INREV RESEARCH & MARKET INFORMATION

EUROPEAN REAL ESTATE DEBT FUND STUDY

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INREV is the European Association for Investors in Non-Listed Real Estate Vehicles. Our aim is to improve the accessibility of non-listed real estate funds for institutional investors by promoting greater transparency, accessibility, professionalism and standards of best practice.

As a pan European body, INREV represents an excellent platform for the sharing and dissemination of knowledge on the non-listed real estate funds market.

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EXECUTIVE SUMMARY

The European real estate lending market is undergoing significant structural changes as a consequence of the credit and financial crisis and the regulatory changes that are being imposed on European banks, its traditional source of debt.

At the same time, banks are trying to reduce their exposure to commercial real estate, the sector needs to refinance at least €1 trillion in the next four years (source: DTZ), resulting in a widening funding gap that needs to be filled by other sources of debt or additional equity. This situation has created opportunities for other market players to enter the commercial real estate lending market. Institutional investors are establishing their own loan desks and an increasing number of debt funds are being launched, which this report focuses on.

In this report INREV has interviewed the leading real estate debt fund managers and a number of institutional investors to map the developments in the debt fund sector and identify opportunities and threats. The report identifies a number of distinct real estate debt fund strategies that fund managers are currently offering: senior debt, whole loans, subordinated debt, mixed debt, distressed loans.

In the 2009–2010 period, the first wave of European debt funds successfully raised and deployed capital that focused almost exclusively on mezzanine loans. Now, a broad mix of strategies has appeared, particularly as providing only mezzanine loans proved to be problematic due to the lack of senior lenders to lend alongside. In the last three years, at least 19 real estate debt funds have been launched bringing the target size of the sector to an estimated €9–10 billion.

Depending on the strategy, investors view debt fund investments from two different angles. Higher-risk subordinated debt strategies tend to be more suitable for pension funds that view them as a real estate investment while senior and whole loan strategies are viewed as lower risk and fit into the fixed income investment allocations for insurance companies.

The main drivers that have led to a growing number of newly-launched funds and increased investor appetite are the improved loan pricing for lenders in the lending market; attractive risk-adjusted returns in combination with downside protection from falls in real estate values; the fixed annual income component from the outset of the fund launch, and lower capital requirements that might be applicable for certain institutions.

Fund managers and investors also highlight the risks of debt funds. These include a combination of the following risks: real estate, tenant, liquidity, refinancing, early repayment, strategy execution and legal.

Fund managers have to limit and mitigate these risks when launching and operating debt funds. When providing loans, especially subordinated loans, attention is paid to the analysis and due diligence of the underlying real estate, key tenants and the borrower. Origination loans have to fit the fund strategy and create a diversified portfolio of loans. After origination, fund managers monitor the loans closely to be able to act in case of difficulties.

In order to execute debt fund strategies fund managers must employ teams with the right skills and experience. This includes loan origination, underwriting and loan management skills as well as the real estate knowledge and experience to effectively manage debt funds and their risks. The fund manager's experience and track record in debt are the main criteria that investors focus on when selecting a fund manager and making an investment.

1 INTRODUCTION

In the last three years the European real estate market has witnessed the launch of a number of non-listed real estate debt funds from large and small fund managers with more expected to follow.

INREV conducted this study to provide its members with an insight into the debt funds segment. It conducted a series of interviews with debt fund managers, institutional investors, advisors and banks in July, August and September 2012. The fund managers interviewed represent the vast majority of the real estate debt funds sector by assets under management. Investors that were interviewed were all responsible for real estate investments. No fixed income investors were interviewed for this report. Not all market participants were interviewed for this study and their views and opinions might differ from the ones written in this report. The list of companies that were interviewed can be found in the the Appendix.

Chapter 2 looks at the commercial real estate market development and trends while Chapter 3 focuses on other sources of real estate lending in Europe that will compete with debt funds. Chapter 4 describes the different strategies for debt funds as well as their investment process and legal issues. The legal part (section 4.8) of this report was prepared in cooperation with law firm SJ Berwin. In the last chapter, the report looks at investors' views on debt funds.

2 EUROPEAN REAL ESTATE LENDING MARKET

European banks have traditionally dominated the commercial real estate lending market. They currently hold 85%-95% of all outstanding real estate loans and the most recent INREV Capital Raising Survey confirms that banks remain the major source of debt for non-listed real estate funds.

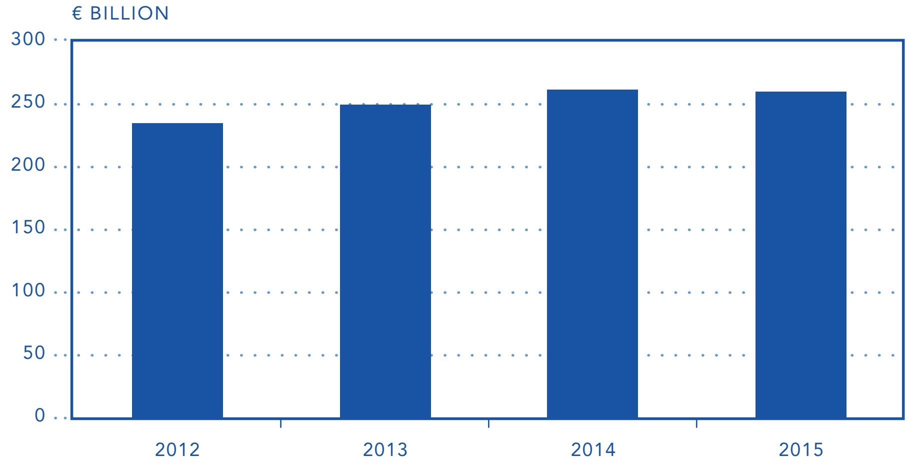
Other financial institutions such as insurance companies and pension funds have played a marginal role as lenders compared with the US. According to US Federal Reserve statistics, banks hold 56% of all outstanding commercial mortgages, holders of CMBS securities 21%, life insurance companies 12% and other institutions hold the remaining 11%.

However, the advent of the credit crisis and the subsequent global financial crisis has caused significant changes to the lending landscape for the European real estate markets.

Regulatory changes have accelerated structural changes for the European financial sector while the write-downs that banks had to take on their real estate exposures has forced many of them to retreat from the real estate lending sector altogether or to significantly reduce their exposure and lending capacity. This has left the European real estate industry facing a widening funding gap that needs to be resolved in the coming period.

According to research conducted by DTZ, banks and other financial institutions hold more than €2 trillion of real estate debt. In the 2012–2015 period more than 50% or €1 trillion needs to be refinanced (Figure 01). As banks are reducing their exposure to real estate and imposing stricter requirements on loans, part of the outstanding amount will not be refinanced. The difference between the (re)financing need and the available capital from lenders and equity holders is known as the debt funding gap. The exact size of this gap is difficult to determine as it is unknown how much of the €1 trillion of debt will be extended. Based on different research studies, it is estimated to be around €200 billion over the next two to three years. Possible sources that could help refinance outstanding loans and fill the funding gap will be discussed in the next chapter.

