DTZ Research

DTZ Insight
The Great Wall of Money
Pause in new raising as capital put to work

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Contents

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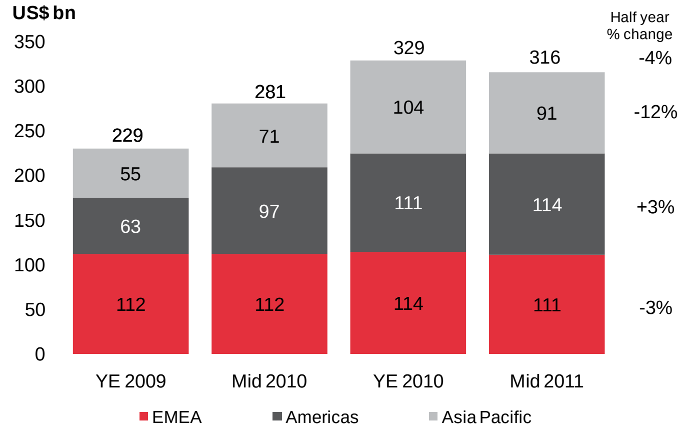
- The amount of new capital for investment in commercial real estate investment markets globally in 2012 has gone down 4% to US$316bn (Figure 1).
- The reduction in available capital points towards funds now clearly putting capital to work as the environment for raising new equity appears less favourable.
- Diversity across markets has continued to reduce, with more funds now focussed on a single country.
- Based on the domicile of investors and their know targets we expect to see higher levels of cross border investment compared to recent levels.
- If the current uncertainties in the global economy continue we would expect to see further reductions in available capital as:
  - Fund managers focus on deploying capital from existing funds as commitment periods near their end.
  - Some funds seek to extend fund lives in order to deploy remaining existing capital commitments.
  - Listed companies delay fresh equity raising or IPOs as global equity markets remain volatile and third party fund managers struggle to attract new investments

Figure 1

Available capital by region 2012



Source: DTZ Research

Introduction

This is the fourth edition of our “Great Wall of Money” report[1]. The report tracks new capital targeting direct real estate and the opportunities this capital is targeting. This report is divided into five key sections.

First we outline the amount of new capital available for investment in 2012 and compare with our previous studies. Second we consider the amount of capital available by investor type. Third we look at the property types the capital is targeting before looking at the geographic distribution in section 4. Finally, based on recent trends we present our outlook for the market.

In the appendix we outline our bottom-up data collection process and methodology and how we reached the amount of capital available in 2012.

New capital available

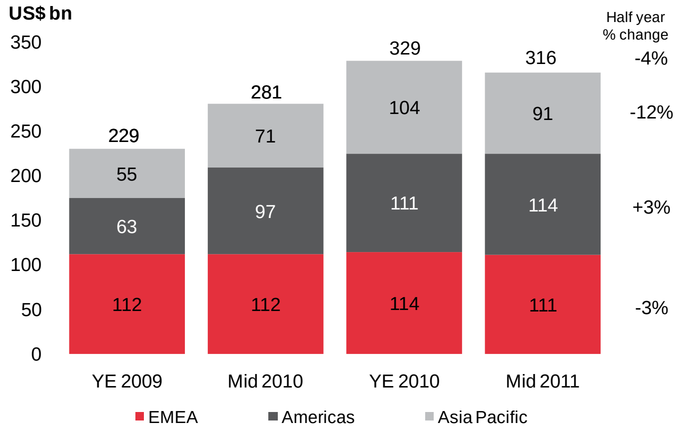
Americas only region to see growth in new capital

The amount of new capital for investment in commercial real estate investment markets globally in 2012 has fallen 4% to US$316bn. The fall marks a reversal in the growth seen since the end of 2009. Despite the 4% fall over the past six months, the amount of capital available is still 38% above the US$229bn reported in our first analysis (Figure 2).

