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Slow recovery in real estate funds sector but array of opportunities

LONDON, 31 October 2011 – Despite the current financial turmoil and uncertainty in the markets, now is the time for fund managers to capitalize on distressed deal opportunities according to Ernst & Young’s *Global Market Outlook: Trends in real estate private equity* released today.

The aftermath of the financial crisis has had a substantial impact on transaction volumes and a material impact on the amount of leverage in the marketplace and availability of debt, and so the market has shrunk.

Mark Grinis, Ernst & Young’s Global Real Estate Funds Leader, comments, “The market is considerably smaller than it was in 2007, and because it’s contracted so substantially, it may have now over-contracted. The market is much smaller in terms of the amount of equity being raised, the availability of debt financing and the number of transactions in the market. However, there are now signs the sector is reaching the bottom, and fund managers should brace themselves for an acceleration of deals and financing activity to hit the market, albeit slowly, over the next several years.”

Market structure likely to change following financial crisis

From the 2008 financial crisis until today, the cycle has had its own very unique issues, and private equity real estate investors need to weigh several new variables to ascertain the proper investment thesis going forward.

Due to various regulatory and financial reporting changes that have recently occurred, as well as the continuing overall volatility in the markets, the future growth of the sector likely will call for new and innovative approaches.

Fund terms still not back to pre-crisis levels

There seems to be a fairly even split in terms of fee modification as a result of the market turmoil and the challenges investors and managers are both facing. Management fees have slightly changed in favor of the investors from the pre-crash to post-crash time period.

Regulation and investor reporting

The regulatory bodies are focusing on the alternative investment industry that until now has been lightly regulated. The new changes will have an impact on the real estate private equity industry to an extent we have never seen before. The regulatory impact on real estate funds could be significant because they are going to have to budget for added costs to comply with the new regulations.

Investor reporting is an area that may change over time, as the main industry associations that represent investors are pushing for more frequent and transparent reporting. Many established funds are in the habit of reporting on a quarterly basis on a sixty day timeline, and within three months of year end. A point to look for in the future will also be additional disclosures on assumptions, fair value criteria, and debt analysis among others.

Howard Roth, Ernst & Young's Global Real Estate Leader comments, "Global investors, regulators and pension advisors are all simultaneously demanding greater transparency in governance, reporting and controls for private equity real estate. What was previously an immature industry is starting to take on an increased element of operational maturity and is benefitting from better deployment of technology solutions."

Gradual pick up but no spike

Grinis concludes, "Hopefully, we'll be able to reflect back on this period as a floor and see a crescendo of deal flow and activity that eventually starts to pick up. The likely scenario will be a gradual build-up, making this a good time to have capital to deploy in the market."

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