FIGURE 01 / EUROPEAN LOAN MATURITY PROFILE



SOURCE: DTZ, MAY 2012

The vast majority of fund managers and investors interviewed for this report are convinced that banks may not return to the market in the medium term. Many also believe that the process of deleveraging is a structural change for the market and that the current situation presents a good opportunity to make debt investments through debt funds or, for some institutional investors, to establish their own loan desks. For the non-listed property funds industry, this has opened up the opportunity to launch and manage debt funds to capitalise on the attractive opportunities.

There are of course major regional differences. Respondents consider the UK to be the most attractive market for alternative real estate lending, as loan margins are higher. Germany is less attractive for other lending sources due to the strong competition among the banks and the functioning *Pfandbriefe* system. Countries such as Spain and Italy are currently out of favour for many investors and lenders due to market conditions.

3 ALTERNATIVE FINANCING SOURCES TO DEBT FUNDS

Before considering the role that debt funds will play in the lending market, it is useful to understand what other sources of finance there are and which are likely to be active in the market. This section will describe these other sources.

3.1 Bank lending

3.1.1 SENIOR DEBT

Commercial real estate lending pricing and conditions have changed considerably since the start of the financial crisis. In 2007, good quality real estate could be financed with only 15%–20% equity with banks prepared to provide loans representing up to 80%–85% loan-to-value (LTV) ratios. In today's market, borrowers need to contribute at least 20%–30% equity for well-located prime buildings. However, banks that currently provide senior loans are not prepared to lend higher than a 60% LTV. This gap between the senior tranche and the equity has to be bridged by subordinated loans (stretched senior, mezzanine or junior), but there are a limited number of lenders able or willing to provide them.

This is less of a problem for borrowers looking for core properties with low leverage as banks are still open to this type of lending. The real challenge is for borrowers that need to refinance loans made in the period 2005–2008. These were originally negotiated on pre-crisis terms but borrowers are now only able to obtain 60% LTV. Meanwhile, the financing market for development is even more challenging as lenders tend not to be providing loans on these types of projects.

Senior loan pricing has increased substantially during the last five years. Loans are now priced at 250–400 basis points over LIBOR/EURIBOR, depending on the country, LTV levels and the type of real estate. Banks continue to charge 100–200 basis point originations fees and 100–150 basis point exit fees.

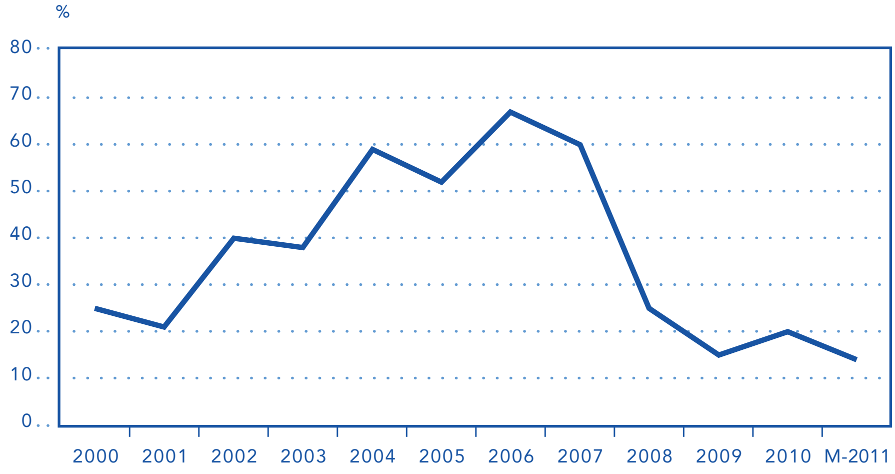
3.1.2 SUBORDINATED DEBT

Subordinated debt consists of a number of loan types that sit within the capital stack: stretched senior (typically 40%–60% LTV), junior (typically 60%–70% LTV) and mezzanine (typically 70%–80% LTV).

Pre-crisis, subordinated lenders did not play a major role in the lending mix. This was mainly due to the fact that banks were prepared to finance up to at least 75%–80% LTV on secondary assets and up to 95% for prime assets. Now, with banks only prepared to provide maximum 50%–60% LTV, borrowers need to contribute more equity or find other sources of capital to bridge the gap.

Research conducted by De Montfort University among UK real estate lenders in 2011 shows that only 14% of respondents were prepared to offer mezzanine financing (Figure 02, page 07). This is much lower compared with the 67% who were prepared to offer this service in 2006. Outside of the UK, this is expected to be similar or worse as many commercial banks do not offer these types of loans.

FIGURE 02 / PROPORTION OF LENDERS PREPARED TO OFFER MEZZANINE FINANCE

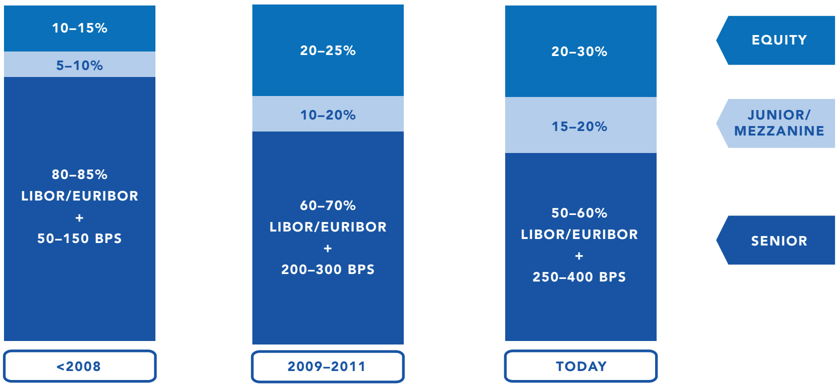


SOURCE: DE MONTFORT UNIVERSITY, CBRE

As banks have left this subordinated lending scene a number other investors are trying to fill the gap. According to a report published by CBRE on mezzanine lending, in the last four years over 100 mezzanine lenders have emerged across Europe. Typically these are property investors, investment managers –backed either by high net worth individuals or institutional investors– and real estate debt funds.

The diagram below shows how pricing and availability has changed for the different tranches of equity and debt. The pricing range in this diagram depends on the LTV levels and types of real estate. Loans on prime assets with lower LTV are priced on the lower side of the range.

DIAGRAM / COMMERCIAL REAL ESTATE LOAN STRUCTURING AND PRICING



SOURCE: INREV, M&G INVESTMENTS, CBRE

3.2 Institutional investors

As banks are retreating from the lending market, institutional investors are looking at direct lending strategies.

3.2.1 INSURANCE COMPANIES

Several large insurance companies are already active or have announced plans to become active in the property lending market. INREV estimates that there are more than 10 large insurers active in debt financing in Europe. On a country level, local insurance companies often finance local borrowers by participating alongside banks.

It is expected that insurance companies will gain a substantial market share in the lending market in the coming years. Last year in the UK, insurance companies provided an estimated 15% of all real estate loans. It is expected that that within five years, this is expected to grow to 30%. In other European countries the picture is somewhat different as insurance companies are still reluctant to provide big ticket loans. There are some exceptions, such as AXA Real Estate and Allianz, which are trying to participate with other banks in syndicates.

Insurance companies have different requirements to banks when providing loans. Banks usually provide loans for five to seven years while insurance companies are mainly focused on longer terms of between 10 and 15 years to help match their insurance liabilities. This is particularly the case for life insurers. In addition to the long-term duration, insurance companies almost exclusively provide senior loans with a maximum LTV of 60%.