The amount of new capital targeting the Americas rose 3% to US$114bn, the only region to record an increase in newly available capital. It is also the region attracting the most capital following falls in available capital in the other regions. In Asia Pacific, new available capital has fallen 12% to US$91bn. The EMEA region recorded a more modest 3% drop to US$111bn (Figure 2).

Figure 2

Available capital by region, 2012



Source: DTZ Research

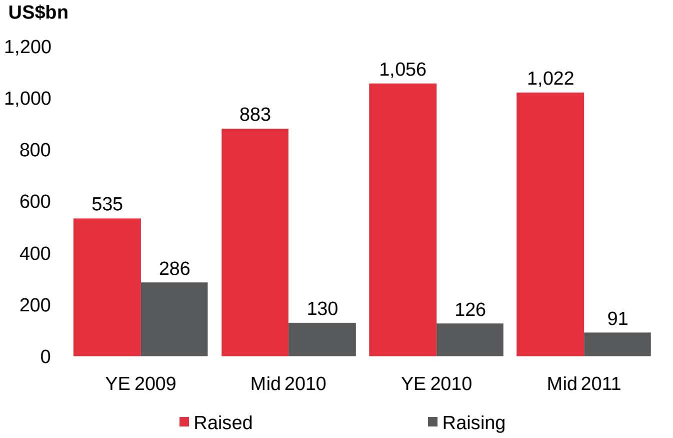
Pause in new raising

In previous reports we have seen a continued rise in the amount of newly raised capital. Our current analysis shows that this figure has now fallen back. At the same time, we continue to see a reduction in new capital raising, which is now less than a third of the level seen at the end of 2009 (Figure 3). These falls are not surprising given the current uncertain global economic outlook.

[1] See previous reports:
The Great Wall of Money – Volumes to double in 2010, December 2009
The Great Wall of Money – Capital shifts to attractive markets, October 2010
The Great Wall of Money – New capital increases most for Asia Pacific, March 2011

Figure 3

Change in available capital



Source: DTZ Research

With the Asia Pacific region attractively priced and showing strong levels of liquidity we suspect many of the funds took advantage of the favourable market conditions to deploy the newly raised capital quickly.

In the EMEA region, the amount of available capital has remained broadly stable since we started our analysis. However, we have only seen a modest uplift in transactional activity. This suggests that relative to Asia Pacific, funds targeting Europe are finding it harder to source appropriate opportunities.

This situation is even more acute in the US, where we have yet to see the strong rebound in transaction volumes seen elsewhere. At the same time, the amount of available capital continues to grow. This implies higher levels of transaction activity to come in the US.

New capital finally put to work

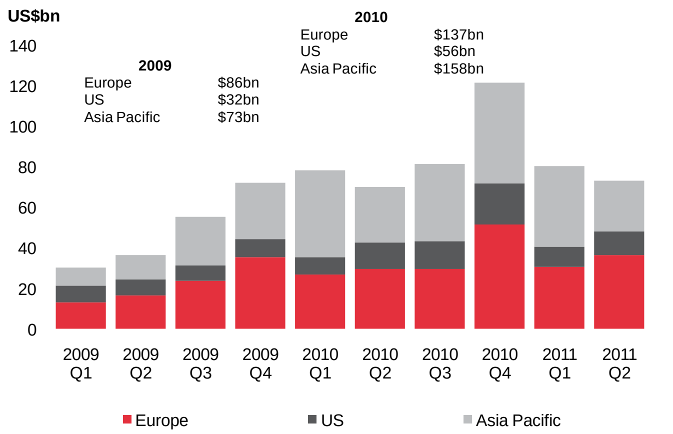
This reduction in available capital shows funds are more focussed on putting existing capital commitments to work as the environment for raising equity has become less favourable.

The 12% fall in capital targeting Asia Pacific is a surprise given the attractiveness of the region. However, part of the fall could reflect a lag between transactional activity and reporting by funds, together with a reduction in the level of new IPOs and capital raisings in the listed sector.

During 2010, transactional activity in the region more than doubled to US$158bn and has remained strong in H1 2011 at US$64.7bn (Figure 4).

