus was the higher the risk, the shorter the life of the vehicle should be. Many core and core-plus vehicles may turn out to have unlimited lives, as investors voted to maintain their exposure to attractive sectors and assets.

### **CO-INVESTMENT**

Most investors preferred – or demanded – co-investment by the vehicle manager, although they saw co-investment as simply one part of the manager's incentive package.

Some investors did not consider investment by an in-house fund related to the manager as 'true' co-investment; they wanted co-investment that was significant to the manager, so-called 'hurt money'. Others would accept in-house co-investment.

### **PREFERRED FEE STRUCTURES**

Investors and managers were united on appropriate fee structures: management costs should cover costs only, and high performance fees were appropriate for good performance. Performance fees should be payable only at the end of a vehicle's life, and on realisations. A single management fee should cover all costs. Investors were frustrated at the complexity and lack of comparability of fee structures.

### **NUMBER OF INVESTORS**

Most respondents wanted quite small groups, of less than ten, with a significant number preferring larger groups. There were no clear divisions between the investor and manager groups.

### **BORROWING**

Most respondents were in favour of leverage ranging from 50% to 75%. Again there was no division between investors' and managers' views. A number of respondents qualified their responses, noting that the level of borrowing depended on the risk profile of the vehicle.

## A STANDARD VEHICLE STRUCTURE

Nearly all interviewees were in favour of a standard vehicle structure, which they thought would help attract new investors and managers, increase liquidity and reduce fees. No one was optimistic about the likelihood of a standard structure being developed in the short or medium term.

## CURRENT PREFERRED SECTORS AND LOCATIONS

Respondents clearly favoured the retail sector, with a third of votes, and twice as many top rankings as given to the industrial or office sectors. The enthusiasm for retail may point to a current shortage of retail focussed vehicles, although diversified vehicles do as a rule include retail property.

Respondents stated a preference for southern Europe, France and the UK. While France and the UK are the target locations of a number of vehicles, currently only one in our universe targets southern Europe solely, and one operates only in southern Europe, although it has the scope to invest more widely.

## THE PPV MARKET IN THE FUTURE

Most investors expected an increase in specialist funds: nearly all would be happy with sector specialists operating across regions, while a minority preferred single country specialist funds. Managers saw growth in both specialist and pan-European vehicles, with 'niche' managers thriving at one end of the spectrum, and a small group of very large managers at the other. In the longer term, investors might back managers rather than individual vehicles.

Views on the future of opportunity funds in Europe were divided. Some thought skilled players would stay in Europe; others thought they would move on, now that market conditions were no longer favourable.

## LIQUIDITY

Virtually all interviewees favoured a more liquid PPV market, to different degrees, and most expected liquidity to improve. Most thought managers were best placed to facilitate trading, while some investors thought their informal networks were more effective. Three managers didn't see any need for liquidity, given the sophistication of investors.

## PERFORMANCE REPORTING

Nearly all investors expected detailed reports, at both asset and vehicle level. All were satisfied with the overall quality of their vehicle managers' reporting.

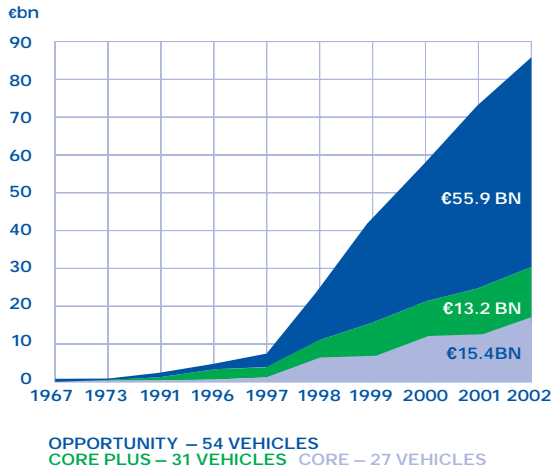
## MARKET TRANSPARENCY

Market players were overwhelmingly in favour of more market transparency. Interviewees listed their priorities as simple information on market players and vehicles; the agreement of a common set of definitions, particularly on fees; and the disclosure of vehicle performance and fees.