Only a few insurance companies have established their own loan desks and are providing loans directly to real estate investors. The majority are doing so in cooperation with banks, which is a strategy that usually requires relatively fewer resources. Real estate lending teams that work for insurance companies are usually three to five people strong and take responsibility for loan origination. In the meantime, their syndication partners take responsibility for due diligence, risk management and administrative tasks. There are a number of insurance companies that have substantially expanded their teams to capitalise on the current market opportunities.

Table 01 (page 09) provides an overview of insurance companies that provide real estate loans.

TABLE 01 / INSURANCE COMPANIES PROVIDING COMMERCIAL REAL ESTATE LOANS

COMPANY	TYPE OF LOANS	TYPE OF PRODUCT	MARKET FOCUS
AXA REAL ESTATE	SENIOR	DEBT FUND AND SEPARATE ACCOUNTS	UK AND WESTERN EUROPE
METLIFE	SENIOR	DIRECT LENDING	UK
LEGAL & GENERAL	SENIOR AND WHOLE LOANS	DIRECT LENDING	UK
PRUDENTIAL (M&G INVESTMENTS)	SENIOR AND MEZZANINE	DEBT FUND AND DIRECT LENDING	UK AND WESTERN EUROPE
ALLIANZ	SENIOR	DIRECT LENDING	UK AND WESTERN EUROPE
BAWAG	SENIOR	DIRECT LENDING	UK AND WESTERN EUROPE
CORNERSTONE/ MASSMUTUAL	SENIOR	DIRECT LENDING	UK
AVIVA INVESTORS	SENIOR	DIRECT LENDING	UK
AIG	SENIOR	DIRECT LENDING	UK
CANADA LIFE	SENIOR	DIRECT LENDING	UK
PRICOA MORTGAGE CAPITAL	SENIOR	DIRECT LENDING AND SYNDICATION	UK AND WESTERN EUROPE

SOURCE: PUBLIC SOURCES

3.2.2 PENSION FUNDS

Pension funds are expected to be subject to similar capital requirements that insurance are experiencing under Solvency II through the Institutions for Occupational Retirement Provision (IORP) Directive. This means that regulation could also drive a change in their investment patterns which could prompt more allocations to debt investment.

In addition, low bond yields are forcing pension funds to look for alternative investment products that offer higher yields with a relatively low risk profile. The significant yield spread over government bonds that real estate lending offers is perceived to be attractive by many institutional investors.

A number of pensions fund that were interviewed for this report have indicated that investing into real estate debt is becoming an increasingly interesting option but they do not expect increase their allocation substantially in the near term.

According to INREV Investment Intentions Survey 2012, real estate debt funds are the most popular mandate among the alternatives investments for investors and fund of funds managers. Around 41% of investors said that they are likely or very likely to make an investment in real estate debt funds in 2012 and 2013.

3.3 European Commercial Mortgage Backed Securities (CMBS) market

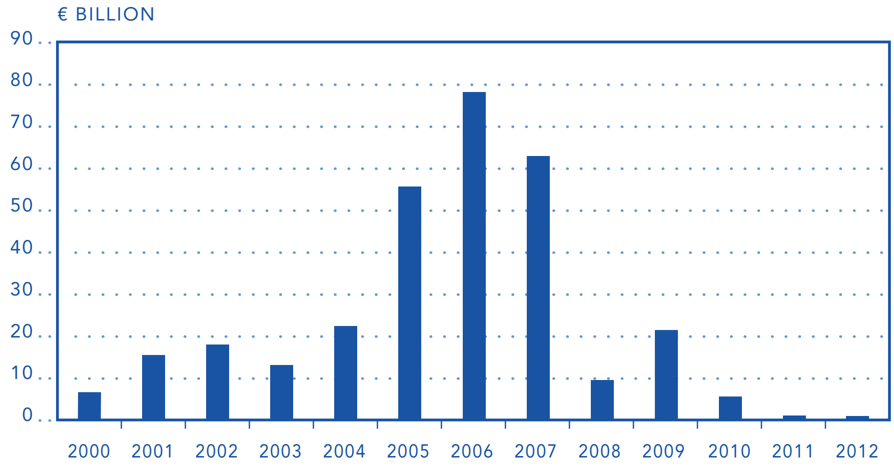
CMBS is a relatively small source of commercial real estate lending in Europe. The European CMBS market grew consistently prior to the credit crisis but issuance volumes have collapsed in the last four years. During this time less than €40 billion of CMBS was issued compared with the €64 billion issued in 2007 alone (Figure 03).

Since the crisis, the European CMBS market is undergoing a structural shift with originators' business models being revised and the investor base changing significantly. In addition, those investment banks which were main providers of loans to be securitised have exited the market.

Many pre-credit crisis CMBS issues need to be refinanced in the 2012–2014 period in a back-drop where the market has seen a number of unsuccessful refinancing attempts and defaults.

It is expected that CMBS will remain only a marginal provider of real estate loans in the medium-term due to regulatory challenges, prohibitive investor hurdle rates and conservative rating agency treatment, resulting in less investor interest to invest in CMBS products.

FIGURE 03 / EUROPEAN CMBS ISSUANCE



SOURCE: ASSOCIATION FOR FINANCIAL MARKETS IN EUROPE

3.4 *Pfandbriefe*

Pfandbriefe is a German mortgage backed security collateralised by long-term assets such as property mortgages or public sector loans under the Pfandbrief Act. They are issued by mortgage banks and are considered the safest non-government bond in Germany.

Pfandbriefe are usually associated with asset-backed securities but they are fundamentally different. The major difference is that *Pfandbrief* loans remain on the bank's balance sheet, while asset-backed securities (i.e. CMBS) are typically off-balance-sheet transactions.

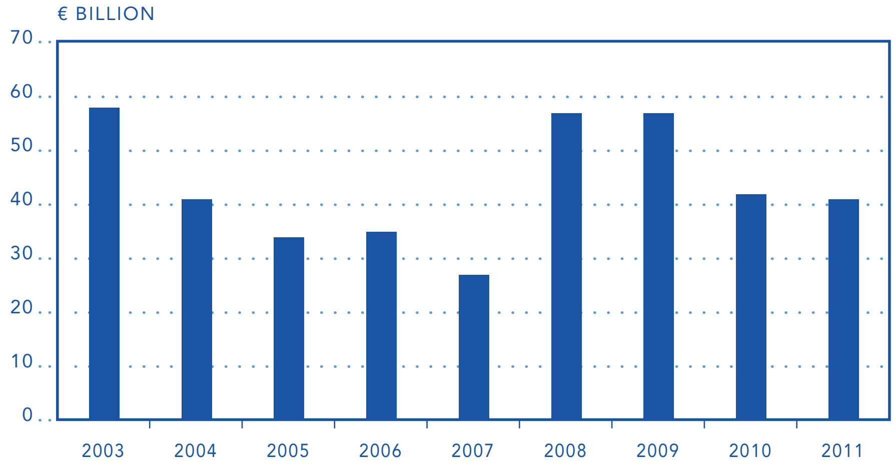
The *Pfandbrief* market and the property mortgage *Pfandbrief* segment, in particular, have proven to be resilient to the consequences of the credit and economic crisis. This success is mainly due to how the *Pfandbrief* market operates and how these products are structured.