Figure 4

Global investment transaction volumes



Source: DTZ Research

Investor type analysis

Publicly listed companies grow market share

While third party managed funds remain the most dominant players, their share of the market has slipped back to 49%, in line with their level a year ago (Figure 5).

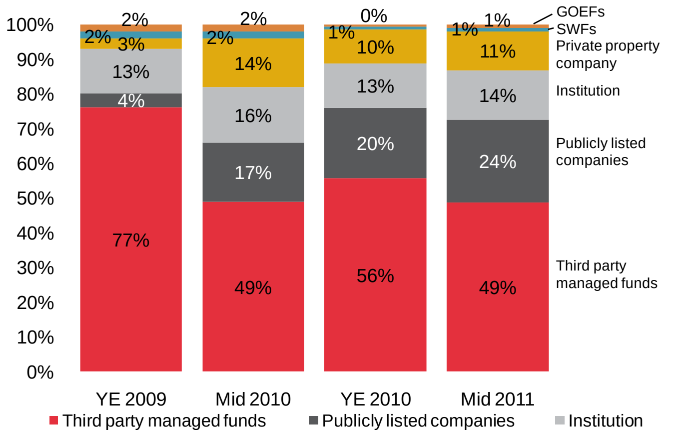
Publicly listed companies have continued to increase their share and now account for 24% of available capital. This follows a strong level of equity raising during 2010 and in the first quarter of this year. However, with equity markets now showing increased volatility as a result of uncertainties in the global economic recovery, we are starting to see fewer new raisings.

Institutions have maintained their share of available capital at 14%. As a wave of new regulation comes in for insurance companies and potentially impacting pension funds in the future we may see some hesitation in the deployment of capital from some of these funds as they review the impact of new legal structures.

The share of capital from German Open Ended Funds and other 'Spezial Fonds' remains weak at just 1%. This reflects the uncertainty in the run-up to planned changes in regulation of funds which came into force in April. Uncertainties have persisted as investors digest the impact of the regulations on their investment strategies. In Box 1 we outline in more detail these impacts and the near term outlook for German funds.

Figure 5

Available capital by investor type 2012



Source: DTZ Research

Box 1: Why are there fewer funds from Germany?

The amount of capital available from German funds has weakened since we started our analysis. But why is this, given the importance of many German funds in cross border activity?

During 2005-2007 many open ended funds attracted growing levels of inflows from institutional money. As quick as this money was invested, so a number of funds have suffered outflows in the wake of the financial crisis. Strong outflows left a number of funds with liquidity issues leading some to freeze redemptions. Others have subsequently chosen to liquidate assets. Uncertainty over planned new regulation (now enacted) only added to the crisis for some funds.

Today, by value, 70% of funds remain open for business, although they suffer from relatively lower levels of inflows. New regulations coming through favour the smaller private investors with restrictions on withdrawing funds now in place[2]. Going forward we would expect to see relatively smaller inflows compared with the recent past.

Much of the money previously invested in real estate, will still want to find a home in this asset class. This could see more equity flow into 'Spezial Fonds', who have the ability to design their contracts in a different way. This would see more money flow into these existing funds, or indeed new funds capable of investing across different countries or even regions. We would also expect to see capital shift into other institutional style vehicles.

[2] See DTZ Insight, GOEFs as of Summer 2011, Small steps towards reopening, 9 September 2011

Property type analysis

Diversity across property types

The majority of investors still favour multiple property types, representing 80% of available capital (Figure 6). This trend is consistent with our previous analysis and highlights the preference of investors towards having flexibility to deploy capital across different property types.

