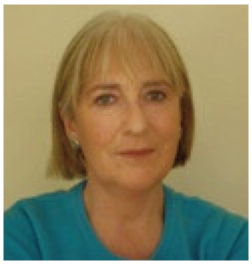
REAL ESTATE CAPITAL
Monthly intelligence for the real estate finance markets



Blackstone banks on stream of deals at PERE Forum

Last week, *Private Equity Real Estate's* annual PERE Forum: Europe provided a useful reality check – a conference room full of international fund managers comparing notes.

They're finding it tough to raise capital – no surprises there, but Blackstone's Chad Pike seemed cautiously upbeat about business this year. Unlike 2010, when Blackstone did zilch in Europe, he now has five deals closing and said the flow will thicken as the 2006-2007 vintage of loans mature.

"The banking system can't afford to take losses," claimed Pike, as he showed us some scary numbers: €380bn of non-performing loans in Europe against €96bn in the US, and a €550bn real estate funding gap in Europe. "As loans mature, something has to give; banks can't hide forever," he pointed out. However, they can't afford to sell wholesale, so it's going to be a European stream, not a US-style flood. "This is going to be a late-dated opportunity and when it starts it's going to take some time."

Pike also saw pricing as distorted, based on last year's low volume of transactions, which were mainly in the UK, and half of them in London. Even in Ireland and Spain, where Blackstone is looking, pricing is not yet right.

Which brings us to returns. Opportunity funds such as Blackstone's are still targeting 20%-plus, though its "special situations" fund takes 10-15% internal rates of return. Over to IPD's Ian Cullen, who said the trend is back towards income and predicted "a couple of years of stable, solid (unleveraged) 5-6% returns: "miles away" from last year's 14% for the UK. Go reconcile.

Anyone expecting insurance companies to go big on real estate debt shouldn't hold their breath. Isabelle Scemama of AXA, one of the few active players, highlighted the obstacles: no transparency, no data, no benchmark, no liquidity, and prepayment fees - or more precisely, the lack thereof.

But there is capital coming from the public markets, albeit in a roundabout way. KKR's newly-appointed head real estate striker, Ralph Rosenberg, has come onto the pitch. KKR, best known for leveraged buyouts (think *Barbarians at the gates*, and more recently, Boots), floated last year. It has $2bn in cash and wants to diversify into other parts of the capital markets – to "create a global asset manager".

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KKR hasn't done real estate before, so it has hired Rosenberg, who left Goldman in 2006, set up his own fund and subsequently merged it with hedge fund manager Eton Park. He's looking at four deals in Europe: from sale and leasebacks and bank portfolios to construction finance.

The big debate was whether investment banks should manage real estate funds at all. Robert Weaver, managing director of Morgan Stanley's investment banking division, and Ted Leary of Crosswater Realty Advisors, squared up to Internos' Jos Short and Roger Barris of Peakside Capital. The pro-investment bank team (Weaver & Leary) faced bad odds: 59% of the audience were opposed to them from the start.

It was good knockabout stuff, with the cons positing that they had already won the argument since most investment banks had run their funds into the ground, or seen the light and pulled out of the business.

The pros argued that 1) there is no evidence to show that performance-wise investment banks were any worse real estate fund manager than others and 2) other management houses are run and staffed by ex-investment bankers, so perhaps it's investment bankers who should be banned from running real estate funds. Barris (ex-Bank of America/Merrill Lynch) had a neat riposte. It's the institution, he claimed: "Investment banks make smart people do dumb things."

The relationship between limited partners and general partners also came in for a rehash. As Peter Pereira Gray of Wellcome Trust noted, not entirely jokingly, this has recently involved the "extraordinary transfer of value from guys whose money it is to guys whose it isn't". He threw out the intriguing suggestion that we might see investors migrating away from third-party funds altogether and going it alone: "Hiring best-of-class managers and rewarding those individuals appropriately".

He was challenged on this – what's the point, if you're still paying 2 and 20 and promotes? And isn't it only big beasts such as Wellcome that can afford to have a go? Pereira Gray pointed to the carry that goes to fund founders – he was interested in the layer of people below. And, he argued, it's about the nature and type of investor, not their scale.

Interestingly, Wellcome has apparently already taken this DIY approach in another area of private equity. Real estate is usually a couple of years behind the curve, Pereira Gray said, so he wouldn't be surprised to see it emerge. And, he hinted, Wellcome is looking at its first real estate investment in three years: a fund that is "doing things differently – it's not a traditional structure".

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