German banks are able to provide real estate loans that qualify for *Pfandbriefe*. The main criterion is that they must have a LTV ratio of less than 60%. Although German banks can also securitise foreign loans, *Pfandbriefe* are mainly backed by German real estate loans and prime foreign real estate. This is because investors that buy *Pfandbrief* securities prefer issues without foreign loans. Almost 80% of all outstanding property mortgage *Pfandbriefe* are secured by German real estate loans while around 47% of all outstanding mortgage *Pfandbriefe* are backed by commercial loans. The market share of commercial real estate loans within a securitisation pool has remained stable during the last five years.

As German banks can issue these securities relatively cheaply, competition in the German senior commercial loan market is strong with competitive pricing. This means that refinancing loans with lower LTVs in Germany is less problematic than in other countries.

At the end of 2011 more than €203 billion of mortgage *Pfandbrief* securities were outstanding. As the CMBS and covered bond markets collapsed, German *Pfandbriefe* issuance remained strong and was even higher than in the pre-crisis period (Figure 04).

FIGURE 04 / MORTGAGE *PFANDBRIEFE* ISSUANCE



SOURCE: THE ASSOCIATION OF GERMAN *PFANDBRIEF* BANKS

4 REAL ESTATE DEBT FUNDS

4.1 Launches and capital raising

In the last three years at least 19 real estate debt funds have been launched bringing the size of the sector to an estimated €9–10 billion.

Based on the interviews with fund managers and other public sources, INREV estimates that during the last three years debt funds raised €4–5 billion. The majority of this capital was raised in 2011 and 2012. The majority of funds launched in 2010 and 2011 have reached their target size while many more recent funds have found raising capital more difficult.

INREV estimates that funds managers also raised €4–5 billion from their separate account clients to be invested in real estate loans.

Within the market there are at least seven debt funds that provide only senior loans, with a total target size of more than €6 billion. There are then 12 funds which have a strategy of providing a mix of whole loans and subordinated loans with a total target size of more than €3–4 billion. A number of these funds focus only on junior and mezzanine loans and others have a mixed strategy.

Although these figures appear to reflect a growing market, both fund managers and investors have indicated that the capital raising environment remains very challenging, particularly for small and independent fund managers. Larger fund managers have been better able to raise capital but often because they have been supported by internal sponsors.

A number of funds that announced plans to launch debt funds have since cancelled these plans as they were not confident that they could deploy the capital at the promised returns.

Table 02 on page 13 gives an overview of all funds that are already invested, raised capital or which have announced their launch. The information in this table is obtained from public sources and has not been confirmed with the fund manager directly.

TABLE 02 / EUROPEAN REAL ESTATE DEBT FUNDS

FUND NAME	FUND MANAGER/ SPONSOR	STATUS	LOAN STRATEGY	TARGET SIZE IN MILLIONS	REGIONAL FOCUS
COMMERCIAL REAL ESTATE SENIOR FUND 1	AXA REAL ESTATE	RAISING CAPITAL, INVESTING	SENIOR	€1700–2000	EUROPE, MAIN FOCUS ON UK, GERMANY AND FRANCE
AEW SENIOR DEBT FUND	AEW EUROPE	RAISING CAPITAL	SENIOR	€500	FRANCE, GERMANY, UK
EUROPEAN REAL ESTATE DEBT FUND	DRC CAPITAL	INVESTED	JUNIOR AND MEZZANINE	£300	UK AND WESTERN EUROPE
LASALLE UK SPECIAL SITUATIONS FUND I	LASALLE INVESTMENT MANAGEMENT	INVESTED	MEZZANINE	£100	UK
LASALLE MEZZANINE DEBT FUND	LASALLE INVESTMENT MANAGEMENT	RAISING CAPITAL, INVESTING	JUNIOR AND MEZZANINE	£700	UK AND GERMANY
M&G REAL ESTATE DEBT FUND	M&G INVESTMENTS	INVESTING	JUNIOR AND MEZZANINE	€343	UK AND WESTERN EUROPE
M&G SENIOR DEBT FUND	M&G INVESTMENTS	RAISING CAPITAL	SENIOR	£1000	UK AND WESTERN EUROPE
PRIME LONDON RESIDENTIAL DEVELOPMENT FUND	CORDEA SAVILLS	RAISING CAPITAL	JUNIOR AND MEZZANINE	£250	UK
PREDIREC IMMO 2019	GROUPAMA/ ACOFI	RAISING CAPITAL	SENIOR	€400	FRANCE
SENIOR DEBT FUND	LA FRANÇAISE AM	RAISING CAPITAL	SENIOR	€600	UK, FRANCE, WESTERN EUROPE
HIGH INCOME REAL ESTATE DEBT FUND	HENDERSON GLOBAL INVESTORS	RAISING CAPITAL	STRETCHED SENIOR, JUNIOR AND MEZZANINE	£250	UK AND WESTERN EUROPE
SENIOR SECURED REAL ESTATE DEBT FUND	HENDERSON GLOBAL INVESTORS	RAISING CAPITAL	SENIOR	£500	UK AND WESTERN EUROPE
SIGNA READ EUROPEAN REAL ESTATE DEBT FUND	SIGNA GROUP	RAISING CAPITAL	JUNIOR AND MEZZANINE	€300	GERMANY, BENELUX
CHENAVARI DEBT FUND	CHENAVARI INVESTMENT MANAGERS	INVESTING	JUNIOR, MEZZANINE AND BRIDGE LOANS	£250	UK, GERMANY, FRANCE
SENIOR DEBT FUND	III-INVESTMENTS	RAISING CAPITAL	SENIOR	€400	GERMANY
MATRIX COMMERCIAL MORTGAGE FUND	MATRIX PROPERTY FUND MANAGEMENT	RAISING CAPITAL/ PARTLY INVESTED	JUNIOR	£200	UK
LONGBOW UK REAL ESTATE DEBT INVESTMENTS II	LONGBOW REAL ESTATE CAPITAL	INVESTED	STRETCHED SENIOR, MEZZANINE AND PREFERRED EQUITY	£242	UK
UK REAL ESTATE DEBT INVESTMENTS III	LONGBOW REAL ESTATE CAPITAL	RAISING CAPITAL	MEZZANINE AND SENIOR	£500	UK
PRAMERICA REAL ESTATE CAPITAL 1 FUND	PRAMERICA	INVESTED	JUNIOR AND MEZZANINE	£492	UK, WESTERN EUROPE

SOURCE: PUBLIC SOURCES

Other fund managers that have reportedly announced plans to launch debt funds include Starwood Capital, LA Banque Postale AM, Aeriance, Fortress Investment Group, JP Morgan, The Blackstone Group, Blackrock and Goldman Sachs.

4.2 Strategies

INREV has identified five commercial real estate debt fund strategies that European fund managers pursue.

1. Senior debt
2. Subordinated debt
3. Whole loans
4. Mixed debt
5. Distressed loans

In Table 03 on page 17 an overview and details of the different commercial real estate debt strategies is provided.

4.2.1 SENIOR DEBT STRATEGY

Senior debt funds invest in senior ranking and conservatively structured real estate loans with leverage of up to 60% LTV. The loans are predominantly newly originated and secured by good-quality, well-located real estate, mainly in the UK and western European countries such as Germany, the Nordics, the Netherlands and France.