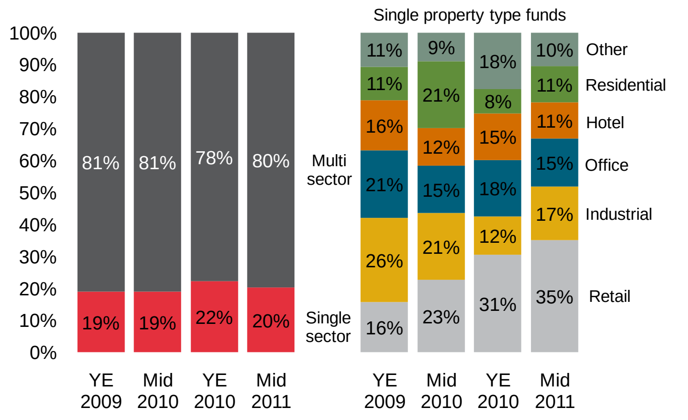
Of those funds targeting a single sector, retail continues to be the favoured target, accounting for 35% of single property type funds, continuing its increased share since 2009. Industrial is now the second most favoured sector, followed by offices and hotels.

These trends are matched by the latest Q2 2011 DTZ Fair Value Index™. According to our index retail has the highest score globally at 64 indicating a higher number of attractive markets. This is followed by Industrial at 57 and offices at 49.

Residential increased its share to 11% of single type funds, on a par with the hotels sector. Other uses, including leisure and healthcare have seen their share diminish to 10% and in line with levels recorded a year ago.

Figure 6

Target property type 2012



Source: DTZ Research

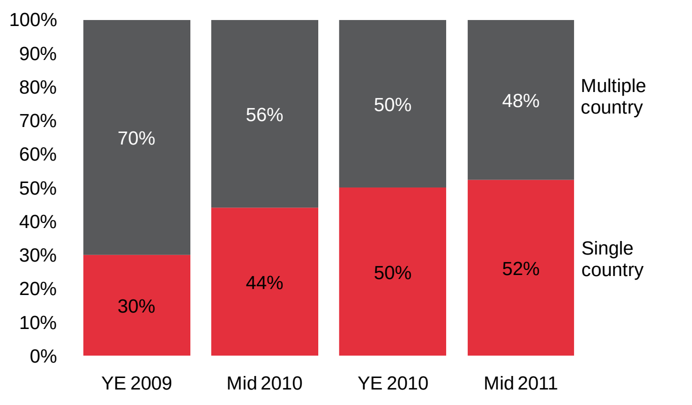
Geographic analysis

Single country funds most popular

Diversity across markets has continued to reduce, with more funds (52%) now focussed on a single country rather than diversifying across multiple countries or regions (Figure 7). This is the first time since we started our analysis that single country funds have been the dominant focus. This is reflective of sentiment post crisis where people prefer to invest in a particular market that they know.

Figure 7

Target geography, 2012

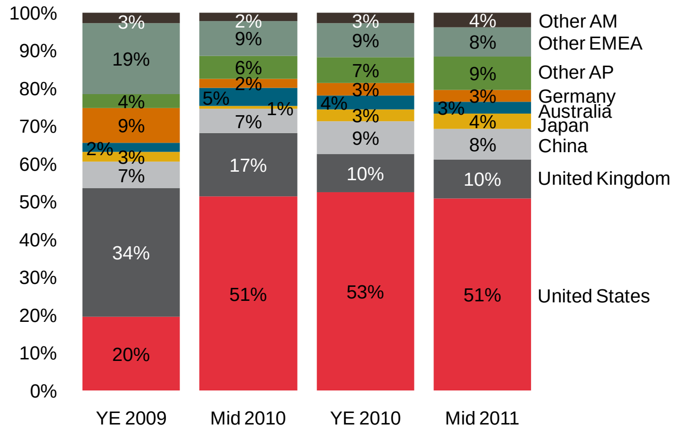


Source: DTZ Research

Of the single country funds, the United States continues to dominate, accounting for just over a half (51%) of all single country funds, followed by the United Kingdom at 10%, unchanged on our previous analysis (Figure 8).

Figure 8

Single country targets, 2012



Source: DTZ Research

The strength of the US is not surprising given it is one of the most attractive countries in our Fair Value analysis. The dominance too of Asia Pacific markets – China, Japan and Australia, is also not surprising given the strength of Asian markets.