## VALUATION

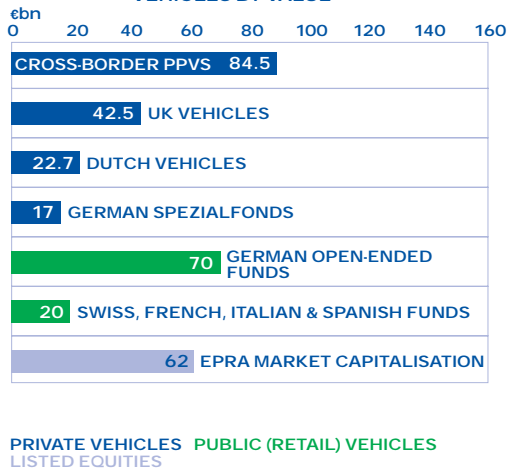
Most interviewees thought the value of a PPV investment depended on the value of the underlying property together with other factors; a second group would normally value the investment in line with the property value alone; while a small minority would apply a discount to the property value. Factors to be considered when valuing a PPV investment included the loss of control, together with tax and other vehicle liabilities, offset by the value of expert management.

**FIGURE 1 PV MARKET GROWTH BY STYLE**



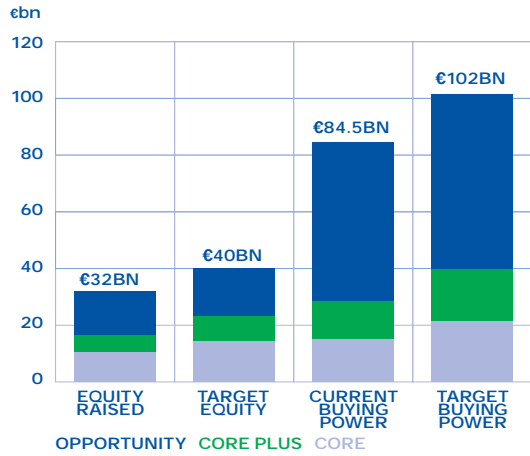
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**FIGURE 2 EUROPEAN PRIVATE AND PUBLIC PROPERTY VEHICLES BY VALUE**



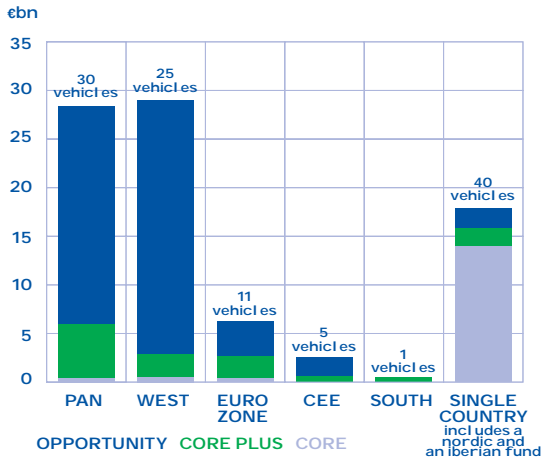
sources: opc, bvi, epra, jll, dexia solutions

**FIGURE 3 CURRENT SIZE V TARGET VALUE**



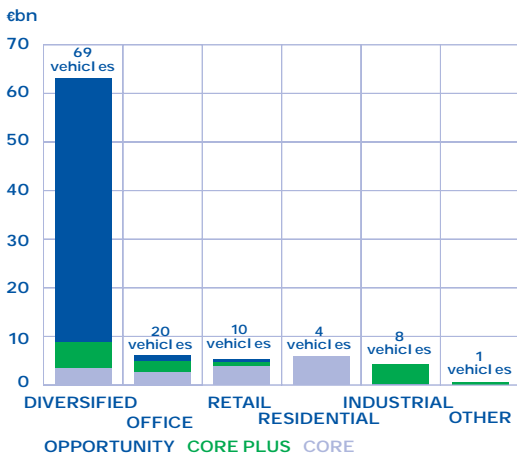
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**FIGURE 4 FOCUS WITHIN EUROPE**



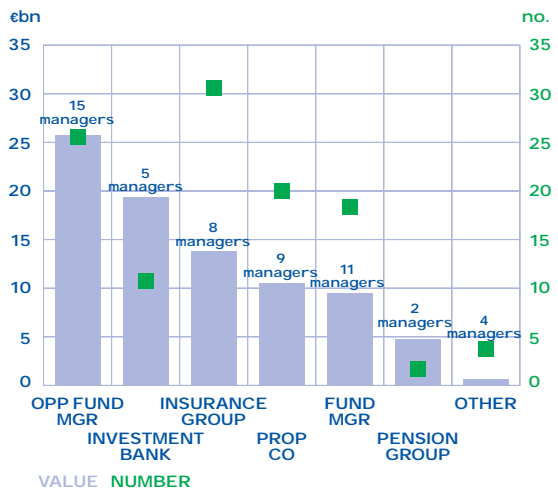
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**FIGURE 5 SECTOR FOCUS**



source: opc

**FIGURE 6 MANAGER TYPES**



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