Senior debt funds aim to take advantage of the current opportunity in the commercial real estate lending market by selectively choosing the loans that will be included in their portfolios.

Managers of senior debt funds often rely on banks to originate loans and then to invite them to participate in a syndicate. Banks have the ability to originate loans but often want to reduce their risk and exposure to single borrowers and assets, as such loans require higher capital charges.

As discussed earlier, the current real estate lending market conditions means that providers of senior loans are able to offer loans with LTVs of 50%–60% under more favourable pricing for the lenders and better financial covenant terms than in previous years.

The fact that senior debt funds provide 60% LTV loans means that debt fund investors have a downside protection against real estate value falls of at least 40% before they have to take losses. Additionally senior debt holders benefit from first mortgage rights on the property and share pledges that ensure their repayment position in case of default. The use of leverage within these funds is very rare.

For this product fund managers mainly target fixed income investors that are willing to invest larger amounts and are interested in investments that provide a stable cash flow.

The returns that these senior debt funds offer are a 4%–6% gross internal rate of return (IRR) and are not usually high enough to be of interest for the real estate investment departments of pension funds, insurance companies and other investors. But these departments usually support their fixed income colleagues in assessing and understanding the real estate industry and products better.

The main sectors that senior debt funds focus on are retail, offices, industrial/logistics and residential. They tend to avoid any real estate type that is considered alternative and do not undertake development financing.

Senior debt funds have an average target size of €1 billion and provide loans of between €50 and €200 million. The majority of market players believe that this type of fund should be of a substantial size to provide large loans and achieve enough diversification within the fund to be successful.

4.2.2 SUBORDINATE DEBT STRATEGY

Funds that have a subordinated debt strategy offer a mix of stretched senior, junior and mezzanine loans. This tranche of finance sits in the space between lower risk senior lending and the equity. This type of loan enables lenders to get higher returns on their debt provision than senior lenders as they occupy the space directly above them on the risk spectrum. However, it does also mean that they sit behind the senior lenders for repayment if there are issues with the loan. These loans usually typically occupy the 60%–80% LTV part of the capital stack. This type of fund offers investors a downside protection against real estate value falls of up to 20% before they have to take losses. Use of leverage within these funds is very rare.

The average fund that follows this type of strategy invests in or provides commercial real estate loans secured on good quality, income producing property located in the UK, France, Germany, the Nordics and the Netherlands.

Mezzanine/junior loans are mainly provided by a single lender and syndication is rare. Funds that offer this type of loan can be invited by banks or borrowers to participate in financing packages where senior debt is also being arranged.

These funds aim to provide loans for a period of three to five years with the intention to retain the investment until maturity. However, funds build in for the potential for early repayment or refinancing, if the opportunity arises. In these cases, the fund manager usually agrees early repayment penalties and/or profit sharing with the borrower.

The average subordinated debt strategy fund has term of five to seven years and targets gross returns of 8%–15%. This is usually a combination of an annual coupon and additional return that comes from other fees, discounts of acquired loans and a profit sharing part. The profit sharing is usually derived from penalties that are paid in case of early repayments.

Subordinated debt fund managers aim to make investments in across sectors, countries and with different borrowers to diversify their risk. They focus on the retail, offices, industrial/logistics and residential sectors. While the majority of fund managers do not exclude hotels and other higher risk sectors, they would offer in this case lower LTVs and charge higher interest rates compared to traditional real estate investment sectors.

Only a small number of funds with this strategy indicated that they would be prepared to provide 100% ground-up developments and redevelopment financing.

Funds that follow this strategy tend to provide newly originated loans, either for new investments or refinancing; existing loans by acquiring loans from lenders, and also buy CMBS bonds with attractive pricing and discount.

4.2.3 WHOLE LOAN STRATEGY

A whole loan is combination of senior and mezzanine debt for which borrowers are prepared to pay a higher margin (cost of borrowing) as it offers them a one stop-shop solution rather than needing to look for separate lenders.

This is particularly attractive for borrowers who need to refinance their loans but are finding that banks require additional equity as their LTVs have risen due to the fall in real estate values. This situation is not helped by the fact that senior loans are more difficult to secure.

This type of borrower is prepared to pay higher interest rates to keep control of their property and a number of fund managers have decided to focus on this part of the market by offering whole loans.

These loans are also a good option for borrowers in cases where senior lenders do not accept subordinated lenders in the capital stack, or make it unattractive for subordinated lenders to step in.

Funds that follow this type of strategy offer loans with LTV of 70%–75%, what means that real estate values have to fall by at least 25% to cause losses. Use of leverage within these funds is very rare.

Whole loan funds have an average size of €500 million and aim to provide 10–15 loans. Within their loan portfolio, fund managers look to diversify their exposure by type of real estate and borrower by focusing on offices, retail and industrial/logistics in countries such as the UK, Germany and France.

The average whole loan strategy fund typically has term of five to seven years and targets gross returns of 6%–8%. This is usually a combination of an annual coupon of 5%–6% and additional return generated from fees and discounts obtained on purchase of existing loans.

4.2.4 MIXED DEBT STRATEGY

Fund managers for debt funds have found it increasingly challenging to source only junior/ mezzanine deals while at the same time meeting their target size and offering returns that are still attractive to potential investors.

Therefore, since 2011 an increasing number of fund managers have adopted a mixed strategy where the fund provides a mix of loans within the whole capital stack. These funds are usually a well diversified mix of whole loans, stretched senior, junior and mezzanine loans. Only pure senior loans are not provided as returns are too low for their risk/return profile.

Funds that follow this strategy have on average €500 million under management and aim to provide 15–25 loans of various sizes and returns.

The average mixed debt strategy fund has term of five to seven years and targets gross returns of 8%–10%. This is usually a combination of an annual coupon of 7%–8% and additional return that comes from other fees, discounts of acquired loans and a profit sharing part. The profit sharing is usually derived from penalties that are paid in case of early repayments.

The levels of returns depend directly on the risk level of loans and this is determined by the LTV, the type of real estate and the nature of the borrower.

As with other debt funds, those with a mixed debt strategy use no or very little leverage and provide 20%–25% downside protection against real estate value falls.

4.2.5 DISTRESSED LOANS STRATEGY

A distressed debt strategy is usually associated with opportunity funds that purchase large portfolios of loans from banks, governments and defaulted CMBS issues at significant discounts.

The expected unlevered return of these funds is usually 10%–15%. But many use leverage to enhance their returns to the 15%–20% range.

In order to execute such a strategy, managers need to have skills and capabilities that will allow them to extract as much value as possible from distressed loans. This is done through a number of methods. Funds can modify and extend the loan if they believe that the borrower can resume payments. In this case, funds negotiate higher interest payments and/or a significant pay-down in exchange for extending the loan.

Another option is to convert the loan into equity and work together with the borrower to minimise loses and maximise the upside.

If these options do not work, the fund usually forecloses on the loan and manages the assets itself.

4.2.6 SUMMARY OF REAL ESTATE DEBT FUND STRATEGIES

Table 03 gives a summary of strategies that European real estate debt funds follow.