Although European markets score low, we do still see opportunities in core markets such as the UK and Germany, which also attract a relatively higher share of capital.

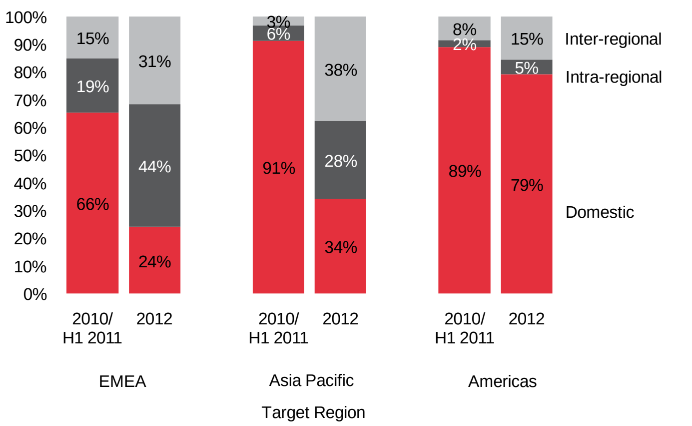
Growth in cross border investment outside US

Through analysing the domicile of investors and their target geographies we are able to establish how this new capital may influence future investment flows.

From our analysis we can see that much of the capital raised will potentially lead to a higher level of cross border activity in all regions in 2012, relative to recent transactional activity (Figure 9).

Figure 9

2010/H1 2011 capital flows and 2012 expected flows



Source: DTZ Research

Our analysis implies a potentially higher proportion of capital targeting Asia Pacific from outside the region, with inter-regional investment accounting for 38% of flows. A further 28% comes from Asian investors investing outside their home market, but within their region (Intra-regional investment). This compares with total cross border flows in 2010 and H1 2011 at 9%.

Cross border investment could potentially reach 75% in the EMEA region. Of this, 31% is expected to come from outside the region, and a further 44% within the region itself. This compares to total cross border flows of 34% in 2010/11. In the Americas, we see a different picture. Although cross border activity is set to grab an increased share of overall activity, notably from outside the region, we still see domestic investment dominating, accounting for over three quarters (79%) of new capital available.

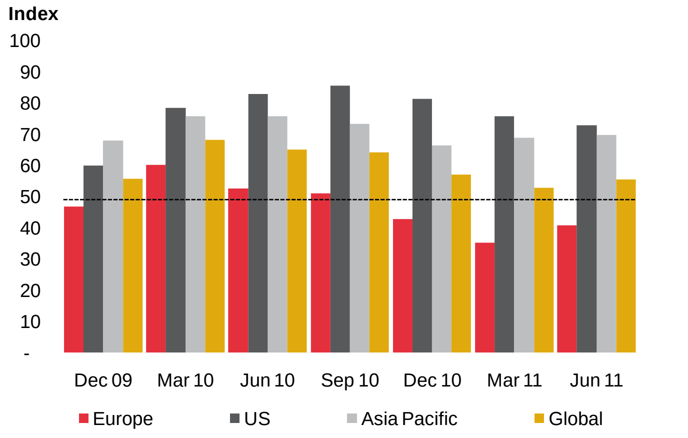
However, given the recent uncertainty in global markets, it is likely that levels of cross border activity will be more modest than our analysis suggests as investor focus more on their home market.

Core markets remain attractive

The US remains the most attractive market according to our Fair Value analysis (Figure 10), and is also now attracting the greatest share of capital (Figure 11). The pick-up in transactional activity across the US has been weaker compared to Europe or Asia. We would expect the strength of capital and attractiveness to lead to a higher level of investment activity going forward.