TABLE 03 / COMMERCIAL REAL ESTATE DEBT FUND STRATEGIES

	LOAN TYPES	LTV RANGE (%)	TARGET GROSS IRR RETURN (%)	LEVERAGE
SENIOR DEBT STRATEGY	SENIOR LOANS	0–60	4–6	UNLIKELY
SUBORDINATED DEBT STRATEGY	JUNIOR AND MEZZANINE	LOW RISK 60–70 HIGH RISK 70–80	8–12 12–15	UNLIKELY UNLIKELY
WHOLE LOAN STRATEGY	SENIOR AND MEZZANINE	0–75	6–8	UNLIKELY
MIXED DEBT STRATEGY	WHOLE LOANS, STRETCHED SENIOR, JUNIOR, MEZZANINE	0–80	8–10	UNLIKELY
DISTRESSED DEBT STRATEGY	DISTRESSED LOANS	50–100	15–20	LIKELY

4.3 Structure, terms and conditions

Almost all debt funds that currently operate in the European market have a closed end structure. The majority of funds that follow subordinated or whole loan strategy have a fund term of five to seven years with an extension option of one or two years. Some senior debt funds have a fund term of up to 10 years. All types of funds have an investment period of 24–36 months that sometimes can be extended by additional six month period.

TABLE 04 / DEBT FUND TERMS AND CONDITIONS

	FUND STRUCTURE	FUND LIFE (YEARS)	EXTENSION OPTION (YEARS)	INVESTMENT PERIOD (MONTHS)
SENIOR DEBT FUNDS	CLOSED END	5–10	1–2	24–36
SUBORDINATED DEBT FUNDS	CLOSED END	5–7	1–2	24–36
WHOLE LOANS FUNDS	CLOSED END	5–7	1–2	24–36
MIXED DEBT FUNDS	CLOSED END	5–7	1–2	24–36

4.4 Loan pricing and target returns for fund strategies

Market conditions have resulted in the interest rate margins rising considerably while LTV levels have fallen. Due to low LIBOR and EURIBOR rates the total cost of lending is comparable to pre-crisis levels. Across the region, it is possible to conclude that pricing for higher-risk whole loans and subordinated loans is comparable. However, senior loans are cheaper in Germany and France compared to the UK, where they are at the upper end of the range.

In Table 05 the average loan terms, prices and other loan terms that fund managers said are achievable are summarised.

Mezzanine funds that were launched two to three years ago offered returns of more than 15% but those now coming to the market have lower target returns. This can be explained by the fact that, as senior loans become more difficult to secure, it is also becoming more difficult to offer only mezzanines loans. Instead, funds also include whole loans and stretched loans in fund portfolios to meet investment targets.

TABLE 05 / LOAN PRICING AND TERMS (AS AT SEPTEMBER 2012)

STYLE	LOAN PRICING	OTHER FEES	LOAN TERMS YEARS	YEARLY CASH PAYMENT (%)	AVERAGE LOAN SIZE (€ MILLION)
SENIOR LOANS	LIBOR/EURIBOR + 250–400 BP	COMBINATION OF UPFRONT AND EXIT FEES: 2–4%	5–10	2–4	50–150
SUBORDINATED LOANS	8–12% FIXED RATE	COMBINATION OF UPFRONT AND EXIT FEES: 2–4%	3–7	7–10	10–25
WHOLE LOANS	LIBOR/EURIBOR + 400–700 BP	COMBINATION OF UPFRONT AND EXIT FEES: 2–4%	5–7	5–7	40–100

For individual loans, fund managers agree with borrowers on early re-payment penalties and profit sharing clauses that will compensate the fund in these cases. The size of the penalty/profit share usually depends on the remaining loan term and the borrower's actual IRR compared to projection when the loan was provided. Some funds also implement minimum loan periods and the requirement to maintain a certain yield.

It should be noted that these types of penalties are not always easily enforceable. In the UK, the legislation is in favour of this type of clause but it is more challenging in Germany, France and other European countries.

4.5 Fees and terms for investors into debt funds

The fee structure of many debt funds consist of management fees, performance fees, commitment fees and loan origination/acquisition fees.

All funds implement management fees and performance fees. The management fee is based on invested capital while the performance fees are paid at fund termination and are based on an agreed hurdle rate and absolute realised return. Fund managers usually receive 20% of the profit if the return exceeds the hurdle rate. Some investors interviewed expressed their concerns about performance fees as they can induce fund managers to take on unnecessary risk.

A number of funds also charge commitment fees while other fees such as acquisition, origination and set-up are seen in some separate funds but are not uniform and are rare.

All the fees that are mentioned in the Table 6 are general for these types of funds and can vary based on the following factors:

1. Size of investment: depending on their investment size, investors into debt funds usually get a discount of 20-40 basis points on management fees. They can also negotiate on other fees and may get discounts compared to smaller investors.
2. Strategy: higher fees are charged by funds that take greater risks by providing higher LTV loans or that finance high risk projects to obtain higher returns.

TABLE 06 / DEBT FUND FEE STRUCTURE

FUND TYPE	MANAGEMENT FEES (BASIS POINTS)	PERFORMANCE FEES	COMMITMENT FEES (BASIS POINTS)
SENIOR DEBT STRATEGY	40–70 ON INVESTED CAPITAL	20% OVER HURDLE RATE OF 4–5%	50–90
WHOLE LOANS STRATEGY	60–100 ON INVESTED CAPITAL	20% OVER HURDLE RATE OF 6–7%	50–90
MIXED DEBT STRATEGY	80–150 ON INVESTED CAPITAL	20% OVER HURDLE RATE OF 7–8%	50–90
SUBORDINATED DEBT STRATEGY	100–200 ON INVESTED CAPITAL	20% OVER HURDLE RATE OF 8–9%	50–90

4.6 Investment process, due diligence and risk management

The investment process that real estate debt fund managers undertake is a combination of the bank and real estate processes and usually consists of five phases:

1. Origination and screening
2. Underwriting and due diligence
3. Approval by investment committee
4. Execution
5. Monitoring

In the origination and screening phase, fund managers look for debt investments by meeting with potential borrowers, banks or other parties.

Loans or investments that meet the fund's investment criteria and strategy are carried forward to the underwriting and due diligence phase, and usually focus on the following activities:

– Analysis of the underlying real estate and key lessees
– Analysis and structuring of credit agreements
– Analysis of the borrowers
– Portfolio diversification analysis in terms of property type, location, tenant and sponsor
– Cash-flow and exit stress testing
– Pricing and determining terms and conditions

The term, conditions and pricing depend largely on the analysis of all factors and negotiation with the borrowers. Taking all aspects into account, fund managers will prepare a loan proposal with conditions that will limit the downside risk and provide pricing that correctly reflects these risks.

Fund managers focus on the loan terms and inter-creditors agreements as these determine in the case of default whether they will be able to easily repossess the underlying property. While enforcing mortgage rights is relatively easy in the UK and Germany, in other countries it can be more challenging.

Investment proposals then need to be approved by the fund's investment committee, which assesses if the loan fits with the fund's objectives, strategy and other parameters. Investment committees might reject the loan or set out extra conditions under which the loan can be accepted. Following approval by the investment committee, the loan is provided to the borrower.

Once the loan has been provided, the fund manager is responsible for regularly monitoring the loan's performance and taking corrective action as needed. Fund managers usually require borrowers to provide quarterly data updates, which are then used by fund managers to compare with the business plans that were agreed at the outset of the loan.

The majority of subordinated debt fund managers prefer to undertake the loan management internally to ensure close control. Senior debt fund managers tend to use the services of external companies.

4.6.1 DUE DILIGENCE

Borrower, real estate and key lessee due diligence are also important parts of the loan arrangement process. When conducting the due diligence process, the following aspects are considered:

– legal due diligence
– valuation
– technical/structural due diligence
– environmental due diligence

Downside protection for falls in real estate values for subordinated debt is only 20%–25% compared with around 40% for senior debt providers. Therefore, for subordinated debt, fund managers said that their analysis of the underlying real estate is as detailed as an equity investment.

Fund managers that manage both senior and subordinated loan funds said that they do a lot more assessment on default scenarios for subordinated loans and make more extensive enquiries about the underlying property.

The majority of fund managers that established debt funds also manage real estate funds so have the knowledge and capability to assess the underlying real estate. Within the organisation direct real estate teams and debt funds team work together closely.

Fund managers also prefer to focus on newly originated loans as they can control the conditions under which it is originated and then do not face any refinancing risk early in the fund life.

For many subordinated debt fund managers it is standard procedure to get second mortgage rights, share pledges from the property company and a pledge on insurance proceeds. Second mortgage rights give the lender the right to claim the proceedings from the sale of real estate after the claims of the first mortgage right holders are satisfied.

Share pledge clauses allow subordinated lenders to get shareholding rights of the property company and resolve financing problems without an immediate foreclosure. A pledge on insurance proceeds gives lender the right to claim insurance payments if a part of the loan is still outstanding.

4.6.2 EXIT STRATEGIES AND WORKOUTS

The vast majority of debt fund managers said their funds would exclusively focus on originating performing loans rather than taking over assets with non-performing loans, which is sometimes called a "loan-to-own" strategy.

Loans that are provided during the investment period are set up to have a duration that is no longer that the fund life time. The strategy of all funds is that borrowers repay their loans at the end of the loan term.

If loans are not repaid on time, funds may agree an extension period of one or two years to allow them to resolve these loan repayments. However, fund managers mitigate the risk of extension by implementing amortisation schedules that reduce the loans' LTV ratios during the loan period. Amortisation schedules are usually agreed by senior lenders but this has a knock on effect of lowering the LTVs of subordinated debt holders.

Funds also have two contingency scenarios in case of default. If the borrower goes bankrupt and the real estate is performing, the fund will take over the asset, which is usually structured within a protected special purpose vehicle (SPV). The fund manager will dispose of the property to repay the loan.

In a second scenario, where the real estate is not performing, the fund manager will try to take over the property as soon as possible, attempt to resolve the problem and then sell the property to repay the loan.

In both scenarios fund managers said that they would deal with the problem by using the skills of specialised firms that will manage the real estate for them. Debt fund managers that are part of larger firms will rely on the real estate knowledge and experience of their colleagues.

For both scenarios to succeed, it is very important that managers can take control over the assets. Therefore, having appropriate loans covenants and inter-creditor agreements is especially crucial in distressed situations.

4.7 Corporate governance

As with direct real estate funds, corporate governance and alignment of interest are important issues for both debt fund managers and their investors. The negative experience that investors experienced through the crisis has made them more aware of the risks and pitfalls around these two topics.

There are no real differences between debt funds and other more traditional real estate funds for these issues with debt fund managers implementing current best practice such as an active advisory committee, no fault divorce clauses, and key person clause, for example. Fund managers also said that they either co-invested on a personal level or that their holding companies invested substantial amounts in their fund. Investors in debt funds said they expected some form of co-investment.

4.8 Debt fund legal construction and banking license

4.8.1 STRUCTURING OF DEBT FUNDS

As with real estate funds, the main aims of a debt fund structure are for it to:

- be tax neutral and to put the investor in materially the same tax position as they would have been in had they invested in the underlying assets directly;
- mitigate as far as possible any irrecoverable VAT;
- be subject to a workable regulatory regime; and
- be a vehicle which can have flexible contractual terms and which investors are comfortable with.

However, there are important differences as a result of the nature of the assets and activities of debt fund which means that there are additional structural drivers such as:

- mitigation of withholding tax on interest payments in respect of loans;
- additional analysis being needed in relation to VAT;
- ensuring that principal is not returned to investors as a capital gain and capital is not returned to investors as income; and
- consideration of the regulatory position relating to banking licences and/or consents.

Set out below in more detail are some of the key structural features which need to be considered carefully when designing a debt fund.

4.8.2 CHOICE OF FUND VEHICLE

There are a number of possible options for the fund vehicle but a key driver is whether the fund vehicle will be regulated or non-regulated. The regulated route has benefits in that some regulated entities (especially those in Luxembourg) are authorised to originate loans whereas unregulated structures need loans to be originated in low-regulatory jurisdictions such as the Channel Islands. However, it is much more costly to set up and operate the regulated structure than the non-regulated structure. A commonly used regulated vehicle is a Luxembourg SICAV, a variable capital company under the specialised investment funds (SIF) regime.

With a non-regulated structure, investors could use a limited partnership to be established in any number of jurisdictions such as England or the Channel Islands. The disadvantage of this is that additional structuring is often needed so that no regulated lending activities are undertaken in any jurisdiction.

In Germany, investors often use Spezialfonds. However, these funds are not allowed to originate loans and, due to certain restrictions, German insurance companies are not permitted to use this type of structure. Therefore, other typical structures offered to German investors include English Limited Partnerships and Luxembourg fund structures.

Another key issue in Germany for the fund is under which quota the investment can be allocated for insurance regulatory purposes. Generally, a debt fund interest is allocated to the equity investment quota. From a tax point of view, certain tax exempt investors cannot invest directly into trading limited partnerships. Therefore, those investors would need a blocker structure and such structures may trigger the German foreign transactions tax (CFC Rules).

In France, there are two types of structures that are available for debt funds: the "fonds commun de titrisation" (FCT) and the "société de titrisation" (SDT). The FCT is the main joint venture vehicle used for implementing securitisation transactions under French law. An FCT is a collective debt investment fund organised –like most French funds– with a fund manager and fund custodian. FCTs have no share capital, no shareholders, no board of directors and no employees.

The SDT is a securitisation entity which is a specific form of share company. It may bring significant advantages in transactions where the benefit of international tax treaties is important. An SDT is a corporation and can issue bonds. It is regulated by its constituting documents (that is, regulations or articles of association) and is subject to regulatory requirements.

4.8.3 CAPITAL AND INCOME

The strategy of the debt fund drives the blend of return being generated. Debt origination provides primarily income return on a risk adjusted basis although a capital return could be achieved on development and mezzanine loans depending on the exit arrangements. As capital returns are often taxed at a lower rate than income returns, additional structuring can be undertaken with mezzanine funds in order to preserve capital receipts. This includes ensuring that capital receipts are not converted into income receipts, which enhances net taxable returns to investors and the management teams.

4.8.4 BANKING LICENSE AND SHADOW BANKING ISSUES

Loan origination is a regulated activity in certain jurisdictions and can require a banking licence. Luxembourg banking regulations in principle regulate all loan origination activities. These banking regulations do, however, also provide for certain exemptions if the activities are carried out by another regulated person in the financial sector or if the activities are structured in such a way that they fall outside the scope of the banking regulations.