Figure 10

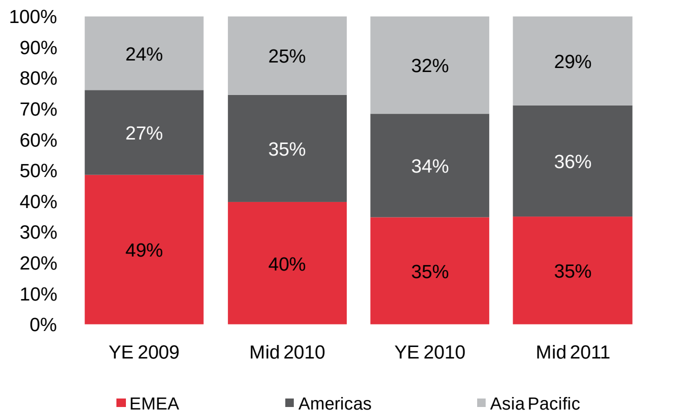
DTZ Fair Value Index™ regional scores, Q2 2011



Source: DTZ Research

Figure 11

Target region, 2012



Source: DTZ Research

The Great Wall of Money

Asia Pacific has maintained its attractiveness, despite the fall in available capital. With strong levels of liquidity we expect investors to be able to deploy capital in the region with ease. Further, with over US$100bn of raised capital targeting more than one region, we would expect to see this money targeting the most attractive markets, which could see more capital moving towards the US and Asia.

Europe's share of capital has remained broadly stable over the past six months. Whilst its Fair Value score remains below 50 and lags both the US and Asia Pacific, there are still many attractive opportunities in core markets as well as more opportunistic plays in Russia and within the wider CEE markets.

Outlook

The reduction in available capital at a time of heightened global uncertainty indicates increased caution from investors towards real estate. Although down on six months ago, the amount of available capital is still higher year on year, and will support transactional activity, in particular higher levels of cross border activity across regions.

Shift towards core opportunities

Given the increased uncertainty in the market we see some investors retreating towards core opportunities as the economy and leasing market conditions soften. This is supported by our Fair Value Index, particularly in Europe, where a reduction in Government bond yields has led to an increase in the attractiveness of many core markets.

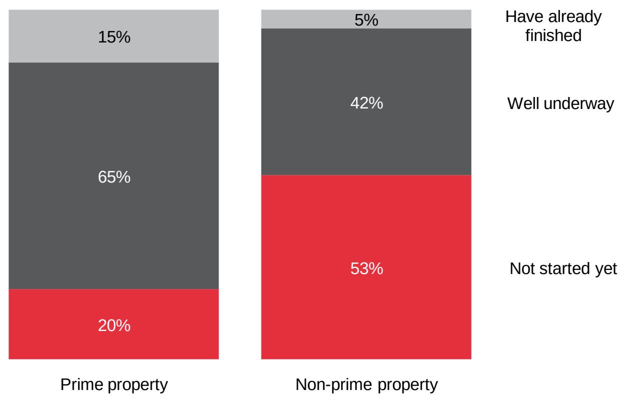
Pressure to deploy capital leads to opportunities in secondary markets

With over a third of capital raised before 2008, we expect many fund managers to be under increasing pressure to deploy legacy capital over the next twelve months or risk returning it to investors. This could lead some fund managers to focus on more value-add or opportunistic product.

Having made headway in dealing with problematic loans on prime assets, we see a growing level of opportunities emerging from the banks focussing on more secondary assets going forward (Figure 12).

Figure 12

Lenders' assessment in working-out



Source: DTZ Research

This will provide opportunities for investors looking at secondary assets, though selectivity will be critical in seeking the best opportunities.

Regulation could delay investment

As we highlighted in our previous report, there is a raft of new regulation due to come into force in the wake of the 2008 financial crisis. With the details and timing surrounding some of these initiatives e.g. Solvency II potentially delayed, this could lead some institutional investors to pause their deployment of capital until the full impacts of the new regulations have been detailed. Changes also, to the regulation of German Open Ended Funds will also lead to a shift in capital over the coming year. This is particularly important for real estate which is seen as a longer term investment.