While the regulatory authorities are currently exercising more scrutiny in relation to debt funds and have rejected certain projects, the Commission de Surveillance du Secteur Financier (CSSF) in Luxembourg has in the past granted regulatory clearance on certain fund structures. This area is still uncertain and is the subject of continued discussion with the CSSF and other regulatory bodies across Europe.

There is also a concerted international effort to bring shadow banking into the scope of regulation and various proposals have been published but at this stage there is little clarity on either the scope of the regulation or its impact. Shadow banking is lending by entities outside the bank system.

It seems likely that any proposed regulation will recognise that not all non-bank lending should be captured as only those entities carrying on bank-like activities are exposed to bank-like risks, but the final shape of any regulation, and whether the proposed regulation will be limited to provision of information or something more intrusive, remains to be seen.

5 REAL ESTATE DEBT FUNDS INVESTORS

In this section we focus on the investors' view on investing in real estate loans in general and debt funds in particular.

The idea of investing in real estate debt products is still new to European investors and in the last three to four years fund managers have spent time educating investors about this part of the market. This is partly because historically real estate debt, and in particular mezzanine debt, has had an image of being a high risk investment.

Instead, fund managers have been educating investors on the differences compared with direct real estate investment and demonstrating the closer relationship between real estate and subordinated debt compared with senior debt financing, which is more aligned with fixed income investing.

The types of investors considering real estate debt funds are similar to traditional property investment. Pension funds and insurance companies dominate the list of investors, but there is also interest from investment managers, high net worth individuals, family offices, funds of funds and sovereign wealth funds.

Pension funds tend to be more interested in subordinated debt funds that more closely meet their higher return requirement while insurance companies prefer senior debt funds. This is often related to the fact that those considering senior debt funds have big fixed income exposures as an organisation and are looking for ways to diversify their credit allocation.

Investors from different regions have expressed interest or invested into debt funds, but the principal investor base is from the UK, Western Europe and the Nordics.

In line with their other real estate investments, pension funds prefer indirect investment into debt through funds. Meanwhile, large insurance companies often have the ability and willingness to provide the loans directly but the majority have opted for separate accounts or taking a stake in a debt fund. According to the majority of investors interviewed, this is because they see providing loans as a specialist business and therefore it makes sense to source expertise from the market rather than build that expertise internally.

In many cases funds also co-invest or have capital committed from internal sponsors.

Despite the real estate angle, investment into senior debt funds is often viewed by the investor as fixed income and in many cases the fixed income departments are usually managing the investments into senior debt funds. In contrast, the subordinated fund investments are managed by the real estate teams.

For many investors an investment into debt funds is an income decision as they provide stable and predictable cash coupon.

The majority of investors interviewed said they find the risk/return characteristics of debt funds to be attractive. On one hand, those coming from a fixed income approach are faced with very low interest rates so are looking for alternative investment opportunities. In general they are prepared to accept the specific risks of debt funds, such as the lack of liquidity, as they are compensated by the extra return that senior debt fund provides compared to other fixed income investments.

For those with a real estate perspective, they said that they have limited investment opportunities that meet their risk/return requirements. Therefore, they see that subordinated debt funds can provide an attractive return at what they see as an acceptable risk level.

In addition, the real estate debt fund can provide a steady cash coupon from close to the beginning of the fund and the J-curve of a debt fund is very limited compared with closed end equity real estate funds. The J-curve is where returns are low or negative at the outset, often due to costs related to early investments.

There is speculation that, under Solvency II, investments into real estate debt will be treated more favourably compared with direct real estate investment. However, the full details of how Solvency II will be applied still have to be finalised so the impact on insurance companies' investment appetite for debt is not yet clear.

The main risks that investors face when investing into debt fund are:

- Real estate risk: risk that real estate values will fall.
- Tenant risk: risk that major tenants will go bankrupt or will not extend their rental contracts leading to a substantial decrease in rental income.
- Liquidity risk: real estate loans are very illiquid, if forced to sell the loan lenders usually need to offer substantial discounts.
- Refinancing risk: as loans are usually provided for five years there is always a risk that borrowers will not be able to refinance the loan within the life of a fund.
- Early repayment risk: due to various reasons some borrowers might choose to pay back their loans earlier than agreed. This risk is usually mitigated by minimum holding periods, early repayment penalties or profit sharing clauses.
- Strategy execution and capital deployment risk: debt fund investors are concerned about a debt fund's ability to deploy capital and execute the fund's strategy as a number of early fund managers were forced to extend their investment periods.
- Legal risk: in case of default or other problems with borrowers, fund managers need to have the ability to handle the situation by enforcing their mortgage rights, which in some countries can be costly.

5.1 Selection of fund manager

Debt funds have been slow to take off due to their unfamiliarity to investors and also because few fund managers could demonstrate a track record in this area. While fund managers are working hard to educate the investment community, in general the investors interviewed still think that many fund managers lack the necessary experience that is needed to successfully manage these funds.

However, after being in the spotlight for a number of years, debt funds are becoming more common and investors are beginning to understand the risks and return characteristics of these products.

Investors now view senior and subordinated debt fund managers separately, as they understand the different skill sets needed to set-up and manage these funds.

Investors also pay attention to the team composition and are looking for fund managers with proven fund management, real estate, loan origination and loan management skills. Debt funds managers need to be able to demonstrate both banking and real estate management experience with investors looking for a specialist real estate lending team with access to a wider real estate network and proven track record.

For investors, the fund manager's track record in loan origination and real estate management plays a crucial role while those with experience and real estate capabilities are preferred to boutique funds that try to enter this market.

Investors also expect fund managers to co-invest in their funds to align their interests. In many cases, fund managers are co-invested in their funds or have obtained substantial capital allocations from internal sponsors.

5.2 Fund selection

When investing into debt funds, investors will consider particular criteria. One of the main issues will be the real estate characteristics of the loans currently in the portfolio or targeted as part of the strategy.

At this time, investors are looking for well-located and income producing properties, with a particular focus on the UK, Germany and France. The country focus should also reflect those locations with a good recourse process. Germany and the UK are seen as having the most favourable legal environment.

They are also focused on the property types comprising offices, retail, logistics and residential. While some investors will accept alternative property types, in these cases investors expect a good business plan and lower risk in terms of LTV. Investors tend not to be interested in development exposure and also tend to favour newly-originated loans or loans with renegotiated inter-creditor agreements and financial covenants.

From a fund point of view, investors like to see a good sponsor, no-fault divorce clauses and appropriate fees structures based on realised gains and not valuations. The majority of investors think fees being charged by fund managers are too high. During the last two to three years, average management fees have dropped by 40–50 basis points.

APPENDIX: LIST OF CONTRIBUTORS

ABN AMRO

AEW Europe

Allianz Real Estate

APG Asset Management

AXA Real Estate

CBRE

DRC Capital

DTZ

Gothaer Asset Management AG

Henderson Global Investors

ICG – Longbow

Internos Global Investors

La Francaise

LaSalle Investment Management

Legal & General

M&G Investments

Palatium Investment Management

PGGM

Pramerica Real Estate Investors

Russell Investments

Signa Holding

SJ Berwin LLP

SSWZ