Little new capital expected to be raised

Real estate looks relatively attractive compared other assets. However, given the current uncertainties in the global economy, it continues to impact on new capital raising. If these uncertainties persist in the near term we would expect to see further falls in the amount of new capital available as:

- Fund managers focus on deploying capital from exiting funds as investment periods near their end.
- Some funds seek to extend fund lives in order to deploy existing capital
- The level of new equity raising softens further as listed companies delay fresh equity raising or IPOs as equity markets remain volatile and third party funds struggle to attract new investments

Appendix 1: Methodology

Our approach to calculating the amount of capital available remains in line with the five step approach developed in our previous paper. As a recap we have summarised this approach based on the new numbers in Figure 13 below.

Step 1. US$425bn of equity raised

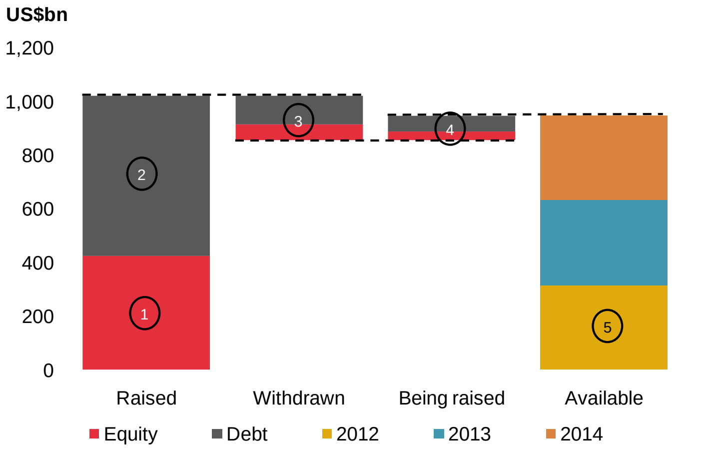
Our starting point for this research has been to update our previous database through amending existing records, adding in details on new or existing funds from existing and new sources and removing records where capital has been spent or the record has become historic for the purposes of this research. In total we have records on over 1,700 individual funds. Additionally we have utilised our Money into Property database. On the basis of this bottom-up data gathering exercise, we have identified US$425bn of raised equity.

Step 2. US$1,022bn in total raised capital

Assuming an overall LTV ratio of 58% we have estimated there to be US$1,022bn in total capital raised. Our overall LTV assumption of 60% is based on a combination of stated LTVs from the research we have undertaken and data from our Money into Property database for Institutions. We have assumed no gearing for Sovereign Wealth Funds. For funds with no stated gearing we have assumed these to have similar gearing to those funds where we have a stated LTV. Our assumptions are summarised in Table 1.

Figure 13

Available capital – step-by-step



Source: DTZ Research

Step 3. US$166bn of capital to be withdrawn

We expect US$166bn of capital will be withdrawn by third party funds reflecting the fact that some fund managers have not been able to invest all committed funds. With over 60% of capital available today having been raised since 2008 it is likely that some funds will not be able to deploy all the capital investors have agreed to provide.

Step 4. US$91bn capital being raised

A further US$66bn of equity is expected to be available for investment in the next few years. Assuming an overall LTV of 63%, this would equate to US$182bn in total capital. However, we expect that many of these plans will not be realised. Therefore, we assume only half of this capital (US$91bn) to be available for investment over the commitment period.

Step 5. US$329bn of capital available

DTZ Research estimates that US$316bn of capital will be available for investment in commercial property globally in 2012.

After taking into account the previous steps, we have a total amount of capital available for investment in the next three calendar years of approximately US$948bn. Just to recap, this consists of:

- US$1,022bn in raised capital
- Minus US$166bn of capital to be withdrawn
- Plus US$91bn of additional capital being raised

But this capital is expected to be available for investment over a three year period. Therefore, we estimate that a third will be invested in 2012.

Table 1

Average LTV by investor type

	Equity	Debt	Total	LTV
Funds: Stated LTV	67	123	189	65%
Institutions	109	37	147	25%
SWFs	10	0	10	0%
German OE Funds	5	4	9	48%
Funds: Unstated LTV	234	433	667	65%
Total (US$bn)	**425**	**597**	**1,022**	**58%**

Source: DTZ Research

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